



## FEDERAL RESERVE BANK OF DALLAS

2200 N. PEARL ST.  
DALLAS, TX 75201-2272

July 29, 2004

**Notice 04-48**

**TO:** The Chief Executive Officer of each  
financial institution and others concerned  
in the Eleventh Federal Reserve District

### **SUBJECT**

#### **Final Rule on Capital Requirements for Asset-Backed Commercial Paper Programs**

### **DETAILS**

The Board of Governors of the Federal Reserve System, Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, and Office of Thrift Supervision are amending their risk-based capital standards by removing a sunset provision that would preclude a certain capital treatment for asset-backed commercial paper (ABCP) programs after a certain date. The final rule will permanently permit sponsoring banks, bank holding companies, and thrifts (collectively, sponsoring banking organizations) to exclude from their risk-weighted asset base those assets in ABCP programs that are consolidated onto sponsoring banking organizations' balance sheets as a result of Financial Accounting Standards Board Interpretation No. 46, Consolidation of Variable Interest Entities, as revised (FIN 46-R).

The agencies also are implementing more risk-sensitive risk-based capital standards for credit exposures arising from involvement with ABCP. This final rule generally requires banking organizations to hold risk-based capital against eligible ABCP liquidity facilities with an original maturity of one year or less that provide liquidity support to ABCP by imposing a 10 percent credit conversion factor on such facilities.

The agencies have decided not to implement the proposed risk-based capital charge for securitizations of revolving retail credit facilities (for example, credit card receivables) that

incorporate early amortization provisions. In addition, the agencies are making technical amendments to their risk-based capital standards by deleting tables and attachments that summarize risk categories, credit conversion factors, and transitional arrangements.

The final rule is effective September 30, 2004. However, any banking organization may elect to adopt, as of July 28, 2004, the capital treatment described in this final rule for assets in ABCP programs that are consolidated onto the balance sheets of sponsoring banking organizations as a result of FIN 46–R. All liquidity facilities that provide support to ABCP will be treated as “eligible ABCP liquidity facilities,” regardless of their compliance with the definition of “eligible ABCP liquidity facilities” in the final rule, until September 30, 2005. On that date and thereafter, liquidity facilities that do not meet the final rule’s definition of “eligible ABCP liquidity facility” will be treated as recourse obligations or direct credit substitutes.

#### **ATTACHMENT**

A copy of the Board’s notice as it appears on pages 44908–25, Vol. 69, No. 144 of the *Federal Register* dated July 28, 2004, is attached.

#### **MORE INFORMATION**

For more information, please contact Dorsey Davis, Banking Supervision Department, at (214) 922-6051. Paper copies of this notice or previous Federal Reserve Bank notices can be printed from our web site at [www.dallasfed.org/banking/notices/index.html](http://www.dallasfed.org/banking/notices/index.html).

Corporation; and Office of Thrift Supervision, Treasury.

**ACTION:** Final rule.

**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 amending their risk-based capital standards by removing a sunset provision that would preclude a certain capital treatment for asset-backed commercial paper (ABCP) programs after a certain date. The final rule will permanently permit sponsoring banks, bank holding companies, and thrifts (collectively, sponsoring banking organizations) to exclude from their risk-weighted asset base those assets in ABCP programs that are consolidated onto sponsoring banking organizations' balance sheets as a result of Financial Accounting Standards Board Interpretation No. 46, Consolidation of Variable Interest Entities, as revised (FIN 46-R).

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be treated as recourse obligations or direct credit substitutes.

**FOR FURTHER INFORMATION CONTACT:**

OCC: Amrit Sekhon, Risk Expert, Capital Policy Division, (202) 874-5211; Laura Goldman, Counsel, 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 Project Manager, Policy, (202) 452-2982, David Kerns, Supervisory Financial Analyst, (202) 452-2428, Barbara Bouchard, Deputy Associate Director, (202) 452-3072, Division of Banking Supervision and Regulation; or Mark E. Van Der Weide, Senior 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: Christine A. Smith, Project Manager, (202) 906-5740; or Karen Osterloh, Special Counsel, Regulation and Legislation Division, Chief Counsel's Office, (202) 906-6639, Office of Thrift Supervision, 1700 G Street, NW., Washington, DC 20552.

**SUPPLEMENTARY INFORMATION:**

## I. Background

### A. Asset-Backed Commercial Paper Programs

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.<sup>1</sup> 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 externally rated commercial paper into the market. Typically, the sponsoring banking organization provides liquidity

<sup>1</sup> ABCP programs generally also include structured investment vehicles, which are entities that earn a spread by issuing commercial paper and medium-term notes and using the proceeds to purchase highly-rated debt securities.

## DEPARTMENT OF THE TREASURY

### Office of the Comptroller of the Currency

#### 12 CFR Part 3

[Docket No. 04-19]

RIN 1557-AC76

## 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. 2004-36]

RIN 1550-AB79

### Risk-Based Capital Guidelines; Capital Adequacy Guidelines; Capital Maintenance: Consolidation of Asset-Backed Commercial Paper Programs and Other Related Issues

**AGENCIES:** Office of the Comptroller of the Currency, Treasury; Board of Governors of the Federal Reserve System; Federal Deposit Insurance

and credit enhancements to the ABCP program, which aid the program in obtaining high credit ratings that facilitate the issuance of the commercial paper.<sup>2</sup>

#### *B. ABCP Programs and FIN 46-R*

In January 2003, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 46, "Consolidation of Variable Interest Entities" (FIN 46). FIN 46 required the consolidation of variable interest entities (VIEs) onto the balance sheets of companies deemed to be the primary beneficiaries of those entities by no later than the end of the first annual reporting period beginning after June 15, 2003. FIN 46 was then revised by FASB in December 2003 (that is, FIN 46-R) and generally was effective for public banking organizations by March 31, 2004. FIN 46-R clarified several issues relating to the consolidation of VIEs and provided multiple and delayed effective dates, but did not directly affect issues relevant to this rulemaking.

FIN 46-R requires the consolidation of many ABCP programs onto the balance sheets of banking organizations.<sup>3</sup> In contrast, under pre-FIN 46 accounting standards, the sponsors of ABCP programs normally were not required to consolidate the assets of these programs. Banking organizations that are required to consolidate ABCP program assets must include all of the program assets (mostly receivables and securities) and liabilities (mainly commercial paper) on their balance sheets for purposes of the bank Reports of Condition and Income

<sup>2</sup>For the purposes of this final 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 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.

<sup>3</sup>Under FIN 46-R, 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-R if it is designed to have adequate capital, as described in FIN 46-R, and its shareholders control the entity with their voting or similar rights and are proportionally 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-R 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 (or both) is the primary beneficiary and must consolidate the VIE.

(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 the tier 1 leverage and risk-based capital ratios of banking organizations that must consolidate the assets held in ABCP programs.

#### *C. Interim Final and Proposed Rules*

The agencies believe that the consolidation of ABCP program assets generally would result in risk-based capital requirements that do not appropriately reflect the risks faced by banking organizations involved with the programs. Sponsoring banking organizations generally face limited risk exposure to ABCP programs. This risk usually is confined to the credit enhancements and liquidity facility arrangements that sponsoring 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 risks to which sponsoring banking organizations are exposed.

Because of the limited risks, the agencies adopted an interim final rule with a request for comment that permitted sponsoring banking organizations, through the end of the first quarter of 2004, to exclude from risk-weighted assets (for purposes of calculating the risk-based capital ratios) ABCP program assets that require consolidation under FIN 46-R (October 2003 interim final rule). See 68 FR 56530 (October 1, 2003). The agencies also amended their risk-based capital rules to exclude from tier 1 and total capital any minority interest in sponsored ABCP programs that are consolidated under FIN 46-R. 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 was initially scheduled to expire on April 1, 2004. However, the agencies subsequently issued another interim final rule to extend to July 1, 2004 the time during which the interim risk-based capital treatment would be in effect. See 69 FR 22382 (April 26, 2004).

Concurrent with the publication of the October 2003 interim final rule, the agencies also published a notice of proposed rulemaking (NPR) that would

make permanent the interim risk-based capital treatment for consolidated ABCP program assets. See 68 FR 56568 (October 1, 2003). The NPR also proposed to establish risk-based capital requirements for (1) short-term liquidity facilities extended to ABCP programs and (2) securitizations of revolving credit exposures (for example, credit card receivables) that incorporate early amortization provisions. The period during which the interim final rules have been in effect has provided the agencies with additional time to develop appropriate risk-based capital requirements for banking organizations' sponsorship of ABCP programs and their provision of liquidity support to ABCP, and to receive and analyze comments from the industry on the NPR.

Collectively, the agencies received 13 comment letters on the October 2003 interim final rule and the NPR. Commenters uniformly supported the exclusion of ABCP program assets from the risk-based capital calculations. Commenters expressed concern, however, with certain other aspects of the NPR, notably the credit conversion factor for eligible, short-term liquidity facilities and the NPR's relationship to the Basel Accord revision process.<sup>4</sup>

## **II. Final Rule**

### *A. Exclusion of ABCP Program Assets and Related Minority Interests*

In this final rule, the agencies are amending their risk-based capital standards by removing the interim final rule's July 1, 2004 sunset provision. Thus, the final rule will make permanent the exclusion of ABCP program assets consolidated under FIN 46-R and any associated minority interests from risk-weighted assets and tier 1 capital, respectively, when sponsoring banking organizations calculate their tier 1 and total risk-based capital ratios.

The risk-based capital treatment does not alter generally accepted accounting principles (GAAP) or the manner in which banking organizations must report consolidated on-balance sheet assets pursuant to FIN 46-R. In addition, the risk-based capital treatment does not affect the denominator of the tier 1 leverage capital ratio, which is based primarily

<sup>4</sup>The risk-based capital standards of the agencies are based on the July 1988 Accord on International Convergence of Capital Measurements and Capital Standards adopted by the Basel Committee on Banking Supervision. The Basel Committee, however, is currently in the process of revising the 1988 Accord. See the proposed revision of the Basel Capital Accord, dated June 2004, issued by the Basel Committee.

on on-balance sheet assets as reported under GAAP. Thus, as a result of FIN 46–R, banking organizations must include all assets of consolidated ABCP programs as part of on-balance sheet assets for purposes of calculating the tier 1 leverage capital ratio. One commenter objected to this treatment, arguing that ABCP program assets should also be excluded from on-balance sheet assets when calculating the tier 1 leverage ratio. However, the agencies typically do not remove on-balance sheet assets from the total asset base for purposes of calculating the leverage ratio because the leverage ratio is intended to work in conjunction with the risk-based capital standards by providing a simple, GAAP-based measure of capital adequacy. There was not, in the agencies' judgment, sufficient reason to revise the leverage ratio in the manner suggested.

As a general matter, 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. However, under this final rule, minority interests related to sponsoring banking organizations' ABCP program assets consolidated as a result of FIN 46–R are not to be included in tier 1 capital. Because the program's assets would not be consolidated for risk-based capital purposes, the agencies believe that the minority interest that supports those assets should not be included in the banking organization's consolidated regulatory capital. Thus, the reported tier 1 leverage capital ratio for a sponsoring banking organization would likely be lower than it would be if the ABCP program assets were consolidated and related minority interest were permitted to remain in the capital calculation. The agencies do not anticipate that the exclusion of minority interests related to consolidated ABCP program 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.

In addition, commenters noted that the definitions of an "ABCP program" proposed in the NPR were not consistent among the agencies, and requested that the definitions be harmonized. Two commenters asked that the definition be broadened to explicitly include structured investment vehicles.<sup>5</sup> The agencies believe that it is

important that the definition of an ABCP program be both clear and consistent among the agencies. Therefore, the final rule for each agency defines an "ABCP program" to be a program that primarily issues (that is, more than 50 percent) externally rated commercial paper backed by assets or other exposures held in a bankruptcy-remote, special purpose entity. As a result, the definition of "ABCP program" generally includes structured investment vehicles and securities arbitrage programs. The agencies believe that the "primarily issues" requirement ensures that programs covered by this final rule retain their ABCP character by requiring that such programs generally issue no less than 50 percent ABCP.

Under the final rule, a banking organization will be able to exclude FIN 46–R related assets from its risk-weighted asset base only with respect to programs that meet the rule's definition of an "ABCP program." Thus, a banking organization sponsoring a program issuing ABCP that does not meet the rule's definition of an "ABCP program" must continue to include the program's assets in the institution's risk-weighted asset base.

#### *B. Liquidity Facilities Supporting ABCP*

In addition to the exclusion of consolidated ABCP program assets from risk-weighted assets and related minority interests from tier 1 capital, the agencies are amending their risk-based capital requirements with respect to liquidity facilities that support ABCP. Liquidity facilities supporting ABCP often take the form of commitments to lend to, or purchase assets from, the ABCP 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. Under the current risk-based capital standards, 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. Prior to this final rule, liquidity facilities with an original maturity of one year or less (that is, short-term liquidity facilities) were converted to an on-balance sheet credit equivalent amount utilizing the zero percent credit conversion factor. As a result, such short-term liquidity facilities were not

subject to any risk-based capital charge prior to this rule.

In the agencies' view, a banking organization that provides liquidity facilities to ABCP is exposed to credit risk regardless of the term of the liquidity facilities. For example, an ABCP program may require a liquidity facility to purchase assets from the program at the first sign of deterioration in the credit quality of an asset pool, thereby removing such assets from the program. In such an event, a draw on the liquidity facility exposes the banking organization to credit risk. The agencies believe that the existing risk-based capital rules do not adequately reflect the risks associated with liquidity facilities supporting ABCP.

Although the agencies believe that liquidity facilities expose banking organizations to credit risk, the agencies also believe that the short term of commitments with an original maturity of one year or less exposes banking organizations to a lower degree of credit risk than longer term commitments, provided the liquidity facility meets certain asset quality requirements discussed below. This difference in degree of credit risk should be reflected in the risk-based capital requirement for the exposure. For this reason, in the NPR the agencies proposed a 20 percent credit conversion factor on eligible short-term liquidity facilities providing liquidity support to ABCP.

Two commenters explicitly agreed with the agencies' position that regulatory capital should be held against liquidity facilities that provide liquidity support to ABCP and that have an original maturity of one year or less. Seven commenters stated that the proposed 20 percent credit conversion factor for short-term liquidity facilities was too high given the low historical losses and the overall strength of the credit risk profiles of such liquidity facilities. Six of these seven commenters instead suggested that a conversion factor in the range of 5–10 percent would be more appropriate given banking organizations' credit loss experience with short-term liquidity facilities. One commenter noted that the proposed capital charge would put U.S. banks at a competitive disadvantage relative to foreign banks and non-bank funding sources. The agencies generally agree with these commenters. In addition, recent examination experience suggests that application of a 10 percent credit conversion factor would result in an effective capital charge that is more reflective of the amount of economic capital that banking organizations maintain internally for short-term liquidity facilities supporting ABCP.

<sup>5</sup> Structured investment vehicles are ABCP programs that issue commercial paper and medium-

term notes and use the proceeds to purchase highly-rated debt securities.

After consideration of the comments, the agencies have decided to impose a 10 percent credit conversion factor on eligible short-term liquidity facilities supporting ABCP, as opposed to the 20 percent credit conversion factor set forth in the NPR. A 50 percent credit conversion factor will continue to apply to eligible long-term ABCP liquidity facilities. These credit conversion factors will apply regardless of whether the structure issuing the ABCP meets the definition of an "ABCP program" under the final rule. For example, a capital charge would apply to an eligible short-term liquidity facility that provides liquidity support to ABCP where the ABCP constitutes less than 50 percent of the securities issued causing the issuing structure not to meet this final rule's definition of an "ABCP program." However, if a banking organization (1) does not meet this final rule's definition of an "ABCP program" and must include the program's assets in its risk-weighted asset base, or (2) otherwise chooses to include the program's assets in risk-weighted assets, then there will be no risk-based capital requirement assessed against any liquidity facilities that support that program's ABCP. In addition, ineligible liquidity facilities will be treated as recourse obligations or direct credit substitutes.

The resulting credit equivalent 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 an eligible short-term liquidity facility providing liquidity support to ABCP covered an asset-backed security (ABS) externally rated AAA, then the notional amount of the liquidity facility would be converted at 10 percent to an on-balance sheet credit equivalent amount and assigned to the 20 percent risk weight category appropriate for AAA-rated ABS.<sup>6</sup>

#### C. Overlapping Exposures to an ABCP Program

In many cases, a banking organization may have multiple exposures to 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. Accordingly, the final rule requires that

a banking organization must hold risk-based capital only once against the assets 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 that results in the highest capital charge to the overlapping portion of the exposures.

For example, assume a banking organization provides a program-wide credit enhancement that would absorb 10 percent of the losses in all of the underlying asset pools in an ABCP program and pool-specific liquidity facilities that cover 100 percent of each of the underlying asset pools.<sup>7</sup> 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. However, if a banking organization chooses to consolidate ABCP program assets onto its balance sheet for risk-based capital purposes 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 have overlapping exposures to an ABCP program, 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, some systemic duplication may occur where multiple banking organizations have overlapping exposures to the same ABCP program.

#### D. Asset Quality Test

In order for a liquidity facility, either short- or long-term, that supports ABCP not to be considered a recourse obligation or a direct credit substitute, it must meet the rule's definition of an "eligible ABCP liquidity facility." The NPR proposed that the liquidity facility, in order to be an eligible liquidity facility, meet a reasonable asset quality test that, among other things, precluded funding assets that are 60 days or more past due or in default. The funding of assets past due 60 days or more using a liquidity facility exposes the institution to a greater degree of credit

risk than the funding of assets of a more current nature.

Five commenters objected to the uniform 60 days past due asset quality test, noting that although it may be appropriate for trade receivables, it is not appropriate for many other asset classes. These commenters believed that a reasonable asset quality test could be defined to include assets that are 90 to 180 days or more past due, depending upon the type of asset (for example, residential mortgages or credit cards). Furthermore, one commenter stated that the 60-day delinquency standard would significantly overstate the risk of default in the case of credit cards since the amount of credit card receivables that is ultimately charged-off between 120 days and 180 days usually is far less than the amount that is 60-days delinquent. Five commenters suggested that the definition of an eligible liquidity facility should be more flexible and incorporate asset quality tests that vary based on the specific transaction structures or underlying asset types.

Specifically, these commenters proposed that each banking organization should be allowed to develop its own asset quality tests, subject to supervisory oversight. Although the agencies considered the possibility of developing separate past due requirements for different asset categories, and the possibility of permitting each banking organization to develop its own asset quality test, the agencies believe that these approaches would be complex to develop and burdensome to administer, and would lack uniform application among banking organizations.

The agencies believe that it is important to ensure that the primary function of an eligible liquidity facility is to provide liquidity and, accordingly, such a facility should not be used to fund assets with the higher degree of credit risk typically associated with seriously delinquent assets. However, the agencies agree that a limitation of 60 days or more past due might be too constraining for some asset types held in an ABCP program.

This final rule increases the number of days in the past due requirement to 90 days or more past due. The agencies believe that when assets are 90 days or more past due, they typically have deteriorated to the point where there is an extremely high probability of default. Assets that are 90 days past due, for example, often must be placed on non-accrual status in accordance with the agencies' Uniform Retail Credit Classification and Account Management Policy. See 65 FR 36904 (June 12, 2000). Further, they generally must also be

<sup>6</sup> 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).

<sup>7</sup> This example assumes that a banking organization is able to use the internal ratings that it has assigned to liquidity facilities providing support to ABCP and also assumes that such facilities would be assigned to the 100 percent risk category.

classified “substandard” under that Policy.

Commenters also suggested that the asset quality test should be modified to reflect guarantees providing credit protection to the bank providing the liquidity facility. The agencies agree that in the case of a government guarantee, the past due limitation is not a relevant asset quality test. As a result, this final rule does not apply the “days past due” limitation in the asset quality test with respect to assets that are either conditionally or unconditionally guaranteed by the United States government or its agencies, or another OECD central government subsequent to a draw on a liquidity facility.

In addition, to qualify as an eligible liquidity facility, the agencies proposed in the NPR that, if the assets covered by the liquidity facility are initially externally rated (at the time the facility is provided), the facility may be used to fund only those assets that are externally rated investment grade at the time of funding. If the asset quality tests are not met (that is, if a banking organization actually funds through the liquidity facility assets that do not satisfy the facility’s asset quality tests), the liquidity facility will be considered a recourse obligation or a direct credit substitute and generally will be converted at 100 percent as opposed to 10 or 50 percent.<sup>8</sup>

Three commenters asserted that the asset quality test proposed for transactions with externally rated assets was inappropriate, noting that the test is irrelevant for transactions without a ratings-based trigger where asset quality is determined using cash flow or other benchmarks. These commenters also noted that, in some cases, the price of assets purchased under the liquidity facility is adjusted for the assets’ credit quality, mitigating the need for a ratings-based asset quality test. Moreover, one commenter asserted that the increase in regulatory capital that occurs when the rating on an asset-backed security underlying a liquidity facility declines makes the additional limitation on non-investment grade assets unnecessary.

While the agencies acknowledge that some liquidity facility agreements adjust the purchase price of assets for credit quality, the agencies believe that most purchases of rated assets through liquidity facilities are conducted at a price that exceeds the assets’ market

value, which in the agencies’ view is equivalent to credit enhancement. Even in cases where the purchase price is adjusted, it is not necessarily adjusted to market value.

For these reasons, the final rule considers the practice of purchasing assets that are externally rated below investment grade out of an ABCP program as the equivalent of providing credit protection to the commercial paper investors. Thus, liquidity facilities permitting purchases of below investment grade securities will be considered either recourse or direct credit substitutes. However, for the same reason mentioned previously, this final rule does not apply the “investment grade” limitation in the asset quality test with respect to assets that are conditionally or unconditionally guaranteed by the United States government or its agencies, or another OECD central government subsequent to a draw on a liquidity facility.

#### *E. Applicability of the Market Risk Capital Requirements*

The amendments to the risk-based capital standards with respect to liquidity facilities reflect the efforts of the agencies to ensure that banking organizations maintain adequate capital with respect to exposures represented by liquidity facilities supporting ABCP. Under the current risk-based capital standards, liquidity facilities held in the trading book may be subject to the market risk capital requirements instead of the banking book capital requirements. Consequently, in the NPR, the agencies proposed that banking organizations subject to the market risk capital rules would not be permitted to apply those rules to any liquidity facility supporting ABCP held in the trading book. This final rule adopts the proposed market risk exception to preclude banking organizations that are subject to the market risk capital rules from applying those rules to positions held in a bank’s trading book that act, in form or in substance, as liquidity facilities supporting ABCP.

Under this final rule, any facility held in the trading book whose primary function, in form or in substance, is to provide liquidity to ABCP—even if the facility does not qualify as an eligible ABCP liquidity facility under the rule—will be subject to the banking book risk-based capital requirements. Specifically, organizations will be required to convert the notional amount of all trading book positions that provide liquidity to ABCP to credit equivalent amounts by applying the appropriate banking book

credit conversion factors. For example, the full amount of all eligible ABCP liquidity facilities with an original maturity of one year or less will be subject to a 10 percent conversion factor, as described previously, regardless of whether the facility is carried in the trading account or the banking book.

Two commenters objected to this provision, noting that it ignores GAAP accounting decisions with respect to the trading book classification of individual transactions, and that a well-defined mechanism for assessing capital in the trading book already exists. In addition, these commenters stated that the market-to-market accounting discipline applied to trading book positions, combined with individual banking organizations’ market value adjustments for illiquidity or pricing uncertainty, assures that adequate capital is held on a “real-time” basis. These commenters also suggested that banking organizations be permitted to apply the trading book capital rules to liquidity facilities or arrangements that satisfy certain criteria. While the agencies understand the benefit of consistent classification under GAAP and appreciate the value of the market risk capital framework, the agencies believe that a market risk exception for ABCP-related liquidity facilities is necessary to ensure an adequate risk-based capital charge for such exposures and to mitigate regulatory capital arbitrage opportunities.

### **III. Early Amortization Capital Charge**

In the NPR, the agencies also proposed 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 risk of significant credit losses.

The NPR was not the first time that the agencies have raised the issue of whether to impose a capital charge on securitizations of revolving credit exposures that incorporate early amortization provisions. On March 8, 2000, the agencies published a notice of proposed rulemaking on recourse obligations and direct credit substitutes (March 2000 NPR). See 65 FR 12320. In

<sup>8</sup>In the NPR, the agencies proposed an additional requirement that ABCP liquidity facilities only fund against assets that met the funding criteria under the asset quality test. The agencies believe that this criterion is unnecessary and, as a result, have deleted it from the final rule.



the March 2000 NPR, 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 NPR 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 a particular securitization transaction. In the subsequent November 2001 final rule (66 FR 59614) (November 2001 final rule), which implemented many of the provisions in the March 2000 NPR, the agencies reiterated their concerns with early amortization, indicating that the risks associated with securitization, including those posed by an early amortization feature, were not fully captured in the then current capital rules. In the November 2001 final rule, however, the agencies did not impose a special capital charge on securitizations with early amortization features.

In the interim, the Basel Committee on Banking Supervision (Basel Committee) 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. The risk-based capital charge for early amortization proposed in the NPR was based on the proposal set forth by the Basel Committee in its third consultative paper issued in April 2003.<sup>9</sup>

Three commenters stated that the proposal as set forth in the NPR was, in their view, a significant improvement over previous proposed capital charges for early amortization. Five commenters, however, recommended that any changes to the regulatory capital guidelines in this area be made through the Basel process. Coordinating both the timing and the substance of an early amortization capital charge internationally would help maintain a level playing field across countries and would avoid requiring U.S. banking organizations to implement new capital rules, only to require them to implement slightly different rules in the future when the agencies implement the Basel changes. Moreover, three commenters

requested that the agencies establish an alternative approach for controlled early amortization transactions similar to that proposed by the Basel Committee in the third Consultative Paper (dated April 2003).

At this time, the capital treatment of retail credit, including securitizations of revolving credits, may change as the revised Basel framework proceeds through the U.S. rulemaking process. Therefore, the ultimate treatment of securitizations of revolving credit exposures incorporating early amortization provisions is still uncertain. As a result, the agencies have decided that, at this time, it would not be appropriate to implement a risk-based capital charge for securitizations of revolving credits when the treatment may be revised with the implementation of the new Basel Accord. However, the agencies intend to revisit this issue in the near future for possible domestic implementation for all U.S. banking organizations.

#### IV. Elimination of Summary Sections of Rules Text

The final rule also removes tables and attachments in the risk-based capital standards that summarize the risk categories, credit conversion factors, and transitional arrangements. These tables and attachments are 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 in 1989. No comments were received on this issue. The agencies consider this change to be technical in nature and do not intend any substantive impact on the risk-based capital standards.

#### V. Effective Dates

This final rule is effective September 30, 2004. However, any banking organization may elect to adopt, as of July 28, 2004, the capital treatment described in this final rule for assets in ABCP programs that are consolidated onto the balance sheets of sponsoring banking organizations as a result of FIN 46-R. All liquidity facilities providing liquidity support to ABCP will be treated as "eligible ABCP liquidity facilities" until September 30, 2005. On that date, all ABCP-related liquidity facilities that do not meet this final rule's definition of an eligible ABCP liquidity facility will be treated as direct credit substitutes or recourse

obligations. This transition period for ABCP-related liquidity facilities existing prior to this final rule's effective date should provide banking organizations with sufficient time to revise their liquidity facilities over the next year to ensure that the facilities meet the eligibility criteria set forth in this final rule.

#### VI. Regulatory Analysis

##### *Riegle Community Development and Regulatory Improvement Act*

Section 302 of Riegle Community Development and Regulatory Improvement Act (12 U.S.C. 4802) generally requires that regulations take effect on the first day of a calendar quarter unless an agency finds good cause that the regulations should become effective sooner and publishes its finding with the rule. The agencies believe that it is important to make this final rule effective before banking organizations must calculate their regulatory risk-based capital ratios at the end of the third quarter 2004. If ABCP program assets are consolidated onto the balance sheets of sponsoring banking organizations under FIN 46-R, then the agencies believe that the resulting capital requirements could be excessive in light of the risks incurred by those organizations as related to those assets. In addition, with respect to liquidity facilities that support ABCP, the current risk-based capital charges may not sufficiently reflect the risks associated with such liquidity facilities. The issuance of this final rule with a September 30, 2004, effective date will ensure that banking organizations maintain appropriate risk-based capital levels with respect to ABCP program assets and ABCP liquidity facilities in calculating their regulatory capital ratios for the third quarter 2004.

##### *Regulatory Flexibility Act Analysis*

Pursuant to section 605(b) of the Regulatory Flexibility Act, the Agencies have determined that this final rule will 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.*). For purposes of the Regulatory Flexibility Act, "small entities" are banking organizations having assets of \$150 million or less. There are approximately 18 banking organizations that will be affected by this final rule. All are well over that size threshold. Accordingly, a regulatory flexibility analysis is not required.

<sup>9</sup>The credit conversion factors used in the October 2003 NPR mirror those in the agencies' August 2003 Advance Notice of Proposed Rulemaking for non-controlled early amortization of uncommitted retail credit lines. See 68 FR 45899 (August 4, 2003).



Paperwork Reduction Act

The Agencies have determined that this final 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

Section 202 of the Unfunded Mandates Reform Act of 1995, Public Law 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 and OTS believe that exclusion of consolidated ABCP program assets from risk-weighted assets for risk-based capital purposes will not result in any expenditures by national banks or savings associations. The exclusion of consolidated ABCP program assets is designed to offset the effect of FIN 46-R on risk-based capital. With respect to the risk-based capital treatment of liquidity facilities, because all national banks and savings associations that provide liquidity facilities to ABCP programs currently exceed regulatory minimum capital requirements, the OCC and OTS do not believe these banks will be required to raise additional capital.

Executive Order 12866

The OCC and OTS have determined that this final rule is not a significant regulatory action under Executive Order 12866.

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, Mortgages, Reporting and recordkeeping requirements, Securities.

12 CFR Part 225

Administrative practice and procedure, Banks, banking, 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 amended as follows:

PART 3—MINIMUM CAPITAL RATIOS; ISSUANCE OF DIRECTIVES

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

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

■ 2. In appendix A to part 3, section 1 is amended as follows:

■ a. Paragraphs (c)(31) to (c)(37) are redesignated as paragraphs (c)(32) to (c)(38);

■ b. Paragraph (c)(30) is removed;

■ c. Paragraphs (c)(19) to (c)(29) are redesignated as paragraphs (c)(21) to (c)(31);

■ d. New paragraph (c)(20) is added;

■ e. Paragraphs (c)(9) to (c)(18) are redesignated as paragraphs (c)(10) to (c)(19);

■ f. Paragraph (c)(8) is redesignated as paragraph (c)(9) and revised;

■ g. Paragraphs (c)(4) to (c)(7) are redesignated as paragraphs (c)(5) to (c)(8);

■ h. New paragraph (c)(4) is added; and

■ i. Paragraph (c)(3) is revised.

■ 3. In appendix A to part 3, section 2, paragraph (a)(3) is revised.

■ 4. In appendix A to part 3, section 3 is amended as follows:

■ a. Paragraph (a)(4)(iii) is revised;

■ b. New paragraphs (a)(5) and (a)(6) are added;

■ c. Paragraph (b) introductory text is revised by amending the fourth sentence;

■ d. Paragraphs (b)(2)(ii) is revised;

■ e. Paragraphs (b)(4) and (b)(5) are redesignated as paragraphs (b)(5) and (b)(7), respectively;

■ f. New paragraph (b)(4) is added;

■ g. Newly redesignated paragraph (b)(5)(i) is revised; and

■ h. New paragraph (b)(6) is added.

■ 5. In appendix A to part 3, section 4 is amended as follows:

■ a. Paragraphs (a)(4)(vi) and (a)(4)(vii) are revised;

■ b. New paragraph (a)(4)(viii) is added;

■ c. Paragraphs (a)(11)(vi) and (a)(11)(vii) are revised;

■ d. New paragraph (a)(11)(viii) is added; and

■ e. Paragraphs (j) and (k) are removed.

■ 6. In appendix A to part 3, 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 primarily issues externally rated commercial paper backed by assets or other exposures held in a bankruptcy-remote, special-purpose entity.

(4) Asset-backed commercial paper 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.

\* \* \* \* \*

(9) Commitment means any arrangement that obligates a national bank to: (i) Purchase loans or securities; or (ii) extend credit in the form of loans or leases, participations in loans or leases, overdraft facilities, revolving credit facilities, home equity lines of credit, liquidity facilities, or similar transactions.

\* \* \* \* \*

(20) Liquidity facility means a legally binding commitment to provide liquidity to various types of transactions, structures or programs. A liquidity facility that supports asset-backed commercial paper, in any amount, by lending to, or purchasing assets from any structure, program, or conduit constitutes an asset-backed commercial paper liquidity facility.

\* \* \* \* \*

*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)(23) 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 3(a)(5)(i) of this appendix A.

\* \* \* \*

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

\* \* \* \*

(a) \* \* \*

\* \* \* \*

(4) \* \* \*

\* \* \* \*

(iii) Asset- or mortgage backed securities that are externally rated are risk weighted in accordance with section 4(d) of this appendix A.

\* \* \* \*

(5) *Asset-backed commercial paper programs subject to consolidation.* (i) 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.

(ii) 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, asset-backed commercial paper liquidity facilities, and loans, in accordance with section 3 and section 4 of this appendix A.

(iii) If a bank either is not permitted to exclude consolidated asset-backed

commercial paper program assets or elects not to exclude consolidated asset-backed commercial paper program assets from its risk-weighted 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 sections 3(a) and 4 of this appendix A. Any direct credit substitutes and recourse obligations (including residual interests and asset-backed commercial paper liquidity facilities), and loans that sponsoring banks provide to such asset-backed commercial paper programs are not subject to a capital charge under this section 4 of this appendix A.

(iv) If a bank has multiple overlapping exposures (such as a program-wide credit enhancement and an asset-backed commercial paper liquidity facility) to an asset-backed commercial paper program that is not consolidated for risk-based capital purposes, the bank must apply the highest capital charge applicable to the exposures but is not required to hold capital multiple times for the overlapping exposures under section 4 of this appendix A.

(6) *Other variable interest entities subject to consolidation.* If a bank is required to consolidate the assets of a variable interest entity other than an asset-backed commercial paper program 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 sections 3(a) and 4 of this appendix A. Any direct credit substitutes and recourse obligations (including residual interests), and loans that a bank may provide to such a variable interest entity are not subject to any capital charge under section 4 of this appendix A.

(b) \* \* \* Second, the resulting credit equivalent amount is then assigned to the proper risk category using the criteria regarding obligors, guarantors, and collateral listed in section 3(a) of this appendix A, or external credit rating in accordance with section 4(d), if applicable. \* \* \*

\* \* \* \*

(2) \* \* \*

(i) \* \* \*

(ii) Unused portion of commitments with an original maturity exceeding one-year;<sup>17</sup> however, commitments that are asset-backed commercial paper liquidity facilities must satisfy the eligibility requirements under section 3(b)(6)(ii) of this appendix A;

\* \* \* \*

(4) *10 percent credit conversion factor.* Unused portion of asset-backed commercial paper liquidity facilities with an original maturity of one year or less that satisfy the eligibility requirements under section 3(b)(6)(ii) of this appendix A.

(5) \* \* \* (i) Unused portion of commitments with an original maturity of one year or less, but excluding any asset-backed commercial paper liquidity facilities;

\* \* \* \*

(6) *Liquidity facility provided to asset-backed commercial paper.* (i)

*Noneligible asset-backed commercial paper liquidity facilities treated as recourse or direct credit substitute.*

Unused portion of asset-backed commercial paper liquidity facilities that do not meet the criteria for an eligible liquidity facility provided to asset-backed commercial paper in accordance with section 3(b)(6)(ii) 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 with section 4 of this appendix A.

(ii) *Eligible asset-backed commercial paper liquidity facility.* Except as provided in section 3(b)(6)(iii) of this appendix A, in order for the unused portion of an asset-backed commercial paper liquidity facility to be eligible for either the 50 percent or 10 percent credit conversion factors under section 3(b)(2)(ii) or 3(b)(4) of this appendix A, the asset-backed commercial paper liquidity facility must satisfy the following criteria:

(A) At the time of draw, the asset-backed commercial paper liquidity facility must be subject to an asset quality test that:

(1) Precludes funding of assets that are 90 days or more past due or in default; and

(2) If the assets that an asset-backed commercial paper liquidity facility is required to fund are externally rated securities at the time they are transferred into the program, the asset-backed commercial paper liquidity 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.

(B) The asset-backed commercial paper 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 as provided in section 3(b)(6)(ii)(A) of this appendix A.

<sup>17</sup> Participations in commitments are treated in accordance with section 4 of this Appendix A.

(iii) Exception to eligibility requirements for assets guaranteed by the United States Government or its agencies, or the central government of an OECD country. Notwithstanding the eligibility requirements for asset-backed commercial paper program liquidity facilities in section 3(b)(6)(ii), the unused portion of an asset-backed commercial paper liquidity facility may still qualify for either the 50 percent or 10 percent credit conversion factors under section 3(b)(2)(ii) or 3(b)(4) of this appendix A, if the assets required to be funded by the asset-back commercial paper liquidity facility are guaranteed, either conditionally or unconditionally, by the United States Government or its agencies, or the central government of an OECD country.

(iv) Transition period for asset-backed commercial paper liquidity facilities. Notwithstanding the eligibility requirements for asset-backed commercial paper program liquidity facilities in section 3(b)(6)(i) of this appendix A, the unused portion of an asset-backed commercial paper liquidity will be treated as eligible liquidity facilities pursuant to section 3(b)(6)(ii) of this appendix A regardless of their compliance with the definition of eligible liquidity facilities until September 30, 2005. On that date and thereafter, the unused portions of asset-backed commercial paper liquidity facilities that do not meet the eligibility requirements in section 3(b)(6)(i) of this appendix A will be treated as recourse obligations or direct credit substitutes.

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

(a) \* \* \*
\* \* \* \* \*
(4) \* \* \*
\* \* \* \* \*

(vi) 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 case advances that meet the conditions of section 4(a)(8)(i) and (ii) of this appendix A, are not direct credit substitutes;

(vii) Clean-up calls on third-party assets. Clean-up calls that are 10% or less of the original pool balance and that are exercisable at the option of the bank are not direct credit substitutes; and (viii) Unused portion of noneligible asset-backed commercial paper liquidity facilities.

\* \* \* \* \*

(11) \* \* \*
\* \* \* \* \*

(vi) Credit derivatives issued that absorb more than the bank's pro rata share of losses from the transferred assets;

(vii) Clean-up calls. Clean-up calls that are 10% or less of the original pool balance and that are exercisable at the option of the bank are not recourse arrangements; and

(viii) Noneligible asset-backed commercial paper liquidity facilities.
\* \* \* \* \*

■ 7. Appendix B to part 3 is amended by adding a new sentence at the end of section 2, paragraph (a) to read as follows:

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

\* \* \* \* \*

Section 2. Definitions

\* \* \* \* \*

(a) \* \* \* Asset backed commercial paper liquidity facilities, in form or in substance, 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.

\* \* \* \* \*

Dated: July 13, 2004.

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 amends 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 made:

- a. Section II.A.1.c. is revised.
■ b. Section III.B.3.a., Definitions, is revised.

- c. Section III.B.6. is revised.
■ d. In section III.D.—
■ i. The third sentence of the introductory paragraph is revised and the last sentence is removed.
■ ii. In paragraph 2., Items with a 50 percent conversion factor, the fourth undesignated paragraph is removed, the five remaining undesignated paragraphs are designated as 2.a. through 2.e., and the newly designated paragraph 2.c. is revised.
■ iii. Paragraph 4., Items with a zero percent conversion factor, is redesignated as paragraph 5. and a new paragraph 4., Items with a 10 percent conversion factor, is added.
■ iv. The first sentence in redesignated paragraph 5., Items with a zero percent conversion factor, is revised.
■ v. Footnote 54 is removed and reserved.
■ e. Attachments IV, V, and VI are removed.

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 capital 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 (ABCP) (as defined in section III.B.6. of this appendix A) 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 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;

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; and

8. Liquidity facilities that provide liquidity support to ABCP (other than eligible ABCP liquidity facilities).

iv. *Eligible ABCP liquidity facility* means a liquidity facility supporting ABCP, in form or in substance, 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 assets or exposures at the inception of the facility, the facility can be used to fund only those assets or exposures that are externally rated investment grade at the time of funding. Notwithstanding the eligibility requirements set forth in the two preceding sentences, a liquidity facility will be considered an eligible ABCP liquidity facility if the assets that are funded under the liquidity facility and which do not meet the eligibility requirements are guaranteed, either conditionally or unconditionally, by the U.S. government or its agencies, or by the central government of an OECD country.

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

vi. *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.

vii. *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.

viii. *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.

ix. *Liquidity Facility* means a legally binding commitment to provide liquidity support to ABCP by lending to, or purchasing assets from, any structure, program, or conduit in the event that funds are required to repay maturing ABCP.

x. *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.

xi. *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.

xii. *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.x. 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;

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; and

8. Liquidity facilities that provide liquidity support to ABCP (other than eligible ABCP liquidity facilities).

xiii. *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.

xiv. *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.

xv. *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.

xvi. *Sponsor* means a bank that establishes an ABCP program; approves the sellers permitted to participate in the program; approves the asset pools to be purchased by the program; or administers the 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.

xvii. *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.

xviii. *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.

\* \* \* \* \*

6. *Asset-backed commercial paper programs*. a. An asset-backed commercial paper (ABCP) program means a program that primarily issues externally rated commercial paper backed by assets or other exposures held in a bankruptcy-remote, special purpose entity.

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 ABCP program. If a bank excludes such consolidated ABCP program assets, the bank must assess the appropriate risk-based capital charge against any 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.

c. If a bank has multiple overlapping exposures (such as a program-wide credit enhancement and multiple pool-specific liquidity facilities) to an ABCP program that is not consolidated for risk-based capital purposes, the bank is not required to hold duplicative risk-based capital under this appendix against the overlapping position. Instead, the bank should apply to the overlapping position the applicable risk-based capital treatment that results in the highest capital charge.

\* \* \* \* \*

III. \* \* \*

D. \* \* \* The resultant credit equivalent amount is assigned to the appropriate risk category according to the obligor or, if relevant, the guarantor, the nature of any collateral, or external credit ratings.<sup>47</sup>

\* \* \* \* \*

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

c.i. 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 ABCP liquidity facilities, 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.

ii Banks that are subject to the market risk rules are required to convert the notional amount of eligible ABCP liquidity facilities, in form or in substance, with an original maturity of over one year that are carried in the trading account at 50 percent to determine the appropriate credit equivalent

<sup>47</sup> The sufficiency of collateral and guarantees for off-balance-sheet items is determined by the market value of the collateral or the amount of the guarantee in relation to the face amount of the item, except for derivative contracts, for which this determination is generally made in relation to the credit equivalent amount. Collateral and guarantees are subject to the same provisions noted under section III.B of this appendix A.

amount even though those facilities are structured or characterized as derivatives or other trading book assets. Liquidity facilities that support ABCP, in form or in substance, (including those positions to which the market risk rules may not be applied as set forth in section 2(a) of appendix E to part 208) that are not eligible ABCP liquidity facilities are to be considered recourse obligations or direct credit substitutes, and assessed the appropriate risk-based capital treatment in accordance with section III.B.3. of this appendix.

\* \* \* \* \*

4. *Items with a 10 percent conversion factor*. a. Unused portions of eligible ABCP liquidity facilities with an original maturity of one year or less are converted at 10 percent.

b. Banks that are subject to the market risk rules are required to convert the notional amount of eligible ABCP liquidity facilities, in form or in substance, with an original maturity of one year or less that are carried in the trading account at 10 percent to determine the appropriate credit equivalent amount even though those facilities are structured or characterized as derivatives or other trading book assets. Liquidity facilities that support ABCP, in form or in substance, (including those positions to which the market risk rules may not be applied as set forth in section 2(a) of appendix E of this part) that are not eligible ABCP liquidity facilities 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.

5. \* \* \* These include unused portions of commitments (with the exception of eligible ABCP liquidity facilities) with an original maturity of one year or less,<sup>54</sup> or which are unconditionally cancelable at any time, provided a separate credit decision is made before each drawing under the facility. \* \* \*

\* \* \* \* \*

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

**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 liquidity facilities that provide liquidity support to asset-backed commercial paper. Such excluded positions are subject to the risk-based capital requirements set forth in appendix A of this part.

\* \* \* \* \*

<sup>54</sup> [Reserved].

## 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 made:

■ a. Section II.A.1.c. is revised.

■ b. Section III.B.3.a., *Definitions*, is revised.

■ c. Section III.B.6. is revised.

■ d. In section III.D—

■ i. The third sentence of the introductory paragraph is revised and the last sentence is removed.

■ ii. In paragraph 2., *Items with a 50 percent conversion factor*, the fourth undesignated paragraph is removed, the five remaining undesignated paragraphs are designated as 2.a. through 2.e., and the newly designated paragraph 2.c. is revised.

■ iii. Paragraph 4, *Items with a zero percent conversion factor*, is redesignated as paragraph 5. and a new paragraph 4. is added.

■ iv. The first sentence is redesignated paragraph 5., *Items with a zero percent conversion factor*, is revised.

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

### 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 capital because, as a general rule, it represents equity that is freely available to absorb losses in operating subsidiaries whose assets are included in a banking 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 (ABCP) (as defined in section III.B.6. of this

appendix A) 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;

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; and

8. Liquidity facilities that provide liquidity support to ABCP (other than eligible ABCP liquidity facilities).

iv. *Eligible ABCP liquidity facility* means a liquidity facility supporting ABCP, in form or in substance, 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 assets or exposures at the inception of the facility, the facility can be used to fund only those assets or exposures that are externally rated investment grade at the time of funding. Notwithstanding the eligibility requirements set forth in the two preceding sentences, a liquidity facility will be considered an eligible ABCP liquidity facility if the assets that are funded under the liquidity facility and which do not meet the eligibility requirements are guaranteed, either conditionally or unconditionally, by the U.S. government or its agencies, or by the central government of an OECD country.

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

vi. *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.

vii. *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.

viii. *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.

ix. *Liquidity Facility* means a legally binding commitment to provide liquidity support to ABCP by lending to, or purchasing assets from, any structure, program, or conduit in the event that funds are required to repay maturing ABCP.

x. *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.

xi. *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.

xii. *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.x. 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;

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 holding company are not recourse arrangements; and

8. Liquidity facilities that provide liquidity support to ABCP (other than eligible ABCP liquidity facilities).

xiii. *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.

xiv. *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.

xv. *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.

xvi. *Sponsor* means a bank holding company that establishes an ABCP program; approves the sellers permitted to participate in the program; approves the asset pools to be purchased by the program; or administers the 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.

xvii. *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.

xviii. *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.

\* \* \* \* \*

6. *Asset-backed commercial paper programs*. a. An asset-backed commercial paper (ABCP) program means a program that primarily issues externally rated commercial paper backed by assets or exposures held in a bankruptcy-remote, special purpose entity.

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 holding company is the sponsor of the 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 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.

c. If a bank holding company has multiple overlapping exposures (such as a program-wide credit enhancement and multiple pool-specific liquidity facilities) to an ABCP program that is not consolidated for risk-based capital purposes, the bank holding company is not required to hold duplicative risk-based capital under this appendix against the overlapping position. Instead, the bank holding company should apply to the overlapping position the applicable risk-based capital treatment that results in the highest capital charge.

\* \* \* \* \*

III. \* \* \*

D. \* \* \* The resultant credit equivalent amount is assigned to the appropriate risk category according to the obligor or, if relevant, the guarantor, the nature of any collateral, or external credit ratings.<sup>51</sup>

\* \* \* \* \*

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

c.i. 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

<sup>51</sup> The sufficiency of collateral and guarantees for off-balance-sheet items is determined by the market value of the collateral or the amount of the guarantee in relation to the face amount of the item, except for derivative contracts, for which this determination is generally made in relation to the credit equivalent amount. Collateral and guarantees are subject to the same provisions noted under section III.B of this appendix A.



loans and leases. They also include overdraft facilities, revolving credit, home equity and mortgage lines of credit, eligible ABCP liquidity facilities, 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.

ii. Banking organizations that are subject to the market risk rules are required to convert the notional amount of eligible ABCP liquidity facilities, in form or in substance, with an original maturity of over one year that are carried in the trading account at 50 percent to determine the appropriate credit equivalent amount even though those facilities are structured or characterized as derivatives or other trading book assets. Liquidity facilities that support ABCP, in form or in substance, (including those positions to which the market risk rules may not be applied as set forth in section 2(a) of appendix E of this part) that are not eligible ABCP liquidity facilities are to be considered recourse obligations or direct credit substitutes, and assessed the appropriate risk-based capital treatment in accordance with section III.B.3. of this appendix.

\* \* \* \* \*

4. *Items with a 10 percent conversion factor.* a. Unused portions of eligible ABCP liquidity facilities with an original maturity of one year or less also are converted at 10 percent.

b. Banking organizations that are subject to the market risk rules are required to convert the notional amount of eligible ABCP liquidity facilities, in form or in substance, with an original maturity of one year or less that are carried in the trading account at 10 percent to determine the appropriate credit equivalent amount even though those facilities are structured or characterized as derivatives or other trading book assets. Liquidity facilities that support ABCP, in form or in substance, (including those positions to which the market risk rules may not be applied as set forth in section 2(a) of appendix E of this part) that are not eligible ABCP liquidity facilities 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.

5. \* \* \* These include unused portions of commitments (with the exception of eligible ABCP liquidity facilities) 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. \* \* \*

\* \* \* \* \*

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

## 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 liquidity facilities that provide liquidity support to asset-backed commercial paper. Such excluded positions are subject to the risk-based capital requirements set forth in appendix A of this part.

\* \* \* \* \*

By order of the Board of Governors of the Federal Reserve System, July 19, 2004.

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 amends 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 made:

■ a. Section I.A.1. is revised.

■ b. Section II.B.5(a), *Definitions*, is revised.

■ c. Section II.B.6. is revised.

■ d. In section II.D—

■ i. The third sentence of the introductory paragraph is revised and the last sentence is removed;

■ ii. In paragraph 2., *Items With a 50 Percent Conversion Factor*, the five undesignated paragraphs are designated as 2.a. through 2.e., the newly designated paragraph 2.c. is revised, and the second sentence of the newly designated paragraph 2.d. is revised;

■ iii. Paragraph 4., *Items With a Zero Percent Conversion Factor*, is redesignated as paragraph 5. and a new paragraph 4., *Items With a 10 Percent Conversion Factor*, is added; and

■ iv. The first sentence in redesignated paragraph 5., *Items With a Zero Percent Conversion Factor*, is revised.

■ e. Tables III and IV are removed.

## 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,<sup>2</sup> including any related surplus; and

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

(a) 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)),<sup>3</sup> 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.

(b) 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.

(c) Although minority interests in consolidated subsidiaries are generally included in 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

<sup>2</sup> 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.

<sup>3</sup> 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.

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.

(d) 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 (ABCP) 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 similar instruments backing financial claims;

(iii) Purchased subordinated interests or securities that absorb more than their *pro rata* share of credit losses from the underlying assets;

(iv) Credit derivative contracts 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;

(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; and

(viii) Liquidity facilities that provide liquidity support to ABCP (other than eligible ABCP liquidity facilities).

(5) *Eligible ABCP liquidity facility* means a liquidity facility supporting ABCP, in form or in substance, 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 assets or exposures at the inception of the facility, the facility can be used to fund only those assets or exposures that are externally rated investment grade at the time of funding. Notwithstanding the

eligibility requirements set forth in the two preceding sentences, a liquidity facility will be considered an eligible ABCP liquidity facility if the assets that are funded under the liquidity facility and which do not meet the eligibility requirements are guaranteed, either conditionally or unconditionally, by the U.S. government or its agencies, or by the central government of an OECD country.

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

(7) *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.

(8) *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.

(9) *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.

(10) *Liquidity facility* means a legally binding commitment to provide liquidity support to ABCP by lending to, or purchasing assets from, any structure, program, or conduit in the event that funds are required to repay maturing ABCP.

(11) *Mortgage servicer cash advance* means funds that a residential mortgage 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:

(i) The mortgage 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

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

(12) *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).

(13) *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, or

(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)(11) of this Appendix A).

(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;

(vii) 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; and

(viii.) Liquidity facilities that provide liquidity support to ABCP (other than eligible ABCP liquidity facilities).

(14) *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 (GAAP)) 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 for purposes of the risk-based capital treatment in this appendix.

(15) *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.

(16) *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.

(17) *Sponsor* means a bank that establishes an ABCP 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.

(18) *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.

(19) *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.

\* \* \* \* \*

6. *Asset-backed commercial paper programs*. a. An asset-backed commercial paper (ABCP) program means a program that primarily issues externally rated commercial paper backed by assets or other exposures held in a bankruptcy-remote, special purpose entity.

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 ABCP program. If a bank excludes such consolidated ABCP program assets, the bank must assess the appropriate risk-based capital charge against any 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.

c. If a bank has multiple overlapping exposures (such as a program-wide credit enhancement and multiple pool-specific

liquidity facilities) to an ABCP program that is not consolidated for risk-based capital purposes, the bank is not required to hold capital under duplicative risk-based capital requirements under this appendix against the overlapping position. Instead, the bank should apply to the overlapping position the applicable risk-based capital treatment that results in the highest capital charge.

\* \* \* \* \*

## II. \* \* \*

D. \* \* \* The resultant credit equivalent amount is assigned to the appropriate risk category according to the obligor or, if relevant, the guarantor, the nature of any collateral, or external credit ratings.<sup>45</sup>

\* \* \* \* \*

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

\* \* \* \* \*

c.i. Commitments 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 ABCP liquidity facilities, 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.

ii. Banks that are subject to the market risk rules in appendix C to part 325 are required to convert the notional amount of eligible ABCP liquidity facilities, in form or in substance, with an original maturity of over one year that are carried in the trading account at 50 percent to determine the appropriate credit equivalent amount even though those facilities are structured or characterized as derivatives or other trading book assets. Liquidity facilities that support ABCP, in form or in substance, (including those positions to which the market risk rules may not be applied as set forth in section 2(a) of appendix C of this part) that are not eligible ABCP liquidity facilities are to be considered recourse obligations or direct credit substitutes, and assessed the appropriate risk-based capital treatment in accordance with section II.B.5. of this appendix.

<sup>45</sup> The sufficiency of collateral and guarantees for off-balance-sheet items is determined by the market value of the collateral or the amount of the guarantee in relation to the face amount of the item, except for derivative contracts, for which this determination is generally made in relation to the credit equivalent amount. Collateral and guarantees are subject to the same provisions noted under section II.B of this appendix A.

d. \* \* \*

Thus, after a commitment has been converted at 50 percent, portions of commitments that have been conveyed to other U.S. depository institutions or OECD banks, but for which the originating bank retains the full obligation to the borrower if the participating bank fails to pay when the commitment is drawn upon, will be assigned to the 20 percent risk category.

\* \* \* \* \*

4. *Items With a 10 Percent Conversion Factor.* a. Unused portions of eligible ABCP liquidity facilities with an original maturity of one year or less that provide liquidity support to ABCP also are converted at 10 percent.

b. Banks that are subject to the market risk rules in appendix C to part 325 are required to convert the notional amount of eligible ABCP liquidity facilities, in form or in substance, with an original maturity of one year or less that are carried in the trading account at 10 percent to determine the appropriate credit equivalent amount even though those facilities are structured or characterized as derivatives or other trading book assets. Liquidity facilities that provide liquidity support to ABCP, in form or in substance, (including those positions to which the market risk rules may not be applied as set forth in section 2(a) of appendix C of this part) that are not eligible ABCP liquidity facilities 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.

5. *Items with a Zero Percent Conversion Factor.* These include unused portions of commitments, with the exception of eligible ABCP liquidity facilities, 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. \* \* \*

\* \* \* \* \*

■ 3. In Appendix C to part 325, add two new sentences to the end of section 2(a) to read as follows:

**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 liquidity facilities that provide liquidity support to asset-backed commercial paper. Such excluded positions are subject to the risk-based capital requirements set forth in appendix A of this part.

\* \* \* \* \*

By order of the Board of Directors.

Dated at Washington, DC, this 28th day of June, 2004.

Federal Deposit Insurance Corporation.

**Valerie J. Best,**

*Assistant Executive Secretary.*

**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 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. Amend § 567.1 by:

■ A. Revising the definition of an “asset-backed commercial paper program;”

■ B. Revising the definition of “commitment;”

■ C. Revising paragraphs (6) and (7) and adding a new paragraph (8) to the definition of “direct credit substitute;”

■ D. Adding a definition of “eligible ABCP liquidity facility;”

■ E. Adding a definition of “liquidity facility;” and

■ F. Revising paragraphs (6) and (7) and adding a new paragraph (8) to the definition of “recourse;”

**§ 567.1 Definitions**

\* \* \* \* \*

*Asset-backed commercial paper program.* The term *asset-backed commercial paper program* (ABCP program) means a program that primarily issues commercial paper that has received a credit rating from an NRSRO and that is backed by assets or other exposures held in a bankruptcy-remote special purpose entity. The term *sponsor* of an ABCP program means a savings association that:

(1) Establishes an ABCP program;

(2) Approves the sellers permitted to participate in an ABCP program;

(3) Approves the asset pools to be purchased by an ABCP program; or

(4) 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.

\* \* \* \* \*

*Commitment.* The term *commitment* means any arrangement that obligates a savings association to:

(1) Purchase loans or securities;

(2) Extend credit in the form of loans or leases, participations in loans or leases, overdraft facilities, revolving

credit facilities, home equity lines of credit, eligible ABCP liquidity facilities, or similar transactions.

\* \* \* \* \*

*Direct credit substitute.* \* \* \*

\* \* \* \* \*

(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. Servicer cash advances as defined in this section are not direct credit substitutes;

(7) Clean-up calls on third party assets. However, clean-up calls that are 10 percent or less of the original pool balance and that are exercisable at the option of the savings association are not direct credit substitutes; and

(8) Liquidity facilities that provide support to asset-backed commercial paper (other than eligible ABCP liquidity facilities).

*Eligible ABCP liquidity facility.* The term *eligible ABCP liquidity facility* means a liquidity facility that supports asset-backed commercial paper, in form or in substance, and that meets the following criteria:

(1)(i) At the time of the draw, the liquidity facility must be subject to an asset quality test that precludes funding against assets that are 90 days or more past due or in default; and

(ii) If the assets that the liquidity facility is required to fund against are assets or exposures that have received a credit rating by a NRSRO at the time of the inception of the facility, the facility can be used to fund only those assets or exposures that are rated investment grade by an NRSRO at the time of funding; or

(2) If the assets that are funded under the liquidity facility do not meet the criteria described in paragraph (1) of this definition, the assets must be guaranteed, conditionally or unconditionally, by the United States Government, its agencies, or the central government of an OECD country.

\* \* \* \* \*

*Liquidity facility.* The term *liquidity facility* means a legally binding commitment to provide liquidity support to asset-backed commercial paper by lending to, or purchasing assets from any structure, program or conduit in the event that funds are required to repay maturing asset-backed commercial paper.

\* \* \* \* \*

*Recourse.* \* \* \*

\* \* \* \* \*

(6) Credit derivatives that absorb more than the savings association's pro rata

share of losses from the transferred assets;

(7) Clean-up calls on assets the savings association has sold. However, clean-up calls that are 10 percent or less of the original pool balance and that are exercisable at the option of the savings association are not recourse arrangements; and

(8) Liquidity facilities that provide support to asset-backed commercial paper (other than eligible ABCP liquidity facilities).

\* \* \* \* \*

■ 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 savings association excludes the consolidated assets of such programs 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)(iv) and (a)(2)(v) as paragraphs (a)(2)(v) and (vi), respectively;

■ C. Adding paragraph (a)(2)(iv);

■ D. Revising redesignated paragraph (a)(2)(v)(A);

■ E. Revising the heading to redesignated paragraph (a)(2)(vi), and revising the references to paragraph (a)(2)(v) in that redesignated paragraph to refer to paragraph (a)(2)(vi);

■ F. Revising paragraph (a)(3); and

■ G. Removing paragraph (a)(4).

**§ 567.6 Risk-based capital credit risk-weight categories.**

(a) \* \* \*

(2) \* \* \*

(ii) \* \* \*

(B) Unused portions of commitments (including home equity lines of credit and eligible ABCP liquidity facilities) with an original maturity exceeding one year except those listed in paragraph (a)(2)(v) of this section. For eligible ABCP liquidity facilities, the resulting credit equivalent amount is assigned to the risk category appropriate to the assets to be funded by the liquidity facility based on the assets or the obligor, after considering any collateral or guarantees, or external credit ratings under paragraph (b)(3) of this section, if applicable; and

\* \* \* \* \*

(iv) *10 percent credit conversion factor (Group D)*. Unused portions of eligible ABCP liquidity facilities with an original maturity of one year or less. The resulting credit equivalent amount is assigned to the risk category appropriate to the assets to be funded by the liquidity facility based on the assets or the obligor, after considering any collateral or guarantees, or external credit ratings under paragraph (b)(3) of this section, if applicable;

(v) *Zero percent credit conversion factor (Group E)*. (A) Unused portions of commitments with an original maturity of one year or less, except for eligible ABCP liquidity facilities.

(vi) *Off-balance sheet contracts; interest rate and foreign exchange rate contracts (Group F)*. \* \* \*

\* \* \* \* \*

(3) *Asset-backed commercial paper programs*. (i) A savings association that qualifies as a primary beneficiary and must consolidate an ABCP program that is a variable interest entity under generally accepted accounting principles may exclude the consolidated ABCP program assets from risk-weighted assets if the savings association is the sponsor of the ABCP program.

(ii) If a savings association excludes such consolidated ABCP program assets from risk-weighted assets, the savings association must assess the appropriate risk-based capital requirement against any exposures of the savings association arising in connection with such ABCP programs, including direct credit substitutes, recourse obligations, residual interests, liquidity facilities, and loans, in accordance with paragraphs (a)(1) and (2) and (b) of this section.

(iii) If a savings association bank has multiple overlapping exposures (such as a program-wide credit enhancement and a liquidity facility) to an ABCP program that is not consolidated for risk-based capital purposes, the savings association is not required to hold duplicative risk-based capital under this part against the overlapping position. Instead, the savings association should apply to the overlapping position the applicable risk-based capital treatment that results in the highest capital charge.

\* \* \* \* \*

Dated: June 24, 2004.

By the Office of Thrift Supervision.

**James T. Gilleran,**

*Director.*

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