Office of the Comptroller of the Currency

Board of Governors of the Federal Reserve System

March 1, 2007

Interpretive Letter #1098
June 2008

Mr. George Miller, Executive Director
American Securitization Forum
360 Madison Avenue, 17th Floor
New York, NY 10017

Dear Mr. Miller:

This letter responds to various communications from the American Securitization Forum (ASF) requesting additional guidance on the risk-based capital charges for liquidity facilities that support asset-backed commercial paper (ABCP) conduits. In your communications submitted on behalf of the bank members of ASF's ABCP Sponsors Sub-Forum, you posed three questions:

- Would a private rating issued by a Nationally Recognized Statistical Rating Organization (NRSRO) qualify as an external rating for purposes of determining the eligibility of an ABCP liquidity facility as specified in the asset quality test for these facilities? [1]
- Would an ABCP liquidity facility that supported asset-backed securities that are backed by assets guaranteed by the U.S. government, its agencies, or by central governments of countries that are members of the Organization for Economic Cooperation and Development (OECD) qualify for the government guarantee exception to the eligibility requirements?
- How should a banking organization apply the risk-based capital requirements and the "Interagency Guidance on the Eligibility of Asset-Backed Commercial Paper Liquidity Facilities" (ABCP guidance)[2] to ABCP liquidity facilities that support assets that have no maturity and no external rating?

Discussion

In July 2004, after consideration of industry comments, the Office of the Comptroller of the Currency (OCC), the Federal Reserve Board (FRB), the Office of Thrift Supervision (OTS), and

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[1] In order to qualify as an eligible ABCP liquidity facility, the liquidity facility must satisfy the asset quality test which requires (1) at the time of draw, the facility is precluded from funding assets that are 90 days or more past due or in default or (2) if the assets that a facility is required to fund are externally rated assets at the inception of the facility, the facility can be used to fund only those assets that are externally rated investment grade at the time of funding. In addition, liquidity facilities that would fund assets that are guaranteed, either conditionally or unconditionally, by the U.S. government, its agencies, or by an OECD central government are excepted from the eligibility requirements, i.e., the asset quality test. 12 C.F.R. Part 3, Appendix A Section 3(b)(6)(ii) and (iii) (OCC) and 12 C.F.R. Parts 208 and 225, Appendix A, Section III.B.3.a.iv. (FRB).

[2] OCC Bulletin 2005-26 (August 4, 2005) and Federal Reserve Supervision and Regulation letter SR 05-13 (August 4, 2005).

the Federal Deposit Insurance Corporation (FDIC) (collectively, banking agencies) published a final rule on asset-backed commercial paper programs (ABCP rule).[3] This rule included a new risk-based capital charge for short-term ABCP liquidity facilities and was fully effective on September 30, 2005. Just prior to the full implementation of the ABCP rule, the banking agencies issued the ABCP guidance that responded to industry questions regarding the implementation of the asset quality test component included in the definition of an eligible ABCP liquidity facility.[4] Since the publication of the ABCP guidance, the industry has posed the aforementioned questions relating to the risk-based capital treatment for ABCP liquidity facilities.

Private Ratings – For purposes of determining the eligibility of an ABCP liquidity facility and risk weighting conduit assets, you believe that the term "external rating" in the asset quality test should be interpreted to exclude a private rating. Furthermore, you assert that a banking organization can, on a regular basis, obtain the aging analyses and status of any credit enhancements for the underlying assets in many of the cases where a conduit's securities have private ratings, e.g., single seller programs. Thus, you propose to determine the eligibility of an ABCP liquidity facility that supports privately rated asset-backed securities by looking through to the underlying assets and risk weighting the facility by reference to the risk weights appropriate for those underlying assets.

In a number of ABCP structures, a bank-provided liquidity facility supports asset pools that have private ratings from an NRSRO. While private ratings provide an indication of credit quality, they generally lack two important characteristics of public ratings issued by NRSROs: private ratings are not widely disseminated and are generally not monitored. These ratings may be distributed to deal participants only or, in some cases, "interested parties," but they are not widely available to the general investing public. The private ratings are also frequently point-in-time ratings that are reaffirmed only at the request of the issuer. The NRSROs have confirmed that they do not publish private ratings and do not include them in their default studies or transition matrices.

When the banking agencies permitted the use of external ratings in their risk-based capital rules for recourse, direct credit substitutes and residual interests in asset securitizations (Recourse rule), widespread market acceptance of the rating was an important part of the rationale for permitting use of an NRSRO rating.[5] The Recourse rule specifically states that external ratings for non-traded positions must be publicly available. The Recourse rule does not, however, explicitly state a similar requirement for traded positions. Notwithstanding the absence of an explicit public availability requirement, staffs of the OCC and the FRB (the Agencies) conclude that it is reasonable to expect that an NRSRO rating on a traded position should be publicly available. Accordingly, an NRSRO rating will qualify as an external rating under the risk-based

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[3] 69 FR 44908 (July 28, 2004).

[4] Under the banking agencies' risk-based capital requirements, an eligible ABCP liquidity facility is treated as an unfunded commitment while an ineligible ABCP liquidity facility is treated as a direct credit substitute.

[5] 66 FR 59614, 59625 (November 29, 2001) ("Investors rely on ratings to make investment decisions. This reliance exerts market discipline on the rating agencies and gives their ratings market credibility. The market's reliance on ratings, in turn, gives the agencies confidence that it is appropriate to consider ratings as a major factor in the risk weighting of assets for regulatory capital purposes.").

capital rules of the Agencies if the rating is published in accessible public form and is monitored so that the rating reflects any deterioration in the issuance. For example, the rating should be published on the NRSRO's website or disseminated to appropriate financial media. In the view of Agencies' staffs, this further enhances the element of market visibility and is an additional indication that the external rating is public.

Thus, the Agencies' staffs conclude that private ratings do not meet the goal of widespread market acceptance inherent in the use of external ratings and, therefore, should not qualify as external ratings for purposes of the Agencies' risk-based capital rules. The Agencies' staffs further conclude that private ratings should not qualify as external ratings for purposes of determining the eligibility of an ABCP liquidity facility.

Look Through Approach – In an ABCP conduit where a liquidity facility supports privately-rated or unrated asset-backed securities, the staffs of the Agencies conclude that a banking organization may look through the securities to the underlying assets to determine the eligibility of the liquidity facility with respect to the "90 days past due" or in default requirement. In order to look through to the underlying assets, a banking organization must be able to obtain the aging analyses and status of any relevant credit enhancements for the underlying assets. If this information is not available, the banking organization may not look through the securities to the underlying assets.

If a banking organization looks through to the underlying assets in the circumstances cited above for purposes of determining the eligibility of a liquidity facility, then the banking organization must assign the credit equivalent amount of the liquidity facility to the risk weight appropriate to those underlying assets. The risk weight applied to the credit equivalent amount of the liquidity facility should be subject to a floor of 20 percent, consistent with the banking agencies' risk-based capital rules for indirect holdings of assets, e.g., investment in shares of a fund.[6]

Government Guarantee Exception - The ABCP rule provides an exception to the eligibility requirements for an ABCP liquidity facility that supports assets guaranteed by the U.S. government or its agencies or the central government of an OECD country.[7] The ABCP rule does not, however, explicitly apply the exception to securitizations of these types of guaranteed assets. For example, an ABCP conduit may hold externally rated asset-backed securities where the underlying assets are student loans guaranteed by the U.S. Department of Education.

Staffs of the Agencies believe that the credit risks are similar for OECD central government-guaranteed assets and asset-backed securities backed by such assets. Accordingly, staffs of the Agencies determine that a liquidity facility supporting asset-backed securities in an ABCP conduit would be deemed eligible if an OECD central government guarantees the underlying assets. As noted above, the risk weight applied to the credit equivalent amount of the liquidity

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[6] 12 C.F.R. Part 3, Appendix A, Section 3 (second undesignated paragraph) (OCC) and 12 C.F.R. Parts 208 and 225, Appendix A, Section III.A (FRB).

[7] 12 C.F.R. Part 3, Appendix A, Section 3(b)(6)(iii) (OCC) and 12 C.F.R. Parts 208 and 225, Appendix A, Section III.B.3.a.iv. (FRB).

facility should be subject to a floor of 20 percent, consistent with the Agencies' risk-based capital rules.

Summary

The staffs of the OCC and the FRB, in consultation with the staffs of the OTS and FDIC, conclude that, for risk-based capital purposes, private ratings should not qualify as external ratings for purposes of determining eligibility for liquidity facilities that support ABCP conduit assets. In the absence of an acceptable external rating, a banking organization may, in certain instances, look through asset-backed securities to the underlying assets to determine the eligibility of an ABCP liquidity facility.

For purposes of determining the eligibility of an ABCP liquidity facility, staffs of the Agencies conclude that a banking organization may apply the eligibility exception for government-guaranteed assets to conduit assets that are themselves backed by qualifying government-guaranteed assets. The question of how to apply the risk-based capital rules and the ABCP guidance to assets that have no firm maturity and are not externally rated is still under consideration.

Should you have additional questions, please contact Nancy Hunt, Risk Expert, Capital Policy Division, OCC, at (202) 874-5070, Thomas R. Boemio, Senior Project Manager, Policy, Division of Banking Supervision and Regulation, FRB, at (202) 452-2982 or Larry Rufrano, Senior Supervisory Financial Analyst, Division of Banking Supervision and Regulation, FRB, at (202) 452-2808.

Sincerely,

/s/	/s/
Tommy Snow	Barbara Bouchard
Director, Capital Policy	Deputy Associate Director
OCC	Federal Reserve Board