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M E M O R A N D U M

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To Our Clients and Friends

Re: Agency Action on Risk-Based Capital Standards and
Asset-Backed Commercial Paper Programs

The Federal Reserve Board, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision (the “Agencies”) have issued an interim final rule to amend their risk-based capital standards for the treatment of assets in asset-backed commercial paper (“ABCP”) programs¹ and a notice of proposed rule-making that would make these changes permanent. The proposed rule would also impose risk-based capital requirements on short-term liquidity facilities provided in connection with ABCP programs and assess risk-based capital charges for certain types of securitizations. Comments are due by the end of October.

INTERIM FINAL RULE

In the interim final rule the Agencies are amending their risk-based capital standards by providing an interim capital treatment for assets in ABCP programs that are consolidated onto the balance sheets of sponsoring banks, bank holding companies, and thrifts as a result of the Financial Accounting Standards Board Interpretation No. 46, Consolidation of Variable Interest Entities (“FIN 46”). Under FIN 46 ABCP programs may need to be consolidated on the balance sheets of these banking organizations beginning in the third quarter of 2003.

¹ An ABCP program is a program through which a banking organization provides funding to its corporate customers by sponsoring and administering a bankruptcy-remote special purpose entity that purchases asset pools from, or extends loans, to those customers. The ABCP program raises cash to provide funding to the banking organization’s customers through the issuance of commercial paper. The banking organization, in turn, provides liquidity and credit enhancements to the ABCP program, which aids the program in obtaining high quality credit ratings that facilitate the issuance of the commercial paper.

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The rule allows these banking organizations to remove the consolidated ABCP program assets from their risk-weighted asset base for the purpose of calculating their tier 1 and total risk-based capital ratios. The rule also provides that any minority interests in ABCP programs that are consolidated as a result of FIN 46 are to be excluded from a banking organization's minority interest component of tier 1 capital, and thus from total risk-based capital. The rule applies to the fiscal quarters ending September 30, 2003, December 31, 2003 and March 31, 2004.

The rule does not affect accounting requirements as established by GAAP or the manner in which banking organizations report consolidated on-balance sheet assets. Banking organizations must continue to assess risk-based capital against any credit enhancements or long-term liquidity facilities that they provide to such ABCP programs.

PROPOSED RULE

The proposed rule would make permanent the treatment of ABCP programs contained in the interim rule and would also:

- Require banking organizations to hold risk-based capital against liquidity facilities with an original maturity of one year or less that organizations provide to ABCP programs, regardless of whether the organization sponsors the program or must consolidate the program under GAAP.
- Require banking organizations to convert short-term liquidity facilities provided to ABCP programs to on-balance sheet credit equivalent amounts utilizing the 20 percent credit conversion factor, as opposed to the 50 percent conversion factor applied to longer term commitments.
- Assess a risk-based capital charge for certain types of securitizations of revolving retail credit facilities that incorporate early amortization provisions.

The interim final and proposed rules can be found at http://www.schwartzandballen.com/whats_new.html.

If you have any questions concerning either of the rules, please call Gilbert Schwartz, Robert Ballen or Tom Fox at (202) 776-0700.