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M E M O R A N D U M

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To Our Clients and Friends

Re: Interagency Guidance on the Eligibility of ABCP Liquidity Facilities

The Comptroller of the Currency, the Federal Reserve Board, the Federal Deposit Insurance Corporation and the Office of Thrift Supervision (“the Agencies”) have issued guidance clarifying their rules regarding the risk-based capital treatment of liquidity facilities that support asset-backed commercial paper (“ABCP”). In July 2004, the Agencies instituted a new capital charge for ABCP liquidity facilities that require a banking organization to provide funding for the program’s underlying assets as a result of deterioration in the credit quality of the asset pool because a draw on such a facility exposes the institution to credit risk. The rule bases the risk-based capital treatment of an ABCP liquidity facility on whether the facility is “eligible” or “ineligible.”

Effective September 30, 2005, “eligible” facilities may apply a credit conversion factor of 10 percent for short-term liquidity facilities and 50 percent for long-term facilities. To be an eligible facility, the liquidity provider may not fund against assets that are 90 days or more past due, in default or below investment grade. If the liquidity facility is “ineligible,” it will be treated as recourse or as a direct credit substitute and be subject to a 100 percent credit conversion factor for risk-based capital purposes.

The guidance indicates that the Agencies will regard an ABCP liquidity as meeting the asset quality test if:

- The liquidity provider has access to certain types of acceptable credit enhancements, and
- The notional amount of the credit enhancements exceeds the amount of underlying assets that are 90 days or more past due, defaulted or below investment grade.

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The Agencies stated that if the above criteria are met, the liquidity facility will be an “eligible” facility because the provider of the credit enhancement bears the credit risk of such assets. The guidance also provides examples of the types of credit enhancement that will be acceptable. The forms include “funded” credit enhancements, surety bonds and letters of credit issued by institutions rated A or better, and under certain circumstances, one month’s worth of excess spread. Recourse directly to the seller generally will not be an acceptable form of credit enhancement for purposes of meeting the asset quality test.

A copy of the guidance can be found on our web site at http://www.schwartzandballen.com/whats_new.html.

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