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November 17, 2003

Ms. Jennifer J. Johnson, Secretary
Board of Governors of the
Federal Reserve System
20th and Constitution Ave., NW
Washington, DC 20551
regs.comments@federalreserve.gov

Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, NW.
Washington, DC 20552
regs.comments@ots.treas.gov

Public Information Room
Office of the Comptroller of the
Currency
Mailstop1–5
250 E Street, SW
Washington, DC 20219
regs.comments@occ.treas.gov

Mr. Robert E. Feldman,
Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation,
550 17th Street, NW
Washington, DC 20429
comments@fdic.gov

Re: **FDIC** RIN 1550–AB79; **FRB** Docket No. R–1156; **OCC** Docket No. 03–21; **OTS** No. 2003–48; Risk-Based Capital Guidelines; Interim Capital Treatment of Consolidated Asset-Backed Commercial Paper Program Assets; 68 Federal Register 56530; October 1, 2003; **and**

FDIC RIN 3064–AC75; **FRB** Docket No. R–1162; **OCC** Docket No. 03–22; **OTS** No. 2003–47; Risk-Based Capital Guidelines; Capital Maintenance: Asset-Backed Commercial Paper Programs and Early Amortization Provisions; 68 Federal Register 56568; October 1, 2003

Ladies and Gentlemen:

The Federal Deposit Insurance Corporation, the Federal Reserve Board and The Office of the Comptroller of the Currency (the "Agencies") are requesting comments on an interim rule providing for appropriate capital treatment of asset-backed commercial paper ("ABCP") program assets affected by the recently issued Financial Accounting Standards Board's ("FASB") FIN 46: Consolidation of Variable Interest Entities. In a separate but related proposal, the Agencies are requesting comment on a proposed final capital treatment of ABCP program assets, including a provision relating to early amortization of these assets. Both the interim rule and the proposed rule make changes to the capital adequacy standard for all commercial banks and savings associations. The American Bankers Association ("ABA") brings together all categories of banking institutions to best represent the interests of this rapidly changing industry. Its membership - which includes community, regional and money center banks and holding companies, as well as savings associations, trust companies and savings banks - makes ABA the largest banking trade association in the country.

Comments on the Interim Rule

In January 2003, FASB issued interpretation FIN 46, "Consolidation of Variable Interest Entities" requiring the consolidation of variable interest entities ("VIEs") onto the balance sheets of companies deemed to be the primary beneficiaries of those entities. FIN 46 may result in the consolidation of many ABCP programs onto the balance sheets of banking organizations beginning in the third quarter of 2003. Under pre-FIN 46 accounting standards, banking organizations normally have not been required to consolidate the assets of these programs. Banking organizations that are required to consolidate ABCP program assets will have to include all of these program assets (mostly receivables and securities) and liabilities (mainly commercial paper) on their September 30, 2003 balance sheets for their quarterly financial reports. If no changes were made to regulatory capital standards, the resulting increase in the asset base would lower both the tier 1 leverage and risk-based capital ratios of banking organizations that must consolidate these assets.

The interim rule allows banking organizations to exclude from their assets for regulatory capital calculations any assets from an ABCP program that was previously excluded from their assets but is not required to be included as a result of FIN 46.[1] The interim rule also provides alternative capital treatment if a banking organization elects not to exclude these ABCP program assets. This will prevent the existing direct credit substitute and recourse capital rules from requiring double capitalization of the asset risk. Finally, the Agencies exclude from Tier 1 and total risk-based capital any minority interest in sponsored ABCP programs that are required to be consolidated by FIN 46. The Agencies have issued this interim rule effective for the quarterly financial reports for the last two quarters of 2003 and for the first quarter of 2004 to give the Agencies time to amend permanently their capital adequacy standards. The Agencies have separately requested comment on such a permanent change to their capital standards.[2]

An 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. The asset pools in an ABCP program may 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 commercial paper into the market. Typically, the sponsoring banking organization 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. The Agencies state that they believe that sponsoring banking organizations generally face limited risk exposure from ABCP programs. Generally that risk is confined to the credit enhancements and liquidity facility arrangements that they provide to these programs. In addition, the risk is usually further mitigated by the existence of operational controls and structural provisions, along with overcollateralization or other credit enhancements provided by the companies that sell assets into ABCP programs.

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[1] The interim rule does not change the accounting treatment of the assets under Generally Accepted Accounting Principles.

[2] 68 Fed. Reg. 56568 (October 1, 2003)

The American Bankers Association supports the Agencies' interim rule, as providing the best solution to the problems posed by the change in accounting treatment of ABCP program assets.

Comments on the Proposed Rule

In the separate proposed rule, the Agencies proposed to make the interim rule permanent. However, before doing so, the Agencies propose to assess additional capital charges against the credit exposures that arise from ABCP programs, including liquidity facilities with an original maturity of one year or less. These additional charges will apply, even if the assets are not required to be consolidated on the balance sheet by FIN 46. Currently, 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. Short-term liquidity facilities are converted to an on-balance sheet credit equivalent amount utilizing the zero percent credit conversion factor. As a result, such short-term facilities currently are not subject to a risk-based capital charge. The Agencies propose to convert short-term liquidity facilities provided to ABCP programs to on-balance sheet credit equivalent amounts utilizing the 20 percent credit conversion factor. This 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.

Additionally, the Agencies assessment of a risk-based capital charge against the risks associated with early amortization, a common feature in securitizations of revolving retail credit exposures, <u>but only against credit card exposures</u>. This proposal is actually part of the current proposed New Basel Capital Accord ("New Accord"). The maximum risk-based capital requirement that would be assessed under the proposal would be equal to the greater of (i) the capital requirement for residual interests or (ii) the capital requirement that would have applied if the securitized assets were held on the securitizing banking organization's balance sheet.

<u>The Agencies Should Coordinate This Proposal with the New Accord</u>
In effect, the proposal for liquidity facilities is an adoption of the Standardized Approach under the Accord—an approach that the Agencies have themselves rejected in their initial implementation proposal for the Accord in the U.S. The 20% conversion factor appears to be the substitution of one arbitrary line for another (the current 0% conversion factor) as part of an early adoption of a small part of the New Accord. Instead of such a piecemeal approach, ABA believes that the proposed changes for treatment of liquidity facilities and revolving transactions with early amortization features should be made only as part of the U.S. implementation of the New Accord. This is particularly true, given that the Basel Committee is considering revising the Accord to eliminate or simplify the Standardized Approach in whole or in part for securitizations with a less complex approach.

<u>Specific Comments on the Proposal</u>
ABA member banks that securitize credit card receivables make the following technical comments on the proposal. First, their own experiences with liquidity facilities strongly suggests that the 20% conversion factor is too high. Their own internal data suggests a conversion factor of no more than 10%, on the conservative side, down to 5%. Second, consistent with the proposed New Accord, if the Agencies adopt their proposal, then the Agencies should also adopt the provision in the New Accord for addressing controlled early amortization. A controlled early amortization would be one in which the period for amortization is sufficient for 90% of the total debt outstanding at the beginning of the amortization period to be repaid or be in default and the amortization pace is no more rapid than a straight-line amortization. Credit conversion factors for the four segments would

be as set out in the Agencies' New Accord ANPR: 1%, 2%, 20%, and 40%. Third, they recommend a simplification of the conversion factor early amortization capital requirement that would make implementation much easier. The methodology should use the lesser of 4%, or the point at which the organization would be required to begin trapping excess spread as the starting reference point. This would allow for broad consistency across the industry, with four, simple 1% quadrants. This would also help the test be more operational for originators and verifiable for examiners. Slight variances in the starting point for trapping excess spread are not uncommon and not necessarily indicative of significant risk differentiation in the underlying assets. Finally, Finally, they recommend a reduction to the required conversion factors for early amortization risk. For early amortization structures, they suggest credit conversion factors of twice that for controlled early amortization: 0%, 2%, 4%, 40%, and 80%.

Extension of Implementation Deadline
The interim rule is proposed to expire on April 1, 2004. This would appear to make the additional proposals effective as of that April 1. We recommend that, if the Agencies adopt the early amortization proposal, that it be delayed until one year past the adoption of the Permanent Rules to permit any required changes in liquidity facilities to be implemented as these facilities come up for renewal. Otherwise, this would appear to require a potentially conduit-wide amendment process within the next several months. At a minimum, we suggest that all existing liquidity facilities be deemed to be "eligible" facilities until the earlier to occur of (i) an amendment to that facility or (ii) the first renewal date for such facility following the effective date of the new rules to allow for an orderly implementation of the new requirements for liquidity facilities in the current market.

Sincerely,

Paul Alan Smith

Paul Smith
Senior Counsel