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MEMORANDUM

July 21, 2004

To Our Clients and Friends

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

The Federal Reserve Board, the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision (the “Agencies”) have issued a final rule amending their risk-based capital standards for the treatment of assets in asset-backed commercial paper (“ABCP”) programs.¹ The final rule will become effective September 30, 2004, although banking organizations may elect to adopt the capital treatment described in the rule as of the date of its publication in the Federal Register.

The Agencies have made permanent an interim rule issued in September 2003, which addressed risk-based capital guidelines and the Financial Accounting Standards Board Interpretation No. 46, “Consolidation of Variable Interest Entities (“FIN 46”). FIN-46 requires the consolidation of many ABCP programs onto the balance sheets of banking organizations. The Agencies’ action allows banking organizations to permanently exclude from their risk-weighted asset base assets derived from consolidated ABCP programs when calculating their tier 1 and total risk-based capital ratios. The Agencies also excluded minority interests in sponsored ABCP programs that are consolidated under FIN-46 from tier 1 and total capital.

The Agencies’ final rule includes the following provisions:

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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- provides a definition of an ABCP program
- imposes a risk weight of 10 percent on liquidity facilities with an original maturity of one year or less that support ABCP
- a banking organization with multiple exposures to an ABCP program need hold risk-based capital only once against assets covered by the overlapping exposures
- in order for a liquidity facility to be considered exempt from risk-based capital requirements, the facility may not fund assets that are 90 days or more past due
- precludes banking organizations that are subject to the market risk capital rules from applying those rules to positions which act as liquidity facilities supporting ABCP and which are held in a bank's trading book.

The Agencies did not adopt their proposal to assess a risk-based capital charge against risks associated with early amortization of securitizations.

The Agencies' rule can be found 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.