**Federal Deposit Insurance Corporation**
550 17th Street NW, Washington, DC 20429

Division of Supervision

Capital Standards

FIL-117-97
November 7, 1997

TO: CHIEF EXECUTIVE OFFICER

SUBJECT: *Proposed Revisions to the Risk-Based Capital Treatment of Recourse and Direct Credit Substitutes*

The FDIC Board of Directors is seeking comment on the attached proposal to make consistent the risk-based capital standards for two types of credit enhancements - "recourse" arrangements and "direct credit substitutes." The proposal would also require different amounts of capital for different risk positions in asset securitization transactions.

The proposed rule is being issued jointly by the Federal Reserve Board, the Office of the Comptroller of the Currency and the Office of Thrift Supervision. The agencies will accept comments on the proposal through February 3, 1998.

Banks provide credit enhancements to protect investors who purchase loans and securities from incurring losses. Recourse arrangements arise when an institution retains all or part of the risk of loss on an asset or pool of assets it has sold to another financial institution, a government agency or some other party. A direct credit substitute is an arrangement, such as a standby letter of credit or a guarantee, in which an institution assumes all or part of the risk of loss on an asset or pool of assets owned by another party, even though the institution had not owned and sold the asset.

Under the current risk-based capital standards, different amounts of capital can be required for recourse arrangements and direct credit substitutes that expose an institution to equivalent risk of loss. In addition, the standards do not recognize differences in risks associated with different loss positions in asset securitizations. To eliminate these inconsistencies, the proposal would:

- Extend the current risk-based capital treatment of recourse obligations to direct credit substitutes. For both types of credit enhancements, this generally would mean that capital must be held against the entire outstanding amount of assets that the enhancement supports, except for qualifying enhancements in asset securitizations that would receive a more favorable risk-based capital treatment.

- Implement a multi-level approach to capital requirements for asset securitizations. For positions in securitizations that are traded, the multi-level approach would base the risk-based capital treatment on credit ratings from nationally recognized rating agencies. For positions in securitizations that are not traded, the proposal presents three alternative approaches for determining the capital requirements. In general, these approaches would use ratings from two rating agencies, benchmark guidelines developed by the banking agencies for standard securitization structures based on information available from the rating agencies, and statistical evaluations of historical loss data.

Inactive

The proposal would require institutions to maintain higher amounts of capital against certain direct credit substitutes, but would reduce the risk-based capital charge for positions in asset securitizations with the highest credit quality. In addition, loss positions in securitizations that meet the proposed criteria would receive a more favorable risk-based capital treatment than would otherwise apply to recourse obligations and direct credit substitutes.

The attached Federal Register notice contains a detailed discussion of the proposed rule and a series of specific questions for comment. For further information, please contact Robert F. Storch, Chief of the Accounting Section in the FDIC's Division of Supervision, on (202) 898-8906.

Nicholas J. Ketcha Jr.

Director

Attachment: (Available on the FDIC's web site, www.fdic.gov/news) Federal Register, Nov. 5, 1997, pp 59944-59976.

Distribution: FDIC-Supervised Banks (Commercial and Savings)

NOTE: Paper copies of FDIC financial institution letters may be obtained through the FDIC's Public Information Center, 801 17th Street, N.W., Room 100, Washington, D.C. 20434 ((703) 562-2200 or 800-276-6003). Electronic versions are available on the FDIC web site at: http://www.fdic.gov/news/

Inactive