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

Division of Supervision

Capital Standards

FIL-82-98
August 11, 1998

TO: CHIEF EXECUTIVE OFFICER

SUBJECT: *Final Rule Revising the Regulatory Capital Treatment of Servicing Assets*

The FDIC Board of Directors has approved the attached final rule relaxing the regulatory capital limitations on servicing assets and aligning the terminology used in the FDIC's capital standards more closely with the terminology used under generally accepted accounting principles. The rule, which reduces banks' regulatory burden, is being issued jointly with the rules of the Federal Reserve Board, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision.

The revised rule will take effect on October 1, 1998. However, institutions may choose to apply the revised limits on servicing assets beginning August 10, 1998, the date of the final rule's publication in the Federal Register.

Specifically, the final rule increases the amount of mortgage servicing assets (MSAs) recognized for regulatory capital purposes and, for the first time, recognizes limited amounts of nonmortgage servicing assets (NMSAs) in regulatory capital calculations. The rule also retains the current capital limitations that apply to purchased credit card relationships.

Servicing assets arise from contracts to service loans or other financial assets (that have been securitized or are owned by others) under which the benefits of servicing are expected to more than adequately compensate the servicer for performing the servicing. The values assigned to servicing assets are potentially volatile due to interest rate and prepayment risk. Because of these risks, excessive concentrations in these assets could cause a significant adverse impact on bank capital.

MSAs arise from contracts to service loans secured by real estate that have been securitized or are owned by others. NMSAs originate from contracts to service financial assets other than loans secured by real estate. Purchased credit card relationships (PCCRs) arise when an institution purchases existing credit card receivables and also has the right to provide credit card services to those customers. In general, PCCRs are the amount paid in excess of the value of the purchased credit card receivables.

The final rule makes the following revisions to the FDIC's capital standards:

- **100 Percent Aggregate Limit.** The limitation on the amount of servicing assets (when combined with PCCRs) that can be recognized as a percent of Tier 1 capital will increase from 50 percent to 100 percent.

- **25 Percent Sublimit.** For the first time, NMSAs will be recognized (rather than deducted) for regulatory capital purposes, subject to the 25 percent of Tier 1 capital sublimit that previously applied only to PCCRs. Thus, NMSAs will be combined with PCCRs for

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purposes of applying this 25 percent sublimit and will also be combined with MSAs and PCCRs for purposes of applying the 100 percent aggregate limit.

- **10 Percent Haircut.** The 90 percent of fair value limit (also referred to as the 10 percent "haircut") will be retained for MSAs and PCCRs and extended to cover NMSAs.

Any balance sheet assets for MSAs, NMSAs and PCCRs that exceed the above limitations will be deducted from assets and from Tier 1 capital when calculating a bank's leverage and risk-based capital ratios.

The final rule will not impose any regulatory capital limitation on interest-only (I/O) strips receivable. I/O strips are assets that represent rights to receive some or all of the future interest income from serviced assets in excess of the contractually specified servicing fees. However, consistent with current capital rules, the FDIC will continue to apply the risk-based capital treatment for financial assets sold with recourse to those arrangements where retained I/O strips are used as a credit enhancement to absorb credit risk on the underlying assets that have been sold.

This rule is generally consistent with the proposal that the four federal banking agencies issued for comment in August 1997, with the exception that under the proposal all NMSAs would have been deducted when determining the amount of Tier 1 capital. However, the final rule will allow NMSAs to be recognized in calculating Tier 1 capital, subject to the 10 percent haircut and the same 25 percent of capital sublimit that previously applied only to PCCRs.

For more information, please contact Stephen G. Pfeifer, Examination Specialist in the FDIC's Division of Supervision, on 202-898-8904.

Nicholas J. Ketcha Jr.
Director

Attachment

Distribution: FDIC-Supervised Banks (Commercial and Savings)

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