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

Division of Supervision

CAPITAL STANDARDS

FIL-15-2000
March 10, 2000

TO: CHIEF EXECUTIVE OFFICER

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

The Federal Deposit Insurance Corporation (FDIC) Board of Directors is seeking comment on the attached proposal to amend the risk-based capital standards. The proposal would revise the treatment of recourse arrangements, direct credit substitutes, and asset securitization transactions. The FDIC is issuing the proposed rule jointly with 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 June 7, 2000.

Banks and thrifts often provide credit enhancements-recourse and direct credit substitutes-when loans and other financial assets are sold or securitized in order to protect investors from incurring credit losses. In general, recourse arises when an institution retains all or part of the risk of credit loss when it transfers its own assets to another party. Direct credit substitutes represent financial guarantees in which an institution assumes all or part of the risk of credit loss from another party's assets. In a securitization, assets such as residential mortgages, commercial mortgages, credit-card receivables, or automobile loans are pooled and reconstituted into securities. The securitization typically carves up the risk of credit loss from the underlying assets and redistributes the risk among different parties.

The agencies' proposal addresses a number of concerns about the current risk-based capital treatment of recourse and direct credit substitutes. First, the required amount of capital can differ for recourse arrangements and direct credit substitutes that expose an institution to equivalent risk of loss. Second, the current capital standards do not recognize differences in risk associated with different loss positions in asset securitizations. Third, the agencies' standards do not provide uniform definitions of terms in this area. Therefore, the proposal would amend the risk-based capital standards by:

- Defining recourse and related terms, and revising the definition of direct credit substitute.
- Providing more consistent risk-based capital treatment for recourse arrangements and direct credit substitutes.
- Adopting a "ratings-based" approach that sets the capital requirements for positions in securitized transactions according to their relative risk exposure, using credit ratings from nationally recognized rating agencies to measure the level of risk.
- Permitting the limited use of an institution's internal risk-rating system and other alternative approaches for determining the risk-based capital requirement for unrated direct credit substitutes associated with asset-backed commercial paper programs and other structured finance programs.

- Requiring an institution that sponsors a revolving credit securitization with an early amortization feature, such as some securitizations of credit cards and home equity lines, to hold capital against the risks presented by this feature of the securitization.

The proposal incorporates many of the industry comments received in response to an earlier version published in November 1997. A consultative paper issued in June 1999 by the Basel Committee on Banking Supervision sets forth an approach similar to that contained in this proposal.

The attached Federal Register notice contains a detailed discussion of the proposed rule and a number of specific questions for which comments are requested. For further information, please contact Robert F. Storch, Chief of the Division of Supervision's Accounting Section, at (202) 898-8906 or Jamey Basham, Counsel in the Legal Division, at (202) 898-7265.

James L. Sexton
Director

Attachment: March 8, 2000 Federal Register, pages 12320-12352
HTML or PDF (353 KB File - PDF Help or Hard Copy)

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