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SUPPLEMENTARY INFORMATION:

I. Asset-Backed Commercial Paper Programs

Background

An asset-backed commercial paper (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 might 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 aid the program in obtaining high quality credit ratings that facilitate the issuance of the commercial paper.¹

In January 2003, the Financial Accounting Standards Board (FASB) issued interpretation No. 46, "Consolidation of Variable Interest Entities" (FIN 46), requiring the consolidation of variable interest entities (VIEs) onto the balance sheets of companies deemed to be the primary beneficiaries of those entities.² FIN 46

¹ For the purposes of this proposed rule, a banking organization is considered the sponsor of an ABCP program if it establishes the program; approves the sellers permitted to participate in the program; approves the asset pools to be purchased by the programs; or administers the ABCP program by monitoring the assets, arranging for debt placement, compiling monthly reports, or ensuring compliance with the program documents and with the program's credit and investment policy.

² Under FIN 46, the FASB broadened the criteria for determining when one entity is deemed to have a controlling financial interest in another entity and, therefore, when an entity must consolidate another entity in its financial statements. An entity generally does not need to be analyzed under FIN 46 if it is designed to have "adequate capital," as described in FIN 46, and its shareholders control the entity with their share votes and are allocated its profits and losses. If the entity fails these criteria, it typically is deemed a VIE and each stakeholder in the entity (a group that can include, but is not limited to, legal-form equity holders, creditors, sponsors, guarantors, and servicers) must assess whether it is the entity's "primary beneficiary" using the FIN 46 criteria. This analysis considers whether effective control exists by evaluating the

likely will result in the consolidation of many ABCP programs onto the balance sheets of banking organizations beginning in the third quarter of 2003. In contrast, under pre-FIN 46 accounting standards, the sponsors of ABCP programs 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 the program assets (mostly receivables and securities) and liabilities (mainly commercial paper) on their September 30, 2003 balance sheets for purposes of the bank Reports of Condition and Income (Call Report), the Thrift Financial Report (TFR), and the bank holding company financial statements (FR Y-9C Report). 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 the assets held in ABCP programs.

The agencies believe that the consolidation of ABCP program assets could result in risk-based capital requirements that do not appropriately reflect the risks faced by banking organizations involved with these programs. In the view of the agencies, banking organizations generally face limited risk exposure to ABCP programs. This risk usually is confined to the credit enhancements and liquidity facility arrangements that banking organizations provide to these programs. In addition, operational controls and structural provisions, along with overcollateralization or other credit enhancements provided by the companies that sell assets into ABCP programs mitigate the risk to which sponsoring banking organizations are exposed.

Because of the limited risks, in a related joint interim rule published elsewhere in today's **Federal Register**, the agencies amended their risk-based capital standards to permit sponsoring banking organizations to exclude ABCP program assets that must be consolidated by the organization under FIN 46 from risk-weighted assets for purposes of calculating the risk-based capital ratios through the end of the first quarter of 2004. The agencies also amended their risk-based capital rules to exclude from tier 1 and total risk-based capital any minority interest in sponsored ABCP programs that are

entity's risks and rewards. In the end, the stakeholder who holds the majority of the entity's risks or rewards is the primary beneficiary and must consolidate the VIE.