

consolidated under FIN 46. Exclusion of minority interests associated with consolidated ABCP programs is appropriate when such programs' assets are not included in a sponsoring organization's risk-weighted asset base and, thus, are not assessed a risk-based capital charge. This interim risk-based capital treatment will expire on April 1, 2004. The period during which the interim rule is in effect provides the agencies with additional time to develop appropriate risk-based capital requirements for banking organizations' sponsorship and other involvement with ABCP programs and to receive comments from the industry on this proposal.

The interim risk-based capital treatment does not alter any accounting requirements as established by GAAP or the manner in which banking organizations report consolidated on-balance sheet assets. In addition, the risk-based capital treatment set forth in the interim final rule and its proposed continuation in this joint notice of proposed rulemaking does not affect the denominator of the tier 1 leverage capital ratio, which would continue to be based primarily on on-balance sheet assets as reported under GAAP. Thus, as a result of FIN 46, banking organizations must include all assets of consolidated ABCP programs in on-balance sheet assets for purposes of calculating the tier 1 leverage capital ratio.

In contrast to most other cases where minority interests in consolidated subsidiaries are included as a component of tier 1 capital and, hence, are incorporated into the tier 1 leverage capital ratio calculation, minority interests related to sponsoring banking organizations' ABCP program assets consolidated as a result of FIN 46 are not to be included in tier 1 capital. Thus, the reported tier 1 leverage capital ratio for a sponsoring banking organization would likely be lower than it would be if only the ABCP program assets were consolidated. The agencies do not anticipate that the exclusion of minority interests related to consolidated ABCP programs assets would significantly affect the tier 1 leverage capital ratio of sponsoring banking organizations because the amount of equity in ABCP programs generally is small relative to the capital levels of the sponsoring organizations.

#### *Proposed Risk-Based Capital Treatment for ABCP Exposures*

In this notice of proposed rulemaking, the agencies are proposing to amend their risk-based capital standards by removing the April 1, 2004 sunset provision so that ABCP program assets

consolidated under FIN 46 and any associated minority interests continue to be excluded from risk-weighted assets and tier 1 capital, respectively, when sponsoring banking organizations calculate their tier 1 and total risk-based capital ratios. The proposed removal of the sunset provision is contingent upon the agencies implementing an alternative, more risk-sensitive approach to the risk exposures arising from ABCP programs.

Accordingly, the agencies are proposing to amend their risk-based capital requirements to assess more appropriate capital charges against the credit exposures that arise from ABCP programs, including liquidity facilities with an original maturity of one year or less (that is, short-term liquidity facilities). The agencies believe that this proposal would result in a capital requirement that is more commensurate with the credit risk to which banking organizations are exposed as a result of their sponsorship and other involvement with ABCP programs. The capital charge for short-term liquidity facilities that are provided to ABCP programs generally would apply even if FIN 46 would not require the program to be consolidated.

Liquidity facilities extended to ABCP programs are commitments to lend to, or purchase assets from, the programs in the event that funds are needed to repay maturing commercial paper. Typically, this need for liquidity is due to a timing mismatch between cash collections on the underlying assets in the program and scheduled repayments of the commercial paper issued by the program. Currently, liquidity facilities with an original maturity of over one year (that is, long-term liquidity facilities) are converted to an on-balance sheet credit equivalent amount using the 50 percent credit conversion factor. Short-term liquidity facilities are converted to an on-balance sheet credit equivalent amount utilizing the zero percent credit conversion factor. As a result, such short-term facilities currently are not subject to a risk-based capital charge.

In the agencies' view, a banking organization that provides liquidity facilities to ABCP programs is exposed to credit risk regardless of the tenure of the liquidity facilities. For example, an ABCP program may draw on a liquidity facility at the first sign of deterioration in the credit quality of an asset pool to buy out the assets and remove them from the program. In such an event, a draw exposes the banking organization providing the liquidity facility to credit risk. The agencies believe that the existing risk-based capital rules do not

adequately reflect the risks associated with short-term liquidity facilities extended to ABCP programs.

Although the agencies are of the view that liquidity facilities expose banking organizations to credit risk, the agencies also believe that the short tenure of commitments with an original maturity of one year or less exposes banking organizations to a lower degree of credit risk than longer tenure commitments. This difference in degree of credit risk exposure should be reflected in any potential capital requirement. The agencies, therefore, are proposing to convert short-term liquidity facilities provided to ABCP programs to on-balance sheet credit equivalent amounts utilizing the 20 percent credit conversion factor, as opposed to the 50 percent credit conversion factor applied to commitments with an original maturity of greater than one year. This amount would then be risk-weighted according to the underlying assets or the obligor, after considering any collateral or guarantees, or external credit ratings, if applicable. For example, if a short-term liquidity facility provided to an ABCP program covered an asset-backed security (ABS) externally rated AAA, then the amount of the security would be converted at 20 percent to an on-balance sheet credit equivalent amount and assigned to the 20 percent risk category appropriate for AAA-rated ABS.<sup>3</sup>

In many cases, a banking organization may have multiple exposures that may be drawn under varying circumstances within a single ABCP program (for example, both a credit enhancement and a liquidity facility). The agencies do not intend to subject a banking organization to duplicative risk-based capital requirements against these multiple exposures where they overlap and cover the same underlying asset pool. Rather, a banking organization must hold risk-based capital only once for the position covered by the overlapping exposures. Where the overlapping exposures are subject to different risk-based capital requirements, the banking organization must apply the risk-based capital treatment resulting in the highest capital charge to the overlapping portion of the exposures.

For example, assume a banking organization provides a program-wide credit enhancement covering 10 percent of the underlying asset pools in an ABCP program and pool-specific liquidity facilities covering 100 percent

<sup>3</sup> See 12 CFR part 3, appendix A, Section 4(d) (OCC); 12 CFR parts 208 and 225, appendix A, III.B.3.c. (FRB); 12 CFR part 325, appendix A, II.B.5.d. (FDIC); 12 CFR 567.6(b) (OTS).