

(4) *Direct credit substitute* means an arrangement in which a bank assumes, in form or in substance, credit risk associated with an on-or off-balance sheet credit exposure that was not previously owned by the bank (third-party asset) and the risk assumed by the bank exceeds the *pro rata* share of the bank's interest in the third-party asset. If the bank has no claim on the third-party asset, then the bank's assumption of any credit risk with respect to the third party asset is a direct credit substitute. Direct credit substitutes include, but are not limited to:

(i) Financial standby letters of credit, which includes any letter of credit or similar arrangement, however named or described, that support financial claims on a third party that exceed a bank's *pro rata* share of losses in the financial claim;

(ii) Guarantees, surety arrangements, credit derivatives, and irrevocable guarantee-type instruments backing financial claims such as outstanding loans, or other financial claims, or that back off-balance-sheet items against which risk-based capital must be maintained;

(iii) Purchased subordinated interests or securities that absorb more than their *pro rata* share of credit losses from the underlying assets. Purchased subordinated interests that are credit-enhancing interest-only strips are subject to the higher capital charge specified in section II.B.5.(f) of this appendix A;

(iv) Entering into a credit derivative contract under which the bank assumes more than its *pro rata* share of credit risk on a third party asset or exposure;

(v) Loans or lines of credit that provide credit enhancement for the financial obligations of an account party;

(vi) Purchased loan servicing assets if the servicer:

(A) Is responsible for credit losses with the loans being serviced,

(B) Is responsible for making servicer cash advances (unless the advances are not direct credit substitutes because they meet the conditions specified in section II.B.5.(a)(9) of this appendix A), or

(C) Makes or assumes credit-enhancing representations and warranties with respect to the loans serviced; and

(vii) Clean-up calls on third party assets. Clean-up calls that are exercisable at the option of the bank (as servicer or as an affiliate of the servicer) when the pool balance is 10 percent or less of the original pool balance are not direct credit substitutes.

(viii.) Liquidity facilities extended to ABCP programs that are not eligible liquidity facilities (as defined in section II.B.5.a. of this appendix).

(5) *Early amortization triggers* mean contractual requirements that, if triggered, would cause a securitization to begin repaying investors prior to the originally scheduled payment dates.

(6) *Eligible liquidity facility* means a facility subject to a reasonable asset quality test at the time of draw that precludes funding against assets in the ABCP program that are 60 days or more past due or in default. In addition, if the assets that an eligible liquidity facility is required to fund against are externally rated exposures at the inception of the facility, the facility can be

used to fund only those exposures that are externally rated investment grade at the time of funding. Furthermore, an eligible liquidity facility must contain provisions that, prior to any draws, reduces the bank's funding obligation to cover only those assets that would meet the funding criteria under the facility's asset quality tests.

(7) *Excess spread* means gross finance charge collections and other income received by the trust or special purpose entity (SPE) minus certificate interest, servicing fees, charge-offs, and other trust or SPE expenses.

(8) *Externally rated* means that an instrument or obligation has received a credit rating from a nationally-recognized statistical rating organization.

(9) *Face amount* means the notional principal, or face value, amount of an off-balance sheet item; the amortized cost of an asset not held for trading purposes; and the fair value of a trading asset.

(10) *Financial asset* means cash or other monetary instrument, evidence of debt, evidence of an ownership interest in an entity, or a contract that conveys a right to receive or exchange cash or another financial instrument from another party.

(11) *Financial standby letter of credit* means a letter of credit or similar arrangement that represents an irrevocable obligation to a third-party beneficiary:

(i) To receive money borrowed by, or advanced to, or advanced to, or for the account of, a second party (the account party), or

(ii) To make payment on behalf of the account party, in the event that the account party fails to fulfill its obligation to the beneficiary.

(12) *Mortgage servicer cash advance* means funds that a residential mortgage servicer advances to ensure an uninterrupted flow of payments or the timely collection of residential mortgage loans, including disbursements made to cover foreclosure costs or other expenses arising from a mortgage loan to facilitate its timely collection. A mortgage servicer cash advance is not a recourse obligation or a direct credit substitute if:

(i) The mortgage servicer is entitled to full reimbursement or, for any one residential mortgage loan, nonreimbursable advances are contractually limited to an insignificant amount of the outstanding principal on that loan, and

(ii) The servicer's entitlement to reimbursement is not subordinated.

(13) *Nationally recognized statistical rating organization (NRSRO)* means an entity recognized by the Division of Market Regulation of the Securities and Exchange Commission (or any successor Division) (Commission) as a nationally recognized statistical rating organization for various purposes, including the Commission's uniform net capital requirements for brokers and dealers (17 CFR 240.15c3-1).

(14) *Recourse* means an arrangement in which a bank retains, in form or in substance, of any credit risk directly or indirectly associated with an asset it has sold (in accordance with generally accepted accounting principles) that exceeds a *pro rata* share of the bank's claim on the asset. If a

bank has no claim on an asset it has sold, then the retention of any credit risk is recourse. A recourse obligation typically arises when an institution transfers assets in a sale and retains an obligation to repurchase the assets or absorb losses due to a default of principal or interest or any other deficiency in the performance of the underlying obligor or some other party. Recourse may exist implicitly where a bank provides credit enhancement beyond any contractual obligation to support assets it has sold. The following are examples of recourse arrangements:

(i) Credit-enhancing representations and warranties made on the transferred assets;

(ii) Loan servicing assets retained pursuant to an agreement under which the bank:

(A) Is responsible for losses associated with the loans being serviced,

(B) Is responsible for making mortgage servicer cash advances (unless the advances are not a recourse obligation because they meet the conditions specified in section II.B.5.(a)(12) of this appendix A), or

(C) Makes or assumes credit-enhancing representations and warranties on the serviced loans;

(iii) Retained subordinated interests that absorb more than their *pro rata* share of losses from the underlying assets;

(iv) Assets sold under an agreement to repurchase, if the assets are not already included on the balance sheet;

(v) Loan strips sold without contractual recourse where the maturity of the transferred portion of the loan is shorter than the maturity of the commitment under which the loan is drawn;

(vi) Credit derivative contracts under which the bank retains more than its *pro rata* share of credit risk on transferred assets; and

(vii) Clean-up calls. Clean-up calls that are exercisable at the option of the bank (as servicer or as an affiliate of the servicer) when the pool balance is 10 percent or less of the original pool balance are not recourse arrangements.

(viii.) Liquidity facilities extended to ABCP programs that are not eligible liquidity facilities (as defined in section II.B.5.a. of this appendix).

(15) *Residual interest* means any on-balance sheet asset that represents an interest (including a beneficial interest) created by a transfer that qualifies as a sale (in accordance with generally accepted accounting principles) of financial assets, whether through a securitization or otherwise, and that exposes a bank to credit risk directly or indirectly associated with the transferred assets that exceeds a *pro rata* share of the bank's claim on the assets, whether through subordination provisions or other credit enhancement techniques. Residual interests generally include credit-enhancing I/Os, spread accounts, cash collateral accounts, retained subordinated interests, other forms of over-collateralization, and similar assets that function as a credit enhancement. Residual interests further include those exposures that, in substance, cause the bank to retain the credit risk of an asset or exposure that had qualified as a residual interest before it was sold. Residual interests generally do not include interests purchased