Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

May 28, 2002

Interpretive Letter #947
November 2002
12 CFR 3

Subject: Risk-Based Capital Treatment for Purchase of Interests in Master Trust

Dear **[ ]**:

This letter is in response to a request regarding the appropriate risk-based capital treatment stemming from the February 5, 2002, purchase by **[ ]** (the Bank) of a portfolio of credit card accounts and receivables from **[*Bank 2*]**. Outstanding receivables, securitized in the **[*Bank 2*]** Master Trust, were approximately $7.6 billion. The purchase included approximately $1.3 billion of seller's interest; approximately $6.3 billion of investor interests are outstanding. The purchase also included a combination of subordinated interests, cash collateral, and other residual interests valued at approximately $600 million.[1] Under generally accepted accounting principles, the Bank cannot initially avail itself of the nonconsolidation guidance of Statement of Financial Accounting Standards No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities," because the Bank was not the original transferor of the assets held in the master trust. Consequently, the Bank must initially consolidate the master trust and account for the previously sold receivables as a financing.

Sales treatment will apply to new receivable balances transferred into the trust to replenish those that are paid down. It will take an estimated 14 months for substantially all the receivables existing at the acquisition date to completely turn over, resulting in full sales treatment.

Issues
Under the recently published final rule, "Risk-Based Capital Guidelines; Capital Adequacy Guidelines; Capital Maintenance: Capital Treatment of Recourse, Direct Credit Substitutes and Residual Interests in Asset Securitizations,"[2] unrated residual interests in securitized assets attract a dollar-for-dollar capital charge. Sellers' interests (i.e., pro rata claims) are generally

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[1] This is a simplified summary of our understanding of the transaction, based on our discussions with Bank staff. Additional assets and reserves included in the purchase are ignored for simplicity in this discussion.
[2] See 66 Fed. Reg. 59614 (November 29, 2001).

risk-weighted in accordance with the underlying receivables. Therefore, if the Bank received sales treatment on the above transaction, it would hold a minimum of $704 million risk-based capital, as calculated below:

Residual interests (dollar-for-dollar)	$ 600
Seller's interest ($1.3 billion X 100% risk weight X 8%) (not certificated; unrated; shares losses pro rata with investors' interests)	104
	$ 704

The Bank has expressed concern that, under the new residual interest rule, as soon as the transaction qualifies for partial sales treatment, the entire residual interest will be subject to a dollar-for-dollar capital charge, and the remaining on-balance receivables backing the investor interests will be risk-weighted at 100%. This would result in a capital charge of as much as $1.2 billion (dollar-for-dollar on $600 million in residual interests, plus 8% of the $7.6 billion on-balance sheet receivables). Because the dollar-for-dollar capital charge on the residual interests captures credit-enhancement on the "sold" receivables that continue to be accounted for as a financing, you believe this would result in capital being double-charged for the same credit risk. The OCC agrees that this potential double-charging was not intended under the new rule.

Regulatory Provisions
The new recourse/residual interest rule contemplated the potential for double-charging when a residual interest supports transferred assets that are subject to other contractual recourse provisions as well. See 12 C.F.R. Part 3, Appendix A, section 4(f)(4).[3] However, it does not appear that the unique accounting provisions encountered in this acquisition were contemplated in the new regulation; there are no similar provisions to directly address potential double-charging when a residual interest supports *on*-balance sheet receivables.[4]

The rule also expanded the OCC's reservation of authority provisions found at 12 C.F.R. 3.4(b). These provisions permit the OCC to determine a different risk weight than otherwise required by the risk-based capital regulations.

[3] Section 4(f)(4) provides: "*Residual interests and other recourse obligations.* Where the aggregate capital requirements for residual interests (including credit-enhancing interest-only strips) and recourse obligations arising from the same transfer of assets exceed the full risk-based capital requirements for those assets, a bank must maintain risk-based capital equal to the greater of the risk-based capital requirement for the residual interest as calculated under sections 4(f)(1) through (3) of this appendix A or the full risk-based capital requirement for the assets transferred."

[4] Twelve C.F.R. Part 3, Appendix A, section 4(h)(2) provides that if an asset is included in the calculation of the risk-based capital requirement under the recourse/residual interest provisions (section 4) and also appears as an asset on a bank's balance sheet, the asset is generally risk-weighted only under section 4. This ensures that on-balance-sheet residual interests that are subject to a dollar-for-dollar capital requirement are not also risk weighted. It does not appear to address the situation where the underlying loans supported by the residual interest are also on-balance sheet.

OCC Determination
We have determined that the Bank's minimum risk-based capital requirement should be based on the higher of (1) the booked residual interest (i.e., up to $600 million -- dollar-for-dollar) *plus* 8% of the risk-weighted seller's interest; or (2) 8% of on-balance sheet risk-weighted assets (as well as any off-balance sheet receivables sold subject to recourse other than the residual), but not both. Thus, the initial charge would be $704 million, which represents the dollar-for-dollar charge on the $600 million residual, plus 8% of the $1.3 billion seller's interest ($104 million). This amount must be compared to the $656 million risk based capital charge on the on-balance sheet assets (8% of $7.6 billion on-balance sheet receivables plus $600 million residual interest, all assumed to be risk-weighted at 100%), and the higher of the two applies. The result will be a risk-based capital charge that is consistent with either full sales treatment or full financing treatment, but that avoids double-charging for the blended accounting treatment applicable to this transaction. We believe this approach to be generally consistent with the methodology used in 12 C.F.R. Part 3, Appendix A, section 4(f)(4), as well as the underlying purpose of that regulatory provision -- preventing the double-counting of both recourse obligations and residual interests. However, because the current capital regulations do not explicitly provide an exception to risk-weighting the entire on-balance sheet receivables, in addition to the charge on the residual interests, we rely on our reservation of authority pursuant to 12 C.F.R. 3.4(b) to determine the appropriate risk weight in light of the specific features of the transaction you have described.

This determination is made specifically under the facts presented in this particular transaction, and may not be relied on for determining the risk-based capital treatment of any other transaction, or for determining the risk-based capital treatment of any components of this transaction other than the residual interests, the seller's interest, and the related on-balance sheet receivables. This determination does not affect the Bank's calculation of its leverage ratio, which will continue to be based on adjusted total assets as defined in 12 C.F.R. 3.2(a).

If you have questions or need additional information, please contact me or Amrit Sekhon at 202-874-5070.

Sincerely,

-signed-

Tommy Snow
Director, Capital Policy