Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

September 6, 2006

Interpretive Letter #1070
October 2006
12 USC 84
12 USC 26(7)

Subject: Municipal Bond Tender Option Certificates

Dear **[ ]**:

This is in response to your request for confirmation that **[ ]** (the "Bank") may acquire and hold the Class A and Class B certificates described below as Type III investment securities pursuant to 12 C.F.R. Part 1. The Bank also has requested confirmation that it may enter into the reimbursement agreement described below.

For the reasons discussed below, based on the facts and representations provided by the Bank, we conclude that the proposed investments would be permissible pursuant to 12 C.F.R. Part 1, provided the certificates meet applicable marketability and rating requirements. The Bank's purchase of the certificates also would be permissible under the authority in 12 U.S.C. § 24(Seventh) to discount and negotiate evidences of debt, subject to the standards and limitations discussed herein. In addition, the Bank may enter into the proposed reimbursement agreement, provided it adheres to the prudential standards set forth in the *Comptroller's Handbook*, "Risk Management of Financial Derivatives" (January 1997) ("*OCC Derivatives Handbook")* and in OCC Banking Circular 277, "Risk Management of Financial Derivatives" (October 27, 1993) ("BC-277").

Proposal

Common TOB Structure

The Bank has proposed to acquire and hold Class A and Class B certificates issued as a part of a municipal bond trust structure often called a tender option bond ("TOB") structure. In the most common TOB structure (hereinafter referred to as "TOB 1"), a trust purchases tax-exempt long-term fixed rate municipal bonds ("Bonds") that are eligible bank investments.[1] To fund the

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[1] The Bonds will be eligible for the Bank to invest in directly and are generally high credit quality. The TOB trust will be a U.S. common law grantor trust and a partnership for federal income tax purposes. Generally, the trust will either directly hold the Bonds or will hold a custodial receipt issued by a custodial trust which in turn holds the Bonds together with a letter of credit supporting the Bonds.

purchase of the Bonds, the trust issues two classes of certificates: Class A certificates, which are floating rate interests that would pay a rate of interest linked to the Bond Market Association Municipal Swap Index ("BMA Index")[2] or some other short-term pricing mechanism, and Class B certificates, which are inverse floating rate interests that would pay the difference between the long-term rate earned on the Bonds and the short-term rates paid on the Class A certificates.[3] Each certificate represents a beneficial interest in the Bonds. Interest on the Class A and the Class B certificates is tax-exempt.

Class A holders have the right to tender the Class A certificates to the trust at par, unless certain events have occurred (*e.g.*, Bonds are downgraded below investment grade). There is a remarketing agent that facilitates this process.

Because the Class A certificates are tender option certificates, the trust also acquires a liquidity facility from a liquidity provider.[4] The liquidity provider may be the sponsor of the TOB trust or an unrelated third party.[5] Upon maturity or liquidation of the trust, the Class A holders are entitled to receive par plus a portion (usually around 10%) of any gains in the market value of the underlying Bonds. The liquidity provider is generally required to advance any shortfall from par from the liquidation of the Bonds to the Class A certificate holder unless certain events occur (*e.g.*, Bonds are downgraded below investment grade). The Class A certificates are offered pursuant to Securities and Exchange Commission Rule 144A and rated investment grade.

The Class B certificate usually has a single holder. The Class B holder pays a nominal amount ($5,000 or more) for the Class B certificates compared to the principal amount of the Bonds. However, the Class B holder receives an inverse floating interest rate based on the entire

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[2] The BMA Index is a high-grade market index that is comprised of 7-day tax-exempt variable rate demand bonds with the highest short-term ratings and with at least $10 million outstanding. The BMA Index includes nearly 250 variable rate issues in the municipal tax-exempt market in a given week. *See* The *Bond Market Association,* "Answering Your Questions about the Bond Market Association Municipal Swap Index," www.bondmarkets.com.

[3] An inverse floating rate note is a debt instrument that has an interest rate that increases as a benchmark interest rate, such as the London Interbank Offered Rate (LIBOR), declines. So-called inverse floaters are securities that are generally created by depositing fixed rate securities in a trust and dividing the income stream of the underlying securities in two parts: 1) a variable rate security and 2) a residual interest bond. The interest rate for the variable rate security is determined by an index or an auction process, while the residual interest holder receives the balance of the income from the underlying fixed rate securities less applicable fees. *See Financial Dictionary,* http://financial-dictionary.thefreedictionary.com/Inverse+floating-rate+note.

[4] The liquidity facility is an agreement with a third party, usually a bank, to provide ready cash to purchase the bonds in the event the bondholders tender the bonds to the issuer. If the remarketing agent is successful in remarketing the bonds to new bondholders, the purchase price paid by the new bondholders is used to reimburse the liquidity provider. A liquidity facility may be in the form of a letter of credit or a stand-by bond purchase agreement.

[5] The Bank currently provides similar liquidity facilities for TOB trusts where third parties are Class B holders. It may also provide liquidity facilities in some of the proposed TOB 1 structures.

principal amount of the Bonds. For example, assume the trust purchases $10 million principal amount of fixed rate municipal bonds of a single issuer with a coupon of 6%. Interest paid to the Class B holder would equal 6% of the entire bond principal less the interest rate on the Class A certificates and less the fees of the TOB trust. In other words, the Class B certificate entitles the holder to any interest received by the TOB trust that is not payable to the Class A certificate holders (less applicable fees).

The Class B holder has the right to the return of its principal either pro rata with the Class A holders or subordinate to the Class A holders' right to receive par. The Class B holder also is entitled to most (often around 90%) of any gains upon liquidation of the Bonds. In addition, the Class B holder typically has the right to terminate the trust at any time. The Class B certificate is not rated, but the Bank represents the TOB trust can be structured so that both the principal and interest of the Class B are eligible to be rated and would receive the same long term rating as the Class A certificates.

The Bank notes that because of the inverse floating rate, any fluctuation in the market value of the Class B Certificate may be larger than comparable changes in the market value of a direct holding of an equivalent principal amount of the underlying Bonds. The Bank represents that it intends to manage this interest rate risk in accordance with the Bank's standard interest rate risk management policies.

The Class B holder also may enter into a reimbursement agreement with the liquidity provider that obligates the Class B holder to pay the liquidity provider for any shortfall that may result from the sale of the Bonds and the par redemption of the Class A certificates.[6] Compensation for assuming this contingent obligation will be received in the form of the return received by the Bank under the Class B certificate. The reimbursement agreement does not obligate the Class B holder to pay the liquidity provider the shortfall if certain events occur (*e.g.*, bonds fall below BBB-), however.

The Bank anticipates that the Class A certificates will be sold to money market mutual funds. The Bank intends to purchase and hold the Class B certificate and may hold the Class A certificates during a remarketing period. The Bank represents that it generally would consolidate the TOB trust when it owns the Class B certificate, unless the TOB trust is considered to be a Qualified Special Purpose Entity ("QSPE") and not in the scope of FIN 46(R).[7]

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[6] If the Bank is also the liquidity provider, it may not enter into a reimbursement agreement. If the Bank does enter into a reimbursement obligation, the Bank represents that the reimbursement obligation would typically be documented as a derivative under standard ISDA documentation.

[7] The Bank represents that, upon consolidation, the municipal bonds held by the trust would be accounted for pursuant to Financial Accounting Standard 115, "Accounting for Certain Investments in Debt and Equity Securities" and the liabilities assumed would be reported as beneficial interests issued by consolidated variable interest entities unless investors have recourse to the Bank.

Alternative TOB Structure

In a variation on the TOB 1 structure described above (hereinafter referred to as "TOB 2"), the Bank will purchase multiple variable rate 30-year multi-modal[8] municipal bonds[9] ("Bonds"), with initial coupons based on the BMA Index plus a fixed spread. The Bonds will be subject to a mandatory tender at par on a three to five year put date and will pay interest semiannually. The Bank will issue a letter of credit ("LOC") on each Bond. The LOCs will run through the put date on the Bonds. The Bank will then transfer the Bonds and the supporting LOCs to a custodial trust.[10] The custodial trust will then issue separate custodial receipts for each Bond enhanced by a LOC. Each custodial receipt will represent the right to receive all proceeds from payments on the respective Bond and draws under the LOC. The custodial trust will then sell each of the custodial receipts to the TOB trust. To finance the purchase of the custodial receipts, the TOB Trust will issue Class A floating rate certificates and a Class B floating rate certificate that pays the difference between the floating rate on the Bonds and the floating rate on the Class A certificates.[11] In addition, the Class A certificate holders will be entitled to 100% of the gain (if any) on the Bonds. The Bank, in its capacity as Class B holder, will be the liquidity provider for the TOB Trust.

The Bank intends to use this TOB structure to pool small variable rate demand bond transactions backed with LOCs into TOB programs with multiple LOC backed custodial receipts. For example, a typical $50 million TOB trust may contain 10-20 separate custodial receipts, each representing a single bond with its own LOC.

Like the TOB 1 structure, the Bank anticipates that the Class A certificates will be sold to money market mutual funds, and the Bank will retain the Class B certificate. Also, under this structure, the Bank represents that the TOB Trust will be consolidated on the Bank's balance sheet.

The Bank represents, with regard to both TOB structures, that it will comply with the requirements of section 23A and 23B of the Federal Reserve Act, the Federal Reserve Board's Regulation W and the Bank's section 23A/23B and Regulation W compliance policy.

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[8] Multi-modal bonds are bonds that can be converted to different interest rates at the option of the issuer. Typically, multi-modal bond documents permit bonds to be remarketed in daily, weekly, or monthly interest rate modes as variable rate tender option bonds and in term or fixed rate modes as well. *See* http://www.fieldman.com/Glossary_ip.asp (citing the *California Debt Securities Primer).*

[9] The Bonds may be unrated or below-investment grade rated bonds and each Bond would be credit enhanced by a letter of credit from the Bank. The credit rating of the LOC-backed Bonds will be based on the short-term credit rating of the Bank as LOC provider. The Bonds will qualify as Type I securities (eligible for investing and dealing in by the Bank). *See* 12 C.F.R. § 1.2(j)(4).

[10] The Bank will serve as custodian for the custodial trust. Custodian fees will be paid out of the return received by the Bank under the Class B certificate.

[11] The Bank will serve as trustee of the TOB trust. Trustee fees will be paid out of the return received by the Bank under the Class B certificate.

Discussion

The Bank's proposed purchase of Class A and Class B certificates under both the TOB 1 and TOB 2 structures is legally permissible for a national bank under well-established authority. The certificates represent beneficial interests in bank eligible municipal bonds held by a trust. The OCC has determined that similar trust interests may qualify as investment securities under 12 C.F.R. Part 1.[12] The OCC also has determined that a national bank may purchase municipal bond TOB certificates, pursuant to its authority to discount and negotiate evidences of debt.[13] In addition to the Bank's purchase of the Class A and Class B certificates, the Bank may enter into the proposed reimbursement agreement provided it adheres to the prudential standards set forth in the *OCC Derivatives Handbook* and BC-277. The payment obligations under the agreement are based on the value of the underlying municipal bonds. The OCC has long permitted national banks to enter into agreements where payment obligations are based, in whole or in part, on the value of an underlying bank permissible asset.

Part 1

The Class A and Class B certificates would qualify as Type III investment securities under 12 C.F.R. Part 1 provided applicable marketability and rating requirements are met. Part 1 defines an "investment security" as a "marketable debt obligation that is not predominantly speculative in nature."[14] A debt security is deemed marketable if it is: 1) registered under the Securities Act of 1933; 2) exempt from registration as a municipal revenue bond under the '33 Act; 3) offered and sold under Rule 144A and rated investment grade or is the credit equivalent thereof; or 4) can be sold with reasonable promptness at a price that corresponds reasonably to its fair value.[15] A debt security is "not predominantly speculative in nature" if it is rated investment grade or if not rated, is the credit equivalent of investment grade.[16]

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[12] For example, the OCC has determined that trust preferred securities may qualify as investment securities if the securities meet applicable rating and marketability requirements. *See* OCC Interpretive Letter No. 777 (April 8, 1997) ("IL No. 777").

[13] *See* OCC Corporate Decision No. 96-52 (September 20, 1996).

[14] 12 C.F.R. § 1.2(e).

[15] 12 C.F.R. § 1.2(f).

[16] 12 C.F.R. § 1.2(e). Part 1 defines the term "investment grade" to mean a security that is rated in one of the four highest rating categories by either (1) two or more nationally recognized statistical rating organizations ("NRSROs"); or (2) one NRSRO if the security has been rated by only one NRSRO. 12 C.F.R. § 1.2(d). A security is the credit equivalent of a security rated investment grade if the bank can document, through its own financial analysis, that there is a high probability that the security will produce a reasonable investment return over the life of the investment. *See also* OCC Bulletin 2002-19, *Unsafe and Unsound Investment Portfolio Practices* (May 22, 2002) (" . . .to show that a non-rated security is the credit equivalent of investment grade, a bank must document, through its own credit assessment and analysis, that the security is a strong "pass" asset under its internal credit rating standards.")

Under these criteria, the Class A certificates qualify as Type III investment securities.[17] Under both TOB structures, the Class A certificates finance almost the entire purchase price of the Bonds. The Class A certificates return par (and potentially a small upside on the market value of the bonds upon termination of the Trust).[18] They receive periodic floating rate interest payments. They also have an effective maturity, since the Class A holders may "tender" the certificates to the trust on a periodic basis and in any event are repayable upon liquidation of the trust. The OCC has previously concluded that instruments with these characteristics are, in substance, debt obligations and may qualify as investment securities if they meet applicable marketability and rating requirements.[19]

The Class A certificates also satisfy the marketability and rating requirements for investment securities, because they are sold pursuant to Securities and Exchange Commission Rule 144A, and they are rated investment grade. The investment grade rating also means the Class A certificates are not "predominantly speculative in nature."[20]

The Class B certificate in both the TOB 1 and TOB 2 structures also would qualify as a Type III investment security under 12 C.F.R. Part 1, provided the Bank can demonstrate that the Class B certificate is a marketable debt obligation and the credit equivalent of investment grade.

The Class B certificate has many of the same debt characteristics as the Class A certificates. The Class B certificate finances a portion of the purchase price of the Bonds, and it has the same *de facto* maturity as the Class A certificates, since the Trust must liquidate its assets at a specified point and pay the obligation owing to the Class B certificate holder at the same time or subordinate to the Class A holder's right to receive par on the Class A certificates. In addition, the Class B certificate receives periodic distributions that resemble periodic interest payments (although with an inverse floating rate). Thus, it qualifies as a debt obligation for purposes of 12 C.F.R. Part 1.

Under Part 1, a debt security is deemed marketable if it is offered and sold under Rule 144A and rated investment grade or is the credit equivalent of investment grade. An investment security also must be rated investment grade or the credit equivalent of investment grade to show that it is "not predominantly speculative in nature." Here, the Class B certificate is offered and sold pursuant to Rule 144A. However, it is not rated. As a result, to satisfy the marketability and

[17] The OCC categorizes debt securities into Types I, II, III, IV or V. Type III securities are investment securities that do not qualify as Type I, II, IV, or V securities. The definition of a Type III security is general and nonexclusive and relies on the substantive characteristics of investment securities.

[18] In the TOB 1 structure, the Class A certificate holders are eligible to receive 10% of any gains in the market value of the bonds. Under the TOB 2 structure, the Class A certificate holders are eligible to receive 100% of the appreciation of the bonds upon termination of the trust. The gain from the appreciation on the bonds in the TOB 2 structure is not expected to be significant, however, because both the Class A certificates and the underlying municipal bonds have a variable interest rate.

[19] *See, e.g.,* IL No. 777, *supra*.

[20] *See* 12 C.F.R. § 1.2(e).

rating requirements under Part 1, the Bank must demonstrate that the principal and interest on the Class B certificate are the credit equivalent of investment grade. The Bank's conclusion or analysis regarding credit equivalence must be sufficient, as documented by the Bank at the time the Class B certificate is purchased.

Discounting and Negotiating Evidences of Debt

The Bank also may acquire and hold the Class A and Class B certificates under the authority in 12 U.S.C. § 24(Seventh) to discount and negotiate evidences of debt, subject to the limitations of 12 U.S.C. § 84 and the requirements of OCC Banking Circular 181 (Rev.) ("BC-181").[21] Section 24(Seventh) expressly authorizes national banks to conduct the business of banking, including "by discounting and negotiating promissory notes, drafts, bills of exchange and other evidences of debt."[22] 12 U.S.C. § 24(Seventh). This authority has long included the power to acquire and hold a variety of debt and debt-like instruments, including interests created from a TOB trust.

For example, in OCC Corporate Decision 96-52, the OCC concluded that an operating subsidiary could sponsor a series of TOB trusts that would finance the purchase of municipal bonds through the issuance and sale of trust interests representing interests in the underlying bonds. The Bank had proposed to purchase general obligation municipal bonds and sell the bonds to its subsidiary. The subsidiary would then transfer the bonds to a TOB trust in exchange for tender option certificates that the Bank would sell to institutional investors. The trust also would issue a residual interest certificate, resembling the Class B certificate in this case, that would entitle the holders to any interest received by the trust that was not payable to the other certificate holders. The OCC concluded that the proposed activities were essentially discounting and negotiating (that is, buying and selling) evidences of debt, because the Bank was buying municipal bonds and selling (and buying) interests in those bonds.

As in OCC Corporate Decision 96-52, the Bank will purchase municipal bonds and transfer the bonds to a TOB trust in exchange for certificates representing interests in those bonds. National banks have clear authority to purchase and sell municipal bonds. Likewise, national banks have authority to purchase and sell interests in those bonds, pursuant to the authority to discount and negotiate evidences of debt.

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[21] *See* OCC Banking Circular 181 (Rev.), "Purchases of Loans in Whole or in Part – Participations" (August 2, 1984).

[22] The courts have long held that the term "discount" includes purchases of notes and other evidences of debt. *See, e.g., National Bank v. Johnson*, 104 U.S. 271 (1881); *Steward v. Atlantic National Bank*, 27 F.2d 224, 228 (9th Cir. 1928); *Morris v. Third National Bank*, 142 F. 25 (8th Cir. 1905); *Danforth v. National State Bank of Elizabeth*, 48 F. 271 (3d Cir. 1891). *See also* 12A *Words and Phrases* 285-95 (West 1954 and Supp. 1986). And negotiation is a form of transfer, disposition or sale. *Black's Law Dictionary* 934 (5th ed. 1979); 28 *Words and Phrases* 758-766 (West 1955 & Supp. 1986). Thus, the OCC has concluded that the authority to discount and negotiate evidences of debt includes the authority to purchase and sell debt and debt-like instruments. *See, e.g.,* OCC Conditional Approval No. 262, *Interpretations and Actions*, Dec. 1997, Vol. 10, No. 12 ("the power to discount and negotiate is the power to purchase and sell, and purchasing and selling as principal defines underwriting and dealing").

National banks also have authority to retain interests in assets they have sold. For example, the OCC has long recognized the authority of national banks to retain a residual interest in loans securitized by a trust. [23] In OCC Interpretive Letter No. 1035, a national bank had proposed to engage in a series of simultaneous transactions that would have the effect of the bank transferring its own home equity loans to a trust and taking back asset-backed ownership interests in those loans, including a subordinated residual interest.[24] The OCC concluded that the bank's retention of a subordinated interest in the securitization of its own loans was part of, or incidental to, the bank's general lending authority and its ability to securitize. The OCC viewed the subordinated interests as "interests created from the loans in a different form (investment securities)."

That same reasoning can be applied in this case. Here, the Bank is transferring municipal bonds to a TOB Trust and taking back ownership interests in those bonds, including a residual interest in the bonds through its purchase of the Class B certificate. The Bank's ownership of the Class B certificate is simply part of, or incidental to the Bank's authority to purchase the municipal bonds.[25] The Class B certificate is an interest created from municipal bonds in a different form (trust certificates).

For these reasons, the Class A and Class B certificates may be purchased pursuant to the authority in 12 U.S.C. § 24(Seventh) to discount and negotiate evidences of debt, subject to the limitations of 12 U.S.C. § 84 and the requirements of BC-181.[26]

Authority to Enter into the Reimbursement Agreement with a Liquidity provider

As a Class B holder in the TOB 1 structure, the Bank may be required to enter into a reimbursement agreement with the liquidity provider.[27] As explained above, the reimbursement agreement obligates the Class B holder to pay the liquidity provider for any shortfall that may

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[23] *See, e.g., Capital Treatment of Recourse, Direct Credit Substitutes and Residual Interests in Asset Securitizations: Final Rule*, 66 Fed. Reg. 59614, 59616 (banks have long provided "recourse," or retained some ownership interest, in connections with sales of whole loans or loan participations); *Interagency Guidance on Asset Securitization Activities*, OCC Bulletin 99-46 (April 4, 1999) (seller typically retains one of more interests in the assets sold); OCC Interpretive Letter No. 585 (June 8, 1992) (bank retains Class B certificates in a senior/subordinated structure).

[24] OCC Interpretive Letter No. 1035 (July 21, 2005).

[25] *Id.*

[26] The Bank may use this authority to purchase and sell or retain the certificates even if the certificates do not qualify as "investment securities" under 12 C.F.R. Part 1. The OCC has previously held that a national bank could acquire privately placed assets-backed securities under its authority to discount and negotiate evidences of debt even though the securities did not meet the marketability requirements for investment securities. The OCC stated that the ability of a national bank to acquire asset-backed securities is not limited by the fact that such investments may not be eligible as investment securities. *See* OCC Interpretive Letter No. 600 (July 31, 1992).

[27] As noted above, in the TOB 2 structure, the Bank will provide a letter of credit on the underlying municipal bonds and provide a liquidity facility for the TOB trust. The Bank will not enter into a reimbursement agreement with the liquidity provider.

result from the sale of the Bonds and the par redemption of the Class A certificates unless certain events occur (*e.g.*, bonds fall below BBB-). Compensation for this risk will be received in the form of the return received by the Bank under the Class B certificate. The obligation the Bank assumes under the reimbursement agreement is similar to the obligation it assumes as a liquidity provider. In both cases, the Bank is lending its credit in exchange for a fee. These activities involve the core banking powers of lending and acting as financial intermediary and therefore are permissible for a national bank.[28]

Moreover, the OCC has long permitted national banks to enter into agreements where payment obligations are based, in whole or in part, on the value of an underlying bank permissible asset.[29] Such agreements meet the broad definition of "financial derivatives."[30] The payment obligation under the reimbursement obligation is based in part on the value of the underlying municipal bonds. National banks have clear authority to purchase municipal bonds under 12 C.F.R. Part 1. Thus, the Bank has authority to enter into an agreement to make payments based on the value of underlying bonds, provided the Bank adheres to the prudential standards set forth in the *OCC Derivatives Handbook* and BC-277.

Safety and Soundness Considerations

If the Bank purchases the Class A and Class B certificates as Type III investment securities pursuant to 12 U.S.C. § 24(Seventh) and 12 C.F.R. Part 1, it will be subject to the marketability and rating requirements and investment limits contained therein.[31] In addition, the Bank must adhere to safe and sound banking practices and consider, as appropriate, the interest rate, credit, liquidity, price, foreign exchange, transaction, compliance, strategic and reputation risks presented by the certificates.[32] In particular, the Bank should evaluate its interest rate risk exposure from the inverse floating rate on the Class B certificate and from the reimbursement agreement the Bank may be required to enter into with the liquidity provider. The Bank has acknowledged that these features may expose the Bank to interest rate risk, and the Bank has represented that it intends to manage this risk in accordance with standard interest rate risk management policies including the use of interest rate swaps and swap options. The Bank also can mitigate its exposure and minimize losses and payouts by exercising its right to terminate the TOB trust when it deems such termination appropriate.[33]

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[28] *See, e.g., NationsBank of North Carolina, N.A. v. Variable Annuity Life Insurance Co.*, 513 U.S. 251 (1995).

[29] *See, e.g.*, OCC Interpretive Letter No. 408 (May 13, 1992) (national bank operating subsidiaries may originate, trade, and make markets in swap contracts and related derivative products, including interest rate swaps). Congress also has recognized the authority of national banks to enter into such agreements, in section 206 of the Gramm-Leach-Bliley Act of 1999. *See* 15 U.S.C. § 78c *note*.

[30] *See, e.g.*, BC-277 and the *OCC Derivatives Handbook*.

[31] National banks may purchase investment securities for their own account in an amount that generally may not exceed 10% of the bank's capital and surplus. *See, e.g.*, 12 C.F.R. § 1.3(c).

[32] *See* 12 C.F.R. §1.5(a).

[33] In most TOB structures, the Class B certificate holder has the right to terminate the trust at any time.

If the Bank acquires the Class A or Class B certificates pursuant to its authority to discount and negotiate evidences of debt, it will be subject to the legal lending limitations of 12 U.S.C. § 84, and also must adhere to the prudential requirements in BC-181. In that regard, the Bank should conduct an independent analysis to determine that the acquisition of the Class A and Class B certificates meet the Bank's own internal underwriting standards. The nature and extent of the Bank's independent analysis is a function of the type of transaction at issue and the Bank's lending policies and procedures.

If the Bank enters into a reimbursement agreement with the liquidity provider, it must adhere to the prudential standards described in the *OCC Derivatives Handbook* and BC-277. In that regard, Bank must establish an appropriate risk measurement and management process that includes board supervision, managerial and staff expertise, comprehensive policies and operating procedures, risk identification and measurement, and management information systems, as well as an effective risk control function that oversees and ensures the appropriateness of the risk management process.

Conclusion

For the reasons discussed above, the Bank may purchase and hold the Class A and Class B certificates described above as Type III investment securities under Part 1, provided applicable marketability and rating requirements are met. Alternatively, the Bank may purchase the TOB certificates pursuant to the authority to discount or negotiate evidences of debt, subject to the limitations of 12 U.S.C. § 84 and the requirements of BC-181. In addition, the Bank may enter into the proposed reimbursement agreement, provided it adheres to the prudential standards set forth in the *OCC Derivatives Handbook* and BC-277. Our conclusions herein are specifically based on the Bank's representations and written submissions describing the facts and circumstances of the subject transactions. Any change in the facts or circumstances could result in different conclusions. If you have any questions concerning this letter, please contact Beth Kirby, Special Counsel, Securities and Corporate Practices Division, at (202) 874-5210.

Sincerely,

/s/

Julie L. Williams
First Senior Deputy Comptroller and Chief Counsel