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OTS 97-63 - Agencies Propose Standard Capital Treatment for Securitizations

Office of Thrift Supervision

NEWS

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AGENCIES PROPOSE STANDARD CAPITAL TREATMENT FOR SECURITIZATIONS

WASHINGTON, D.C., Sept. 5, 1997 -- The Office of Thrift Supervision (OTS) announced today it has approved a proposed regulation to standardize risk-based capital rules for assets sold with recourse and direct credit substitutes.

The proposed rule is being adopted jointly by the four federal bank regulatory agencies. In addition to OTS, the proposed rule has already been approved by the Comptroller of the Currency and the Federal Reserve Board. The Federal Deposit Insurance Corporation is expected to consider the proposed rule in late September. Following adoption by the FDIC, the proposed rule will be published jointly in the Federal Register. The 90-day comment period will not begin until the date of publication.

Currently, certain types of recourse arrangements and direct credit substitutes require different amounts of capital even though the risk of credit loss related to these arrangements may be the same. The agencies propose to rectify this inconsistency by establishing the same risk-based capital requirements for assets with equivalent credit risks, regardless of whether the risk stems from assets sold with recourse or direct credit substitutes.

- Assets sold with recourse include assets a depository institution sells while retaining all or part of the risk of credit loss from the underlying assets.

- Direct credit substitutes are assets owned by a third party for which a depository institution assumes all or part of the risk of potential credit losses. In this category are standby letters of credit and guarantees.

In addition, to better reflect the actual level of credit risk related to recourse transactions and direct credit substitutes that are part of securitization structures, the agencies are proposing to adopt a "multilevel" capital approach for assigning risk weights to various types of positions in such securitizations. For traded positions in asset securitizations, the proposal would use ratings issued by commercial rating agencies. An asset-backed security with an "AAA" rating would be placed in the 20 percent risk-weight category, meaning only 20 percent of its face amount would be subject to the 8 percent risk-based capital requirement. For positions rated below "AAA", two alternative approaches are presented for comment: a "modified gross-up" approach that would apply a 50 percent risk weight to the value of the assets underlying the security and a "face value" approach which would apply a 100 percent risk weight to the face amount of the security.

This proposed rule, however, would not change the current treatment of high quality mortgage-related securities (generally, qualifying AAA and AA mortgage-related securities) under the OTS risk-based capital rule.

For positions in asset securitizations that are not traded, the proposal sets forth three possible approaches for determining credit risk. One would require institutions to obtain individual credit ratings by two different rating agencies. The second approach would allow institutions to use generic credit risk standards established by the banking agencies for categories of assets. The standards would be keyed to the standards required for an "A" grade from the rating agencies. The third approach would use historical loss data. The agencies invite comment on these and other capital approaches contemplated in the proposal.

The agencies intend that if the proposal is adopted as a final rule, any resulting increased capital requirements for banks and thrifts would apply only to transactions consummated after a final rule goes into effect. Any resulting decrease in the capital requirements would apply immediately.

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