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Comptroller of the Currency  
Administrator of National Banks

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Washington, DC 20219

July 21, 2005

**Interpretive Letter #1035**  
**August 2005**  
**12 CFR 1**

Re: [ ] (“Bank”)

Dear [ ]:

This letter responds to your request on behalf of the Bank concerning the Bank’s proposed guaranteed mortgage securitization of certain home equity lines of credit (“HELOC Loans”) it currently owns. As described in your letters dated November 10, 2004, and January 25, 2005, the Bank plans to engage in a series of simultaneous transactions that will have the effect of the Bank transferring its own HELOC Loans through an affiliated special purpose entity to a newly created qualified special purpose entity designated as “Owner Trust.” The Bank then will take back the asset-backed ownership interests issued by Owner Trust through the securitization process. You represent that the Bank’s primary purpose for the securitization transactions is to create liquidity for the Bank. You have requested the views of OCC staff with respect to the application of certain National Bank Act provisions and OCC regulations to the proposed transactions.

### **Background**

The Bank, an indirect wholly owned subsidiary of [ *Corporation* ], originates, services, and sells home equity loans, and performs loan-related activities with respect to interests in pools of those loans, as part of its banking business. According to the Bank’s documentation, the proposed securitization structure involves various entities to facilitate the sale by the Bank and the purchase by [ ] (“*AInc.*”) or “SPE”) of certain home equity loans the Bank currently owns and the subsequent issuance of certain revolving home equity asset-backed notes (“HELOC notes”). [ *AInc.* ], a [ *State* ] corporation, is an affiliated special purpose entity of the Bank.<sup>1</sup> [ *AInc.* ] then will transfer the loans into a qualified special

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<sup>1</sup>[ *AInc.* ] is a subsidiary of [ *Corporation* ], which maintains a current shelf registration filed under the federal securities laws and under which the HELOC notes will be issued. The Bank has requested

purpose entity (“QSPE”), [ ] 2004-H (also known as “Owner Trust”), which will issue two forms of interests: the HELOC notes and an Owners Trust Certificate (“OTC”) (representing a subordinated interest or a so-called “subordinated certificate”).<sup>2</sup> The HELOC notes and OTC will be passed back through the SPE and returned to the Bank in consideration for its sale<sup>3</sup> of the original loans to the SPE.<sup>4</sup> The Bank also will own the mortgage servicing rights stemming from the loans in the securitized pool.

As described by the Bank, the HELOC notes are expected to be floating rate securities with a coupon of approximately LIBOR plus 25 basis points. The underlying loans will generate the cash flows used to pay the HELOC notes and the subordinated certificate. The overcollateralization on the underlying loans combined with the subordination of the excess spread that the OTC holder is entitled to receive provide the HELOC notes with a BBB credit enhancement level. The Bank plans to engage a triple-A rated monoline insurance company to provide a deficiency guarantee or insurance “wrap” to take the notes from the BBB to the AAA level. In consideration of a fee, the monoline will guarantee to pay all principal and interest due on the notes. The Bank represents this guarantee will be sufficient to obtain AAA ratings on the HELOC notes from two nationally recognized statistical rating organizations, Moody’s and Standard & Poor’s. The Bank asserts it is undertaking the securitization primarily to create liquidity by facilitating its ability to engage in repurchase transactions with the AAA-rated HELOC notes.

For accounting treatment, the Bank represents the transactions qualify as a “Guaranteed Mortgage Securitization” and that the Owner Trust qualifies as a “QSPE” as described in FASB Statement of Standards No. 140 “Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities” (“FAS 140”). As defined, a guaranteed mortgage securitization includes a substantive guarantee by a third party. The Bank represents that the insurance wrap covers more than 90% of the securitized assets, which fulfills the substantive guarantee requirement. Also, the Bank represents that the Owner Trust meets the requirements of a QSPE

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confidential treatment pursuant to 5 U.S.C. § 552(b)(4) for its submissions related to the proposed securitization. The Bank represents that its letters and the appendices thereto contain confidential business information that if released would be detrimental to the Bank’s business.

<sup>2</sup> The Bank refers to this subordinated interest as a “residual” in certain places. However, this piece technically does not represent a residual interest because there is no “sale” for purposes of generally accepted accounting principles (“GAAP”). “Residual interest” is defined in 12 C.F.R. Part 3’s capital rules. *See* 12 C.F.R. Part 3, appendix A § 4(a)(12).

<sup>3</sup> The Bank represents the HELOC Loans will be accorded “sale” treatment for legal purposes, but not for accounting purposes.

<sup>4</sup> This is a simplified description of the complex securitization structure proposed in connection with the issuance by [ *AInc.* ] Revolving Home Equity Loan Trust, Series 2004-H (the “Trust”) of the Revolving Home Equity Loan Asset-backed Notes, Series 2004-H, pursuant to an Indenture between the Trust and [ *Trustee Bank* ], as indenture trustee. The Trust will be created by a Trust Agreement between [ *AInc.* ] and [ *Trust Co.* ]. The Bank is obtaining several outside legal opinions addressing the legality and expected treatment of the securitization transactions for various purposes separate from the matters discussed in this letter. The Bank represents that the proposed structure of the securitization is in accordance with all applicable requirements.

as defined in FAS 140 which includes conditions to limit the permissible activities of the QSPE, what the QSPE can hold, and when the QSPE can sell or dispose of non cash financial assets. Accordingly, the accounting treatment would permit the Bank to record the resulting interests as securities even though none of the beneficial interests are being sold to a third party.<sup>5</sup> However, the Bank would not be able to record a gain or a loss on the transfer of the assets.

In addition, the Bank is creating two wholly-owned special purposes entities, [ *SPE1* ] and [ *SPE2* ], as bank operating subsidiaries. The OTC/subordinated interest resulting from the securitization will be held by [ *SPE1* ], and [ *SPE2* ] will hold 51% of the HELOC notes. The Bank itself will retain 49% of the notes. Combined with the operating subsidiaries' ownership interests, however, the Bank will in effect hold 100% of the interests created from the securitization of its own loans.

## Discussion

### A. Legal Authority Applicable to Retaining the Securitized HELOC Notes under 12 U.S.C. § 24(Seventh)

Citing broad authority granted by the national banking laws, the OCC has long held that national banks may use asset securitization as a means of selling or borrowing against their mortgage or other loan assets, and engage in securitization activities.<sup>6</sup> Securitization provides banks an efficient tool for buying and selling loan assets and thereby increasing a bank's liquidity, among other advantages. Securitizations carve up the risk of credit losses from the underlying assets. Thus, the "first dollar," or most subordinate, loss position is first to absorb credit losses; the most "senior" investor position is last to absorb losses; and there may be one or more loss positions in between.<sup>7</sup> Important accounting, capital, and tax implications often also arise with respect to securitization activities.

The Bank's proposed securitization of its HELOCs and use of an owner trust<sup>8</sup> vehicle to facilitate those transactions is legally permissible for national banks under well-established

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<sup>5</sup> The only consideration being received by the Bank in the transfer of the HELOC Loans are the HELOC notes and the OTC, representing the entire beneficial ownership interest in the HELOC Loans transferred to the QSPE.

<sup>6</sup> See, e.g., Interpretive Letter No. 540 (Dec. 12, 1990) (12 U.S.C. § 24(Seventh) grants express power to discount and negotiate evidences of debt, and engage in all such incidental powers as shall be necessary to carry on the business of banking); Interpretive Letter No. 378 (Mar. 24, 1987) (broad authority to borrow money and to pledge their assets as collateral for such borrowings); No Objection-Letter No. 87-9 (Dec. 16, 1987) (power to sell or transfer interests on one's lawfully acquired assets is an incident of ownership); Interpretive Letter No. 92 (Apr. 20, 1979) (authorizing securitization of bank mortgage assets in a senior/subordinate structure).

<sup>7</sup> See 66 Fed. Reg. 59614, 59616 (Nov. 29, 2001) (capital treatment rule issued by the federal banking agencies). Each loss position functions as a credit enhancement for the more senior position in the structure. See generally OCC Bulletin 99-46, *Interagency Guidance on Asset Securitization Activities* (Dec. 1999); *Comptroller's Handbook for Asset Securitization* (Nov. 1997).

<sup>8</sup> In an owner trust securitization structure, the assets are usually subject to a lien of indenture through which notes are issued. The beneficial ownership of the owner trust's assets is represented by the certificates, which may be sold

authority.<sup>9</sup> Retention of the Bank's own securitized loan assets in the form of the HELOC notes also is legally permissible. In 12 C.F.R. Part 1, the OCC has recognized a national bank's ability to purchase and hold securitized assets as securities.<sup>10</sup> In 1996, the OCC specifically added "Type V" securities to its rule, to address separately investment grade securities representing interests in assets a bank may invest in directly.<sup>11</sup> The rule defines a Type V security as a security rated investment grade, marketable, not a Type IV,<sup>12</sup> and fully secured by interests in a pool of loans to numerous obligors and in which a national bank could invest in directly.<sup>13</sup> The OCC explained that this definition reflects long-standing OCC interpretations providing that, in addition to the investments described in 12 U.S.C. § 24(Seventh), a national bank may hold securitized forms of assets in which it may invest directly.<sup>14</sup>

Here the interests designated as the HELOC notes created through the Bank's securitization process satisfy the requirements for Type V securities under 12 C.F.R. § 1.2(n). The HELOC notes are high quality investment grade securities with a AAA rating by two NRSROs, as required in section 1.2(d); the notes are marketable as set forth in section 1.2(f); they are not Type IV securities as defined in section 1.2(m); and they are composed of underlying loans

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or retained by the bank. *See Securitization of Financial Assets* § 4.02(E) (Jason H.P. Kravitt ed., 2d ed. 2003); *Comptroller's Handbook on Asset Securitization* 15 (Nov. 1997). The OCC has approved the use of an owner trust structure. *See, e.g.*, Interpretive Letter No. 514 (May 5, 1990).

<sup>9</sup> *See, e.g.*, 12 C.F.R. § 1.3(g) (bank may securitize and sell assets); Interpretive Letter No. 540 (Dec. 12, 1990) (credit card securitization); Interpretive Letter No. 92 (Apr. 20, 1979) (securitized assets in a senior/subordinate structure). *See also Securities Industry Ass'n v. Clarke*, 885 F.2d 1034 (2d Cir. 1989), *cert. denied*, 493 U.S. 1070 (1990) (certificates representing undivided interests in pooled bank assets are legally transparent for purposes of the Glass-Steagall Act (upholding Interpretive Letter No. 388)). The OCC does not opine on the strict legality of the Bank's securitization process itself, but finds under the general authorities that the activities are permissible for a national bank. The OCC assumes compliance by the Bank with all applicable legal requirements related to the securitization.

<sup>10</sup> Part 1 prescribes standards for national banks engaged in purchasing, selling, dealing in, underwriting, and holding securities, consistent with the authority contained in 12 U.S.C. § 24(Seventh) and safe and sound banking practices. *See* 12 C.F.R. § 1.1; 61 Fed. Reg. 63972 (Dec. 2, 1996) (the OCC's so-called "investment securities" rule).

<sup>11</sup> *See* 61 Fed. Reg. at 63976. The rule 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 organization ("NRSROs"); or (2) one NRSRO if the security has been rated by only one NRSRO. 12 C.F.R. § 1.2(d). By definition, an "investment security" is a marketable debt obligation that is not predominantly speculative in nature. A security is not predominantly speculative in nature if it is rated investment grade. 12 C.F.R. § 1.2(e).

<sup>12</sup> The 1996 rule also created a new category of Type IV securities that national banks may purchase implementing amendments to 12 U.S.C. § 24(Seventh) in the Secondary Mortgage Market Enhancement Act of 1984 ("SMMEA) and the Riegle Community Development and Regulatory Improvement Act ("CDRI") concerning certain mortgage-related and small business-related securities. *See* 12 C.F.R. §§ 1.2(m) and 1.3(e).

<sup>13</sup> 12 C.F.R. § 1.2(n). In this context, "obligor" means the borrowers on the underlying loans backing the security.

<sup>14</sup> *See* 61 Fed. Reg. at 63976.

eligible for direct investment by a national bank. Accordingly, the Bank has the legal authority under part 1 to retain the HELOC notes as Type V securities.

Twelve C.F.R. § 1.3(f) ordinarily limits a national bank's purchase of Type V securities from any one issuer (or certain related issuers) to 25 percent of the bank's capital and surplus.<sup>15</sup> In adding Type V securities to its investment securities rule, the OCC explained that the 25 percent of capital limit was a prudential limit to provide sufficient protection against undue risk concentrations.<sup>16</sup> Typically the purchasing bank places significant reliance on the entity that originates and services the pooled loans rather than evaluating the individual obligors in the loan pool and the limit curtails exposure to the entity to address safety and soundness concerns.<sup>17</sup>

The Bank's situation differs in that the economic substance of the resulting securitized interests simply represent a recharacterization of the Bank's own loans.<sup>18</sup> The continued holding of the HELOCs in a securitized form as Type V securities does not by itself raise the usual concerns of undue concentration. By originating all of the underlying loans and continuing to service the securitized loans and retaining the entire interest in the securitization, the Bank is uniquely able to evaluate its risk exposure and maintain compliance with all applicable safety and soundness requirements.<sup>19</sup> Further, the Bank's purchase of the insurance wrap guaranteeing all principal and interest on the HELOC notes provides an additional risk diversification mitigant and, significantly, is sufficient for the notes to receive a triple-A securities rating. Accordingly, in this specific situation the 25 percent prudential limit in section 1.3(f), usually applicable to purchases and holdings of Type V securities of one issuer, is not intended to apply. This determination applies only to the particular set of facts and the proposed securitization transactions described herein. Any change in the facts and circumstances could lead to a different conclusion.

## **B. Continued Holding of the Subordinated Interest**

The Bank's retention of a subordinated interest, here the OTC, in the securitization of its own HELOC Loans is simply part of, or incidental to, the bank's general lending authority and its ability to securitize. The Bank originally made the loans and, likewise, may continue to hold the interests created from the loans in a different form under the same general power.<sup>20</sup> Various

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<sup>15</sup> See 12 C.F.R. § 1.3(f); *see also* 1.4(d).

<sup>16</sup> 61 Fed. Reg. at 63977.

<sup>17</sup> *See, e.g.*, 61 Fed. Reg. at 63979; Interpretive Letter No. 579, *supra*.

<sup>18</sup> However, from a general capital markets perspective, other investors will view the securitized assets in the form of the HELOC notes differently from the unsecuritized loan assets.

<sup>19</sup> This is in contrast to usual Type V scenarios involving the purchase of securitized interests from third party issuers.

<sup>20</sup> As oft recognized by the courts, legal classification for one purpose does not necessitate the same treatment for other purposes. *See, e.g., Securities Industry Ass'n v. Clarke*, 885 F.2d 1034, 1052 (2d Cir. 1989), *cert. denied*, 493

OCC letters and issuances relating to securitization activities recognize a bank's authority to retain an interest in its securitized assets.<sup>21</sup>

### C. Safety and Soundness Requirements

The Bank must adhere to the prudential requirements as specifically set forth in 12 C.F.R. § 1.5, and other supervisory guidance on safe and sound banking practices, as appropriate.<sup>22</sup> For example, section 1.5 identifies certain risks the Bank should consider as part of safe and sound banking, including, among others, the interest rate, credit, liquidity, price, transaction, strategic, and reputation risk presented by the proposed securitization and related activities.

In addition, the Bank must establish to the OCC's satisfaction that the Bank has an adequate and effective risk measurement and management program for the described securitization transactions. Because the securitized HELOC holdings are not subject to the diversification limits in 12 C.F.R. § 1.3(f), the holdings require unique prudential oversight.<sup>23</sup> Accordingly, in order for the OCC to conclude that the proposed activities are permissible for the Bank the Bank must demonstrate to the satisfaction of the OCC that the Bank has established an appropriate risk measurement and management process for this home equity lending and securitization activity. An effective risk measurement and management process includes board supervision, managerial

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U.S. 1070 (1990) (requirement that certificates be registered under the securities laws does not make them "securities" for purposes of the Glass Steagall Act prohibitions).

<sup>21</sup> See, e.g., 66 Fed. Reg. at 59616 (banks have long provided "recourse," or retained some ownership interest, in connection with sales of whole loans or loan participations); OCC Bulletin 99-46, *supra* (seller typically retains one or more interests in the assets sold); Interpretive Letter No. 585 (June 8, 1992) (bank retains Class B certificates in a senior/subordinated structure); Interpretive Letter No. 514, *supra* (subsidiaries may sell residual interest); Interpretive Letter No. 378, *supra* (reversionary interest in assets likely to be substantial); Interpretive Letter No. 92, *supra* (bank to retain Class B certificates); Letter from Robert Bloom, First Deputy Comptroller for Policy (July 1, 1976) ("the creation of the Trust, the sale of loans to the Trust, and retention of a residual interest in the Trust are permissible under the general powers conferred on national banks").

<sup>22</sup> See e.g., OCC Bulletin 2004-20, *Risk Management of New, Expanded, or Modified Bank Products and Services* (May 10, 2004); OCC Bulletin 2002-19, *Unsafe and Unsound Investment Portfolio Practices* (May 22, 2002); OCC Bulletin 99-46, *Interagency Guidance on Asset Securitization Activities* (Dec. 13, 1999); Comptroller's Handbook for Asset Securitization (Nov. 1997). In addition, with respect to safe and sound banking practices related to the underlying HELOCs, see OCC Bulletin 2005-22, *Home Equity Lending* (May 16, 2005).

<sup>23</sup> The OCC has long considered safety and soundness as part of determining whether an activity is permissible under 12 U.S.C. § 24(Seventh). See e.g., Interpretive Letter No. 1018 (Feb. 10, 2005) (affiliate hedging activities must be conducted in safe and sound manner to be permissible); Interpretive Letter No. 949 (Sept. 19, 2002) (proposed activity cannot be part of the "business of banking" if the bank in question lacks the capacity to conduct the activity on a safe and sound basis); Interpretive Letter 892 (Sept. 13, 2000) (national bank may engage in equity hedging activities only if it has an appropriate risk management process in place); Interpretive Letter No. 684 (Aug. 4, 1995) (commodity hedging is a permissible banking activity provided the activity is conducted in accordance with safe and sound banking practices); Interpretive Letter No. 274 (Dec. 2, 1983) (a national bank's authority to lease its office space provides the authority for it to establish appropriate lease terms if consistent with safe and sound banking practices).

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.<sup>24</sup>

In addition to the risk management program, the Bank's process must include an on-going compliance monitoring program to ensure compliance with the specific commitments made by the Bank related to the described securitization, such as the transactions qualifying as a Guaranteed Mortgage Securitization and the Owner Trust qualifying as a QSPE. The Bank must have an adequate and effective compliance monitoring program that includes policies, training, independent surveillance and well-defined exception approval and reporting procedures.

The OCC will make the determinations on risk measurement and management, and on-going compliance monitoring through the Bank's Examiner-in-Charge ("EIC"), and the Bank may not commence the proposed securitization activities unless and until its EIC has determined that there is no supervisory objection to the securitization activities described in this letter. The Bank also must consult with and receive EIC approval prior to engaging in any subsequent securitizations of a similar nature to those described in this letter.

#### **D. Risk-Based Capital Treatment**

Section 4 of 12 C.F.R. Part 3, appendix A sets forth the risk-based capital treatment for exposures, both on- and off-balance sheet, related to securitizations. The rule contemplates the capital treatment of rated and unrated stratified risk positions acquired or retained by banks in transactions involving third-party market participants. In contrast, in this proposal, the Bank sells its own assets into a trust and retains all of the risk positions associated with those assets. This recharacterization of the Bank's loans does not affect the risk-based capital requirements because the OCC's capital rules do not recognize insurance companies as eligible guarantors. Thus, for purposes of the risk-based capital rules, there is no transfer of risk recognized in association with the insurance wrap.<sup>25</sup> Accordingly, the OCC has determined that the proposed transaction falls outside the scope of risk-based capital treatment for securitizations. The risk-based capital charge for the AAA-rated securities and the OTC would be the full capital charge for the underlying HELOC Loans as if the loans were still on the Bank's balance sheet.

#### **Conclusion**

Based on the facts and circumstances presented, we conclude that the Bank may hold the securitized loan assets in the form of the HELOC notes as Type V securities under 12 C.F.R. Part 1. The usual 25% prudential limitation under part 1 applicable to Type V securities is not intended to apply in this particular situation based on the described facts. Further, the deficiency

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<sup>24</sup> Further detailing the risk measurement and management process, see the Comptroller's Handbook, *Risk Management of Financial Derivatives* (Jan. 1997) and BC-277, *Risk Management of Financial Derivatives* (Oct. 23, 1993).

<sup>25</sup> The current rules recognize credit enhancements provided by other Organization for Economic Cooperation and Development ("OECD") banks, highly-rated securities companies, and OECD government and government-related guarantees. See 12 C.F.R. part 3, appendix A § 3(a)(2).

guarantee or insurance “wrap,” among other factors as described in the letter, provides sufficient risk mitigation for safety and soundness purposes. The Bank’s retention of a subordinated interest, here the OTC, in a securitization of its own loans is permissible under the bank’s general lending authority of 12 U.S.C. § 24(Seventh). These conclusions are subject to the condition that the Bank will have an appropriate risk measurement and management process, and on-going compliance monitoring program in place satisfactory to the Bank’s EIC. Accordingly, the Bank may not commence the proposed securitization transactions unless and until its EIC has determined that he has no supervisory objection to the Bank’s proposed securitization activities, as described herein. The appropriate risk-based capital treatment is the risk-based capital charge for the underlying HELOC Loans.

The OCC views expressed in this letter are based specifically on the Bank’s representations and written submissions describing the facts and circumstances of the Bank’s proposed guaranteed mortgage securitization of its own HELOC Loans. Any change in the facts or circumstances could result in different conclusions. If you have any questions concerning this letter, please contact Suzette H. Greco, Special Counsel, Securities & Corporate Practices Division at 202/874-5210.

Sincerely,

**signed**

Daniel P. Stipano  
Acting Chief Counsel