Office of the Comptroller of the Currency

Washington, DC 20219

Interpretive Letter #1182
July 2024

Supervisory Letter [ ]

May [ ], 2024

[BANK]

Subject: **Regulatory Capital Treatment for Exposures to [*the Special Purpose Vehicle*]**

Dear **[ ]**:

This Supervisory Letter (SL) addresses the application of the Office of the Comptroller of the Currency's (OCC) regulatory capital rule[1] to [the Bank's] (Bank) exposures to [the Special Purpose Vehicle]. As discussed below, we conclude that for the purpose of the OCC's regulatory capital rule, these exposures do not meet the definition of securitization exposures.[2] Instead, the Bank must treat these exposures as corporate exposures subject to the general credit risk framework of subpart D of the capital rule [3] and as wholesale exposures subject to the general credit risk framework of subpart E of the capital rule,[4] as applicable. As such, this SL applies to both the generally applicable risk-based capital rule and the advanced approaches risk-based capital rule.

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[1] 12 C.F.R. Part 3.

[2] *See* 12 C.F.R. § 3.2.

[3] *See* 12 C.F.R. § 3.32.

[4] *See* 12 C.F.R. § 3.131.

I. Securitization Requirements

For risk-based capital purposes, a *securitization exposure* is one that arises from, or directly or indirectly references, a *traditional securitization* or *synthetic securitization*, as defined in 12 C.F.R. § 3.2, respectively. To qualify as a traditional securitization, among other requirements, the transaction must be one in which (1) all or substantially all of the underlying exposures are financial exposures; (2) the performance of the securitization exposures depends upon the performance of the underlying exposures, and (3) the underlying exposures are not owned by an operating company.[5] If a transaction fails to meet any one of these requirements, the transaction would not qualify as a traditional securitization under the capital rule and a bank's exposures to the transaction would not be securitization exposures.[6]

II. [The Company's Transaction]

[The Company], a [ ] company, has transferred assets that generate [a significant majority] of its income into a special purpose vehicle ([ ] or SPV). The assets transferred include (1) [service contracts], (2) intellectual property (IP), (3) [ ] software [ ], and (4) [physical assets including hardware]. [The Company] no longer owns the [service contracts], but as the servicer of the contracts on behalf of the SPV, [the Company] continues to conduct the day-to-day operations associated with those contracts. As [the Company] enters into new [service contracts] with customers, [the Company] transfers these new [service contracts] to the SPV. The SPV issues notes to investors, including the Bank, to fund the transfer of the [service contracts] to the SPV ([transaction]).

III. Analysis

The preamble to the U.S. Basel III Final Rule explains that "the designation of exposures as securitization exposures . . . [is] guided by the economic substance of a transaction rather than its legal form."[7] As discussed below, the OCC has determined that the [transaction] does not meet the requirements for a traditional securitization under the capital rule. It is also not a synthetic securitization because it is not in the form of a guarantee or credit derivative.

A. All or substantially all of the underlying exposures must be financial exposures.

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[5] For the complete list of requirements, see 12 C.F.R. § 3.2, definition of *traditional securitization*. For the complete list of requirements for synthetic securitizations, see 12 C.F.R. § 3.2, definition of *synthetic securitization*.

[6] As a general matter, banks hold risk-based capital against securitization exposures according to the capital rule's securitization framework, which may result in a lower risk-weight when compared to the corporate and wholesale exposure frameworks in subparts D and E of the capital rule, respectively. *See* 12 C.F.R. §§ 3.41- 3.45; 3.141- 3.145.

[7] 78 Fed. Reg. 62018, 62112 (Oct. 11, 2013).

A requirement for a traditional securitization under the capital rule is that all or substantially all of the underlying exposures must be financial exposures.[8] According to the preamble to the U.S. Basel III Final Rule, this requirement "creates an important boundary between the general credit risk framework and the securitization framework," and the federal banking agencies will examine the "cash flow characteristics" of the transaction to determine the category in which an exposure belongs.[9] The preamble to the U.S. Basel III Final Rule lists the following items as examples of financial exposures: loans, commitments, credit derivatives, guarantees, receivables, asset-backed securities, mortgage-backed securities, other debt securities, or equity securities.[10]

A substantial amount of the underlying exposures in the SPV are not financial exposures. The SPV includes items such as IP, [ ] software [ ], and [physical assets including hardware] that are neither included in nor similar to the examples of financial exposures set forth in the preamble. These assets comprise more than an immaterial amount of the total assets in the SPV. Unlike an exposure to a pool of loans or receivables, which generate a stream of cash flows, the SPV includes nonfinancial exposures that do not exhibit similar cash flow characteristics or risks. The securitization framework "is not designed . . . to apply to tranched credit exposures to commercial or industrial companies or nonfinancial assets."[11]

B. The performance of the securitization exposures must depend on the performance of the underlying exposures.

To be considered a traditional securitization, the performance of the securitization exposures must depend on the performance of the underlying exposures.[12] Rather than meeting this requirement, the performance of the Bank's exposures to the SPV is heavily dependent upon [the Company's] continued ability to provide services under the [service contracts].

In the [transaction], the SPV only receives regular payments from the [service contracts], *i.e.*, customers make their contractual payments, if the customers receive the agreed upon services under the contract. The value of the [service contracts] is based on [the Company's] contractual obligation to provide ongoing services, [ ], in addition to the customer's creditworthiness. Typically, a securitization SPV holds underlying exposures that depend only on the borrower's creditworthiness and ability to make regular payments. In this transaction, the performance of the underlying exposures would be severely impacted if [the Company's] ability to provide services required under the contracts is

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[8] *See* 12 C.F.R. § 3.2, definition of *traditional securitization*.

[9] 78 Fed. Reg. at 62112.

[10] *Id*.

[11] *Id*.

[12] *See* 12 C.F.R. § 3.2, definition of *traditional securitization*.

interrupted, regardless of the customers' creditworthiness. While the transaction is structured so that the SPV could employ an alternative servicer, it is uncertain whether another company could meet all the terms of the [service contracts], affecting the customers' willingness to pay and thus the performance of the [service contracts].

C. The underlying exposures must not be owned by an operating company.

Finally, a traditional securitization under the capital rules may not have underlying exposures that are owned by an operating company.[13] The preamble to the US Basel III Final Rule explains that operating companies "generally refer to companies that are established to conduct business with clients with the intention of earning a profit in their own right and generally produce goods or provide services beyond the business of investing, reinvesting, holding, or trading in financial assets."[14] The preamble provides that "the designation of exposures as securitization exposures" under the capital rule is "guided by the economic substance of a transaction rather than its legal form."[15]

While the transaction is structured so that [the Company] services the underlying assets that are now owned by the SPV, the SPV holds significant assets typically associated with conducting business with clients, such as IP, [ ]software[ ], and [physical assets including hardware]. The economic substance of the transaction represents the transfer of a significant business enterprise to the SPV, and not just the transfer of assets to an entity established to simply invest, reinvest, hold, or trade in financial assets. The SPV, through its servicer, actively uses those assets to deliver [services] to [customers] in order to earn income to repay the note holders rather than passively earning a return on financial assets. Accordingly, based on the economic substance of the transaction, the OCC has determined that the underlying assets are owned by an operating company that "produce[s] goods or provide[s] services beyond the business of investing, reinvesting, holding, or trading in financial assets."[16]

IV. Conclusion

The OCC has determined that the [transaction] does not meet the definition of a traditional securitization in the capital rule. Therefore, the Bank's exposures to [the SPV] are not traditional securitization exposures that qualify for the risk-based capital treatment under the securitization framework in 12 C.F.R. §§ 3.41-3.45 or 12 C.F.R. §§ 3.141-3.145, as applicable. The Bank's exposures to [the SPV] meet the definition of a corporate exposure under 12 C.F.R. § 3.2 and

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[13] *See id*.

[14] 78 Fed. Reg. at 62112.

[15] *Id*.

[16] *Id*.

wholesale exposure under 12 C.F.R. § 3.101, as applicable.[17] The Bank must assign the transaction the appropriate risk weight for corporate exposures and wholesale exposures, respectively and as applicable.[18]

If you have any questions about these determinations, please contact: [ ].

Sincerely,
/s/
Monica A. Freas
Deputy Comptroller
Large Bank Supervision

cc: **[]**

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[17] The exposure meets the definition of *corporate exposure* because it is an exposure to a company that is not an exposure to a sovereign, GSE, residential mortgage exposure, pre-sold construction loan, statutory multifamily mortgage, HVCRE exposure, cleared transaction, default fund contribution, securitization exposure, equity exposure, unsettled transaction, policy loan, separate account, or Paycheck Protection Program covered loan. The exposure meets the definition of *wholesale exposure* because it is a credit exposure to a company (other than a securitization exposure, retail exposure, pre-sold construction loan, or equity exposure).

[18] *See* 12 C.F.R. § 3.32 and 12 C.F.R. § 3.131.