

# CORPORATE CREDIT UNION GUIDANCE LETTER

No. 2000-01

DATE: May 19, 2000

SUBJ: Asset-Backed Securities (ABS) with Foreign Exposure

TO: The Corporate Credit Union Addressed

Innovations in the ABS market have resulted in many domestically issued ABS with varying degrees of foreign exposure. Section 704.5(c)(5) of the NCUA Rules and Regulations permits investments in ABS. Section 704.2 defines an ABS as “ a security that is primarily serviced by the cash-flows of a discrete pool of receivables or other financial assets....” This definition makes no differentiation between domestic and/or foreign collateral. This raises an issues as to whether or not corporate credit unions are required to have Part III Expanded Authorities to invest in ABS with any foreign exposure.

Currently, the largest sectors of the ABS market continue to be traditional credit cards, automobiles, and home equity backed bonds. However, one of the fastest growing ABS sectors consists of collateralized debt obligations (CDO), which can be either collateralized bond obligations (CBO) or collateralized loan obligations (CLO).

Financial globalization has affected the ABS market as issuers securitize domestic and foreign assets. Some sectors, such as CDO, may have heavy concentrations of foreign collateral within their structures. Every sector, even the traditional credit cards sector, is showing increasing levels of collateral defined as “other.” “Other” collateral may be anything from cash to foreign assets. Additionally, an ABS structure may include an interest rate swap, cap, or floor with a foreign counterparty. In short, many ABS have some type of foreign exposure.

Part III Expanded Authorities restricts corporate credit unions to a defined set of securities, which are generally not found in an ABS structure. Furthermore, the percentage of new ABS issuances containing some foreign exposure is growing significantly. Hence, a whole regulation interpretation would generally prohibit ABS with any foreign exposure and may unduly restrict corporate credit unions from participating in the ABS market.

To remedy this concern, the Office of Corporate Credit Unions has interpreted Part 704 to permit all corporate credit unions (without regard to Part III Expanded Authorities) to invest in any domestically issued ABS meeting applicable regulatory credit rating requirements. This interpretation removes uncertainty about the requirements of Part 704 and permits any corporate credit union to invest in domestically issued ABS with underlying foreign exposures. A State chartered corporate credit union should contact its State Supervisory Authority regarding the permissibility of such investments.

Any undue concentrations and/or safety and soundness issues arising from such investments will be adequately addressed as a supervision issue. Examiners have been instructed to evaluate the ability of corporate credit union staff to analyze ABS structures containing significant foreign exposure. The degree of foreign credit analysis expertise required at a corporate credit union will depend on the extent of foreign exposure. In the case of reliance on a domestic mono-line insurance wrap of foreign collateral, examiners would review a corporate credit union’s credit analysis of the insurance company and determine whether credit concentration limits to the insurance company were appropriate.

If you have any questions, please contact this office.

Sincerely,

Robert F. Schafer  
Director

Office of Corporate Credit Unions

cc: NASCUS

All SSAs

ACCU

bcc: Reading File

Misc.-Corporate CU Guidance Letter

All OCCU Staff

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