DEPARTMENT OF THE TREASURY
Office of the Comptroller of the Currency
12 CFR Parts 3, 5, 6, 165, 167
Docket ID OCC-2012-0008
RIN 1557-AD46

FEDERAL RESERVE SYSTEM
12 CFR Parts 208, 217, and 225
Regulations H, Q, and Y
Docket No. R-[XX]
RIN [XX]

FEDERAL DEPOSIT INSURANCE CORPORATION
12 CFR Parts 324 and 325
RIN 3064-AD95

Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Corrective Action

AGENCIES: Office of the Comptroller of the Currency, Treasury; Board of Governors of the Federal Reserve System; and the Federal Deposit Insurance Corporation.

ACTION: Joint notice of proposed rulemaking.

SUMMARY: The Office of the Comptroller of the Currency (OCC), Board of Governors of the Federal Reserve System (Board), and the Federal Deposit Insurance Corporation (FDIC) (collectively, the agencies) are seeking comment on three notices of proposed rulemaking (NPRs) that would revise and replace the agencies' current capital rules.

In this NPR, the agencies are proposing to revise their risk-based and leverage capital requirements consistent with agreements reached by the Basel Committee on Banking Supervision (BCBS) in "Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems" (Basel III). The proposed revisions would include implementation of a new common equity tier 1 minimum capital requirement, a higher minimum tier 1 capital requirement, and, for banking organizations subject to the advanced approaches capital rules, a supplementary leverage ratio that incorporates a broader set of exposures in the denominator measure. Additionally, consistent with Basel III, the agencies are proposing to apply limits on a banking organization's capital distributions and certain discretionary bonus payments if the banking organization does not hold a specified amount of common equity tier 1 capital in addition to the amount necessary to meet its minimum risk-based capital requirements. This NPR also would establish more conservative standards for including an instrument in regulatory capital. As discussed in the proposal, the revisions set forth in this NPR are consistent with section 171 of the Dodd-Frank Act, which requires the agencies to establish minimum risk-based and leverage capital requirements.

In connection with the proposed changes to the agencies' capital rules in this NPR, the agencies are also seeking comment on the two related NPRs published elsewhere in today's Federal Register. In the notice titled "Regulatory Capital Rules: Standardized Approach for Risk-weighted Assets; Market Discipline and Disclosure Requirements" (Standardized Approach NPR), the agencies are proposing to revise and harmonize their rules for calculating risk-weighted assets to enhance risk sensitivity and address weaknesses identified over recent years, including by incorporating aspects of the BCBS's Basel II standardized framework in the "International Convergence of Capital Measurement and Capital Standards: A Revised Framework," including subsequent amendments to that standard, and recent BCBS consultative papers. The Standardized Approach NPR also includes alternatives to credit ratings, consistent with section 939A of the Dodd-Frank Act. The revisions include methodologies for determining risk-weighted assets for residential mortgages, securitization exposures, and counterparty credit risk. The Standardized Approach NPR also would introduce disclosure requirements that would apply to top-tier banking organizations domiciled in the United States with $50 billion or more in total assets, including disclosures related to regulatory capital instruments.

The proposals in this NPR and the Standardized Approach NPR would apply to all banking organizations that are currently subject to minimum capital requirements (including national banks, state member banks, state nonmember banks, state and federal savings associations, and top-tier bank holding companies domiciled in the United States not subject to the Board's Small Bank Holding Company Policy Statement (12 CFR part 225, Appendix C)), as well as top-tier savings and loan holding companies domiciled in the United States (together, banking organizations).

In the notice titled "Regulatory Capital Rules: Advanced Approaches Risk-based Capital Rule; Market Risk Capital Rule," (Advanced Approaches and Market Risk NPR) the agencies are proposing to revise the advanced approaches risk-based capital rules consistent with Basel III and other changes to the BCBS's capital standards. The agencies also propose to revise the advanced approaches risk-based capital rules to be consistent with section 939A and section 171 of the Dodd-Frank Act. Additionally, in the Advanced Approaches and Market Risk NPR, the OCC and FDIC are proposing that the market risk capital rules be applicable to federal and state savings associations and the Board is proposing that the advanced approaches and market risk capital rules apply to top-tier savings and loan holding companies domiciled in the United States, in each case, if stated thresholds for trading activity are met.

As described in this NPR, the agencies also propose to codify their regulatory capital rules, which currently reside in various appendices to their respective regulations. The proposals are published in three separate NPRs to reflect the distinct objectives of each proposal, to allow interested parties to better understand the various aspects of the overall capital framework, including which aspects of the rules would apply to which banking organizations, and to help interested parties better focus their comments on areas of particular interest.

DATES: Comments must be submitted on or before September 7, 2012.

ADDRESSES: Comments should be directed to:

OCC: Because paper mail in the Washington, D.C. area and at the OCC is subject to delay, commenters are encouraged to submit comments by the Federal eRulemaking Portal or e-mail, if possible. Please use the title "Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Corrective Action" to facilitate the organization and distribution of the comments. You may submit comments by any of the following methods:

Federal eRulemaking Portal—"regulations.gov": Go to http://www.regulations.gov. Click "Advanced Search". Select "Document Type" of "Proposed Rule", and in "By Keyword or ID" box, enter Docket ID "OCC-2012-0008," and click "Search". If proposed rules for more than one agency are listed, in the "Agency" column, locate the notice of proposed rulemaking for the OCC. Comments can be filtered by Agency using the filtering tools on the left side of the screen. In the "Actions" column, click on "Submit a Comment" or "Open Docket Folder" to submit or view public comments and to view supporting and related materials for this rulemaking action.

- Click on the "Help" tab on the Regulations.gov home page to get information on using Regulations.gov, including instructions for submitting or viewing public comments, viewing other supporting and related materials, and viewing the docket after the close of the comment period.

- E-mail: regs.comments@occ.treas.gov.

- Mail: Office of the Comptroller of the Currency, 250 E Street, S.W., Mail Stop 2-3, Washington, DC 20219.

- Fax: (202) 874-5274.

- Hand Delivery/Courier: 250 E Street, S.W., Mail Stop 2-3, Washington, D.C. 20219.

Instructions: You must include "OCC" as the agency name and "Docket ID OCC-2012-0008" in your comment. In general, the OCC will enter all comments received into the docket and publish them on the Regulations.gov Web site without change, including any business or personal information that you provide such as name and address information, e-mail addresses, or phone numbers. Comments received, including attachments and other supporting materials, are part of the public record and subject to public disclosure. Do not enclose any information in your comment or supporting materials that you consider confidential or inappropriate for public disclosure.

You may review comments and other related materials that pertain to this notice by any of the following methods:

- Viewing Comments Electronically: Go to http://www.regulations.gov. Click "Advanced Search". Select "Document Type" of "Public Submission" and in "By Keyword or ID" box enter Docket ID "OCC-2012-0008," and click "Search". If comments from more than one agency are listed, the "Agency" column will indicate which comments were

received by the OCC. Comments can be filtered by Agency using the filtering tools on the left side of the screen.

- Viewing Comments Personally: You may personally inspect and photocopy comments at the OCC, 250 E Street, S.W., Washington, D.C. For security reasons, the OCC requires that visitors make an appointment to inspect comments. You may do so by calling (202) 874-4700. Upon arrival, visitors will be required to present valid government-issued photo identification and to submit to security screening in order to inspect and photocopy comments.

- Docket: You may also view or request available background documents and project summaries using the methods described previously.

Board: When submitting comments, please consider submitting your comments by e-mail or fax because paper mail in the Washington, D.C. area and at the Board may be subject to delay. You may submit comments, identified by Docket No. [XX][XX], by any of the following methods:

- Agency Web Site: http://www.federalreserve.gov. Follow the instructions for submitting comments at http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm.

- Federal eRulemaking Portal: http://www.regulations.gov. Follow the instructions for submitting comments.

- E-mail: regs.comments@federalreserve.gov. Include docket number in the subject line of the message.

- Fax: (202) 452-3819 or (202) 452-3102.

- Mail: Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, N.W., Washington, D.C. 20551.

All public comments are available from the Board's website at http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm as submitted, unless modified for technical reasons. Accordingly, your comments will not be edited to remove any identifying or contact information. Public comments may also be viewed electronically or in paper form in Room MP-500 of the Board's Martin Building (20th and C Street, N.W., Washington, D.C. 20551) between 9:00 a.m. and 5:00 p.m. on weekdays.

FDIC: You may submit comments by any of the following methods:

- Federal eRulemaking Portal: http://www.regulations.gov. Follow the instructions for submitting comments.

- Agency Web site: http://www.FDIC.gov/regulations/laws/federal/propose.html

- Mail: Robert E. Feldman, Executive Secretary, Attention: Comments/Legal ESS, Federal Deposit Insurance Corporation, 550 17th Street, N.W., Washington, D.C. 20429.

- Hand Delivered/Courier: The guard station at the rear of the 550 17th Street Building (located on F Street), on business days between 7:00 a.m. and 5:00 p.m.

- E-mail: comments@FDIC.gov.

- Instructions: Comments submitted must include "FDIC" and "RIN [xx][xx]-[xx][xx]." Comments received will be posted without change to http://www.FDIC.gov/regulations/laws/federal/propose.html, including any personal information provided.

FOR FURTHER INFORMATION CONTACT:

OCC: Margot Schwadron, Senior Risk Expert, (202) 874-6022, David Elkes, Risk Expert, (202) 874- 3846, or Mark Ginsberg, Risk Expert, (202) 927-4580, or Ron Shimabukuro, Senior Counsel, Patrick Tierney, Counsel, or Carl Kaminski, Senior Attorney, Legislative and Regulatory Activities Division, (202) 874-5090, Office of the Comptroller of the Currency, 250 E Street, S.W., Washington, D.C. 20219.

Board: Anna Lee Hewko, Assistant Director, (202) 530-6260, Thomas Boemio, Manager, (202) 452-2982, Constance M. Horsley, Manager, (202) 452-5239, or Juan C. Climent, Senior Supervisory Financial Analyst, (202) 872-7526, Capital and Regulatory Policy, Division of Banking Supervision and Regulation; or Benjamin McDonough, Senior Counsel, (202) 452-2036, April C. Snyder, Senior Counsel, (202) 452-3099, or Christine Graham, Senior Attorney, (202) 452-3005, Legal Division, Board of Governors of the Federal Reserve System, 20th and C Streets, N.W., Washington, D.C. 20551. For the hearing impaired only, Telecommunication Device for the Deaf (TDD), (202) 263-4869.

FDIC: Bobby R. Bean, Associate Director, bbean@fdic.gov; Ryan Billingsley, Senior Policy Analyst, rbillingsley@fdic.gov; Karl Reitz, Senior Policy Analyst, kreitz@fdic.gov, Division of Risk Management Supervision; David Riley, Senior Policy Analyst, dariley@fdic.gov, Division of Risk Management Supervision, Capital Markets Branch, (202) 898-6888; or Mark Handzlik, Counsel, mhandzlik@fdic.gov, Michael Phillips, Counsel, mphillips@fdic.gov, Greg Feder, Counsel, gfeder@fdic.gov, or Ryan Clougherty, Senior Attorney, rclougherty@fdic.gov; Supervision Branch, Legal Division, Federal Deposit Insurance Corporation, 550 17th Street, N.W., Washington, D.C. 20429.

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Addendum 1: Summary of this NPR as it would Generally Apply to Community Banking Organizations

I. Introduction

A. Overview of the Proposed Changes to the Agencies' Current Capital Framework

The Office of the Comptroller of the Currency (OCC), Board of Governors of the Federal Reserve System (Board), and the Federal Deposit Insurance Corporation (FDIC) (collectively, the agencies) are proposing comprehensive revisions to their regulatory capital framework through three concurrent notices of proposed rulemaking (NPRs). These proposals would revise the agencies' current general risk-based, advanced approaches risk-based capital rules (advanced approaches), and leverage capital rules (collectively, the current capital rules).[2] The proposed revisions incorporate changes made by the Basel Committee on Banking Supervision (BCBS) to the Basel capital framework, including those in "Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems" (Basel III).[3] The proposed revisions also would implement relevant provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) and restructure the agencies' capital rules into a harmonized, codified regulatory capital framework.[4]

This notice (Basel III NPR) proposes the Basel III revisions to international capital standards related to minimum requirements, regulatory capital, and additional capital "buffers"

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[2] The agencies' general risk-based capital rules are at 12 CFR part 3, appendix A, 12 CFR part 167 (OCC); 12 CFR parts 208 and 225, appendix A (Board); and 12 CFR part 325, appendix A, and 12 CFR part 390, subpart Z (FDIC). The agencies' current leverage rules are at 12 CFR 3.6(b), 3.6(c), and 167.6 (OCC); 12 CFR part 208, appendix B, and 12 CFR part 225, appendix D (Board); and 12 CFR 325.3, and 390.467 (FDIC) (general risk-based capital rules). For banks and bank holding companies with significant trading activity, the general risk-based capital rules are supplemented by the agencies' market risk rules, which appear at 12 CFR part 3, appendix B (OCC); 12 CFR part 208, appendix E, and 12 CFR part 225, appendix E (Board); and 12 CFR part 325, appendix C (FDIC) (market risk rules).

The agencies' advanced approaches rules are at 12 CFR part 3, appendix C, 12 CFR part 167, appendix C, (OCC); 12 CFR part 208, appendix F, and 12 CFR part 225, appendix G (Board); 12 CFR part 325, appendix D, and 12 CFR part 390, subpart Z, Appendix A (FDIC) (advanced approaches rules). The advanced approaches rules are generally mandatory for banking organizations and their subsidiaries that have $250 billion or more in total consolidated assets or that have consolidated total on-balance sheet foreign exposure at the most recent year-end equal to $10 billion or more. Other banking organizations may use the advanced approaches rules with the approval of their primary federal supervisor. See 12 CFR part 3, appendix C, section 1(b) (national banks); 12 CFR part 167, appendix C (federal savings associations); 12 CFR part 208, appendix F, section 1(b) (state member banks); 12 CFR part 225, appendix G, section 1(b) (bank holding companies); 12 CFR part 325, appendix D, section 1(b) (state nonmember banks); and 12 CFR part 390, subpart Z, appendix A, section 1(b) (state savings associations).

The market risk capital rules apply to a banking organization if its total trading assets and liabilities is 10 percent or more of total assets or exceeds $1 billion. See 12 CFR part 3, appendix B, section 1(b) (national banks); 12 CFR parts 208 and 225, appendix E, section 1(b) (state member banks and bank holding companies, respectively), and 12 CFR part 325, appendix C, section 1(b) (state nonmember banks).

[3] The BCBS is a committee of banking supervisory authorities, which was established by the central bank governors of the G–10 countries in 1975. It currently consists of senior representatives of bank supervisory authorities and central banks from Argentina, Australia, Belgium, Brazil, Canada, China, France, Germany, Hong Kong SAR, India, Indonesia, Italy, Japan, Korea, Luxembourg, Mexico, the Netherlands, Russia, Saudi Arabia, Singapore, South Africa, Sweden, Switzerland, Turkey, the United Kingdom, and the United States. Documents issued by the BCBS are available through the Bank for International Settlements Web site at http:// www.bis.org.

[4] Pub. L. 111–203, 124 Stat. 1376, 1435–38 (2010) (Dodd-Frank Act).

to enhance the resiliency of banking organizations, particularly during periods of financial stress. It also proposes transition periods for many of the proposed requirements, consistent with Basel III and the Dodd-Frank Act. A second NPR (Standardized Approach NPR) would revise the methodologies for calculating risk-weighted assets in the general risk-based capital rules, incorporating aspects of the Basel II Standardized Approach and other changes.[5] The Standardized Approach NPR also proposes alternative standards of creditworthiness (to credit ratings) consistent with section 939A of the Dodd-Frank Act.[6] A third NPR (Advanced Approaches and Market Risk NPR) proposes changes to the advanced approaches rules to incorporate applicable provisions of Basel III and other agreements reached by the BCBS since 2009, proposes to apply the market risk capital rule (market risk rule) to savings associations and savings and loan holding companies and to apply the advanced approaches rule to savings and loan holding companies, and also removes references to credit ratings.

Other than bank holding companies subject to the Board's Small Bank Holding Company Policy Statement[7] (small bank holding companies), the proposals in the Basel III NPR and the Standardized Approach NPR would apply to all banking organizations currently subject to minimum capital requirements, including national banks, state member banks, state nonmember banks, state and federal savings associations, top-tier bank holding companies domiciled in the United States that are not small bank holding companies, as well as top-tier savings and loan holding companies domiciled in the United States (together, banking organizations).[8] Certain aspects of these proposals would apply only to advanced approaches banking organizations or banking organizations with total consolidated assets of more than $50 billion. Consistent with the Dodd-Frank Act, a bank holding company subsidiary of a foreign banking organization that is currently relying on the Board's Supervision and Regulation Letter (SR) 01–1 would not be required to comply with the proposed capital requirements under any of these NPRs until July 21, 2015.[9] In addition, the Board is proposing for all three NPRs to apply on a consolidated basis to top-tier savings and loan holding companies domiciled in the United States, subject to the applicable thresholds of the advanced approaches rules and the market risk rules.

The agencies are publishing all the proposed changes to the agencies' current capital rules at the same time in these three NPRs so that banking organizations can read the three NPRs together and assess the potential cumulative impact of the proposals on their operations and plan appropriately. The overall proposal is being divided into three separate NPRs to reflect the

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[5] See BCBS, "International Convergence of Capital Measurement and Capital Standards: A Revised Framework," (June 2006), available at http://www.bis.org/publ/bcbs128.htm (Basel II).

[6] See section 939A of the Dodd-Frank Act (15 U.S.C. 78o-7 note).

[7] 12 CFR part 225, appendix C (Small Bank Holding Company Policy Statement).

[8] Small bank holding companies would continue to be subject to the Small Bank Holding Company Policy Statement. Application of the proposals to all savings and loan holding companies (including small savings and loan holding companies) is consistent with the transfer of supervisory responsibilities to the Board and the requirements of section 171 of the Dodd-Frank Act. Section 171 of the Dodd-Frank Act by its terms does not apply to small bank holding companies, but there is no exemption from the requirements of section 171 for small savings and loan holding companies. See 12 U.S.C. 5371.

[9] See section 171(b)(4)(E) of the Dodd-Frank Act (12 U.S.C. 5371(b)(4)(E)); see also SR letter 01–1 (January 5, 2001), available at http://www.federalreserve.gov/boarddocs/srletters/2001/sr0101.htm.

distinct objectives of each proposal and to allow interested parties to better understand the various aspects of the overall capital framework, including which aspects of the rules will apply to which banking organizations, and to help interested parties better focus their comments on areas of particular interest. The agencies believe that separating the proposals into three NPRs makes it easier for banking organizations of all sizes to more easily understand which proposed changes are related to the agencies' objective to improve the quality and increase the quantity of capital (Basel III NPR) and which are related to the agencies' objective to enhance the overall risk-sensitivity of the calculation of a banking organization's total risk-weighted assets (Standardized Approach NPR).

The agencies believe that the proposals would result in capital requirements that better reflect banking organizations' risk profiles and enhance their ability to continue functioning as financial intermediaries, including during periods of financial stress, thereby improving the overall resiliency of the banking system. The agencies have carefully considered the potential impact of the three NPRs on all banking organizations, including community banking organizations, and sought to minimize the potential burden of these changes where consistent with applicable law and the agencies' goals of establishing a robust and comprehensive capital framework.

In developing each of the three NPRs, wherever possible and appropriate, the agencies have tailored the proposed requirements to the size and complexity of a banking organization. The agencies believe that most banking organizations already hold sufficient capital to meet the proposed requirements, but recognize that the proposals entail significant changes with respect to certain aspects of the agencies' capital requirements. The agencies are proposing transition arrangements or delayed effective dates for aspects of the revised capital requirements consistent with Basel III and the Dodd-Frank Act. The agencies anticipate that they separately would seek comment on regulatory reporting instructions to harmonize regulatory reports with these proposals in a subsequent Federal Register notice.

Many of the proposed requirements in the three NPRs are not applicable to smaller, less complex banking organizations. To assist these banking organizations in rapidly identifying the elements of these proposals that would apply to them, this NPR and the Standardized Approach NPR provide, as addenda to the corresponding preambles, a summary of the various aspects of each NPR designed to clearly and succinctly describe the two NPRs as they would typically apply to smaller, less complex banking organizations.[10]

Basel III NPR

In 2010, the BCBS published Basel III, a comprehensive reform package that is designed to improve the quality and the quantity of regulatory capital and to build additional capacity into

[10] The Standardized Approach NPR also contains a second addendum to the preamble, which contains the definitions proposed under the Basel III NPR. Many of the proposed definitions also are applicable to the Standardized Approach NPR. This addendum to the NPR is found at [insert reference to Federal Register notice].

the banking system to absorb losses in times of future market and economic stress.[11] This NPR proposes the majority of the revisions to international capital standards in Basel III, including a more restrictive definition of regulatory capital, higher minimum regulatory capital requirements, and a capital conservation and a countercyclical capital buffer, to enhance the ability of banking organizations to absorb losses and continue to operate as financial intermediaries during periods of economic stress. [12] The proposal would place limits on banking organizations' capital distributions and certain discretionary bonuses if they do not hold specified "buffers" of common equity tier 1 capital in excess of the new minimum capital requirements.

This NPR also includes a leverage ratio contained in Basel III that incorporates certain off-balance sheet assets in the denominator (supplementary leverage ratio). The supplementary leverage ratio would apply only to banking organizations that use the advanced approaches rules (advanced approaches banking organizations). The current leverage ratio requirement (computed using the proposed new definition of capital) would continue to apply to all banking organizations, including advanced approaches banking organizations.

In this NPR, the agencies also propose revisions to the agencies' prompt corrective action (PCA) rules to incorporate the proposed revisions to the minimum regulatory capital ratios.[13]

Standardized Approach NPR

The Standardized Approach NPR aims to enhance the risk-sensitivity of the agencies' capital requirements by revising the calculation of risk-weighted assets. It would do this by incorporating aspects of the Basel II Standardized Approach, including aspects of the 2009 "Enhancements to the Basel II Framework" (2009 Enhancements), and other changes designed to improve the risk-sensitivity of the general risk-based capital requirements. The proposed changes are described in further detail in the preamble to the Standardized Approach NPR. [14] As compared to the general risk-based capital rules, the Standardized Approach NPR includes a greater number of exposure categories for purposes of calculating total risk-weighted assets, provides for greater recognition of financial collateral, and permits a wider range of eligible guarantors. In addition, to increase transparency in the derivatives market, the Standardized Approach NPR would provide a more favorable capital treatment for derivative and repo-style

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[11] BCBS published Basel III in December 2010 and revised it in June 2011. The text is available at http://www.bis.org/publ/bcbs189.htm. This NPR does not incorporate the Basel III reforms related to liquidity risk management, published in December 2010, "Basel III: International Framework for Liquidity Risk Measurement, Standards and Monitoring." The agencies expect to propose rules to implement the Basel III liquidity provisions in a separate rulemaking.

[12] Selected aspects of Basel III that would apply only to advanced approaches banking organizations are proposed in the Advanced Approaches and Market Risk NPR.

[13] 12 CFR part 6, 12 CFR 165 (OCC); 12 CFR part 208, subpart E (Board); 12 CFR part 325 and part 390, subpart Y (FDIC).

[14] See BCBS, "Enhancements to the Basel II Framework" (July 2009), available at http://www.bis.org/publ/bcbs157.htm (2009 Enhancements). See also BCBS, "International Convergence of Capital Measurement and Capital Standards: A Revised Framework," (June 2006), available at http://www.bis.org/publ/bcbs128.htm (Basel II).

transactions cleared through central counterparties (as compared to the treatment for bilateral transactions) in order to create an incentive for banking organizations to enter into cleared transactions. Further, to promote transparency and market discipline, the Standardized Approach NPR proposes disclosure requirements that would apply to top-tier banking organizations domiciled in the United States with $50 billion or more in total assets that are not subject to disclosure requirements under the advanced approaches rule.

In the Standardized Approach NPR, the agencies also propose to revise the calculation of risk-weighted assets for certain exposures, consistent with the requirements of section 939A of the Dodd-Frank Act by using standards of creditworthiness that are alternatives to credit ratings. These alternative standards would be used to assign risk weights to several categories of exposures, including sovereigns, public sector entities, depository institutions, and securitization exposures. These alternative standards and risk-based capital requirements have been designed to result in capital requirements that are consistent with safety and soundness, while also exhibiting risk sensitivity to the extent possible. Furthermore, these capital requirements are intended to be similar to those generated under the Basel capital framework.

The Standardized Approach NPR would require banking organizations to implement the revisions contained in that NPR on January 1, 2015; however, the proposal would also allow banking organizations to early adopt the Standardized Approach revisions.

Advanced Approaches and Market Risk NPR

The proposals in the Advanced Approaches and Market Risk NPR would amend the advanced approaches rules and integrate the agencies' revised market risk rules into the codified regulatory capital rules.[15] The Advanced Approaches and Market Risk NPR would incorporate revisions to the Basel capital framework published by the BCBS in a series of documents between 2009 and 2011, including the 2009 Enhancements and Basel III. The proposals would also revise the advanced approaches rules to achieve consistency with relevant provisions of the Dodd-Frank Act.

Significant proposed revisions to the advanced approaches rules include the treatment of counterparty credit risk, the methodology for computing risk-weighted assets for securitization exposures, and risk weights for exposures to central counterparties. For example, the Advanced Approaches and Market Risk NPR proposes capital requirements to account for credit valuation adjustments (CVA), wrong-way risk, cleared derivative and repo-style transactions (similar to proposals in the Standardized Approach NPR) and default fund contributions to central counterparties. The Advanced Approaches and Market Risk NPR would also require banking organizations subject to the advanced approaches rules (advanced approaches banking organizations) to conduct more rigorous credit analysis of securitization exposures and implement certain disclosure requirements.

The Advanced Approaches and Market Risk NPR additionally proposes to remove the ratings-based approach and the internal assessment approach from the current advanced

[15] The agencies' market risk rules are revised by a final rule published elsewhere today in the Federal Register.

approaches rules' securitization hierarchy consistent with section 939A of the Dodd-Frank Act, and to include in the hierarchy the simplified supervisory formula approach (SSFA) as a methodology to calculate risk-weighted assets for securitization exposures. The SSFA methodology is also proposed in the Standardized Approach NPR and is included in the market risk rule. The agencies also are proposing to remove references to credit ratings from certain defined terms under the advanced approaches rules and replace them with alternative standards of creditworthiness.

Banking organizations currently subject to the advanced approaches rule would continue to be subject to the advanced approaches rules. In addition, the Board proposes to apply the advanced approaches and market risk rules to savings and loan holding companies, and the OCC and FDIC propose to apply the market risk rules to federal and state savings associations that meet the scope of application of those rules, respectively.

For advanced approaches banking organizations, the regulatory capital requirements proposed in this NPR and the Standardized Approach NPR would be "generally applicable" capital requirements for purposes of section 171 of the Dodd-Frank Act.[16]

Proposed Structure of the Agencies' Regulatory Capital Framework and Key Provisions of the Three Proposals

In connection with the changes proposed in the three NPRs, the agencies intend to codify their current regulatory capital requirements under applicable statutory authority. Under the revised structure, each agency's capital regulations would include definitions in Subpart A. The minimum risk-based and leverage capital requirements and buffers would be contained in Subpart B and the definition of regulatory capital would be included in Subpart C. Subpart D would include the risk-weighted asset calculations required of all banking organizations; these proposed risk-weighted asset calculations are described in the Standardized Approach NPR. Subpart E would contain the advanced approaches rules, including changes made pursuant to the advanced approach NPR. The market risk rule would be contained in Subpart F. Transition provisions would be in Subpart G. The agencies believe that this revision would reduce the burden associated with multiple reference points for applicable capital requirements, promote consistency of capital rules across the banking agencies, and reduce repetition of certain features, such as definitions, across the rules.

Table 1 outlines the proposed structure of the agencies' capital rules, as well as references to the proposed revisions to the PCA rules.

[16] See 12 U.S.C. 5371.

Table 1—The Proposed Structure of the Agencies' Capital Rules and Proposed Revisions to the PCA Framework

Subpart or Regulation	Description of Content
Subpart A (included in the Basel III NPR)	Purpose; applicability; reservation of authority; definitions.
Subpart B (included in the Basel III NPR)	Minimum capital requirements; minimum leverage capital requirements; capital buffers.
Subpart C (included in the Basel III NPR)	Regulatory capital: eligibility criteria, minority interest, adjustments and deductions.
Subpart D (included in the Standardized Approach NPR)	Calculation of standardized total risk-weighted assets for general credit risk, off-balance sheet items, OTC derivative contracts, cleared transactions and default fund contributions, unsettled transactions, securitization exposures, and equity exposures. Description of credit risk mitigation.
Subpart E (included in the Advanced Approaches and Market Risk NPR)	Calculation of advanced approaches total risk-weighted assets.
Subpart F (included in the Advanced Approaches and Market Risk NPR)	Calculation of market risk-weighted assets.
Subpart G (included in the Basel III NPR)	Transition provisions.
Subpart D of Regulation H (Board) 12 CFR part 6 (OCC) Subpart H of part 324 (FDIC)	Revised PCA capital framework, including introduction of a common equity tier 1 capital threshold; revision of the current PCA thresholds to incorporate the proposed regulatory capital minimums; an update of the definition of tangible common equity, and, for advanced approaches organizations only, a supplementary leverage ratio.

While the agencies are mindful that the proposal will result in higher capital requirements and costs associated with changing systems to calculate capital requirements, the agencies believe that the proposed changes are necessary to address identified weaknesses in the agencies' current capital rules; strengthen the banking sector and help reduce risk to the deposit insurance fund and the financial system; and revise the agencies' capital rules consistent with the

international agreements and U.S. law. Accordingly, this NPR includes transition arrangements that aim to provide banking organizations sufficient time to adjust to the proposed new rules and that are generally consistent with the transitional arrangements of the Basel capital framework.

In December 2010, the BCBS conducted a quantitative impact study of internationally active banks to assess the impact of the capital adequacy standards announced in July 2009 and the Basel III proposal published in December 2009. Overall, the BCBS found that as a result of the proposed changes, banking organizations surveyed will need to hold more capital to meet the new minimum requirements. In addition, quantitative analysis by the Macroeconomic Assessment Group, a working group of the BCBS, found that the stronger Basel capital requirements would lower the probability of banking crises and their associated output losses while having only a modest negative impact on gross domestic product and lending costs, and that the negative impact could be mitigated by phasing the requirements in over time.[17] The agencies believe that the benefits of these changes to the U.S. financial system, in terms of the reduction of risk to the deposit insurance fund and the financial system, ultimately outweigh the burden on banking organizations of compliance with the new standards.

As part of developing this proposal, the agencies conducted an impact analysis using depository institution and bank holding company regulatory reporting data to estimate the change in capital that banking organizations would be required to hold to meet the proposed minimum capital requirements. The impact analysis assumed the proposed definition of capital for purposes of the numerator and the proposed standardized risk-weights for purposes of the denominator, and made stylized assumptions in cases where necessary input data were unavailable from regulatory reports. Based on the agencies' analysis, the vast majority of banking organizations currently would meet the fully phased-in minimum capital requirements as of March 31, 2012, and those organizations that would not meet the proposed minimum requirements should have ample time to adjust their capital levels by the end of the transition period.

Table 2 summarizes key changes proposed in the Basel III and Standardized Approach NPRs and how these changes compare to the agencies' general risk-based and leverage capital rules.

[17] See "Assessing the Macroeconomic Impact of the Transition to Stronger Capital and Liquidity Requirements" (August 2010), available at http://www.bis.org/publ/othp10.pdf; "An assessment of the long-term economic impact of stronger capital and liquidity requirements" (August 2010), available at http://www.bis.org/publ/bcbs173.pdf.

Table 2— Key Provisions of the Basel III and Standardized Approach NPRs as Compared to the Current Risk-Based and Leverage Capital Rules

Aspect of Proposed Requirements	Proposed Treatment
Basel III NPR	
Minimum Capital Ratios	
Common equity tier 1 capital ratio (section 10)	Introduces a minimum requirement of 4.5 percent.
Tier 1 capital ratio (section 10)	Increases the minimum requirement from 4.0 percent to 6.0 percent.
Total capital ratio (section 10)	Minimum unchanged (remains at 8.0 percent).
Leverage ratio (section 10)	Modifies the minimum leverage ratio requirement based on the new definition of tier 1 capital. Introduces a supplementary leverage ratio requirement for advanced approaches banking organizations.
Components of Capital and Eligibility Criteria for Regulatory Capital Instruments (sections 20-22)	Enhances the eligibility criteria for regulatory capital instruments and adds certain adjustments to and deductions from regulatory capital, including increased deductions for MSAs and DTAs and new limits on the inclusion of minority interests in capital. Provides that unrealized gains and losses on all AFS securities and gains and losses associated with certain cash flow hedges flow through to common equity tier 1 capital.
Capital Conservation Buffer (section 11)	Introduces a capital conservation buffer of common equity tier 1 capital above the minimum risk-based capital requirements, which must be maintained to avoid restrictions on capital distributions and certain discretionary bonus payments.

Countercyclical Capital Buffer (section 11)	Introduces for advanced approaches banking organizations a mechanism to increase the capital conservation buffer during times of excessive credit growth.
Standardized Approach NPR	
Risk-weighted Assets	
Credit exposures to: U.S. government and its agencies U.S. government-sponsored entities U.S. depository institutions and credit unions U.S. public sector entities, such as states and municipalities (section 32)	Unchanged.
Credit exposures to: Foreign sovereigns Foreign banks Foreign public sector entities (section 32)	Introduces a more risk-sensitive treatment using the Country Risk Classification measure produced by the Organization for Economic Cooperation and Development.
Corporate exposures (section 32)	Assigns a 100 percent risk weight to corporate exposures, including exposures to securities firms.
Residential mortgage exposures (section 32)	Introduces a more risk-sensitive treatment based on several criteria, including certain loan characteristics and the loan-to-value-ratio of the exposure.
High volatility commercial real estate exposures (section 32)	Applies a 150 percent risk weight to certain credit facilities that finance the acquisition, development or construction of real property.
Past due exposures	Applies a 150 percent risk weight to exposures that are not sovereign exposures or residential

(section 32)	mortgage exposures and that are more than 90 days past due or on nonaccrual.
Securitization exposures (sections 41-45)	Maintains the gross-up approach for securitization exposures. Replaces the current ratings-based approach with a formula-based approach for determining a securitization exposure's risk weight based on the underlying assets and exposure's relative position in the securitization's structure.
Equity exposures (sections 51-53)	Introduces more risk-sensitive treatment for equity exposures.
Off-balance Sheet Items (sections 33)	Revises the measure of the counterparty credit risk of repo-style transactions. Raises the credit conversion factor for most short-term commitments from zero percent to 20 percent.
Derivative Contracts (section 34)	Removes the 50 percent risk weight cap for derivative contracts.
Cleared Transactions (section 35)	Provides preferential capital requirements for cleared derivative and repo-style transactions (as compared to requirements for non-cleared transactions) with central counterparties that meet specified standards. Also requires that a clearing member of a central counterparty calculate a capital requirement for its default fund contributions to that central counterparty.
Credit Risk Mitigation (section 36)	Provides a more comprehensive recognition of collateral and guarantees.
Disclosure Requirements (sections 61-63)	Introduces qualitative and quantitative disclosure requirements, including regarding regulatory capital instruments, for banking organizations with total consolidated assets of $50 billion or more that are not subject to the separate advanced approaches disclosure

	requirements.

Under section 165 of the Dodd-Frank Act, the Board is required to establish the enhanced risk-based and leverage capital requirements for bank holding companies with total consolidated assets of $50 billion or more and nonbank financial companies that the Financial Stability Oversight Council has designated for supervision by the Board (collectively, covered companies).[18] The Board published for comment in the Federal Register on January 5, 2012, a proposal regarding the enhanced prudential standards and early remediation requirements. The capital requirements as proposed in the three NPRs would become a key part of the Board's overall approach to enhancing the risk-based capital and leverage standards applicable to covered companies in accordance with section 165 of the Dodd-Frank Act.[19] In addition, the Board intends to supplement the enhanced risk-based capital and leverage requirements included in its January 2012 proposal with a subsequent proposal to implement a quantitative risk-based capital surcharge for covered companies or a subset of covered companies. The BCBS is calibrating a methodology for assessing an additional capital surcharge for global systemically important banks.[20] The Board intends to propose a quantitative risk-based capital surcharge in the United States based on the BCBS approach and consistent with the BCBS's implementation timeframe. The forthcoming proposal would contemplate adopting implementing rules in 2014, and requiring G–SIBs to meet the capital surcharges on a phased-in basis from 2016–2019. The OCC also is reviewing the BCBS proposal and is considering whether to propose to apply a similar surcharge for globally significant national banks.

Question 1: The agencies solicit comment on all aspects of the proposals including comment on the specific issues raised throughout this preamble. Commenters are requested to provide a detailed qualitative or quantitative analysis, as appropriate, as well as any relevant data and impact analysis to support their positions.

B. Background

In 1989, the agencies established a risk-based capital framework for U.S. national banks, state member and nonmember banks, and bank holding companies with the general risk-based capital rules.[21] The agencies based the framework on the "International Convergence of Capital Measurement and Capital Standards" (Basel I), released by the BCBS in 1988.[22] The general risk-based capital rules instituted a uniform risk-based capital system that was more risk-

[18] See section 165 of the Dodd-Frank Act (12 U.S.C. 5365).

[19] 77 FR 594 (January 5, 2012).

[20] See "Global Systemically Important Banks: Assessment Methodology and the Additional Loss Absorbency Requirement" (July 2011), available at http://www.bis.org/publ/bcbs201.pdf.

[21] See 54 FR 4186 (January 27, 1989) (Board); 54 FR 4168 (January 27, 1989) (OCC); 54 FR 11500 (March 21, 1989).

[22] BCBS, International Convergence of Capital Measurement and Capital Standards (July 1988), available at http://www.bis.org/publ/bcbs04a.htm.

sensitive than, and addressed several shortcomings in, the regulatory capital rules in effect prior to 1989. The agencies' capital rules also included a minimum leverage measure of capital to total assets, established in the early 1980s, to place a constraint on the maximum degree to which a banking organization can leverage its capital base.

In 2004, the BCBS introduced a new international capital adequacy framework (Basel II) that was intended to improve risk measurement and management processes and to better align minimum risk-based capital requirements with risk of the underlying exposures.[23] Basel II is designed as a "three pillar" framework encompassing risk-based capital requirements for credit risk, market risk, and operational risk (Pillar 1); supervisory review of capital adequacy (Pillar 2); and market discipline through enhanced public disclosures (Pillar 3). To calculate risk-based capital requirements for credit risk, Basel II provides three approaches: the standardized approach (Basel II standardized approach), the foundation internal ratings-based approach, and the advanced internal ratings-based approach. Basel II also introduces an explicit capital requirement for operational risk, which may be calculated using one of three approaches: the basic indicator approach, the standardized approach, or the advanced measurement approaches. On December 7, 2007, the agencies implemented the advanced approaches rules that incorporated Basel II advanced internal ratings-based approach for credit risk and the advanced measurement approaches for operational risk.[24]

To address some of the shortcomings in the international capital standards exposed during the crisis, the BCBS issued the "2009 Enhancements" in July 2009 to enhance certain risk-based capital requirements and to encourage stronger management of credit and market risk. The "2009 Enhancements" strengthen the risk-based capital requirements for certain securitization exposures to better reflect their risk, increase the credit conversion factors for certain short-term liquidity facilities, and require that banking organizations conduct more rigorous credit analysis of their exposures.[25]

In 2010, the BCBS published a comprehensive reform package, Basel III, which is designed to improve the quality and the quantity of regulatory capital and to build additional capacity into the banking system to absorb losses in times of future market and economic stress. Basel III introduces or enhances a number of capital standards, including a stricter definition of regulatory capital, a minimum tier 1 common equity ratio, the addition of a regulatory capital buffer, a leverage ratio, and a disclosure requirement for regulatory capital instruments. Implementing Basel III is the focus of this NPR, as described below. Certain elements of Basel III are also proposed in the Standardized Approach NPR and the Advanced Approaches and Market Risk NPR, as discussed in those notices.

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[23] See "International Convergence of Capital Measurement and Capital Standards: A Revised Framework" (June 2006), available at http://www.bis.org/publ/bcbs128.htm.

[24] See 72 FR 69288 (December 7, 2007).

[25] In July 2009, the BCBS also issued "Revisions to the Basel II Market Risk Framework," available at http://www.bis.org/publ/bcbs193.htm. The agencies issued an NPR in January 2011 and a supplement in December 2011 that included provisions to implement the market-risk related provisions. 76 FR 1890 (January 11, 2011); 76 FR 79380 (December 21, 2011).

Quality and Quantity of Capital

The recent financial crisis demonstrated that the amount of high-quality capital held by banks globally was insufficient to absorb losses during that period. In addition, some non-common stock capital instruments included in tier 1 capital did not absorb losses to the extent previously expected. A lack of clear and easily understood disclosures regarding the amount of high-quality regulatory capital and characteristics of regulatory capital instruments, as well as inconsistencies in the definition of capital across jurisdictions, contributed to the difficulties in evaluating a bank's capital strength. To evaluate banks' creditworthiness and overall stability more accurately, market participants increasingly focused on the amount of banks' tangible common equity, the most loss-absorbing form of capital.

The crisis also raised questions about banks' ability to conserve capital during a stressful period or to cancel or defer interest payments on tier 1 capital instruments. For example, in some jurisdictions banks exercised call options on hybrid tier 1 capital instruments, even when it became apparent that the banks' capital positions would suffer as a result.

Consistent with Basel III, the proposals in this NPR would address these deficiencies by imposing, among other requirements, stricter eligibility criteria for regulatory capital instruments and increasing the minimum tier 1 capital ratio from 4 to 6 percent. To help ensure that a banking organization holds truly loss-absorbing capital, the proposal also introduces a minimum common equity tier 1 capital to total risk-weighted assets ratio of 4.5 percent. In addition, the proposals would require that most regulatory deductions from, and adjustments to, regulatory capital (for example, the deductions related to mortgage servicing assets (MSAs) and deferred tax assets (DTAs)) be applied to common equity tier 1 capital. The proposals would also eliminate certain features of the current risk-based capital rules, such as adjustments to regulatory capital to neutralize the effect on the capital account of unrealized gains and losses on AFS debt securities. To reduce the double counting of regulatory capital, Basel III also limits investments in the capital of unconsolidated financial institutions that would be included in regulatory capital and requires deduction from capital if a banking organization has exposures to these institutions that go beyond certain percentages of its common equity tier 1 capital. Basel III also revises risk-weights associated with certain items that are subject to deduction from regulatory capital.

Finally, to promote transparency and comparability of regulatory capital across jurisdictions, Basel III introduces public disclosure requirements, including those for regulatory capital instruments, that are designed to help market participants assess and compare the overall stability and resiliency of banking organizations across jurisdictions.

Capital Conservation and Countercyclical Capital Buffer

As noted previously, some banking organizations continued to pay dividends and substantial discretionary bonuses even as their financial condition weakened as a result of the recent financial crisis and economic downturn. Such capital distributions had a significant negative impact on the overall strength of the banking sector. To encourage better capital conservation by banking organizations and to improve the resiliency of the banking system, Basel III and this proposal include limits on capital distributions and discretionary bonuses for

banking organizations that do not hold a specified amount of common equity tier 1 capital in addition to the common equity necessary to meet the minimum risk-based capital requirements (capital conservation buffer).

Under this proposal, for advanced approaches banking organizations, the capital conservation buffer may be expanded by up to 2.5 percent of risk-weighted assets if the relevant national authority determines that financial markets in its jurisdiction are experiencing a period of excessive aggregate credit growth that is associated with an increase in system-wide risk. The countercyclical capital buffer is designed to take into account the macro-financial environment in which banking organizations function and help protect the banking system from the systemic vulnerabilities.

Basel III Leverage Ratio

Since the early 1980s, U.S. banking organizations have been subject to a minimum leverage measure of capital to total assets designed to place a constraint on the maximum degree to which a banking organization can leverage its equity capital base. However, prior to the adoption of Basel III, the Basel capital framework did not include a leverage ratio requirement. It became apparent during the crisis that some banks built up excessive on- and off-balance sheet leverage while continuing to present strong risk-based capital ratios. In many instances, banks were forced by the markets to reduce their leverage and exposures in a manner that increased downward pressure on asset prices and further exacerbated overall losses in the financial sector.

The BCBS introduced a leverage ratio (the Basel III leverage ratio) to discourage the acquisition of excess leverage and to act as a backstop to the risk-based capital requirements. The Basel III leverage ratio is defined as the ratio of tier 1 capital to a combination of on- and off-balance sheet assets; the minimum ratio is 3 percent. The introduction of the leverage requirement in the Basel capital framework should improve the resiliency of the banking system worldwide by providing an ultimate limit on the amount of leverage a banking organization may incur.

As described in section II.B of this preamble, the agencies are proposing to apply the Basel III leverage ratio only to advanced approaches banking organizations as an additional leverage requirement (supplementary leverage ratio). For all banking organizations, the agencies are proposing to update and maintain the current leverage requirement, as revised to reflect the proposed definition of tier 1 capital.

Additional Revisions to the Basel Capital Framework

To facilitate the implementation of Basel III, the BCBS issued a series of releases in 2011 in the form of the frequently asked questions.[26] In addition, in 2011, the BCBS proposed to revise the treatment of counterparty credit risk and specific capital requirements for derivative and repo-style transaction exposures to central counterparties (CCPs) to address concerns related

[26] See, e.g., "Basel III FAQs answered by the Basel Committee" (July, October, December 2011), available at http://www.bis.org/list/press_releases/index.htm.

to the interconnectedness and complexity of the derivatives markets.[27] The proposed revisions provide incentives for banking organizations to clear derivatives and repo-style transactions through qualifying central counterparties (QCCPs) to help promote market transparency and improve the ability of market participants to unwind their positions quickly and efficiently. The agencies have incorporated these provisions in the Standardized Approach NPR and the Advanced Approaches and Market Risk NPR.

II. Minimum Regulatory Capital Ratios, Additional Capital Requirements, and Overall Capital Adequacy

A. Minimum Risk-Based Capital Ratios and Other Regulatory Capital Provisions

Consistent with Basel III, the agencies are proposing to require that banking organizations comply with the following minimum capital ratios: (i) a common equity tier 1 capital ratio of 4.5 percent; (ii) a tier 1 capital ratio of 6 percent; (iii) a total capital ratio of 8 percent; and (iv) a tier 1 capital to average consolidated assets of 4 percent and, for advanced approaches banking organizations only, an additional requirement tier 1 capital to total leverage exposure ratio of 3 percent.[28] As noted above, the common equity tier 1 capital ratio would be a new minimum requirement. It is designed to ensure that banking organizations hold high-quality regulatory capital that is available to absorb losses. The proposed capital ratios would apply to a banking organization on a consolidated basis.

Under this NPR, tier 1 capital would equal the sum of common equity tier 1 capital and additional tier 1 capital. Total capital would consist of three capital components: common equity tier 1, additional tier 1, and tier 2 capital. The definitions of each of these categories of regulatory capital are discussed below in section III of this preamble. To align the proposed regulatory capital requirements with the agencies' current PCA rules, this NPR also would incorporate the proposed revisions to the minimum capital requirements into the agencies' PCA framework, as further discussed in section II.E of this preamble.

In addition, a banking organization would be subject to a capital conservation buffer in excess of the risk-based capital requirements that would impose limitations on its capital distributions and certain discretionary bonuses, as described in sections II.C and II.D of this preamble. Because the regulatory capital buffer would apply in addition to the regulatory minimum requirements, the restrictions on capital distributions and discretionary bonus payments associated with the regulatory capital buffer would not give rise to any applicable restrictions under section 38 of the Federal Deposit Insurance Act and the agencies'

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[27] The BCBS left unchanged the treatment of exposures to CCPs for settlement of cash transactions such as equities, fixed income, spot foreign exchange and spot commodities. See "Capitalization of Banking Organization Exposures to Central Counterparties" (December 2010, revised November 2011) (CCP consultative release), available at http://www.bis.org/publ/bcbs206.pdf.

[28] Advanced approaches banking organizations should refer to section 10 of the proposed rule text and to the Advanced Approaches and Market Risk NPR for a more detailed discussion of the applicable minimum capital ratios.

implementing PCA rules, which apply when an insured institution's capital levels drop below certain regulatory thresholds.[29]

As a prudential matter, the agencies have a long-established policy that banking organizations should hold capital commensurate with the level and nature of the risks to which they are exposed, which may entail holding capital significantly above the minimum requirements, depending on the nature of the banking organization's activities and risk profile. Section II.F of this preamble describes the requirement for overall capital adequacy of banking organizations and the supervisory assessment of an entity's capital adequacy.

Furthermore, consistent with the agencies' authority under the current capital rules, section 10(d) of the proposal includes a reservation of authority that would allow a banking organization's primary federal supervisor to require a banking organization to hold a different amount of regulatory capital than otherwise would be required under the proposal, if the supervisor determines that the regulatory capital held by the banking organization is not commensurate with a banking organization's credit, market, operational, or other risks.

B. Leverage Ratio

1. Minimum Tier 1 Leverage Ratio

Under the proposal, all banking organizations would remain subject to a 4 percent tier 1 leverage ratio, which would be calculated by dividing an organization's tier 1 capital by its average consolidated assets, minus amounts deducted from tier 1 capital. The numerator for this ratio would be a banking organization's tier 1 capital as defined in section 20 of the proposal. The denominator would be its average total on-balance sheet assets as reported on the banking organization's regulatory report, net of amounts deducted from tier 1 capital.[30]

In this NPR, the agencies are proposing to remove the tier 1 leverage ratio exception for banking organizations with a supervisory composite rating of 1 that exists under the current leverage rules.[31] This exception provides for a 3 percent tier 1 leverage measure for such institutions.[32] The current exception would also be eliminated for bank holding companies with

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[29] 12 U.S.C. 1831o; 12 CFR part 6, 12 CFR part 165 (OCC); 12 CFR part 208.45 (Board); 12 CFR 325.105, 12 CFR 390.455 (FDIC).

[30] Specifically, to determine average total on-balance sheet assets, bank holding companies and savings and loan holding companies would use the Consolidated Financial Statements for Bank Holding Companies (FR Y-9C); national banks, state member banks, state nonmember banks, and savings associations would use On-balance sheet Reports of Condition and Income (Call Report).

[31] Under the agencies' current rules, the minimum ratio of tier 1 capital to total assets for strong banking organizations (that is, rated composite "1" under the CAMELS system for state nonmember and national banks, "1" under UFIRS for state member banks, and "1" under RFI/CD for bank holding companies) not experiencing or anticipating significant growth is 3 percent. See 12 CFR 3.6, 12 CFR 167.8 (OCC); 12 CFR 208.43, 12 CFR part 225, Appendix B (Board); 12 CFR 325.3, 12 CFR 390.467 (FDIC).

[32] See 12 CFR 3.6 (OCC); 12 CFR part 208, appendix B and 12 CFR part 225, appendix D (Board); and 12 CFR part 325.3 (FDIC).

a supervisory composite rating of 1 and subject to the market risk rule. Accordingly, as proposed, all banking organizations would be subject to 4 percent minimum tier 1 leverage ratio.

2. Supplementary Leverage Ratio for Advanced Approaches Banking Organizations

Advanced approaches banking organizations would also be required to maintain the supplementary leverage ratio of tier 1 capital to total leverage exposure of 3 percent. The supplementary leverage ratio incorporates the Basel III definition of tier 1 capital as the numerator and uses a broader exposure base, including certain off-balance sheet exposures (total leverage exposure), for the denominator.

The agencies believe that the supplementary leverage ratio is most appropriate for advanced approaches banking organizations because these banking organizations tend to have more significant amounts of off-balance sheet exposures that are not captured by the current leverage ratio. Applying the supplementary leverage ratio rather than the current tier 1 leverage ratio to other banking organizations would increase the complexity of their leverage ratio calculation, and in many cases could result in a reduced leverage capital requirement. The agencies believe that, along with the 5 percent "well-capitalized" PCA leverage threshold described in section II.E of this preamble, the proposed leverage requirements are, for the majority of banking organizations that are not subject to the advanced approaches rule, both more conservative and simpler than the supplementary leverage ratio.

An advanced approaches banking organization would calculate the supplementary leverage ratio, including each of the ratio components, at the end of every month and then calculate a quarterly leverage ratio as the simple arithmetic mean of the three monthly leverage ratios over the reporting quarter. As proposed, total leverage exposure would equal the sum of the following exposures:

(1) The balance sheet carrying value of all of the banking organization's on-balance sheet assets; minus amounts deducted from tier 1 capital;

(2) The potential future exposure amount for each derivative contract to which the banking organization is a counterparty (or each single-product netting set for such transactions) determined in accordance with section 34 of the proposal;

(3) 10 percent of the notional amount of unconditionally cancellable commitments made by the banking organization; and

(4) The notional amount of all other off-balance sheet exposures of the banking organization (excluding securities lending, securities borrowing, reverse repurchase transactions, derivatives and unconditionally cancellable commitments).

The BCBS continues to assess the Basel III leverage ratio, including through supervisory monitoring during a parallel run period in which the proposed design and calibration of the Basel III leverage ratio will be evaluated, and the impact of any differences in national accounting frameworks material to the definition of the leverage ratio will be considered. A final decision by the BCBS on the measure of exposure for certain transactions and calibration of the leverage ratio is not expected until closer to 2018.

Due to these ongoing observations and international discussions on the most appropriate measurement of exposure for repo-style transactions, the agencies are proposing to maintain the current on-balance sheet measurement of repo-style transactions for purposes of calculating total leverage exposure. Under this NPR, a banking organization would measure exposure as the value of repo-style transactions (including repurchase agreements, securities lending and borrowing transactions, reverse repos) carried as an asset on the balance sheet, consistent with the measure of exposure used in the agencies' current leverage measure. The agencies are participating in international discussions and ongoing quantitative analysis of the exposure measure for repo-style transactions, and will consider modifying in the future the measurement of repo-style transactions in the calculation of total leverage exposure to reflect results of these international efforts.

The agencies are proposing to apply the supplementary leverage ratio as a requirement for advanced approaches banking organizations beginning in 2018, consistent with Basel III. However, beginning on January 1, 2015, advanced approaches banking organizations would be required to calculate and report their supplementary leverage ratio.

Question 2: The agencies solicit comments on all aspects of this proposal, including regulatory burden and competitive impact. Should all banking organizations, banking organizations with total consolidated assets above a certain threshold, or banking organizations with certain risk profiles (for examples, concentrations in derivatives) be required to comply with the supplementary leverage ratio, and why? What are the advantages and disadvantages of the application of two leverage ratio requirements to advanced approaches banking organizations?

Question 3: What modifications to the proposed supplementary leverage ratio should be considered and why? Are there alternative measures of exposure for repo-style transactions that should be considered by the agencies? What alternative measures should be used in cases in which the use of the current exposure method may overstate leverage (for example, in certain cases of calculating derivative exposure) or understate leverage (for example, in the case of credit protection sold)? The agencies request data and supplementary analysis that would support consideration of such alternative measures.

Question 4: Given differences in international accounting, particularly the difference in how International Financial Reporting Standards and GAAP treat securities for securities lending, the agencies solicit comments on the adjustments that should be contemplated to mitigate or offset such differences.

Question 5: The agencies solicit comments on the advantages and disadvantages of including off-balance sheet exposures in the supplementary leverage ratio. The agencies seek detailed comments, with supporting data, on the proposed method of calculating exposures and estimates of burden, particularly for off-balance sheet exposures.

C. Capital Conservation Buffer

Consistent with Basel III, the proposal incorporates a capital conservation buffer that is designed to bolster the resilience of banking organizations throughout financial cycles. The buffer would provide incentives for banking organizations to hold sufficient capital to reduce the

risk that their capital levels would fall below their minimum requirements during stressful conditions. The capital conservation buffer would be composed of common equity tier 1 capital and would be separate from the minimum risk-based capital requirements.

As proposed, a banking organization's capital conservation buffer would be the lowest of the following measures: (i) the banking organization's common equity tier 1 capital ratio minus its minimum common equity tier 1 capital ratio; (ii) the banking organization's tier 1 capital ratio minus its minimum tier 1 capital ratio; and (iii) the banking organization's total capital ratio minus its minimum total capital ratio.[33] If the banking organization's common equity tier 1, tier 1 or total capital ratio were less than or equal to its minimum common equity tier 1, tier 1 or total capital ratio, respectively, the banking organization's capital conservation buffer would be zero. For example, if a banking organization's common equity tier 1, tier 1, and total capital ratios are 7.5, 9.0, and 10 percent, respectively, and the banking organization's minimum common equity tier 1, tier 1, and total capital ratio requirements are 4.5, 6, and 8, respectively, the banking organization's applicable capital conservation buffer would be 2 percent for purposes of establishing a 60 percent maximum payout ratio under table 3.

Under the proposal, a banking organization would need to hold a capital conservation buffer in an amount greater than 2.5 percent of total risk-weighted assets (plus, for an advanced approaches banking organization, 100 percent of any applicable countercyclical capital buffer amount) to avoid being subject to limitations on capital distributions and discretionary bonus payments to executive officers, as defined under the proposal. The maximum payout ratio would be the percentage of eligible retained income that a banking organization would be allowed to pay out in the form of capital distributions and certain discretionary bonus payments during the current calendar quarter and would be determined by the amount of the capital conservation buffer held by the banking organization during the previous calendar quarter. Under the proposal, eligible retained income would be defined as a banking organization's net income (as reported in the banking organization's quarterly regulatory reports) for the four calendar quarters preceding the current calendar quarter, net of any capital distributions, certain discretionary bonus payments, and associated tax effects not already reflected in net income.

A banking organization's maximum payout amount for the current calendar quarter would be equal to the banking organization's eligible retained income, multiplied by the applicable maximum payout ratio in accordance with table 3. A banking organization with a capital conservation buffer that is greater than 2.5 percent (plus, for an advanced approaches banking organization, 100 percent of any applicable countercyclical buffer) would not be subject to a maximum payout amount as a result of the application of this provision (but the agencies' authority to restrict capital distributions for other reasons remains undiminished).

In a scenario where a banking organization's risk-based capital ratios fall below its minimum risk-based capital ratios plus 2.5 percent of total risk-weighted assets, the maximum payout ratio would also decline, in accordance with table 3. A banking organization that

[33] For purposes of the capital conservation buffer calculations, a banking organization would be required to use standardized total risk weighted assets if it is a standardized approach banking organization and it would be required to use advanced total risk weighted assets if it is an advanced approaches banking organization.

becomes subject to a maximum payout ratio would remain subject to restrictions on capital distributions and certain discretionary bonus payments until it is able to build up its capital conservation buffer through retained earnings, raising additional capital, or reducing its risk-weighted assets. In addition, as a general matter, a banking organization would not be able to make capital distributions or certain discretionary bonus payments during the current calendar quarter if the banking organization's eligible retained income is negative and its capital conservation buffer is less than 2.5 percent as of the end of the previous quarter.

As illustrated in table 3, the capital conservation buffer is divided into equal quartiles, each associated with increasingly stringent limitations on capital distributions and discretionary bonus payments to executive officers as the capital conservation buffer falls closer to zero percent. As described in more detail in the next section, each quartile, associated with a certain maximum payout ratio in table 3, would expand proportionately for advanced approaches banking organizations when the countercyclical capital buffer amount is greater than zero.

The agencies propose to define a capital distribution as: (1) a reduction of tier 1 capital through the repurchase of a tier 1 capital instrument or by other means; (2) a reduction of tier 2 capital through the repurchase, or redemption prior to maturity, of a tier 2 capital instrument or by other means; (3) a dividend declaration on any tier 1 capital instrument; (4) a dividend declaration or interest payment on any tier 2 capital instrument if such dividend declaration or interest payment may be temporarily or permanently suspended at the discretion of the banking organization; or (5) any similar transaction that the agencies determine to be in substance a distribution of capital. The proposed definition is similar in effect to the definition of capital distribution in the Board's rule requiring annual capital plan submissions for bank holding companies with $50 billion or more in total assets.[34]

The agencies propose to define a discretionary bonus payment as a payment made to an executive officer of a banking organization or an individual with commensurate responsibilities within the organization, such as a head of a business line, where: (1) the banking organization retains discretion as to the fact of the payment and as to the amount of the payment until the discretionary bonus is paid to the executive officer; (2) the amount paid is determined by the banking organization without prior promise to, or agreement with, the executive officer; and (3) the executive officer has no contract right, express or implied, to the bonus payment.

An executive officer would be defined as a person who holds the title or, without regard to title, salary, or compensation, performs the function of one or more of the following positions: president, chief executive officer, executive chairman, chief operating officer, chief financial officer, chief investment officer, chief legal officer, chief lending officer, chief risk officer, or head of a major business line, and other staff that the board of directors of the banking organization deems to have equivalent responsibility.[35] The purpose of limiting restrictions on discretionary bonus payments to executive officers is to focus these measures on the individuals within a banking organization who could expose the organization to the greatest risk. The

[34] See 12 CFR 225.8.

[35] See 76 FR 21170 (April 14, 2011).

agencies note that a banking organization may otherwise be subject to limitations on capital distributions under other laws or regulations.[36]

Table 3 shows the relationship between the capital conservation buffer and the maximum payout ratio. The maximum dollar amount that a banking organization would be permitted to pay out in the form of capital distributions or discretionary bonus payments during the current calendar quarter would be equal to the maximum payout ratio multiplied by the banking organization's eligible retained income. The calculation of the maximum payout amount would be made as of the last day of the previous calendar quarter and any resulting restrictions would apply during the current calendar quarter.

Table 3— Capital Conservation Buffer and Maximum Payout Ratio[37]

Capital conservation buffer (as a percentage of total risk-weighted assets)	**Maximum payout ratio (as a percentage of eligible retained income)**
Greater than 2.5 percent	No payout ratio limitation applies
Less than or equal to 2.5 percent, and greater than 1.875 percent	60 percent
Less than or equal to 1.875 percent, and greater than 1.25 percent	40 percent
Less than or equal to 1.25 percent, and greater than 0.625 percent	20 percent
Less than or equal to 0.625 percent	0 percent

For example, a banking organization with a capital conservation buffer between 1.875 and 2.5 percent (for example, a common equity tier 1 capital ratio of 6.5 percent, a tier 1 capital ratio of 8 percent, or a total capital ratio of 10 percent) as of the end of the previous calendar quarter would be allowed to distribute no more than 60 percent of its eligible retained income in the form of capital distributions or discretionary bonus payments during the current calendar quarter. That is, the banking organization would need to conserve at least 40 percent of its eligible retained income during the current calendar quarter.

A banking organization with a capital conservation buffer of less than or equal to 0.625 percent (for example, a banking organization with a common equity tier 1 capital ratio of 5.0 percent, a tier 1 capital ratio of 6.5 percent, or a total capital ratio of 8.5 percent) as of the end of

[36] See 12 U.S.C. 56, 60, and 1831o(d)(1); 12 CFR 1467a(f); see also 12 CFR 225.8.

[37] Calculations in this table are based on the assumption that the countercyclical buffer amount is zero.

the previous calendar quarter would not be permitted to make any capital distributions or discretionary bonus payments during the current calendar quarter.

In contrast, a banking organization with a capital conservation buffer of more than 2.5 percent (for example, a banking organization with a common equity tier 1 capital ratio of 7.5 percent, a tier 1 capital ratio of 9.0 percent, and a total capital ratio of 11.0 percent) as of the end of the previous calendar quarter would not be subject to restrictions on the amount of capital distributions and discretionary bonus payments that could be made during the current calendar quarter. Consistent with the agencies' current practice with respect to regulatory restrictions on dividend payments and other capital distributions, each agency would retain its authority to permit a banking organization supervised by that agency to make a capital distribution or a discretionary bonus payment, if the agency determines that the capital distribution or discretionary bonus payment would not be contrary to the purposes of the capital conservation buffer or the safety and soundness of the banking institution. In making such a determination, the agency would consider the nature and extent of the request and the particular circumstances giving rise to the request.

The agencies are proposing that banking organizations that are not subject to the advanced approaches rule would calculate their capital conservation buffer using total risk-weighted assets as calculated by all banking organizations, and that banking organizations subject to the advanced approaches rule would calculate the buffer using advanced approaches total risk-weighted assets. Under the proposed approach, internationally active U.S. banking organizations using the advanced approaches would face capital conservation buffers determined in a manner comparable to those of their foreign competitors. Depending on the difference in risk-weighted assets calculated under the two approaches, capital distributions and bonus restrictions applied to an advanced approaches banking organization could be more or less stringent than if its capital conservation buffer were based on risk-weighted assets as calculated by all banking organizations.

Question 6: The agencies seek comment on all aspects of the proposed capital buffer framework, including issues of domestic and international competitive equity, and the adequacy of the proposed buffer to provide incentives for banking organizations to hold sufficient capital to withstand a stress event and still remain above regulatory minimum capital levels. What are the advantages and disadvantages of requiring advanced approaches banking organizations to calculate their capital buffers using total risk-weighted assets that are the greater of standardized total risk-weighted assets and advanced total risk-weighted assets? What is the potential effect of the proposal on banking organizations' processes for planning and executing capital distributions and utilization of discretionary bonus payments to retain key staff? What modifications, if any, should the agencies consider?

Question 7: The agencies solicit comments on the scope of the definition of executive officer for purposes of the limitations on discretionary bonus payments under the proposal. Is the scope too broad or too narrow? Should other categories of employees that could expose the institution to material risk be included within the scope of employees whose discretionary bonuses could be subject to the restriction? If so, how should such a class of employees be defined? What are the potential implications for a banking organization of restricting

discretionary bonus payments for executive officers or for broader classes of employees? Please provide data and analysis to support your views.

Question 8: What are the pros and cons of the proposed definition for eligible retained income in the context of the proposed quarterly limitations on capital distributions and discretionary bonus payments?

Question 9: What would be the impact, if any, in terms of the cost of raising new capital, of not allowing a banking organization that is subject to a maximum payout ratio of zero percent to make a penny dividend to common stockholders? Please provide data to support any responses.

D. Countercyclical Capital Buffer

Under Basel III, the countercyclical capital buffer is designed to take into account the macro-financial environment in which banking organizations function and to protect the banking system from the systemic vulnerabilities that may build-up during periods of excessive credit growth, then potentially unwind in a disorderly way that may cause disruptions to financial institutions and ultimately economic activity. As proposed and consistent with Basel III, the countercyclical capital buffer would serve as an extension of the capital conservation buffer.

The agencies propose to apply the countercyclical capital buffer only to advanced approaches banking organizations, because large banking organizations generally are more interconnected with other institutions in the financial system. Therefore, the marginal benefits to financial stability from a countercyclical buffer function should be greater with respect to such institutions. Application of the countercyclical buffer to advanced approaches banking organizations also reflects the fact that making cyclical adjustments to capital requirements is costly for institutions to implement and the marginal costs are higher for smaller institutions.

The countercyclical capital buffer aims to protect the banking system and reduce systemic vulnerabilities in two ways. First, the accumulation of a capital buffer during an expansionary phase could increase the resilience of the banking system to declines in asset prices and consequent losses that may occur when the credit conditions weaken. Specifically, when the credit cycle turns following a period of excessive credit growth, accumulated capital buffers would act to absorb the above-normal losses that a banking organization would likely face. Consequently, even after these losses are realized, banking organizations would remain healthy and able to access funding, meet obligations, and continue to serve as credit intermediaries. Countercyclical capital buffers may also reduce systemic vulnerabilities and protect the banking system by mitigating excessive credit growth and increases in asset prices that are not supported by fundamental factors. By increasing the amount of capital required for further credit extensions, countercyclical capital buffers may limit excessive credit extension.

Consistent with Basel III, the agencies propose a countercyclical capital buffer that would augment the capital conservation buffer under certain circumstances, upon a determination by the agencies.

The countercyclical capital buffer amount in the U.S. would initially be set to zero, but it could increase if the agencies determine that there is excessive credit in the markets, possibly

leading to subsequent wide-spread market failures.[38] The agencies expect to consider a range of macroeconomic, financial, and supervisory information indicating an increase in systemic risk including, but not limited to, the ratio of credit to gross domestic product, a variety of asset prices, other factors indicative of relative credit and liquidity expansion or contraction, funding spreads, credit condition surveys, indices based on credit default swap spreads, options implied volatility, and measures of systemic risk. The agencies anticipate making such determinations jointly. Because the countercyclical capital buffer amount would be linked to the condition of the overall U.S. financial system and not the characteristics of an individual banking organization, the agencies expect that the countercyclical capital buffer amount would be the same at the depository institution and holding company levels.

To provide banking organizations with time to adjust to any changes, the agencies expect to announce an increase in the countercyclical capital buffer amount up to12 months prior to implementation. If the agencies determine that a more immediate implementation would be necessary based on economic conditions, the agencies may announce implementation of a countercyclical capital buffer in less than 12 months. The agencies would make their determination and announcement in accordance with any applicable legal requirements. The agencies would follow the same procedures in adjusting the countercyclical capital buffer applicable for exposures located in foreign jurisdictions.

A decrease in the countercyclical capital buffer amount would become effective the day following announcement or the earliest date permitted by applicable law or regulation. In addition, the countercyclical capital buffer amount would return to zero percent 12 months after its effective date, unless an agency announces a decision to maintain the adjusted countercyclical capital buffer amount or adjust it again before the expiration of the 12-month period.

In the United States, the countercyclical capital buffer would augment the capital conservation buffer by up to 2.5 percent of a banking organization's total risk-weighted assets. For other jurisdictions, an advanced approaches banking organization would determine its countercyclical capital buffer amount by calculating the weighted average of the countercyclical capital buffer amounts established for the national jurisdictions where the banking organization has private sector credit exposures, as defined below in this section. The contributing weight assigned to a jurisdiction's countercyclical capital buffer amount would be calculated by dividing the total risk-weighted assets for the banking organization's private sector credit exposures located in the jurisdiction by the total risk-weighted assets for all of the banking organization's private sector credit exposures.[39]

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[38] The proposed operation of the countercyclical capital buffer is also consistent with section 616(c) of the Dodd-Frank Act. See 12 U.S.C. 3907(a)(1).

[39] As described in the discussion of the capital conservation buffer, an advanced approaches banking organization would calculate its total risk-weighted assets using the advanced approaches rules for purposes of determining the capital conservation buffer amount. An advanced approaches banking organizations may also be subject to the capital plan rule and its stress testing provisions, which may have a separate effect on a banking organization's capital distributions. See 12 CFR 225.8.

As proposed, a private sector credit exposure would be defined as an exposure to a company or an individual that is included in credit risk-weighted assets, not including an exposure to a sovereign, the Bank for International Settlements, the European Central Bank, the European Commission, the International Monetary Fund, a multilateral development bank (MDB), a public sector entity (PSE), or a government sponsored entity (GSE).

The geographic location of a private sector credit exposure (that is not a securitization exposure) would be the national jurisdiction where the borrower is located (that is, where the borrower is incorporated, chartered, or similarly established or, if it is an individual, where the borrower resides). If, however, the decision to issue the private sector credit exposure is based primarily on the creditworthiness of the protection provider, the location of the non-securitization exposure would be the location of the protection provider. The location of a securitization exposure would be the location of the borrowers of the underlying exposures. If the borrowers on the underlying exposures are located in multiple jurisdictions, the location of a securitization exposure would be the location of the borrowers of the underlying exposures in one jurisdiction with the largest proportion of the aggregate unpaid principal balance of the underlying exposures.

Table 4 illustrates how an advanced approaches banking organization would calculate the weighted average countercyclical capital buffer. In the following example, the countercyclical capital buffer established in the various jurisdictions in which the banking organization has private sector credit exposures is reported in column A. Column B contains the banking organization's risk-weighted asset amounts for the private sector credit exposures in each jurisdiction. Column C shows the contributing weight for each countercyclical buffer amount, which is calculated by dividing each of the rows in column B by the total for column B. Column D shows the contributing weight applied to each countercyclical capital buffer amount, calculated as the product of the corresponding contributing weight (column C) and the countercyclical capital buffer set by each jurisdiction's national supervisor (column A). The sum of the rows in column D shows the banking organization's weighted average countercyclical capital buffer, which is 1.4 percent of risk-weighted assets.

Table 4—Example of Weighted Average Buffer Calculation for Advanced Approaches Banking Organizations

	(A) Countercyclical buffer amount set by national supervisor (percent)	(B) Banking organization's RWA for private sector credit exposures ($b)	(C) Contributing weight (column B/ column B total)	(D) Contributing weight applied to each countercyclical capital buffer amount (column A * column C)
Non-U.S. jurisdiction 1	2.0	250	0.29	0.6
Non-U.S. jurisdiction 2	1.5	100	0.12	0.2
U.S.	1	500	0.59	0.6
Total		850	1.00	1.4

A banking organization's maximum payout ratio for purposes of its capital conservation buffer would vary depending on its countercyclical buffer amount. For instance, if its countercyclical capital buffer amount is equal to zero percent of total risk-weighted assets, the banking organization that held only U.S. credit exposures would need to hold a combined capital conservation buffer of at least 2.5 percent to avoid restrictions on its capital distributions and certain discretionary bonus payments. However, if its countercyclical capital buffer amount is equal to 2.5 percent of total risk-weighted assets, the banking organization whose assets consist of only U.S. credit exposures would need to hold a combined capital conservation and countercyclical buffer of at least 5 percent to avoid restrictions on its capital distributions and discretionary bonus payments.

Question 10: The agencies solicit comment on potential inputs used in determining whether excessive credit growth is occurring and whether a formula-based approach might be useful in determining the appropriate level of the countercyclical capital buffer. What additional factors, if any, should the agencies consider when determining the countercyclical capital buffer amount? What are the pros and cons of using a formula-based approach and what factors might be incorporated in the formula to determine the level of the countercyclical capital buffer amount?

Question 11: The agencies solicit comment on the appropriateness of the proposed 12-month prior notification period to adjust to a newly implemented or adjusted countercyclical capital buffer amount.

E. Prompt Corrective Action Requirements

Section 38 of the Federal Deposit Insurance Act directs the federal banking agencies to take prompt corrective action (PCA) to resolve the problems of insured depository institutions at the least cost to the Deposit Insurance Fund.[40] To facilitate this purpose, the agencies have established five regulatory capital categories in the current PCA regulations that include capital thresholds for the leverage ratio, tier 1 risk-based capital ratio, and the total risk-based capital ratio for insured depository institutions. These five PCA categories under section 38 of the Act and the PCA regulations are: "well capitalized," "adequately capitalized," "undercapitalized," "significantly undercapitalized," and "critically undercapitalized." Insured depository institutions that fail to meet these capital measures are subject to increasingly strict limits on their activities, including their ability to make capital distributions, pay management fees, grow their balance sheet, and take other actions.[41] Insured depository institutions are expected to be closed within 90 days of becoming "critically undercapitalized," unless their primary federal regulator takes such other action as the agency determines, with the concurrence of the FDIC, would better achieve the purpose of PCA.[42]

All insured depository institutions, regardless of total asset size or foreign exposure, are required to compute PCA capital levels using the agencies' general risk-based capital rules, as supplemented by the market risk capital rule. Under this NPR, the agencies are proposing to augment the PCA capital categories by introducing a common equity tier 1 capital measure for four of the five PCA categories (excluding the critically undercapitalized PCA category).[43] In addition, the agencies are proposing to amend the current PCA leverage measure to include in the leverage measure for the "adequately capitalized" and "undercapitalized" capital categories for advanced approaches depository institutions an additional leverage ratio based on the leverage ratio in Basel III. All banking organizations would continue to be subject to leverage measure thresholds using the current tier 1, or "standard" leverage ratio in the form of tier 1 capital to total assets. In addition, the agencies are proposing to revise the three current capital measures for the five PCA categories to reflect the changes to the definition of capital, as provided in the proposed revisions to the agencies' PCA regulations.

The proposed changes to the current minimum PCA thresholds and the introduction of a new common equity tier 1 capital measure would take effect January 1, 2015. Consistent with transition provisions in Basel III, the proposed amendments to the current PCA leverage measure for advanced approaches depository institutions would take effect on January 1, 2018. In contrast, changes to the definitions of the individual capital components that are used to calculate the relevant capital measures under PCA would coincide with the transition arrangements discussed in section V of the preamble, or with the transition provisions of other capital regulations, as applicable. Thus, the changes to these definitions, including any deductions or

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[40] 12 U.S.C. 1831o.

[41] 12 U.S.C. 1831o(e) – (i). See 12 CFR part 6 (OCC); 12 CFR part 208, subpart D (Board); 12 CFR part 325, subpart B (FDIC).

[42] 12 U.S.C. 1831o(g)(3).

[43] See 12 U.S.C. 1831o(c)(1)(B)(i).

modifications to capital, automatically would flow through to the definitions in the PCA framework.

Table 5 sets forth the current risk-based and leverage capital thresholds for each of the PCA capital categories for insured depository institutions.

Table 5 – Current PCA Levels

Requirement	Total Risk-Based Capital (RBC) measure (total RBC ratio -- percent)	Tier 1 RBC measure (tier 1 RBC ratio -- percent)	Leverage measure (Tier 1 (standard) leverage ratio - - percent)	PCA requirements
Well Capitalized	≥ 10	≥6	≥ 5	None
Adequately Capitalized	≥ 8	≥4	≥ 4% (or ≥3)[44]	May limit nonbanking activities at DI's FHC and includes limits on brokered deposits
Undercapitalized	< 8	< 4	< 4 (or < 3)	Includes adequately capitalized restrictions, and also includes restrictions on asset growth; dividends; requires a capital plan
Significantly undercapitalized	< 6	< 3	< 3	Includes undercapitalized restrictions, and also includes restrictions on sub-debt payments

[44] The minimum ratio of tier 1 capital to total assets for strong depository institutions (rated composite "1" under the CAMELS system and not experiencing or anticipating significant growth) is 3 percent.

Critically undercapitalized	Tangible Equity to Total Assets ≤ 2	Generally receivership /conservatorship within 90 days

Table 6 sets forth the proposed risk-based and leverage capital thresholds for each of the PCA capital categories for insured depository institutions that are not advanced approaches banks. For each PCA category except critically undercapitalized, an insured depository institution would be required to meet a minimum common equity tier 1 capital ratio, in addition to a minimum tier 1 risk-based capital ratio, total risk-based capital ratio, and leverage ratio.

Table 6—Proposed PCA Levels for Insured Depository Institutions not Subject to the Advanced Approaches Rule

Requirement	Total RBC measure (total RBC ratio -- percent)	Tier 1 RBC measure (tier 1 RBC ratio -- percent)	Common Equity tier 1 RBC measure (common equity tier 1 RBC ratio (percent)	Leverage Measure (leverage ratio-- percent)	PCA requirements
Well Capitalized	≥ 10	≥ 8	≥6.5	≥ 5	Unchanged from current rules*
Adequately Capitalized	≥ 8	≥ 6	≥4.5	≥4	”
Undercapitalized	< 8	< 6	< 4.5	< 4	”
Significantly undercapitalized	< 6	< 4	< 3	< 3	”
Critically undercapitalized	Tangible Equity (defined as tier 1 capital plus non-tier 1 perpetual preferred stock) to Total Assets ≤ 2				”

*Additional restrictions on capital distributions that are not reflected in the agencies’ proposed revisions to the PCA regulations are described in section II.C of this preamble.

To be well capitalized, an insured depository institution would be required to maintain a total risk-based capital ratio equal to or greater than 10 percent; a tier 1 capital ratio equal to or greater than 8 percent; a common equity tier 1 capital ratio equal to or greater than 6.5 percent; and a leverage ratio equal to or greater than 5 percent. An adequately capitalized depository institution would be required to maintain a total risk-based capital ratio equal to or greater than 8 percent; a tier 1 capital ratio equal to or greater than 6 percent; common equity tier 1 capital ratio equal to or greater than 4.5 percent; and a leverage ratio equal to or greater than 4 percent.[45]

An insured depository institution would be considered undercapitalized under the proposal if its total capital ratio were less than 8 percent, or if its tier 1 capital ratio were less than 6 percent, if its common equity tier 1 ratio were less than 4.5 percent, or if its leverage ratio were less than 4 percent. If an institution's tier 1 capital ratio were less than 4 percent, or if its common equity tier 1 ratio were less than 3 percent, it would be considered significantly undercapitalized. The other numerical capital ratio thresholds for being significantly undercapitalized would be unchanged.[46]

Table 7 sets forth the proposed risk-based and leverage thresholds for advanced approaches depository institutions. As indicated in the table, in addition to the PCA requirements and categories described above, the leverage measure for advanced approaches depository institutions in the adequately capitalized and undercapitalized PCA capital categories would include a supplementary leverage ratio based on the Basel III leverage ratio.

[45] An insured depository institution is considered adequately capitalized if it meets the qualifications for the adequately capitalized capital category and does not qualify as well capitalized.

[46] Under current PCA standards, in order to qualify as well capitalized, an insured depository institution must not be subject to any written agreement, order, capital directive, or prompt corrective action directive issued by the Board pursuant to section 8 of the Federal Deposit Insurance Act, the International Lending Supervision Act of 1983, or section 38 of the Federal Deposit Insurance Act, or any regulation thereunder, to meet a maintain a specific capital level for any capital measure. See 12 CFR 6.4(b)(1)(iv) (OCC); 12 CFR 208.43(b)(1)(iv) (Board); 12 CFR 325.103(b)(1)(iv) (FDIC). The agencies are not proposing any changes to this requirement.

Table 7—Proposed PCA Levels for Insured Depository Institutions Subject to the Advanced Approaches Rule

Requirement	Total RBC measure (total RBC ratio -- percent)	Tier 1 RBC measure (tier 1 RBC ratio -- percent)	Common Equity tier 1 RBC measure (common equity tier 1 RBC ratio percent)	Leverage Measure		PCA requirements
				leverage ratio (percent)	Supplementary leverage ratio (percent)	
Well Capitalized	≥ 10	≥ 8	≥6.5	≥ 5	Not applicable	Unchanged from current rule*
Adequately Capitalized	≥ 8	≥ 6	≥4.5	≥4	≥ 3.0	”
Undercapitalized	< 8	< 6	< 4.5	< 4	<3.00	”
Significantly undercapitalized	< 6	< 4	< 3	< 3	Not applicable	”
Critically undercapitalized	Tangible Equity (defined as tier 1 capital plus non-tier 1 perpetual preferred stock) to Total Assets ≤ 2				Not applicable	”

*Additional restrictions on capital distributions that are not reflected in the agencies’ proposed revisions to the PCA regulations are described in section II.C of this preamble.

As discussed above, the agencies believe that the supplementary leverage ratio is an important measure of an advanced approaches depository institution’s ability to support its on- and off-balance sheet exposures, and advanced approaches institutions tend to have significant amounts of off-balance sheet exposures that are not captured by the current leverage ratio. Consistent with other minimum ratio requirements, the agencies propose that the minimum requirement for the supplementary leverage ratio in section 10 of the proposal would be the minimum supplementary leverage ratio a banking organization would need to maintain in order to be adequately capitalized. With respect to the other PCA categories (other than critically undercapitalized), the agencies are proposing ranges of minimum thresholds for comment. The agencies intend to specify the minimum threshold for each of those categories when the proposed PCA requirements are finalized.

Under the proposed PCA framework, for each measure other than the leverage measure, an advanced approaches depository institution would be well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized on the same basis as all other insured depository institutions. An advanced approaches bank would also be subject to the same thresholds with respect to the leverage ratio on the same basis as other insured depository institutions. In addition, with respect to the supplementary leverage ratio, in order to be adequately capitalized, an advanced approaches depository institution would be required to maintain a supplementary leverage ratio of greater than or equal to 3 percent. An advanced approaches depository institution would be undercapitalized if its supplementary leverage ratio were less than 3 percent.

Question 12: The agencies seek comment regarding the proposed incorporation of the supplementary leverage ratio into the PCA framework, as well as the proposed ranges of PCA categories for the supplementary leverage ratio. Within the proposed ranges, what is the appropriate percentage for each PCA category? Please provide data to support your answer.

As discussed in section II of this preamble, the current PCA framework permits an insured depository institution that is rated composite 1 under the CAMELS rating system and not experiencing or anticipating significant growth to maintain a 3 percent ratio of tier 1 capital to average total consolidated assets (leverage ratio) rather than the 4.0 percent minimum leverage ratio that is otherwise required for an institution to be adequately capitalized under PCA. The agencies believe that it would be appropriate for all insured depository institutions, regardless of their CAMELS rating, to meet the same minimum leverage ratio requirements. Accordingly, the agencies propose to eliminate the 3 percent leverage ratio requirement for insured depository institutions with composite 1 CAMELS ratings.

The proposal would increase some of the existing PCA capital requirements while maintaining the structure of current PCA framework. For example, similar to the current PCA requirements, the risk-based capital ratios for well capitalized banking organizations would be two percentage points higher than the ratios for adequately capitalized banking organizations. The tier 1 leverage ratio for well capitalized banking organizations would be one percentage point higher than for adequately capitalized banking organizations. While the PCA levels do not explicitly incorporate the capital conservation buffer, the agencies believe that the PCA and capital conservation buffer frameworks will complement each other to ensure that banking organizations hold an adequate amount of common equity tier 1 capital.

The determination of whether an insured depository institution is critically undercapitalized for PCA purposes is based on its ratio of tangible equity to total assets. This is a statutory requirement within the PCA framework, and the experience of the recent financial crisis has confirmed that tangible equity is of critical importance in assessing the viability of an insured depository institution. Tangible equity for PCA purposes is currently defined as including core capital elements, which consist of (i) common stock holder's equity, (ii) qualifying noncumulative perpetual preferred stock (including related surplus), and (iii) minority interest in the equity accounts of consolidated subsidiaries; plus outstanding cumulative preferred perpetual stock; minus all intangible assets except mortgage servicing rights that are included in tier 1 capital. The current PCA definition of tangible equity does not address the

treatment of DTAs in determining whether an insured depository institution is critically undercapitalized.

The agencies propose to clarify the calculation of the capital measures for the critically undercapitalized PCA category by revising the definition of tangible equity to consist of tier 1 capital, plus outstanding perpetual preferred stock (including related surplus) not included in tier 1 capital. The revised definition would more appropriately align the calculation of tangible equity with the calculation of tier 1 capital generally for regulatory capital requirements. Assets included in a banking organization's equity account under GAAP, such as DTAs, would be included in tangible equity only to the extent that they are included in tier 1 capital. This modification should promote consistency and provide for clearer boundaries across and between the various PCA categories. In connection with this modification to the definition of tangible equity, the agencies propose to retain the current critically undercapitalized capital category threshold for insured depository institutions of less than 2 percent tangible equity to total assets. Based on the proposed new definition of tier 1 capital, the agencies believe the proposed critically undercapitalized threshold is at least as stringent as the agencies' current approach.

Question 13: The agencies solicit comment on the proposed regulatory capital requirements in the PCA framework, the introduction of a common equity tier 1 ratio as a new capital measure for purposes of PCA, and the proposed PCA thresholds for each PCA category.

In addition to the changes described in this section, the OCC is proposing the following amendments to 12 CFR part 6 to integrate the rules governing national banks and federal savings associations. Under the proposal, part 6 would be applicable to federal savings associations. The OCC also would make various non-substantive, technical amendments to part 6. In addition, the OCC proposes to rescind the current PCA rules in part 165 governing federal savings associations, with the exception of sections 165.8, Procedures for reclassifying a federal savings association based on criteria other than capital, and 165.9, Order to dismiss a director or senior executive officer; and to make non-substantive, technical amendments to sections 165.8 and 165.9. Any substantive issues regarding sections 165.8 and 165.9 will be addressed as part of a separate integration rulemaking.

F. Supervisory Assessment of Overall Capital Adequacy

Capital helps to ensure that individual banking organizations can continue to serve as credit intermediaries even during times of stress, thereby promoting the safety and soundness of the overall U.S. banking system. The agencies' current capital rules indicate that the capital requirements are minimum standards based on broad credit-risk considerations. The risk-based capital ratios do not explicitly take account of the quality of individual asset portfolios or the range of other types of risk to which banking organizations may be exposed, such as interest-rate, liquidity, market, or operational risks.

A banking organization is generally expected to have internal processes for assessing capital adequacy that reflect a full understanding of its risks and to ensure that it holds capital

corresponding to those risks to maintain overall capital adequacy.[47] Accordingly, a supervisory assessment of capital adequacy must take account of the internal processes for capital adequacy, as well as risks and other factors that can affect a banking organization's financial condition, including, for example, the level and severity of problem assets and its exposure to operational and interest rate risk. For this reason, a supervisory assessment of capital adequacy may differ significantly from conclusions that might be drawn solely from the level of a banking organization's risk-based capital ratios.

In light of these considerations, as a prudential matter, a banking organization is generally expected to operate with capital positions well above the minimum risk-based ratios and to hold capital commensurate with the level and nature of the risks to which it is exposed, which may entail holding capital significantly above the minimum requirement. For example, banking organizations contemplating significant expansion proposals are expected to maintain strong capital levels substantially above the minimum ratios and should not allow significant diminution of financial strength below these strong levels to fund their expansion plans. Banking organizations with high levels of risk are also expected to operate even further above minimum standards. In addition to evaluating the appropriateness of a banking organization's capital level given its overall risk profile, the supervisory assessment takes into account the quality and trends in a banking organization's capital composition, including the share of common and non-common-equity capital elements.

Section 10(d) of the proposal would maintain and reinforce these supervisory expectations by requiring that a banking organization maintain capital commensurate with the level and nature of all risks to which it is exposed and that a banking organization have a process for assessing its overall capital adequacy in relation to its risk profile, as well as a comprehensive strategy for maintaining an appropriate level of capital.

The supervisory evaluation of a banking organization's capital adequacy, including compliance with section 10(d), may include such factors as whether the banking organization is newly chartered, entering new activities, or introducing new products. The assessment would also consider whether a banking organization is receiving special supervisory attention, has or is expected to have losses resulting in capital inadequacy, has significant exposure due to risks from concentrations in credit or nontraditional activities, or has significant exposure to interest rate risk, operational risk, or could be adversely affected by the activities or condition of a banking organization's holding company.

In addition, a banking organization should have an appropriately rigorous process for assessing its overall capital adequacy in relation to its risk profile and a comprehensive strategy for maintaining an appropriate level of capital, consistent with the longstanding approach employed by the agencies in their supervision of banking organizations. Supervisors also would evaluate the comprehensiveness and effectiveness of a banking organization's capital planning in light of its activities and capital levels. An effective capital planning process would require a banking organization to assess the risks to which it is exposed and its processes for managing and mitigating those risks, evaluate its capital adequacy relative to its risks, and consider

[47] The Basel framework incorporates similar requirements under Pillar 2 of Basel II.

potential impact on its earnings and capital base from current and prospective economic conditions.[48]

While the elements of supervisory review of capital adequacy would be similar across banking organizations, evaluation of the level of sophistication of an individual banking organization's capital adequacy process would be commensurate with the banking organization's size, sophistication, and risk profile, similar to the current supervisory practice.

G. Tangible Capital Requirement for Federal Savings Associations

As part of the OCC's overall effort to integrate the regulatory requirements for national banks and federal savings associations, the OCC is proposing to include a tangible capital requirement for Federal savings associations in this NPR. [49] Under section 5(t)(2)(B) of the Home Owners' Loan Act (HOLA),[50] federal savings associations are required to maintain tangible capital in an amount not less than 1.5 percent of adjusted total assets.[51] This statutory requirement is implemented in the capital rules applicable to federal savings associations at 12 CFR 167.9.[52] Under that rule, tangible capital is defined differently from other capital measures, such as tangible equity in 12 CFR part 165.

After reviewing HOLA, the OCC has determined that a unique regulatory definition of tangible capital is not necessary to satisfy the requirement of the statute. Therefore, the OCC is proposing to define "tangible capital" as the amount of tier 1 capital plus the amount of outstanding perpetual preferred stock (including related surplus) not included in tier 1 capital. This definition mirrors the proposed definition of "tangible equity" for PCA purposes.[53]

While OCC recognizes that the terms used are not identical ("capital" as compared to "equity"), the OCC believes that this revised definition of tangible capital would reduce the computational burden on federal savings associations in complying with this statutory mandate, as well as being consistent with both the purposes of HOLA and PCA. Similarly, the FDIC also

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[48] See, for example, SR 09-4, Applying Supervisory Guidance and Regulations on the Payment of Dividends, Stock Redemptions, and Stock Repurchases at Bank Holding Companies (Board).

[49] Under Title III of the Dodd-Frank Act, the OCC assumed all functions of the Office of Thrift Supervision (OTS) and the Director of the OTS relating to Federal savings associations. As a result, the OCC has responsibility for the ongoing supervision, examination and regulation of Federal savings associations as of the transfer date of July 21, 2011. The Act also transfers to the OCC the rulemaking authority of the OTS relating to all savings associations, both state and Federal for certain rules. Section 312(b)(2)(B)(i) (to be codified 12 U.S.C. 5412(b)(2)(B)(i)). The FDIC has rulemaking authority for the capital and PCA rules pursuant to section 38 of the FDI Act (12 U.S.C. 1831n) and section 5(t)(1)(A) of the Home Owners' Loan Act (12U.S.C.1464(t)(1)(A)).

[50] 12 U.S.C. 1464(t).

[51] "Tangible capital" is defined in section 5(t)(9)(B) to mean "core capital minus any intangible assets (as intangible assets are defined by the Comptroller of the Currency for national banks.)" Section 5(t)(9)(A) defines "core capital" to mean "core capital as defined by the Comptroller of the Currency for national banks, less any unidentifiable intangible assets [goodwill]" unless the OCC prescribes a more stringent definition.

[52] 54 FR 49649 (Nov. 30, 1989).

[53] See 12 CFR 6.2.

is proposing to include a tangible capital requirement for state savings associations as part of this proposal.

III. Definition of Capital

A. Capital Components and Eligibility Criteria for Regulatory Capital Instruments

1. Common Equity Tier 1 Capital

Under this proposal, a banking organization's common equity tier 1 capital would be the sum of its outstanding common equity tier 1 capital instruments and related surplus (net of treasury stock), retained earnings, accumulated other comprehensive income (AOCI), and common equity tier 1 minority interest subject to the provisions set forth in section 21 of the proposal, minus regulatory adjustments and deductions specified in section 22 of the proposal.

a. Criteria

To ensure that a banking organization's common equity tier 1 capital is available to absorb losses as they occur, consistent with Basel III, the agencies propose to require that common equity tier 1 capital instruments issued by a banking organization satisfy the following criteria:

(1) The instrument is paid in, issued directly by the banking organization, and represents the most subordinated claim in a receivership, insolvency, liquidation, or similar proceeding of the banking organization.

(2) The holder of the instrument is entitled to a claim on the residual assets of the banking organization that is proportional with the holder's share of the banking organization's issued capital after all senior claims have been satisfied in a receivership, insolvency, liquidation, or similar proceeding. That is, the holder has an unlimited and variable claim, not a fixed or capped claim.

(3) The instrument has no maturity date, can only be redeemed via discretionary repurchases with the prior approval of the agency, and does not contain any term or feature that creates an incentive to redeem.

(4) The banking organization did not create at issuance of the instrument through any action or communication an expectation that it will buy back, cancel, or redeem the instrument, and the instrument does not include any term or feature that might give rise to such an expectation.

(5) Any cash dividend payments on the instrument are paid out of the banking organization's net income and retained earnings and are not subject to a limit imposed by the contractual terms governing the instrument.

(6) The banking organization has full discretion at all times to refrain from paying any dividends and making any other capital distributions on the instrument without triggering an

event of default, a requirement to make a payment-in-kind, or an imposition of any other restrictions on the banking organization.

(7) Dividend payments and any other capital distributions on the instrument may be paid only after all legal and contractual obligations of the banking organization have been satisfied, including payments due on more senior claims.

(8) The holders of the instrument bear losses as they occur equally, proportionately, and simultaneously with the holders of all other common stock instruments before any losses are borne by holders of claims on the banking organization with greater priority in a receivership, insolvency, liquidation, or similar proceeding.

(9) The paid-in amount is classified as equity under GAAP.

(10) The banking organization, or an entity that the banking organization controls, did not purchase or directly or indirectly fund the purchase of the instrument.

(11) The instrument is not secured, not covered by a guarantee of the banking organization or of an affiliate of the banking organization, and is not subject to any other arrangement that legally or economically enhances the seniority of the instrument.

(12) The instrument has been issued in accordance with applicable laws and regulations. In most cases, the agencies, understand that the issuance of these instruments would require the approval of the board of directors of the banking organization or, where applicable, of the banking organization's shareholders or of other persons duly authorized by the banking organization's shareholders.

(13) The instrument is reported on the banking organization's regulatory financial statements separately from other capital instruments.

These proposed criteria have been designed to ensure that common equity tier 1 capital instruments do not possess features that would cause a banking organization's condition to further weaken during periods of economic and market stress. For example, the proposed requirement that a banking organization have full discretion on the amount and timing of distributions and dividend payments would enhance the ability of the banking organization to absorb losses during periods of stress. The agencies believe that most existing common stock instruments previously issued by U.S. banking organizations fully satisfy the proposed criteria.

The criteria would also apply to instruments issued by banking organizations where ownership of the company is neither freely transferable, nor evidenced by certificates of ownership or stock, such as mutual banking organizations. For these entities, instruments that would be considered common equity tier 1 capital would be those that are fully equivalent to common stock instruments in terms of their subordination and availability to absorb losses, and that do not possess features that could cause the condition of the company to weaken as a going concern during periods of market stress.

The agencies believe that stockholders' voting rights generally are a valuable corporate governance tool that permits parties with an economic interest at stake to take part in the

decision-making process through votes on establishing corporate objectives and policy, and in electing the banking organization's board of directors. For that reason, the agencies continue to expect under the proposal that voting common stockholders' equity (net of the adjustments to and deductions from common equity tier 1 capital proposed under the rule) should be the dominant element within common equity tier 1 capital. To the extent that a banking organization issues non-voting common shares or common shares with limited voting rights, such shares should be identical to the banking organization's voting common shares in all respects except for any limitations on voting rights.

Question 14: The agencies solicit comments on the eligibility criteria for common equity tier 1 capital instruments. Which, if any, criteria could be problematic given the main characteristics of outstanding common stock instruments and why? Please provide supporting data and analysis.

b. Treatment of Unrealized Gains and Losses of Certain Debt Securities in Common Equity Tier 1 Capital

Under the agencies' general risk-based capital rules, unrealized gains and losses on AFS debt securities are not included in regulatory capital, unrealized losses on AFS equity securities are included in tier 1 capital, and unrealized gains on AFS equity securities are partially included in tier 2 capital.[54] As proposed, unrealized gains and losses on all AFS securities would flow through to common equity tier 1 capital. This would include those unrealized gains and losses related to debt securities whose valuations primarily change as a result of fluctuations in a benchmark interest rate, as opposed to changes in credit risk (for example, U.S. Treasuries and U.S. government agency debt obligations).

The agencies believe this proposed treatment would better reflect an institution's actual risk. In particular, while unrealized gains and losses on AFS securities might be temporary in nature and might reverse over a longer time horizon, (especially when they are primarily attributable to changes in a benchmark interest rate), unrealized losses could materially affect a banking organization's capital position at a particular point in time and associated risks should be reflected in its capital ratios. In addition, the proposed treatment would be consistent with the common market practice of evaluating a firm's capital strength by measuring its tangible common equity.

Accordingly, the agencies propose to require unrealized gains and losses on all AFS securities to flow through to common equity tier 1 capital. However, the agencies recognize that including unrealized gains and losses related to certain debt securities whose valuations primarily change as a result of fluctuations in a benchmark interest rate could introduce substantial volatility in a banking organization's regulatory capital ratios. The potential increased volatility could significantly change a banking organization's risk-based capital ratios, in some cases, due primarily to fluctuations in a benchmark interest rate and could result in a change in the banking organization's PCA category. Likewise, the agencies recognize that such volatility could

[54] See 12 CFR part 3, appendix A, section 2(b)(5) (OCC); 12 CFR parts 208 and 225, appendix A, section II.A.2.e (Board); 12 CFR part 325, appendix A, section I.A.2.f (FDIC).

discourage some banking organizations from holding highly liquid instruments with very low levels of credit risk even where prudent for liquidity risk management.

The agencies seek comment on alternatives to the proposed treatment of unrealized gains and losses on AFS securities, including an approach where the unrealized gains and losses related to debt securities whose valuations primarily change as a result of fluctuations in a benchmark interest rate would be excluded from a banking organization's regulatory capital. In particular, the agencies seek comment on an approach that would not include in regulatory capital unrealized gains and losses on U.S. government and agency debt obligations, U.S. GSE debt obligations and other sovereign debt obligations that would qualify for a zero percent risk weight under the proposed standardized approach. The agencies also seek comment on whether unrealized gains and losses on general obligations issued by states or other political subdivisions of the United States should receive similar treatment, even though unrealized gains and losses on these obligations are more likely to result from changes in credit risk and not primarily from fluctuations in a benchmark interest rate.

Question 15: To what extent would a requirement to include unrealized gains and losses on all debt securities whose changes in fair value are recognized in AOCI (i) result in excessive volatility in regulatory capital; (ii) impact the levels of liquid assets held by banking organizations; (iii) affect the composition of the banking organization's securities portfolios; and (iv) pose challenges for banking organizations' asset-liability management? Please provide supporting data and analysis.

Question 16: What are the pros and cons of an alternative treatment that would allow U.S. banking organizations to exclude from regulatory capital unrealized gains and losses on debt securities whose changes in fair value are predominantly attributable to fluctuations in a benchmark interest rate (for example, U.S. government and agency debt obligations and U.S. GSE debt obligations)? In the context of such an alternative treatment, what other categories of securities should be considered and why? Are there other alternatives that the agencies should consider (for example, retaining the current treatment for unrealized gains and losses on AFS debt and equity securities)?

2. Additional Tier 1 Capital

Consistent with Basel III, under the proposal, additional tier 1 capital would be the sum of: additional tier 1 capital instruments that satisfy certain criteria, related surplus, and tier 1 minority interest that is not included in a banking organization's common equity tier 1 capital (subject to the limitations on minority interests set forth in section 21 of the proposal); less applicable regulatory adjustments and deductions. Under the agencies' existing capital rules, non-cumulative perpetual preferred stock, which currently qualifies as tier 1 capital, generally would continue to qualify as additional tier 1 capital under the proposal. The proposed criteria for qualifying additional tier 1 capital instruments, consistent with Basel III criteria, are:

(1) The instrument is issued and paid in.

(2) The instrument is subordinated to depositors, general creditors, and subordinated debt holders of the banking organization in a receivership, insolvency, liquidation, or similar proceeding.

(3) The instrument is not secured, not covered by a guarantee of the banking organization or of an affiliate of the banking organization, and not subject to any other arrangement that legally or economically enhances the seniority of the instrument.

(4) The instrument has no maturity date and does not contain a dividend step-up or any other term or feature that creates an incentive to redeem.

(5) If callable by its terms, the instrument may be called by the banking organization only after a minimum of five years following issuance, except that the terms of the instrument may allow it to be called earlier than five years upon the occurrence of a regulatory event (as defined in the agreement governing the instrument) that precludes the instrument from being included in additional tier 1 capital or a tax event. In addition:

(i) The banking organization must receive prior approval from the agency to exercise a call option on the instrument.

(ii) The banking organization does not create at issuance of the instrument, through any action or communication, an expectation that the call option will be exercised.

(iii) Prior to exercising the call option, or immediately thereafter, the banking organization must either:
(A) Replace the instrument to be called with an equal amount of instruments that meet the criteria under section 20(b) or (c) of the proposal (replacement can be concurrent with redemption of existing additional tier 1 capital instruments); or

(B) Demonstrate to the satisfaction of the agency that following redemption, the banking organization will continue to hold capital commensurate with its risk.

(6) Redemption or repurchase of the instrument requires prior approval from the agency.

(7) The banking organization has full discretion at all times to cancel dividends or other capital distributions on the instrument without triggering an event of default, a requirement to make a payment-in-kind, or an imposition of other restrictions on the banking organization except in relation to any capital distributions to holders of common stock.

(8) Any capital distributions on the instrument are paid out of the banking organization's net income and retained earnings.

(9) The instrument does not have a credit-sensitive feature, such as a dividend rate that is reset periodically based in whole or in part on the banking organization's credit quality, but may have a dividend rate that is adjusted periodically independent of the banking organization's credit quality, in relation to general market interest rates or similar adjustments.

(10) The paid-in amount is classified as equity under GAAP.

(11) The banking organization, or an entity that the banking organization controls, did not purchase or directly or indirectly fund the purchase of the instrument.

(12) The instrument does not have any features that would limit or discourage additional issuance of capital by the banking organization, such as provisions that require the banking organization to compensate holders of the instrument if a new instrument is issued at a lower price during a specified time frame.

(13) If the instrument is not issued directly by the banking organization or by a subsidiary of the banking organization that is an operating entity, the only asset of the issuing entity is its investment in the capital of the banking organization, and proceeds must be immediately available without limitation to the banking organization or to the banking organization's top-tier holding company in a form which meets or exceeds all of the other criteria for additional tier 1 capital instruments. De minimis assets related to the operation of the issuing entity can be disregarded for purposes of this criterion.

(14) For an advanced approaches banking organization, the governing agreement, offering circular, or prospectus of an instrument issued after January 1, 2013 must disclose that the holders of the instrument may be fully subordinated to interests held by the U.S. government in the event that the banking organization enters into a receivership, insolvency, liquidation, or similar proceeding.

The proposed criteria are designed to ensure that additional tier 1 capital instruments are available to absorb losses on a going concern basis. Trust preferred securities and cumulative perpetual preferred securities, which are eligible for limited inclusion in tier 1 capital under the general risk-based capital rules for bank holding companies, would generally not qualify for inclusion in additional tier 1 capital.[55] The agencies believe that instruments that allow for the accumulation of interest payable are not sufficiently loss-absorbent to be included in tier 1 capital. In addition, the exclusion of these instruments from the tier 1 capital of depository institution holding companies is consistent with section 171 of the Dodd-Frank Act.

The agencies recognize that instruments classified as liabilities for accounting purposes could potentially be included in additional tier 1 capital under Basel III. However, as proposed, an instrument classified as a liability under GAAP would not qualify as additional tier 1 capital. The agencies believe that only allowing the inclusion of instruments classified as equity under GAAP in tier 1 capital would help strengthen the loss-absorption capabilities of additional tier 1 capital instruments, further increasing the quality of the capital base of U.S. banking organizations.

The agencies are also proposing to allow banking organizations to include in additional tier 1 capital instruments that were (i) issued under the Small Business Jobs Act of 2010 or, prior to October 4, 2010, under the Emergency Economic Stabilization Act of 2008, and (ii) included in tier 1 capital under the agencies' current general risk-based capital rules.[56] These instruments

[55] See 12 CFR part 225, appendix A, section II.A.1.

[56] Pub. L. 110-343, 122 Stat. 3765 (October 3, 2008).

would be included in tier 1 capital whether or not they meet the proposed qualifying criteria for common equity tier 1 or additional tier 1 capital instruments. The agencies believe that continued tier 1 capital treatment of these instruments is important to promote financial recovery and stability following the recent financial crisis.[57]

Question 17: The agencies solicit comments and views on the eligibility criteria for additional tier 1 capital instruments. Is there any specific criterion that could potentially be problematic given the main characteristics of outstanding non-cumulative perpetual preferred instruments? If so, please explain.

Additional criterion regarding certain institutional investors' minimum dividend payment requirements

Some banking organizations may want or need to limit their capital distributions during a particular payout period, but may opt to pay a penny dividend instead of fully cancelling dividends to common shareholders because certain institutional investors only hold stocks that do not pay a dividend. The agencies believe that the payment of a penny dividend on common stock should not preclude a banking organization from canceling (or making marginal) dividend payments on additional tier 1 capital instruments. The agencies are therefore considering a revision to criterion (7) of additional tier 1 capital instruments that would require a banking organization to have the ability to cancel or substantially reduce dividend payments on additional tier 1 capital instruments during a period of time when the banking organization is paying a penny dividend to its common shareholders.

The agencies believe that such a requirement could substantially increase the loss-absorption capacity of additional tier 1 capital instruments. To maintain the hierarchy of the capital structure under these circumstances, banking organizations would have the ability to pay the holders of additional tier 1 capital instruments the equivalent of what they pay out to common shareholders.

Question 18: What is the potential impact of such a requirement on the traditional hierarchy of capital instruments and on the market dynamics and cost of issuing additional tier 1 capital instruments?

Question 19: What mechanisms could be used to ensure, contractually, that such a requirement would not result in an additional tier 1 capital instrument being effectively more loss absorbent than common stock?

3. Tier 2 Capital

Under the proposal, tier 2 capital would be the sum of: tier 2 capital instruments that satisfy certain criteria, related surplus, total capital minority interests not included in a banking organization's tier 1 capital (subject to the limitations and requirements on minority interests set forth in section 21 of the proposal), and limited amounts of the allowance for loan and lease

[57] See 73 FR 43982 (July 29, 2008). See also 76 FR 35959 (June 21, 2011).

losses (ALLL); less any applicable regulatory adjustments and deductions. Consistent with the general risk-based capital rules, when calculating its standardized total capital ratio, a banking organization would be able to include in tier 2 capital the amount of ALLL that does not exceed 1.25 percent of its total standardized risk-weighted assets not including any amount of the ALLL (a banking organization subject to the market risk capital rules would exclude its standardized market risk-weighted assets from the calculation).[58]

When calculating its advanced approaches total capital ratio, rather than including in tier 2 capital the amount of ALLL described previously, an advanced approaches banking organization may include the excess of eligible credit reserves over its total expected credit losses (ECL) to the extent that such amount does not exceed 0.6 percent of its total credit risk weighted-assets.[59]

The proposed criteria for tier 2 capital instruments, consistent with Basel III, are:

(1) The instrument is issued and paid in.

(2) The instrument is subordinated to depositors and general creditors of the banking organization.

(3) The instrument is not secured, not covered by a guarantee of the banking organization or of an affiliate of the banking organization, and not subject to any other arrangement that legally or economically enhances the seniority of the instrument in relation to more senior claims.

(4) The instrument has a minimum original maturity of at least five years. At the beginning of each of the last five years of the life of the instrument, the amount that is eligible to be included in tier 2 capital is reduced by 20 percent of the original amount of the instrument (net of redemptions) and is excluded from regulatory capital when remaining maturity is less than one year. In addition, the instrument must not have any terms or features that require, or create significant incentives for, the banking organization to redeem the instrument prior to maturity.

(5) The instrument, by its terms, may be called by the banking organization only after a minimum of five years following issuance, except that the terms of the instrument may allow it to be called sooner upon the occurrence of an event that would preclude the instrument from being included in tier 2 capital, or a tax event. In addition:

(i) The banking organization must receive the prior approval of the agency to exercise a call option on the instrument.

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[58] A banking organization would deduct the amount of ALLL in excess of the amount permitted to be included in tier 2 capital, as well as allocated transfer risk reserves, from standardized total risk-weighted risk assets and use the resulting amount as the denominator of the standardized total capital ratio.

[59] An advanced approaches banking organization would deduct any excess eligible credit reserves that are not permitted to be included in tier 2 capital from advanced approaches total risk-weighted assets and use the resulting amount as the denominator of the total capital ratio.

(ii) The banking organization does not create at issuance, through action or communication, an expectation the call option will be exercised.

(iii) Prior to exercising the call option, or immediately thereafter, the banking organization must either:

(A) Replace any amount called with an equivalent amount of an instrument that meets the criteria for regulatory capital under this section,[60] or

(B) Demonstrate to the satisfaction of the agency that following redemption, the banking organization would continue to hold an amount of capital that is commensurate with its risk.

(6) The holder of the instrument must have no contractual right to accelerate payment of principal or interest on the instrument, except in the event of a receivership, insolvency, liquidation, or similar proceeding of the banking organization.

(7) The instrument has no credit-sensitive feature, such as a dividend or interest rate that is reset periodically based in whole or in part on the banking organization's credit standing, but may have a dividend rate that is adjusted periodically independent of the banking organization's credit standing, in relation to general market interest rates or similar adjustments.

(8) The banking organization, or an entity that the banking organization controls, has not purchased and has not directly or indirectly funded the purchase of the instrument.

(9) If the instrument is not issued directly by the banking organization or by a subsidiary of the banking organization that is an operating entity, the only asset of the issuing entity is its investment in the capital of the banking organization, and proceeds must be immediately available without limitation to the banking organization or the banking organization's top-tier holding company in a form that meets or exceeds all the other criteria for tier 2 capital instruments under this section.[61]

(10) Redemption of the instrument prior to maturity or repurchase requires the prior approval of the agency.

(11) For an advanced approaches banking organization, the governing agreement, offering circular, or prospectus of an instrument issued after January 1, 2013 must disclose that the holders of the instrument may be fully subordinated to interests held by the U.S. government in the event that the banking organization enters into a receivership, insolvency, liquidation, or similar proceeding.

As explained previously, under the proposed eligibility criteria for additional tier 1 capital instruments, trust preferred securities and cumulative perpetual preferred securities would not qualify for inclusion in additional tier 1 capital. However, many of these instruments could

[60] Replacement of tier 2 capital instruments can be concurrent with redemption of existing tier 2 capital instruments.

[61] De minimis assets related to the operation of the issuing entity can be disregarded for purposes of this criterion.

qualify for inclusion in tier 2 capital under the proposed eligibility criteria for tier 2 capital instruments.

Given that as proposed, unrealized gains and losses on AFS securities would flow through to common equity tier 1 capital, the agencies propose to eliminate the inclusion of a portion of certain unrealized gains on AFS equity securities in tier 2 capital.

As a result of the proposed new minimum common equity tier 1 capital requirement, higher tier 1 capital requirement, and the broader goal of simplifying the definition of tier 2 capital, the agencies are proposing to eliminate some existing limits related to tier 2 capital. Specifically, there would be no limit on the amount of tier 2 capital that could be included in a banking organization's total capital. Likewise, existing limitations on term subordinated debt, limited-life preferred stock and trust preferred securities within tier 2 would also be eliminated.[62]

Question 20: The agencies solicit comments on the eligibility criteria for tier 2 capital instruments. Is there any specific criterion that could potentially be problematic? If so, please explain.

For the reasons explained previously with respect to tier 1 capital instruments, the agencies propose to allow an instrument that qualified as tier 2 capital under the general risk-based capital rules and that was issued under the Small Business Jobs Act of 2010 or, prior to October 4, 2010, under the Emergency Economic Stabilization Act of 2008, to continue to be includable in tier 2 capital regardless of whether it meets all of the proposed qualifying criteria.

4. Capital Instruments of Mutual Banking Organizations

Most of the capital of mutual banking organizations is generally in the form of retained earnings (including retained earnings surplus accounts) and the agencies believe that mutual banking organizations generally should be able to meet the proposed regulatory capital requirements.

Consistent with Basel III, the proposed criteria for regulatory capital instruments would potentially permit the inclusion in regulatory capital of certain capital instruments issued by mutual banking organizations (for example, non-withdrawable accounts, pledged deposits, or mutual capital certificates), provided that the instruments meet all the proposed eligibility criteria of the relevant capital component.

However, some previously-issued mutual capital instruments that were includable in the regulatory capital of mutual banking organizations may not meet all of the relevant criteria for capital instruments under the proposal. For example, instruments that are liabilities or that are cumulative would not meet the criteria for additional tier 1 capital instruments. However, these instruments would be subject to the proposed transition provisions and excluded from capital over time.

[62] See 12 CFR part 3, Appendix A, section 2(b)(3); 12 CFR parts 208 and 225, appendix A, section II.A.2; 12 CFR part 325, appendix A, section I.A.2.

Question 21: What instruments or accounts currently included in the regulatory capital of mutual banking organizations would not meet the proposed criteria for capital instruments?

Question 22: What impact, if any, would the exclusion of such instruments or accounts have on the regulatory capital ratios of mutual banking organizations? Please provide data supporting your answer.

Question 23: Would such instruments be unable to meet any of the proposed criteria? Could the terms of such instruments be modified to align with the proposed criteria for capital instruments? Please explain.

Question 24: Would the proposed criteria for capital instruments affect the ability of mutual banking organizations to increase regulatory capital levels going forward?

5. Grandfathering of Certain Capital Instruments

Under Basel III, capital investments in a banking organization made before September 12, 2010 by the government where the banking organization is domiciled are grandfathered until January 1, 2018. However, as described above with respect to qualifying criteria for tier 1 and tier 2 instruments, the agencies are proposing a different grandfathering treatment for the capital investments by the U.S. government, consistent with the Dodd-Frank Act.[63]

As discussed above, as proposed, capital investments by the U.S. government included in the tier 1 and tier 2 capital of banking organizations issued under the Small Business Jobs Act of 2010 or, prior to October 4, 2010,[64] under the Emergency Economic Stabilization Act[65] (for example, tier 1 instruments issued under the TARP program) would be grandfathered permanently. Transitional arrangements for regulatory capital instruments that do not comply with the Basel III criteria and transitional arrangements for debt or equity instruments issued by depository institution holding companies that do not qualify as regulatory capital under the general risk-based capital rules are discussed under section V of this preamble.

6. Agency Approval of Capital Elements

The agencies expect that most existing common stock instruments that banking organizations currently include in tier 1 capital would meet the proposed eligibility criteria for common equity tier 1 capital instruments. In addition, the agencies expect that most existing non-cumulative perpetual preferred stock instruments that banking organizations currently include in tier 1 capital and most existing subordinated debt instruments they include in tier 2 capital would meet the proposed eligibility criteria for additional tier 1 and tier 2 capital instruments, respectively. However, the agencies recognize that over time, capital instruments that are equivalent in quality and loss-absorption capacity to existing instruments may be created

[63] See 12 U.S.C. 5371(b)(5)(A).

[64] Pub. L. 111-240 (September 27, 2010).

[65] Pub. L. 110-343, 122 Stat. 3765 (October 3, 2008).

to satisfy different market needs and are proposing to consider the eligibility of such instruments on a case-by-case basis.

Accordingly, the agencies propose to require a banking organization request approval from its primary federal supervisor before it may include a capital element in regulatory capital, unless:

(i) Such capital element is currently included in regulatory capital under the agencies' general risk-based capital and leverage rules and the underlying instrument complies with the applicable proposed eligibility criteria for regulatory capital instruments; or

(ii) The capital element is equivalent in terms of capital quality and loss-absorption capabilities to an element described in a previous decision made publicly available by the banking organization's primary federal supervisor.

The agency that is considering a request to include a new capital element in regulatory capital would consult with the other agencies when determining whether the element should be included in common equity tier 1, additional tier 1, or tier 2 capital. Once an agency determines that a capital element may be included in a banking organization's common equity tier 1, additional tier 1, or tier 2 capital, the agency would make its decision publicly available, including a brief description of the element and the rationale for the conclusion.

7. Addressing the Point of Non-viability Requirements under Basel III

During the recent financial crisis, in the United States and other countries, governments lent to, and made capital investments in, distressed banking organizations. These investments helped to stabilize the recipient banking organizations and the financial sector as a whole. However, because of the investments, the recipient banking organizations' existing tier 2 capital instruments, and (in some cases) tier 1 capital instruments, did not absorb the banking organizations' credit losses consistent with the purpose of regulatory capital. At the same time, taxpayers became exposed to those losses.

On January 13, 2011, the BCBS issued international standards for all additional tier 1 and tier 2 capital instruments issued by internationally active banking organizations, to ensure that such regulatory capital instruments fully absorb losses before taxpayers are exposed to such losses (Basel non-viability standard). Under the Basel non-viability standard, all non-common stock regulatory capital instruments issued by an internationally active banking organization must include terms that subject the instruments to write-off or conversion to common equity at the point that either (i) the write-off or conversion of those instruments occurs or (ii) a government (or public sector) injection of capital would be necessary to keep the banking organization solvent. Alternatively, if the governing jurisdiction of the banking organization has established laws that require such tier 1 and tier 2 capital instruments to be written off or otherwise fully absorb losses before tax payers are exposed to loss, the standard is already met. If the governing jurisdiction has such laws in place, the Basel non-viability standard states that documentation for such instruments should disclose that information to investors and market

participants, and should clarify that the holders of such instruments would fully absorb losses before taxpayers are exposed to loss.[66]

The agencies believe that U.S. law generally is consistent with the Basel non-viability standard. The resolution regime established in Title 2, section 210 of the Dodd-Frank Act provides the FDIC with the authority necessary to place failing financial companies that pose a significant risk to the financial stability of the United States into receivership.[67] The Dodd-Frank Act provides that this authority shall be exercised in the manner that minimizes systemic risk and moral hazard, so that (i) creditors and shareholders will bear the losses of the financial company; (ii) management responsible for the condition of the financial company will not be retained; and (iii) the FDIC and other appropriate agencies will take steps necessary and appropriate to ensure that all parties, including holders of capital instruments, management, directors, and third parties having responsibility for the condition of the financial company, bear losses consistent with their respective ownership or responsibility.[68] Section 11 of the Federal Deposit Insurance Act has similar provisions for the resolution of depository institutions.[69] Additionally, under U.S. bankruptcy law, regulatory capital instruments issued by a company in bankruptcy would absorb losses before more senior unsecured creditors.

Furthermore, consistent with the Basel non-viability standard, under the proposal, additional tier 1 and tier 2 capital instruments issued by advanced approaches banking organizations after the proposed requirements for capital instruments are finalized would be required to include a disclosure that the holders of the instrument may be fully subordinated to interests held by the U.S. government in the event that the banking organization enters into liquidation, insolvency, or receivership.

8. Qualifying Capital Instruments Issued by Consolidated Subsidiaries of a Banking Organization

Investments by third parties in a consolidated subsidiary of a banking organization may significantly improve the overall capital adequacy of that subsidiary. However, as became apparent during the financial crisis, while capital issued by consolidated subsidiaries and not owned by the parent banking organization (minority interest) is available to absorb losses at the subsidiary level, that capital does not always absorb losses at the consolidated level. Therefore, inclusion of minority interests in the regulatory capital at the consolidated level should be limited to prevent highly capitalized subsidiaries from overstating the amount of capital available to absorb losses at the consolidated level.

Under the proposal, a banking organization would be allowed to include in its consolidated capital limited amounts of minority interests, if certain requirements are met.

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[66] See "Final Elements of the Reforms to Raise the Quality of Regulatory Capital" (January 2011), available at: http://www.bis.org/press/p110113.pdf.

[67] See 12 U.S.C. 5384.

[68] 12 U.S.C. 5384.

[69] 12 U.S.C. 1821.

Minority interest would be classified as a common equity tier 1, tier 1, or total capital minority interest depending on the underlying capital instrument and on the type of subsidiary issuing such instrument. Any instrument issued by the consolidated subsidiary to third parties would need to meet the relevant eligibility criteria under section 20 of the proposal in order for the resulting minority interest to be included in the banking organization's common equity tier 1, additional tier 1 or tier 2 capital elements, as appropriate. In addition, common equity tier 1 minority interest would need to be issued by a depository institution or foreign bank that is a consolidated subsidiary of a banking organization.

The limits on the amount of minority interest that may be included in the consolidated capital of a banking organization would be based on the amount of capital held by the consolidated subsidiary, relative to the amount of capital the subsidiary would have to hold in order to avoid any restrictions on capital distributions and discretionary bonus payments under the capital conservation buffer framework, as provided in section 11 of the proposal.

For example, if a subsidiary needs to maintain a common equity tier 1 capital ratio of more than 7 percent to avoid limitations on capital distributions and discretionary bonus payments, and the subsidiary's common equity tier 1 capital ratio is 8 percent, the subsidiary would be considered to have "surplus" common equity tier 1 capital and, at the consolidated level, the banking organization would not be able to include the portion of such surplus common equity tier 1 capital held by third party investors.

The steps for determining the amount of minority interest includable in a banking organization's regulatory capital are described in this section below and are illustrated in a numerical example that follows. For example, the amount of common equity tier 1 minority interest includable in the common equity tier 1 capital of a banking organization under the proposal would be: (i) the common equity tier 1 minority interest of the subsidiary minus (ii) the ratio of the subsidiary's common equity tier 1 capital owned by third parties to the total common equity tier 1 capital of the subsidiary, multiplied by the difference between the common equity tier 1 capital of the subsidiary and the lower of: (A) the amount of common equity tier 1 capital the subsidiary must hold to avoid restrictions on capital distributions and discretionary bonus payments, or (B) the total risk-weighted assets of the banking organization that relate to the subsidiary, multiplied by the common equity tier 1 capital ratio needed by the banking organization subsidiary to avoid restrictions on capital distributions and discretionary bonus payments. If the subsidiary were not subject to the same minimum regulatory capital requirements or capital conservation buffer framework of the banking organization, the banking organization would need to assume, for purposes of the calculation described above, that the subsidiary is subject to the minimum capital requirements and to the capital conservation buffer framework of the banking organization.

To determine the amount of tier 1 minority interest includable in the tier 1 capital of the banking organization and the total capital minority interest includable in the total capital of the banking organization, a banking organization would follow the same methodology as the one outlined previously for common equity tier 1 minority interest. Section 21 of the proposal sets forth the precise calculations. The amount of tier 1 minority interest that can be included in the additional tier 1 capital of the banking organization is equivalent to the banking organization's tier 1 minority interest, subject to the limitations outlined above, less any tier 1 minority interest

that is included in the banking organization's common equity tier 1 capital. Likewise, the amount of total capital minority interest that can be included in the tier 2 capital of the banking organization is equivalent to its total capital minority interest, subject to the limitations outlined previously, less any tier 1 minority interest that is included in the banking organization's tier 1 capital.

As proposed, minority interest related to qualifying common or noncumulative perpetual preferred stock directly issued by a consolidated U.S. depository institution or foreign bank subsidiary, which are eligible for inclusion in tier 1 capital under the general risk-based capital rules without limitation, would generally qualify for inclusion in common equity tier 1 and additional tier 1 capital, respectively, subject to the appropriate limits under section 21 of the proposed rule. Likewise, under the proposed rule, minority interest related to qualifying cumulative perpetual preferred stock directly issued by a consolidated U.S. depository institution or foreign bank subsidiary, which are eligible for limited inclusion in tier 1 capital under the general risk-based capital rules, would generally not qualify for inclusion in additional tier 1 capital under the proposal.

Table 8— Example of the calculation of the proposed limits on minority interest

	(a) Capital issued by subsidiary ($)	(b) Capital owned by third parties (percent)	(c) Amount of minority interest ($) ((a)*(b))	(d) Minimum capital requirement plus capital conservation buffer (percent)	(e) Minimum capital requirement plus capital conservation buffer ($) (RWAs*(d))	(f) Surplus capital of subsidiary ($) ((a)-(e))	(g) Surplus minority interest ($) ((f)*(b))	(h) Minority interest included at banking organization level ($) ((c)-(g))
Common equity tier 1 capital	80	30	24	7	70	10	3	21
Additional tier 1 capital	30	50	15					9.1
Tier 1 capital	**110**	**35**	**39**	**8.5**	**85**	**25**	**8.9**	**30.1**
Tier 2 capital	20	75	15					13.5
Total capital	**130**	**42**	**54**	**10.5**	**105**	**25**	**10.4**	**43.6**

For purposes of the example in table 8, assume a consolidated depository institution subsidiary has common equity tier 1, additional tier 1 and tier 2 capital of $80, $30, and $20, respectively, and third parties own 30 percent of the common equity tier 1 capital ($24), 50 percent of the additional tier 1 capital ($15) and 75 percent of the tier 2 capital ($15). If the subsidiary has $1000 of total risk-weighted assets, the sum of its minimum common equity tier 1 capital requirement (4.5 percent) plus the capital conservation buffer (2.5 percent) (assuming a countercyclical capital buffer amount of zero) is 7 percent ($70), the sum of its minimum tier 1 capital requirement (6.0 percent) plus the capital conservation buffer (2.5 percent) is 8.5 percent ($85), and the sum of its minimum total capital requirement (8 percent) plus the capital conservation buffer (2.5 percent) is 10.5 percent ($105).

In this example, the surplus common equity tier 1 capital of the subsidiary equals $10 ($80 - $70), the amount of the surplus common equity tier 1 minority interest is equal to $3

($10*$24/$80), and therefore the amount of common equity tier 1 minority interest that may be included at the consolidated level is equal to $21 ($24 - $3).

The surplus tier 1 capital of the subsidiary is equal to $25 ($110 - $85), the amount of the surplus tier 1 minority interest is equal to $8.9 ($25*$39/$110), and therefore the amount of tier 1 minority interest that may be included in the banking organization is equal to $30.1 ($39 - $8.9). Since the banking organization already includes $21 of common equity tier 1 minority interest in its common equity tier 1 capital, it would include $9.1 ($30.1-$21) of such tier 1 minority interest in its additional tier 1 capital.

The surplus total capital of the subsidiary is equal to $25 ($130 - $105), the amount of the surplus total capital minority interest is equal to $10.4 ($25*$54/$130), and therefore the amount of total capital minority interest that may be included in the banking organization is equal to $43.6 ($54 - $10.4). Since the banking organization already includes $30.1 of tier 1 minority interest in its tier 1 capital, it would include $13.5 ($43.6-$30.1) of such total capital minority interest in its tier 2 capital.

Question 25: The agencies solicit comments on the proposed qualitative restrictions and quantitative limits for including minority interest in regulatory capital. What is the potential impact of these restrictions and limitations on the issuance of certain types of capital instruments (for example, subordinated debt) by depository institution subsidiaries of banking organizations? Please provide data to support your answer.

Real Estate Investment Trust Preferred Capital

A Real Estate Investment Trust (REIT) is a company that is required to invest in real estate and real estate-related assets and make certain distributions in order to maintain a tax-advantaged status. Some banking organizations have consolidated subsidiaries that are REITs, and such REITs may have issued capital instruments to be included in the regulatory capital of the consolidated banking organization as minority interest.

Under the agencies' general risk-based capital rules, preferred shares issued by a REIT subsidiary generally may be included in a banking organization's tier 1 capital as minority interest if the preferred shares meet the eligibility requirements for tier 1 capital.[70] The agencies have interpreted this requirement to entail that the REIT preferred shares must be exchangeable automatically into noncumulative perpetual preferred stock of the banking organization under certain circumstances. Specifically the primary federal supervisor may direct the banking organization in writing to convert the REIT preferred shares into noncumulative perpetual preferred stock of the banking organization because the banking organization: (i) became

[70] 12 CFR part 325, subpart B (FDIC); 12 CFR part 3, Appendix A, Sec. 2(a)(3) (OCC).

undercapitalized under the PCA regulations;[71] (ii) was placed into conservatorship or receivership; or (iii) was expected to become undercapitalized in the near term.[72]

Under the proposed rule, the limitations described previously on the inclusion of minority interest in regulatory capital would apply to capital instruments issued by consolidated REIT subsidiaries. Specifically, REIT preferred shares issued by a REIT subsidiary that meets the proposed definition of an operating entity would qualify for inclusion in the regulatory capital of a banking organization subject to the limitations outlined in section 21 of the proposed rule only if the REIT preferred shares meet the criteria for additional tier 1 or tier 2 capital instruments outlined in section 20 of the proposed rule. Under the proposal, an operating entity is a subsidiary of the banking organization set up to conduct business with clients with the intention of earning a profit in its own right.

Because a REIT must distribute 90 percent of its earnings in order to maintain its beneficial tax status, a banking organization might be reluctant to cancel dividends on the REIT preferred shares. However, for a capital instrument to qualify as additional tier 1 capital, which must be available to absorb losses, the issuer must have the ability to cancel dividends. In cases where a REIT could maintain its tax status by declaring a consent dividend and has the ability to do so, the agencies generally would consider REIT preferred shares to satisfy criterion (7) of the proposed eligibility criteria for additional tier 1 capital instruments under the proposed rule.[73] The agencies do not expect preferred stock issued by a REIT that does not have the ability to declare a consent dividend to qualify as tier 1 minority interest; however, such instrument could qualify as total capital minority interest if it meets all of the relevant tier 2 eligibility criteria under the proposed rule.

Question 26: The agencies are seeking comment on the proposed treatment of REIT preferred capital. Specifically, how would the proposed minority interest limitations and interpretation of criterion (7) of the proposed eligibility criteria for additional tier 1 capital instruments affect the future issuance of REIT preferred capital instruments?

B. Regulatory Adjustments and Deductions

1. Regulatory Deductions from Common Equity Tier 1 Capital

The proposed rule would require a banking organization to make the deductions described in this section from the sum of its common equity tier 1 capital elements. Amounts

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[71] 12 CFR part 3, appendix A, section 2(a)(3), 12 CFR 167.5(a)(1)(iii) (OCC); 12 CFR part 208, subpart D (Board); 12 CFR part 325, subpart B, 12 CFR part 390, subpart Y (FDIC).

[72] See OCC Corporate Decision No. 97-109 (December 1997) available at http://www.occ.gov/static/interpretations-and-precedents/dec97/cd97-109.pdf and the Comptroller's licensing manual, Capital and Dividends available at http://www.occ.gov/static/publications/capital3.pdf; 12 CFR parts 208 and 225, appendix A (Board); 12 CFR part 325, subpart B (FDIC).

[73] A consent dividend is a dividend that is not actually paid to the shareholders, but is kept as part of a company's retained earnings, yet the shareholders have consented to treat the dividend as if paid in cash and include it in gross income for tax purposes.

deducted would be excluded from the banking organization's risk-weighted assets and leverage exposure.

Goodwill and other intangibles (other than MSAs)

Goodwill and other intangible assets have long been either fully or partially excluded from regulatory capital in the U.S. because of the high level of uncertainty regarding the ability of the banking organization to realize value from these assets, especially under adverse financial conditions.[74] Likewise, U.S. federal banking statutes generally prohibit inclusion of goodwill in the regulatory capital of insured depository institutions.[75]

Accordingly, under the proposal, goodwill and other intangible assets other than MSAs (for example, purchased credit card relationships (PCCRs) and non-mortgage servicing assets), net of associated deferred tax liabilities (DTLs), would be deducted from common equity tier 1 capital elements. Goodwill for purposes of this deduction would include any goodwill embedded in the valuation of significant investments in the capital of an unconsolidated financial institution in the form of common stock. Such deduction of embedded goodwill would apply to investments accounted for under the equity method. Under GAAP, if there is a difference between the initial cost basis of the investment and the amount of underlying equity in the net assets of the investee, the resulting difference should be accounted for as if the investee were a consolidated subsidiary (which may include imputed goodwill). Consistent with Basel III, these deductions would be taken from common equity tier 1 capital. Although MSAs are also intangibles, they are subject to a different treatment under Basel III and the proposal, as explained in this section.

DTAs

As proposed, consistent with Basel III, a banking organization would deduct DTAs that arise from operating loss and tax credit carryforwards net of any related valuation allowances (and net of DTLs calculated as outlined in section 22(e) of the proposal) from common equity tier 1 capital elements because of the high degree of uncertainty regarding the ability of the banking organization to realize value from such DTAs.

DTAs arising from temporary differences that the banking organization could not realize through net operating loss carrybacks net of any related valuation allowances and net of DTLs calculated as outlined in section 22(e) of the proposal (for example, DTAs resulting from the banking organization's ALLL), would be subject to strict limitations described in section 22(d) of the proposal because of concerns regarding a banking organization's ability to realize such DTAs.

DTAs arising from temporary differences that the banking organization could realize through net operating loss carrybacks are not subject to deduction, and instead receive a 100 percent risk weight. For a banking organization that is a member of a consolidated group for tax

[74] See 54 FR 4186, 4196 (1989) (Board); 54 FR 4168, 4175 (1989) (OCC); 54 FR 11509 (FDIC).

[75] 12 U.S.C. 1828(n).

purposes, the amount of DTAs that could be realized through net operating loss carrybacks may not exceed the amount that the banking organization could reasonably expect to have refunded by its parent holding company.

Gain-on-sale associated with a securitization exposure

A banking organization would deduct from common equity tier 1 capital elements any after-tax gain-on-sale associated with a securitization exposure. Under this proposal, gain-on-sale means an increase in the equity capital of a banking organization resulting from the consummation or issuance of a securitization (other than an increase in equity capital resulting from the banking organization's receipt of cash in connection with the securitization).

Defined benefit pension fund assets

As proposed, defined benefit pension fund liabilities included on the balance sheet of a banking organization would be fully recognized in common equity tier 1 capital (that is, common equity tier 1 capital cannot be increased via the de-recognition of these liabilities). However, under the proposal, defined benefit pension fund assets (defined as excess assets of the pension fund that are reported on the banking organization's balance sheet due to its overfunded status), net of any associated DTLs, would be deducted in the calculation of common equity tier 1 capital given the high level of uncertainty regarding the ability of the banking organization to realize value from such assets.

Consistent with Basel III, under the proposal, with supervisory approval, a banking organization would not be required to deduct a defined benefit fund assets to which the banking organization has unrestricted and unfettered access. In this case, the banking organization would assign to such assets the risk weight they would receive if they were directly owned by the banking organization. Under the proposal, unrestricted and unfettered access would mean that a banking organization is not required to request and receive specific approval from pension beneficiaries each time it would access excess funds in the plan.

The FDIC has unfettered access to the excess assets of an insured depository institution's pension plan in the event of receivership. Therefore, the agencies have determined that generally an insured depository institution would not be required to deduct any assets associated with a defined benefit pension plan from common equity tier 1 capital. Similarly, a holding company would not need to deduct any assets associated with a subsidiary insured depository institution's defined benefit pension plan from capital.

Activities by Federal Savings Association Subsidiaries that are Impermissible for National Banks

As part of the OCC's overall effort to integrate the regulatory requirements for national banks and federal savings associations, the OCC is proposing to incorporate in the proposal a deduction requirement specifically applicable to federal savings association subsidiaries that engage in activities impermissible for national banks. Similarly, the FDIC is proposing to incorporate in the proposal a deduction requirement specifically applicable to state savings

association subsidiaries that engage in activities impermissible for national banks. Section 5(t)(5)[76] of HOLA requires a separate capital calculation for Federal savings associations for "investments in and extensions of credit to any subsidiary engaged in activities not permissible for a national bank." This statutory provision is implemented through the definition of "includable subsidiary" as a deduction from the core capital of the federal savings association for those subsidiaries that are not "includable subsidiaries."[77] Specifically, where a subsidiary of a federal savings association engages in activities that are impermissible for national banks, the rules require the deconsolidation and deduction of the federal savings association's investment in the subsidiary from the assets and regulatory capital of the Federal savings association. If the activities of the federal savings association subsidiary are permissible for a national bank, then consistent with GAAP, the balance sheet of the subsidiary generally is consolidated with the balance sheet of the federal savings association.

The OCC is proposing to carryover the general regulatory treatment of includable subsidiaries, with some technical modifications, by adding a new paragraph to section 22(a) of the proposal. The OCC notes that such treatment is consistent with how a national bank deducts its equity investments in financial subsidiaries. Under this proposal, investments (both debt and equity) by a federal savings association in a subsidiary that is not an "includable subsidiary" are required to be deducted (with certain exceptions) from the common equity tier 1 capital of the federal savings association. Among other things, includable subsidiary is defined as a subsidiary of a federal savings association that engages solely in activities not impermissible for a national bank. Aside from a few technical modifications, this proposal is intended to carryover the current general regulatory treatment of includable subsidiaries for federal savings associations into the proposal.

Question 27: The OCC and FDIC request comments on all aspects of this proposal to incorporate the current deduction requirement for federal and state, savings association subsidiaries that engage in activities impermissible for national banks. In particular, the OCC and FDIC are interested in whether this statutorily required deduction can be revised to reduce burden on federal and state savings associations.

2. Regulatory Adjustments to Common Equity Tier 1 Capital

Unrealized gains and losses on certain cash flow hedges

Consistent with Basel III, the agencies are proposing that unrealized gains and losses on cash flow hedges that relate to the hedging of items that are not recognized at fair value on the balance sheet (including projected cash flows) be excluded from regulatory capital. That is, if the banking organization has an unrealized-net-cash-flow-hedge gain, it would deduct it from common equity tier 1 capital, and if it has an unrealized-net-cash-flow-hedge loss it would add it back to common equity tier 1 capital, net of applicable tax effects. That is, if the amount of the cash flow hedge is positive, a banking organization would deduct such amount from common

[76] 12 U.S.C. 1464(t)(5).

[77] See 12 CFR 167.1; 12 CFR 167.5(a)(2)(iv).

equity tier 1 capital elements, and if the amount is negative, a banking organization would add such amount to common equity tier 1 capital elements.

This proposed regulatory adjustment would reduce the artificial volatility that can arise in a situation where the unrealized gain or loss of the cash flow hedge is included in regulatory capital but any change in the fair value of the hedged item is not. However, the agencies recognize that in a regulatory capital framework where unrealized gains and losses on AFS securities flow through to common equity tier 1 capital, the exclusion of unrealized cash flow hedge gains and losses might have an adverse effect on banking organizations that manage their interest rate risk by using cash flow hedges to hedge items that are not recognized on the balance sheet at fair value (for example, floating rate liabilities) and that are used to fund the banking organizations' AFS investment portfolios. In this scenario, a banking organization's regulatory capital could be adversely affected by fluctuations in a benchmark interest rate even if the banking organization's interest rate risk is effectively hedged because its unrealized gains and losses on the AFS securities would flow through to regulatory capital while its unrealized gains and losses on the cash flow hedges would not, resulting in a regulatory capital asymmetry.

Question 28: How would a requirement to exclude unrealized net gains and losses on cash flow hedges related to the hedging of items that are not measured at fair value in the balance sheet (in the context of a framework where the unrealized gains and losses on AFS debt securities would flow through to regulatory capital) change the way banking organizations currently hedge against interest rate risk? Please explain and provide supporting data and analysis.

Question 29: Could this adjustment potentially introduce excessive volatility in regulatory capital predominantly as a result of fluctuations in a benchmark interest rate for institutions that are effectively hedged against interest rate risk? Please explain and provide supporting data and analysis.

Question 30: What are the pros and cons of an alternative treatment where floating rate liabilities are deemed to be fair valued for purposes of the proposed adjustment for unrealized gains and losses on cash flow hedges? Please explain and provide supporting data and analysis.

Changes in the banking organization's creditworthiness

The agencies believe that it would be inappropriate to allow banking organizations to increase their capital ratios as a result of a deterioration in their own creditworthiness, and are therefore proposing, consistent with Basel III, that banking organizations not be allowed to include in regulatory capital any change in the fair value of a liability that is due to changes in their own creditworthiness. Therefore, a banking organization would be required to deduct any unrealized gain from and add back any unrealized loss to common equity tier 1 capital elements due to changes in a banking organization's own creditworthiness. An advanced approaches banking organization would deduct from common equity tier 1 capital elements any unrealized gains associated with derivative liabilities resulting from the widening of a banking organization's credit spread premium over the risk free rate.

3. Regulatory Deductions Related to Investments in Capital Instruments

Deduction of investments in own regulatory capital instruments

To avoid the double-counting of regulatory capital, under the proposal a banking organization would be required to deduct the amount of its investments in its own capital instruments, whether held directly or indirectly, to the extent such investments are not already derecognized from regulatory capital. Specifically, a banking organization would deduct its investment in its own common equity tier 1, own additional tier 1 and own tier 2 capital instruments from the sum of its common equity tier 1, additional tier 1, and tier 2 capital elements, respectively. In addition, any common equity tier 1, additional tier 1 or tier 2 capital instrument issued by a banking organization which the banking organization could be contractually obliged to purchase would also be deducted from its common equity tier 1, additional tier 1 or tier 2 capital elements, respectively. If a banking organization already deducts its investment in its own shares (for example, treasury stock) from its common equity tier 1 capital elements, it does not need to make such deduction twice.

A banking organization would be required to look through its holdings of index securities to deduct investments in its own capital instruments. Gross long positions in investments in its own regulatory capital instruments resulting from holdings of index securities may be netted against short positions in the same underlying index. Short positions in indexes that are hedging long cash or synthetic positions may be decomposed to recognize the hedge. More specifically, the portion of the index that is composed of the same underlying exposure that is being hedged may be used to offset the long position only if both the exposure being hedged and the short position in the index are positions subject to the market risk rule, the positions are fair valued on the banking organization's balance sheet, and the hedge is deemed effective by the banking organization's internal control processes, which have been assessed by the primary supervisor of the banking organization. If the banking organization finds it operationally burdensome to estimate the exposure amount as a result of an index holding, it may, with prior approval from the primary federal supervisor, use a conservative estimate. In all other cases, gross long positions would be allowed to be deducted net of short positions in the same underlying instrument only if the short positions involve no counterparty risk (for example, the position is fully collateralized or the counterparty is a qualifying central counterparty).

Definition of financial institution

Consistent with Basel III, the proposal would require banking organizations to deduct investments in the capital of unconsolidated financial institutions where those investments exceed certain thresholds, as described further below. These deduction requirements are one of the measures included in Basel III designed to address systemic risk arising out of interconnectedness between banking organizations.

Under the proposal, "financial institution" would mean:

(1)(i) A bank holding company, savings and loan holding company, non-bank financial institution supervised by the Board under Title I of the Dodd-Frank Act, depository institution as defined in section 3 of the Federal Deposit Insurance Act 12 U.S.C. 1813), foreign bank, credit union, insurance company, or securities firm;

(ii) A commodity pool as defined in section 1a(10) of the Commodity Exchange Act (7 U.S.C. 1a(10));

(iii) An entity that is a covered fund for purposes of section 13 of the Bank Holding Company Act (12 U.S.C. 1851(h)(2)) and regulations issued thereunder;

(iv) An employee benefit plan as defined in paragraphs (3) and (32) of section 3 of the Employee Retirement Income and Security Act of 1974 (29 U.S.C. 1002) (other than an employee benefit plan established by the bank for the benefit of its employees or the employees of its affiliates);

(v) Any other company predominantly engaged in the following activities:

(A) Lending money, securities or other financial instruments, including servicing loans;

(B) Insuring, guaranteeing, or indemnifying against loss, harm, damage, illness, disability, or death, or issuing annuities;

(C) Underwriting, dealing in, making a market in, or investing as principal in securities or other financial instruments;

(D) Asset management activities (not including investment or financial advisory activities); or

(E) Acting as a futures commission merchant.

(vi) Any entity not domiciled in the United States (or a political subdivision thereof) that would be covered by any of paragraphs (1)(i) through (v) if such entity were domiciled in the United States; or

(vii) Any other company that the agency may determine is a financial institution based on the nature and scope of its activities.

(2) For the purposes of this definition, a company is "predominantly engaged" in an activity or activities if:

(i) 85 percent or more of the total consolidated annual gross revenues (as determined in accordance with applicable accounting standards) of the company in either of the two most recent calendar years were derived, directly or indirectly, by the company on a consolidated basis from the activities; or

(ii) 85 percent or more of the company's consolidated total assets (as determined in accordance with applicable accounting standards) as of the end of either of the two most recent calendar years were related to the activities.

(3) For the purpose of this part, "financial institution" does not include the following entities:

(i) GSEs.

(ii) Entities described in section 13(d)(1)(E) of the Bank Holding Company Act (12 U.S.C. 1851(d)(1)(E) and regulations issued thereunder (exempted entities) and entities that are predominantly engaged in providing advisory and related services to exempted entities.

(iii) Entities designated as a Community Development Financial Institutions (CDFIs) under 12 U.S.C. 4701 et seq. and 12 CFR part 1805.

The proposed definition is designed to include entities whose primary business is financial activities and therefore could contribute to risk in the financial system, including entities whose primary business is banking, insurance, investing, and trading, or a combination thereof. The proposed definition is also designed to align with similar definitions and concepts included in other rulemakings, including those funds that are covered by the restrictions of section 13 of the Bank Holding Company Act. The proposed definition also includes a standard for "predominantly engaged" in financial activities similar to the standard from the Board's proposed rule to define "predominantly engaged in financial activities" for purposes of Title I of the Dodd-Frank Act.[78] Likewise, the proposed definition seeks to exclude firms that are predominantly engaged in activities that have a financial nature but are focused on community development, public welfare projects, and similar objectives.

Question 31: The agencies seek comment on the proposed definition of financial institution. The agencies have sought to achieve consistency in the definition of financial institution with similar definitions proposed in other proposed regulations. The agencies seek comment on the appropriateness of this standard for purposes of the proposal and whether a different threshold, such as greater than 50 percent, would be more appropriate. The agencies ask that commenters provide detailed explanations in their responses.

The corresponding deduction approach

The proposal incorporates the Basel III corresponding deduction approach for the deductions from regulatory capital related to reciprocal cross holdings, non-significant investments in the capital of unconsolidated financial institutions, and non-common stock significant investments in the capital of unconsolidated financial institutions. Under this approach a banking organization would be required to make any such deductions from the same component of capital for which the underlying instrument would qualify if it were issued by the banking organization itself. If a banking organization does not have a sufficient amount of a specific regulatory capital component to effect the deduction, the shortfall would be deducted from the next higher (that is, more subordinated) regulatory capital component. For example, if a banking organization does not have enough additional tier 1 capital to satisfy the required deduction from additional tier 1 capital, the shortfall would be deducted from common equity tier 1 capital.

If the banking organization invests in an instrument issued by a non-regulated financial institution, the banking organization would treat the instrument as common equity tier 1 capital if the instrument is common stock (or if it is otherwise the most subordinated form of capital of the

[78] 76 FR 7731 (February 11, 2011) and 77 FR 21494 (April 10, 2012).

financial institution) and as additional tier 1 capital if the instrument is subordinated to all creditors of the financial institution except common shareholders. If the investment is in the form of an instrument issued by a regulated financial institution and the instrument does not meet the criteria for any of the regulatory capital components for banking organizations, the banking organization would treat the instrument as (i) common equity tier 1 capital if the instrument is common stock included in GAAP equity or represents the most subordinated claim in liquidation of the financial institution; (ii) additional tier 1 capital if the instrument is GAAP equity and is subordinated to all creditors of the financial institution and is only senior in liquidation to common shareholders; and (iii) tier 2 capital if the instrument is not GAAP equity but it is considered regulatory capital by the primary regulator of the financial institution.

Deduction of reciprocal cross holdings in the capital instruments of financial institutions

A reciprocal cross holding results from a formal or informal arrangement between two financial institutions to swap, exchange, or otherwise intend to hold each other's capital instruments. The use of reciprocal cross holdings of capital instruments to artificially inflate the capital positions of each of the banking organizations involved would undermine the purpose of regulatory capital, potentially affecting the stability of such banking organizations as well as the financial system.

Under the agencies' general risk-based capital rules, reciprocal holdings of capital instruments of banking organizations are deducted from regulatory capital. Consistent with Basel III, the proposal would require a banking organization to deduct reciprocal holdings of capital instruments of other financial institutions, where these investments are made with the intention of artificially inflating the capital positions of the banking organizations involved. The deductions would be made by using the corresponding deduction approach.

Determining the exposure amount for investments in the capital of unconsolidated financial institutions

Under the proposal, the exposure amount of an investment in the capital of an unconsolidated financial institution would refer to a net long position in an instrument that is recognized as capital for regulatory purposes by the primary supervisor of an unconsolidated regulated financial institution or in an instrument that is part of the GAAP equity of an unconsolidated unregulated financial institution. It would include direct, indirect, and synthetic exposures to capital instruments, and exclude underwriting positions held by the banking organization for five business days or less. It would be equivalent to the banking organization's potential loss on such exposure should the underlying capital instrument have a value of zero.

The net long position would be the gross long position in the exposure (including covered positions under the market risk capital rules) net of short positions in the same exposure where the maturity of the short position either matches the maturity of the long position or has a residual maturity of at least one year. The long and short positions in the same index without a maturity date would be considered to have matching maturities. For covered positions under the market risk capital rules, if a banking organization has a contractual right or obligation to sell a long position at a specific point in time, and the counterparty in the contract has an obligation to purchase the long position if the banking organization exercises its right to sell, this point in time

may be treated as the maturity of the long position. Therefore, if these conditions are met, the maturity of the long position and the short position would be deemed to be matched even if the maturity of the short position is less than one year.

Gross long positions in investments in the capital instruments of unconsolidated financial institutions resulting from holdings of index securities may be netted against short positions in the same underlying index. However, short positions in indexes that are hedging long cash or synthetic positions may be decomposed to recognize the hedge. More specifically, the portion of the index that is composed of the same underlying exposure that is being hedged may be used to offset the long position as long as both the exposure being hedged and the short position in the index are positions subject to the market risk rule, the positions are fair valued on the banking organization's balance sheet, and the hedge is deemed effective by the banking organization's internal control processes assessed by the primary supervisor of the banking organization. Also, instead of looking through and monitoring its exact exposure to the capital of other financial institutions included in an index security, a banking organization may be permitted, with the prior approval of its primary federal supervisor, to use a conservative estimate of the amount of its investments in the capital instruments of other financial institutions through the index security.

An indirect exposure would result from the banking organization's investment in an unconsolidated entity that has an exposure to a capital instrument of a financial institution. A synthetic exposure results from the banking organization's investment in an instrument where the value of such instrument is linked to the value of a capital instrument of a financial institution. Examples of indirect and synthetic exposures would include: (i) an investment in the capital of an unconsolidated entity that has an investment in the capital of an unconsolidated financial institution; (ii) a total return swap on a capital instrument of another financial institution; (iii) a guarantee or credit protection, provided to a third party, related to the third party's investment in the capital of another financial institution; (iv) a purchased call option or a written put option on the capital instrument of another financial institution; and (v) a forward purchase agreement on the capital of another financial institution.

Investments, including indirect and synthetic exposures, in the capital of unconsolidated financial institutions would be subject to the corresponding deduction approach if they surpass certain thresholds described below. With the prior written approval of the primary federal supervisor, for the period of time stipulated by the supervisor, a banking organization would not be required to deduct investments in the capital of unconsolidated financial institutions described in this section if the investment is made in connection with the banking organization providing financial support to a financial institution in distress. Likewise, a banking organization that is an underwriter of a failed underwriting can request approval from its primary federal supervisor to exclude underwriting positions related to such failed underwriting for a longer period of time.

Question 32: The agencies solicit comments on the scope of indirect exposures for purposes of determining the exposure amount for investments in the capital of unconsolidated financial institutions. Specifically, what parameters (for example, a specific percentage of the issued and outstanding common shares of the unconsolidated financial institution) would be appropriate for purposes of limiting the scope of indirect exposures in this context and why?

Question 33: What are the pros and cons of the proposed exclusion from the exposure amount of an investment in the capital of an unconsolidated financial institution for underwriting positions held by the banking organization for 5 business days or fewer? Would limiting the exemption to 5 days affect banking organizations' willingness to underwrite stock offerings by smaller banking organizations? Please provide data to support your answer.

Deduction of non-significant investments in the capital of unconsolidated financial institutions

Under the proposal, non-significant investments in the capital of unconsolidated financial institutions would be investments where a banking organization owns 10 percent or less of the issued and outstanding common shares of an unconsolidated financial institution.

Under the proposal, if the aggregate amount of a banking organization's non-significant investments in the capital of unconsolidated financial institutions exceeds 10 percent of the sum of the banking organization's common equity tier 1 capital elements, minus certain applicable deductions and other regulatory adjustments to common equity tier 1 capital (the 10 percent threshold for non-significant investments), the banking organization would have to deduct the amount of the non-significant investments that are above the 10 percent threshold for non-significant investments, applying the corresponding deduction approach.[79]

The amount to be deducted from a specific capital component would be equal to the amount of a banking organization's non-significant investments in the capital of unconsolidated financial institutions exceeding the 10 percent threshold for non-significant investments multiplied by the ratio of (i) the amount of non-significant investments in the capital of unconsolidated financial institutions in the form of such capital component to (ii) the amount of the banking organization's total non-significant investments in the capital of unconsolidated financial institutions. The amount of a banking organization's non-significant investments in the capital of unconsolidated financial institutions that does not exceed the 10 percent threshold for non-significant investments would generally be assigned the applicable risk weight under sections 32 (in the case of non-common stock instruments), 52 (in the case of common stock instruments), or 53 (in the case of indirect investments via a mutual fund) of the proposal, as appropriate.

For example, if a banking organization has a total of $200 in non-significant investments in the capital of unconsolidated financial institutions (of which 50 percent is in the form of common stock, 30 percent is in the form of an additional tier 1 capital instrument, and 20 percent

[79] The regulatory adjustments and deductions applied in the calculation of the 10 percent threshold for non-significant investments are those required under sections 22(a) through 22(c)(3) of the proposal. That is, the required deductions and adjustments for goodwill and other intangibles (other than MSAs) net of associated DTLs, DTAs that arise from operating loss and tax credit carryforwards net of related valuation allowances and DTLs (as described below), cash flow hedges associated with items that are not reported at fair value, excess ECLs (for advanced approaches banking organizations only), gains-on-sale on securitization exposures, gains and losses due to changes in own credit risk on fair valued financial liabilities, defined benefit pension fund net assets for banking organizations that are not insured by the FDIC (net of associated DTLs), investments in own regulatory capital instruments (not deducted as treasury stock), and reciprocal cross holdings.

is in the form of tier 2 capital subordinated debt) and $100 of these investments exceed the 10 percent threshold for non-significant investments, the banking organization would need to deduct $50 from its common equity tier 1 capital elements, $30 from its additional tier 1 capital elements and $20 from its tier 2 capital elements.

Deduction of significant investments in the capital of unconsolidated financial institutions that are not in the form of common stock

Under the proposal, a significant investment of a banking organization in the capital of an unconsolidated financial institution would be an investment where the banking organization owns more than 10 percent of the issued and outstanding common shares of the unconsolidated financial institution. Significant investments in the capital of unconsolidated financial institutions that are not in the form of common stock would be deducted applying the corresponding deduction approach described previously. Significant investments in the capital of unconsolidated financial institutions that are in the form of common stock would be subject to the common equity deduction threshold approach described in section III.B.4 of this preamble.

Section 121 of the Graham-Leach-Bliley Act (GLBA) allows national banks and insured state banks to establish entities known as financial subsidiaries.[80] One of the statutory requirements for establishing a financial subsidiary is that a national bank or insured state bank must deduct any investment in a financial subsidiary from the bank's capital.[81] The agencies implemented this statutory requirement through regulation at 12 CFR 5.39(h)(1) (OCC), 12 CFR 208.73 (Board), and 12 CFR 362.18 (FDIC). Under the agencies' current rules, a bank must deduct the aggregate amount of its outstanding equity investment, including retained earnings, in its financial subsidiaries from its total assets and tangible equity, and deduct such investment from its total risk-based capital (made equally from tier 1 and tier 2 capital).

Under the NPR, investments by a national bank or insured state bank in financial subsidiaries would be deducted entirely from the bank's common equity tier 1 capital.[82] Because common equity tier 1 capital is a component of tangible equity, the proposed deduction from common equity tier 1 would automatically result in a deduction from tangible equity. The agencies believe that the more conservative treatment is appropriate for financial subsidiaries, given the risks associated with nonbanking activities.

4. Items Subject to the 10 and 15 Percent Common Equity Tier 1 Capital Threshold Deductions

Under the proposal, a banking organization would deduct from the sum of its common equity tier 1 capital elements the amount of each of the following items that individually exceeds the 10 percent common equity tier 1 capital deduction threshold described below: (i) DTAs arising from temporary differences that could not be realized through net operating loss

[80] Pub.L. 106-102, 113 Stat. 1338, 1373 (Nov. 12, 1999).

[81] 12 U.S.C. 24a(c); 12 U.S.C. 1831w(a)(2).

[82] The deduction provided for in the agencies' existing regulations would be removed.

carrybacks (net of any related valuation allowances and net of DTLs, as described in section 22(e) of the proposal); (ii) MSAs net of associated DTLs; and (iii) significant investments in the capital of financial institutions in the form of common stock (referred to herein as items subject to the threshold deductions).

A banking organization would calculate the 10 percent common equity tier 1 capital deduction threshold by taking 10 percent of the sum of a banking organization's common equity tier 1 elements, less adjustments to, and deductions from common equity tier 1 capital required under sections 22(a) through (c) of the proposal.[83]

As mentioned above, banking organizations would deduct from common equity tier 1 capital elements any goodwill embedded in the valuation of significant investments in the capital of unconsolidated financial institutions in the form of common stock. Therefore, a banking organization would be allowed to net such embedded goodwill against the exposure amount of such significant investment. For example, if a banking organization has deducted $10 of goodwill embedded in a $100 significant investment in the capital of an unconsolidated financial institution in the form of common stock, the banking organization would be allowed to net such embedded goodwill against the exposure amount of such significant investment (that is, the value of the investment would be $90 for purposes of the calculation of the amount that would be subject to deduction under this part of the proposal).

In addition, the aggregate amount of the items subject to the threshold deductions that are not deducted as a result of the 10 percent common equity tier 1 capital deduction threshold described above would not be permitted to exceed 15 percent of a banking organization's common equity tier 1 capital, as calculated after applying all regulatory adjustments and deductions required under the proposal (the 15 percent common equity tier 1 capital deduction threshold). That is, a banking organization would be required to deduct the amounts of the items subject to the threshold deductions that exceed 17.65 percent (the proportion of 15 percent to 85 percent) of common equity tier 1 capital elements, less all regulatory adjustments and deductions required for the calculation of the 10 percent common equity tier 1 capital deduction threshold mentioned above, and less the items subject to the 10 and 15 percent common equity tier 1 capital deduction thresholds in full. As described below, banking organization would be required to include the amounts of these three items that are not deducted from common equity tier 1 capital in its risk-weighted assets and assign a 250 percent risk weight to them.

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[83] The regulatory adjustments and deductions applied in the calculation of the 10 percent common equity deduction threshold are those required under sections 22(a) through (c) of the proposal. That is, the required deductions and adjustments for goodwill and other intangibles (other than MSAs) net of associated DTLs, DTAs that arise from operating loss and tax credit carryforwards net of related valuation allowances and DTLs (as described below), cash flow hedges associated with items that are not reported at fair value, excess ECLs (for advanced approaches banking organizations only), gains-on-sale on securitization exposures, gains and losses due to changes in own credit risk on fair valued financial liabilities, defined benefit pension fund net assets for banking organizations that are not insured by the FDIC (net of associated DTLs), investments in own regulatory capital instruments (not deducted as treasury stock), reciprocal cross holdings, non-significant investments in the capital of unconsolidated financial institutions, and, if applicable, significant investments in the capital of unconsolidated financial institutions that are not in the form of common stock.

Under section 475 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (12 U.S.C. 1828 note), the amount of readily marketable MSAs that a banking organization may include in regulatory capital cannot be valued at more than 90 percent of their fair market value[84] and the fair market value of such MSAs must be determined at least on a quarterly basis. Therefore, if the amount of MSAs a banking organization deducts after the application of the 10 percent and 15 percent common equity tier 1 deduction threshold is less than 10 percent of the fair value of its MSAs, the banking organization must deduct an additional amount of MSAs so that the total amount of MSAs deducted is at least 10 percent of the fair value of its MSAs.

Question 34: The agencies solicit comments and supporting data on the additional regulatory capital deductions outlined in this section above.

5. Netting of DTLs Against DTAs and Other Deductible Assets

Under the proposal, the netting of DTLs against assets (other than DTAs) that are subject to deduction under section 22 of the proposal would be permitted provided the DTL is associated with the asset and the DTL would be extinguished if the associated asset becomes impaired or is derecognized under GAAP. Likewise, banking organizations would be prohibited from using the same DTL for netting purposes more than once. This practice would be generally consistent with the approach that the agencies currently take with respect to the netting of DTLs against goodwill.

With respect to the netting of DTLs against DTAs, the amount of DTAs that arise from operating loss and tax credit carryforwards, net of any related valuation allowances, and the amount of DTAs arising from temporary differences that the banking organization could not realize through net operating loss carrybacks, net of any related valuation allowances, would be allowed to be netted against DTLs if the following conditions are met. First, only the DTAs and DTLs that relate to taxes levied by the same taxation authority and that are eligible for offsetting by that authority would be offset for purposes of this deduction. And second, the amount of DTLs that the banking organization would be able to net against DTAs that arise from operating loss and tax credit carryforwards, net of any related valuation allowances, and against DTAs arising from temporary differences that the banking organization could not realize through net operating loss carrybacks, net of any related valuation allowances, would be allocated in proportion to the amount of DTAs that arise from operating loss and tax credit carryforwards (net of any related valuation allowances, but before any offsetting of DTLs) and of DTAs arising from temporary differences that the banking organization could not realize through net operating loss carrybacks (net of any related valuation allowances, but before any offsetting of DTLs), respectively.

6. Deduction from Tier 1 Capital of Investments in Hedge Funds and Private Equity Funds Pursuant to Section 619 of the Dodd-Frank Act

[84] Section 475 also provides that mortgage servicing rights may be valued at more than 90 percent of their fair market value but no more than 100 percent of such value, if the agencies jointly make a finding that such valuation would not have an adverse effect on the deposit insurance funds or the safety and soundness of insured depository institutions. The agencies have not made such a finding.

Section 619 of the Dodd-Frank Act (the Volcker Rule) contains a number of restrictions and other prudential requirements applicable to any "banking entity"[85] that engages in proprietary trading or has certain interests in, or relationships with, a hedge fund or a private equity fund.[86]

Section 13(d)(3) of the Bank Holding Company Act, as added by the Volcker Rule, provides that the agencies "shall ... adopt rules imposing additional capital requirements and quantitative limitations, including diversification requirements, regarding activities permitted under the Volcker Rule if the appropriate Federal banking agencies, the Securities and Exchange Commission, and the Commodities Future Trading Commission determine that additional capital and quantitative limitations are appropriate to protect the safety and soundness of banking entities engaged in such activities."

The Volcker Rule also added section 13(d)(4)(B)(iii) to the Bank Holding Company Act, which pertains to ownership interests in a hedge fund or private equity fund organized and offered by a banking entity (or an affiliate or subsidiary thereof) and provides, "For the purposes of determining compliance with the applicable capital standards under paragraph (3), the aggregate amount of the outstanding investments by a banking entity under this paragraph, including retained earnings, shall be deducted from the assets and tangible equity of the banking entity, and the amount of the deduction shall increase commensurate with the leverage of the hedge fund or private equity fund."

In October 2011, the agencies and the SEC issued a proposal to implement the Volcker Rule (the Volcker Rule proposal).[87] Section 12(d) of the Volcker Rule proposal included a provision that would require a "banking entity" to deduct from tier 1 capital its investments in a hedge fund or a private equity fund that the banking entity organizes and offers pursuant to the Volcker rule as provided by section 13(d)(3) and (4)(B)(iii) of the Bank Holding Company Act.

Under the Volcker Rule proposal, a banking organization subject to the Volcker Rule[88] would be required to deduct from tier 1 capital the aggregate value of its investments in hedge

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[85] The term "banking entity" is defined in section 13(h)(1) of the Bank Holding Company Act (BHC Act), as amended by section 619 of the Dodd-Frank Act. *See* 12 U.S.C. 1851(h)(1). The statutory definition includes any insured depository institution (other than certain limited purpose trust institutions), any company that controls an insured depository institution, any company that is treated as a bank holding company for purposes of section 8 of the International Banking Act of 1978 (12 U.S.C. 3106), and any affiliate or subsidiary of any of the foregoing.

[86] Section 13 of the BHC Act defines the terms "hedge fund" and "private equity fund" as "an issuer that would be an investment company, as defined in the Investment Company Act of 1940 (15 U.S.C 80a-1 et seq.), but for section 3(c)(1) or 3(c)(7) of that Act, or such similar funds as the appropriate Federal banking agencies, the Securities and Exchange Commission, and the Commodities Futures Trading Commission may, by rule, . . . determine." See 12 U.S.C. 1851(h)(2).

[87] The agencies sought public comment on the Volcker Rule proposal on October 11, 2011, and the Securities and Exchange Commission sought public comment on the same proposal on October 12, 2011. See 76 FR 68846 (Nov. 7, 2011). On January 11, 2012, the Commodities Futures Trading Commission requested comment on a substantively similar proposed rule implementing section 13 of the BHC Act. See 77 FR 8332 (Feb. 14, 2012).

[88] The Volcker rule regulations apply to "banking entities," as defined in section 13(h)(1) of the Bank Holding Company Act (BHC Act), as amended by section 619 of the Dodd-Frank Act. This term generally includes all

funds and private equity funds that the banking organization organizes and offers pursuant to section 13(d)(1)(G) of the Bank Holding Company Act. As proposed, the Volcker Rule deduction would not apply to an ownership interest in a hedge fund or private equity fund held by a banking entity pursuant to any of the exemption activity categories in section 13(d)(1) of the Bank Holding Company Act. For instance, a banking entity that acquires or retains an investment in a small business investment company or an investment designed to promote the public welfare of the type permitted under 12 U.S.C. 24 (Eleventh), which are specifically permitted under section 13(d)(1)(E) of the Bank Holding Company Act, would not be required to deduct the value of such ownership interest from its tier 1 capital.

The agencies believe that this proposed capital requirement, as it applies to banking organizations, should be considered within the context of the agencies' entire regulatory capital framework, so that its potential interaction with all other regulatory capital requirements is assessed fully. The agencies intend to avoid prescribing overlapping regulatory capital requirements for the same exposures. Therefore, once the regulatory capital requirements prescribed by the Volcker Rule are finalized, the Federal banking agencies expect to amend the regulatory capital treatment for investments in the capital of an unconsolidated financial institution – currently set forth in section 22 of the proposal – to include the deduction that would be required under the Volcker Rule. Exposures subject to that deduction would not also be subject to the capital requirements for investments in the capital of an unconsolidated financial institution nor would they be considered for the purpose of determining the relevant thresholds for the deductions from regulatory capital required for investments in the capital of an unconsolidated financial institution.

IV. Denominator Changes Related to the Proposed Regulatory Changes

Consistent with Basel III, for purposes of calculating total risk-weighted assets, the proposal would require a banking organization to assign a 250 percent risk weight to (i) MSAs, (ii) DTAs arising from temporary differences that a banking organization could not realize through net operating loss carrybacks (net of any related valuation allowances and net of DTLs, as described in section 22(e) of the proposal), and (iii) significant investments in the capital of unconsolidated financial institutions in the form of common stock that are not deducted from tier 1 capital pursuant to section 22 of the proposal.

Basel III also requires banking organizations to apply a 1,250 percent risk weight to certain exposures that are deducted from total capital under the general risk-based capital rules. Accordingly, for purposes of calculating total risk-weighted assets, the proposal would require a banking organization to apply a 1,250 percent risk weight to the portion of a credit-enhancing interest-only strips that does not constitute an after-tax-gain-on-sale. A banking organization would not be required to deduct such exposures from regulatory capital.

V. Transitions Provisions

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banking organizations subject to the Federal banking agencies' capital regulations with the exception of limited purpose trust institutions that are not affiliated with a depository institution or bank holding company.

The main goal of the transition provisions is to give banking organizations sufficient time to adjust to the proposal while minimizing the potential impact that implementation could have on their ability to lend. The proposed transition provisions have been designed to ensure compliance with the Dodd-Frank Act. As a result, they could, in certain circumstances, be more stringent than the transitional arrangements proposed in Basel III.

The transition provisions would apply to the following areas: (i) the minimum regulatory capital ratios; (ii) the capital conservation and countercyclical capital buffers; (iii) the regulatory capital adjustments and deductions; and (iv) non-qualifying capital instruments. In the Standardized Approach NPR, the agencies are proposing changes to the calculation of risk-weighted assets that would be effective January 1, 2015, with an option to early adopt.

A. Minimum regulatory capital ratios

The transition period for the minimum common equity tier 1 and tier 1 capital ratios is from January 1, 2013 to December 31, 2014 as set forth below.

Table 9—Transition for Minimum Capital Ratios

Transition Minimum Common Equity Tier 1 and Tier 1 Capital Ratios		
Transition Period	Common equity tier 1 capital ratio	Tier 1 capital ratio
Calendar year 2013	3.5	4.5
Calendar year 2014	4.0	5.5
Calendar year 2015 and thereafter	4.5	6.0

The minimum common equity tier 1 and tier 1 capital ratios, as well as the minimum total capital ratio, will be calculated during the transition period using the definitions for the respective capital components in section 20 of the proposed rule and using the proposed transition provisions for the regulatory adjustments and deductions and for the non-qualifying capital instruments described in this section.

B. Capital conservation and countercyclical capital buffer

As explained in more detail in section 11 of the proposed rule, a banking organization's applicable capital conservation buffer would be the lowest of the following three ratios: the

banking organization's common equity tier 1, tier 1 and total capital ratio less its minimum common equity tier 1, tier 1 and total capital ratio requirement, respectively. Table 10 shows the regulatory capital levels banking organizations would generally need to meet during the transition period to avoid becoming subject to limitations on capital distributions and discretionary bonus payments from January 1, 2016 until January 1, 2019.

Table 10—Proposed Regulatory Capital Levels

	Jan. 1, 2013	**Jan. 1, 2014**	**Jan. 1, 2015**	**Jan. 1, 2016**	**Jan. 1, 2017**	**Jan. 1, 2018**	**Jan. 1, 2019**
Capital conservation buffer				0.625 %	1.25%	1.875 %	2.5%
Minimum common equity tier 1 capital ratio + capital conservation buffer	3.5%	4.0%	4.5%	5.125 %	5.75%	6.375 %	7.0%
Minimum tier 1 capital ratio + capital conservation buffer	4.5%	5.5%	6.0%	6.625 %	7.125 %	7.875 %	8.5%
Minimum total capital ratio + capital conservation buffer	8.0%	8.0%	8.0%	8.625 %	9.125 %	9.875 %	10.5%
Maximum potential countercyclical capital buffer				0.625 %	1.25%	1.875 %	2.5%

Banking organizations would not be subject to the capital conservation and the countercyclical capital buffer until January 1, 2016. From January 1, 2016 through December 31, 2018, banking organizations would be subject to transitional arrangements with respect to the capital conservation and countercyclical capital buffers as outlined in more detail in table 11.

Table 11—Transition Provision for the Capital Conservation and Countercyclical Capital Buffer

Transition Period	Capital conservation buffer (assuming a countercyclical capital buffer of zero)	Maximum payout ratio (as a percentage of eligible retained income)
Calendar year 2016	Greater than 0.625 percent	No payout ratio limitation applies
	Less than or equal to 0.625 percent, and greater than 0.469 percent	60 percent
	Less than or equal to 0.469 percent, and greater than 0.313 percent	40 percent
	Less than or equal to 0.313 percent, and greater than 0.156 percent	20 percent
	Less than or equal to 0.156 percent	0 percent
Calendar year 2017	Greater than 1.25 percent	No payout ratio limitation applies
	Less than or equal to 1.25 percent, and greater than 0.938 percent	60 percent
	Less than or equal to 0.938 percent, and greater than 0.625 percent	40 percent
	Less than or equal to 0.625 percent, and greater than 0.313 percent	20 percent
	Less than or equal to 0.313 percent	0 percent
Calendar year 2018	Greater than 1.875 percent	No payout ratio limitation applies
	Less than or equal to 1.875 percent, and greater than 1.406 percent	60 percent
	Less than or equal to 1.406 percent, and greater than 0.938 percent	40 percent
	Less than or equal to 0.938 percent, and greater than 0.469 percent	20 percent

	Less than or equal to 0.469 percent	0 percent

As illustrated in table 11, from January 1, 2016 through December 31, 2016, a banking organization would be able to make capital distributions and discretionary bonus payments without limitation under this section as long as it maintains a capital conservation buffer greater than 0.625 percent (plus for an advanced approaches banking organization, any applicable countercyclical capital buffer amount). From January 1, 2017 through December 31, 2017, a banking organization would be able to make capital distributions and discretionary bonus payments without limitation under this section as long as it maintains a capital conservation buffer greater than 1.25 percent (plus for an advanced approaches banking organization, any applicable countercyclical capital buffer amount). From January 1, 2018 through December 31, 2018, a banking organization would be able to make capital distributions and discretionary bonus payments without limitation under this section as long as it maintains a capital conservation buffer greater than 1.875 percent (plus for an advanced approaches banking organization, any applicable countercyclical capital buffer amount). From January 1, 2019 onward, a banking organization would be able to make capital distributions and discretionary bonus payments without limitation under this section as long as it maintains a capital conservation buffer greater than 2.5 percent (plus for an advanced approaches banking organization, 100 percent of the applicable countercyclical capital buffer amount).

For example, if a banking organization's capital conservation buffer is 1.0 percent (for example, its common equity tier 1 capital ratio is 5.5 percent or its tier 1 capital ratio is 7.0 percent) as of December 31, 2017, the banking organization's maximum payout ratio during the first quarter of 2018 would be 60 percent. If a banking organization has a capital conservation buffer of 0.25 percent as of December 31, 2017, the banking organization would not be allowed to make capital distributions and discretionary bonus payments during the first quarter of 2018 under the proposed transition provisions. If a banking organization has a capital conservation buffer of 1.5 percent as of December 31, 2017, it would not have any restrictions under this section on the amount of capital distributions and discretionary bonus payments during the first quarter of 2018.

If applicable, the countercyclical capital buffer would be phased-in according to the transition schedule described in table 11 by proportionately expanding each of the quartiles in the table by the countercyclical capital buffer amount. The maximum countercyclical capital buffer amount would be 0.625 percent on January 1, 2016 and would increase each subsequent year by an additional 0.625 percentage points, to reach its fully phased-in maximum of 2.5 percent on January 1, 2019.

C. Regulatory Capital Adjustments and Deductions

Banking organizations are currently subject to a series of deductions from and adjustments to regulatory capital, most of which apply at the tier 1 capital level, including deductions for goodwill, MSAs, certain DTAs, and adjustments for net unrealized gains and losses on AFS securities and for accumulated net gains and losses on cash flow hedges and defined benefit pension obligations. Under section 22 of the proposed rule, banking

organizations would become subject to a series of deductions and adjustments, the bulk of which will be applied at the common equity tier 1 capital level. In order to give sufficient time to banking organizations to adapt to the new regulatory capital adjustments and deductions, the proposed rule incorporates transition provisions for such adjustments and deductions. From January 1, 2013 through December 31, 2017, a banking organization would be required to make the regulatory capital adjustments to and deductions from regulatory capital in section 22 of the proposed rule in accordance with the proposed transition provisions for such adjustments and deductions outlined below. Starting on January 1, 2018, banking organizations would apply all regulatory capital adjustments and deductions as outlined in section 22 of the proposed rule.

Deductions for certain items in section 22(a) of the proposed rule

From January 1, 2013 through December 31, 2017, a banking organization would deduct from common equity tier 1 or from tier 1 capital elements goodwill (section 22(a)(1)), DTAs that arise from operating loss and tax credit carryforwards (section 22(a)(3)), gain-on-sale associated with a securitization exposure (section 22(a)(4)), defined benefit pension fund assets (section 22(a)(5)), and expected credit loss that exceeds eligible credit reserves for the case of banking organizations subject to subpart E of the proposed rule (section 22(a)(6)), in accordance with table 12 below. During this period, any of these items that are not deducted from common equity tier 1 capital, are deducted from tier 1 capital instead.

Table 12—Proposed Transition Deductions under Section 22(a)(1) and Sections 22(a)(3)-(a)(6) of the proposal

Transition Period	Transition deductions under section 22(a)(1)	Transition deductions under sections 22(a)(3)-(a)(6)	
	Percentage of the deductions from common equity tier 1 capital	Percentage of the deductions from common equity tier 1 capital	Percentage of the deductions from tier 1 capital
Calendar year 2013	100	0	100
Calendar year 2014	100	20	80
Calendar year 2015	100	40	60
Calendar year 2016	100	60	40
Calendar year 2017	100	80	20
Calendar year 2018, and thereafter	100	100	0

In accordance with table 12, starting in 2013, banking organizations would be required to deduct the full amount of goodwill (net of any associated DTLs), including any goodwill embedded in the valuation of significant investments in the capital of unconsolidated financial institutions, from common equity tier 1 capital elements. This approach is stricter than that under Basel III, which transitions the goodwill deduction from common equity tier 1 capital in line with the rest of the deductible items. Under U.S. law, goodwill cannot be included in a

banking organization's regulatory capital. Additionally, the agencies believe that fully deducting goodwill from common equity tier 1 capital elements starting on January 1, 2013 would result in a more meaningful common equity tier 1 capital ratio from a supervisory and market perspective.

For example, from January 1, 2014 through December 31, 2014, a banking organization would deduct 100 percent of goodwill from common equity tier 1 capital elements. However, during that same period, only 20 percent of the aggregate amount of DTAs that arise from operating loss and tax credit carryforwards, gain-on-sale associated with a securitization exposure, defined benefit pension fund assets, and expected credit loss that exceeds eligible credit reserves (for a banking organization subject to subpart E of the proposed rule), would be deducted from common equity tier 1 capital elements while 80 percent of such aggregate amount would be deducted from tier 1 capital elements. Starting on January 1, 2018, 100 percent of the items in section 22(a) of the proposed rule would be fully deducted from common equity tier 1 capital elements.

Deductions for intangibles other than goodwill and MSAs

For intangibles other than goodwill and MSAs, including PCCRs (section 22(a)(2) of the proposal), the transition arrangement is outlined in table 13. During this transition period, any of these items that are not deducted would be subject to a risk weight of 100 percent.

Table 13—Proposed Transition Deductions under Section 22(a)(2) of the proposal

Transition Period	Transition deductions under section 22(a)(2) – Percentage of the deductions from common equity tier 1 capital
Calendar year 2013	0
Calendar year 2014	20
Calendar year 2015	40
Calendar year 2016	60
Calendar year 2017	80
Calendar year 2018 and thereafter	100

For example, from January 1, 2014 through December 31, 2014, 20 percent of the aggregate amount of the deductions that would be required under section 22(a)(2) of the proposed rule for intangibles other than goodwill and MSAs would be applied to common equity tier 1 capital, while any such intangibles that are not deducted from capital during the transition period would be risk-weighted at 100 percent.

Regulatory adjustments under section 22(b)(2) of the proposed rule

From January 1, 2013 through December 31, 2017, banking organizations would apply the regulatory adjustments under section 22(b)(2) of the proposed rule related to changes in the fair value of liabilities due to changes in the banking organization's own credit risk to common equity tier 1 or tier 1 capital in accordance with table 14. During this period, any of the adjustments related to this item that are not applied to common equity tier 1 capital are applied to tier 1 capital instead.

Table 14—Proposed Transition Adjustments under Section 22(b)(2)

Transition Period	Transition adjustments under section 22(b)(2)	
	Percentage of the adjustment applied to common equity tier 1 capital	Percentage of the adjustment applied to tier 1 capital
Calendar year 2013	0	100
Calendar year 2014	20	80
Calendar year 2015	40	60
Calendar year 2016	60	40
Calendar year 2017	80	20
Calendar year 2018, and thereafter	100	0

For example, from January 1, 2013 through December 31, 2013, no regulatory adjustments to common equity tier 1 capital related to changes in the fair value of liabilities due to changes in the banking organization's own credit risk would be applied to common equity tier 1 capital, but 100 percent of such adjustments would be applied to tier 1 capital (that is, if the aggregate amount of these adjustments is positive, 100 percent would be deducted from tier 1 capital elements and if such aggregate amount is negative, 100 percent would be added back to tier 1 capital elements). Likewise, from January 1, 2014 through December 31, 2014, 20 percent of the aggregate amount of the regulatory adjustments to common equity tier 1 capital related to this item would be applied to common equity tier 1 capital and 80 percent would be applied to tier 1 capital. Starting on January 1, 2018, 100 percent of the regulatory capital adjustments related to changes in the fair value of liabilities due to changes in the banking organization's own credit risk would be applied to common equity tier 1 capital.

Phase out of current AOCI regulatory capital adjustments

Until December 31, 2017, the aggregate amount of net unrealized gains and losses on AFS debt securities, accumulated net gains and losses related to defined benefit pension obligations, unrealized gains on AFS equity securities, and accumulated net gains and losses on cash flow hedges related to items that are reported on the balance sheet at fair value included in AOCI (transition AOCI adjustment amount) is treated as set forth in table 15 below. Specifically, if a banking organization's transition AOCI adjustment amount is positive, it would need to adjust its common equity tier 1 capital by deducting the appropriate percentage of such aggregate amount in accordance with table 15 below and if such amount is negative, it would need to adjust its common equity tier 1 capital by adding back the appropriate percentage of such aggregate amount in accordance with table 15 below.

Table 15— Proposed Percentage of the transition AOCI adjustment amount

Transition Period	Percentage of the transition AOCI adjustment amount to be applied to common equity tier 1 capital
Calendar year 2013	100
Calendar year 2014	80
Calendar year 2015	60
Calendar year 2016	40
Calendar year 2017	20
Calendar year 2018 and thereafter	0

For example, if during calendar year 2013 a banking organization's transition AOCI adjustment amount is positive 100 percent would be deducted from common equity tier 1 capital elements and if such aggregate amount is negative 100 percent would be added back to common equity tier 1 capital elements. Starting on January 1, 2018, there would be no adjustment for net unrealized gains and losses on AFS securities or for accumulated net gains and losses on cash flow hedges related to items that are reported on the balance sheet at fair value included in AOCI.

Phase out of unrealized gains on AFS equity securities in tier 2 capital

A banking organization would gradually decrease the amount of unrealized gains on AFS equity securities it currently holds in tier 2 capital during the transition period in accordance with table 16.

Table 16—Proposed Percentage of Unrealized Gains on AFS equity Securities that may be Included in Tier 2 Capital

Transition Period	Percentage of unrealized gains on AFS equity securities that may be included in tier 2 capital
Calendar year 2013	45
Calendar year 2014	36
Calendar year 2015	27
Calendar year 2016	18
Calendar year 2017	9
Calendar year 2018 and thereafter	0

For example, during calendar year 2014, banking organizations would include up to 36 percent (80 percent of 45 percent) of unrealized gains on AFS equity securities in tier 2 capital; during calendar years 2015, 2016, 2017, and 2018 (and thereafter) these percentages would go down to 27, 18, 9 and zero, respectively.

Deductions under sections 22(c) and 22(d) of the proposed rule

From January 1, 2013 through December 31, 2017, a banking organization would calculate the appropriate deductions under sections 22(c) and 22(d) of the proposed rule related to investments in capital instruments and to the items subject to the 10 and 15 percent common equity tier 1 capital deduction thresholds (that is, MSAs, DTAs arising from temporary differences that the banking organization could not realize through net operating loss carrybacks, and significant investments in the capital of unconsolidated financial institutions in the form of

common stock) as set forth in table 17. Specifically, during such transition period, the banking organization would make the percentage of the aggregate common equity tier 1 capital deductions related to these items in accordance with the percentages outlined in table 17 and would apply a 100 percent risk-weight to the aggregate amount of such items that are not deducted under this section. Beginning on January 1, 2018, a banking organization would be required to apply a 250 percent risk-weight to the aggregate amount of the items subject to the 10 and 15 percent common equity tier 1 capital deduction thresholds that are not deducted from common equity tier 1 capital.

Table 17—Proposed Transition Deductions under Sections 22(c) and 22(d) of the proposal

Transition Period	Transition deductions under sections.22(c) and 22(d) – Percentage of the deductions from common equity tier 1 capital elements
Calendar year 2013	0
Calendar year 2014	20
Calendar year 2015	40
Calendar year 2016	60
Calendar year 2017	80
Calendar year 2018 and thereafter	100

However, banking organizations would not be subject to the methodology to calculate the 15 percent common equity deduction threshold for DTAs arising from temporary differences that the banking organization could not realize through net operating loss carrybacks, MSAs, and significant investments in the capital of unconsolidated financial institutions in the form of common stock described in section 22(d) of the proposed rule from January 1, 2013 through December 31, 2017. During this transition period, a banking organization would be required to deduct from its common equity tier 1 capital elements a specified percentage of the amount by which the aggregate sum of the items subject to the 10 and 15 percent common equity tier 1 capital deduction thresholds exceeds 15 percent of the sum of the banking organization's

common equity tier 1 capital elements after making the deductions required under sections 22(a) through (c) of the proposed rule. These deductions include goodwill, intangibles other than goodwill and MSAs, DTAs that arise from operating loss and tax credit carryforwards cash flow hedges associated with items that are not fair valued, excess ECLs (for advanced approaches banking organizations), gains-on-sale on certain securitization exposures, defined benefit pension fund net assets for banks that are not insured by the FDIC, and reciprocal cross holdings, gains (or adding back losses) due to changes in own credit risk on fair valued financial liabilities, and after applying the appropriate common equity tier 1 capital deductions related to non-significant investments in the capital of unconsolidated financial institutions (the 15 percent common equity deduction threshold for transition purposes).

Notwithstanding the transition provisions for the items under sections 22(c) and 22(d) of the proposed rule described above, if the amount of MSAs a banking organization deducts after the application of the appropriate thresholds is less than 10 percent of the fair value of its MSAs, the banking organization must deduct an additional amount of MSAs so that the total amount of MSAs deducted is at least 10 percent of the fair value of its MSAs.

Beginning January 1, 2018, the aggregate amount of the items subject to the 10 and 15 percent common equity tier 1 capital deduction thresholds would not be permitted to exceed 15 percent of the banking organization's common equity tier 1 capital after all deductions. That is, as of January 1, 2018, the banking organization would be required to deduct, from common equity tier 1 capital elements the items subject to the 10 and 15 percent common equity tier 1 capital deduction thresholds that exceed 17.65 percent of common equity tier 1 capital elements less the regulatory adjustments and deductions mentioned in the previous paragraph and less the aggregate amount of the items subject to the 10 and 15 percent common equity tier 1 capital deduction thresholds in full.

For example, during calendar year 2014, 20 percent of the aggregate amount of the deductions required for the items subject to the 10 and 15 percent common equity tier 1 capital deduction thresholds would be applied to common equity tier 1 capital, while any such items not deducted would be risk weighted at 100 percent. Starting on January 1, 2018, 100 percent of the appropriate aggregate deductions described in sections 22(c) and 22(d) of the proposed rule would be fully applied, while any of the items subject to the 10 and 15 percent common equity tier 1 capital deduction thresholds that are not deducted would be risk weighted at 250 percent.

Numerical Example for the Transition Provisions

The following example illustrates the potential impact from regulatory capital adjustments and deductions on the common equity tier 1 capital ratios of a banking organization. As outlined in table 18, the banking organization in this example has common equity tier 1 capital elements (before any deductions) and total risk weighted assets of $200 and $1000 respectively, and also has goodwill, DTAs that arise from operating loss and tax credit carryforwards, non-significant investments in the capital of unconsolidated financial institutions, DTAs arising from temporary differences that could not be realized through net operating loss carrybacks, MSAs, and significant investments in the capital of unconsolidated financial institutions in the form of common stock of $40, $30, $10, $30, $20, and $10, respectively.

Table 18—Example – Impact of Regulatory Deductions During Transition Period

Common equity tier 1 capital elements, net of treasury stock (CET1) elements (before deductions)	200
Items subject to full deduction	
Goodwill	40
Deferred tax assets (DTAs) that arise from operating loss and tax credit carryforwards (DTAs from operating loss carryforwards)	30
Items subject to threshold deductions	
Non-significant investments in the capital of unconsolidated financial institutions (non-significant investments)	10
Items subject to aggregate 15% threshold	
DTAs arising from temporary differences that the banking organization could not realize through net operating loss carrybacks (temporary differences DTAs)	30
MSAs	20
Significant investments in the capital of unconsolidated financial institutions in the form of common stock (significant investments)	10
Risk-weighted assets (RWAs)	1000

Table 19 below illustrates the process to calculate the deductions while showing the potential impact of the deductions on the common equity tier 1 capital ratio of the banking organization during the transition period.

Table 19— Example – Impact of Regulatory Deductions during Transition Period

	Base case						
Transition calendar years		2013	2014	2015	2016	2017	2018
Percentage of deduction			20%	40%	60%	80%	100%
CET1 before deductions	**200**	**200**	**200**	**200**	**200**	**200**	**200**
Deduction of goodwill	**40**	**40**	**40**	**40**	**40**	**40**	**40**
Deduction of DTAs from operating loss carryforwards	30	0	6	12	18	24	30
CET1 after non-threshold deductions	**130**	**160**	**154**	**148**	**142**	**136**	**130**
10% limit for non-significant investments	*13.0*	*16.0*	*15.4*	*14.8*	*14.2*	*13.6*	*13.0*
Deduction of non-significant investments	0	0	0	0	0	0	0
CET1 after non-threshold deductions and deduction of non-significant investments	**130**	**160**	**154**	**148**	**142**	**136**	**130**
10% CET1 limit for items subject to 15% threshold	*13.0*	*16.0*	*15.4*	*14.8*	*14.2*	*13.6*	*13.0*
Deduction of significant investments due to 10% limit	0	0	0	0	0	0	0
Deduction of temporary differences DTAs due to 10% limit	17.0	0	3.4	6.8	10.2	13.6	17.0
Deduction of MSAs due	7.0	0	1.4	2.8	4.2	5.6	7.0

to 10% limit							
CET1 after deductions related to 10% limit	**106**	**160**	**149.2**	**138.4**	**127.6**	**116.8**	**106.0**
Outstanding significant investments	10	10	10	10	10	10	10
Outstanding temporary differences DTAs	13	30	27	23	20	16	13
Outstanding MSAs	13	20	19	17	16	14	13
Sum of outstanding items subject to 15% threshold	36	60	55	50	46	41	36
15% CET1 limit (for items subject to 15% threshold) (pre-2018)	19.5	24.0	23.1	22.2	21.3	20.4	19.5
Deduction of outstanding items subject to 15% threshold due to 15% limit (pre-2018)	16.5	0.0	3.3	6.6	9.9	13.2	
Additional MSA deduction as of the statutory limit (i.e., 10% of FV of MSAs)	*0*	*2*	*0*	*0*	*0*	*0*	*0*
CET1 after all deductions (pre-2018)	**89.5**	**158.0**	**145.9**	**131.8**	**117.7**	**103.6**	
Total New RWAs (pre-2018)	889.5	928.0	921.9	913.8	905.7	897.6	
15% CET1 limit (for items subject to 15% threshold) (2018)							*12*
Deduction of outstanding items subject to 15% threshold due to 15% limit (2018)							*24*
CET1 after all deductions - starting 2018							***82.4***

2018 RWAs							*882*
CET1 ratio		**17.0%**	**15.8%**	**14.4%**	**13.0%**	**11.5%**	**9.3%**

To establish the starting point (or "base case") for the deductions, the banking organization calculates the fully phased-in deductions, except in the case of the 15 percent deduction threshold, which is calculated during the transition period as described above. Common equity tier 1 capital elements, after the deduction of items that are not subject to the threshold deductions are $160, $154, $148, $142, and $136, and $130 as of January 1, 2013, January 1, 2014, January 1, 2015, January 1, 2016, January 1, 2017, and January 1, 2018, respectively. In this particular example, these numbers are obtained after fully deducting goodwill, and after deducting the base case deduction for DTAs that arise from operating loss and tax credit carryforwards multiplied by the appropriate percentage under the transition arrangement for deductions outlined in table 12 of this section. That is, after deducting from common equity tier 1 capital elements 100 percent of goodwill and 20 percent of the base case deduction for DTAs that arise from operating loss and tax credit carryforwards during 2014, 40 percent during 2015, 60 percent during 2016, 80 percent during 2017, and 100 percent during 2018).[89]

After applying the required deduction as a result of the 10 and 15 percent common equity tier 1 deduction thresholds outlined in table 17 of this section and after making the additional $2 deduction of MSAs during 2013 as a result of the MSA minimum statutory deduction (that is, 10 percent of the fair value of the MSAs), the common equity tier 1 capital elements would be $158, $146, $132, $118, $104, and $82 as of January 1, 2013, January 1, 2014, January 1, 2015, January 1, 2016, January 1, 2017, and January 1, 2018, respectively. After adjusting the total risk weighted assets measure as a result of the numerator deductions, the common equity tier 1 capital ratios would be 17.0 percent, 15.8 percent, 14.4 percent, 13.0 percent, 11.5 percent and 9.3 percent as of January 1, 2013, January 1, 2014, January 1, 2015, January 1, 2016, January 1, 2017, and January 1, 2018, respectively. Any DTAs arising from temporary differences that could not be realized through net operating loss carrybacks, MSAs, or significant investments in the capital of unconsolidated financial institutions in the form of common stock that are not deducted from common equity tier 1 capital elements as a result of the transitional arrangements would be risk weighted at 100 percent during the transition period and would be risk weighted at 250 percent starting on 2018.

D. Non-qualifying Capital Instruments

Under the NPR, non-qualifying capital instruments, including instruments that are part of minority interest, would be phased out from regulatory capital depending on the size of the issuing banking organization and the type of capital instrument involved. Under the proposed rule, and in line with the requirements under the Dodd-Frank Act, instruments like cumulative

[89] As outlined in table 12, the amount of DTAs that arise from operating loss and tax credit carryforwards that are not deducted from common equity tier 1 capital during the transition period are deducted from tier 1 capital instead.

perpetual preferred stock and trust preferred securities, which bank holding companies have historically included (subject to limits) in tier 1 capital under the "restricted core capital elements" bucket generally would not comply with either the eligibility criteria for additional tier 1 capital instruments outlined in section 20 of the proposed rule or the general risk-based capital rules for depository institutions and therefore would be phased out from tier 1 capital as outlined in more detail below. However, these instruments would generally be included without limits in tier 2 capital if they meet the eligibility criteria for tier 2 capital instruments outlined in section 20 of the proposed rule.

Phase-out schedule for non-qualifying capital instruments of depository institution holding companies of $15 billion or more in total consolidated assets

Under section 171 of the Dodd-Frank Act, depository institution holding companies with total consolidated assets greater than or equal to $15 billion as of December 31, 2009 (depository institution holding companies of $15 billion or more) would be required to phase out their non-qualifying capital instruments as set forth in table 20 below. In the case of depository institution holding companies of $15 billion or more, non-qualifying capital instruments are debt or equity instruments issued before May 19, 2010, that do not meet the criteria in section 20 of the proposed rule and were included in tier 1 or tier 2 capital as of May 19, 2010. Table 20 would apply separately to additional tier 1 and tier 2 non-qualifying capital instruments but the amount of non-qualifying capital instruments that would be excluded from additional tier 1 capital under this section would be included in tier 2 capital without limitation if they meet the eligibility criteria for tier 2 capital instruments under section 20 of the proposed rule. If a depository institution holding company of $15 billion or more acquires a depository institution holding company with total consolidated assets of less than $15 billion as of December 31, 2009 (depository institution holding company under $15 billion) or a depository institution holding company that was a mutual holding company as of May 19, 2010 (2010 MHC), the non-qualifying capital instruments of the resulting organization would be subject to the phase-out schedule outlined in table 20. Likewise, if a depository institution holding company under $15 billion makes an acquisition and the resulting organization has total consolidated assets of $15 billion or more, its non-qualifying capital instruments would also be to the phase-out schedule outlined in table 20.

Table 20—Proposed Percentage of Non-qualifying Capital Instruments Included in Additional Tier 1 or Tier 2 Capital

Transition Period (Calendar year)	Percentage of non-qualifying capital instruments included in additional tier 1 or tier 2 capital
Calendar year 2013	75
Calendar year 2014	50
Calendar year 2015	25
Calendar year 2016 and thereafter	0

Accordingly, under the proposed rule a depository institution holding company of $15 billion or more would be allowed to include only 75 percent of non-qualifying capital instruments in regulatory capital as of January 1, 2013, 50 percent as of January 1, 2014, 25 percent as of January 1, 2015, and zero percent as of January 1, 2016 and thereafter.

Phase-out schedule for non-qualifying capital instruments of depository institution holding companies under $15 billion for and depository institutions

Under the proposed rule, non-qualifying capital instruments of depository institutions and of depository institution holding companies under $15 billion and 2010 MHCs (issued before September 12, 2010), that were outstanding as of January 1, 2013 would be included in capital up to the percentage of the outstanding principal amount of such non-qualifying capital instruments as of December 31, 2013 indicated in table 21. Table 21 applies separately to additional tier 1 and tier 2 non-qualifying capital instruments but the amount of non-qualifying capital instruments that would be excluded from additional tier 1 capital under this section would be included in the tier 2 capital, provided the instruments meet the eligibility criteria for tier 2 capital instruments under section 20 of the proposed rule.

Table 21—Proposed Percentage of Non-qualifying Capital Instruments Included in Additional Tier 1 or Tier 2 Capital

Transition Period (Calendar year)	Percentage of non-qualifying capital instruments included in additional tier 1 or tier 2 capital
Calendar year 2013	90
Calendar year 2014	80
Calendar year 2015	70
Calendar year 2016	60
Calendar year 2017	50
Calendar year 2018	40
Calendar year 2019	30
Calendar year 2020	20
Calendar year 2021	10
Calendar year 2022 and thereafter	0

For example, a banking organization that issued a tier 1 non-qualifying capital instrument in August 2010 would be able to count 90 percent of the notional outstanding amount of the instrument as of January 1, 2013 during calendar year 2013 and 80 percent during calendar year

2014. As of January 1, 2022, no tier 1 non-qualifying capital instruments would be recognized in tier 1 capital.

Transition Provisions for Standardized Approach NPR

In addition, under the Standardized Approach NPR, beginning on January 1, 2015, a banking organization would be required to calculate risk-weighted assets using the proposed new approaches described in that NPR. The Standardized Approach NPR proposes that until then, the banking organization may calculate risk-weighted assets using the current methodologies unless it decides to early adopt the proposed changes. Notwithstanding the transition provisions in the Standardized Approach NPR, the banking organization would be subject to the transition provisions described in this Basel III NPR.

Question 35: The agencies solicit comments on the transitions arrangements outlined previously. In particular, what specific regulatory reporting burden or complexities would result from the application of the transition arrangements described in this section of the preamble, and what specific alternatives exist to deal with such burden or complexity while still adhering to the general transitional provisions required under the Dodd-Frank Act?

Question 36: What are the pros and cons of a potentially stricter (but less complex) alternative transitions approach for the regulatory adjustments and deductions outlined in this section C under which banking organizations would be required to (1) apply all the regulatory adjustments and deductions currently applicable to tier 1 capital under the general risk-based capital rules to common equity tier 1 capital from January 1, 2013 through December 31, 2015; and (2) fully apply all the regulatory adjustments and deductions proposed in section 22 of the propped rule starting on January 1, 2016? Please provide data to support your views.

E. Leverage Ratio

The agencies are proposing to apply the supplementary leverage ratio beginning in 2018. However, beginning on January 1, 2015, advanced approaches banking organizations would be required to calculate and report the supplementary leverage ratio using the proposed definition of tier 1 capital and total exposure measure.

Question 37: The agencies solicit comment on the proposed transition arrangements for the supplementary leverage ratio. In particular, what specific challenges do banking organizations anticipate with regard to the proposed arrangements and what specific alternative arrangements would address these challenges?

VI. Additional OCC Technical Amendments

In addition to the changes described above, the OCC is proposing to redesignate subpart C, Establishment of Minimum Capital Ratios for an Individual Bank, subpart D, Enforcement, and subpart E, Issuance of a Directive, as subparts H, I, and J, respectively. The OCC is also proposing to redesignate section 3.100, Capital and Surplus, as subpart K, Capital and Surplus. The OCC is carrying over redesignated subpart K, which includes definitions of the terms "capital" and "surplus" and related definitions that are used for determining statutory limits applicable to national banks that are based on capital and surplus. The agencies have

systematically adopted a definition of capital and surplus that is based on tier 1 and tier 2 capital. The OCC believes that the definitions in redesignated subpart K may no longer be necessary and is considering whether to delete these definitions in the final rule. Finally, as part of the integration of the rules governing national banks and federal savings associations, the OCC proposes to make part 3 applicable to federal savings associations, make other non-substantive, technical amendments, and rescind part 167, Capital.

In the final rule, the OCC may need to make additional technical and conforming amendments to other OCC rules, such as §5.46, subordinated debt, which contains cross references to Part 3 that we propose to change pursuant to this rule. Cross references to appendices A, B, or C will also need to be amended because we propose to replace those appendices with subparts A through H.

Question 38: The OCC requests comment on all aspects of these proposed changes, but is specifically interested in whether it is necessary to retain the definitions of capital and surplus and related terms in redesignated subpart K.

VII. List of Acronyms

ABCP Asset-Backed Commercial Paper

ABS Asset Backed Security

ADC Acquisition, Development, or Construction

AFS Available For Sale

AOCI Accumulated Other Comprehensive Income

BCBS Basel Committee on Banking Supervision

BHC Bank Holding Company

BIS Bank for International Settlements

CAMELS Capital adequacy, Asset quality, Management, Earnings, Liquidity, and Sensitivity to market risk

CCF Credit Conversion Factor

CCP Central Counterparty

CDC Community Development Corporation

CDFI Community Development Financial Institution

CDO Collateralized Debt Obligation

CDS Credit Default Swap

CDSind Index Credit Default Swap

CEIO Credit-Enhancing Interest-Only Strip

CF Conversion Factor

CFR Code of Federal Regulations

CFTC Commodity Futures Trading Commission

CMBS Commercial Mortgage Backed Security

CPSS Committee on Payment and Settlement Systems

CRC Country Risk Classifications

CRAM Country Risk Assessment Model

CRM Credit Risk Mitigation

CUSIP Committee on Uniform Securities Identification Procedures

DCO Derivatives Clearing Organizations

DFA Dodd-Frank Act

DI Depository Institution

DPC Debts Previously Contracted

DTA Deferred Tax Asset

DTL Deferred Tax Liability

DVA Debit Valuation Adjustment

DvP Delivery-versus-Payment

E Measure of Effectiveness

EAD Exposure at Default

ECL Expected Credit Loss

EE Expected Exposure

E.O. Executive Order

EPE Expected Positive Exposure

FASB Financial Accounting Standards Board

FDIC Federal Deposit Insurance Corporation

FFIEC Federal Financial Institutions Examination Council

FHLMC Federal Home Loan Mortgage Corporation

FMU Financial Market Utility

FNMA Federal National Mortgage Association

FR Federal Register

GAAP Generally Accepted Accounting Principles

GDP Gross Domestic Product

GLBA Gramm-Leach-Bliley Act

GSE Government-Sponsored Entity

HAMP Home Affordable Mortgage Program

HELOC Home Equity Line of Credit

HOLA Home Owners' Loan Act

HVCRE High-Volatility Commercial Real Estate

IFRS International Reporting Standards

IMM Internal Models Methodology

I/O Interest-Only

IOSCO International Organization of Securities Commissions

LTV Loan-to-Value Ratio

M Effective Maturity

MDB Multilateral Development Banks

MSA Mortgage Servicing Assets

NGR Net-to-Gross Ratio

NPR Notice of Proposed Rulemaking

NRSRO Nationally Recognized Statistical Rating Organization

OCC Office of the Comptroller of the Currency

OECD Organization for Economic Co-operation and Development

OIRA Office of Information and Regulatory Affairs

OMB Office of Management and Budget

OTC Over-the-Counter

PCA Prompt Corrective Action

PCCR Purchased Credit Card Receivables

PFE Potential Future Exposure

PMI Private Mortgage Insurance

PSE Public Sector Entities

PvP Payment-versus-Payment

QCCP Qualifying Central Counterparty

RBA Ratings-Based Approach

REIT Real Estate Investment Trust

RFA Regulatory Flexibility Act

RMBS Residential Mortgage Backed Security

RTCRRI Act Resolution Trust Corporation Refinancing, Restructuring, and Improvement Act of 1991

RVC Ratio of Value Change

RWA Risk-Weighted Asset

SEC Securities and Exchange Commission

SFA Supervisory Formula Approach

SFT Securities Financing Transactions

SLHC Savings and Loan Holding Company

SPE Special Purpose Entity

SPV Special Purpose Vehicle

SR Supervision and Regulation Letter

SRWA Simple Risk-Weight Approach

SSFA Simplified Supervisory Formula Approach

UMRA Unfunded Mandates Reform Act of 1995

U.S. United States

U.S.C. United States Code

VaR Value-at-Risk

VIII. Regulatory Flexibility Act

The Regulatory Flexibility Act, 5 U.S.C. 601 et seq. (RFA) requires an agency to provide an initial regulatory flexibility analysis with a proposed rule or to certify that the rule will not have a significant economic impact on a substantial number of small entities (defined for purposes of the RFA to include banking entities with assets less than or equal to $175 million) and publish its certification and a short, explanatory statement in the Federal Register along with the proposed rule.

The agencies are separately publishing initial regulatory flexibility analyses for the proposals as set forth in this NPR.

Board

A. Statement of the Objectives of the Proposal; Legal Basis

As discussed previously in the Supplementary Information, the Board is proposing in this NPR to revise its capital requirements to promote safe and sound banking practices, implement Basel III, and codify its capital requirements. The proposals also satisfy certain requirements under the Dodd-Frank Act by imposing new or revised minimum capital requirements on certain depository institution holding companies.[90] Under section 38(c)(1) of the Federal Deposit Insurance Act, the agencies may prescribe capital standards for depository institutions that they regulate.[91] In addition, among other authorities, the Board may establish capital requirements for state member banks under the Federal Reserve Act,[92] for state member banks and bank holding

[90] See 12 U.S.C. 5371.

[91] See 12 U.S.C. 1831o(c)(1).

[92] See 12 CFR 208.43.

companies under the International Lending Supervision Act and Bank Holding Company Act,[93] and for savings and loan holding companies under the Home Owners Loan Act.[94]

B. Small Entities Potentially Affected by the Proposal.

Under regulations issued by the Small Business Administration,[95] a small entity includes a depository institution or bank holding company with total assets of $175 million or less (a small banking organization). As of March 31, 2012 there were 373 small state member banks. As of December 31, 2011, there were approximately 128 small savings and loan holding companies and 2,385 small bank holding companies.[96]

The proposal would not apply to small bank holding companies that are not engaged in significant nonbanking activities, do not conduct significant off-balance sheet activities, and do not have a material amount of debt or equity securities outstanding that are registered with the SEC. These small bank holding companies remain subject to the Board's Small Bank Holding Company Policy Statement (Policy Statement).[97]

Small state member banks and small savings and loan holding companies (covered small banking organizations) would be subject to the proposals in this NPR

C. Impact on Covered Small Banking Organizations

The proposals may impact covered small banking organizations in several ways. The proposals would affect covered small banking organizations' regulatory capital requirements. They would change the qualifying criteria for regulatory capital, including required deductions and adjustments, and modify the risk weight treatment for some exposures. They also would require covered small banking organizations to meet new minimum common equity tier 1 to risk-weighted assets ratio of 4.5 percent and an increased minimum tier 1 capital to risk-weighted assets risk-based capital ratio of 6 percent. Under the proposals, all banking organizations would remain subject to a 4 percent minimum tier 1 leverage ratio.[98]

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[93] See 12 U.S.C. 3907; 12 U.S.C. 1844.

[94] See 12 U.S.C. 1467a(g)(1).

[95] See 13 CFR 121.201.

[96] The December 31, 2011 data are the most recent available data on small savings and loan holding companies and small bank holding companies.

[97] See 12 CFR Part 225, appendix C. Section 171 of the Dodd-Frank provides an exemption from its requirements for bank holding companies subject to the Policy Statement (as in effect on May 19, 2010). Section 171 does not provide a similar exemption for small savings and loan holding companies and they are therefore subject to the proposals. 12 U.S.C. § 5371(b)(5)(C).

[98] Banking organizations subject to the advanced approaches rules also would be required in 2018 to achieve a minimum tier 1 capital to total leverage exposure ratio (the supplementary leverage ratio) of 3 percent. Advanced approaches banking organizations should refer to section 10 of subpart B of the proposed rule and section II.B of the preamble for a more detailed discussion of the applicable minimum capital ratios.

In addition, as described above, the proposals would impose limitations on capital distributions and discretionary bonus payments for covered small banking organizations that do not hold a buffer of common equity tier 1 capital above the minimum ratios. As a result of these new requirements, some covered small banking organizations may have to alter their capital structure (including by raising new capital or increasing retention of earnings) in order to achieve compliance.

Most small state member banks already hold capital in excess of the proposed minimum risk-based regulatory ratios. Therefore, the proposed requirements are not expected to significantly impact the capital structure of most covered small state member banks. Comparing the capital requirements proposed in this NPR and the Standardized Approach NPR on a fully phased-in basis to minimum requirements of the current rules, the capital ratios of approximately 1-2 percent of small state member banks would fall below at least one of the proposed minimum risk-based capital requirements. Thus, the Board believes that the proposals in this NPR and the Standardized NPR would affect an insubstantial number of small state member banks.

Because the Board has not fully implemented reporting requirements for savings and loan holding companies, it is unable to determine the impact of the proposed requirements on small savings and loan holding companies. The Board seeks comment on the potential impact of the proposed requirements on small savings and loan holding companies.

Covered small banking organizations that would have to raise additional capital to comply with the requirements of the proposals may incur certain costs, including costs associated with issuance of regulatory capital instruments. The Board has sought to minimize the burden of raising additional capital by providing for transitional arrangements that phase-in the new capital requirements over several years, allowing banking organizations time to accumulate additional capital through retained earnings as well as raising capital in the market. While the proposals would establish a narrower definition of capital, a minimum common equity tier 1 capital ratio and a minimum tier 1 capital ratio that is higher than under the general risk-based capital rules, the majority of capital instruments currently held by small covered banking organizations under existing capital rules, such as common stock and noncumulative perpetual preferred stock, would remain eligible as regulatory capital instruments under the proposed requirements.

As discussed above, the proposals would modify criteria for regulatory capital, deductions and adjustments to capital, and risk weights for exposures, as well as calculation of the leverage ratio. Accordingly, covered small banking organizations would be required to change their internal reporting processes to comply with these changes. These changes may require some additional personnel training and expenses related to new systems (or modification of existing systems) for calculating regulatory capital ratios.

For small savings and loan holding companies, the compliance burdens described above may be greater than for those of other covered small banking organizations. Small savings and loan holding companies previously were not subject to regulatory capital requirements and reporting requirements tied regulatory capital requirements. Small savings and loan holding companies may therefore need to invest additional resources in establishing internal systems (including purchasing software or hiring personnel) or raising capital to come into compliance with the proposed requirements.

D. Transitional Arrangements to Ease Compliance Burden

For those covered small banking organizations that would not immediately meet the proposed minimum requirements, this NPR provides transitional arrangements for banking organizations to make adjustments and to come into compliance. Small covered banking organizations would be required to meet the proposed minimum capital ratio requirements beginning on January 1, 2013 thorough to December 31, 2014. On January 1, 2015, small covered banking organizations would be required to comply with the proposed minimum capital ratio requirements.

E. Identification of Duplicative, Overlapping, or Conflicting Federal Rules

The Board is unaware of any duplicative, overlapping, or conflicting federal rules. As noted above, the Board anticipates issuing a separate proposal to implement reporting requirements that are tied to (but do not overlap or duplicate) the proposed requirements. The Board seeks comments and information regarding any such rules that are duplicative, overlapping, or otherwise in conflict with the proposed requirements.

F. Discussion of Significant Alternatives

The Board has sought to incorporate flexibility and provide alternative treatments in this NPR and the Standardized NPR to lessen burden and complexity for smaller banking organizations wherever possible, consistent with safety and soundness and applicable law, including the Dodd-Frank Act. These alternatives and flexibility features include the following:

- Covered small banking organizations would not be subject to the proposed enhanced disclosure requirements.

- Covered small banking organizations would not be subject to possible increases in the capital conservation buffer through the countercyclical buffer.

- Covered small banking organizations would not be subject to the new supplementary leverage ratio.

- Covered small institutions that have issued capital instruments to the U.S. Treasury through the Small Business Lending Fund (a program for banking organizations with less than $10 billion in consolidated assets) or under the Emergency Economic Stabilization Act of 2008 prior to October 4, 2010, would be able to continue to include those instruments in tier 1 or tier 2 capital (as applicable) even if not all criteria for inclusion under the proposed requirements are met.

- Covered small banking organizations that issued capital instruments that could no longer be included in tier 1 capital or tier 2 capital under the proposed requirements would have a longer transition period for removing the instruments from tier 1 or tier 2 capital (as applicable).

The Board welcomes comment on any significant alternatives to the proposed requirements applicable to covered small banking organizations that would minimize their

impact on those entities, as well as on all other aspects of its analysis. A final regulatory flexibility analysis will be conducted after consideration of comments received during the public comment period.

OCC

In accordance with section 3(a) of the Regulatory Flexibility Act (5 U.S.C. 601 et seq.) (RFA), the OCC is publishing this summary of its Initial Regulatory Flexibility Analysis (IRFA) for this NPR. The RFA requires an agency to publish in the Federal Register its IRFA or a summary of its IRFA at the time of the publication of its general notice of proposed rulemaking[99] or to certify that the proposed rule will not have a significant economic impact on a substantial number of small entities.[100] For its IRFA, the OCC analyzed the potential economic impact of this NPR on the small entities that it regulates.

The OCC welcomes comment on all aspects of the summary of its IRFA. A final regulatory flexibility analysis will be conducted after consideration of comments received during the public comment period.

A. Reasons Why the Proposed Rule is Being Considered by the Agencies; Statement of the Objectives of the Proposed Rule; and Legal Basis

As discussed in the Supplementary Information section above, the agencies are proposing to revise their capital requirements to promote safe and sound banking practices, implement Basel III, and harmonize capital requirements across charter type. Federal law authorizes each of the agencies to prescribe capital standards for the banking organizations that it regulates.[101]

B. Small Entities Affected by the Proposal.

Under regulations issued by the Small Business Administration,[102] a small entity includes a depository institution or bank holding company with total assets of $175 million or less (a small banking organization). As of March 31, 2012, there were approximately 599 small national banks and 284 small federally chartered savings associations.

C. Projected Reporting, Recordkeeping, and Other Compliance Requirements

This NPR includes changes to the general risk-based capital requirements that affect small banking organizations. Under this NPR, the changes to minimum capital requirements that would impact small national banks and federal savings associations include a more conservative definition of regulatory capital, a new common equity tier 1 capital ratio, a higher minimum tier 1 capital ratio, new thresholds for prompt corrective action purposes, and a new capital conservation buffer. To estimate the impact of this NPR on national banks' and federal savings

[99] 5 U.S.C. 603(a).

[100] 5 U.S.C. 605(b).

[101] See, e.g., 12 U.S.C. 1467a(g)(1); 12 U.S.C. 1831o(c)(1); 12 U.S.C. 1844; 12 U.S.C. 3907; and 12 U.S.C. 5371.

[102] See 13 CFR 121.201.

associations' capital needs, the OCC estimated the amount of capital the banks will need to raise to meet the new minimum standards relative to the amount of capital they currently hold. To estimate new capital ratios and requirements, the OCC used currently available data from banks' quarterly Consolidated Report of Condition and Income (Call Reports) to approximate capital under the proposed rule, which shows that most banks have raised their capital levels well above the existing minimum requirements. After comparing existing levels with the proposed new requirements, the OCC has determined that 28 small institutions that it regulates would fall short of the proposed increased capital requirements. Together, those institutions would need to raise approximately $82 million in regulatory capital to meet the proposed minimum requirements. The OCC estimates that the cost of lost tax benefits associated with increasing total capital by $82 million will be approximately $0.5 million per year. Averaged across the 28 affected institutions, the cost is approximately $18,000 per institution per year.

To determine if a proposed rule has a significant economic impact on small entities we compared the estimated annual cost with annual noninterest expense and annual salaries and employee benefits for each small entity. Based on this analysis, the OCC has concluded for purposes of this IRFA that the changes described in this NPR, when considered without regard to other changes to the capital requirements that the agencies simultaneously are proposing, would not result in a significant economic impact on a substantial number of small entities.

However, as discussed in the Supplementary Information section above, the changes proposed in this NPR also should be considered together with changes proposed in the separate Standardized Approach NPR also published in today's Federal Register. The changes described in the Standardized NPR include:

1. Changing the denominator of the risk-based capital ratios by revising the asset risk weights;

2. Revising the treatment of counterparty credit risk;

3. Replacing references to credit ratings with alternative measures of creditworthiness;

4. Providing more comprehensive recognition of collateral and guarantees; and

5. Providing a more favorable capital treatment for transactions cleared through qualifying central counterparties.

These changes are designed to enhance the risk-sensitivity of the calculation of risk-weighted assets. Therefore, capital requirements may go down for some assets and up for others. For those assets with a higher risk weight under this NPR, however, that increase may be large in some instances, e.g., requiring the equivalent of a dollar-for-dollar capital charge for some securitization exposures.

The Basel Committee on Banking Supervision has been conducting periodic reviews of the potential quantitative impact of the Basel III framework.[103] Although these reviews monitor the impact of implementing the Basel III framework rather than the proposed rule, the OCC is using estimates consistent with the Basel Committee's analysis, including a conservative estimate of a 20 percent increase in risk-weighted assets, to gauge the impact of the Standardized Approach NPR on risk-weighted assets. Using this assumption, the OCC estimates that a total of 56 small national banks and federally chartered savings associations will need to raise additional capital to meet their regulatory minimums. The OCC estimates that this total projected shortfall will be $143 million and that the cost of lost tax benefits associated with increasing total capital by $143 million will be approximately $0.8 million per year. Averaged across the 56 affected institutions, the cost is approximately $14,000 per institution per year.

To comply with the proposed rules in the Standardized Approach NPR, covered small banking organizations would be required to change their internal reporting processes. These changes would require some additional personnel training and expenses related to new systems (or modification of existing systems) for calculating regulatory capital ratios.

Additionally, covered small banking organizations that hold certain exposures would be required to obtain additional information under the proposed rules in order to determine the applicable risk weights. Covered small banking organizations that hold exposures to sovereign entities other than the United States, foreign depository institutions, or foreign public sector entities would have to acquire Country Risk Classification ratings produced by the OECD to determine the applicable risk weights. Covered small banking organizations that hold residential mortgage exposures would need to have and maintain information about certain underwriting features of the mortgage as well as the LTV ratio in order to determine the applicable risk weight. Generally, covered small banking organizations that hold securitization exposures would need to obtain sufficient information about the underlying exposures to satisfy due diligence requirements and apply either the simplified supervisory formula or the gross-up approach described in section __.43 of the Standardized Approach NPR to calculate the appropriate risk weight, or be required to assign a 1,250 percent risk weight to the exposure.

Covered small banking organizations typically do not hold significant exposures to foreign entities or securitization exposures, and the agencies expect any additional burden related to calculating risk weights for these exposures, or holding capital against these exposures, would be relatively modest. The OCC estimates that, for small national banks and federal savings associations, the cost of implementing the alternative measures of creditworthiness will be approximately $36,125 per institution.

Some covered small banking organizations may hold significant residential mortgage exposures. However, if the small banking organization originated the exposure, it should have sufficient information to determine the applicable risk weight under the proposed rule. If the small banking organization acquired the exposure from another institution, the information it

[103] See, "Update on Basel III Implementation Monitoring," Quantitative Impact Study Working Group, January 28, 2012.

would need to determine the applicable risk weight is consistent with information that it should normally collect for portfolio monitoring purposes and internal risk management.

Covered small banking organizations would not be subject to the disclosure requirements in subpart D of the proposed rule. However, the agencies expect to modify regulatory reporting requirements that apply to covered small banking organizations to reflect the changes made to the agencies' capital requirements in the proposed rules. The agencies expect to propose these changes to the relevant reporting forms in a separate notice.

To determine if a proposed rule has a significant economic impact on small entities the OCC compared the estimated annual cost with annual noninterest expense and annual salaries and employee benefits for each small entity. If the estimated annual cost was greater than or equal to 2.5 percent of total noninterest expense or 5 percent of annual salaries and employee benefits the OCC classified the impact as significant. As noted above, the OCC has concluded for purposes of this IRFA that the proposed rules in this NPR, when considered without regard to changes in the Standardized NPR, would not exceed these thresholds and therefore would not result in a significant economic impact on a substantial number of small entities, However, the OCC has concluded that the proposed rules in the Standardized Approach NPR would have a significant impact on a substantial number of small entities. The OCC estimates that together, the changes proposed in this NPR and the Standardized Approach NPR will exceed these thresholds for 500 small national banks and 253 small federally chartered private savings institutions. Accordingly, when considered together, this NPR and the Standardized Approach NPR appear to have a significant economic impact on a substantial number of small entities.

D. Identification of Duplicative, Overlapping, or Conflicting Federal Rules

The OCC is unaware of any duplicative, overlapping, or conflicting federal rules. As noted previously, the OCC anticipates issuing a separate proposal to implement reporting requirements that are tied to (but do not overlap or duplicate) the requirements of the proposed rules. The OCC seeks comments and information regarding any such federal rules that are duplicative, overlapping, or otherwise in conflict with the proposed rule.

E. Discussion of Significant Alternatives to the Proposed Rule

The agencies have sought to incorporate flexibility into the proposed rule and lessen burden and complexity for smaller banking organizations wherever possible, consistent with safety and soundness and applicable law, including the Dodd-Frank Act. The agencies are requesting comment on potential options for simplifying the rule and reducing burden, including whether to permit certain small banking organizations to continue using portions of the current general risk-based capital rules to calculate risk-weighted assets. Additionally, the agencies proposed the following alternatives and flexibility features:

- Covered small banking organizations are not subject to the enhanced disclosure requirements of the proposed rules.

- Covered small banking organizations would continue to apply a 100 percent risk weight to corporate exposures (as described in section __.32 of the Standardized Approach NPR).

- Covered small banking organizations may choose to apply the simpler gross-up method for securitization exposures rather than the Simplified Supervisory Formula Approach (SSFA) (as described in section __.43 of the Standardized Approach NPR).

- The proposed rule offers covered small banking organizations a choice between a simpler and more complex methods of risk weighting equity exposures to investment funds (as described in section __.53 of the Standardized Approach NPR).

The agencies welcome comment on any significant alternatives to the proposed rules applicable to covered small banking organizations that would minimize their impact on those entities.

FDIC

IX. Paperwork Reduction Act

A. Request for Comment on Proposed Information Collection

In accordance with the requirements of the Paperwork Reduction Act (PRA) of 1995, the Agencies may not conduct or sponsor, and the respondent is not required to respond to, an information collection unless it displays a currently valid Office of Management and Budget (OMB) control number. The Agencies are requesting comment on a proposed information collection.

The information collection requirements contained in this joint notice of proposed rulemaking (NPR) have been submitted by the OCC and FDIC to OMB for review under the PRA, under OMB Control Nos. 1557-0234 and 3064-0153. In accordance with the PRA (44 U.S.C. 3506; 5 CFR part 1320, Appendix A.1), the Board has reviewed the NPR under the authority delegated by OMB. The Board's OMB Control No. is 7100-0313. The requirements are found in §§ __.2.

The Agencies have published two other NPRs in this issue of the Federal Register. Please see the NPRs entitled "Regulatory Capital Rules: Standardized Approach for Risk-Weighted Assets; Market Discipline and Disclosure Requirements" and "Regulatory Capital Rules: Advanced Approaches Risk-based Capital Rules; Market Risk Capital Rule." While the three NPRs together comprise an integrated capital framework, the PRA burden has been divided among the three NPRs and a PRA statement has been provided in each.

Comments are invited on:

(a) Whether the collection of information is necessary for the proper performance of the Agencies' functions, including whether the information has practical utility;

(b) The accuracy of the estimates of the burden of the information collection, including the validity of the methodology and assumptions used;

(c) Ways to enhance the quality, utility, and clarity of the information to be collected;

(d) Ways to minimize the burden of the information collection on respondents, including through the use of automated collection techniques or other forms of information technology; and

(e) Estimates of capital or start up costs and costs of operation, maintenance, and purchase of services to provide information.

All comments will become a matter of public record.
Comments should be addressed to:

OCC: Communications Division, Office of the Comptroller of the Currency, Public Information Room, Mail stop 1-5, Attention: 1557-NEW, 250 E Street, SW., Washington, DC 20219. In addition, comments may be sent by fax to 202-874-4448, or by electronic mail to regs.comments@occ.treas.gov. You can inspect and photocopy the comments at the OCC's Public Information Room, 250 E Street, SW., Washington, DC 20219. You can make an appointment to inspect the comments by calling 202-874-5043.

Board: You may submit comments, identified by R-1255, by any of the following methods:

• Agency Web Site: http://www.federalreserve.gov. Follow the instructions for submitting comments on the http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm.

• Federal eRulemaking Portal: http://www.regulations.gov. Follow the instructions for submitting comments.

• E-mail: regs.comments@federalreserve.gov. Include docket number in the subject line of the message.

• FAX: 202-452-3819 or 202-452-3102.

• Mail: Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, NW, Washington, DC 20551.

All public comments are available from the Board's Web site at http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm as submitted, unless modified for technical reasons. Accordingly, your comments will not be edited to remove any identifying or contact information. Public comments may also be viewed electronically or in paper in Room MP-500 of the Board's Martin Building (20th and C Streets, NW.) between 9 a.m. and 5 p.m. on weekdays.

FDIC: You may submit written comments, which should refer to 3064-____, by any of the following methods:

• Agency Web Site: http://www.fdic.gov/regulations/laws/federal/propose.html. Follow the instructions for submitting comments on the FDIC Web site.

• Federal eRulemaking Portal: http://www.regulations.gov. Follow the instructions for submitting comments.

• E-mail: Comments@FDIC.gov.

• Mail: Robert E. Feldman, Executive Secretary, Attention: Comments, FDIC, 550 17th Street, NW., Washington, DC 20429.

• Hand Delivery/Courier: Guard station at the rear of the 550 17th Street Building (located on F Street) on business days between 7 a.m. and 5 p.m.
Public Inspection: All comments received will be posted without change to http://www.fdic.gov/regulations/laws/federal/propose/html including any personal information provided. Comments may be inspected at the FDIC Public Information Center, Room 100, 801 17th Street, NW., Washington, DC, between 9 a.m. and 4:30 p.m. on business days.

B. Proposed Information Collection

Title of Information Collection: Basel III.

Frequency of Response: On occasion

Affected Public:

OCC: National banks and federally chartered savings associations.

Board: State member banks, bank holding companies, and savings and loan holding companies.

FDIC: Insured state nonmember banks and certain subsidiaries of these entities.

Abstract:

Section __.2 allows the use of a conservative estimate of the amount of a bank's investment in the capital of unconsolidated financial institutions held through the index security with prior approval by the appropriate agency. It also provides for termination and close-out netting across multiple types of transactions or agreements if the bank obtains a written legal opinion verifying the validity and enforceability of the agreement under certain circumstances and maintains sufficient written documentation of this legal review.

Estimated Burden:

OCC

Number of Respondents: 775.

Estimated Burden per Respondent: 16 hours.

Total Estimated Annual Burden: 12,400 hours.

Board

Estimated Number of Respondents: SMBs, 831; BHCs, 933; SLHCs, 438.
Estimated Burden per Respondent: 16 hours.

Total Estimated Annual Burden: 35,232 hours.

FDIC

Number of Respondents: __.

Estimated Burden per Respondent: 16 hours.

Total Estimated Annual Burden: __ hours.

X. Plain Language

Section 722 of the Gramm-Leach-Bliley Act requires the Federal banking agencies to use plain language in all proposed and final rules published after January 1, 2000. The agencies invited comment on whether the proposed rule was written plainly and clearly or whether there were ways the agencies could make the rule easier to understand. The agencies received no comments on these matters and believe that the final rule is written plainly and clearly in conjunction with the agencies' risk-based capital rules.

XI. OCC Unfunded Mandates Reform Act of 1995 Determinations

Section 202 of the Unfunded Mandates Reform Act of 1995 (UMRA) (2 U.S.C. 1532 et seq.) requires that an agency prepare a written statement before promulgating a rule that includes a Federal mandate that may result in the expenditure by State, local, and Tribal governments, in the aggregate, or by the private sector of $100 million or more (adjusted annually for inflation) in any one year. If a written statement is required, the UMRA (2 U.S.C. 1535) also requires an agency to identify and consider a reasonable number of regulatory alternatives before promulgating a rule and from those alternatives, either select the least costly, most cost-effective or least burdensome alternative that achieves the objectives of the rule, or provide a statement with the rule explaining why such an option was not chosen.

Under this NPR, the changes to minimum capital requirements include a new common equity tier 1 capital ratio, a higher minimum tier 1 capital ratio, a supplementary leverage ratio for advanced approaches banks, new thresholds for prompt corrective action purposes, a new capital conservation buffer, and a new countercyclical capital buffer for advanced approaches banks. To estimate the impact of this NPR on bank capital needs, the OCC estimated the amount of capital banks will need to raise to meet the new minimum standards relative to the amount of capital they currently hold. To estimate new capital ratios and requirements, the OCC used currently available data from banks' quarterly Consolidated Report of Condition and Income (Call Reports) to approximate capital under the proposed rule. Most banks have raised their capital levels well above the existing minimum requirements and, after comparing existing levels with the proposed new requirements, the OCC has determined that its proposed rule will not result in expenditures by State, local, and Tribal governments, or by the private sector, of $100 million or more. Accordingly, the UMRA does not require that a written statement accompany this NPR.

Addendum 1: Summary of this NPR for Community Banking Organizations

Overview

The agencies are issuing a notice of proposed rulemaking (NPR, proposal, or proposed rule) to revise the general risk-based capital rules to incorporate certain revisions by the Basel Committee on Banking Supervision to the Basel capital framework (Basel III). The proposed rule would:

- Revise the definition of regulatory capital components and related calculations;
- Add a new regulatory capital component: common equity tier 1 capital;
- Increase the minimum tier 1 capital ratio requirement;
- Impose different limitations to qualifying minority interest in regulatory capital than those currently applied;
- Incorporate the new and revised regulatory capital requirements into the Prompt Corrective Action (PCA) capital categories;
- Implement a new capital conservation buffer framework that would limit payment of capital distributions and certain discretionary bonus payments to executive officers and key risk takers if the banking organization does not hold certain amounts of common equity tier 1 capital in addition to those needed to meet its minimum risk-based capital requirements; and
- Provide for a transition period for several aspects of the proposed rule, including a phase-out period for certain non-qualifying capital instruments, the new minimum capital ratio requirements, the capital conservation buffer, and the regulatory capital adjustments and deductions.

This addendum presents a summary of the proposed rule that is more relevant for smaller, non-complex banking organizations that are <u>not</u> subject to the market risk rule or the advanced approaches capital rule. The agencies intend for this addendum to act as a guide for these banking organizations, helping them to navigate the proposed rule and identify the changes most relevant to them. The addendum does not, however, by itself provide a complete understanding of the proposed rules and the agencies expect and encourage all institutions to review the proposed rule in its entirety.

1. Revisions to the Minimum Capital Requirements

The NPR proposes definitions of common equity tier 1 capital, additional tier 1 capital, and total capital. These proposed definitions would alter the existing definition of capital by imposing, among other requirements, additional constraints on including of minority interests, mortgage servicing assets (MSAs), deferred tax assets (DTAs) and certain investments in unconsolidated financial institutions in regulatory capital. In addition, the NPR would require that most regulatory capital deductions be made from common equity tier 1 capital. The NPR would also

require that most of a banking organization's accumulated other comprehensive income (AOCI) be included in regulatory capital.

Under the NPR, a banking organization would maintain the following minimum capital requirements:

(1) A ratio of common equity tier 1capital to total risk-weighted assets of 4.5 percent.

(2) A ratio of tier 1 capital to total risk-weighted assets of 6 percent.

(3) A ratio of total capital to total risk-weighted assets of 8 percent.

(4) A ratio of tier 1 capital to adjusted average total assets of 4 percent.[104]

The new minimum capital requirements would be implemented over a transition period, as outlined in the proposed rule. For a summary of the transition period, refer to section 7 of this Addendum. As noted in the NPR, banking organizations are generally expected, as a prudential matter, to operate well above these minimum regulatory ratios, with capital commensurate with the level and nature of the risks they hold.

2. Capital Conservation Buffer

In addition to these minimum capital requirements, the NPR would establish a capital conservation buffer. Specifically, banking organizations would need to hold common equity tier 1 capital in excess of their minimum risk-based capital ratios by at least 2.5 percent of risk-weighted assets in order to avoid limits on capital distributions (including dividend payments, discretionary payments on tier 1 instruments, and share buybacks) and certain discretionary bonus payments to executive officers, including heads of major business lines and similar employees.

Under the NPR, a banking organization's capital conservation buffer would be the smallest of the following ratios: a) its common equity tier 1 capital ratio (in percent) minus 4.5 percent; b) its tier 1 capital ratio (in percent) minus 6 percent; and c) its total capital ratio (in percent) minus 8 percent.

To the extent a banking organization's capital conservation buffer falls short of 2.5 percent of risk-weighted assets, the banking organization's maximum payout amount for capital distributions and discretionary bonus payments (calculated as the maximum payout ratio multiplied by the sum of eligible retained income, as defined in the NPR) would decline. The following table shows the maximum payout ratio, depending on the banking organization's capital conservation buffer.

[104] Banking organizations should be aware that their leverage ratio requirements would be affected by the new definition of tier 1 capital under this proposal. See section 4 of this addendum on the definition of capital.

Table 1

Capital Conservation Buffer (as a percentage of risk-weighted assets)	Maximum payout ratio (as a percentage or eligible retained income)
Greater than 2.5 percent	No payout limitation applies
Less than or equal to 2.5 percent and greater than 1.875 percent	60 percent
Less than or equal to 1.875 percent and greater than 1.25 percent	40 percent
Less than or equal to 1.25 percent and greater than 0.625 percent	20 percent
Less than or equal to 0.625 percent	0 percent

Eligible retained income for purposes of the proposed rule would mean a banking organization's net income for the four calendar quarters preceding the current calendar quarter, based on the banking organization's most recent quarterly regulatory reports, net of any capital distributions and associated tax effects not already reflected in net income.

Under the NPR, the maximum payout amount for the current calendar quarter would be equal to the banking organization's eligible retained income, multiplied by the applicable maximum payout ratio in **Table 1**.

The proposed rule would prohibit a banking organization from making capital distributions or certain discretionary bonus payments during the current calendar quarter if: (A) its eligible retained income is negative; and (B) its capital conservation buffer ratio was less than 2.5 percent as of the end of the previous quarter.

The NPR does not diminish the agencies' authority to place additional limitations on capital distributions.

3. Adjustments to Prompt Corrective Action (PCA) Thresholds

The NPR proposes to revise the PCA capital category thresholds to levels that reflect the new capital ratio requirements. The NPR also proposes to introduce the common equity tier 1 capital ratio as a PCA capital category threshold. In addition, the NPR proposes to revise the existing definition of tangible equity. Under the NPR, tangible equity would be defined as tier 1 capital (composed of common equity tier 1 and additional tier 1 capital) plus any outstanding perpetual preferred stock (including related surplus) that is not already included in tier 1 capital.

Table 2. Proposed PCA Threshold Requirements*

PCA Capital Category	Threshold Ratios			
	Total Risk-based Capital ratio	**Tier 1 Risk-based Capital ratio**	**Common Equity Tier 1 Risk-based Capital ratio**	**Tier 1 Leverage ratio**
Well capitalized	10%	8%	6.5%	5%
Adequately capitalized	8%	6%	4.5%	4%
Undercapitalized	< 8%	< 6%	< 4.5%	<4%
Significantly undercapitalized	< 6%	< 4%	< 3%	<3%
Critically undercapitalized	Tangible Equity/Total Assets</= 2%			

*Proposed effective date: January 1, 2015. This date coincides with the phasing in of the new minimum capital requirements, which would be implemented over a transition period.

4. Definition of Capital

The NPR proposes to revise the definition of capital to include the following regulatory capital components: common equity tier 1 capital, additional tier 1 capital, and tier 2 capital. These are summarized below (see summary table attached). Section 20 of the proposed rule describes the capital components and eligibility criteria for regulatory capital instruments. Section 20 also describes the criteria that each primary federal supervisor would consider when determining whether a capital instrument should be included in a specific regulatory capital component.

a. Common Equity Tier 1 Capital

The NPR defines common equity tier 1 capital as the sum of the common equity tier 1 elements, less applicable regulatory adjustments and deductions. Common equity tier 1 capital elements would include:

1. Common stock instruments (that satisfy specified criteria in the proposed rule) and related surplus (net of any treasury stock);

2. Retained earnings;

3. Accumulated other comprehensive income (AOCI); and

4. Common equity minority interest (as defined in the proposed rule) subject to the limitations outlined in section 21 of the proposed rule.

b. Additional Tier 1 Capital

The NPR would define additional tier 1 capital as the sum of additional tier 1 capital elements and related surplus, less applicable regulatory adjustments and deductions. Additional tier 1 capital elements would include:

1. Noncumulative perpetual preferred stock (that satisfy specified criteria in the proposed rule) and related surplus;

2. Tier 1 minority interest (as defined in the proposed rule), subject to limitations described in section 21 of the proposed rule, not included in the banking organization's common equity tier 1 capital; and

3. Instruments that currently qualify as tier 1 capital under the agencies' general risk-based capital rules and that were issued under the Small Business Job's Act of 2010, or, prior to October 4, 2010, under the Emergency Economic Stabilization Act of 2008.

c. Tier 2 Capital

The proposed rule would define tier 2 capital as the sum of tier 2 capital elements and related surplus, less regulatory adjustments and deductions. The tier 2 capital elements would include:

1. Subordinated debt and preferred stock (that satisfy specified criteria in the proposed rule). This will include most of the subordinated debt currently included in tier 2 capital according to the agencies' existing risk-based capital rules;

2. Total capital minority interest (as defined in the proposed rule), subject to the limitations described in section 21 of the proposed rule, and not included in the banking organization's tier 1 capital;

3. Allowance for loan and lease losses (ALLL) not exceeding 1.25 percent of the banking organization's total risk-weighted assets; and

4. Instruments that currently qualify as tier 2 capital under the agencies' general risk-based capital rules and that were issued under the Small Business Job's Act of 2010, or, prior to October 4, 2010, under the Emergency Economic Stabilization Act of 2008.

d. Minority Interest

The NPR proposes a calculation method that limits the amount of minority interest in a subsidiary that is not owned by the banking organization that may be included in regulatory capital.

Under the NPR, common equity tier 1 minority interest would mean any minority interest arising from the issuance of common shares by a fully consolidated subsidiary. Common equity tier 1 minority interest may be recognized in common equity tier 1 only if both of the following are true:

1. The instrument giving rise to the minority interest would, if issued by the banking organization itself, meet all of the criteria for common stock instruments.

2. The subsidiary is itself a depository institution.

If not recognized in common equity tier 1, the minority interest may be eligible for inclusion in additional tier 1 capital or tier 2 capital.

For a capital instrument that meets all of the criteria for common stock instruments, the amount of common equity minority interest includable in the banking organization's common equity tier 1 capital is equal to:

The common equity tier 1 minority interest of the subsidiary

minus

(The percentage of the subsidiary's common equity tier 1 capital that is not owned by the banking organization**)**
multiplied by the difference between
(common equity tier 1 capital of the subsidiary
and the lower of:
- 7% of the risk weighted assets of the banking organization that relate to the subsidiary *or*,
- 7% of the risk weighted assets of the subsidiary)

For tier 1 minority interest, the NPR proposes the same calculation method, but substitutes tier 1 capital in place of common equity tier 1 capital and 8.5 percent in place of 7 percent in the illustration above (and assuming the banking organization has a common equity tier 1 capital ratio of at least 7 percent). In the case of tier 1 minority interest, there is no requirement that the subsidiary be a depository institution. However, the NPR would require that any instrument giving rise to the minority interest must meet all of the criteria for either a common stock instrument or an additional tier 1 capital instrument.

For total capital minority interest, the NPR proposes an equivalent calculation method (by substituting total capital in place of common equity tier 1 capital and 10.5 percent in place of 7 percent in the illustration above; and assuming the banking organization has a common equity tier 1 capital ratio of at least 7 percent). In the case of total capital minority interest, there is no requirement that the subsidiary be a depository institution. However, the NPR would require that any instrument giving rise to the minority interest must meet all of the criteria for either a common stock instrument, an additional tier 1 capital instrument, or a tier 2 capital instrument.

e. Regulatory capital adjustments and deductions

A. Regulatory deductions from common equity tier 1 capital.

The NPR would require that a banking organization deduct the following from the sum of its common equity tier 1 capital elements:

- Goodwill and all other intangible assets (other than MSAs), net of any associated deferred tax liabilities (DTLs). Goodwill for purposes of this deduction includes any goodwill embedded in the valuation of a significant investment in the capital of an unconsolidated financial institution in the form of common stock.

- DTAs that arise from operating loss and tax credit carryforwards net of any valuation allowance and net of DTLs (see section 22 of the proposed rule for the requirements on the netting of DTLs).

- Any gain-on-sale associated with a securitization exposure.

- Any defined benefit pension fund net asset[105], net of any associated deferred tax liability.[106] *(The pension deduction does not apply to insured depository institutions that have their own defined benefit pension plan.)*

[105] With prior approval of the primary federal supervisor, the banking organization may reduce the amount to be deducted by the amount of assets of the defined benefit pension fund to which it has unrestricted and unfettered access, provided that the banking organization includes such assets in its risk-weighted assets as if the banking organization held them directly. For this purpose, unrestricted and unfettered access means that the excess assets of the defined pension fund would be available to protect depositors or creditors of the banking organization in a receivership, insolvency, liquidation, or similar proceeding.

B. Regulatory adjustments to common equity tier 1 capital.

The NPR would require that for the following items, a banking organization deduct any associated unrealized gain and add any associated unrealized loss to the sum of common equity tier 1 capital elements:

- Unrealized gains and losses on cash flow hedges included in AOCI that relate to the hedging of items that are not recognized at fair value on the balance sheet.

- Unrealized gains and losses that have resulted from changes in the fair value of liabilities that are due to changes in the banking organization's own credit risk.

C. Additional deductions from regulatory capital

Under the NPR, a banking organization would be required to make the following deductions with respect to investments in its own capital instruments:

- Deduct from common equity tier 1 elements investments in the banking organization's own common stock instruments (including any contractual obligation to purchase), whether held directly or indirectly.

- Deduct from additional tier 1 capital elements, investments in (including any contractual obligation to purchase) the banking organization's own additional tier 1 capital instruments, whether held directly or indirectly.

- Deduct from tier 2 capital elements, investments in (including any contractual obligation to purchase) the banking organization's own tier 2 capital instruments, whether held directly or indirectly.

D. Corresponding deduction approach.

Under the NPR, a banking organization would use the corresponding deduction approach to calculate the required deductions from regulatory capital for:

- Reciprocal cross-holdings;

- Non-significant investments in the capital of unconsolidated financial institutions; and,

- Non-common stock significant investments in the capital of unconsolidated financial institutions.

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[106] The deferred tax liabilities for this deduction exclude those deferred tax liabilities that have already been netted against DTAs.

Under the corresponding deduction approach, a banking organization would be required to make any such deductions from the same component of capital for which the underlying instrument would qualify if it were issued by the banking organization itself. In addition, if the banking organization does not have a sufficient amount of such component of capital to effect the deduction, the shortfall will be deducted from the next higher (that is, more subordinated) component of regulatory capital (for example, if the exposure may be deducted from additional tier 1 capital but the banking organization does not have sufficient additional tier 1 capital, it would take the deduction from common equity tier 1 capital). The NPR provides additional information regarding the corresponding deduction approach for those banking organizations with such holdings and investments.

Reciprocal crossholdings in the capital of financial institutions: The NPR would require a banking organization to deduct investments in the capital of other financial institutions it holds reciprocally[107].

Non-significant investments in the capital of unconsolidated financial institutions[108]: The proposed rule would require a banking organization to deduct any non-significant investments in the capital of unconsolidated financial institutions that, in the aggregate, exceed 10 percent of the sum of the banking organization's common equity tier 1 capital elements less all deductions and other regulatory adjustments required under sections 22(a) through 22(c)(3) of the proposed rule (the 10 percent threshold for non-significant investments in unconsolidated financial institutions).

- The amount to be deducted from a specific capital component is equal to (i) the amount of a banking organization's non-significant investments exceeding the 10 percent threshold for non-significant investments *multiplied* by (ii) the ratio of the non-significant investments in unconsolidated financial institutions in the form of such capital component to the amount of the banking organization's total non-significant investments in unconsolidated financial institutions.

- The banking organization's non-significant investments in the capital of unconsolidated financial institutions not exceeding the 10 percent threshold for non-significant investments must be assigned the appropriate risk weight under the Standardized Approach NPR.

Significant investments in the capital of unconsolidated financial institutions that are not in the form of common stock: A banking organization must deduct its significant investments in the capital of unconsolidated financial institutions not in the form of common stock.

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[107] An instrument is held reciprocally if the instrument is held pursuant to a formal or informal arrangement to swap, exchange, or otherwise intend to hold each other's capital instruments.

[108] With prior written approval of the primary federal supervisor, for the period of time stipulated by the primary federal supervisor, a banking organization would not be required to deduct exposures to the capital instruments of unconsolidated financial institutions if the investment is made in connection with the banking organization providing financial support to a financial institution in distress

E. Threshold Deductions:

The NPR would require a banking organization to deduct from common equity tier 1 capital elements each of the following assets (together, the threshold deduction items) that, individually, are above 10 percent of the sum of the banking organization's common equity tier 1 capital elements, less all required adjustments and deductions required under sections 22(a) through 22(c) of the proposed rule (the 10 percent common equity deduction threshold):

- DTAs arising from temporary differences that the banking organization could not realize through net operating loss carrybacks, net of any associated valuation allowance, and DTLs, subject to the following limitations:
  - Only the DTAs and DTLs that relate to taxes levied by the same taxation authority and that are eligible for offsetting by that authority may be offset for purposes of this deduction.
  - The DTLs offset against DTAs must exclude amounts that have already been netted against other items that are either fully deducted (such as goodwill) or subject to deduction (such as MSA).
- MSAs, net of associated DTLs.
- Significant investments in the capital of unconsolidated financial institutions in the form of common stock.

In addition, the aggregate amount of the threshold deduction items in this section cannot exceed 15 percent of the banking organization's common equity tier 1 capital net of all deductions (the 15 percent common equity deduction threshold). That is, the banking organization must deduct from common equity tier 1 capital elements, the amount of the threshold deduction items that are not deducted after the application of the 10 percent common equity deduction threshold, and that, in aggregate, exceed 17.65 percent of the sum of the banking organization's common equity tier 1 capital elements, less all required adjustments and deductions required under sections 22(a) through 22(c) of the proposed rule and less the threshold deduction items in full.

5. Changes in Risk-weighted Assets:

The amounts of the threshold deduction items within the limits and not deducted, as described above, would be included in the risk-weighted assets of the banking organization and assigned a risk weight of 250 percent. In addition, certain exposures that are currently deducted under the general risk-based capital rules, for example certain credit enhancing interest-only strips, would receive a 1,250% risk weight.

6. Timeline and Transition Period

The NPR would provide for a multi-year implementation as summarized in the table below:

Table 3 - Phase-in Schedule

Year (as of Jan. 1)	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**
Minimum common equity tier 1 ratio	3.5%	4.0%	4.5%	4.5%	4.5%	4.5%	4.5%
Common equity tier 1 capital conservation buffer				0.625%	1.25%	1.875%	2.50%
Common equity tier 1 plus capital conservation buffer	3.5%	4.0%	4.5%	5.125%	5.75%	6.375%	7.0%
Phase-in of deductions from common equity tier 1 (including threshold deduction items that are over the limits)		20%	40%	60%	80%	100%	100%
Minimum tier 1 capital	4.5%	5.5%	6.0%	6.0%	6.0%	6.0%	6.0%
Minimum tier 1 capital plus capital conservation buffer				6.625%	7.25%	7.875%	8.5%
Minimum total capital	8.0%	8.0%	8.0%	8.0%	8.0%	8.0%	8.0%
Minimum total capital plus conservation buffer	8.0%	8.0%	8.0%	8.625%	9.25%	9.875%	10.5%

As provided in Basel III, capital instruments that no longer qualify as additional tier 1 or tier 2 capital will be phased out over a 10 year horizon beginning in 2013. However, trust preferred securities are phased out as required under the Dodd-Frank Act.

Attached to this Addendum I is a summary of the proposed revision to the components of capital introduced by the NPR.

Attachment: Summary of Capital Components in this NPR:

Components and Tiers	Explanation
(1) COMMON EQUITY TIER 1 CAPITAL	
(a) + Qualifying common stock instruments	Instruments must meet all of the common equity tier 1 criteria (Note 1)
(b) + Retained earnings	
(c) + AOCI	With the exception in Note 2 below, AOCI flows through to common equity tier 1 capital.
(d) + Qualifying common equity tier 1 minority interest	Subject to specific calculation method and limitation.
(e) - Regulatory deductions from common equity tier 1 capital	Deduct: Goodwill and intangible assets (other than MSAs); DTAs that arise from operating loss and tax credit carryforwards; any gain on sale from a securitization; investments in the banking organization's own common stock instruments.
(f) +/- Regulatory adjustments to common equity tier 1 capital	See explanation below (Note 2).
(g) - common equity tier 1 capital	See section 4.e.D above.

deductions per the corresponding deduction approach	
(h) - Threshold deductions	Deduct amount of threshold items that are above the 10 and 15 percent common equity tier 1 thresholds. (See section 4.e. above).
= common equity tier 1 capital	
(2) ADDITIONAL TIER 1 CAPITAL	
(a) + additional tier 1 capital instruments	Instruments must meet all of the additional tier 1 criteria (Note 1).
(b) + Tier 1 minority interest that is not included in common equity tier 1 capital	Subject to specific calculation and limitation
(c) + Non-qualifying tier 1 capital instruments subject to transition phase-out and SBLF related instruments	(Note 3)
(d) - Investments in a banking organization's own additional tier 1 capital instruments	
(e) - Additional tier 1 capital deductions per the corresponding deduction approach	See section 4.e.D above.

= Additional tier 1 capital	
(3) TIER 2 CAPITAL	
(a) + Tier 2 capital instruments	Instruments must meet all of the tier 2 criteria (Note 1)
(b) + Total capital minority interest that is not included in tier 1	Subject to specific calculation and limitation.
(c) + ALLL	Up to 1.25% of risk weighted assets
(d) - Investments in a banking organization's own tier 2 capital instruments	
(e) - Tier 2 capital deductions per the Corresponding Deduction Approach	See section 4.e.D above.
(f) + Non-qualifying tier 2 capital instruments subject to transition phase-out and SBLF related instruments	(Note 3)
= Tier 2 capital	
TOTAL CAPITAL = common equity tier 1 + additional tier 1 + tier 2	

Notes to Table:

Note 1: Includes surplus related to the instruments.

Note 2: Regulatory adjustments: A banking organization must deduct any unrealized gain and add any unrealized loss for cash flow hedges included in AOCI relating to hedging of items not fair valued on the balance sheet and for unrealized gains and losses that have resulted from changes in the fair value of liabilities that are due to changes in the banking organization's own credit risk.

Note 3: Grandfathered SBLF related instruments: These are instruments issued under the Small Business Lending Facility (SBLF); or prior Oct. 4, 2010 under the Emergency Economic Stabilization Act of 2008. If the instrument qualified as tier 1 capital under rules at the time of issuance, it would count as additional tier 1 under this proposal. If the instrument qualified as tier 2 under the rules at that time, it would count as tier 2 under this proposal.

Attachment Comparison of Current Rules vs. Proposal

Minimum regulatory capital requirements			
	Current minimum ratios	**Proposed minimum ratios**	**Comments**
Common equity tier 1 capital / risk weighted assets	N/A	4.5%	
Tier 1 capital / risk weighted assets	4%	6%	
Total capital / risk weighted assets	8%	8%	
Leverage ratio	≥ 4% (or ≥ 3%)	≥ 4%	Minimum required level will not vary depending on the supervisory rating
Capital buffers			
	Current treatment	**Proposed treatment**	**Comment**
Capital conservation buffer	N/A	Capital conservation buffer equivalent to 2.5% of risk-	Not holding the capital conservation buffer may result in restrictions on capital distributions and certain

		weighted assets; composed of common equity tier 1 capital	discretionary bonus payments
Prompt Corrective Action			
	Current PCA levels	**Proposed PCA levels**	**Comment**
Common equity tier 1 capital	N/A	Well capitalized: ≥ 6.5%; Adequately capitalized: ≥ 4.5%; Undercapitalized: < 4.5%; Significantly undercapitalized: < 3%	Proposed adequately capitalized PCA level aligned to new minimum ratio
Tier 1 capital	Well capitalized: ≥ 6%; Adequately capitalized: ≥ 4%; Undercapitalized < 4%; Significantly undercapitalized: < 3%	Well capitalized: ≥ 8%; Adequately capitalized: ≥ 6%; Undercapitalized < 6%; Significantly undercapitalized: < 4%	Proposed adequately capitalized PCA level aligned to new minimum ratio
Total capital	Well capitalized: ≥ 10%; Adequately capitalized: ≥ 8%; Undercapitalized < 8%;	Well capitalized: ≥ 10%; Adequately capitalized: ≥ 8%; Undercapitalized < 8%;	

	Significantly undercapitalized: < 6%	Significantly undercapitalized: < 6%	
Leverage ratio	Well capitalized: ≥ 5%; Adequately capitalized: ≥ 4% (or ≥ 3%); Undercapitalized < 4% (or < 3%); Significantly undercapitalized: < 3%	Well capitalized: ≥ 5%; Adequately capitalized: ≥ 4%; Undercapitalized < 4%; Significantly undercapitalized: < 3%	PCA adequately capitalized level will not vary depending on the supervisory rating
Critically undercapitalized category	*Tangible equity to total assets ratio ≤ 2*	*Tangible equity to total assets ≤ 2*	*Tangible equity under the proposal would be defined as tier 1 capital plus non-tier 1 perpetual preferred stock*
Regulatory capital components			
	Current definition / instruments	**Proposed definition / instruments**	**Comments**
Common equity tier 1 capital	No specific definition	Mostly retained earnings and common stock that meets specified eligibility criteria (plus limited amounts of minority interest in the form of common stock) less the majority of the regulatory deductions	Common stock instruments traditionally issued by U.S. banking organizations expected generally to qualify as common equity tier 1 capital

Additional tier 1 capital	No specific definition	Equity capital instruments that meet specified eligibility criteria (plus limited amounts of minority interest in the form of tier 1 capital instruments)	Non-cumulative perpetual preferred stock traditionally issued by U.S. banking organizations expected to generally qualify; trust preferred instruments traditionally issued by certain bank holding companies would not qualify
Tier 2 capital	Certain capital instruments (e.g., subordinated debt) and limited amounts of ALLL	Capital instruments that meet specified eligibility criteria (e.g., subordinated debt) and limited amounts of ALLL	Traditional subordinated debt instruments are expected to remain tier 2 eligible; there is no specific limitation on the amount of tier 2 capital that can be included in total capital under the proposal
Regulatory deductions and adjustments			
	Current treatment	**Proposed treatment**	**Comment**
Regulatory deductions	Current deductions from regulatory capital include goodwill and other intangibles, DTAs (above certain levels), and MSAs (above certain levels)	Proposed deductions from common equity tier 1 capital include goodwill and other intangibles, DTAs (above certain levels), MSAs (above certain levels) and investments in unconsolidated financial institutions (above certain levels)	Vast majority of regulatory deductions are made at the common equity tier 1 capital level (as opposed to the tier 1 level); the proposed deductions for MSAs and DTAs in the proposed rule are significantly more stringent than the current deductions
Regulatory	Current	Under the	Under the proposed treatment

adjustments	adjustments include the neutralization of unrealized gains and losses on available for sale debt securities for regulatory capital purposes	proposal, AOCI would generally flow through to regulatory capital	unrealized gains and losses on available for sale debt securities would not be neutralized for regulatory capital purposes
MSAs, certain DTAs arising from temporary differences, and certain significant investments in the common stock of unconsolidated financial institutions	MSAs and DTAs that are not deducted are subject to a 100 percent risk weight	Items that are not deducted are subject to a 250 percent risk weight	Under the proposal, these items are subject to deduction if they exceed certain specified common equity deduction thresholds
The portion of a CEIO that does not constitute an after-tax-gain-on-sale	Dollar-for-dollar capital requirement for amounts not deducted based on a concentration limit	Subject to a 1250 percent risk weight	

Text of Common Rule

Part §___ CAPITAL ADEQUACY OF [BANK]s

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Subpart A – General Provisions

§___.1 Purpose, Applicability, and Reservations of Authority

(a) Purpose. This [PART] establishes minimum capital requirements and overall capital adequacy standards for [BANK]s. This [PART] includes methodologies for calculating minimum capital requirements, public disclosure requirements related to the capital requirements, and transition provisions for the application of this [PART].

(b) Nothing in this [PART] shall be read to limit the authority of the [AGENCY] to take action under other provisions of law, including action to address unsafe or unsound practices or conditions, deficient capital levels, or violations of law or regulation, under section 8 of the Federal Deposit Insurance Act.

(c) Applicability. (1) Minimum capital requirements and overall capital adequacy standards. Each [BANK] must calculate its minimum capital requirements and meet the overall capital adequacy standards in subpart B.

(2) Regulatory capital. Each [BANK] must calculate its regulatory capital in accordance with subpart C.

(3) Risk-weighted assets. (i) Each [BANK] must use the methodologies in subpart D (and subpart F for a market risk [BANK]) to calculate standardized total risk-weighted assets.

(ii) Each advanced approaches [BANK] must use the methodologies in subpart E (and subpart F for a market risk [BANK]) to calculate advanced approaches total risk-weighted assets.

(4) Disclosures. (i) A [BANK] with total consolidated assets of $50 billion or more that is not an advanced approaches [BANK] must make the public disclosures described in subpart D.

(ii) Each market risk [BANK] must make the public disclosures described in subparts D and F.

(iii) Each advanced approaches [BANK] must make the public disclosures described in subpart E.

(d) Reservation of authority. (1) Additional capital in the aggregate. The [AGENCY] may require a [BANK] to hold an amount of regulatory capital greater than otherwise required under this part if the [AGENCY] determines that the [BANK]'s capital requirements under this part are not commensurate with the [BANK]'s credit, market, operational, or other risks.

(2) Regulatory capital elements. If the [AGENCY] determines that a particular common equity tier 1, additional tier 1, or tier 2 capital element has characteristics or terms that diminish its ability to absorb losses, or otherwise present safety and soundness concerns, the [AGENCY] may require the [BANK] to exclude all or a portion of such element from common equity tier 1 capital, additional tier 1 capital, or tier 2 capital, as appropriate.

(3) Risk-weighted asset amounts. If the [AGENCY] determines that the risk-weighted asset amount calculated under this part by the [BANK] for one or more exposures is not commensurate with the risks associated with those exposures, the [AGENCY] may require the [BANK] to assign a different risk-weighted asset amount to the exposure(s) or to deduct the amount of the exposure(s) from its regulatory capital.

(4) Total leverage. If the [AGENCY] determines that the leverage exposure amount, or the amount reflected in the [BANK]'s reported average consolidated assets, for an on- or off-balance sheet exposure calculated by a [BANK] under §___.10 is inappropriate for the exposure(s) or the circumstances of the [BANK], the [AGENCY] may require the [BANK] to adjust this exposure amount in the numerator and the denominator for purposes of the leverage ratio calculations.

(5) Consolidation of certain exposures. The [AGENCY] may determine that the risk-based capital treatment for an exposure or the treatment provided to an entity that is not consolidated on the [BANK]'s balance sheet is not commensurate with the risk of the exposure and the relationship of the [BANK] to the entity. Upon making this determination, the [AGENCY] may require the [BANK] to treat the entity as if it were consolidated on the balance sheet of the [BANK] for purposes of determining its regulatory capital requirements and calculate the regulatory capital ratios accordingly. The [AGENCY] will look to the substance of, and risk associated with, the transaction, as well as other relevant factors the [AGENCY] deems appropriate in determining whether to require such treatment.

(6) Other reservation of authority. With respect to any deduction or limitation required under this [PART], the [AGENCY] may require a different deduction or limitation, provided that such alternative deduction or limitation is commensurate with the [BANK]'s risk and consistent with safety and soundness.

(e) Notice and response procedures. In making a determination under this section, the [AGENCY] will apply notice and response procedures in the same manner as the notice and response procedures in 12 CFR 3.12, 12 CFR 167.3(d) (OCC); 12 CFR 263.202 (Board); 12 CFR 325.6(c), 12 CFR 390.463(d) (FDIC).

§___.2 Definitions.

Additional tier 1 capital is defined in §___.20 of subpart C.

Advanced approaches [BANK] means a [BANK] that is described in §___.100(b)(1) of subpart E.

Advanced approaches total risk-weighted assets means:

(1) the sum of:

(i) Credit-risk-weighted assets;
(ii) Credit Valuation Adjustment (CVA) risk-weighted assets;

(iii) Risk-weighted assets for operational risk; and

(iv) For a market risk [BANK] only, advanced market risk-weighted assets; minus

(2) Excess eligible credit reserves not included in the [BANK]'s tier 2 capital.

Advanced market risk-weighted assets means the advanced measure for market risk calculated under §___.204 of subpart F multiplied by 12.5.

Affiliate with respect to a company means any company that controls, is controlled by, or is under common control with, the company.

Allocated transfer risk reserves means reserves that have been established in accordance with Section 905(a) of the International Lending Supervision Act, against certain assets whose value U.S. supervisory authorities have found to be significantly impaired by protracted transfer risk problems.

Allowances for loan and lease losses (ALLL) means reserves that have been established through a charge against earnings to absorb future losses on loans, lease financing receivables or other extensions of credit. ALLL excludes "allocated transfer risk reserves." For purposes of this [PART], ALLL includes reserves that have been established through a charge against earnings to absorb future credit losses associated with off-balance sheet exposures.

Asset-backed commercial paper (ABCP) program means a program established primarily for the purpose of issuing commercial paper that is investment grade and backed by underlying exposures held in a bankruptcy-remote special purpose entity (SPE).

Asset-backed commercial paper (ABCP) program sponsor means a [BANK] that:

(1) Establishes an ABCP program;

(2) Approves the sellers permitted to participate in an ABCP program;

(3) Approves the exposures to be purchased by an ABCP program; or

(4) Administers the ABCP program by monitoring the underlying exposures, underwriting or otherwise arranging for the placement of debt or other obligations issued by the program, compiling monthly reports, or ensuring compliance with the program documents and with the program's credit and investment policy.

Bank holding company means a bank holding company as defined in section 2 of the Bank Holding Company Act.

Bank Holding Company Act means the Bank Holding Company Act of 1956, as amended (12 U.S.C. 1841).

Bankruptcy remote means, with respect to an entity or asset, that the entity or asset would be excluded from an insolvent entity's estate in receivership, insolvency, liquidation, or similar proceeding.

Capital distribution means:

(1) A reduction of tier 1 capital through the repurchase of a tier 1 capital instrument or by other means;

(2) A reduction of tier 2 capital through the repurchase, or redemption prior to maturity, of a tier 2 capital instrument or by other means;

(3) A dividend declaration on any tier 1 capital instrument;

(4) A dividend declaration or interest payment on any tier 2 capital instrument if such dividend declaration or interest payment may be temporarily or permanently suspended at the discretion of the [BANK]; or

(5) Any similar transaction that the [AGENCY] determines to be in substance a distribution of capital.

Carrying value means, with respect to an asset, the value of the asset on the balance sheet of the [BANK], determined in accordance with generally accepted accounting principles (GAAP).

Category 1 residential mortgage exposure means a residential mortgage exposure with the following characteristics:

(1) The duration of the mortgage exposure does not exceed 30 years;

(2) The terms of the mortgage exposure provide for regular periodic payments that do not:

(i) Result in an increase of the principal balance;

(ii) Allow the borrower to defer repayment of principal of the residential mortgage exposure; or

(iii) Result in a balloon payment;

(3) The standards used to underwrite the residential mortgage exposure:

(i) Took into account all of the borrower's obligations, including for mortgage obligations, principal, interest, taxes, insurance (including mortgage guarantee insurance), and assessments; and

(ii) Resulted in a conclusion that the borrower is able to repay the exposure using:

(A) The maximum interest rate that may apply during the first five years after the date of the closing of the residential mortgage exposure transaction; and

(B) The amount of the residential mortgage exposure is the maximum possible contractual exposure over the life of the mortgage as of the date of the closing of the transaction;

(4) The terms of the residential mortgage exposure allow the annual rate of interest to increase no more than two percentage points in any twelve-month period and no more than six percentage points over the life of the exposure;

(5) For a first-lien home equity line of credit (HELOC), the borrower must be qualified using the principal and interest payments based on the maximum contractual exposure under the terms of the HELOC;

(6) The determination of the borrower's ability to repay is based on documented, verified income;

(7) The residential mortgage exposure is not 90 days or more past due or on non-accrual status; and

(8) The residential mortgage exposure is

(i) not a junior-lien residential mortgage exposure, and

(ii) if the residential mortgage exposure is a first-lien residential mortgage exposure held by a single banking organization and secured by first and junior lien(s) where no other party holds an intervening lien, each residential mortgage exposure must have the characteristics of a category 1 residential mortgage exposure as set forth in this definition.

Notwithstanding paragraphs (1) through (8), the [AGENCY] may determine that a residential mortgage exposure that is not prudently underwritten does not qualify as a category 1 residential mortgage exposure.

Category 2 residential mortgage exposure means a residential mortgage exposure that is not a Category 1 residential mortgage exposure.

Central counterparty (CCP) means a counterparty (for example, a clearing house) that facilitates trades between counterparties in one or more financial markets by either guaranteeing trades or novating contracts.

CFTC means the U.S. Commodity Futures Trading Commission.

Clean-up call means a contractual provision that permits an originating [BANK] or servicer to call securitization exposures before their stated maturity or call date.

Cleared transaction means an outstanding derivative contract or repo-style transaction that a [BANK] or clearing member has entered into with a central counterparty (that is, a transaction that a central counterparty has accepted). A cleared transaction includes:

(1) A transaction between a CCP and a [BANK] that is a clearing member of the CCP where the [BANK] enters into the transaction with the CCP for the [BANK]'s own account;

(2) A transaction between a CCP and a [BANK] that is a clearing member of the CCP where the [BANK] is acting as a financial intermediary on behalf of a clearing member client

and the transaction offsets a transaction that satisfies the requirements of paragraph (3) below of this definition.

(3) A transaction between a clearing member client [BANK] and a clearing member where the clearing member acts as a financial intermediary on behalf of the clearing member client and enters into an offsetting transaction with a CCP provided that:

(i) The offsetting transaction is identified by the CCP as a transaction for the clearing member client;

(ii) The collateral supporting the transaction is held in a manner that prevents the [BANK] from facing any loss due to the default, receivership, or insolvency of either the clearing member or the clearing member's other clients;

(iii) The [BANK] has conducted sufficient legal review to conclude with a well-founded basis (and maintains sufficient written documentation of that legal review) that in the event of a legal challenge (including one resulting from a default or receivership, insolvency, liquidation, or similar proceeding) the relevant court and administrative authorities would find the arrangements of paragraph (ii) to be legal, valid, binding and enforceable under the law of the relevant jurisdictions; and

(iv) The offsetting transaction with a clearing member is transferable under the transaction documents or applicable laws in the relevant jurisdiction(s) to another clearing member should the clearing member default, become insolvent, or enter receivership, insolvency, liquidation, or similar proceeding.

(4) A transaction between a clearing member client and a CCP where a clearing member guarantees the performance of the clearing member client to the CCP.

(5) A cleared transaction does not include the exposure of a [BANK] that is a clearing member to its clearing member client where the [BANK] is either acting as a financial intermediary and enters into an offsetting transaction with a CCP or where the [BANK] provides a guarantee to the CCP on the performance of the client.

Clearing member means a member of, or direct participant in, a CCP that is entitled to enter into transactions with the CCP.

Clearing member client means a party to a cleared transaction associated with a CCP in which a clearing member acts either as a financial intermediary with respect to the party or guarantees the performance of the party to the CCP.

Collateral agreement means a legal contract that specifies the time when, and circumstances under which, a counterparty is required to pledge collateral to a [BANK] for a single financial contract or for all financial contracts in a netting set and confers upon the [BANK] a perfected, first-priority security interest (notwithstanding the prior security interest of any custodial agent), or the legal equivalent thereof, in the collateral posted by the counterparty under the agreement. This security interest must provide the [BANK] with a right to close out the financial positions and liquidate the collateral upon an event of default of, or failure to

perform by, the counterparty under the collateral agreement. A contract would not satisfy this requirement if the [BANK]'s exercise of rights under the agreement may be stayed or avoided under applicable law in the relevant jurisdictions, other than in receivership, conservatorship, resolution under the Federal Deposit Insurance Act, Title II of the Dodd-Frank Act, or under any similar insolvency law applicable to GSEs.

Commitment means any legally binding arrangement that obligates a [BANK] to extend credit or to purchase assets.

Commodity derivative contract means a commodity-linked swap, purchased commodity-linked option, forward commodity-linked contract, or any other instrument linked to commodities that gives rise to similar counterparty credit risks.

Common equity tier 1 capital is defined in §___.20 of subpart C.

Common equity tier 1 minority interest means the common equity tier 1 capital of a depository institution or foreign bank that is (i) a consolidated subsidiary of a [BANK], and (ii) not owned by the [BANK].

Company means a corporation, partnership, limited liability company, depository institution, business trust, special purpose entity, association, or similar organization.

Control. A person or company controls a company if it:

(1) Owns, controls, or holds with power to vote 25 percent or more of a class of voting securities of the company; or

(2) Consolidates the company for financial reporting purposes.

Corporate exposure means an exposure to a company that is not:

(1) An exposure to a sovereign, the Bank for International Settlements, the European Central Bank, the European Commission, the International Monetary Fund, a multi-lateral development bank (MDB), a depository institution, a foreign bank, a credit union, or a public sector entity (PSE);

(2) An exposure to a government-sponsored entity (GSE);

(3) A residential mortgage exposure;

(4) A pre-sold construction loan;

(5) A statutory multifamily mortgage;

(6) A high volatility commercial real estate (HVCRE) exposure;

(7) A cleared transaction;

(8) A default fund contribution;

(9) A securitization exposure;

(10) An equity exposure; or

(11) An unsettled transaction.

Country risk classification (CRC) with respect to a sovereign means the most recent consensus CRC published by the Organization for Economic Cooperation and Development (OECD) as of December 31st of the prior calendar year that provides a view of the likelihood that the sovereign will service its external debt.

Credit derivative means a financial contract executed under standard industry credit derivative documentation that allows one party (the protection purchaser) to transfer the credit risk of one or more exposures (reference exposure(s)) to another party (the protection provider) for a certain period of time.

Credit-enhancing interest-only strip (CEIO) means an on-balance sheet asset that, in form or in substance:

(1) Represents a contractual right to receive some or all of the interest and no more than a minimal amount of principal due on the underlying exposures of a securitization; and

(2) Exposes the holder of the CEIO to credit risk directly or indirectly associated with the underlying exposures that exceeds a pro rata share of the holder's claim on the underlying exposures, whether through subordination provisions or other credit-enhancement techniques.

Credit-enhancing representations and warranties means representations and warranties that are made or assumed in connection with a transfer of underlying exposures (including loan servicing assets) and that obligate a [BANK] to protect another party from losses arising from the credit risk of the underlying exposures. Credit enhancing representations and warranties include provisions to protect a party from losses resulting from the default or nonperformance of the counterparties of the underlying exposures or from an insufficiency in the value of the collateral backing the underlying exposures. Credit enhancing representations and warranties do not include warranties that permit the return of underlying exposures in instances of misrepresentation, fraud, or incomplete documentation.

Credit risk mitigant means collateral, a credit derivative, or a guarantee.

Credit-risk-weighted assets means 1.06 multiplied by the sum of:

(1) Total wholesale and retail risk-weighted assets;

(2) Risk-weighted assets for securitization exposures; and

(3) Risk-weighted assets for equity exposures.

Credit union means an insured credit union as defined under the Federal Credit Union Act (12 U.S.C. 1752).

Current exposure means, with respect to a netting set, the larger of zero or the market value of a transaction or portfolio of transactions within the netting set that would be lost upon default of the counterparty, assuming no recovery on the value of the transactions. Current exposure is also called replacement cost.

Custodian means a financial institution that has legal custody of collateral provided to a CCP.

Debt-to-assets ratio means the ratio calculated by dividing a public company's total liabilities by its equity market value (as defined herein) plus total liabilities as reported as of the end of the most recently reported calendar quarter.

Default fund contribution means the funds contributed or commitments made by a clearing member to a CCP's mutualized loss sharing arrangement.

Depository institution means a depository institution as defined in section 3 of the Federal Deposit Insurance Act.

Depository institution holding company means a bank holding company or savings and loan holding company.

Derivative contract means a financial contract whose value is derived from the values of one or more underlying assets, reference rates, or indices of asset values or reference rates. Derivative contracts include interest rate derivative contracts, exchange rate derivative contracts, equity derivative contracts, commodity derivative contracts, credit derivative contracts, and any other instrument that poses similar counterparty credit risks. Derivative contracts also include unsettled securities, commodities, and foreign exchange transactions with a contractual settlement or delivery lag that is longer than the lesser of the market standard for the particular instrument or five business days.

Discretionary bonus payment means a payment made to an executive officer of a [BANK], where:

(1) The [BANK] retains discretion as to whether to make, and the amount of, the payment until the payment is awarded to the executive officer;

(2) The amount paid is determined by the [BANK] without prior promise to, or agreement with, the executive officer; and

(3) The executive officer has no contractual right, whether express or implied, to the bonus payment.

Dodd-Frank Act means the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Pub. L. 111-203, 124 Stat. 1376).

Early amortization provision means a provision in the documentation governing a securitization that, when triggered, causes investors in the securitization exposures to be repaid before the original stated maturity of the securitization exposures, unless the provision:

(1) Is triggered solely by events not directly related to the performance of the underlying exposures or the originating [BANK] (such as material changes in tax laws or regulations); or

(2) Leaves investors fully exposed to future draws by borrowers on the underlying exposures even after the provision is triggered.

Effective notional amount means for an eligible guarantee or eligible credit derivative, the lesser of the contractual notional amount of the credit risk mitigant and the exposure amount of the hedged exposure, multiplied by the percentage coverage of the credit risk mitigant.

Eligible asset-backed commercial paper (ABCP) liquidity facility means a liquidity facility supporting ABCP, in form or in substance, that is subject to an asset quality test at the time of draw that precludes funding against assets that are 90 days or more past due or in default. Notwithstanding the preceding sentence, a liquidity facility is an eligible ABCP liquidity facility if the assets or exposures funded under the liquidity facility that do not meet the eligibility requirements are guaranteed by a sovereign that qualifies for a 20 percent risk weight or lower.

Eligible clean-up call means a clean-up call that:

(1) Is exercisable solely at the discretion of the originating [BANK] or servicer;

(2) Is not structured to avoid allocating losses to securitization exposures held by investors or otherwise structured to provide credit enhancement to the securitization; and

(3)(i) For a traditional securitization, is only exercisable when 10 percent or less of the principal amount of the underlying exposures or securitization exposures (determined as of the inception of the securitization) is outstanding; or

(ii) For a synthetic securitization, is only exercisable when 10 percent or less of the principal amount of the reference portfolio of underlying exposures (determined as of the inception of the securitization) is outstanding.

Eligible credit derivative means a credit derivative in the form of a credit default swap, n^{th}-to-default swap, total return swap, or any other form of credit derivative approved by the [AGENCY], provided that:

(1) The contract meets the requirements of an eligible guarantee and has been confirmed by the protection purchaser and the protection provider;

(2) Any assignment of the contract has been confirmed by all relevant parties;

(3) If the credit derivative is a credit default swap or n^{th}-to-default swap, the contract includes the following credit events:

(i) Failure to pay any amount due under the terms of the reference exposure, subject to any applicable minimal payment threshold that is consistent with standard market practice and with a grace period that is closely in line with the grace period of the reference exposure; and

(ii) Receivership, insolvency, liquidation, conservatorship or inability of the reference exposure issuer to pay its debts, or its failure or admission in writing of its inability generally to pay its debts as they become due, and similar events;

(4) The terms and conditions dictating the manner in which the contract is to be settled are incorporated into the contract;

(5) If the contract allows for cash settlement, the contract incorporates a robust valuation process to estimate loss reliably and specifies a reasonable period for obtaining post-credit event valuations of the reference exposure;

(6) If the contract requires the protection purchaser to transfer an exposure to the protection provider at settlement, the terms of at least one of the exposures that is permitted to be transferred under the contract provide that any required consent to transfer may not be unreasonably withheld;

(7) If the credit derivative is a credit default swap or n^{th}-to-default swap, the contract clearly identifies the parties responsible for determining whether a credit event has occurred, specifies that this determination is not the sole responsibility of the protection provider, and gives the protection purchaser the right to notify the protection provider of the occurrence of a credit event; and

(8) If the credit derivative is a total return swap and the [BANK] records net payments received on the swap as net income, the [BANK] records offsetting deterioration in the value of the hedged exposure (either through reductions in fair value or by an addition to reserves).

Eligible credit reserves means all general allowances that have been established through a charge against earnings to absorb credit losses associated with on- or off-balance sheet wholesale and retail exposures, including the allowance for loan and lease losses (ALLL) associated with such exposures but excluding allocated transfer risk reserves established pursuant to 12 U.S.C. 3904 and other specific reserves created against recognized losses.

Eligible guarantee means a guarantee from an eligible guarantor that:

(1) Is written;

(2) Is either:

(i) Unconditional, or

(ii) A contingent obligation of the U.S. government or its agencies, the enforceability of which is dependent upon some affirmative action on the part of the beneficiary of the guarantee or a third party (for example, meeting servicing requirements);

(3) Covers all or a pro rata portion of all contractual payments of the obligated party on the reference exposure;

(4) Gives the beneficiary a direct claim against the protection provider;

(5) Is not unilaterally cancelable by the protection provider for reasons other than the breach of the contract by the beneficiary;

(6) Except for a guarantee by a sovereign, is legally enforceable against the protection provider in a jurisdiction where the protection provider has sufficient assets against which a judgment may be attached and enforced;

(7) Requires the protection provider to make payment to the beneficiary on the occurrence of a default (as defined in the guarantee) of the obligated party on the reference exposure in a timely manner without the beneficiary first having to take legal actions to pursue the obligor for payment;

(8) Does not increase the beneficiary's cost of credit protection on the guarantee in response to deterioration in the credit quality of the reference exposure; and

(9) Is not provided by an affiliate of the [BANK], unless the affiliate is an insured depository institution, foreign bank, securities broker or dealer, or insurance company that:

(i) Does not control the [BANK]; and

(ii) Is subject to consolidated supervision and regulation comparable to that imposed on depository institutions, U.S. securities broker-dealers, or U.S. insurance companies (as the case may be).

Eligible guarantor means:

(1) A sovereign, the Bank for International Settlements, the International Monetary Fund, the European Central Bank, the European Commission, a Federal Home Loan Bank, Federal Agricultural Mortgage Corporation (Farmer Mac), a multilateral development bank (MDB), a depository institution, a bank holding company, a savings and loan holding company, a credit union, or a foreign bank; or

(2) An entity (other than a special purpose entity):

(i) That at the time the guarantee is issued or anytime thereafter, has issued and outstanding an unsecured debt security without credit enhancement that is investment grade;

(ii) Whose creditworthiness is not positively correlated with the credit risk of the exposures for which it has provided guarantees; and

(iii) That is not an insurance company engaged predominately in the business of providing credit protection (such as a monoline bond insurer or re-insurer).

Eligible margin loan means an extension of credit where:

(1) The extension of credit is collateralized exclusively by liquid and readily marketable debt or equity securities, or gold;

(2) The collateral is marked-to-market daily, and the transaction is subject to daily margin maintenance requirements;

(3) The extension of credit is conducted under an agreement that provides the [BANK] the right to accelerate and terminate the extension of credit and to liquidate or set-off collateral promptly upon an event of default (including upon an event of receivership, insolvency, liquidation, conservatorship, or similar proceeding) of the counterparty, provided that, in any such case, any exercise of rights under the agreement will not be stayed or avoided under applicable law in the relevant jurisdictions;[1] and

(4) The [BANK] has conducted sufficient legal review to conclude with a well-founded basis (and maintains sufficient written documentation of that legal review) that the agreement meets the requirements of paragraph (3) of this definition and is legal, valid, binding, and enforceable under applicable law in the relevant jurisdictions, other than in receivership, conservatorship, resolution under the Federal Deposit Insurance Act, Title II of the Dodd-Frank Act, or under any similar insolvency law applicable to GSEs.

Eligible servicer cash advance facility means a servicer cash advance facility in which:

(1) The servicer is entitled to full reimbursement of advances, except that a servicer may be obligated to make non-reimbursable advances for a particular underlying exposure if any such advance is contractually limited to an insignificant amount of the outstanding principal balance of that exposure;

(2) The servicer's right to reimbursement is senior in right of payment to all other claims on the cash flows from the underlying exposures of the securitization; and

(3) The servicer has no legal obligation to, and does not make advances to the securitization if the servicer concludes the advances are unlikely to be repaid.

Equity derivative contract means an equity-linked swap, purchased equity-linked option, forward equity-linked contract, or any other instrument linked to equities that gives rise to similar counterparty credit risks.

Equity exposure means:

(1) A security or instrument (whether voting or non-voting) that represents a direct or an indirect ownership interest in, and is a residual claim on, the assets and income of a company, unless:

(i) The issuing company is consolidated with the [BANK] under GAAP;

[1] This requirement is met where all transactions under the agreement are (i) executed under U.S. law and (ii) constitute "securities contracts" under section 555 of the Bankruptcy Code (11 U.S.C. 555), qualified financial contracts under section 11(e)(8) of the Federal Deposit Insurance Act, or netting contracts between or among financial institutions under sections 401-407 of the Federal Deposit Insurance Corporation Improvement Act or the Federal Reserve Board's Regulation EE (12 CFR part 231).

(ii) The [BANK] is required to deduct the ownership interest from tier 1 or tier 2 capital under this [PART];

(iii) The ownership interest incorporates a payment or other similar obligation on the part of the issuing company (such as an obligation to make periodic payments); or

(iv) The ownership interest is a securitization exposure;

(2) A security or instrument that is mandatorily convertible into a security or instrument described in paragraph (1) of this definition;

(3) An option or warrant that is exercisable for a security or instrument described in paragraph (1) of this definition; or

(4) Any other security or instrument (other than a securitization exposure) to the extent the return on the security or instrument is based on the performance of a security or instrument described in paragraph (1) of this definition.

ERISA means the Employee Retirement Income and Security Act of 1974 (29 U.S.C. 1002).

Exchange rate derivative contract means a cross-currency interest rate swap, forward foreign-exchange contract, currency option purchased, or any other instrument linked to exchange rates that gives rise to similar counterparty credit risks.

Executive officer means a person who holds the title or, without regard to title, salary, or compensation, performs the function of one or more of the following positions: president, chief executive officer, executive chairman, chief operating officer, chief financial officer, chief investment officer, chief legal officer, chief lending officer, chief risk officer, or head of a major business line, and other staff that the board of directors of the [BANK] deems to have equivalent responsibility.

Expected credit loss (ECL) means:

(1) For a wholesale exposure to a non-defaulted obligor or segment of non-defaulted retail exposures that is carried at fair value with gains and losses flowing through earnings or that is classified as held-for-sale and is carried at the lower of cost or fair value with losses flowing through earnings, zero.

(2) For all other wholesale exposures to non-defaulted obligors or segments of non-defaulted retail exposures, the product of the probability of default (PD) times the loss given default (LGD) times the exposure at default (EAD) for the exposure or segment.

(3) For a wholesale exposure to a defaulted obligor or segment of defaulted retail exposures, the [BANK]'s impairment estimate for allowance purposes for the exposure or segment.

(4) Total ECL is the sum of expected credit losses for all wholesale and retail exposures other than exposures for which the [BANK] has applied the double default treatment in §___.135.

Exposure amount means:

(1) For the on-balance sheet component of an exposure (other than an OTC derivative contract; a repo-style transaction or an eligible margin loan for which the [BANK] determines the exposure amount under §___.37 of subpart D; cleared transaction; default fund contribution; or a securitization exposure), exposure amount means the [BANK]'s carrying value of the exposure.

(2) For the off-balance sheet component of an exposure (other than an OTC derivative contract; a repo-style transaction or an eligible margin loan for which the [BANK] calculates the exposure amount under §___.37 of subpart D; cleared transaction, default fund contribution or a securitization exposure), exposure amount means the notional amount of the off-balance sheet component multiplied by the appropriate credit conversion factor (CCF) in §___.33 of subpart D.

(3) If the exposure is an OTC derivative contract or derivative contract that is a cleared transaction, the exposure amount determined under §___.34 of subpart D.

(4) If the exposure is an eligible margin loan or repo-style transaction (including a cleared transaction) for which the [BANK] calculates the exposure amount as provided in §___.37 of subpart D, the exposure amount determined under §___.37 of subpart D.

(5) If the exposure is a securitization exposure, the exposure amount determined under §___.42 of subpart D.

Federal Deposit Insurance Act means the Federal Deposit Insurance Act (12 U.S.C. 1813).

Federal Deposit Insurance Corporation Improvement Act means the Federal Deposit Insurance Corporation Improvement Act of 1991 (12 U.S.C. 4401).

Financial collateral means collateral:

(1) In the form of:

(i) Cash on deposit with the [BANK] (including cash held for the [BANK] by a third-party custodian or trustee);

(ii) Gold bullion;

(iii) Long-term debt securities that are not resecuritization exposures and that are investment grade;

(iv) Short-term debt instruments that are not resecuritization exposures and that are investment grade;

(v) Equity securities that are publicly-traded;

(vi) Convertible bonds that are publicly-traded; or

(vii) Money market fund shares and other mutual fund shares if a price for the shares is publicly quoted daily; and

(2) In which the [BANK] has a perfected, first-priority security interest or, outside of the United States, the legal equivalent thereof (with the exception of cash on deposit and notwithstanding the prior security interest of any custodial agent).

Financial institution means:

(1)(i) A bank holding company, savings and loan holding company, nonbank financial institution supervised by the Board under Title I of the Dodd-Frank Act, depository institution, foreign bank, credit union, insurance company, or securities firm;

(ii) A commodity pool as defined in section 1a(10) of the Commodity Exchange Act (7 U.S.C. 1a(10));

(iii) An entity that is a covered fund for purposes of section 13 of the Bank Holding Company Act (12 U.S.C. 1851(h)(2)) and regulations issued thereunder;

(iv) An employee benefit plan as defined in paragraphs (3) and (32) of section 3 of the Employee Retirement Income and Security Act of 1974 (29 U.S.C. 1002) (other than an employee benefit plan established by [BANK] for the benefit of its employees or the employees of its affiliates);

(v) Any other company predominantly engaged in the following activities:

(A) Lending money, securities or other financial instruments, including servicing loans;

(B) Insuring, guaranteeing, or indemnifying against loss, harm, damage, illness, disability, or death, or issuing annuities;

(C) Underwriting, dealing in, making a market in, or investing as principal in securities or other financial instruments;

(D) Asset management activities (not including investment or financial advisory activities); or

(E) Acting as a futures commission merchant.

(vi) Any entity not domiciled in the United States (or a political subdivision thereof) that would be covered by any of paragraphs (1)(i) through (v) if such entity were domiciled in the United States; or

(vii) Any other company that the [AGENCY] may determine is a financial institution based on the nature and scope of its activities.

(2) For the purposes of this definition, a company is "predominantly engaged" in an activity or activities if:

(i) 85 percent or more of the total consolidated annual gross revenues (as determined in accordance with applicable accounting standards) of the company in either of the two most recent calendar years were derived, directly or indirectly, by the company on a consolidated basis from the activities; or

(ii) 85 percent or more of the company's consolidated total assets (as determined in accordance with applicable accounting standards) as of the end of either of the two most recent calendar years were related to the activities.

(3) For the purpose of this [PART], "financial institution" does not include the following entities:

(i) GSEs;

(ii) Entities described in section 13(d)(1)(E) of the Bank Holding Company Act (12 U.S.C. 1851(d)(1)(E)) and regulations issued thereunder (exempted entities) and entities that are predominantly engaged in providing advisory and related services to exempted entities; and

(iii) Entities designated as Community Development Financial Institutions (CDFIs) under 12 U.S.C. 4701 et seq. and 12 CFR part 1805.

First-lien residential mortgage exposure means a residential mortgage exposure secured by a first lien or a residential mortgage exposure secured by first and junior lien(s) where no other party holds an intervening lien.

Foreign bank means a foreign bank as defined in section 211.2 of the Federal Reserve Board's Regulation K (12 CFR 211.2) (other than a depository institution).

Forward agreement means a legally binding contractual obligation to purchase assets with certain drawdown at a specified future date, not including commitments to make residential mortgage loans or forward foreign exchange contracts.

GAAP means generally accepted accounting principles as used in the United States.

Gain-on-sale means an increase in the equity capital of a [BANK] (as reported on Schedule RC of the Call Report or Schedule HC of the FR Y–9C) resulting from a securitization (other than an increase in equity capital resulting from the [BANK]'s receipt of cash in connection with the securitization).

General obligation means a bond or similar obligation that is backed by the full faith and credit of a public sector entity (PSE).

Government-sponsored entity (GSE) means an entity established or chartered by the U.S. government to serve public purposes specified by the U.S. Congress but whose debt obligations are not explicitly guaranteed by the full faith and credit of the U.S. government.

Guarantee means a financial guarantee, letter of credit, insurance, or other similar financial instrument (other than a credit derivative) that allows one party (beneficiary) to transfer the credit risk of one or more specific exposures (reference exposure) to another party (protection provider).

High volatility commercial real estate (HVCRE) exposure means a credit facility that finances or has financed the acquisition, development, or construction (ADC) of real property, unless the facility finances:

(1) One- to four-family residential properties; or

(2) Commercial real estate projects in which:

(i) The loan-to-value ratio is less than or equal to the applicable maximum supervisory loan-to-value ratio in the [AGENCY]'s real estate lending standards at 12 CFR part 34, subpart D and 12 CFR part 160, subparts A and B (OCC); 12 CFR part 208, Appendix C (Board); 12 CFR part 365, subpart D and 12 CFR 390.264-390.265 (FDIC);

(ii) The borrower has contributed capital to the project in the form of cash or unencumbered readily marketable assets (or has paid development expenses out-of-pocket) of at least 15 percent of the real estate's appraised "as completed" value; and

(iii) The borrower contributed the amount of capital required by paragraph (2)(ii) of this definition before the [BANK] advances funds under the credit facility, and the capital contributed by the borrower, or internally generated by the project, is contractually required to remain in the project throughout the life of the project. The life of a project concludes only when the credit facility is converted to permanent financing or is sold or paid in full. Permanent financing may be provided by the [BANK] that provided the ADC facility as long as the permanent financing is subject to the [BANK]'s underwriting criteria for long-term mortgage loans.

Home country means the country where an entity is incorporated, chartered, or similarly established.

Interest rate derivative contract means a single-currency interest rate swap, basis swap, forward rate agreement, purchased interest rate option, when-issued securities, or any other instrument linked to interest rates that gives rise to similar counterparty credit risks.

International Lending Supervision Act means the International Lending Supervision Act of 1983 (12 U.S.C. 3907).

Investing bank means, with respect to a securitization, a [BANK] that assumes the credit risk of a securitization exposure (other than an originating [BANK] of the securitization). In the typical synthetic securitization, the investing [BANK] sells credit protection on a pool of underlying exposures to the originating [BANK].

Investment fund means a company:

(1) Where all or substantially all of the assets of the company are financial assets; and

(2) That has no material liabilities.

Investment grade means that the entity to which the [BANK] is exposed through a loan or security, or the reference entity with respect to a credit derivative, has adequate capacity to meet financial commitments for the projected life of the asset or exposure. Such an entity or reference entity has adequate capacity to meet financial commitments if the risk of its default is low and the full and timely repayment of principal and interest is expected.

Investment in the capital of an unconsolidated financial institution means a net long position in an instrument that is recognized as capital for regulatory purposes by the primary supervisor of an unconsolidated regulated financial institutions and in an instrument that is part of the GAAP equity of an unconsolidated unregulated financial institution, including direct, indirect, and synthetic exposures to capital instruments, excluding underwriting positions held by the [BANK] for five business days or less.[2] An indirect exposure results from the [BANK]'s investment in an unconsolidated entity that has an exposure to a capital instrument of a financial institution. A synthetic exposure results from the [BANK]'s investment in an instrument where the value of such instrument is linked to the value of a capital instrument of a financial institution. For purposes of this definition, the amount of the exposure resulting from the investment in the capital of an unconsolidated financial institution is the [BANK]'s loss on such exposure should the underlying capital instrument have a value of zero. In addition, for purposes of this definition:

(1) The net long position is the gross long position in the exposure to the capital of the financial institution (including covered positions under subpart F) net of short positions in the same exposure where the maturity of the short position either matches the maturity of the long position or has a residual maturity of at least one year;

(2) Long and short positions in the same index without a maturity date are considered to have matching maturity. Gross long positions in investments in the capital instruments of unconsolidated financial institutions resulting from holdings of index securities may be netted against short positions in the same underlying index. However, short positions in indexes that are hedging long cash or synthetic positions can be decomposed to provide recognition of the hedge. More specifically, the portion of the index that is composed of the same underlying exposure that is being hedged may be used to offset the long position as long as both the exposure being hedged and the short position in the index are positions subject to the market risk rule, the positions are fair valued on the banking organization's balance sheet, and the hedge is deemed effective by the banking organization's internal control processes assessed by the primary supervisor of the banking organization; and

(3) Instead of looking through and monitoring its exact exposure to the capital of unconsolidated financial institutions included in an index security, a [BANK] may, with the prior approval of the [AGENCY], use a conservative estimate of the amount of its investment in the capital of unconsolidated financial institutions held through the index security.

[2] If the [BANK] is an underwriter of a failed underwriting, the [BANK] can request approval from its primary federal supervisor to exclude underwriting positions related to such failed underwriting for a longer period of time.

Junior-lien residential mortgage exposure means a residential mortgage exposure that is not a first-lien residential mortgage exposure.

Main index means the Standard & Poor's 500 Index, the FTSE All-World Index, and any other index for which the [BANK] can demonstrate to the satisfaction of the [AGENCY] that the equities represented in the index have comparable liquidity, depth of market, and size of bid-ask spreads as equities in the Standard & Poor's 500 Index and FTSE All-World Index.

Market risk [BANK] means a [BANK] that is described in §___.201(b) of subpart F.

Money market fund means an investment fund that is subject to 17 CFR 270.2a-7 or any foreign equivalent thereof.

Mortgage servicing assets (MSAs) means the contractual rights owned by a [BANK] to service for a fee mortgage loans that are owned by others.

Multilateral development bank (MDB) means the International Bank for Reconstruction and Development, the Multilateral Investment Guarantee Agency, the International Finance Corporation, the Inter-American Development Bank, the Asian Development Bank, the African Development Bank, the European Bank for Reconstruction and Development, the European Investment Bank, the European Investment Fund, the Nordic Investment Bank, the Caribbean Development Bank, the Islamic Development Bank, the Council of Europe Development Bank, and any other multilateral lending institution or regional development bank in which the U.S. government is a shareholder or contributing member or which the [AGENCY] determines poses comparable credit risk.

National Bank Act means the National Bank Act (12 U.S.C. 24).

Netting set means a group of transactions with a single counterparty that are subject to a qualifying master netting agreement or a qualifying cross-product master netting agreement. For purposes of calculating risk-based capital requirements using the internal models methodology in subpart E, a transaction (1) that is not subject to such a master netting agreement or (2) where the [BANK] has identified specific wrong-way risk is its own netting set.

Non-significant investment in the capital of an unconsolidated financial institution means an investment where the [BANK] owns 10 percent or less of the issued and outstanding common shares of the unconsolidated financial institution.

N^{th}-to-default credit derivative means a credit derivative that provides credit protection only for the n^{th}-defaulting reference exposure in a group of reference exposures.

Operating entity means a company established to conduct business with clients with the intention of earning a profit in its own right.

Original maturity with respect to an off-balance sheet commitment means the length of time between the date a commitment is issued and:

(1) For a commitment that is not subject to extension or renewal, the stated expiration date of the commitment; or

(2) For a commitment that is subject to extension or renewal, the earliest date on which the [BANK] can, at its option, unconditionally cancel the commitment.

Originating [BANK], with respect to a securitization, means a [BANK] that:

(1) Directly or indirectly originated or securitized the underlying exposures included in the securitization; or

(2) Serves as an ABCP program sponsor to the securitization.

Over-the-counter (OTC) derivative contract means a derivative contract that is not a cleared transaction. An OTC derivative includes a transaction:

(1) Between a [BANK] that is a clearing member and a counterparty where the [BANK] is acting as a financial intermediary and enters into a cleared transaction with a CCP that offsets the transaction with the counterparty; or

(2) In which a [BANK] that is a clearing member provides a CCP a guarantee on the performance of the counterparty to the transaction.

Performance standby letter of credit (or performance bond) means an irrevocable obligation of a [BANK] to pay a third-party beneficiary when a customer (account party) fails to perform on any contractual nonfinancial or commercial obligation. To the extent permitted by law or regulation, performance standby letters of credit include arrangements backing, among other things, subcontractors' and suppliers' performance, labor and materials contracts, and construction bids.

Pre-sold construction loan means any one-to-four family residential construction loan to a builder that meets the requirements of section 618(a)(1) or (2) of the Resolution Trust Corporation Refinancing, Restructuring, and Improvement Act of 1991 and the following criteria:

(1) The loan is made in accordance with prudent underwriting standards;

(2) The purchaser is an individual(s) that intends to occupy the residence and is not a partnership, joint venture, trust, corporation, or any other entity (including an entity acting as a sole proprietorship) that is purchasing one or more of the residences for speculative purposes;

(3) The purchaser has entered into a legally binding written sales contract for the residence;

(4) The purchaser has not terminated the contract; however, if the purchaser terminates the sales contract the [BANK] must immediately apply a 100 percent risk weight to the loan and report the revised risk weight in [BANK]'s next quarterly [REGULATORY REPORT];

(5) The purchaser of the residence has a firm written commitment for permanent financing of the residence upon completion;

(6) The purchaser has made a substantial earnest money deposit of no less than 3 percent of the sales price, which is subject to forfeiture if the purchaser terminates the sales contract; provided that, the earnest money deposit shall not be subject to forfeiture by reason of breach or termination of the sales contract on the part of the builder;

(7) The earnest money deposit must be held in escrow by the [BANK] or an independent party in a fiduciary capacity, and the escrow agreement must provide that in the event of default the escrow funds shall be used to defray any cost incurred by [BANK] relating to any cancellation of the sales contract by the purchaser of the residence;

(8) The builder must incur at least the first 10 percent of the direct costs of construction of the residence (that is, actual costs of the land, labor, and material) before any drawdown is made under the loan;

(9) The loan may not exceed 80 percent of the sales price of the presold residence; and

(10) The loan is not more than 90 days past due, or on nonaccrual.

Private company means a company that is not a public company.

Private sector credit exposure means an exposure to a company or an individual that is included in credit risk-weighted assets and is not an exposure to a sovereign, the Bank for International Settlements, the European Central Bank, the European Commission, the International Monetary Fund, a MDB, a PSE, or a GSE.

Protection amount (P) means, with respect to an exposure hedged by an eligible guarantee or eligible credit derivative, the effective notional amount of the guarantee or credit derivative, reduced to reflect any currency mismatch, maturity mismatch, or lack of restructuring coverage (as provided in §___.36 of subpart D or §___.134 of subpart E, as appropriate).

Public company means a company that has issued publicly-traded debt or equity.

Publicly-traded means traded on:

(1) Any exchange registered with the SEC as a national securities exchange under section 6 of the Securities Exchange Act; or

(2) Any non-U.S.-based securities exchange that:

(i) Is registered with, or approved by, a national securities regulatory authority; and

(ii) Provides a liquid, two-way market for the instrument in question.

Public sector entity (PSE) means a state, local authority, or other governmental subdivision below the sovereign level.

Qualifying central counterparty (QCCP) means a central counterparty that:

(1) Is a designated financial market utility (FMU) under Title VIII of the Dodd-Frank Act;

(2) If not located in the United States, is regulated and supervised in a manner equivalent to a designated FMU; or

(3) Meets the following standards:

(i) The central counterparty requires all parties to contracts cleared by the counterparty to be fully collateralized on a daily basis;

(ii) The [BANK] demonstrates to the satisfaction of the [AGENCY] that the central counterparty:

(A) Is in sound financial condition;

(B) Is subject to supervision by the Board, the CFTC, or the Securities Exchange Commission (SEC), or if the central counterparty is not located in the United States, is subject to effective oversight by a national supervisory authority in its home country; and

(C) Meets or exceeds (1) the risk-management standards for central counterparties set forth in regulations established by the Board, the CFTC, or the SEC under Title VII or Title VIII of the Dodd-Frank Act, or (2) if the central counterparty is not located in the United States, similar risk-management standards established under the law of its home country that are consistent with international standards for central counterparty risk management as established by the relevant standard setting body of the Bank of International Settlements;

(4) Provides the [BANK] with the central counterparty's hypothetical capital requirement or the information necessary to calculate such hypothetical capital requirement, and other information the [BANK] is required to obtain under §___.35(d)(3);

(5) Makes available to the [AGENCY] and the CCP's regulator the information described in paragraph (4) of this definition; and

(6) Has not otherwise been determined by the [AGENCY] to not be QCCP due to its financial condition, risk profile, failure to meet supervisory risk management standards, or other weaknesses or supervisory concerns that are inconsistent with the risk weight assigned to qualifying central counterparties under §___.35 of subpart D; and

(7) If a [BANK] determines that a CCP ceases to be a QCCP due to the failure of the CCP to satisfy one or more of the requirements set forth at paragraphs (1) through (6) of this definition, the [BANK] may continue to treat the CCP as a QCCP for up to three months following the determination. If the CCP fails to remedy the relevant deficiency within three months after the initial determination, or the CCP fails to satisfy the requirements set forth in paragraphs (1) through (6) continuously for a three month period after remedying the relevant deficiency, a [BANK] may not treat the CCP as a QCCP for the purposes of this [PART] until

after the [BANK] has determined that the CCP has satisfied the requirements in paragraphs (1) through (6) for three continuous months.

Qualifying master netting agreement means any written, legally enforceable agreement provided that:

(1) The agreement creates a single legal obligation for all individual transactions covered by the agreement upon an event of default, including receivership, insolvency, liquidation, or similar proceeding, of the counterparty;

(2) The agreement provides the [BANK] the right to accelerate, terminate, and close-out on a net basis all transactions under the agreement and to liquidate or set-off collateral promptly upon an event of default, including upon an event of receivership, insolvency, liquidation, or similar proceeding, of the counterparty, provided that, in any such case, any exercise of rights under the agreement will not be stayed or avoided under applicable law in the relevant jurisdictions, other than in receivership, conservatorship, resolution under the Federal Deposit Insurance Act, Title II of the Dodd-Frank Act, or under any similar insolvency law applicable to GSEs;

(3) The [BANK] has conducted sufficient legal review to conclude with a well-founded basis (and maintains sufficient written documentation of that legal review) that:

(i) The agreement meets the requirements of paragraph (2) of this definition; and

(ii) In the event of a legal challenge (including one resulting from default or from receivership, insolvency, liquidation, or similar proceeding) the relevant court and administrative authorities would find the agreement to be legal, valid, binding, and enforceable under the law of the relevant jurisdictions;

(4) The [BANK] establishes and maintains procedures to monitor possible changes in relevant law and to ensure that the agreement continues to satisfy the requirements of this definition; and

(5) The agreement does not contain a walkaway clause (that is, a provision that permits a non-defaulting counterparty to make a lower payment than it otherwise would make under the agreement, or no payment at all, to a defaulter or the estate of a defaulter, even if the defaulter or the estate of the defaulter is a net creditor under the agreement).

Regulated financial institution means a financial institution subject to consolidated supervision and regulation comparable to that imposed on the following U.S. financial institutions: depository institutions, depository institution holding companies, nonbank financial companies supervised by the Board, designated financial market utilities, securities broker-dealers, credit unions, or insurance companies.

Repo-style transaction means a repurchase or reverse repurchase transaction, or a securities borrowing or securities lending transaction, including a transaction in which the [BANK] acts as agent for a customer and indemnifies the customer against loss, provided that:

(1) The transaction is based solely on liquid and readily marketable securities, cash, or gold;

(2) The transaction is marked-to-market daily and subject to daily margin maintenance requirements;

(3)(i) The transaction is a "securities contract" or "repurchase agreement" under section 555 or 559, respectively, of the Bankruptcy Code (11 U.S.C. 555 or 559), a qualified financial contract under section 11(e)(8) of the Federal Deposit Insurance Act, or a netting contract between or among financial institutions under sections 401-407 of the Federal Deposit Insurance Corporation Improvement Act or the Federal Reserve Board's Regulation EE (12 CFR part 231); or

(ii) If the transaction does not meet the criteria set forth in paragraph (3)(i) of this definition, then either:

(A) The transaction is executed under an agreement that provides the [BANK] the right to accelerate, terminate, and close-out the transaction on a net basis and to liquidate or set-off collateral promptly upon an event of default (including upon an event of receivership, insolvency, liquidation, or similar proceeding) of the counterparty, provided that, in any such case, any exercise of rights under the agreement will not be stayed or avoided under applicable law in the relevant jurisdictions, other than in receivership, conservatorship, resolution under the Federal Deposit Insurance Act, Title II of the Dodd-Frank Act, or under any similar insolvency law applicable to GSEs; or

(B) The transaction is:

(1) Either overnight or unconditionally cancelable at any time by the [BANK]; and

(2) Executed under an agreement that provides the [BANK] the right to accelerate, terminate, and close-out the transaction on a net basis and to liquidate or set-off collateral promptly upon an event of counterparty default; and

(4) The [BANK] has conducted sufficient legal review to conclude with a well-founded basis (and maintains sufficient written documentation of that legal review) that the agreement meets the requirements of paragraph (3) of this definition and is legal, valid, binding, and enforceable under applicable law in the relevant jurisdictions.

Resecuritization means a securitization in which one or more of the underlying exposures is a securitization exposure.

Resecuritization exposure means:
(1) an on- or off-balance sheet exposure to a resecuritization;
(2) an exposure that directly or indirectly references a resecuritization exposure.
(3) an exposure to an asset-backed commercial paper program is not a resecuritization exposure if either:
(i) the program-wide credit enhancement does not meet the definition of a resecuritization exposure; or

(ii) the entity sponsoring the program fully supports the commercial paper through the provision of liquidity so that the commercial paper holders effectively are exposed to the default risk of the sponsor instead of the underlying exposures.

Residential mortgage exposure means an exposure (other than a securitization exposure, equity exposure, statutory multifamily mortgage, or presold construction loan) that is:

(1) An exposure that is primarily secured by a first or subsequent lien on one-to-four family residential property; or

(2)(i) An exposure with an original and outstanding amount of $1 million or less that is primarily secured by a first or subsequent lien on residential property that is not one-to-four family; and

(ii) For purposes of calculating capital requirements under subpart E, is managed as part of a segment of exposures with homogeneous risk characteristics and not on an individual-exposure basis.

Revenue obligation means a bond or similar obligation that is an obligation of a PSE, but which the PSE is committed to repay with revenues from the specific project financed rather than general tax funds.

Savings and loan holding company means a savings and loan holding company as defined in section 10 of the Home Owners' Loan Act (12 U.S.C. 1467a).

Securities and Exchange Commission (SEC) means the U.S. Securities and Exchange Commission.

Securities Exchange Act means the Securities Exchange Act of 1934 (15 U.S.C. 78).

Securitization exposure means:

(1) An on-balance sheet or off-balance sheet credit exposure (including credit-enhancing representations and warranties) that arises from a traditional securitization or synthetic securitization (including a resecuritization), or

(2) An exposure that directly or indirectly references a securitization exposure described in paragraph (1) of this definition.

Securitization special purpose entity (securitization SPE) means a corporation, trust, or other entity organized for the specific purpose of holding underlying exposures of a securitization, the activities of which are limited to those appropriate to accomplish this purpose, and the structure of which is intended to isolate the underlying exposures held by the entity from the credit risk of the seller of the underlying exposures to the entity.

Servicer cash advance facility means a facility under which the servicer of the underlying exposures of a securitization may advance cash to ensure an uninterrupted flow of payments to investors in the securitization, including advances made to cover foreclosure costs or other expenses to facilitate the timely collection of the underlying exposures.

Significant investment in the capital of unconsolidated financial institutions means an investment where the [BANK] owns more than 10 percent of the issued and outstanding common shares of the unconsolidated financial institution.

Small Business Act means the Small Business Act (15 U.S.C. 632).

Small Business Investment Act means the Small Business Investment Act of 1958 (15 U.S.C. 682)

Sovereign means a central government (including the U.S. government) or an agency, department, ministry, or central bank of a central government.

Sovereign default means noncompliance by a sovereign with its external debt service obligations or the inability or unwillingness of a sovereign government to service an existing loan according to its original terms, as evidenced by failure to pay principal and interest timely and fully, arrearages, or restructuring.

Sovereign exposure means:

(1) A direct exposure to a sovereign; or

(2) An exposure directly and unconditionally backed by the full faith and credit of a sovereign.

Specific wrong-way risk means wrong-way risk that arises when either (1) the counterparty and issuer of the collateral supporting the transaction, or (2) the counterparty and the reference asset of the transaction, are affiliates or are the same entity.

Standardized market risk-weighted assets means the standardized measure for market risk calculated under §___.204 of subpart F multiplied by 12.5.

Standardized total risk-weighted assets means:

(1) The sum of:

(i) Total risk-weighted assets for general credit risk as calculated under §___.31 of subpart D;

(ii) Total risk-weighted assets for cleared transactions and default fund contributions as calculated under §___.35 of subpart D;

(iii) Total risk-weighted assets for unsettled transactions as calculated under §___.38 of subpart D;

(iv) Total risk-weighted assets for securitization exposures as calculated under §___.42 of subpart D;

(v) Total risk-weighted assets for equity exposures as calculated under §___.52 and §___.53 of subpart D; and

(vi) For a market risk [BANK] only, standardized market risk-weighted assets; minus

(2) Any amount of the [BANK]'s allowance for loan and lease losses that is not included in tier 2 capital.

Statutory multifamily mortgage means a loan secured by a multifamily residential property that meets the requirements under section 618(b)(1) of the Resolution Trust Corporation Refinancing, Restructuring, and Improvement Act of 1991, and that meets the following criteria:

(1) The loan is made in accordance with prudent underwriting standards;

(2) The loan-to-value (LTV) ratio of the loan, calculated in accordance with §___.32(g)(3) of subpart D, does not exceed 80 percent (or 75 percent if the loan is based on an interest rate that changes over the term of the loan);

(3) All principal and interest payments on the loan must have been made on time for at least one year prior to applying a 50 percent risk weight to the loan, or in the case where an existing owner is refinancing a loan on the property, all principal and interest payments on the loan being refinanced must have been made on time for at least one year prior to applying a 50 percent risk weight to the loan;

(4) Amortization of principal and interest on the loan must occur over a period of not more than 30 years and the minimum original maturity for repayment of principal must not be less than 7 years;

(5) Annual net operating income (before debt service on the loan) generated by the property securing the loan during its most recent fiscal year must not be less than 120 percent of the loan's current annual debt service (or 115 percent of current annual debt service if the loan is based on an interest rate that changes over the term of the loan) or, in the case of a cooperative or other not-for-profit housing project, the property must generate sufficient cash flow to provide comparable protection to the [BANK]; and

(6) The loan is not more than 90 days past due, or on nonaccrual.

Subsidiary means, with respect to a company, a company controlled by that company.

Synthetic securitization means a transaction in which:

(1) All or a portion of the credit risk of one or more underlying exposures is transferred to one or more third parties through the use of one or more credit derivatives or guarantees (other than a guarantee that transfers only the credit risk of an individual retail exposure);

(2) The credit risk associated with the underlying exposures has been separated into at least two tranches reflecting different levels of seniority;

(3) Performance of the securitization exposures depends upon the performance of the underlying exposures; and

(4) All or substantially all of the underlying exposures are financial exposures (such as loans, commitments, credit derivatives, guarantees, receivables, asset-backed securities, mortgage-backed securities, other debt securities, or equity securities).

Tier 1 capital means the sum of common equity tier 1 capital and additional tier 1 capital.

Tier 1 minority interest means the tier 1 capital of a consolidated subsidiary of a [BANK] that is not owned by the [BANK].

Tier 2 capital is defined in §___.20 of subpart C.

Total capital means the sum of tier 1 capital and tier 2 capital.

Total capital minority interest means the total capital of a consolidated subsidiary of a [BANK] that is not owned by the [BANK].

Total leverage exposure means the sum of the following:

(1) The balance sheet carrying value of all of the [BANK]'s on-balance sheet assets, less amounts deducted from tier 1 capital;

(2) The potential future exposure amount for each derivative contract to which the [BANK] is a counterparty (or each single-product netting set of such transactions) determined in accordance with §___.34;

(3) 10 percent of the notional amount of unconditionally cancellable commitments made by the [BANK]; and

(4) The notional amount of all other off-balance sheet exposures of the [BANK] (excluding securities lending, securities borrowing, reverse repurchase transactions, derivatives and unconditionally cancellable commitments).

Traditional securitization means a transaction in which:

(1) All or a portion of the credit risk of one or more underlying exposures is transferred to one or more third parties other than through the use of credit derivatives or guarantees;
(2) The credit risk associated with the underlying exposures has been separated into at least two tranches reflecting different levels of seniority;
(3) Performance of the securitization exposures depends upon the performance of the underlying exposures;
(4) All or substantially all of the underlying exposures are financial exposures (such as loans, commitments, credit derivatives, guarantees, receivables, asset-backed securities, mortgage-backed securities, other debt securities, or equity securities);
(5) The underlying exposures are not owned by an operating company;
(6) The underlying exposures are not owned by a small business investment company described in section 302 of the Small Business Investment Act;
(7) The underlying exposures are not owned by a firm an investment in which qualifies as a community development investment under section 24 (Eleventh) of the National Bank Act;

(8) The [AGENCY] may determine that a transaction in which the underlying exposures are owned by an investment firm that exercises substantially unfettered control over the size and composition of its assets, liabilities, and off-balance sheet exposures is not a traditional securitization based on the transaction's leverage, risk profile, or economic substance;

(9) The [AGENCY] may deem a transaction that meets the definition of a traditional securitization, notwithstanding paragraph (5), (6), or (7) of this definition, to be a traditional securitization based on the transaction's leverage, risk profile, or economic substance; and

(10) The transaction is not: (i) an investment fund; (ii) a collective investment fund (as defined in 12 CFR 208.34 (Board), 12 CFR 9.18 (OCC), and 12 CFR 344.3 (FDIC)); (iii) a pension fund regulated under the ERISA or a foreign equivalent thereof; or (iv) regulated under the Investment Company Act of 1940 (15 U.S.C. 80a-1) or a foreign equivalent thereof.

Tranche means all securitization exposures associated with a securitization that have the same seniority level.

Two-way market means a market where there are independent bona fide offers to buy and sell so that a price reasonably related to the last sales price or current bona fide competitive bid and offer quotations can be determined within one day and settled at that price within a relatively short time frame conforming to trade custom.

Unconditionally cancelable means with respect to a commitment, that a [BANK] may, at any time, with or without cause, refuse to extend credit under the commitment (to the extent permitted under applicable law).

Underlying exposures means one or more exposures that have been securitized in a securitization transaction.

U.S. Government agency means an instrumentality of the U.S. Government whose obligations are fully and explicitly guaranteed as to the timely payment of principal and interest by the full faith and credit of the U.S. Government.

Value-at-Risk (VaR) means the estimate of the maximum amount that the value of one or more exposures could decline due to market price or rate movements during a fixed holding period within a stated confidence interval.

Wrong-way risk means the risk that arises when an exposure to a particular counterparty is positively correlated with the probability of default of such counterparty itself.

Subpart B – Capital Ratio Requirements and Buffers

§___.10 Minimum Capital Requirements

(a) Minimum capital requirements. A [BANK] must maintain the following minimum capital ratios:

(1) A common equity tier 1 capital ratio of 4.5 percent.

(2) A tier 1 capital ratio of 6 percent.

(3) A total capital ratio of 8 percent.

(4) A leverage ratio of 4 percent.

(5) For advanced approaches [BANK]s, a supplementary leverage ratio of 3 percent.

(b) Standardized capital ratio calculations. All [BANK]s must calculate standardized capital ratios as follows:

(1) Common equity tier 1 capital ratio. A [BANK]'s common equity tier 1 capital ratio is the ratio of the [BANK]'s common equity tier 1 capital to standardized total risk-weighted assets.

(2) Tier 1 capital ratio. A [BANK]'s tier 1 capital ratio is the ratio of the [BANK]'s tier 1 capital to standardized total risk-weighted assets.

(3) Total capital ratio. A [BANK]'s total capital ratio is the ratio of the [BANK]'s total capital to standardized total risk-weighted assets.

(4) Leverage ratio. A [BANK]'s leverage ratio is the ratio of the [BANK]'s tier 1 capital to the [BANK]'s average consolidated assets as reported on the [BANK]'s [REGULATORY REPORT] minus amounts deducted from tier 1 capital.

(c) Advanced approaches capital ratio calculations. (1) Common equity tier 1 capital ratio. An advanced approaches [BANK]'s common equity tier 1 capital ratio is the lower of:

(i) The ratio of the [BANK]'s common equity tier 1 capital to standardized total risk-weighted assets; and

(ii) The ratio of the [BANK]'s common equity tier 1 capital to advanced approaches total risk-weighted assets.

(2) Tier 1 capital ratio. An advanced approaches [BANK]'s tier 1 capital ratio is the lower of:

(i) The ratio of the [BANK]'s tier 1 capital to standardized total risk-weighted assets; and

(ii) The ratio of the [BANK]'s tier 1 capital to advanced approaches total risk-weighted assets.

(3) Total capital ratio. An advanced approaches [BANK]'s total capital ratio is the lower of:

(i) The ratio of the [BANK]'s total capital to standardized total risk-weighted assets; and

(ii) The ratio of the [BANK]'s advanced-approaches-adjusted total capital to advanced approaches total risk-weighted assets. A [BANK]'s advanced-approaches-adjusted total capital is the [BANK]'s total capital after being adjusted as follows:

(A) An advanced approaches [BANK] must deduct from its total capital any allowance for loan and lease losses included in its tier 2 capital in accordance with §___.20(d)(3); and

(B) An advanced approaches [BANK] must add to its total capital any eligible credit reserves that exceed the [BANK]'s total expected credit losses to the extent that the excess reserve amount does not exceed 0.6 percent of the [BANK]'s credit risk-weighted assets.

(4) Supplementary leverage ratio. An advanced approaches [BANK]'s supplementary leverage ratio is the simple arithmetic mean of the ratio of its tier 1 capital to total leverage exposure calculated as of the last day of each month in the reporting quarter.

(d) Capital adequacy. (1) Notwithstanding the minimum requirements in this [PART] a [BANK] must maintain capital commensurate with the level and nature of all risks to which the [BANK] is exposed. The supervisory evaluation of a [BANK]'s capital adequacy is based on an individual assessment of numerous factors, including those listed at 12 CFR 3.10 (for national banks), 12 CFR 167.3(c) (for Federal savings associations) and 12 CFR 208.4 (for state member banks).

(2) A [BANK] must have a process for assessing its overall capital adequacy in relation to its risk profile and a comprehensive strategy for maintaining an appropriate level of capital.

§___.11 Capital Conservation Buffer and Countercyclical Capital Buffer Amount

(a) Capital conservation buffer. (1) Composition of the capital conservation buffer. The capital conservation buffer is composed solely of common equity tier 1 capital.

(2) Definitions. For purposes of this section, the following definitions apply:

(i) Eligible retained income. The eligible retained income of a [BANK] is the [BANK]'s net income for the four calendar quarters preceding the current calendar quarter, based on the [BANK]'s most recent quarterly [REGULATORY REPORT], net of any capital distributions and associated tax effects not already reflected in net income.[1]

(ii) Maximum payout ratio. The maximum payout ratio is the percentage of eligible retained income that a [BANK] can pay out in the form of capital distributions and discretionary bonus payments during the current calendar quarter. The maximum payout ratio is based on the [BANK]'s capital conservation buffer, calculated as of the last day of the previous calendar quarter, as set forth in Table 1.

(iii) Maximum payout amount. A [BANK]'s maximum payout amount for the current calendar quarter is equal to the [BANK]'s eligible retained income, multiplied by the applicable maximum payout ratio, as set forth in Table 1.

[1] Net income, as reported in the [REGULATORY REPORT], reflects discretionary bonus payments and certain capital distributions that are expense items (and their associated tax effects).

(3) Calculation of capital conservation buffer.[2] A [BANK]'s capital conservation buffer is equal to the lowest of the following ratios, calculated as of the last day of the previous calendar quarter based on the [BANK]'s most recent [REGULATORY REPORT]:

(i) The [BANK]'s common equity tier 1 capital ratio minus the [BANK]'s minimum common equity tier 1 capital ratio requirement under §___.10;

(ii) The [BANK]'s tier 1 capital ratio minus the [BANK]'s minimum tier 1 capital ratio requirement under §___.10; and

(iii) The [BANK]'s total capital ratio minus the [BANK]'s minimum total capital ratio requirement under §___.10.

(iv) If the [BANK]'s common equity tier 1, tier 1 or total capital ratio is less than or equal to the [BANK]'s minimum common equity tier 1, tier 1 or total capital ratio requirement under §___.10, respectively, the [BANK]'s capital conservation buffer is zero.

(4) Limits on capital distributions and discretionary bonus payments. (i) A [BANK] shall not make capital distributions or discretionary bonus payments or create an obligation to make such distributions or payments during the current calendar quarter that, in the aggregate, exceed the maximum payout amount.

(ii) A [BANK] with a capital conservation buffer that is greater than 2.5 percent plus 100 percent of its applicable countercyclical buffer, in accordance with §___.11(b), is not subject to a maximum payout amount under §___.11.

(iii) Negative eligible retained income. Except as provided in §___.11(a)(4)(iv), a [BANK] may not make capital distributions or discretionary bonus payments during the current calendar quarter if the [BANK]'s:

(A) Eligible retained income is negative; and

(B) Capital conservation buffer was less than 2.5 percent as of the end of the previous calendar quarter.

(iv) Prior approval. Notwithstanding the limitations in §§___.11(a)(4)(i) through (iii) the [AGENCY] may permit a [BANK] to make a capital distribution or discretionary bonus payment upon a request of the [BANK], if the [AGENCY] determines that the capital distribution or discretionary bonus payment would not be contrary to the purposes of this section, or the safety and soundness of the [BANK]. In making such a determination, the [AGENCY] will consider the nature and extent of the request and the particular circumstances giving rise to the request.

TABLE 1 – CALCULATION OF MAXIMUM PAYOUT AMOUNT

[2] For purposes of the capital conservation buffer calculations, a [BANK] must use standardized total risk weighted assets if it is a standardized approach [BANK] and it must use advanced total risk weighted assets if it is an advanced approaches [BANK].

Capital conservation buffer (as a percentage of total risk-weighted assets)	**Maximum payout ratio (as a percentage of eligible retained income)**
Greater than 2.5 percent plus 100 percent of the [BANK]'s applicable countercyclical capital buffer amount	No payout ratio limitation applies
Less than or equal to 2.5 percent plus 100 percent of the [BANK]'s applicable countercyclical capital buffer amount, and greater than 1.875 percent plus 75 percent of the [BANK]'s applicable countercyclical capital buffer amount	60 percent
Less than or equal to 1.875 percent plus 75 percent of the [BANK]'s applicable countercyclical capital buffer amount, and greater than 1.25 percent plus 50 percent of the [BANK]'s applicable countercyclical capital buffer amount	40 percent
Less than or equal to 1.25 percent plus 50 percent of the [BANK]'s applicable countercyclical capital buffer amount, and greater than 0.625 percent plus 25 percent of the [BANK]'s applicable countercyclical capital buffer amount	20 percent
Less than or equal to 0.625 percent plus 25 percent of the [BANK]'s applicable countercyclical capital buffer amount	0 percent

(v) Other limitations on capital distributions. Additional limitations on capital distributions may apply to a [BANK] under 12 CFR 225.4; 12 CFR 225.8; and 12 CFR 263.202.

(b) Countercyclical capital buffer amount. (1) General. An advanced approaches [BANK] must apply, calculate, and maintain a countercyclical capital buffer amount in accordance with the following paragraphs.

(i) Composition. The countercyclical capital buffer amount is composed solely of common equity tier 1 capital.

(ii) Amount. An advanced approaches [BANK] has a countercyclical capital buffer amount determined by calculating the weighted average of the countercyclical capital buffer amounts established for the national jurisdictions where the [BANK]'s private sector credit exposures are located, as specified in §§___.11(b)(2) and (3).

(iii) Weighting. The weight assigned to a jurisdiction's countercyclical capital buffer amount is calculated by dividing the total risk-weighted assets for the [BANK]'s private sector credit exposures located in the jurisdiction by the total risk-weighted assets for all of the [BANK]'s private sector credit exposures.

(iv) Location. (A) Except as provided in §___.11(b)(iv)(B), the location of a private sector credit exposure (other than a securitization exposure) is the national jurisdiction where the borrower is located (that is, where it is incorporated, chartered, or similarly established or, if the borrower is an individual, where the borrower resides).

(B) If, in accordance with subpart D or subpart E of this rule, the [BANK] has assigned to a private sector credit exposure a risk weight associated with a protection provider on a guarantee or credit derivative, the location of the exposure is the national jurisdiction where the protection provider is located.

(C) The location of a securitization exposure is the location of the borrowers of underlying exposures in a single jurisdiction with the largest aggregate unpaid principal balance.

(2) Countercyclical capital buffer amount for credit exposures in the United States. (i) Initial countercyclical buffer amount with respect to credit exposures in the United States. The initial countercyclical capital buffer amount in the United States is zero.

(ii) Adjustment of the countercyclical buffer amount. The [AGENCY] will adjust the countercyclical capital buffer amount for credit exposures in the United States in accordance with applicable law.[3]

(iii) Range of countercyclical buffer amount. The [AGENCY] will adjust the countercyclical capital buffer amount for credit exposures in the United States between zero percent and 2.5 percent of total risk-weighted assets. Generally, a zero percent countercyclical capital buffer amount will reflect an assessment that economic and financial conditions are consistent with a period of little or no excessive ease in credit markets associated with no material increase in system-wide credit risk. A 2.5 percent countercyclical capital buffer amount will reflect an assessment that financial markets are experiencing a period of excessive ease in credit markets associated with a material increase in credit system-wide risk.

[3] The [AGENCY] expects that any adjustment will be based on a determination made jointly by the Board, OCC, and FDIC.

(iv) Adjustment Determination. The [AGENCY] will base its decision to adjust the countercyclical capital buffer amount under this section on a range of macroeconomic, financial, and supervisory information indicating an increase in systemic risk including, but not limited to, the ratio of credit to gross domestic product, a variety of asset prices, other factors indicative of relative credit and liquidity expansion or contraction, funding spreads, credit condition surveys, indices based on credit default swap spreads, options implied volatility, and measures of systemic risk..

(v) Effective date of adjusted countercyclical capital buffer amount. (A) Increase adjustment. A determination by the [AGENCY] under §___.11(b)(2)(ii) to increase the countercyclical capital buffer amount will be effective 12 months from the date of announcement, unless the [AGENCY] establishes an earlier effective date and includes a statement articulating the reasons for the earlier effective date.

(B) Decrease adjustment. A determination by the [AGENCY] to decrease the established countercyclical capital buffer amount under §___.11(b)(2)(ii) will be effective at the later of the day following announcement of the final determination or the earliest date permissible under applicable law or regulation.

(vi) Twelve month sunset. The countercyclical capital buffer amount will return to zero percent 12 months after the effective date of the adjusted countercyclical capital buffer amount announced, unless the [AGENCY] announces a decision to maintain the adjusted countercyclical capital buffer amount or adjust it again before the expiration of the 12-month period.

(3) Countercyclical capital buffer amount for foreign jurisdictions. The [AGENCY] will adjust the countercyclical capital buffer amount for private sector credit exposures to reflect decisions made by foreign jurisdictions consistent with due process requirements described in §___.11(b)(2).

Subpart C – Definition of Capital

§___.20 Capital Components and Eligibility Criteria for Regulatory Capital Instruments

(a) Regulatory capital components. A [BANK]'s regulatory capital components are:
(1) Common equity tier 1 capital;

(2) Additional tier 1 capital; and

(3) Tier 2 capital.

(b) Common equity tier 1 capital. Common equity tier 1 capital is the sum of the common equity tier 1 capital elements as set forth in §___.22(b), minus regulatory adjustments and deductions as set forth in §___.22.[1] The common equity tier 1 capital elements are:

[1] Voting common stockholders' equity, which is the most desirable capital element from a supervisory standpoint, generally should be the dominant element within common equity tier 1 capital.

(1) Any common stock instruments (plus any related surplus) issued by the [BANK], net of treasury stock, that meet all the following criteria:[2]

(i) The instrument is paid-in, issued directly by the [BANK], and represents the most subordinated claim in a receivership, insolvency, liquidation, or similar proceeding of the [BANK].

(ii) The holder of the instrument is entitled to a claim on the residual assets of the [BANK] that is proportional with the holder's share of the [BANK]'s issued capital after all senior claims have been satisfied in a receivership, insolvency, liquidation, or similar proceeding.

(iii) The instrument has no maturity date, can only be redeemed via discretionary repurchases with the prior approval of the [AGENCY], and does not contain any term or feature that creates an incentive to redeem.

(iv) The [BANK] did not create at issuance of the instrument through any action or communication an expectation that it will buy back, cancel, or redeem the instrument, and the instrument does not include any term or feature that might give rise to such an expectation.

(v) Any cash dividend payments on the instrument are paid out of the [BANK]'s net income and retained earnings and are not subject to a limit imposed by the contractual terms governing the instrument.

(vi) The [BANK] has full discretion at all times to refrain from paying any dividends and making any other capital distributions on the instrument without triggering an event of default, a requirement to make a payment-in-kind, or an imposition of any other restrictions on the [BANK].

(vii) Dividend payments and any other capital distributions on the instrument may be paid only after all legal and contractual obligations of the [BANK] have been satisfied, including payments due on more senior claims.

(viii) The holders of the instrument bear losses as they occur equally, proportionately, and simultaneously with the holders of all other common stock instruments before any losses are borne by holders of claims on the [BANK] with greater priority in a receivership, insolvency, liquidation, or similar proceeding.

(ix) The paid-in amount is classified as equity under GAAP.

(x) The [BANK], or an entity that the [BANK] controls, did not purchase or directly or indirectly fund the purchase of the instrument.

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[2] Capital instruments issued by mutual banking organizations may qualify as common equity tier 1 capital provided that the instruments meet all of the criteria in this section.

(xi) The instrument is not secured, not covered by a guarantee of the [BANK] or of an affiliate of the [BANK], and is not subject to any other arrangement that legally or economically enhances the seniority of the instrument.

(xii) The instrument has been issued in accordance with applicable laws and regulations.

(xiii) The instrument is reported on the [BANK]'s regulatory financial statements separately from other capital instruments.

(2) Retained earnings.

(3) Accumulated other comprehensive income.

(4) Common equity tier 1 minority interest subject to the limitations in §___.21(a).

(c) Additional tier 1 capital. Additional tier 1 capital is the sum of additional tier 1 capital elements and any related surplus, minus the regulatory adjustments and deductions in §___.22. Additional tier 1 capital elements are:

(1) Instruments (plus any related surplus) that meet the following criteria:

(i) The instrument is issued and paid in.

(ii) The instrument is subordinated to depositors, general creditors, and subordinated debt holders of the [BANK] in a receivership, insolvency, liquidation, or similar proceeding.

(iii) The instrument is not secured, not covered by a guarantee of the [BANK] or of an affiliate of the [BANK], and not subject to any other arrangement that legally or economically enhances the seniority of the instrument.

(iv) The instrument has no maturity date and does not contain a dividend step-up or any other term or feature that creates an incentive to redeem.

(v) If callable by its terms, the instrument may be called by the [BANK] only after a minimum of five years following issuance, except that the terms of the instrument may allow it to be called earlier than five years upon the occurrence of a regulatory event that precludes the instrument from being included in additional tier 1 capital or a tax event. In addition:

(A) The [BANK] must receive prior approval from the [AGENCY] to exercise a call option on the instrument.

(B) The [BANK] does not create at issuance of the instrument, through any action or communication, an expectation that the call option will be exercised.

(C) Prior to exercising the call option, or immediately thereafter, the [BANK] must either:

(1) Replace the instrument to be called with an equal amount of instruments that meet the criteria under §§___.20 (b) or (c);[3] or

(2) Demonstrate to the satisfaction of the [AGENCY] that following redemption, the [BANK] will continue to hold capital commensurate with its risk.

(vi) Redemption or repurchase of the instrument requires prior approval from the [AGENCY].

(vii) The [BANK] has full discretion at all times to cancel dividends or other capital distributions on the instrument without triggering an event of default, a requirement to make a payment-in-kind, or an imposition of other restrictions on the [BANK] except in relation to any capital distributions to holders of common stock.

(viii) Any capital distributions on the instrument are paid out of the [BANK]'s net income and retained earnings.

(ix) The instrument does not have a credit-sensitive feature, such as a dividend rate that is reset periodically based in whole or in part on the [BANK]'s credit quality, but may have a dividend rate that is adjusted periodically independent of the [BANK]'s credit quality, in relation to general market interest rates or similar adjustments.

(x) The paid-in amount is classified as equity under GAAP.

(xi) The [BANK], or an entity that the [BANK] controls, did not purchase or directly or indirectly fund the purchase of the instrument.

(xii) The instrument does not have any features that would limit or discourage additional issuance of capital by the [BANK], such as provisions that require the [BANK] to compensate holders of the instrument if a new instrument is issued at a lower price during a specified time frame.

(xiii) If the instrument is not issued directly by the [BANK] or by a subsidiary of the [BANK] that is an operating entity, the only asset of the issuing entity is its investment in the capital of the [BANK], and proceeds must be immediately available without limitation to the [BANK] or to the [BANK]'s top-tier holding company in a form which meets or exceeds all of the other criteria for additional tier 1 capital instruments.[4]

(xiv) For an advanced approaches [BANK], the governing agreement, offering circular, or prospectus of an instrument issued after January 1, 2013 must disclose that the holders of the

[3] Replacement can be concurrent with redemption of existing additional tier 1 capital instruments.

[4] De minimis assets related to the operation of the issuing entity can be disregarded for purposes of this criterion.

instrument may be fully subordinated to interests held by the U.S. government in the event that the [BANK] enters into a receivership, insolvency, liquidation, or similar proceeding.

(2) Tier 1 minority interest, subject to the limitations in §___.21(b), that is not included in the [BANK]'s common equity tier 1 capital.

(3) Any and all instruments that qualified as tier 1 capital under the [AGENCY]'s general risk-based capital rules under 12 CFR part 3, appendix A, 12 CFR 167 (OCC); 12 CFR part 208, appendix A, 12 CFR part 225, appendix A (Board); and 12 CFR part 325, appendix A, 12 CFR part 390, subpart Z (FDIC) as then in effect, that were issued under the Small Business Jobs Act of 2010[5] or prior to October 4, 2010, under the Emergency Economic Stabilization Act of 2008.[6]

(d) Tier 2 Capital. Tier 2 capital is the sum of tier 2 capital elements and any related surplus, minus regulatory adjustments and deductions in §___.22. Tier 2 capital elements are:

(1) Instruments (plus related surplus) that meet the following criteria:

(i) The instrument is issued and paid in.

(ii) The instrument is subordinated to depositors and general creditors of the [BANK].

(iii) The instrument is not secured, not covered by a guarantee of the [BANK] or of an affiliate of the [BANK], and not subject to any other arrangement that legally or economically enhances the seniority of the instrument in relation to more senior claims.

(iv) The instrument has a minimum original maturity of at least five years. At the beginning of each of the last five years of the life of the instrument, the amount that is eligible to be included in tier 2 capital is reduced by 20 percent of the original amount of the instrument (net of redemptions) and is excluded from regulatory capital when remaining maturity is less than one year. In addition, the instrument must not have any terms or features that require, or create significant incentives for, the [BANK] to redeem the instrument prior to maturity.

(v) The instrument, by its terms, may be called by the [BANK] only after a minimum of five years following issuance, except that the terms of the instrument may allow it to be called sooner upon the occurrence of an event that would preclude the instrument from being included in tier 2 capital, or a tax event. In addition:

(A) The [BANK] must receive the prior approval of the [AGENCY] to exercise a call option on the instrument.

(B) The [BANK] does not create at issuance, through action or communication, an expectation the call option will be exercised.

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[5] Pub.L. 111-240; 124 Stat. 2504 (2010).

[6] Pub.L. 110-343, 122 Stat 3765 (2008).

(C) Prior to exercising the call option, or immediately thereafter, the [BANK] must either:

(1) Replace any amount called with an equivalent amount of an instrument that meets the criteria for regulatory capital under this section,[7] or

(2) Demonstrate to the satisfaction of the [AGENCY] that following redemption, the [BANK] would continue to hold an amount of capital that is commensurate with its risk.

(vi) The holder of the instrument must have no contractual right to accelerate payment of principal or interest on the instrument, except in the event of a receivership, insolvency, liquidation, or similar proceeding of the [BANK].

(vii) The instrument has no credit-sensitive feature, such as a dividend or interest rate that is reset periodically based in whole or in part on the [BANK]'s credit standing, but may have a dividend rate that is adjusted periodically independent of the [BANK]'s credit standing, in relation to general market interest rates or similar adjustments.

(viii) The [BANK], or an entity that the [BANK] controls, has not purchased and has not directly or indirectly funded the purchase of the instrument.

(ix) If the instrument is not issued directly by the [BANK] or by a subsidiary of the [BANK] that is an operating entity, the only asset of the issuing entity is its investment in the capital of the [BANK], and proceeds must be immediately available without limitation to the [BANK] or the [BANK]'s top-tier holding company in a form that meets or exceeds all the other criteria for tier 2 capital instruments under this section.[8]

(x) Redemption of the instrument prior to maturity or repurchase requires the prior approval of the [AGENCY].

(xi) For an advanced approaches [BANK], the governing agreement, offering circular, or prospectus of an instrument issued after January 1, 2013 must disclose that the holders of the instrument may be fully subordinated to interests held by the U.S. government in the event that the [BANK] enters into a receivership, insolvency, liquidation, or similar proceeding.

(2) Total capital minority interest, subject to the limitations set forth in §___.21(c), that is not included in the [BANK]'s tier 1 capital.

(3) Allowance for loan and lease losses (ALLL) up to 1.25 percent of the [BANK]'s standardized total risk-weighted assets not including any amount of the ALLL (and excluding in the case of a market risk [BANK], its standardized market risk-weighted assets).

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[7] Replacement of tier 2 capital instruments can be concurrent with redemption of existing tier 2 capital instruments.

[8] De minimis assets related to the operation of the issuing entity can be disregarded for purposes of this criterion.

(4) Any instrument that qualified as tier 2 capital under the [AGENCY]'s general risk-based capital rules under 12 CFR part 3, appendix A, 12 CFR 167 (OCC); 12 CFR part 208, appendix A, 12 CFR part 225, appendix A (Board); 12 CFR part 325, appendix A, 12 CFR part 390 (FDIC) as then in effect, that were issued under the Small Business Jobs Act of 2010 (Pub. L. 111-240; 124 Stat. 2504 (2010)) or prior to October 4, 2010, under the Emergency Economic Stabilization Act of 2008 (Pub. L. 110-343, 122 Stat. 3765 (2008)).

(e) [AGENCY] approval of a capital element. (1) Notwithstanding the criteria for regulatory capital instruments set forth in this section, the [AGENCY] may find that a capital element may be included in a [BANK]'s common equity tier 1 capital, additional tier 1 capital, or tier 2 capital on a permanent or temporary basis.

(2) A [BANK] must receive [AGENCY] prior approval to include a capital element (as listed in §___.20) in its common equity tier 1 capital, additional tier 1 capital, or tier 2 capital unless the element:

(i) Was included in a [BANK]'s tier 1 capital or tier 2 capital as of May 19, 2010 in accordance with the [AGENCY]'s risk-based capital rules that were effective as of that date and the underlying instrument continues to be includable under the criteria set forth in this section; or

(ii) Is equivalent in terms of capital quality and ability to absorb credit losses with respect to all material terms to a regulatory capital element described in a decision made publicly available under §___. 20(e)(3) by the [AGENCY].

(3) When considering whether a [BANK] may include a regulatory capital element in its common equity tier 1 capital, additional tier 1 capital, or tier 2 capital, the [AGENCY] will consult with the other federal banking agencies.

(4) After determining that a regulatory capital element may be included in a [BANK]'s common equity tier 1 capital, additional tier 1 capital, or tier 2 capital, the [AGENCY] will make its decision publicly available, including a brief description of the material terms of the regulatory capital element and the rationale for the determination.

§___.21 Minority Interest[9]

(a) Common equity tier 1 minority interest includable in the common equity tier 1 capital of the [BANK]. For each consolidated subsidiary of a [BANK], the amount of common equity tier 1 minority interest the [BANK] may include in common equity tier 1 capital is equal to:

(1) The common equity tier 1 minority interest of the subsidiary; minus

[9] For purposes of the minority interest calculations, if the consolidated subsidiary issuing the capital is not subject to the same minimum capital requirements or capital conservation buffer framework of the [BANK], the [BANK] must assume that the minimum capital requirements and capital conservation buffer framework of the [BANK] apply to the subsidiary.

(2) The percentage of the subsidiary's common equity tier 1 capital that is not owned by the [BANK], multiplied by the difference between the common equity tier 1 capital of the subsidiary and the lower of:

(i) The amount of common equity tier 1 capital the subsidiary must hold to not be subject to restrictions on capital distributions and discretionary bonus payments under §___. 11 or equivalent regulations established by the subsidiary's home country supervisor, or

(ii) (A) The standardized total risk-weighted assets of the [BANK] that relate to the subsidiary multiplied by

(B) The common equity tier 1 capital ratio the subsidiary must maintain to not be subject to restrictions on capital distributions and discretionary bonus payments under §___. 11 or equivalent regulations established by the subsidiary's home country supervisor.

(b) Tier 1 minority interest includable in the tier 1 capital of the [BANK]. For each consolidated subsidiary of the [BANK], the amount of tier 1 minority interest the [BANK] may include in tier 1 capital is equal to:

(1) The tier 1 minority interest of the subsidiary; minus
(2) The percentage of the subsidiary's tier 1 capital that is not owned by the [BANK] multiplied by the difference between the tier 1 capital of the subsidiary and the lower of:
(i) The amount of tier 1 capital the subsidiary must hold to not be subject to restrictions on capital distributions and discretionary bonus payments under §___. 11 or equivalent standards established by the subsidiary's home country supervisor, or
(ii) (A) The standardized total risk-weighted assets of the [BANK] that relate to the subsidiary multiplied by
(B) The tier 1 capital ratio the subsidiary must maintain to avoid restrictions on capital distributions and discretionary bonus under §___. 11 or equivalent standards established by the subsidiary's home country supervisor.

(c) Total capital minority interest includable in the total capital of the [BANK]. For each consolidated subsidiary of the [BANK], the amount of total capital minority interest the [BANK] may include in total capital is equal to:

(1) The total capital minority interest of the subsidiary; minus
(2) The percentage of the subsidiary's total capital that is not owned by the [BANK] multiplied by the difference between the total capital of the subsidiary and the lower of:
(i) The amount of total capital the subsidiary must hold to not be subject to restrictions on capital distributions and discretionary bonus payments under §___. 11 or equivalent standards established by the subsidiary's home country supervisor, or
(ii) (A) The standardized total risk-weighted assets of the [BANK] that relate to the subsidiary multiplied by
(B) The total capital ratio the subsidiary must maintain to avoid restrictions on capital distributions and discretionary bonus payments under §___. 11 or equivalent standards established by the subsidiary's home country supervisor.

§___.22 Regulatory Capital Adjustments and Deductions

(a) Regulatory capital deductions from common equity tier 1 capital. A [BANK] must deduct the following items from the sum of its common equity tier 1 capital elements:

(1) Goodwill, net of associated deferred tax liabilities (DTLs), in accordance with §___.22(e), and goodwill embedded in the valuation of a significant investment in the capital of an unconsolidated financial institution in the form of common stock, in accordance with §___.22(d).

(2) Intangible assets, other than MSAs, net of associated DTLs, in accordance with §___.22(e).

(3) Deferred tax assets (DTAs) that arise from operating loss and tax credit carryforwards net of any related valuation allowances and net of DTLs, in accordance with §___.22(e).

(4) Any gain-on-sale associated with a securitization exposure.

(5) For a [BANK] that is not an insured depository institution, any defined benefit pension fund asset, net of any associated DTL, in accordance with §___.22(e). With the prior approval of the [AGENCY], the [BANK] may reduce the amount to be deducted by the amount of assets of the defined benefit pension fund to which it has unrestricted and unfettered access, provided that the [BANK] includes such assets in its risk-weighted assets as if the [BANK] held them directly.[10]

(6) For a [BANK] subject to subpart E of this [PART], the amount of expected credit loss that exceeds its eligible credit reserves.

(7) Financial subsidiaries. (i) A [BANK] must deduct the aggregate amount of its outstanding equity investment, including retained earnings, in its financial subsidiaries (as defined in 12 CFR 5.39 (OCC); 12 CFR 208.77 (FDIC); and 12 CFR 362.17 (Board)) and may not consolidate the assets and liabilities of a financial subsidiary with those of the national bank.

(ii) No other deduction is required under §___.22(c) for investments in the capital instruments of financial subsidiaries.

(b) Regulatory adjustments to common equity tier 1 capital. A [BANK] must make the following adjustments to the sum of common equity tier 1 capital elements:

(1) Deduct any unrealized gain and add any unrealized loss on cash flow hedges included in accumulated other comprehensive income (AOCI), net of applicable tax effects, that relate to the hedging of items that are not recognized at fair value on the balance sheet.

(2) Deduct any unrealized gain and add any unrealized loss related to changes in the fair value of liabilities that are due to changes in the [BANK]'s own credit risk. Advanced

[10] For this purpose, unrestricted and unfettered access means that the excess assets of the defined benefit pension fund would be available to protect depositors or creditors of the [BANK] in the event of receivership, insolvency, liquidation, or similar proceeding.

approaches [BANK]s must deduct the credit spread premium over the risk free rate for derivatives that are liabilities.

(c) Deductions from regulatory capital related to investments in capital instruments.

(1) Investments in the [BANK]'s own capital instruments.

(i) A [BANK] must deduct investments in (including any contractual obligation to purchase) its own common stock instruments, whether held directly or indirectly, from its common equity tier 1 capital elements to the extent such instruments are not excluded from regulatory capital under §___.20(b)(1).

(ii) A [BANK] must deduct investments in (including any contractual obligation to purchase) its own additional tier 1 capital instruments, whether held directly or indirectly, from its additional tier 1 capital elements.

(iii) A [BANK] must deduct investments in (including any contractual obligation to purchase) its own tier 2 capital instruments, whether held directly or indirectly, from its tier 2 capital elements.

(iv) For any deduction required under this section, gross long positions may be deducted net of short positions in the same underlying instrument only if the short positions involve no counterparty risk.

(v) For any deduction required under this section, a [BANK] must look through any holdings of index securities to deduct investments in its own capital instruments. In addition:

(A) Gross long positions in investments in a [BANK]'s own regulatory capital instruments resulting from holdings of index securities may be netted against short positions in the same index;

(B) Short positions in index securities that are hedging long cash or synthetic positions can be decomposed to recognize the hedge; and

(C) The portion of the index that is composed of the same underlying exposure that is being hedged may be used to offset the long position if both the exposure being hedged and the short position in the index are covered positions under subpart F, and the hedge is deemed effective by the banking organization's internal control processes.

(2) Corresponding deduction approach. For purposes of this subpart, the corresponding deduction approach is the methodology used for the deductions from regulatory capital related to reciprocal cross holdings, non-significant investments in the capital of unconsolidated financial institutions, and non-common stock significant investments in the capital of unconsolidated financial institutions. Under the corresponding deduction approach, a [BANK] must make any such deductions from the component of capital for which the underlying instrument would qualify if it were issued by the [BANK] itself. In addition:

(i) If the [BANK] does not have a sufficient amount of a specific component of capital to effect the required deduction, the shortfall must be deducted from the next higher (that is, more subordinated) component of regulatory capital.

(ii) If the investment is in the form of an instrument issued by a non-regulated financial institution, the [BANK] must treat the instrument as:

(A) A common equity tier 1 capital instrument if it is common stock or represents the most subordinated claim in liquidation of the financial institution; and

(B) An additional tier 1 capital instrument if it is subordinated to all creditors of the financial institution and is only senior in liquidation to common shareholders.

(iii) If the investment is in the form of an instrument issued by a regulated financial institution and the instrument does not meet the criteria for common equity tier 1, additional tier 1 or tier 2 capital instruments under §___.20, the [BANK] must treat the instrument as:

(A) A common equity tier 1 capital instrument if it is common stock included in GAAP equity or represents the most subordinated claim in liquidation of the financial institution;

(B) An additional tier 1 capital instrument if it is included in GAAP equity, subordinated to all creditors of the financial institution, and senior in a receivership, insolvency, liquidation, or similar proceeding only to common shareholders; and

(C) A tier 2 capital instrument if it is not included in GAAP equity but considered regulatory capital by the primary regulator of the financial institution.

(3) Reciprocal crossholdings in the capital of financial institutions. A [BANK] must deduct investments in the capital of other financial institutions it holds reciprocally, where such reciprocal crossholdings result from a formal or informal arrangement to swap, exchange, or otherwise intend to hold each other's capital instruments, by applying the corresponding deduction approach.

(4) Non-significant investments in the capital of unconsolidated financial institutions. (i) A [BANK] must deduct its non-significant investments in the capital of unconsolidated financial institutions that, in the aggregate, exceed 10 percent of the sum of the [BANK]'s common equity tier 1 capital elements minus all deductions from and adjustments to common equity tier 1 capital elements required under §§___.22(a) through (c)(3) (the 10 percent threshold for non-significant investments) by applying the corresponding deduction approach.[11]

(ii) The amount to be deducted under this section from a specific capital component is equal to:

[11] With prior written approval of the [AGENCY], for the period of time stipulated by the [AGENCY], a [BANK] is not required to deduct exposures to the capital instruments of unconsolidated financial institutions pursuant to this section if the investment is made in connection with the [BANK] providing financial support to a financial institution in distress.

(A) The amount of a [BANK]'s non-significant investments exceeding the 10 percent threshold for non-significant investments multiplied by

(B) The ratio of the non-significant investments in unconsolidated financial institutions in the form of such capital component to the amount of the [BANK]'s total non-significant investments in unconsolidated financial institutions.

(iii) Any non-significant investments in the capital of unconsolidated financial institutions that do not exceed the 10 percent threshold for non-significant investments under this section must be assigned the appropriate risk weight under subpart D, E, or F, as applicable.

(5) Significant investments in the capital of unconsolidated financial institutions that are not in the form of common stock. The [BANK] must deduct its significant investments in the capital of unconsolidated financial institutions that are not in the form of common stock by applying the corresponding deduction approach.[12]

(d) Items subject to the 10 and 15 percent common equity tier 1 capital deduction thresholds. (1) A [BANK] must deduct from common equity tier 1 capital elements the amount of each of the following items that, individually, exceeds 10 percent of the sum of the [BANK]'s common equity tier 1 capital elements, less adjustments to and deductions from common equity tier 1 capital required under §§___.22(a) through (c) (the 10 percent common equity tier 1 capital deduction threshold):[13]

(i) DTAs arising from temporary differences that the [BANK] could not realize through net operating loss carrybacks, net of any related valuation allowances and net of DTLs, in accordance with §___.22(e).[14]

(ii) MSAs net of associated DTLs, in accordance with §___.22(e).

(iii) Significant investments in the capital of unconsolidated financial institutions in the form of common stock net of associated DTLs, in accordance with §___.22(e).[15]

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[12] With prior written approval of the [AGENCY], for the period of time stipulated by the [AGENCY], a [BANK] is not required to deduct exposures to the capital instruments of unconsolidated financial institutions pursuant to this section if the investment is made in connection with the [BANK] providing financial support to a financial institution in distress.

[13] For purposes of calculating the 10 and 15 percent common equity tier 1 capital deduction thresholds, any goodwill embedded in the valuation of a significant investments in the capital of unconsolidated financial institutions in the form of common stock that is deducted under §___.22(a)(1) can be excluded.

[14] A [BANK] is not required to deduct from the sum of its common equity tier 1 capital elements net DTAs arising from timing differences that the [BANK] could realize through net operating loss carrybacks. The [BANK] must risk weight these assets at 100 percent. Likewise, for a [BANK] that is a member of a consolidated group for tax purposes, the amount of DTAs that could be realized through net operating loss carrybacks may not exceed the amount that the [BANK] could reasonably expect to have refunded by its parent holding company.

[15] With the prior written approval of the [AGENCY], for the period of time stipulated by the [AGENCY], a [BANK] is not required to deduct exposures to the capital instruments of unconsolidated financial institutions

(2) A [BANK] must deduct from common equity tier 1 capital elements the amount of the items listed in §___.22(d)(1) that are not deducted as a result of the application of the 10 percent common equity tier 1 capital deduction threshold, and that, in aggregate, exceeds 17.65 percent of the sum of the [BANK]'s common equity tier 1 capital elements, minus adjustments to and deductions from common equity tier 1 capital required under §§___.22(a) through (c), minus the items listed in §___.22(d)(1) (the 15 percent common equity tier 1 capital deduction threshold).[16]

(3) If the total amount of MSAs deducted under §§___.22(d)(1) and (d)(2) is less than 10 percent of the fair value of MSAs, a [BANK] must deduct an additional amount of MSAs equal to the difference between 10 percent of the fair value of MSAs and the amount of MSAs deducted under §§___.22(d)(1) and (d)(2).

(4) The amount of the items in §___.22(d)(1) that is not deducted from common equity tier 1 capital pursuant to this section must be included in the risk-weighted assets of the [BANK] and assigned a 250 percent risk weight.

(e) Netting of DTLs against assets subject to deduction.

(1) Except as described in §___.22(e)(3), netting of DTLs against assets that are subject to deduction under §___.22 is permitted if the following conditions are met:

(i) The DTL is associated with the asset.

(ii) The DTL would be extinguished if the associated asset becomes impaired or is derecognized under GAAP.

(2) A DTL can only be netted against a single asset.

(3) The amount of DTAs that arise from operating loss and tax credit carryforwards, net of any related valuation allowances, and of DTAs arising from temporary differences that the [BANK] could not realize through net operating loss carrybacks, net of any related valuation allowances, may be netted against DTLs (that have not been netted against assets subject to deduction pursuant to §___.22(e)(1) subject to the following conditions:

(i) Only the DTAs and DTLs that relate to taxes levied by the same taxation authority and that are eligible for offsetting by that authority may be offset for purposes of this deduction.

(ii) The amount of DTLs that the [BANK] nets against DTAs that arise from operating loss and tax credit carryforwards, net of any related valuation allowances, and against DTAs arising from temporary differences that the [BANK] could not realize through net operating loss

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pursuant to this section if the investment is made in connection with the [BANK] providing financial support to a financial institution in distress.

[16] For purposes of calculating the 15 percent common equity tier 1 capital deduction threshold, any goodwill that has already been deducted under §___.22(a)(1) can be excluded from the amount of the significant investments in the capital of unconsolidated financial institutions in the form of common stock.

carrybacks, net of any related valuation allowances, must be allocated in proportion to the amount of DTAs that arise from operating loss and tax credit carryforwards (net of any related valuation allowances, but before any offsetting of DTLs) and of DTAs arising from temporary differences that the [BANK] could not realize through net operating loss carrybacks (net of any related valuation allowances, but before any offsetting of DTLs), respectively.

(f) Treatment of assets that are deducted. A [BANK] need not include in risk-weighted assets any asset that is deducted from regulatory capital under this section.

(g) Items subject to a 1250 percent risk weight. A [BANK] must apply a 1250 percent risk weight to the portion of a CEIO that does not constitute an after-tax-gain-on-sale.

Subpart G - Transition Provisions

§___. 300 Transitions

(a) Common equity tier 1 and tier 1 capital minimum ratios. From January 1, 2013 through December 31, 2015, a [BANK] must calculate its capital ratios in accordance with this subpart and maintain at least the transition minimum capital ratios set forth in Table 1.

TABLE 1

Transition Minimum Common Equity Tier 1 and Tier 1 Capital Ratios		
Transition Period	Common equity tier 1 capital ratio	Tier 1 capital ratio
Calendar year 2013	3.5	4.5
Calendar year 2014	4.0	5.5
Calendar year 2015	4.5	6.0

(b) Capital conservation and countercyclical capital buffer. From January 1, 2013 through December 31, 2018, a [BANK] is subject to limitations on capital distributions and discretionary bonus payments with respect to its capital conservation buffer and any applicable countercyclical capital buffer amount, as set forth in this section.

(1) From January 1, 2013 through December 31, 2015, a [BANK] is not subject to limits on capital distributions and discretionary bonus payments under §___.11 notwithstanding the amount of its capital conservation buffer.

(2) From January 1, 2016 through December 31, 2018:

(i) A [BANK] that maintains a capital conservation buffer above 0.625 percent during calendar year 2016, above 1.25 percent during calendar year 2017, and above 1.875 percent during calendar year 2018 is not subject to limits on capital distributions and discretionary bonus payments under §___.11.

(ii) A [BANK] that maintains a capital conservation buffer that is less than 0.625 percent during calendar year 2016, less than 1.25 percent during calendar year 2017, and less than 1.875 percent during calendar year 2018 cannot make capital distributions and discretionary bonus payments above the maximum payout amount (as defined under §___.11) as described in Table 2.

TABLE 2

Transition Period	Capital conservation buffer (assuming a countercyclical capital buffer amount of zero)	Maximum payout ratio (as a percentage of eligible retained income)
Calendar year 2016	Greater than 0.625 percent	No payout ratio limitation applies under this section
	Less than or equal to 0.625 percent, and greater than 0.469 percent	60 percent
	Less than or equal to 0.469 percent, and greater than 0.313 percent	40 percent
	Less than or equal to 0.313 percent, and greater than 0.156 percent	20 percent
	Less than or equal to 0.156 percent	0 percent
Calendar year 2017	Greater than 1.25 percent	No payout ratio limitation applies under this section
	Less than or equal to 1.25 percent, and greater than 0.938 percent	60 percent
	Less than or equal to 0.938 percent, and greater than 0.625 percent	40 percent
	Less than or equal to 0.625 percent, and greater than 0.313 percent	20 percent
	Less than or equal to 0.313 percent	0 percent
Calendar year 2018	Greater than 1.875 percent	No payout ratio limitation applies under this section

	Less than or equal to 1.875 percent, and greater than 1.406 percent	60 percent
	Less than or equal to 1.406 percent, and greater than 0.938 percent	40 percent
	Less than or equal to 0.938 percent, and greater than 0.469 percent	20 percent
	Less than or equal to 0.469 percent	0 percent

(c) Regulatory capital adjustments and deductions. From January 1, 2013 through December 31, 2017, a [BANK] must make the capital adjustments and deductions in §___.22 in accordance with the transition requirements in §___.300(c). Beginning on January 1, 2018, a [BANK] must make all regulatory capital adjustments and deductions in accordance with §___.22.

(1) Transition deductions from common equity tier 1 capital. From January 1, 2013 through December 31, 2017, a [BANK] must allocate the deductions required under §___. 22(a) from common equity tier 1 or tier 1 capital elements as described below.

(i) A [BANK] must deduct goodwill (§___. 22(a)(1)), DTAs that arise from operating loss and tax credit carryforwards (§___. 22(a)(3)), gain-on-sale associated with a securitization exposure (§___. (a)(4)), defined benefit pension fund assets (§___. 22(a)(5)), and expected credit loss that exceeds eligible credit reserves (for [BANK]s subject to subpart E of this [PART]) (§___.22(a)(6)), from common equity tier 1 and additional tier 1 capital in accordance with the percentages set forth in Table 3.

TABLE 3

Transition Period	Transition deductions under §___.22(a)(1) of subpart C	Transition deductions under §§___.22(a)(3) -- (a)(6) of subpart C	
	Percentage of the deductions from common equity tier 1 capital	Percentage of the deductions from common equity tier 1 capital	Percentage of the deductions from tier 1 capital
Calendar year 2013	100	0	100
Calendar year 2014	100	20	80
Calendar year 2015	100	40	60
Calendar year 2016	100	60	40
Calendar year 2017	100	80	20
Calendar year 2018, and thereafter	100	100	0

(ii) A [BANK] must deduct from common equity tier 1capital any intangible assets other than goodwill and MSAs in accordance with the percentages set forth in Table 4.

(iii)A [BANK] must apply a 100 percent risk-weight to the aggregate amount of intangible assets other than goodwill and MSAs that are not required to be deducted from common equity tier 1 capital under this section.

TABLE 4

Transition Period	Transition deductions under §___.22(a)(2) of subpart C – Percentage of the deductions from common equity tier 1 capital
Calendar year 2013	0
Calendar year 2014	20
Calendar year 2015	40
Calendar year 2016	60
Calendar year 2017	80
Calendar year 2018 and thereafter	100

(2) Transition adjustments to common equity tier 1 capital. From January 1, 2013 through December 31, 2017, a [BANK] must allocate the regulatory adjustments related to changes in the fair value of liabilities due to changes in the [BANK]'s own credit risk (§___. 22(b)(2)) between common equity tier 1 capital and tier 1 capital in accordance with the percentages described in Table 5.

(i) If the aggregate amount of the adjustment is positive, the [BANK] must allocate the deduction between common equity tier 1 and tier 1 capital in accordance with Table 5.

(ii) If the aggregate amount of the adjustment is negative, the [BANK] must add back the adjustment to common equity tier 1 capital or to tier 1 capital, in accordance with Table 5.

TABLE 5

Transition Period	Transition adjustments under §___.22(b)(2) of subpart C	
	Percentage of the adjustment applied to common equity tier 1 capital	Percentage of the adjustment applied to tier 1 capital
Calendar year 2013	0	100
Calendar year 2014	20	80
Calendar year 2015	40	60
Calendar year 2016	60	40
Calendar year 2017	80	20
Calendar year 2018, and thereafter	100	0

(3) Transition adjustments to AOCI. From January 1, 2013 through December 31, 2017, a [BANK] must adjust common equity tier 1 capital with respect to the aggregate amount of (i) unrealized gains on AFS equity securities, plus (ii) net unrealized gains or losses on AFS debt securities, plus (iii) accumulated net unrealized gains and losses on defined benefit pension obligations, plus (iv) accumulated net unrealized gains or losses on cash flow hedges related to items that are reported on the balance sheet at fair value included in AOCI (the transition AOCI adjustment amount) as reported on the [BANK's] [REGULATORY REPORT] as follows:

(i) If the transition AOCI adjustment amount is positive, the appropriate amount must be deducted from common equity tier 1 capital in accordance with Table 6.

(ii) If the transition AOCI adjustment amount is negative, the appropriate amount must be added back to common equity tier 1 capital in accordance with Table 6.

TABLE 6

Transition Period	Percentage of the transition AOCI adjustment amount to be applied to common equity tier 1 capital
Calendar year 2013	100
Calendar year 2014	80
Calendar year 2015	60
Calendar year 2016	40
Calendar year 2017	20
Calendar year 2018 and thereafter	0

(iii) A [BANK] may include a certain amount of unrealized gains on AFS equity securities in tier 2 capital during the transition period in accordance with Table 7.

TABLE 7

Transition Period	Percentage of unrealized gains on AFS equity securities that may be included in tier 2 capital
Calendar year 2013	45
Calendar year 2014	36
Calendar year 2015	27
Calendar year 2016	18
Calendar year 2017	9
Calendar year 2018 and thereafter	0

(4) Additional deductions from regulatory capital. (i) From January 1, 2013 through December 31, 2017, a [BANK] must use Table 8 to determine the amount of investments in capital instruments and the items subject to the 10 and 15 percent common equity tier 1 capital deduction thresholds (§___.22(d)) (that is, MSAs, DTAs arising from temporary differences that the [BANK] could not realize through net operating loss carrybacks, and significant investments in the capital of unconsolidated financial institutions in the form of common stock) that must be deducted from common equity tier 1.

(ii) From January 1, 2013 through December 31, 2017, a [BANK] must apply a 100 percent risk-weight to the aggregate amount of the items subject to the 10 and 15 percent common equity tier 1 capital deduction thresholds that are not deducted under this section. As set forth in §___.22(d)(4), beginning on January 1, 2018, a [BANK] must apply a 250 percent risk-weight to the aggregate amount of the items subject to the 10 and 15 percent common equity tier 1 capital deduction thresholds that are not deducted from common equity tier 1 capital.

TABLE 8

Transition Period	Transition deductions under §§___.22(c) and (d) – Percentage of the deductions from common equity tier 1 capital
Calendar year 2013	0
Calendar year 2014	20
Calendar year 2015	40
Calendar year 2016	60
Calendar year 2017	80
Calendar year 2018 and thereafter	100

(iii) For purposes of calculating the transition deductions in this section, from January 1, 2013 through December 31, 2017, a [BANK]'s 15 percent common equity tier 1 capital deduction threshold for MSAs, DTAs arising from temporary differences that the [BANK] could not realize through net operating loss carrybacks, and significant investments in the capital of unconsolidated financial institutions in the form of common stock is equal to 15 percent of the sum of the [BANK]'s common equity tier 1 elements, after deductions required under §___.22(a) through (c) (transition 15 percent common equity tier 1 capital deduction threshold).

(iv) If the amount of MSAs the [BANK] deducts after the application of the appropriate thresholds is less than 10 percent of the fair value of the [BANK]'s MSAs, the [BANK] must deduct an additional amount of MSAs so that the total amount of MSAs deducted is at least 10 percent of the fair value of the [BANK]'s MSAs.

(v) Beginning on January 1, 2018, a [BANK] must calculate the 15 percent common equity tier 1 capital deduction threshold in accordance with §___.22(d).

(d) Transition arrangements for capital instruments.

(1) A depository institution holding company with total consolidated assets greater than or equal to $15 billion as of December 31, 2009 (depository institution holding company of $15 billion or more) may include in capital the percentage indicated in Table 9 of the aggregate outstanding principal amount of debt or equity instruments issued before May 19, 2010, that do not meet the criteria in §___.20 for additional tier 1 or tier 2 capital instruments (non-qualifying capital instruments), but that were included in tier 1 or tier 2 capital, respectively, as of May 19, 2010.

(i) The [BANK] must apply Table 9 separately to additional tier 1 and tier 2 non-qualifying capital instruments.

(ii) The amount of non-qualifying capital instruments that may not be included in additional tier 1 capital under this section may be included in tier 2 capital without limitation, provided the instrument meets the criteria for tier 2 capital under §___.20(d).

(iii) A depository institution holding company of $15 billion or more that acquires either a depository institution holding company with total consolidated assets of less than $15 billion as of December 31, 2009 (depository institution holding company under $15 billion) or a depository institution holding company that was a mutual holding company as of May 19, 2010, may include in regulatory capital non-qualifying capital instruments issued prior to May 19, 2010, by the acquired organization only to the extent provided in Table 9.

(iv) If a depository institution holding company under $15 billion acquires a depository institution holding company under $15 billion or a 2010 MHC and the resulting organization has total consolidated assets of $15 billion or more as reported on the resulting organization's FR Y-9C for the period in which the transaction occurred, the resulting organization may include in regulatory capital non-qualifying capital instruments issued prior to May 19, 2010 to the extent provided in Table 9.

TABLE 9

Transition Period (Calendar year)	Percentage of non-qualifying capital instruments included in additional tier 1 or tier 2 capital
Calendar year 2013	75
Calendar year 2014	50
Calendar year 2015	25
Calendar year 2016 and thereafter	0

(2) Depository institution holding companies under $15 billion, depository institutions, and 2010 MHCs that are not subject to §___.300(d)(1)(iii) may include in regulatory capital non-qualifying capital instruments issued prior to May 19, 2010 subject to the transition arrangements described in §___.300(d)(2).

(i) Non-qualifying capital instruments issued before September 12, 2010, that were outstanding as of January 1, 2013 may be included in a [BANK]'s capital up to the percentage of the outstanding principal amount of such non-qualifying capital instruments as of January 1, 2013 in accordance with Table 10.

(ii) Table 10 applies separately to additional tier 1 and tier 2 non-qualifying capital instruments.

(iii) The amount of non-qualifying capital instruments that cannot be included in additional tier 1 capital under this section may be included in the tier 2 capital, provided the instruments meet the criteria for tier 2 capital instruments under §___.20(d).

TABLE 10

Transition Period (Calendar year)	Percentage of non-qualifying capital instruments included in additional tier 1 or tier 2 capital
Calendar year 2013	90
Calendar year 2014	80
Calendar year 2015	70
Calendar year 2016	60
Calendar year 2017	50
Calendar year 2018	40
Calendar year 2019	30
Calendar year 2020	20
Calendar year 2021	10
Calendar year 2022 and thereafter	0

(3) The transition arrangements outlined in this section also apply to non-qualifying capital instruments issued by consolidated subsidiaries of the [BANK] that are in the form of tier 1 minority interest or total capital minority interest.

End of Common Rule

List of Subjects

12 CFR Part 3

Administrative practice and procedure, Capital, National banks, Reporting and recordkeeping requirements, Risk.

12 CFR Part 5

Administrative practice and procedure, National banks, Reporting and recordkeeping requirements, Securities.

12 CFR Part 6

National banks.

12 CFR Part 165

Administrative practice and procedure, Savings associations.

12 CFR Part 167

Capital, Reporting and recordkeeping requirements, Risk, Savings associations.

12 CFR Part 208

Confidential business information, Crime, Currency, Federal Reserve System, Mortgages, reporting and recordkeeping requirements, Securities.

12 CFR 217

Administrative practice and procedure, Banks, banking, Federal Reserve System, Holding companies, Reporting and recordkeeping requirements, Securities.

12 CFR Part 225

Administrative practice and procedure, Banks, banking, Federal Reserve System, Holding companies, Reporting and recordkeeping requirements, Securities.

12 CFR Part 325

Administrative practice and procedure, Banks, banking, Capital Adequacy, Reporting and recordkeeping requirements, Savings associations, State non-member banks.

The adoption of the final common rules by the agencies, as modified by the agency-specific text, is set forth below:

DEPARTMENT OF THE TREASURY

Office of the Comptroller of the Currency

12 CFR Chapter I

Authority and Issuance

For the reasons set forth in the common preamble and under the authority of 12 U.S.C. 93a and 5412(b)(2)(B), the Office of the Comptroller of the Currency proposes to further amend part 3 of chapter I of title 12, Code of Federal Regulations as proposed to be amended elsewhere in this issue of the Federal Register under Docket IDs OCC-2012-0009 and OCC-2012-0010, as follows:

PART 3 – MINIMUM CAPITAL RATIOS; ISSUANCE OF DIRECTIVES

1. The authority citation for part 3 is revised to read as follows:

Authority: 12 U.S.C. 93a, 161, 1462, 1462a, 1463, 1464, 1818, 1828(n), 1828 note, 1831n note, 1835, 3907, 3909, and 5412(b)(2)(B).

2. Part 3 is amended by:

i. Redesignating subparts C-E as subparts H-J, §§ 3.300-3.304, 3.400, 3.500-3.506, respectively, and designating parts A-G of the common rule as part 3, subparts A-G;

ii. Redesignating § 3.100 as subpart K, §3.600; and

iii. Removing appendices A-C.

3. Subparts A-G of part 3 are amended as set forth below:

i. Remove "[AGENCY]" and add "OCC" in its place, wherever it appears;

ii. Remove "[BANK]" and add "national bank and Federal savings association" in its place, wherever it appears in the phrase "Each [BANK]" or "each [BANK]";

iii. Remove "[BANK]" and add "national bank or Federal savings association" in its place, wherever it appears in the phrases "A [BANK]", "a [BANK]", "The [BANK]", or "the [BANK]";

iv. Remove "[BANKS]" and add "national banks and Federal savings associations" in its place, wherever it appears;

v. Remove "[PART]" and add "Part 3" in its place, wherever it appears;

vi. Remove "[AGENCY]" and add "OCC" in its place, wherever it appears; and

vii. Remove "[REGULATORY REPORT]" and add "Call Report" in its place, wherever it appears.

4. New § 3.2 is amended by adding the following definitions in alphabetical order:

* * * * *

Core capital means Tier 1 capital, as calculated in accordance with § XX of subpart XX.

* * * * *

Federal savings association means an insured Federal savings association or an insured Federal savings bank chartered under section 5 of the Home Owners' Loan Act of 1933.

* * * * *

Tangible capital means the amount of core capital (Tier 1 capital), as calculated in accordance with subpart B of this part, plus the amount of outstanding perpetual preferred stock (including related surplus) not included in Tier 1 capital.

* * * * *

5. New § 3.10 is amended by adding paragraphs (a)(6), (b)(5), and (c)(5) to read as follows:

§ 3.10 Minimum Capital Requirements.

(a) * * *

(6) For Federal savings associations, a tangible capital ratio of 1.5 percent.

(b) * * *

(5) Federal savings association tangible capital ratio. A Federal savings association's tangible capital ratio is the ratio of the Federal savings association's core capital (Tier 1 capital) to total adjusted assets as calculated under subpart B of this part.

(c) * * *

(5) Federal savings association tangible capital ratio. A Federal savings association's tangible capital ratio is the ratio of the Federal savings association's core capital (Tier 1 capital) to total adjusted assets as calculated under subpart B of this part.

* * * * *

6. New § 3.22 is amended to add new paragraph (a)(8), to read as follows:

§ 3.22 Regulatory capital adjustments and deductions.

(a) * * *

(8) (i) A Federal savings association must deduct the aggregate amount of its outstanding investments, (both equity and debt) as well as retained earnings in subsidiaries that are not includable subsidiaries as defined in paragraph 8(iv) of this section (including those subsidiaries where the Federal savings association has a minority ownership interest) and may not consolidate the assets and liabilities of the subsidiary with those of the Federal savings association. Any such deductions shall be deducted from common equity tier 1 except as provided in paragraphs (a)(8)(ii) and (a)(8)(iii) of this section.

(ii) If a Federal savings association has any investments (both debt and equity) in one or more subsidiaries engaged in any activity that would not fall within the scope of activities in which includable subsidiaries as defined in paragraph 8(iv) of this section may engage, it must deduct such investments from assets and, thus, common equity tier 1 in accordance with this paragraph (c)(8)(i). The Federal savings association must first deduct from assets and, thus, common equity tier 1 the amount by which any investments in such subsidiary(ies) exceed the amount of such investments held by the Federal savings association as of April 12, 1989. Next the Federal savings association must deduct from assets and, thus, common equity tier 1 the Federal savings association's investments in and extensions of credit to the subsidiary on the date as of which the savings association's capital is being determined.

(iii) If a Federal savings association holds a subsidiary (either directly or through a subsidiary) that is itself a domestic depository institution, the OCC may, in its sole discretion upon determining that the amount of Common Equity Tier 1 that would be required would be higher if the assets and liabilities of such subsidiary were consolidated with those of the parent Federal savings association than the amount that would be required if the parent Federal savings association's investment were deducted pursuant to paragraphs (c)(8)(i) and (c)(8)(ii) of this section, consolidate the assets and liabilities of that subsidiary with those of the parent Federal savings association in calculating the capital adequacy of the parent Federal savings association, regardless of whether the subsidiary would otherwise be an includable subsidiary as defined in paragraph 8(iv) of this section.

(iv) For purposed of this section, the term includable subsidiary means a subsidiary of a Federal savings association that is:

(A) Engaged solely in activities not impermissible for a national bank;

(B) Engaged in activities not permissible for a national bank, but only if acting solely as agent for its customers and such agency position is clearly documented in the Federal savings association's files;

(C) Engaged solely in mortgage-banking activities;

(D)(*i*) Itself an insured depository institution or a company the sole investment of which is an insured depository institution, and

(*ii*) Was acquired by the parent Federal savings association prior to May 1, 1989; or

(E) A subsidiary of any Federal savings association existing as a Federal savings association on August 9, 1989 that

(*i*) Was chartered prior to October 15, 1982, as a savings bank or a cooperative bank under state law, or

(*ii*) Acquired its principal assets from an association that was chartered prior to October 15, 1982, as a savings bank or a cooperative bank under state law.

* * * * *

Subpart H – Establishment of Minimum Capital Ratios for an Individual National Bank or Individual Federal Savings Association

7. Revise the heading of newly redesginated subpart H as set forth above.

§ 3.300 [Amended]

8. Amend newly redesignated section 3.300 by:

a. Removing the word "bank", wherever it appears, and replacing it with the phrase "national bank or Federal savings association"; and

b. Removing "§3.6", wherever it appears, and replacing it with the phrase "subpart B of this part".

§ 3.301 [Amended]

9. Amend newly redesignated § 3.301 by removing the word "bank", wherever it appears, and replacing it with the phrase "national bank or Federal savings association".

§ 3.302 [Amended]

10. Amend newly redesignated § 3.302 by:

a. Removing the word "bank", wherever it appears, and replacing it with the phrase "national bank or Federal savings association"; and

b. Removing the word "bank's", wherever it appears, and replacing it with the phrase "national bank's or Federal savings association's".

§ 3.303 [Amended]

11. Amend newly redesignated § 3.303 by:

a. Removing the word "bank", wherever it appears, and replacing it with the phrase "national bank or Federal savings association"; and

b. Amend newly redesignated § 3.303 by removing the word "bank's", wherever it appears, and replacing it with the phrase "national bank's or Federal savings association's";

c. Removing the word “Office”, wherever it appears, and replacing it with the word “OCC”;

d. Removing the word “Office’s”, wherever it appears, and replacing it with the word “OCC’s”; and

e. In paragraph (a), removing”§3.6” and replacing it with “subpart B of this part”.

§ 3.304 [Amended]

12. Amend newly designated § 3.304 by:

a. Removing the word “bank” and replacing it with the phrase “national bank or Federal savings association”; and

b. Adding the phrase “for national banks and 12 CFR 109.1 through 109.21 for Federal savings associations” after “19.21”.

§ 3.400 [Amended]

13. Newly designated § 3.400 is amended by:

a. In the first sentence, removing the word “bank”, wherever it appears, and replacing it with the phrase “national bank or Federal savings association”, and removing the phrase “subpart C” and replacing it with the phrase “subpart H”; and

b. In the second sentence, removing the phrase “subpart E” and replacing it with the phrase “subpart J”; and

c. In the third sentence add the phrase “or Federal savings association’s” after the word “bank’s”, and removing the phrase “§3.6(a) or (b)” and replacing it with “subpart B of this part”.

§ 3.500 [Amended]

14. Amending newly redesignated § 3.500 by:

a. Removing the word “bank”, wherever it appears, and replacing it with the phrase “national bank or Federal savings association”;

b. Removing the word “Office”, wherever it appears, and replacing it with the word “OCC”; and

c. In the introductory text, removing the phrase “subpart C” and replacing it with the phrase “subpart H”.

§ 3.501 [Amended]

15. Amending newly redesignated § 3.501 by:

a. Removing the word “bank”, and replacing it with the phrase “national bank or Federal savings association”; and

b. Removing the word “Office”, and replacing it with the word “OCC”.

§ 3.502 [Amended]

15. Amending newly redesignated § 3.502 by:

a. Removing the word “bank”, and replacing it with the phrase “national bank or Federal savings association”; and

b. Removing the word “Office”, and replacing it with the word “OCC”.

§ 3.503 [Amended]

16. Amending newly redesignated § 3.503 by:

a. Removing the word “bank’s”, wherever it appears, and replacing it with the phrase “national bank’s or Federal savings association’s”; and

b. Removing the word “Office”, and replacing it with the word “OCC”.

§§ 3.504-3.506 [Amended]

17. Amending newly designated §§ 3.504-3.506 by:

a. Removing the word “bank”, wherever it appears, and replacing it with the phrase “national bank or Federal savings association”;

b. Removing the word “bank’s”, wherever it appears, and replacing it with the phrase “national bank’s or Federal savings association’s”; and

c. Removing the word “Office”, wherever it appears, and replacing it with the word “OCC”.

§ 3.600 [Amended]

18. Amending newly designated § 3.600 by:

a. In paragraphs (a)-(d), removing the phrase “national banking associations”, wherever it appears, and replacing it with the phrase “national banks”;

b. Removing the word “bank”, wherever it appears, and replacing it with the phrase “national bank”;

c. In paragraph (a), removing the word “bank’s” and replacing it with the phrase “national bank’s”, and removing “§ 3.2” and replacing it with the phrase “subparts A-J of this part”; and

d. In paragraph (e)(7), removing the word “bank-owned” and replacing it with the word “national bank-owned”.

PART 5—RULES, POLICIES, AND PROCEDURES FOR CORPORATE ACTIVITIES

19. The authority citation for part 5 continues to read as follows:

Authority: 12 U.S.C. 1 et seq., 93a, 215a–2, 215a–3, 481, and section 5136A of the Revised Statutes (12 U.S.C. 24a).

20. Section 5.39 is amended by revising paragraph (h)(1) and republishing paragraph (h)(2) for reader reference to read as follows:

§ 5.39 Financial subsidiaries.

* * * * *

(h) * * *

(1) For purposes of determining regulatory capital the national bank may not consolidate the assets and liabilities of a financial subsidiary with those of the bank and must deduct the aggregate amount of its outstanding equity investment, including retained earnings, in its financial subsidiaries from regulatory capital as provided by § 3.22(a)(7);

(2) Any published financial statement of the national bank shall, in addition to providing information prepared in accordance with generally accepted accounting principles, separately present financial information for the bank in the manner provided in paragraph (h)(1) of this section;

* * * * *

21. Part 6 is revised to read as follows:

PART 6 – PROMPT CORRECTIVE ACTION

Subpart A – Capital Categories

Sec.

6.1 Authority, Purpose, Scope, Other Supervisory Authority, and Disclosure of Capital Categories.

6.2 Definitions.

6.3 Notice of capital category.

6.4 Capital measures and capital category definition.

6.5 Capital restoration plan

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Subpart B – Directives to Take Prompt Corrective Action

6.20 Scope.

6.21 Notice of intent to issue a directive.

6.22 Response to notice.

6.23 Decision and issuance of a prompt corrective action directive.

6.24 Request for modification or rescission of directive.

6.25 Enforcement of directive.

Authority: 12 U.S.C. 93a, 1831o, 5412(b)(2)(B).

§ 6.1 Authority, Purpose, Scope, Other Supervisory Authority, and Disclosure of Capital Categories.

(a) Authority. This part is issued by the Office of the Comptroller of the Currency (OCC) pursuant to section 38 (section 38) of the Federal Deposit Insurance Act (FDI Act) as added by section 131 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (Pub.L. 102-242, 105 Stat. 2236 (1991)) (12 U.S.C. 1831o).

(b) Purpose. Section 38 of the FDI Act establishes a framework of supervisory actions for insured depository institutions that are not adequately capitalized. The principal purpose of this subpart is to define, for insured national banks and insured Federal savings associations, the capital measures and capital levels, and for insured federal branches, comparable asset-based measures and levels, that are used for determining the supervisory actions authorized under section 38 of the FDI Act. This part 6 also establishes procedures for submission and review of capital restoration plans and for issuance and review of directives and orders pursuant to section 38.

(c) Scope. This subpart implements the provisions of section 38 of the FDI Act as they apply to insured national banks, insured federal branches, and insured Federal savings associations. Certain of these provisions also apply to officers, directors and employees of these insured institutions. Other provisions apply to any company that controls an insured national bank, insured federal branch or insured Federal savings association and to the affiliates of an insured national bank, insured federal branch, or insured Federal savings association.

(d) Other supervisory authority. Neither section 38 nor this part in any way limits the authority of the OCC under any other provision of law to take supervisory actions to address unsafe or unsound practices, deficient capital levels, violations of law, unsafe or unsound conditions, or other practices. Action under section 38 of the FDI Act and this part may be taken

independently of, in conjunction with, or in addition to any other enforcement action available to the OCC, including issuance of cease and desist orders, capital directives, approval or denial of applications or notices, assessment of civil money penalties, or any other actions authorized by law.

(e) Disclosure of capital categories. The assignment of an insured national bank, insured federal branch, or insured Federal savings association under this subpart within a particular capital category is for purposes of implementing and applying the provisions of section 38. Unless permitted by the OCC or otherwise required by law, no national bank or Federal savings association may state in any advertisement or promotional material its capital category under this subpart or that the OCC or any other federal banking agency has assigned the national bank or Federal savings association to a particular capital category.

§ 6.2 Definitions.

For purposes of section 38 and this part, the definitions in part 3 of this chapter shall apply. In addition, except as modified in this section or unless the context otherwise requires, the terms used in this subpart have the same meanings as set forth in section 38 and section 3 of the FDI Act.

Advanced approaches national bank or advanced approaches Federal savings association means a national bank or Federal savings association that is subject to subpart E of part 3 of this chapter.

Common equity Tier 1 capital means common equity Tier 1 capital, as defined in accordance with the OCC's definition in § 3.2 of part 3.

Common equity tier 1 risk-based capital ratio means the ratio of common equity tier 1 capital to total risk-weighted risk assets, as calculated in accordance with subpart B of part 3, as applicable.

Control. (1) Control has the same meaning assigned to it in section 2 of the Bank Holding Company Act (12 U.S.C. 1841), and the term controlled shall be construed consistently with the term control.

(2) Exclusion for fiduciary ownership. No insured depository institution or company controls another insured depository institution or company by virtue of its ownership or control of shares in a fiduciary capacity. Shares shall not be deemed to have been acquired in a fiduciary capacity if the acquiring insured depository institution or company has sole discretionary authority to exercise voting rights with respect thereto.

(3) Exclusion for debts previously contracted. No insured depository institution or company controls another insured depository institution or company by virtue of its ownership or control of shares acquired in securing or collecting a debt previously contracted in good faith, until two years after the date of acquisition. The two-year period may be extended at the discretion of the appropriate federal banking agency for up to three one-year periods.

Controlling person means any person having control of an insured depository institution and any company controlled by that person.

Federal savings association means an insured Federal savings association or an insured Federal savings bank chartered under section 5 of the Home Owners' Loan Act of 1933.

Leverage ratio means the ratio of Tier 1 capital to average total consolidated assets, as calculated in accordance with subpart B of part 3.

Management fee means any payment of money or provision of any other thing of value to a company or individual for the provision of management services or advice to the national bank or Federal savings association or related overhead expenses, including payments related to supervisory, executive, managerial, or policymaking functions, other than compensation to an individual in the individual's capacity as an officer or employee of the national bank or Federal savings association.

National bank means all insured national banks and all insured federal branches, except where otherwise provided in this subpart.

Leverage ratio means the ratio of Tier 1 capital to average total consolidated assets, as calculated in accordance with subpart B of Part 3.

Supplementary leverage ratio means the ratio of Tier 1 capital to total leverage exposure, as calculated in accordance with subpart B of part 3.

Tangible equity means the amount of Tier 1 capital, as calculated in accordance with subpart B of part 3, plus the amount of outstanding perpetual preferred stock (including related surplus) not included in Tier 1 capital.

Tier 1 capital means the amount of Tier 1 capital as defined in subpart B of this chapter.

Tier 1 risk-based capital ratio means the ratio of Tier 1 capital to risk weighted assets, as calculated in accordance with subpart B of part 3.

Total assets means quarterly average total assets as reported in a national bank's or Federal savings association's Consolidated Reports of Condition and Income (Call Report), minus any deduction of assets as provided in the definition of tangible equity. The OCC reserves the right to require a national bank or Federal savings association to compute and maintain its capital ratios on the basis of actual, rather than average, total assets when computing tangible equity.

Total leverage exposure means the total leverage exposure, as calculated in accordance with subpart B of part 3.

Total risk-based capital ratio means the ratio of total capital to total risk-weighted assets, as calculated in accordance with subpart B of part 3.

Total risk-weighted assets means standardized total risk-weighted assets, and for an advanced approaches bank or advanced approaches Federal savings association also includes advanced approaches total risk-weighted assets, as defined in subpart B of part 3.

§ 6.3 Notice of capital category.

(a) Effective date of determination of capital category. A national bank or Federal savings association shall be deemed to be within a given capital category for purposes of section 38 of the FDI Act and this part as of the date the national bank or Federal savings association is notified of, or is deemed to have notice of, its capital category pursuant to paragraph (b) of this section.

(b) Notice of capital category. A national bank or Federal savings association shall be deemed to have been notified of its capital levels and its capital category as of the most recent date:

(1) A Consolidated Report of Condition and Income (Call Report) is required to be filed with the OCC;

(2) A final report of examination is delivered to the national bank or Federal savings association; or

(3) Written notice is provided by the OCC to the national bank or Federal savings association of its capital category for purposes of section 38 of the FDI Act and this part or that the national bank's or Federal savings association's capital category has changed as provided in paragraph (c) of this section or § 6.1 of this subpart and subpart M of part 19 of this chapter with respect to national banks and § 165.8 with respect to Federal savings associations.

(c) Adjustments to reported capital levels and capital category.

(1) Notice of adjustment by national bank or Federal savings association. A national bank or Federal savings association shall provide the OCC with written notice that an adjustment to the national bank's or Federal savings association's capital category may have occurred no later than 15 calendar days following the date that any material event has occurred that would cause the national bank or Federal savings association to be placed in a lower capital category from the category assigned to the national bank or Federal savings association for purposes of section 38 and this part on the basis of the national bank's or Federal savings association's most recent Call Report or report of examination.

(2) Determination to change capital category. After receiving notice pursuant to paragraph (c)(1) of this section, the OCC shall determine whether to change the capital category of the national bank or Federal savings association and shall notify the national bank or Federal savings association of the OCC's determination.

§ 6.4 Capital measures and capital category definition.

(a) Capital measures. (1) Capital measures applicable before January 1, 2015. On or before December 31, 2014, for purposes of section 38 and this part, the relevant capital measures for all national banks and Federal savings associations are:

(i) Total Risk-Based Capital Measure: the total risk-based capital ratio;

(ii) Tier 1 Risk-Based Capital Measure: the tier 1 risk-based capital ratio; and

(iii) Leverage Measure: the leverage ratio.

(2) Capital measures applicable on and after January 1, 2015. On January 1, 2015 and thereafter, for purposes of section 38 and this part, the relevant capital measures are:

(i) Total Risk-Based Capital Measure: the total risk-based capital ratio;

(ii) Tier 1 Risk-Based Capital Measure: the tier 1 risk-based capital ratio;

(iii) Common Equity Tier 1 Capital Measure: the common equity tier 1 risk-based capital ratio; and

(iv) The Leverage Measure: (A) the leverage ratio, and (B) with respect to an advanced approaches national bank or advanced approaches Federal savings association, on January 1, 2018, and thereafter, the supplementary leverage ratio.

(b) Capital categories applicable before January 1, 2015. On or before December 31, 2014, for purposes of the provisions of section 38 and this part, a national bank or Federal savings association shall be deemed to be:

(1) "Well capitalized" if:

(i) Total Risk-Based Capital Measure: the national bank or Federal savings association has a total risk-based capital ratio of 10.0 percent or greater;

(ii) Tier 1 Risk-Based Capital Measure: the bank or Federal savings association has a tier 1 risk-based capital ratio of 6.0 percent or greater;

(iii) Leverage Measure: the national bank or Federal savings association has a leverage ratio of 5.0 percent or greater; and

(iv) The national bank or Federal savings association is not subject to any written agreement, order or capital directive, or prompt corrective action directive issued by the OCC pursuant to section 8 of the FDI Act, the International Lending Supervision Act of 1983 (12 U.S.C. 3907), the Home Owners' Loan Act (12 U.S.C. 1464(t)(6)(A)(ii)), or section 38 of the FDI Act, or any regulation thereunder, to meet and maintain a specific capital level for any capital measure.

(2) "Adequately capitalized" if:

(i) Total Risk-Based Capital Measure: the national bank or Federal savings association has a total risk-based capital ratio of 8.0 percent or greater;

(ii) Tier 1 Risk-Based Capital Measure: the national bank or Federal savings association has a tier 1 risk-based capital ratio of 4.0 percent or greater;

(iii) Leverage Measure:

(A) The national bank or Federal savings association has a leverage ratio of 4.0 percent or greater; or

(B) The national bank or Federal savings association has a leverage ratio of 3.0 percent or greater if the national bank or Federal savings association is rated composite 1 under the CAMELS rating system in the most recent examination of the national bank and or Federal savings association is not experiencing or anticipating any significant growth; and

(iv) Does not meet the definition of a "well capitalized" national bank or Federal savings association.

(3) "Undercapitalized" if:

(i) Total Risk-Based Capital Measure: the national bank or Federal savings association has a total risk-based capital ratio of less than 8.0 percent; or

(ii) Tier 1 Risk-Based Capital Measure: the national bank or Federal savings association has a tier 1 risk-based capital ratio of less than 4.0 percent; or

(iii) Leverage Measure:

(A) Except as provided in paragraph (b)(2)(iii)(B) of this section, the national bank or Federal savings association has a leverage ratio of less than 4.0 percent; or

(iv) The national bank or Federal savings association has a leverage ratio of less than 3.0 percent, if the national bank or Federal savings association is rated composite 1 under the CAMELS rating system in the most recent examination of the national bank or Federal savings association and is not experiencing or anticipating significant growth.

(4) "Significantly undercapitalized" if:

(i) Total Risk-Based Capital Measure: the national bank or Federal savings association has a total risk-based capital ratio of less than 6.0 percent; or

(ii) Tier 1 Risk-Based Capital Measure: the national bank or Federal savings association has a tier 1 risk-based capital ratio of less than 3.0 percent; or

(iii) Leverage Measure: the national bank or Federal savings association has a leverage ratio of less than 3.0 percent.

(5) "Critically undercapitalized" if the national bank or Federal savings association has a ratio of tangible equity to total assets that is equal to or less than 2.0 percent.

(c) Capital categories applicable on and after January 1, 2015. On January 1, 2015, and thereafter, for purposes of the provisions of section 38 and this part, a national bank or Federal savings association shall be deemed to be:

(1) "Well capitalized" if:

(i) Total Risk-Based Capital Measure: the national bank or Federal savings association has a total risk-based capital ratio of 10.0 percent or greater;

(ii) Tier 1 Risk-Based Capital Measure: the national bank or Federal savings association has a tier 1 risk-based capital ratio of 8.0 percent or greater;

(iii) Common Equity Tier 1 Capital Measure: the national bank or Federal savings association has a common equity tier 1 risk-based capital ratio of 6.5 percent or greater;

(iv) Leverage Measure: the national bank or Federal savings association has a leverage ratio of 5.0 or greater; and

(iv) The national bank or Federal savings association is not subject to any written agreement, order or capital directive, or prompt corrective action directive issued by the OCC pursuant to section 8 of the FDI Act, the International Lending Supervision Act of 1983 (12 U.S.C. 3907), the Home Owners' Loan Act (12 U.S.C. 1464(t)(6)(A)(ii)), or section 38 of the FDI Act, or any regulation thereunder, to meet and maintain a specific capital level for any capital measure.

(2) "Adequately capitalized" if:

(i) Total Risk-Based Capital Measure: the national bank or Federal savings association has a total risk-based capital ratio of 8.0 percent or greater;

(ii) Tier 1 Risk-Based Capital Measure: the national bank or Federal savings association has a tier 1 risk-based capital ratio of 6.0 percent or greater;

(iii) Common Equity Tier 1 Capital Measure: the national bank or Federal savings association has a common equity tier 1 risk-based capital ratio of 4.5 percent or greater;

(iv) Leverage Measure:

(A) The national bank or Federal savings association has a leverage ratio of 4.0 percent or greater; and

(B) With respect to an advanced approaches national bank or advanced approaches Federal savings association, on January 1, 2018 and thereafter, the national bank or Federal savings association has an supplementary leverage ratio of 3.0 percent or greater; and

(v) The national bank or Federal savings association does not meet the definition of a "well capitalized" national bank or Federal savings association.

(3) "Undercapitalized" if:

(i) Total Risk-Based Capital Measure: the national bank or Federal savings association has a total risk-based capital ratio of less than 8.0 percent;

(ii) Tier 1 Risk-Based Capital Measure: the national bank or Federal savings association has a tier 1 risk-based capital ratio of less than 6.0 percent;

(iii) Common Equity Tier 1 Capital Measure: the national bank or Federal savings association has a common equity tier 1 risk-based capital ratio of less than 4.5 percent; or

(iv) Leverage Measure: (A) The national bank or Federal savings association has a leverage ratio of less than 4.0 percent; or

(B) With respect to an advanced approaches national bank or advanced approaches Federal savings association, on January 1, 2018, and thereafter, the national bank or Federal savings association has a supplementary leverage ratio of less than 3.0 percent.

(4) "Significantly undercapitalized" if:

(i) Total Risk-Based Capital Measure: the national bank or Federal savings association has a total risk-based capital ratio of less than 6.0 percent;

(ii) Tier 1 Risk-Based Capital Measure: the national bank or Federal savings association has a tier 1 risk-based capital ratio of less than 4.0 percent;

(iii) Common Equity Tier 1 Capital Measure: the national bank or Federal savings association has a common equity tier 1 risk-based capital ratio of less than 3.0 percent; or

(iv) Leverage Measure: the national bank or Federal savings association has a leverage ratio of less than 3.0 percent.

(5) "Critically undercapitalized" if the national bank or Federal savings association has a ratio of tangible equity to total assets that is equal to or less than 2.0 percent.

(d) Capital categories for insured federal branches. For purposes of the provisions of section 38 of the FDI Act and this part, an insured federal branch shall be deemed to be:

(1) Well capitalized if the insured federal branch:

(i) Maintains the pledge of assets required under 12 CFR 347.209; and

(ii) Maintains the eligible assets prescribed under 12 CFR 347.210 at 108 percent or more of the preceding quarter's average book value of the insured branch's third-party liabilities; and

(iii) Has not received written notification from:

(A) The OCC to increase its capital equivalency deposit pursuant to § 28.15 of this chapter, or to comply with asset maintenance requirements pursuant to § 28.20 of this chapter; or

(B) The FDIC to pledge additional assets pursuant to 12 CFR 346.209 or to maintain a higher ratio of eligible assets pursuant to 12 CFR 346.210.

(2) Adequately capitalized if the insured federal branch:

(i) Maintains the pledge of assets prescribed under 12 CFR 346.209; and

(ii) Maintains the eligible assets prescribed under 12 CFR 346.210 at 106 percent or more of the preceding quarter's average book value of the insured branch's third-party liabilities; and

(iii) Does not meet the definition of a well capitalized insured federal branch.

(3) Undercapitalized if the insured federal branch:

(i) Fails to maintain the pledge of assets required under 12 CFR 346.209; or

(ii) Fails to maintain the eligible assets prescribed under 12 CFR 346.210 at 106 percent or more of the preceding quarter's average book value of the insured branch's third-party liabilities.

(4) Significantly undercapitalized if it fails to maintain the eligible assets prescribed under 12 CFR 346.210 at 104 percent or more of the preceding quarter's average book value of the insured federal branch's third-party liabilities.

(5) Critically undercapitalized if it fails to maintain the eligible assets prescribed under 12 CFR 346.210 at 102 percent or more of the preceding quarter's average book value of the insured federal branch's third-party liabilities.

(e) Reclassification based on supervisory criteria other than capital. The OCC may reclassify a well capitalized national bank or Federal savings association as adequately capitalized and may require an adequately capitalized or an undercapitalized national bank or Federal savings association to comply with certain mandatory or discretionary supervisory actions as if the national bank or Federal savings association were in the next lower capital category (except that the OCC may not reclassify a significantly undercapitalized national bank or Federal savings association as critically undercapitalized) (each of these actions are hereinafter referred to generally as reclassifications) in the following circumstances:

(1) Unsafe or unsound condition. The OCC has determined, after notice and opportunity for hearing pursuant to subpart M of part 19 of this chapter with respect to national banks and § 165.8 with respect to Federal savings associations, that the national bank or Federal savings association is in unsafe or unsound condition; or

(2) Unsafe or unsound practice. The OCC has determined, after notice and opportunity for hearing pursuant to subpart M of part 19 of this chapter with respect to national banks and § 165.8 with respect to Federal savings associations, that in the most recent examination of the

national bank or Federal savings association, the national bank or Federal savings association received, and has not corrected a less-than-satisfactory rating for any of the categories of asset quality, management, earnings, or liquidity.

§ 6.5 Capital restoration plan.

(a) Schedule for filing plan.

(1) In general. A national bank or Federal savings association shall file a written capital restoration plan with the OCC within 45 days of the date that the national bank or Federal savings association receives notice or is deemed to have notice that the national bank or Federal savings association is undercapitalized, significantly undercapitalized, or critically undercapitalized, unless the OCC notifies the national bank or Federal savings association in writing that the plan is to be filed within a different period. An adequately capitalized national bank or Federal savings association that has been required pursuant to § 6.4 and subpart M of part 19 of this chapter with respect to national banks and § 165.8 with respect to Federal savings associations to comply with supervisory actions as if the national bank or Federal savings association were undercapitalized is not required to submit a capital restoration plan solely by virtue of the reclassification.

(2) Additional capital restoration plans. Notwithstanding paragraph (a)(1) of this section, a national bank or Federal savings association that has already submitted and is operating under a capital restoration plan approved under section 38 and this subpart is not required to submit an additional capital restoration plan based on a revised calculation of its capital measures or a reclassification of the institution under § 6.4 and subpart M of part 19 of this chapter with respect to national banks and §§ 6.4 and 165.8 with respect to Federal savings associations unless the OCC notifies the national bank or Federal savings association that it must submit a new or revised capital plan. A national bank or Federal savings association that is notified that it must submit a new or revised capital restoration plan shall file the plan in writing with the OCC within 45 days of receiving such notice, unless the OCC notifies the national bank or Federal savings association in writing that the plan must be filed within a different period.

(b) Contents of plan. All financial data submitted in connection with a capital restoration plan shall be prepared in accordance with the instructions provided on the Call Report, unless the OCC instructs otherwise. The capital restoration plan shall include all of the information required to be filed under section 38(e)(2) of the FDI Act. A national bank or Federal savings association that is required to submit a capital restoration plan as the result of a reclassification of the national bank or Federal savings association, pursuant to § 6.4 for both national banks and Federal savings associations and subpart M of part 19 of this chapter with respect to national banks and § 165.8 with respect to Federal savings associations, shall include a description of the steps the national bank or Federal savings association will take to correct the unsafe or unsound condition or practice. No plan shall be accepted unless it includes any performance guarantee described in section 38(e)(2)(C) of that Act by each company that controls the national bank or Federal savings association.

(c) Review of capital restoration plans. Within 60 days after receiving a capital restoration plan under this subpart, the OCC shall provide written notice to the national bank or

Federal savings association of whether the plan has been approved. The OCC may extend the time within which notice regarding approval of a plan shall be provided.

(d) Disapproval of capital restoration plan. If a capital restoration plan is not approved by the OCC, the national bank or Federal savings association shall submit a revised capital restoration plan within the time specified by the OCC. Upon receiving notice that its capital restoration plan has not been approved, any undercapitalized national bank or Federal savings association (as defined in § 6.4) shall be subject to all of the provisions of section 38 and this part applicable to significantly undercapitalized institutions. These provisions shall be applicable until such time as a new or revised capital restoration plan submitted by the national bank or Federal savings association has been approved by the OCC.

(e) Failure to submit a capital restoration plan. A national bank or Federal savings association that is undercapitalized (as defined in § 6.4) and that fails to submit a written capital restoration plan within the period provided in this section shall, upon the expiration of that period, be subject to all of the provisions of section 38 and this part applicable to significantly undercapitalized national banks or Federal savings associations.

(f) Failure to implement a capital restoration plan. Any undercapitalized national bank or Federal savings association that fails, in any material respect, to implement a capital restoration plan shall be subject to all of the provisions of section 38 and this part applicable to significantly undercapitalized national banks or Federal savings associations.

(g) Amendment of capital restoration plan. A national bank or Federal savings association that has submitted an approved capital restoration plan may, after prior written notice to and approval by the OCC, amend the plan to reflect a change in circumstance. Until such time as a proposed amendment has been approved, the national bank or Federal savings association shall implement the capital restoration plan as approved prior to the proposed amendment.

(h) Notice to FDIC. Within 45 days of the effective date of OCC approval of a capital restoration plan, or any amendment to a capital restoration plan, the OCC shall provide a copy of the plan or amendment to the Federal Deposit Insurance Corporation.

(i) Performance guarantee by companies that control a bank or Federal savings association.

(1) Limitation on liability.(i) Amount limitation. The aggregate liability under the guarantee provided under section 38 and this subpart for all companies that control a specific national bank or Federal savings association that is required to submit a capital restoration plan under this subpart shall be limited to the lesser of:

(A) An amount equal to 5.0 percent of the national bank's or Federal savings association’s total assets at the time the national bank or Federal savings association was notified or deemed to have notice that the national bank or Federal savings association was undercapitalized; or

(B) The amount necessary to restore the relevant capital measures of the national bank or Federal savings association to the levels required for the national bank or Federal savings

association to be classified as adequately capitalized, as those capital measures and levels are defined at the time that the national bank or Federal savings association initially fails to comply with a capital restoration plan under this subpart.

(ii) Limit on duration. The guarantee and limit of liability under section 38 and this subpart shall expire after the OCC notifies the national bank or Federal savings association that it has remained adequately capitalized for each of four consecutive calendar quarters. The expiration or fulfillment by a company of a guarantee of a capital restoration plan shall not limit the liability of the company under any guarantee required or provided in connection with any capital restoration plan filed by the same national bank or Federal savings association after expiration of the first guarantee.

(iii) Collection on guarantee. Each company that controls a given national bank or Federal savings association shall be jointly and severally liable for the guarantee for such national bank or Federal savings association as required under section 38 and this subpart, and the OCC may require payment of the full amount of that guarantee from any or all of the companies issuing the guarantee.

(2) Failure to provide guarantee. In the event that a national bank or Federal savings association that is controlled by any company submits a capital restoration plan that does not contain the guarantee required under section 38(e)(2) of the FDI Act, the national bank or Federal savings association shall, upon submission of the plan, be subject to the provisions of section 38 and this part that are applicable to national banks or Federal savings associations that have not submitted an acceptable capital restoration plan.

(3) Failure to perform guarantee. Failure by any company that controls a national bank or Federal savings association to perform fully its guarantee of any capital plan shall constitute a material failure to implement the plan for purposes of section 38(f) of the FDI Act. Upon such failure, the national bank or Federal savings association shall be subject to the provisions of section 38 and this part that are applicable to national banks or Federal savings associations that have failed in a material respect to implement a capital restoration plan.

(j) Enforcement of capital restoration plan. The failure of a national bank or Federal savings association to implement, in any material respect, a capital restoration plan required under section 38 and this section shall subject the national bank or Federal savings association to the assessment of civil money penalties pursuant to section 8(i)(2)(A) of the FDI Act.

§ 6.6 Mandatory and discretionary supervisory actions under section 38.

(a) Mandatory supervisory actions.

(1) Provisions applicable to all national banks and Federal savings associations. All national banks and Federal savings associations are subject to the restrictions contained in section 38(d) of the FDI Act on payment of capital distributions and management fees.

(2) Provisions applicable to undercapitalized, significantly undercapitalized, and critically undercapitalized national banks or Federal savings associations. Immediately upon receiving notice or being deemed to have notice, as provided in § 6.3, that the national bank or Federal

savings association is undercapitalized, significantly undercapitalized, or critically undercapitalized, the national bank or Federal savings association shall become subject to the provisions of section 38 of the FDI Act--

(i) Restricting payment of capital distributions and management fees (section 38(d));

(ii) Requiring that the OCC monitor the condition of the national bank or Federal savings association (section 38(e)(1));

(iii) Requiring submission of a capital restoration plan within the schedule established in this subpart (section 38(e)(2));

(iv) Restricting the growth of the national bank's or Federal savings association's assets (section 38(e)(3)); and

(v) Requiring prior approval of certain expansion proposals (section 38(e)(4)).

(3) Additional provisions applicable to significantly undercapitalized, and critically undercapitalized national banks or Federal savings associations. In addition to the provisions of section 38 of the FDI Act described in paragraph (a)(2) of this section, immediately upon receiving notice or being deemed to have notice, as provided in this subpart, that the national bank or Federal savings association is significantly undercapitalized, or critically undercapitalized or that the national bank or Federal savings association is subject to the provisions applicable to institutions that are significantly undercapitalized because it has failed to submit or implement, in any material respect, an acceptable capital restoration plan, the national bank or Federal savings association shall become subject to the provisions of section 38 of the FDI Act that restrict compensation paid to senior executive officers of the institution (section 38(f)(4)).

(4) Additional provisions applicable to critically undercapitalized national banks or Federal savings associations. In addition to the provisions of section 38 of the FDI Act described in paragraphs (a) (2) and (3) of this section, immediately upon receiving notice or being deemed to have notice, as provided in § 6.3, that the national bank or Federal savings association is critically undercapitalized, the national bank or Federal savings association shall become subject to the provisions of section 38 of the FDI Act--

(i) Restricting the activities of the national bank or Federal savings association (section 38 (h)(1)); and

(ii) Restricting payments on subordinated debt of the national bank or Federal savings association (section 38 (h)(2)).

(b) Discretionary supervisory actions. In taking any action under section 38 that is within the OCC's discretion to take in connection with a national bank or Federal savings association that is deemed to be undercapitalized, significantly undercapitalized, or critically undercapitalized, or has been reclassified as undercapitalized or significantly undercapitalized; an officer or director of such national bank or Federal savings association; or a company that controls such national bank or Federal savings association, the OCC shall follow the procedures

for issuing directives under subpart B of this part for both national banks and Federal savings associations and subpart N of part 19 of this chapter with respect to national banks and subpart B and 12 CFR § 165.9 with respect to Federal savings associations, unless otherwise provided in section 38 or this part.

Subpart B – Directives to Take Prompt Corrective Action

§ 6.20 Scope.

The rules and procedures set forth in this subpart apply to insured national banks, insured federal branches, Federal savings associations, and senior executive officers and directors of national banks and Federal savings associations that are subject to the provisions of section 38 of the Federal Deposit Insurance Act (section 38) and subpart A of this part.

§ 6.21 Notice of intent to issue a directive.

(a) Notice of intent to issue a directive. (1) In general. The OCC shall provide an undercapitalized, significantly undercapitalized, or critically undercapitalized national bank or Federal savings association prior written notice of the OCC's intention to issue a directive requiring such national bank, Federal savings association, or company to take actions or to follow proscriptions described in section 38 that are within the OCC's discretion to require or impose under section 38 of the FDI Act, including section 38(e)(5), (f)(2), (f)(3), or (f)(5). The national bank or Federal savings association shall have such time to respond to a proposed directive as provided under § 6.22.

(2) Immediate issuance of final directive. If the OCC finds it necessary in order to carry out the purposes of section 38 of the FDI Act, the OCC may, without providing the notice prescribed in paragraph (a)(1) of this section, issue a directive requiring a national bank or Federal savings association immediately to take actions or to follow proscriptions described in section 38 that are within the OCC's discretion to require or impose under section 38 of the FDI Act, including section 38(e)(5), (f)(2), (f)(3), or (f)(5). A national bank or Federal savings association that is subject to such an immediately effective directive may submit a written appeal of the directive to the OCC. Such an appeal must be received by the OCC within 14 calendar days of the issuance of the directive, unless the OCC permits a longer period. The OCC shall consider any such appeal, if filed in a timely matter, within 60 days of receiving the appeal. During such period of review, the directive shall remain in effect unless the OCC, in its sole discretion, stays the effectiveness of the directive.

(b) Contents of notice. A notice of intention to issue a directive shall include:

(1) A statement of the national bank's or Federal savings association’s capital measures and capital levels;

(2) A description of the restrictions, prohibitions or affirmative actions that the OCC proposes to impose or require;

(3) The proposed date when such restrictions or prohibitions would be effective or the proposed date for completion of such affirmative actions; and

(4) The date by which the national bank or Federal savings association subject to the directive may file with the OCC a written response to the notice.

§ 6.22 Response to notice.

(a) Time for response. A national bank or Federal savings association may file a written response to a notice of intent to issue a directive within the time period set by the OCC. The date shall be at least 14 calendar days from the date of the notice unless the OCC determines that a shorter period is appropriate in light of the financial condition of the national bank or Federal savings association or other relevant circumstances.

(b) Content of response. The response should include:

(1) An explanation why the action proposed by the OCC is not an appropriate exercise of discretion under section 38;

(2) Any recommended modification of the proposed directive; and

(3) Any other relevant information, mitigating circumstances, documentation, or other evidence in support of the position of the national bank or Federal savings association regarding the proposed directive.

(c) Failure to file response. Failure by a national bank or Federal savings association to file with the OCC, within the specified time period, a written response to a proposed directive shall constitute a waiver of the opportunity to respond and shall constitute consent to the issuance of the directive.

§ 6.23 Decision and issuance of a prompt corrective action directive.

(a) OCC consideration of response. After considering the response, the OCC may:

(1) Issue the directive as proposed or in modified form;

(2) Determine not to issue the directive and so notify the national bank or Federal savings association; or

(3) Seek additional information or clarification of the response from the national bank or Federal savings association, or any other relevant source.

(b) [Reserved]

§ 6.24 Request for modification or rescission of directive.

Any national bank or Federal savings association that is subject to a directive under this subpart may, upon a change in circumstances, request in writing that the OCC reconsider the terms of the directive, and may propose that the directive be rescinded or modified. Unless otherwise ordered by the OCC, the directive shall continue in place while such request is pending before the OCC.

§ 6.25 Enforcement of directive.

(a) Judicial remedies. Whenever a national bank or Federal savings association fails to comply with a directive issued under section 38, the OCC may seek enforcement of the directive in the appropriate United States district court pursuant to section 8(i)(1) of the FDI Act.

(b) Administrative remedies. Pursuant to section 8(i)(2)(A) of the FDI Act, the OCC may assess a civil money penalty against any national bank or Federal savings association that violates or otherwise fails to comply with any final directive issued under section 38 and against any institution-affiliated party who participates in such violation or noncompliance.

(c) Other enforcement action. In addition to the actions described in paragraphs (a) and (b) of this section, the OCC may seek enforcement of the provisions of section 38 or this part through any other judicial or administrative proceeding authorized by law.

PART 165 – PROMPT CORRECTIVE ACTION

22. The authority citation for part 165 continues to read as follows:

Authority: 12 U.S.C. 1831o, 5412(b)(2)(B).

§§ 165.1 – 165.7, 165.10 [Removed]

23. Sections 165.1 – 165.7 and 165.10 are removed.

§ 165.8 [Amended]

24. Section 165.8 is amended in paragraphs (a)(1)(i)(A) and (a)(1)(ii) by removing the phrases "§ 165.4(c) of this part" and "§ 165.4(c)(1)", and replacing them with the phrase "12 CFR 6.4(d)".

PART 167 [REMOVED]

25. Part 167 is removed.

List of Subjects

Board of Governors of the Federal Reserve System

12 CFR CHAPTER II

Authority and Issuance

For the reasons set forth in the common preamble, parts 208 and 225 of chapter II of title 12 of the Code of Federal Regulations are proposed to be amended as follows:

PART 208 – MEMBERSHIP OF STATE BANKING INSTITUTIONS IN THE FEDERAL RESERVE SYSTEM (REGULATION H)

26. The authority citation for part 208 continues to read as follows:

Authority: 12 U.S.C. 24, 36, 92a, 93a, 248(a), 248(c), 321-338a, 371d, 461, 481-486, 601, 611, 1814, 1816, 1818, 1820(d)(9), 1833(j), 1828(o), 1831, 1831o, 1831p-1, 1831r-1, 1831w, 1831x, 1835a, 1882, 2901-2907, 3105, 3310, 3331-3351, and 3905-3909; 15 U.S.C. 78b, 78I(b), 78l(i), 780-4(c)(5), 78q, 78q-1, and 78w, 1681s, 1681w, 6801, and 6805; 31 U.S.C. 5318; 42 U.S.C. 4012a, 4104a, 4104b, 4106 and 4128.

Subpart A—General Membership and Branching Requirements

27. In § 208.2, revise paragraph (d) to read as follows:

§ 208.2 Definitions.

* * * * *

(d) Capital stock and surplus means, unless otherwise provided in this part, or by statute, tier 1 and tier 2 capital included in a member bank's risk-based capital (as defined in § 217.2 of Regulation Q) and the balance of a member bank's allowance for loan and lease losses not included in its tier 2 capital for calculation of risk-based capital, based on the bank's more recent Report of Condition and Income filed under 12 U.S.C. 324.

* * * * *

28. In § 208.4, revise paragraph (a) and (b) to read as follows:

§208.4 Capital adequacy.

(a) Adequacy. A member bank's capital, calculated in accordance with Part 217, shall be at all times adequate in relation to the character and condition liabilities and other corporate responsibilities. If at any time, in light of all the circumstances, the bank's capital appears inadequate in relation to its assets, liabilities, and responsibilities, the bank shall increase the amount of its capital, within such period as the Board deems reasonable, to an amount which, in the judgment of the Board, shall be adequate.

(b) Standards for evaluating capital adequacy. Standards and measures, by which the Board evaluates the capital adequacy of member banks for risk-based capital purposes and for leverage measurement purposes, are located in Part 217.

* * * * *

Subpart B—Investments and Loans

29. In § 208.23, revise paragraph (c) to read as follows:

§ 208.23 Agricultural loan loss amortization.

* * * * *

(c) Accounting for amortization. Any bank that is permitted to amortize losses in accordance with paragraph (b) of this section may restate its capital and other relevant accounts and account for future authorized deferrals and authorization in accordance with the instructions to the FFIEC Consolidated Reports of Condition and Income. Any resulting increase in the capital account shall be included in capital pursuant to Part 217.

* * * * *

Subpart D—Prompt Corrective Action

30. The authority citation for subpart D continues to read as follows:

Authority: Subpart D of Regulation H (12 CFR part 208, Subpart D) is issued by the Board of Governors of the Federal Reserve System (Board) under section 38 (section 38) of the FDI Act as added by section 131 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (Pub. L. 102-242, 105 Stat. 2236 (1991)) (12 U.S.C. 1831o).

31. Revise § 208.41 to read as follows:

§ 208.41 Definitions for purposes of this subpart.

* * * * *

(a) Advanced approaches bank means a bank that is described in § 217.100(b)(1) of Regulation Q (12 CFR 217.100(b)(1)).

(b) Bank means an insured depository institution as defined in section 3 of the FDI Act (12 U.S.C. 1813).

(c) Common equity tier 1 capital means the amount of capital as defined in § 217.2 of Regulation Q (12 CFR 217.2).

(d) Common equity tier 1 risk-based capital ratio means the ratio of common equity tier 1 capital to total risk-weighted risk assets, as calculated in accordance with § 217.10(b)(1) or § 217.10(c)(1) of Regulation Q (12 CFR 217.10(b)(1), 12 CFR 217.10(c)(1)), as applicable.

(e) Control—(1) Control has the same meaning assigned to it in section 2 of the Bank Holding Company Act (12 U.S.C. 1841), and the term controlled shall be construed consistently with the term control.

(2) Exclusion for fiduciary ownership. No insured depository institution or company controls another insured depository institution or company by virtue of its ownership or control of shares in a fiduciary capacity. Shares shall not be deemed to have been acquired in a fiduciary capacity if the acquiring insured depository institution or company has sole discretionary authority to exercise voting rights with respect to the shares.

(3) Exclusion for debts previously contracted. No insured depository institution or company controls another insured depository institution or company by virtue of its ownership or control of shares acquired in securing or collecting a debt previously contracted in good faith, until two years after the date of acquisition. The two-year period may be extended at the discretion of the appropriate Federal banking agency for up to three one-year periods.

(f) Controlling person means any person having control of an insured depository institution and any company controlled by that person.

(g) Management fee means any payment of money or provision of any other thing of value to a company or individual for the provision of management services or advice to the bank, or related overhead expenses, including payments related to supervisory, executive, managerial, or policy making functions, other than compensation to an individual in the individual's capacity as an officer or employee of the bank.

(h) Leverage ratio means the ratio of tier 1 capital to average total consolidated assets, as calculated in accordance with § 217.10 of Regulation Q (12 CFR 217.10).

(i) Supplementary leverage ratio means the ratio of tier 1 capital to total leverage exposure, as calculated in accordance with § 217.10 of Regulation Q (12 CFR 217.10).

(j) Tangible equity means the amount of tier 1 capital, plus the amount of outstanding perpetual preferred stock (including related surplus) not included in tier 1 capital.

(k) Tier 1 capital means the amount of capital as defined in § 217.20 of Regulation Q (12 CFR 217.20).

(l) Tier 1 risk-based capital ratio means the ratio of tier 1 capital to total risk-weighted assets, as calculated in accordance with § 217.10(b)(2) or § 217.10(c)(2) of Regulation Q (12 CFR 217.10(b)(2), 12 CFR 217.10(c)(2)), as applicable.

(m) Total assets means quarterly average total assets as reported in a bank's Report of Condition and Income (Call Report), minus items deducted from tier 1 capital. At its discretion the Federal Reserve may calculate total assets using a bank's period-end assets rather than quarterly average assets.

(n) Total leverage exposure means the total leverage exposure, as calculated in accordance with § 217.11 of Regulation Q (12 CFR 217.11).

(o) Total risk-based capital ratio means the ratio of total capital to total risk-weighted assets, as calculated in accordance with § 217.10(b)(3) or § 217.10(c)(3) of Regulation Q (12 CFR 217.10(b)(3), 12 CFR 217.10(c)(3)), as applicable.

(p) Total risk-weighted assets means standardized total risk-weighted assets, and for an advanced approaches bank also includes advanced approaches total risk-weighted assets, as defined in § 217.2 of Regulation Q (12 CFR 217.2).

* * * * *

32. In § 208.43, amend paragraphs (a) – (b) and redesignate paragraph (c) as paragraph (d) to read as follows:

§ 208.43 Capital measures and capital category definitions.

(a) Capital measures. (1) Capital measures applicable before January 1, 2015. On or before December 31, 2014, for purposes of section 38 and this subpart, the relevant capital measures for all banks are:

(i) Total Risk-Based Capital Measure: the total risk-based capital ratio;

(ii) Tier 1 Risk-Based Capital Measure: the tier 1 risk-based capital ratio; and

(iii) Leverage Measure: the leverage ratio.

(2) Capital measures applicable on and after January 1, 2015. On January 1, 2015 and thereafter, for purposes of section 38 and this subpart, the relevant capital measures are:

(i) Total Risk-Based Capital Measure: the total risk-based capital ratio;

(ii) Tier 1 Risk-Based Capital Measure: the tier 1 risk-based capital ratio;

(iii) Common Equity Tier 1 Capital Measure: the common equity tier 1 risk-based capital ratio; and

(iv) Leverage Measure: (A) the leverage ratio, and (B) with respect to an advanced approaches bank, on January 1, 2018, and thereafter, the supplementary leverage ratio.

(b) Capital categories applicable before January 1, 2015. On or before December 31, 2014, for purposes of section 38 of the FDI Act and this subpart, a member bank is deemed to be:

(1) "Well capitalized" if:

(i) Total Risk-Based Capital Measure: the bank has a total risk-based capital ratio of 10.0 percent or greater;

(ii) Tier 1 Risk-Based Capital Measure: the bank has a tier 1 risk-based capital ratio of 6.0 percent or greater;

(iii) Leverage Measure: the bank has a leverage ratio of 5.0 percent or greater; and

(iv) The bank is not subject to any written agreement, order, capital directive, or prompt corrective action directive issued by the Board pursuant to section 8 of the FDI Act, the International Lending Supervision Act of 1983 (12 U.S.C. 3907), or section 38 of the FDI Act, or any regulation thereunder, to meet and maintain a specific capital level for any capital measure.

(2) "Adequately capitalized" if:

(i) Total Risk-Based Capital Measure: the bank has a total risk-based capital ratio of 8.0 percent or greater;

(ii) Tier 1 Risk-Based Capital Measure: the bank has a tier 1 risk-based capital ratio of 4.0 percent or greater;

(iii) Leverage Measure:

(A) The bank has a leverage ratio of 4.0 percent or greater; or

(B) The bank has a leverage ratio of 3.0 percent or greater if the bank is rated composite 1 under the CAMELS rating system in the most recent examination of the bank and is not experiencing or anticipating any significant growth; and

(iv) Does not meet the definition of a "well capitalized" bank.

(3) "Undercapitalized" if:

(i) Total Risk-Based Capital Measure: the bank has a total risk-based capital ratio of less than 8.0 percent; or

(ii) Tier 1 Risk-Based Capital Measure: the bank has a tier 1 risk-based capital ratio of less than 4.0 percent; or

(iii) Leverage Measure:

(A) Except as provided in paragraph (b)(2)(iii)(B) of this section, the bank has a leverage ratio of less than 4.0 percent; or

(iv) The bank has a leverage ratio of less than 3.0 percent, if the bank is rated composite 1 under the CAMELS rating system in the most recent examination of the bank and is not experiencing or anticipating significant growth.

(4) "Significantly undercapitalized" if:

(i) Total Risk-Based Capital Measure: the bank has a total risk-based capital ratio of less than 6.0 percent; or

(ii) Tier 1 Risk-Based Capital Measure: the bank has a tier 1 risk-based capital ratio of less than 3.0 percent; or

(iii) Leverage Measure: the bank has a leverage ratio of less than 3.0 percent.

(5) "Critically undercapitalized" if the bank has a ratio of tangible equity to total assets that is equal to or less than 2.0 percent.

(c) Capital categories applicable on and after January 1, 2015. On January 1, 2015, and thereafter, for purposes of section 38 and this subpart, a member bank is deemed to be:

(1) "Well capitalized" if:

(i) Total Risk-Based Capital Measure: the bank has a total risk-based capital ratio of 10.0 percent or greater;

(ii) Tier 1 Risk-Based Capital Measure: the bank has a tier 1 risk-based capital ratio of 8.0 percent or greater;

(iii) Common Equity Tier 1 Capital Measure: the bank has a common equity tier 1 risk-based capital ratio of 6.5 percent or greater;

(iv) Leverage Measure: the bank has a leverage ratio of 5.0 or greater; and

(iv) The bank is not subject to any written agreement, order, capital directive, or prompt corrective action directive issued by the Board pursuant to section 8 of the FDI Act, the International Lending Supervision Act of 1983 (12 U.S.C. 3907), or section 38 of the FDI Act, or any regulation thereunder, to meet and maintain a specific capital level for any capital measure.

(2) "Adequately capitalized" if:

(i) Total Risk-Based Capital Measure: the bank has a total risk-based capital ratio of 8.0 percent or greater;

(ii) Tier 1 Risk-Based Capital Measure: the bank has a tier 1 risk-based capital ratio of 6.0 percent or greater;

(iii) Common Equity Tier 1 Capital Measure: the bank has a common equity tier 1 risk-based capital ratio of 4.5 percent or greater;

(iv) Leverage Measure:

(A) The bank has a leverage ratio of 4.0 percent or greater; and

(B) With respect to an advanced approaches bank, on January 1, 2018 and thereafter, the bank has a supplementary leverage ratio of 3.0 percent or greater; and

(v) The bank does not meet the definition of a "well capitalized" bank.

(3) "Undercapitalized" if:

(i) Total Risk-Based Capital Measure: the bank has a total risk-based capital ratio of less than 8.0 percent;

(ii) Tier 1 Risk-Based Capital Measure: the bank has a tier 1 risk-based capital ratio of less than 6.0 percent;

(iii) Common Equity Tier 1 Capital Measure: the bank has a common equity tier 1 risk-based capital ratio of less than 4.5 percent; or

(iv) Leverage Measure: (A) The bank has a leverage ratio of less than 4.0 percent; or

(B) With respect to an advanced approaches bank, on January 1, 2018, and thereafter, the bank has a supplementary leverage ratio of less than 3.0 percent.

(4) "Significantly undercapitalized" if:

(i) Total Risk-Based Capital Measure: the bank has a total risk-based capital ratio of less than 6.0 percent;

(ii) Tier 1 Risk-Based Capital Measure: the bank has a tier 1 risk-based capital ratio of less than 4.0 percent;

(iii) Common Equity Tier 1 Capital Measure: the bank has a common equity tier 1 risk-based capital ratio of less than 3.0 percent; or

(iv) Leverage Measure: the bank has a leverage ratio of less than 3.0 percent.

(5) "Critically undercapitalized" if the bank has a ratio of tangible equity to total assets that is equal to or less than 2.0 percent.

* * * * *

Subpart G—Financial Subsidiaries of State Member Banks

33. In § 208.73, revise paragraph (a) to read as follows:

§ 208.73 What additional provisions are applicable to state member banks with financial subsidiaries?

(a) Capital deduction required. A state member bank that controls or holds an interest in a financial subsidiary must comply with the rules set forth in § 217.22(a)(7) of Regulation Q in determining its compliance with applicable regulatory capital standards (including the well capitalized standard of § 208.71(a)(1)).

* * * * *

34. In § 208.77, remove and reserve paragraph (c).

* * * * *

Appendix A to Part 208—Capital Adequacy Guidelines for State Member Banks: Risk-Based Measure

35. On January 1, 2015, appendix A to part 208 is removed and reserved.

* * * * *

Appendix B to Part 208—Capital Adequacy Guidelines for State Member Banks: Tier 1 Leverage Measure

36. Appendix B to part 208 is removed and reserved.

* * * * *

Appendix C to Part 208—Interagency Guidelines For Real Estate Lending Policies

37. Note 2 is revised to read as follows:

* * * * *

[2] For the state member banks, the term "total capital" refers to that term as defined in subpart A of part 217. For insured state non-member banks and state savings associations, "total capital" refers to that term defined in subpart A of part 324. For national banks and Federal savings associations, the term "total capital" refers to that term as defined in subpart A of part 3.

* * * * *

Appendix E to Part 208—Capital Adequacy Guidelines for State Member Banks: Market-Risk Measure

38. Appendix E to part 208 is removed and reserved.

* * * * *

Appendix F to Part 208—Capital Adequacy Guidelines for State Banks: Internal-Ratings-Based and Advanced Measurement Approach

39. Appendix F to part 208 is removed and reserved.

* * * * *

40. Add new part 217 to read as follows:

PART 217 – CAPITAL ADEQUACY OF BANK HOLDING COMPANIES, SAVINGS AND LOAN HOLDING COMPANIES, AND STATE MEMBER BANKS

a. The authority citation for part 217 shall read as follows:

Authority: 12 U.S.C. 248(a), 321–338a, 481-486, 1462a, 1467a, 1818, 1828, 1831n, 1831o, 1831p–l, 1831w, 1835, 1844(b), 3904, 3906-3909, 4808, 5365, 5371.

b. Part 217 is added as set forth at the end of the common preamble.

c. Part 217 is amended as set forth below:

i. Remove "[AGENCY]" and add "Board" in its place wherever it appears.

ii. Remove "[BANK]" and add "Board-regulated institution" in its place wherever it appears.

iii. Remove "[PART]" and add "part" wherever it appears.

iv. In section 217.1, add new paragraph (c)(1), renumber the subsections in paragraph (c) accordingly, and revise paragraph (e) to read as follows:

* * * * *

§ 217.1 Purpose, Applicability, and Reservations of Authority.

* * * * *

(c)(1) Scope. This part applies to every Board-regulated institution that is:

(A) A state member bank;

(B) A top-tier bank holding company domiciled in the United States that is not subject to 12 CFR part 225, Appendix C, provided that the Board may by order subject any bank holding company to this part, in whole or in part, based on the institution's size, level of complexity, risk profile, scope of operations, or financial condition; or

(C) A top-tier savings and loan holding company domiciled in the United States.

* * * * *

(e) Notice and response procedures. In making a determination under this section, the Board will apply notice and response procedures in the same manner and to the same extent as the notice and response procedures in 12 CFR 263.202.

* * * * *

v. In section 217.2, add definitions of Board, Board-regulated institution, non-guaranteed separate account, policy loan, separate account, state bank, and state member bank or member bank; add paragraphs (12) and (13) to the definition of corporate exposure, and revise paragraph (2)(i) of the definition of high volatility commercial real estate (HVCRE) exposure, paragraph (4) of the definition of pre-sold construction loan, total leverage exposure to read as follows:

* * * * *

§ 217.2 Definitions

* * * * *

Board means the Board of Governors of the Federal Reserve System**.**

* * * * *

Board-regulated institution means a state member bank, bank holding company, or savings and loan holding company.

* * * * *

Corporate exposure * * *

(12) A policy loan; or

(13) A separate account.

* * * * *

Gain-on-sale means an increase in the equity capital of a Board-regulated institution (as reported on Schedule RC of the Call Report, for a state member bank, or Schedule HC of the FR Y–9C, for a bank holding company or savings and loan holding company,[1] as applicable) resulting from a securitization (other than an increase in equity capital resulting from the [BANK]'s receipt of cash in connection with the securitization).

* * * * *

High volatility commercial real estate (HVCRE) exposure * * *

[1] Savings and loan holding companies that do not file the FR Y-9C should follow the instructions to the FR Y-9C.

(2) * * *

(i) The loan-to-value ratio is less than or equal to the applicable maximum supervisory loan-to-value ratio in the Board's real estate lending standards at 12 CFR part 208, Appendix C;

* * * * *

Non-guaranteed separate account means a separate account where the insurance company:

(i) Does not contractually guarantee either a minimum return or account value to the contract holder; and

(ii) Is not required to hold reserves (in the general account) pursuant to its contractual obligations to a policyholder.

* * * * *

Policy loan means a loan by an insurance company to a policy holder pursuant to the provisions of an insurance contract that is secured by the cash surrender value or collateral assignment of the related policy or contract. A policy loan includes:

(1) A cash loan, including a loan resulting from early payment benefits or accelerated payment benefits, on an insurance contract when the terms of contract specify that the payment is a policy loan secured by the policy; and

(2) An automatic premium loan, which is a loan that is made in accordance with policy provisions which provide that delinquent premium payments are automatically paid from the cash value at the end of the established grace period for premium payments.

* * * * *

Pre-sold construction loan means * * * * *

(4) The purchaser has not terminated the contract; however, if the purchaser terminates the sales contract, the Board must immediately apply a 100 percent risk weight to the loan and report the revised risk weight in the next quarterly Call Report, for a state member bank, or the FR Y-9C, for a bank holding company or savings and loan holding company, as applicable,

* * * * *

Separate account means a legally segregated pool of assets owned and held by an insurance company and maintained separately from the insurance company's general account assets for the benefit of an individual contract holder. To be a separate account:

(i) The account must be legally recognized under applicable law;

(ii) The assets in the account must be insulated from general liabilities of the insurance company under applicable law in the event of the company's insolvency;

(iii) The insurance company must invest the funds within the account as directed by the contract holder in designated investment alternatives or in accordance with specific investment objectives or policies, and

(iv) All investment gains and losses, net of contract fees and assessments, must be passed through to the contract holder, provided that the contract may specify conditions under which there may be a minimum guarantee but must not include contract terms that limit the maximum investment return available to the policyholder.

* * * * *

State bank means any bank incorporated by special law of any State, or organized under the general laws of any State, or of the United States, including a Morris Plan bank, or other

incorporated banking institution engaged in a similar business.

* * * * *

State member bank or member bank means a state bank that is a member of the Federal Reserve System.

* * * * *

Total leverage exposure * * * * *

(1) The balance sheet carrying value of all of the Board-regulated institution's on-balance sheet assets, as reported on the Call Report, for a state member bank, or the FR Y-9C, for a bank holding company or savings and loan holding company[2], as applicable, less amounts deducted from tier 1 capital under section 217.22;

* * * * *

vi. In section 217.10, revise paragraph (b)(4) to read as follows:

* * * * *

§217.10 Minimum Capital Requirements

(b) * * * * *

(4) A Board-regulated institution's leverage ratio is the ratio of the Board-regulated institution's tier 1 capital to its average consolidated assets as reported on the Call Report, for a

[2] Savings and loan holding companies that do not file the FR Y-9C should follow the instructions to the FR Y-9C.

state member bank, or FR Y-9C, for a bank holding company or savings and loan holding company[3], as applicable, less amounts deducted from tier 1 capital.

* * * * *

viii. In section 271.12, revise paragraphs (a)(2)(i) and (3) as follows

§217.11 Capital Conservation Buffer and Countercyclical Capital Buffer Amount

* * * * *

(a) * * * * *

(2) Definitions. * * * * *

(i) Eligible retained income. The eligible retained income of a Board-regulated institution is the Board-regulated institution's net income for the four calendar quarters preceding the current calendar quarter, based on the Board-regulated institution's most recent quarterly Call Report, for a state member bank, or the FR Y-9C, for a bank holding company or savings and loan holding company, as applicable, net of any capital distributions and associated tax effects not already reflected in net income.[4]

* * * * *

(3) Calculation of capital conservation buffer. A Board-regulated institution's capital conservation buffer is equal to the lowest of the following ratios, calculated as of the last day of the previous calendar quarter based on the Board-regulated institution's most recent Call Report, for a state member bank, or the FR Y-9C, for a bank holding company or savings and loan holding company,[5] as applicable:

*****

ix. In section 217.22, revise paragraph (a)(7) and add paragraph (b)(3) to read as follows:

§ 217. 22 – Regulatory Capital Adjustments and Deductions.

(a) *****

[3] Savings and loan holding companies that do not file the FR Y-9C should follow the instructions to the FR Y-9C.

[4] Savings and loan holding companies that do not file FR Y-9C should follow the instructions to the FR Y-9C. Net income, as reported in the Call Report or the FR Y-9C, as applicable, reflects discretionary bonus payments and certain capital distributions that are expense items (and their associated tax effects).

[5] Savings and loan holding companies that do not file FR Y-9C should follow the instructions to the FR Y-9C.

(7) Financial subsidiaries. (i) A state member bank must deduct the aggregate amount of its outstanding equity investment, including retained earnings, in its financial subsidiaries (as defined in 12 CFR 208.77) and may not consolidate the assets and liabilities of a financial subsidiary with those of the state member bank.

(ii) No other deduction is required under section 217.22(c) for investments in the capital instruments of financial subsidiaries.

* * * * *

(b) * * *

(3) Regulatory capital requirement of insurance underwriting subsidiary. A bank holding company or savings and loan holding company must deduct an amount equal to the minimum regulatory capital requirement established by the regulator of any insurance underwriting subsidiary of the holding company. For U.S.-based insurance underwriting subsidiaries, this amount generally would be 200 percent of the subsidiary's Authorized Control Level as established by the appropriate state regulator of the insurance company. The bank holding company or savings and loan holding company must take the deduction 50 percent from tier 1 capital and 50 percent from tier 2 capital. If the amount deductible from tier 2 capital exceeds the Board regulated institution's tier 2 capital, the Board regulated institution must deduct the excess from tier 1 capital.

* * * * *

x. In section 217.300, revise paragraph (c)(3) and add new paragraph (f) to read as follows:

* * * * *

§ 217. 300 Transitions

* * * * *

(3) Transition adjustments to AOCI. From January 1, 2013 through December 31, 2017, a Board-regulated institution must adjust common equity tier 1 capital with respect to the aggregate amount of (i) unrealized gains on AFS equity securities, plus (ii) net unrealized gains or losses on AFS debt securities, plus (iii) accumulated net unrealized gains and losses on defined benefit pension obligations, plus (iv) accumulated net unrealized gains or losses on cash flow hedges related to items that are reported on the balance sheet at fair value included in AOCI (the transition AOCI adjustment amount) as reported on the Board-regulated institution's most

recent Call Report, for a state member bank, or the FR Y-9C, for a bank holding company or savings and loan holding company,[6] as applicable, as follows:

* * * * *

(f) Until July 21, 2015, this part will not apply to any bank holding company subsidiary of a foreign banking organization that is currently relying on Supervision and Regulation Letter SR 01–01 issued by the Board (as in effect on May 19, 2010).

* * * * *

PART 225 – BANK HOLDING COMPANIES AND CHANGE IN BANK CONTROL (REGULATION Y)

41. The authority citation for part 225 continues to read as follows:

Authority: 12 U.S.C. 1817(j)(13), 1818, 1828(o), 1831i, 1831p-1,

1843(c)(8), 1844(b), 1972(1), 3106, 3108, 3310, 3331-3351, 3907, and

3909; 15 U.S.C. 1681s, 1681w, 6801 and 6805.

Subpart A—General Provisions

42. In § 225.1, on January 1, 2015, revise paragraphs (c)(12) through (c)(15) to read as follows:

§ 225.1 Authority, purpose, and scope.

* * * * *

(c) Scope * * *

(12) [Reserved]

* * *

(14) [Reserved]

(15) [Reserved]

* * * * *

43. In § 225.2, revise paragraph (r) to read as follows:

§ 225.2 Definitions.

* * * * *

(r) Well-capitalized—(1) Bank holding company. * * *

(i) On a consolidated basis, the bank holding company maintains a total risk-based capital ratio of 10.0 percent or greater, as defined in section 217.10;

[6] Savings and loan holding companies that do not file FR Y-9C should follow the instructions to the FR Y-9C.

(ii) On a consolidated basis, the bank holding company maintains a tier 1 risk-based capital ratio of 6.0 percent or greater, as defined in section 217.10; and

(iii) * * *

* * * * *

44. In § 225.4, revise paragraph (b) to read as follows:

§ 225.4 Corporate Practices.

* * * * *

(b) Purchase or redemption by bank holding company of its own securities.

(1)-(3) * * *

(4) Factors considered in acting on notice.

(i) * * *

(ii) In determining whether a proposal constitutes an unsafe or unsound practice, the Board shall consider whether the bank holding company's financial condition, after giving effect to the proposed purchase or redemption, meets the financial standards applied by the Board under section 3 of the BHC Act, including Part 217 and the Board's Policy Statement for Small Bank Holding Companies (appendix C of this part).

* * * * *

45. In § 225.8, revise paragraph (c) to read as follows:

§ 225.8 Capital Planning.

* * * * *

(c) Definitions. * * *

(1)-(4) * * *

(5) Minimum regulatory capital ratio means any minimum regulatory capital ratio that the Federal Reserve may require of a bank holding company, by regulation or order, including any minimum capital ratio required under section 217.10(a), or any successor regulation.

(6) * * *

(7) Tier 1 capital has the same meaning as under section 217.2 or any successor regulation.

(8) Tier 1 common capital means tier 1 capital less the non-common elements of tier 1 capital, including perpetual preferred stock and related surplus, minority interest in subsidiaries, trust preferred securities and mandatory convertible preferred securities.

(9) Tier 1 common ratio means the ratio of a bank holding company's tier 1 common capital to total risk-weighted assets. This definition will remain in effect until the Board adopts an alternative tier 1 common ratio definition as a minimum regulatory capital ratio.

(10) Total risk-weighted assets has the same meaning as under section 217.2 or any successor regulation.

* * * * *

Subpart B—Acquisition of Bank Securities or Assets

46. In § 225.12, revise paragraph (d) to read as follows:

§ 225.12 Transactions not requiring Board approval.

* * * * *

(d) Acquisitions involving bank mergers and internal corporate reorganizations

(1) * * *

(2) Certain acquisitions subject to Bank Merger Act. * * *

(i)-(iii) * * *

(iv) Both before and after the transaction, the acquiring bank holding company meets the requirements of Part 217;

* * * * *

Subpart C—Nonbanking Activities and Acquisitions by Bank Holding Companies

47. In § 225.22, revise paragraph (d) to read as follows:

§ 225.22 Exempt nonbanking activities and acquisitions.

* * * * *

(d) Nonbanking acquisitions not requiring prior Board approval. * * *

(1)-(7) * * *

(8) Asset acquisitions by lending company or industrial bank. * * *

(i)-(iv) * * *

(v) The acquiring company, after giving effect to the transaction, meets the requirements of Part 217, and the Board has not previously notified the acquiring company that it may not acquire assets under the exemption in this paragraph.

* * * * *

Subpart J—Merchant Banking Investments

48. In § 225.172, revise paragraph (b) to read as follows:

§ 225.22 What are the holding periods permitted for merchant banking investments?

* * * * *

(b) What period of time is generally permitted for holding merchant banking investments?

(1)-(5) * * *

(6) Restrictions applicable to investments held beyond time period. * * *

(i) * * *

(A) Higher than the maximum marginal tier 1 capital charge applicable under Part 217 to merchant banking investments held by that financial holding company; and

(B) * * *

* * * * *

Appendix A to Part 225—Capital Adequacy Guidelines for Bank Holding Companies: Risk-Based Measure

49. On January 1, 2015, appendix A to part 225 is removed and reserved.

* * * * *

Appendix B to Part 225—Capital Adequacy Guidelines for Bank Holding Companies and State Member Banks: Leverage Measure

50. Appendix B to part 225 is removed and reserved.

* * * * *

Appendix D to Part 225—Capital Adequacy Guidelines for Bank Holding Companies: Tier 1 Leverage Measure

51. Appendix D to part 225 is removed and reserved.

* * * * *

Appendix E to Part 225—Capital Adequacy Guidelines for Bank Holding Companies: Market Risk Measure

52. Appendix E to part 225 is removed and reserved.

* * * * *

Appendix G to Part 225—Capital Adequacy Guidelines for Bank Holding Companies: Internal-Ratings-Based and Advanced Measurement Approaches

53. Appendix G to part 225 is removed and reserved.

Federal Deposit Insurance Corporation

12 CFR Chapter III

Authority and Issuance

For the reasons set forth in the common preamble, the Federal Deposit Insurance Corporation amends part 324 to chapter III of title 12 of the Code of Federal Regulations as follows:

PART 324 – CAPITAL ADEQUACY

54. The authority citation for part 324 is as follows:

Authority: 12 U.S.C. 1815(a), 1815(b), 1816, 1818(a), 1818(b), 1818(c), 1818(t), 1819(Tenth), 1828(c), 1828(d), 1828(i), 1828(n), 1828(o), 1831o, 1835, 3907, 3909, 4808; 5371; 5412; Pub. L. 102-233, 105 Stat. 1761, 1789, 1790 (12 U.S.C. 1831n note); Pub. L. 102-242, 105 Stat. 2236, 2355, as amended by Pub. L. 103-325, 108 Stat. 2160, 2233 (12 U.S.C. 1828 note); Pub. L. 102-242, 105 Stat. 2236, 2386, as amended by Pub. L. 102-550, 106 Stat. 3672, 4089 (12 U.S.C. 1828 note); Pub. L. 111-203, 124 Stat. 1376, 1887 (15 U.S.C. 78o-7 note).

55. Subparts A, B, C, and G of part 324 are added as set forth at the end of the common preamble.

56. Subparts A, B, C, and G of part 324 are amended as set forth below:

a. Remove “[AGENCY]” and add “FDIC” in its place, wherever it appears;

b. Remove “[BANK]” and add “bank and state savings association” in its place, wherever it appears in the phrase “Each [BANK]” or “each [BANK]”;

c. Remove “[BANK]” and add “bank or state savings association” in its place, wherever it appears in the phrases “A [BANK]”, “a [BANK]”, “The [BANK]”, or “the [BANK]”;

d. Remove "[BANKS]" and add "banks and state savings associations" in its place, wherever it appears;

e. Remove "[PART]" and add "Part 324" in its place, wherever it appears;

f. Remove "[AGENCY]" and add "FDIC" in its place, wherever it appears; and

g. Remove "[REGULATORY REPORT]" and add "Call Report" in its place, wherever it appears.

57. New § 324.2 is amended by adding the following definitions in alphabetical order:

* * * * *

Bank means an FDIC-insured, state-chartered commercial or savings bank that is not a member of the Federal Reserve System and for which the FDIC is the appropriate federal banking agency pursuant to section 3(q) of the Federal Deposit Insurance Act (12 U.S.C. 1813(q)).

* * * * *

Core capital means Tier 1 capital, as defined in § 324.2 of subpart A of this part.

* * * * *

State savings association means a State savings association as defined in section 3(b)(3) of the Federal Deposit Insurance Act (12 U.S.C. 1813(b)(3)), the deposits of which are insured by the Corporation. It includes a building and loan, savings and loan, or homestead association, or a cooperative bank (other than a cooperative bank which is a State bank as defined in section 3(a)(2) of the Federal Deposit Insurance Act) organized and operating according to the laws of the State in which it is chartered or organized, or a corporation (other than a bank as defined in section 3(a)(1) of the Federal Deposit Insurance Act) that the Board of Directors of the Federal Deposit Insurance Corporation determine to be operating substantially in the same manner as a State savings association.

* * * * *

Tangible capital means the amount of core capital (Tier 1 capital), as defined in accordance with § 324.2 of subpart A of this part, plus the amount of outstanding perpetual preferred stock (including related surplus) not included in Tier 1 capital.

* * * * *

Tangible equity means the amount of Tier 1 capital, as calculated in accordance with § 324.2 of subpart A of this chapter, plus the amount of outstanding perpetual preferred stock (including related surplus) not included in Tier 1 capital.

* * * * *

58. New § 324.10 is amended by adding paragraphs (a)(6), (b)(5), and (c)(5) to read as follows:

§ 324.10 Minimum Capital Requirements.

(a) * * *

(6) For state savings associations, a tangible capital ratio of 1.5 percent.

(b) * * *

(5) State savings association tangible capital ratio. A state savings association's tangible capital ratio is the ratio of the state savings association's core capital (Tier 1 capital) to total adjusted assets as calculated under section § 390.461.

(c) * * *

(5) State savings association tangible capital ratio. A state savings association's tangible capital ratio is the ratio of the state savings association's core capital (Tier 1 capital) to total adjusted assets as calculated under section § 390.461.

* * * * *

59. New § 324.22 is amended to add new paragraph (a)(7), to read as follows:

(7) (i) A state savings association must deduct the aggregate amount of its outstanding investments, (both equity and debt) as well as retained earnings in subsidiaries that are not includable subsidiaries as defined in paragraph 7(iv) of this section (including those subsidiaries where the state savings association has a minority ownership interest) and may not consolidate the assets and liabilities of the subsidiary with those of the state savings association. Any such deductions shall be deducted from common equity tier 1 capital, except as provided in paragraphs (a)(7)(ii) and (a)(7)(iii) of this section.

(ii) If a state savings association has any investments (both debt and equity) in one or more subsidiaries engaged in any activity that would not fall within the scope of activities in which includable subsidiaries as defined in paragraph 7(iv) of this section may engage, it must deduct such investments from assets and common equity tier 1 capital in accordance with this paragraph (c)(7)(i). The state savings association must first deduct from assets and common equity tier 1 capital the amount by which any investments in such subsidiary(ies) exceed the amount of such investments held by the state savings association as of April 12, 1989. Next the state savings association must deduct from assets and common equity tier 1 the state savings association's investments in and extensions of credit to the subsidiary on the date as of which the state savings association's capital is being determined.

(iii) If a state savings association holds a subsidiary (either directly or through a subsidiary) that is itself a [insured] domestic depository institution, the FDIC may, in its sole discretion upon determining that the amount of common equity tier 1 capital that would be required would be higher if the assets and liabilities of such subsidiary were consolidated with

those of the parent state savings association than the amount that would be required if the parent state savings association's investment were deducted pursuant to paragraphs (c)(6)(i) and (c)(6)(ii) of this section, consolidate the assets and liabilities of that subsidiary with those of the parent state savings association in calculating the capital adequacy of the parent state savings association, regardless of whether the subsidiary would otherwise be an includable subsidiary as defined in paragraph 7(iv) of this section.

(iv) For purposes of this section, the term includable subsidiary means a subsidiary of a state savings association that is:

(A) Engaged solely in activities that are permissible for a national bank;

(B) Engaged in activities not permissible for a national bank, but only if acting solely as agent for its customers and such agency position is clearly documented in the state savings association's files;

(C) Engaged solely in mortgage-banking activities;

(D)(i) Itself an insured depository institution or a company the sole investment of which is an insured depository institution, and

(ii) Was acquired by the parent state savings association prior to May 1, 1989; or

(E) A subsidiary of any state savings association existing as a state savings association on August 9, 1989 that

(i) Was chartered prior to October 15, 1982, as a savings bank or a cooperative bank under state law, or

(ii) Acquired its principal assets from an association that was chartered prior to October 15, 1982, as a savings bank or a cooperative bank under state law.

* * * * *

60. Subpart H is added to part 324 to read as follows:

Subpart H – Prompt Corrective Action

§ 324.301 Authority, purpose, scope, other supervisory authority, and disclosure of capital categories.

(a) Authority. This subpart is issued by the FDIC pursuant to section 38 (section 38) of the Federal Deposit Insurance Act (FDI Act), as added by section 131 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (Pub.L. 102-242, 105 Stat. 2236 (1991)) (12 U.S.C. 1831o).

(b) Purpose. Section 38 of the FDI Act establishes a framework of supervisory actions for insured depository institutions that are not adequately capitalized. The principal purpose of this

subpart is to define, for FDIC-insured state-chartered nonmember banks and state-chartered savings associations, the capital measures and capital levels, and for insured branches of foreign banks, comparable asset-based measures and levels, that are used for determining the supervisory actions authorized under section 38 of the FDI Act. This subpart also establishes procedures for submission and review of capital restoration plans and for issuance and review of directives and orders pursuant to section 38.

(c) Scope. Until January 1, 2015, subpart B of part 325 of this chapter will continue to apply to FDIC-insured state-chartered nonmember banks and insured branches of foreign banks for which the FDIC is the appropriate Federal banking agency. Until January 1, 2015, subpart Y of part 390 of this chapter will continue to apply to state savings associations. As of January 1, 2015, this subpart implements the provisions of section 38 of the FDI Act as they apply to FDIC-insured state-chartered nonmember banks, state savings associations, and insured branches of foreign banks for which the FDIC is the appropriate Federal banking agency. Certain of these provisions also apply to officers, directors and employees of those insured institutions. In addition, certain provisions of this subpart apply to all insured depository institutions that are deemed critically undercapitalized.

(d) Other supervisory authority. Neither section 38 nor this subpart in any way limits the authority of the FDIC under any other provision of law to take supervisory actions to address unsafe or unsound practices, deficient capital levels, violations of law, unsafe or unsound conditions, or other practices. Action under section 38 of the FDI Act and this subpart may be taken independently of, in conjunction with, or in addition to any other enforcement action available to the FDIC, including issuance of cease and desist orders, capital directives, approval or denial of applications or notices, assessment of civil money penalties, or any other actions authorized by law.

(e) Disclosure of capital categories. The assignment of a bank, a state savings association, or an insured branch under this subpart within a particular capital category is for purposes of implementing and applying the provisions of section 38. Unless permitted by the FDIC or otherwise required by law, no bank or state savings association may state in any advertisement or promotional material its capital category under this subpart or that the FDIC or any other federal banking agency has assigned the bank or state savings association to a particular capital category.

§ 324.302 Notice of capital category.

(a) Effective date of determination of capital category. A bank or state savings association shall be deemed to be within a given capital category for purposes of section 38 of the FDI Act and this subpart as of the date the bank or state savings association is notified of, or is deemed to have notice of, its capital category, pursuant to paragraph (b) of this section.

(b) Notice of capital category. A bank or state savings association shall be deemed to have been notified of its capital levels and its capital category as of the most recent date:

(1) A Consolidated Report of Condition and Income or Thrift Financial Report (Call Report) is required to be filed with the FDIC;

(2) A final report of examination is delivered to the bank or state savings association; or

(3) Written notice is provided by the FDIC to the bank or state savings association of its capital category for purposes of section 38 of the FDI Act and this subpart or that the bank's or state savings association's capital category has changed as provided in § 324.303(d).

(c) Adjustments to reported capital levels and capital category--

(1) Notice of adjustment by bank or state savings association. A bank or state savings association shall provide the appropriate FDIC regional director with written notice that an adjustment to the bank's or state savings association's capital category may have occurred no later than 15 calendar days following the date that any material event has occurred that would cause the bank or state savings association to be placed in a lower capital category from the category assigned to the bank or state savings association for purposes of section 38 and this subpart on the basis of the bank's or state savings association's most recent Call Report or report of examination.

(2) Determination by the FDIC to change capital category. After receiving notice pursuant to paragraph (c)(1) of this section, the FDIC shall determine whether to change the capital category of the bank or state savings association and shall notify the bank or state savings association of the FDIC's determination.

§ 324.303 Capital measures and capital category definitions

(a) Capital measures. For purposes of section 38 and this subpart, the relevant capital measures shall be:

(1) The total risk-based capital ratio;

(2) The Tier 1 risk-based capital ratio; and

(3) The common equity tier 1 ratio;

(4) The leverage ratio;

(5) The tangible equity to total assets ratio; and

(6) Beginning on January 1, 2018, the supplementary leverage ratio calculated in accordance with § 324.11 of Subpart B of this part for banks or state savings associations that are subject to subpart E of part 324.

(b) Capital categories. For purposes of section 38 and this subpart, a bank or state savings association shall be deemed to be:

(1) "Well capitalized" if the bank or state savings association:

(i) Has a total risk-based capital ratio of 10.0 percent or greater; and

(ii) Has a Tier 1 risk-based capital ratio of 8.0 percent or greater; and

(iii) Has a common equity tier 1 capital ratio of 6.5 percent or greater; and

(iii) Has a leverage ratio of 5.0 percent or greater; and

(iv) Is not subject to any written agreement, order, capital directive, or prompt corrective action directive issued by the FDIC pursuant to section 8 of the FDI Act (12 U.S.C. 1818), the International Lending Supervision Act of 1983 (12 U.S.C. 3907), or the Home Owners' Loan Act (12 U.S.C. 1464(t)(6)(A)(ii)), or section 38 of the FDI Act (12 U.S.C. 1831o), or any regulation thereunder, to meet and maintain a specific capital level for any capital measure.

(2) "Adequately capitalized" if the bank or state savings association:

(i) Has a total risk-based capital ratio of 8.0 percent or greater; and

(ii) Has a Tier 1 risk-based capital ratio of 6.0 percent or greater; and

(iii) Has a common equity tier 1 capital ratio of 4.5 percent or greater; and

(iv) Has a leverage ratio of 4.0 percent or greater; and

(v) Does not meet the definition of a well capitalized bank.

(vi) Beginning January 1, 2018, an advanced approaches bank or state savings association will be deemed to be "adequately capitalized" if the bank or state savings association satisfies paragraphs (b)(2)(i) – (v) of this section and has a supplementary leverage ratio of 3.0 percent or greater, as calculated in accordance with § 324.11 of Subpart B of this part.

(3) "Undercapitalized" if the bank or state savings association:

(i) Has a total risk-based capital ratio that is less than 8.0 percent; or

(ii) Has a Tier 1 risk-based capital ratio that is less than 6.0 percent; or

(iii) Has a common equity tier 1 capital ratio that is less than 4.5 percent; or

(iv) Has a leverage ratio that is less than 4.0 percent.

(v) Beginning January 1, 2018, an advanced approaches bank or state savings association will be deemed to be "undercapitalized" if the bank or state savings association has a supplementary leverage ratio of less than 3.0 percent, as calculated in accordance with § 324.11 of Subpart B of this part.
(4) "Significantly undercapitalized" if the bank or state savings association has:

(i) A total risk-based capital ratio that is less than 6.0 percent; or

(ii) A Tier 1 risk-based capital ratio that is less than 4.0 percent; or

(iii) A common equity tier 1 capital ratio that is less than 3.0 percent; or

(iv) A leverage ratio that is less than 3.0 percent.

(5) “Critically undercapitalized” if the insured depository institution has a ratio of tangible equity to total assets that is equal to or less than 2.0 percent.

(c) Capital categories for insured branches of foreign banks. For purposes of the provisions of section 38 and this subpart, an insured branch of a foreign bank shall be deemed to be:

(1) “Well capitalized” if the insured branch:

(i) Maintains the pledge of assets required under § 347.209 of this chapter; and

(ii) Maintains the eligible assets prescribed under § 347.210 of this chapter at 108 percent or more of the preceding quarter's average book value of the insured branch's third-party liabilities; and

(iii) Has not received written notification from:

(A) The OCC to increase its capital equivalency deposit pursuant to 12 CFR 28.15(b), or to comply with asset maintenance requirements pursuant to 12 CFR 28.20; or

(B) The FDIC to pledge additional assets pursuant to § 347.209 of this chapter or to maintain a higher ratio of eligible assets pursuant to § 347.210 of this chapter.

(2) “Adequately capitalized” if the insured branch:

(i) Maintains the pledge of assets required under § 347.209 of this chapter; and

(ii) Maintains the eligible assets prescribed under § 347.210 of this chapter at 106 percent or more of the preceding quarter's average book value of the insured branch's third-party liabilities; and

(iii) Does not meet the definition of a well capitalized insured branch.

(3) “Undercapitalized” if the insured branch:

(i) Fails to maintain the pledge of assets required under § 347.209 of this chapter; or

(ii) Fails to maintain the eligible assets prescribed under § 347.210 of this chapter at 106 percent or more of the preceding quarter's average book value of the insured branch's third-party liabilities.

(4) “Significantly undercapitalized” if it fails to maintain the eligible assets prescribed under § 347.210 of this chapter at 104 percent or more of the preceding quarter's average book value of the insured branch's third-party liabilities.

(5) “Critically undercapitalized” if it fails to maintain the eligible assets prescribed under § 347.210 of this chapter at 102 percent or more of the preceding quarter's average book value of the insured branch's third-party liabilities.

(d) Reclassifications based on supervisory criteria other than capital. The FDIC may reclassify a well capitalized bank or state savings association as adequately capitalized and may require an adequately capitalized bank or state savings association or an undercapitalized bank or state savings association to comply with certain mandatory or discretionary supervisory actions as if the bank or state savings association were in the next lower capital category (except that the FDIC may not reclassify a significantly undercapitalized bank or state savings association as critically undercapitalized) (each of these actions are hereinafter referred to generally as "reclassifications") in the following circumstances:

(1) Unsafe or unsound condition. The FDIC has determined, after notice and opportunity for hearing pursuant to § 308.202(a) of this chapter, that the bank or state savings association is in unsafe or unsound condition; or

(2) Unsafe or unsound practice. The FDIC has determined, after notice and opportunity for hearing pursuant to § 308.202(a) of this chapter, that, in the most recent examination of the bank or state savings association, the bank or state savings association received and has not corrected a less-than-satisfactory rating for any of the categories of asset quality, management, earnings, or liquidity.

§ 324.304 Capital restoration plans.

(a) Schedule for filing plan--

(1) In general. A bank or state savings association shall file a written capital restoration plan with the appropriate FDIC regional director within 45 days of the date that the bank or state savings association receives notice or is deemed to have notice that the bank or state savings association is undercapitalized, significantly undercapitalized, or critically undercapitalized, unless the FDIC notifies the bank or state savings association in writing that the plan is to be filed within a different period. An adequately capitalized bank or state savings association that has been required pursuant to §324.303(d) of this subpart to comply with supervisory actions as if the bank or state savings association were undercapitalized is not required to submit a capital restoration plan solely by virtue of the reclassification.

(2) Additional capital restoration plans. Notwithstanding paragraph (a)(1) of this section, a bank or state savings association that has already submitted and is operating under a capital restoration plan approved under section 38 and this subpart is not required to submit an additional capital restoration plan based on a revised calculation of its capital measures or a reclassification of the institution under §324.303 unless the FDIC notifies the bank or state savings association that it must submit a new or revised capital plan. A bank or state savings association that is notified that it must submit a new or revised capital restoration plan shall file the plan in writing with the appropriate FDIC regional director within 45 days of receiving such notice, unless the FDIC notifies the bank or state savings association in writing that the plan must be filed within a different period.

(b) Contents of plan. All financial data submitted in connection with a capital restoration plan shall be prepared in accordance with the instructions provided on the Call Report, unless the FDIC instructs otherwise. The capital restoration plan shall include all of the information

required to be filed under section 38(e)(2) of the FDI Act. A bank or state savings association that is required to submit a capital restoration plan as a result of a reclassification of the bank or state savings association pursuant to § 324.303(d) of this subpart shall include a description of the steps the bank or state savings association will take to correct the unsafe or unsound condition or practice. No plan shall be accepted unless it includes any performance guarantee described in section 38(e)(2)(C) of the FDI Act by each company that controls the bank or state savings association.

(c) Review of capital restoration plans. Within 60 days after receiving a capital restoration plan under this subpart, the FDIC shall provide written notice to the bank or state savings association of whether the plan has been approved. The FDIC may extend the time within which notice regarding approval of a plan shall be provided.

(d) Disapproval of capital plan. If a capital restoration plan is not approved by the FDIC, the bank or state savings association shall submit a revised capital restoration plan within the time specified by the FDIC. Upon receiving notice that its capital restoration plan has not been approved, any undercapitalized bank or state savings association (as defined in § 324.303(b) of this subpart) shall be subject to all of the provisions of section 38 and this subpart applicable to significantly undercapitalized institutions. These provisions shall be applicable until such time as a new or revised capital restoration plan submitted by the bank has been approved by the FDIC.

(e) Failure to submit capital restoration plan. A bank or state savings association that is undercapitalized (as defined in § 324.303(b) of this subpart) and that fails to submit a written capital restoration plan within the period provided in this section shall, upon the expiration of that period, be subject to all of the provisions of section 38 and this subpart applicable to significantly undercapitalized institutions.

(f) Failure to implement capital restoration plan. Any undercapitalized bank or state savings association that fails in any material respect to implement a capital restoration plan shall be subject to all of the provisions of section 38 and this subpart applicable to significantly undercapitalized institutions.

(g) Amendment of capital restoration plan. A bank or state savings association that has filed an approved capital restoration plan may, after prior written notice to and approval by the FDIC, amend the plan to reflect a change in circumstance. Until such time as a proposed amendment has been approved, the bank or state savings association shall implement the capital restoration plan as approved prior to the proposed amendment.

(h) Performance guarantee by companies that control a bank or state savings association--

(1) Limitation on liability--

(i) Amount limitation. The aggregate liability under the guarantee provided under section 38 and this subpart for all companies that control a specific bank or state savings association that is required to submit a capital restoration plan under this subpart shall be limited to the lesser of:

(A) An amount equal to 5.0 percent of the bank or state savings association's total assets at the time the bank or state savings association was notified or deemed to have notice that the bank or state savings association was undercapitalized; or

(B) The amount necessary to restore the relevant capital measures of the bank or state savings association to the levels required for the bank or state savings association to be classified as adequately capitalized, as those capital measures and levels are defined at the time that the bank or state savings association initially fails to comply with a capital restoration plan under this subpart.

(ii) Limit on duration. The guarantee and limit of liability under section 38 and this subpart shall expire after the FDIC notifies the bank or state savings association that it has remained adequately capitalized for each of four consecutive calendar quarters. The expiration or fulfillment by a company of a guarantee of a capital restoration plan shall not limit the liability of the company under any guarantee required or provided in connection with any capital restoration plan filed by the same bank or state savings association after expiration of the first guarantee.

(iii) Collection on guarantee. Each company that controls a given bank or state savings association shall be jointly and severally liable for the guarantee for such bank or state savings association as required under section 38 and this subpart, and the FDIC may require and collect payment of the full amount of that guarantee from any or all of the companies issuing the guarantee.

(2) Failure to provide guarantee. In the event that a bank or state savings association that is controlled by any company submits a capital restoration plan that does not contain the guarantee required under section 38(e)(2) of the FDI Act, the bank or state savings association shall, upon submission of the plan, be subject to the provisions of section 38 and this subpart that are applicable to banks and state savings associations that have not submitted an acceptable capital restoration plan.

(3) Failure to perform guarantee. Failure by any company that controls a bank or state savings association to perform fully its guarantee of any capital plan shall constitute a material failure to implement the plan for purposes of section 38(f) of the FDI Act. Upon such failure, the bank or state savings association shall be subject to the provisions of section 38 and this subpart that are applicable to banks and state savings associations that have failed in a material respect to implement a capital restoration plan.

§ 324.305 Mandatory and discretionary supervisory actions under section 38.

(a) Mandatory supervisory actions--

(1) Provisions applicable to all banks and state savings associations. All banks and state savings associations are subject to the restrictions contained in section 38(d) of the FDI Act on payment of capital distributions and management fees.

(2) Provisions applicable to undercapitalized, significantly undercapitalized, and critically undercapitalized banks and state savings associations. Immediately upon receiving notice or being deemed to have notice, as provided in § 324.302 of this subpart, that the bank or state

savings association is undercapitalized, significantly undercapitalized, or critically undercapitalized, the bank or state savings association shall become subject to the provisions of section 38 of the FDI Act:

(i) Restricting payment of capital distributions and management fees (section 38(d));

(ii) Requiring that the FDIC monitor the condition of the bank or state savings association (section 38(e)(1));

(iii) Requiring submission of a capital restoration plan within the schedule established in this subpart (section 38(e)(2));

(iv) Restricting the growth of the bank or state savings association's assets (section 38(e)(3)); and

(v) Requiring prior approval of certain expansion proposals (section 38(e)(4)).

(3) Additional provisions applicable to significantly undercapitalized, and critically undercapitalized banks and state savings associations. In addition to the provisions of section 38 of the FDI Act described in paragraph (a)(2) of this section, immediately upon receiving notice or being deemed to have notice, as provided in § 324.302 of this subpart, that the bank or state savings association is significantly undercapitalized, or critically undercapitalized, or that the bank or state savings association is subject to the provisions applicable to institutions that are significantly undercapitalized because the bank or state savings association failed to submit or implement in any material respect an acceptable capital restoration plan, the bank or state savings association shall become subject to the provisions of section 38 of the FDI Act that restrict compensation paid to senior executive officers of the institution (section 38(f)(4)).

(4) Additional provisions applicable to critically undercapitalized institutions.

(i) In addition to the provisions of section 38 of the FDI Act described in paragraphs (a)(2) and (a)(3) of this section, immediately upon receiving notice or being deemed to have notice, as provided in § 324.302 of this subpart, that the insured depository institution is critically undercapitalized, the institution is prohibited from doing any of the following without the FDIC's prior written approval:

(A) Entering into any material transaction other than in the usual course of business, including any investment, expansion, acquisition, sale of assets, or other similar action with respect to which the depository institution is required to provide notice to the appropriate Federal banking agency;

(B) Extending credit for any highly leveraged transaction;

(C) Amending the institution's charter or bylaws, except to the extent necessary to carry out any other requirement of any law, regulation, or order;

(D) Making any material change in accounting methods;

(E) Engaging in any covered transaction (as defined in section 23A(b) of the Federal Reserve Act (12 U.S.C. 371c(b)));

(F) Paying excessive compensation or bonuses;

(G) Paying interest on new or renewed liabilities at a rate that would increase the institution's weighted average cost of funds to a level significantly exceeding the prevailing rates of interest on insured deposits in the institution's normal market areas; and

(H) Making any principal or interest payment on subordinated debt beginning 60 days after becoming critically undercapitalized except that this restriction shall not apply, until July 15, 1996, with respect to any subordinated debt outstanding on July 15, 1991, and not extended or otherwise renegotiated after July 15, 1991.

(ii) In addition, the FDIC may further restrict the activities of any critically undercapitalized institution to carry out the purposes of section 38 of the FDI Act.

(5) Exception for certain savings associations. The restrictions in paragraph (a)(4) of this section shall not apply, before July 1, 1994, to any insured savings association if:

(i) The savings association had submitted a plan meeting the requirements of section 5(t)(6)(A)(ii) of the Home Owners' Loan Act (12 U.S.C. 1464(t)(6)(A)(ii)) prior to December 19, 1991;

(ii) The Director of Office of Thrift Supervision (OTS) had accepted the plan prior to December 19, 1991; and

(iii) The savings association remains in compliance with the plan or is operating under a written agreement with the appropriate federal banking agency.
(b) Discretionary supervisory actions. In taking any action under section 38 that is within the FDIC's discretion to take in connection with:

(1) An insured depository institution that is deemed to be undercapitalized, significantly undercapitalized, or critically undercapitalized, or has been reclassified as undercapitalized, or significantly undercapitalized; or

(2) An officer or director of such institution, the FDIC shall follow the procedures for issuing directives under §§ 308.201 and 308.203 of this chapter, unless otherwise provided in section 38 or this subpart.
* * * * *

PART 362 – ACTIVITIES OF INSURED STATE BANKS AND INSURED SAVINGS ASSOCIATIONS

61. Amend section 362.18(a)(3) to read as follows:

§ 362.18 Financial subsidiaries of insured state nonmember banks

* * * * *

(a) * * * *

(3) The insured state nonmember bank will deduct the aggregate amount of its outstanding equity investment, including retained earnings, in all financial subsidiaries that engage in activities as principal pursuant to section 46(a) of the Federal Deposit Act (12 U.S.C. 1831w(a)), from the bank's total assets and tangible equity and deduct such investment from common equity tier 1 capital in accordance with part 324, subpart C.

* * * * *

DEPARTMENT OF THE TREASURY
Office of the Comptroller of the Currency
12 CFR Part 3
Docket ID OCC-2012-0009
RIN 1557-AD46

FEDERAL RESERVE SYSTEM
12 CFR Parts 208, 217, and 225
Regulations H, Q, and Y
Docket No. R-[XX]
RIN [XX]

FEDERAL DEPOSIT INSURANCE CORPORATION
12 CFR Part 324
RIN 3064-AD96

Regulatory Capital Rules: Standardized Approach for Risk-weighted Assets; Market Discipline and Disclosure Requirements

AGENCIES: Office of the Comptroller of the Currency, Treasury; Board of Governors of the Federal Reserve System; and the Federal Deposit Insurance Corporation.

ACTION: Joint notice of proposed rulemaking.

SUMMARY: The Office of the Comptroller of the Currency (OCC), Board of Governors of the Federal Reserve System (Board), and the Federal Deposit Insurance Corporation (FDIC) (collectively, the agencies) are seeking comment on three notices of proposed rulemaking (NPRs) that would revise and replace the agencies' current capital rules.

This NPR (the Standardized Approach NPR) includes proposed changes to the agencies' general risk-based capital requirements for determining risk-weighted assets (that is, the calculation of the denominator of a banking organization's risk-based capital ratios). The proposed changes would revise and harmonize the agencies' rules for calculating risk-weighted assets to enhance risk sensitivity and address weaknesses identified over recent years, including by incorporating certain international capital standards of the Basel Committee on Banking Supervision (BCBS) set forth in the standardized approach of the "International Convergence of Capital Measurement and Capital Standards: A Revised Framework" (Basel II), as revised by the BCBS between 2006 and 2009, and other proposals addressed in recent consultative papers of the BCBS.

In this NPR, the agencies also propose alternatives to credit ratings for calculating risk-weighted assets for certain assets, consistent with section 939A of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act). The revisions include methodologies for determining risk-weighted assets for residential mortgages, securitization exposures, and counterparty credit risk. The changes in the Standardized Approach NPR are proposed to take effect on January 1, 2015, with an option for early adoption. The Standardized

Approach NPR also would introduce disclosure requirements that would apply to top-tier banking organizations domiciled in the United States with $50 billion or more in total assets, including disclosures related to regulatory capital instruments.

The agencies are also seeking comment on the two related NPRs published elsewhere in today's Federal Register. In the notice titled "Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Prompt Corrective Action, and Transition Provisions" (Basel III NPR), the agencies are proposing to revise their minimum risk-based capital requirements and criteria for regulatory capital, as well as establish a capital conservation buffer framework, consistent with Basel III. The Basel III NPR also includes transition provisions for banking organizations to come into compliance with the requirements of that proposal.

The proposed requirements in this NPR and the Basel III NPR would apply to all banking organizations that are currently subject to minimum capital requirements (including national banks, state member banks, state nonmember banks, state and federal savings associations, and top-tier bank holding companies domiciled in the United States not subject to the Board's Small Bank Holding Company Policy Statement (12 CFR part 225, appendix C)), as well as top-tier savings and loan holding companies domiciled in the United States (collectively, banking organizations).

In the notice titled "Regulatory Capital Rules: Advanced Approaches Risk-based Capital Rules; Market Risk Capital Rule" (Advanced Approaches and Market Risk NPR), the agencies are proposing to revise the advanced approaches risk-based capital rule (advanced approaches rule) consistent with Basel III and other changes to the BCBS' capital standards. The agencies also propose to revise the advanced approaches rule to be consistent with section 939A of the Dodd-Frank Act. The proposals in the Advanced Approaches and Market Risk NPR also would incorporate the market risk capital rule (market risk rule) into the integrated regulatory capital framework.

Additionally, in the Advanced Approaches and Market Risk NPR, the OCC and FDIC are proposing that the market risk rules be applicable to federal and state savings associations and the Board is proposing that the advanced approaches and market risk rules apply to top-tier savings and loan holding companies domiciled in the United States, in each case, if stated thresholds for trading activity are met.

The proposals are published in three separate NPRs to reflect the distinct objectives of each proposal, to allow interested parties to better understand the various aspects of the overall capital framework, including which aspects of the rules would apply to which banking organizations, and to help interested parties better focus their comments on areas of particular interest.

DATES: Comments must be submitted on or before September 7, 2012.

ADDRESSES: Comments should be directed to:

OCC: Because paper mail in the Washington, D.C. area and at the OCC is subject to delay, commenters are encouraged to submit comments by the Federal eRulemaking Portal or e-

mail, if possible. Please use the title "Regulatory Capital Rules: Standardized Approach for Risk-weighted Assets; Market Discipline and Disclosure Requirements" to facilitate the organization and distribution of the comments. You may submit comments by any of the following methods:

- **Federal eRulemaking Portal—"regulations.gov":** Go to http://www.regulations.gov. Click "Advanced Search". Select "Document Type" of "Proposed Rule," and in "By Keyword or ID" box, enter Docket ID "OCC-2012-0009,"and click "Search." If proposed rules for more than one agency are listed, in the "Agency" column, locate the notice of proposed rulemaking for the OCC. Comments can be filtered by Agency using the filtering tools on the left side of the screen. In the "Actions" column, click on "Submit a Comment" or "Open Docket Folder" to submit or view public comments and to view supporting and related materials for this rulemaking action.

- Click on the "Help" tab on the Regulations.gov home page to get information on using Regulations.gov, including instructions for submitting or viewing public comments, viewing other supporting and related materials, and viewing the docket after the close of the comment period.

- E-mail: regs.comments@occ.treas.gov.

- Mail: Office of the Comptroller of the Currency, 250 E Street, S.W., Mail Stop 2-3, Washington, D.C. 20219.

- Fax: (202) 874-5274.

- Hand Delivery/Courier: 250 E Street, S.W., Mail Stop 2-3, Washington, D.C. 20219.

Instructions: You must include "OCC" as the agency name and "Docket ID OCC-2012-0009." In general, OCC will enter all comments received into the docket and publish them on the Regulations.gov Web site without change, including any business or personal information that you provide such as name and address information, e-mail addresses, or phone numbers. Comments received, including attachments and other supporting materials, are part of the public record and subject to public disclosure. Do not enclose any information in your comment or supporting materials that you consider confidential or inappropriate for public disclosure.

You may review comments and other related materials that pertain to this notice by any of the following methods:

- Viewing Comments Electronically: Go to http://www.regulations.gov. Click "Advanced Search." Select "Document Type" of "Public Submission" and in "By Keyword or ID" box enter Docket ID "OCC-2012-0009," and click "Search." If comments from more than one agency are listed, the "Agency" column will indicate which comments were received by the OCC. Comments can be filtered by Agency using the filtering tools on the left side of the screen.

- Viewing Comments Personally: You may personally inspect and photocopy comments at the OCC, 250 E Street, S.W., Washington, D.C., 20219. For security reasons, the OCC requires that visitors make an appointment to inspect comments. You may do so by calling (202) 874-4700. Upon arrival, visitors will be required to present valid government-issued photo identification and to submit to security screening in order to inspect and photocopy comments.

- Docket: You may also view or request available background documents and project summaries using the methods described above.

Board: When submitting comments, please consider submitting your comments by e-mail or fax because paper mail in the Washington, D.C. area and at the Board may be subject to delay. You may submit comments, identified by Docket No. [XX][XX], by any of the following methods:

- Agency Web Site: http://www.federalreserve.gov. Follow the instructions for submitting comments at http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm.

- Federal eRulemaking Portal: http://www.regulations.gov. Follow the instructions for submitting comments.

- E-mail: regs.comments@federalreserve.gov. Include docket number in the subject line of the message.

- Fax: (202) 452-3819 or (202) 452-3102.

- Mail: Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, N.W., Washington, D.C. 20551.

All public comments are available from the Board's website at http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm as submitted, unless modified for technical reasons. Accordingly, your comments will not be edited to remove any identifying or contact information. Public comments may also be viewed electronically or in paper form in Room MP-500 of the Board's Martin Building (20th and C Street, N.W., Washington, D.C. 20551) between 9:00 a.m. and 5:00 p.m. on weekdays.

FDIC: You may submit comments by any of the following methods:

- Federal eRulemaking Portal: http://www.regulations.gov. Follow the instructions for submitting comments.

- Agency Web site: http://www.FDIC.gov/regulations/laws/federal/propose.html

- Mail: Robert E. Feldman, Executive Secretary, Attention: Comments/Legal ESS, Federal Deposit Insurance Corporation, 550 17th Street, N.W., Washington, D.C. 20429.

- Hand Delivered/Courier: The guard station at the rear of the 550 17th Street Building (located on F Street), on business days between 7:00 a.m. and 5:00 p.m.

- E-mail: comments@FDIC.gov.

- Instructions: Comments submitted must include "FDIC" and "RIN [xx][xx]-[xx][xx]." Comments received will be posted without change to http://www.FDIC.gov/regulations/laws/federal/propose.html, including any personal information provided.

FOR FURTHER INFORMATION CONTACT:

OCC: Margot Schwadron, Senior Risk Expert, (202) 874-6022, David Elkes, Risk Expert, (202) 874- 3846, or Mark Ginsberg, Risk Expert, (202) 927-4580, or Ron Shimabukuro, Senior Counsel, Patrick Tierney, Counsel, or Carl Kaminski, Senior Attorney, Legislative and Regulatory Activities Division, (202) 874-5090, Office of the Comptroller of the Currency, 250 E Street, S.W., Washington, D.C. 20219.

Board: Anna Lee Hewko, Assistant Director, (202) 530-6260, Thomas Boemio, Manager, (202) 452-2982, or Constance M. Horsley, Manager, (202) 452-5239, Capital and Regulatory Policy, Division of Banking Supervision and Regulation; or Benjamin McDonough, Senior Counsel, (202) 452-2036, April C. Snyder, Senior Counsel, (202) 452-3099, or Christine Graham, Senior Attorney, (202) 452-3005, Legal Division, Board of Governors of the Federal Reserve System, 20th and C Streets, N.W., Washington, D.C. 20551. For the hearing impaired only, Telecommunication Device for the Deaf (TDD), (202) 263-4869.

FDIC: Bobby R. Bean, Associate Director, bbean@fdic.gov; Ryan Billingsley, Senior Policy Analyst, rbillingsley@fdic.gov; Karl Reitz, Senior Policy Analyst, kreitz@fdic.gov, Division of Risk Management Supervision; David Riley, Senior Policy Analyst, dariley@fdic.gov, Capital Markets Branch, Division of Risk Management Supervision, (202) 898-6888; or Mark Handzlik, Counsel, mhandzlik@fdic.gov, Michael Phillips, Counsel, mphillips@fdic.gov, Greg Feder, Counsel, gfeder@fdic.gov, or Ryan Clougherty, Senior Attorney, rclougherty@fdic.gov; Supervision Branch, Legal Division, Federal Deposit Insurance Corporation, 550 17th Street, N.W., Washington, D.C. 20429.

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I. Introduction and Overview

The Office of the Comptroller of the Currency (OCC), Board of Governors of the Federal Reserve System (Board), and the Federal Deposit Insurance Corporation (FDIC) (collectively, the agencies) are proposing comprehensive revisions to their regulatory capital framework through three concurrent notices of proposed rulemaking (NPRs). In this NPR (Standardized Approach NPR), the agencies are proposing to revise certain aspects of the general risk-based capital requirements that address the calculation of risk-weighted assets. The agencies believe the proposed changes included in this notice of proposed rulemaking would both enhance the overall risk-sensitivity of the calculation of a banking organization's total risk-weighted assets and be consistent with relevant provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act).[2] Although many of the proposed changes included in this NPR are not specifically included in the Basel capital framework, the agencies believe that these proposed changes are generally consistent with the goals of the international framework.

This NPR contains a standardized approach for determining risk-weighted assets. This NPR would apply to all banking organizations currently subject to minimum capital requirements, including national banks, state member banks, state nonmember banks, state and federal savings associations, top-tier bank holding companies domiciled in the United States not subject to the Board's Small Bank Holding Company Policy Statement (12 CFR part 225, appendix C), as well as top-tier savings and loan holding companies domiciled in the United States (together, banking organizations).[3] The proposed effective date for the provisions of this NPR is January 1, 2015, with an option for early adoption.

In a separate NPR (Basel III NPR), the agencies are proposing to revise their capital regulations to incorporate agreements reached by the Basel Committee on Banking Supervision (BCBS) in "Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems" (Basel III). The Basel III NPR would revise the definition of regulatory capital and minimum capital ratios, establish capital buffers, create a supplementary leverage ratio for advanced approach banking organizations, and revise the agencies' Prompt Corrective Action (PCA) regulations.

The agencies are proposing in a third NPR (Advanced Approaches and Market Risk NPR) to incorporate additional aspects of the Basel III framework into the advanced approaches risk-based capital rule (advanced approaches rule). Additionally, in the Advanced Approaches and Market Risk NPR, the Board proposes to apply the advanced approaches rule to savings and loan holding companies, and the Board, FDIC, and OCC propose to apply the market risk capital rule (market risk rule) to savings and loan holding companies and to state and federal savings associations that meet the scope requirements of these rules, respectively. Thus, the Advanced

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[2] Pub. L. No. 111-203, 124 Stat. 1376 (2010).

[3] Small bank holding companies would continue to be subject to the Small Bank Holding Company Policy Statement. The proposed rule's application to all savings and loan holding companies (including small savings and loan holding companies) is consistent with the transfer of supervisory responsibilities to the Board and the requirements of section 171 of the Dodd-Frank Act. Section 171 of the Dodd-Frank Act by its terms does not apply to small bank holding companies, but there is no exemption from the requirements of section 171 for small savings and loan holding companies. See 12 U.S.C. 5371.

Approaches and Market Risk NPR is applicable only to banking organizations that are or would be subject to the advanced approaches rule (advanced approaches banking organizations) or the market risk rule, and to savings and loan holding companies and state and federal savings associations that would be subject to the advanced approaches rule or market risk rule.

All banking organizations, including organizations subject to the advanced approaches rule, should review both the Basel III NPR and the Standardized Approach NPR. The requirements proposed in the Basel III NPR and the Standardized Approach NPR are proposed to become the "generally applicable" capital requirements for purposes of section 171 of the Dodd-Frank Act because they would be the capital requirements for insured depository institutions under section 38 of the Federal Deposit Insurance Act, without regard to asset size or foreign financial exposure.[4]

The agencies believe that it is important to publish all of the proposed capital rules at the same time so that banking organizations can evaluate the overall potential impact of the proposals on their operations. The proposals are divided into three separate NPRs to reflect the distinct objectives of each proposal, to allow interested parties to better understand the various aspects of the overall capital framework, including which aspects of the proposals would apply to which banking organizations, and to help interested parties better focus their comments on areas of particular interest. Additionally, the agencies believe that separating the proposed requirements into three NPRs makes it easier for banking organizations of all sizes to more easily understand which proposed changes are related to the agencies' objective to improve the quality and increase the quantity of capital and which are related to the agencies' objective to enhance the overall risk-sensitivity of the calculation of a banking organization's total risk-weighted assets. The agencies believe that the proposed changes contained in the three NPRs will result in capital requirements that will improve institutions' ability to withstand periods of economic stress and better reflect their risk profiles. The agencies have carefully considered the potential impact of the three NPRs on all banking organizations, including community banking organizations, and sought to minimize the potential burden of these changes wherever possible.

This NPR proposes new methodologies for determining risk-weighted assets in the agencies' general capital rules, incorporating elements of the Basel II standardized approach[5] as modified by the 2009 "Enhancements to the Basel II Framework" (2009 Enhancements)[6] and recent consultative papers published by the BCBS. This NPR also proposes alternative standards of creditworthiness consistent with section 939A of the Dodd-Frank Act.[7] The proposed revisions in this NPR include revisions to recognition of credit risk mitigation, including a greater recognition of financial collateral and a wider range of eligible guarantors. They also include risk weighting of equity exposures and past due loans, operational requirements for

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[4] 12 U.S.C. 1831o; 12 CFR part 6, 12 CFR part 165 (OCC); 12 CFR 208.43 (Board), 12 CFR 325.105, 12 CFR 390.455 (FDIC).

[5] See BCBS, "International Convergence of Capital Measurement and Capital Standards: A Revised Framework," (June 2006), available at http://www.bis.org/publ/bcbs128.htm (Basel II).

[6] See BCBS, "Enhancements to the Basel II Framework," (July 2009), available at http://www.bis.org/publ/bcbs157.htm.

[7] Dodd-Frank Act, section 939A (15 U.S.C. 78o-7, note).

securitization exposures, more favorable capital treatment for derivatives and repo-style transactions cleared through central counterparties, and disclosure requirements that would apply to top-tier banking organizations with $50 billion or more in total assets that are not subject to the advanced approaches rule. In addition, the proposed risk weights for residential mortgage exposures in this NPR enhance risk sensitivity for capital requirements associated with these exposures. Similarly, the proposals in this NPR would require a higher risk weighting for certain commercial real estate exposures that typically have higher credit risk. The agencies believe these proposals would more appropriately align capital requirements with these exposures and contribute to the resilience of both individual banking organizations and the banking system.

Some of the proposed changes in this NPR are not specifically included in the Basel capital framework. However, the agencies believe that these proposed changes are generally consistent with the goals of that framework. For example, the Basel capital framework seeks to enhance the risk-sensitivity of the international risk-based capital requirements by mapping capital requirements for certain exposures to credit ratings provided by credit rating agencies. Instead of mapping risk weights to credit ratings, the agencies are proposing alternative standards of creditworthiness to assign risk weights to certain exposures, including exposures to sovereigns, companies, and securitization exposures, in a manner consistent with section 939A of the Dodd-Frank Act.[8] These alternative creditworthiness standards and risk-based capital requirements have been designed to be consistent with safety and soundness while also exhibiting risk sensitivity to the extent possible. Furthermore, these capital requirements are intended to be similar to those generated under the Basel framework.

Table 1 summarizes key proposed requirements in this NPR and illustrates how these changes compare to the agencies' general risk-based capital rules.[9] The remaining sections of this notice describe in detail each element of the proposal, how the proposal would differ from the current general risk-based capital rules, and examples for how a banking organization would calculate risk-weighted asset amounts.

[8] Section 939A of the Dodd-Frank Act provides that not later than 1 year after the date of enactment, each Federal agency shall review: (1) any regulation issued by such agency that requires the use of an assessment of the credit-worthiness of a security or money market instrument; and (2) any references to or requirements in such regulations regarding credit ratings. Section 939A further provides that each such agency "shall modify any such regulations identified by the review … to remove any reference to or requirement of reliance on credit ratings and to substitute in such regulations such standard of credit-worthiness as each respective agency shall determine as appropriate for such regulations." See 15 U.S.C. 78o–7 note.

[9] Banking organizations should refer to the Basel III NPR to see a complete table of the key provisions of the proposal.

Table 1– Key Provisions of the Proposed Requirements as Compared to the General Risk-Based Capital Rules

Aspect of Proposed Requirements	Proposed Treatment
Risk-weighted Assets	
Credit exposures to: U.S. government and its agencies U.S. government-sponsored entities U.S. depository institutions and credit unions U.S. public sector entities, such as states and municipalities (section 32 of subpart D)	Unchanged.
Credit exposures to: Foreign sovereigns Foreign banks Foreign public sector entities (section 32 of subpart D)	Introduces a more risk-sensitive treatment using the Country Risk Classification measure produced by the Organization for Economic Co-operation and Development.
Corporate exposures (section 32 of subpart D)	Assigns a 100 percent risk weight to corporate exposures, including exposures to securities firms.
Residential mortgage exposures (section 32 of subpart D)	Introduces a more risk-sensitive treatment based on several criteria, including certain loan characteristics and the loan-to-value-ratio of the exposure.
High volatility commercial real estate exposures (section 32 of subpart D)	Applies a 150 percent risk weight to certain credit facilities that finance the acquisition, development or construction of real property.
Past due exposures	Applies a 150 percent risk weight to exposures that are not sovereign exposures or residential mortgage exposures and that are more than 90

(section 32 of subpart D)	days past due or on nonaccrual.
Securitization exposures (sections 41-45 of subpart D)	Maintains the gross-up approach for securitization exposures. Replaces the current ratings-based approach with a formula-based approach for determining a securitization exposure's risk weight based on the underlying assets and exposure's relative position in the securitization's structure.
Equity exposures (sections 51-53 of subpart D)	Introduces more risk-sensitive treatment for equity exposures.
Off-balance Sheet Items (section 33 of subpart D)	Revises the measure of the counterparty credit risk of repo-style transactions. Raises the credit conversion factor for most short-term commitments from zero percent to 20 percent.
Derivative Contracts (section 34 of subpart D)	Removes the 50 percent risk weight cap for derivative contracts.
Cleared Transactions (section 35 of subpart D)	Provides preferential capital requirements for cleared derivative and repo-style transactions (as compared to requirements for non-cleared transactions) with central counterparties that meet specified standards. Also requires that a clearing member of a central counterparty calculate a capital requirement for its default fund contributions to that central counterparty.
Credit Risk Mitigation (section 36 of subpart D)	Provides a more comprehensive recognition of collateral and guarantees.
Disclosure Requirements (sections 61-63 of subpart D)	Introduces qualitative and quantitative disclosure requirements, including regarding regulatory capital instruments, for banking organizations with total consolidated assets of $50 billion or more that are not subject to the separate advanced approaches disclosure requirements.

This NPR proposes that, beginning on January 1, 2015, a banking organization would be required to calculate risk-weighted assets using the methodologies described herein. Until then, the banking organization may calculate risk-weighted assets using the methodologies in the current general risk-based capital rules.

Some of the proposed requirements in this NPR are not applicable to smaller, less complex banking organizations. To assist these banking organizations in rapidly identifying the elements of these proposals that would apply to them, this NPR and the Basel III NPR provide, as addenda to the corresponding preambles, a summary of the proposed changes in those NPRs as they would generally apply to smaller, less complex banking organizations. This NPR also contains a second addendum to the preamble, which contains the definitions proposed under the Basel III NPR because they are applicable to the Standardized Approach NPR as well.

Question 1: The agencies seek comment on the advantages and disadvantages of the proposed standardized approach rule as it would apply to smaller and less complex banking organizations (community banking organizations). What specific changes, if any, to the rule would accomplish the agencies' goals of establishing improved risk sensitivity and quality of capital in an appropriate manner? For example, in which areas might the proposed standardized approach for calculating risk-weighted assets include simpler approaches for community banking organizations or longer transition periods? Provide specific suggestions.

Question 2: The agencies also seek comment on the advantages and disadvantages of allowing certain community banking organizations to continue to calculate their risk-weighted assets based on the methodology in the current general risk-based capital rules, as modified to meet the new Basel III requirements and any changes required under U.S. law, and as incorporated into a comprehensive regulatory framework.

For example, under this type of alternative approach, community banking organizations would be subject to the proposed new PCA thresholds, a capital conservation buffer, and other Basel III revisions to the capital framework including the definition of capital, as well as any changes related to section 939A of the Dodd-Frank Act. As modified with these revisions, community banking organizations would continue using most of the same risk weights as under the current general risk-based capital rules, including for commercial and residential mortgage exposures.

Under this approach, banking organizations other than community banking organizations would use the proposed standardized approach risk weights to calculate the denominator of the risk-based capital ratio. The agencies request comment on the criteria they should consider when determining which banking organizations, if any, should be permitted to continue to calculate their risk-weighted assets using the methodology in the current general risk-based capital rules (revised as described above). Which banking organizations, consistent with section 171 of the

Dodd-Frank Act, should be required to use the standardized approach?[10] What factors should the agencies consider in making this determination?

II. Standardized Approach for Risk-weighted Assets

A. Calculation of Standardized Total Risk-weighted Assets

Similar to the current general risk-based capital rules, under the proposal, a banking organization would calculate its total risk-weighted assets by adding together its on- and off-balance sheet risk-weighted asset amounts and making any relevant adjustments to incorporate required capital deductions.[11] Banking organizations subject to the market risk rule would be required to supplement their total risk-weighted assets as provided by the market risk rule.[12] Risk-weighted asset amounts generally would be determined by assigning on-balance sheet assets to broad risk-weight categories according to the counterparty, or, if relevant, the guarantor or collateral. Similarly, risk-weighted asset amounts for off-balance sheet items would be calculated using a two-step process: (1) multiplying the amount of the off-balance sheet exposure by a credit conversion factor (CCF) to determine a credit equivalent amount, and (2) assigning the credit equivalent amount to a relevant risk-weight category.

A banking organization would determine its standardized total risk-weighted assets by calculating the sum of: (1) its risk-weighted assets for general credit risk, cleared transactions, default fund contributions, unsettled transactions, securitization exposures, and equity exposures, each as defined below, plus (ii) market risk-weighted assets, if applicable, less (iii) the banking organization's allowance for loan and lease losses (ALLL) that is not included in tier 2 capital (as described in section 20 of the proposal). The sections below describe in more detail how a banking organization would determine the risk-weighted asset amounts for its exposures.

B. Risk-weighted Assets for General Credit Risk

Under this NPR, total risk-weighted assets for general credit risk is the sum of the risk-weighted asset amounts as calculated under section 31(a) of the proposal. As proposed, general credit risk exposures would include a banking organization's on-balance sheet exposures, over-the-counter (OTC) derivative contracts, off-balance sheet commitments, trade and transaction-related contingencies, guarantees, repo-style transactions, financial standby letters of credit, forward agreements, or other similar transactions. General credit risk exposures would generally exclude unsettled transactions, cleared transactions, default fund contributions, securitization exposures, and equity exposures, each as the agencies propose to define. Section 32 describes

[10] Section 171 of the Dodd-Frank Act provides that all banking organizations must be subject to minimum capital requirements that cannot be less than the "generally applicable risk-based capital rules" established by the appropriate federal banking agency to apply to insured depository institutions under section 38 of the Federal Deposit Insurance Act, regardless of total consolidated asset size or foreign financial exposure; which shall serve as a floor for any capital requirements the agency may require.

[11] See generally 12 CFR part 3, appendix A, section III; 12 CFR 167.6 (OCC); 12 CFR parts 208 and 225, appendix A, section III (Board); 12 CFR part 325, appendix A, sections II.C. and II.D and 12 CFR 390.466 (FDIC).

[12] The proposed rules would incorporate the market risk rule into the integrated regulatory framework as subpart F. See the Advanced Approaches and Market Risk NPR for further discussion.

the proposed risk weights that would apply to sovereign exposures; exposures to certain supranational entities and multilateral development banks (MDBs); exposures to government-sponsored entities (GSEs); exposures to depository institutions, foreign banks, and credit unions; exposures to public sector entities (PSEs); corporate exposures; residential mortgage exposures; pre-sold residential construction loans; statutory multifamily mortgages; high volatility commercial real estate (HVCRE) exposures; past due exposures; and other assets (including cash, gold bullion, certain mortgage servicing assets (MSAs) and deferred tax assets (DTAs)).

Generally, the exposure amount for the on-balance sheet component of an exposure is the banking organization's carrying value for the exposure as determined under generally accepted accounting principles (GAAP). The exposure amount for an off-balance sheet component of an exposure is typically determined by multiplying the notional amount of the off-balance sheet component by the appropriate CCF as determined under section 33. The exposure amount for an OTC derivative contract or cleared transaction that is a derivative would be determined under section 34 while exposure amounts for collateralized OTC derivative contracts, collateralized cleared transactions that are derivatives, repo-style transactions, and eligible margin loans would be determined under section 37 of the proposal.

1. Exposures to Sovereigns

The agencies propose to retain the current rules' risk weights for exposures to and claims directly and unconditionally guaranteed by the U. S. government or its agencies.[13] Accordingly, exposures to the U. S. government, its central bank, or a U.S. government agency and the portion of an exposure that is directly and unconditionally guaranteed by the U. S. government, the U.S. central bank, or a U.S. government agency would receive a zero percent risk weight.[14] Consistent with the current risk-based capital rules, the portion of a deposit insured by the FDIC or the National Credit Union Administration also may be assigned a zero percent risk weight. An exposure conditionally guaranteed by the U.S. government, its central bank, or a U.S. government agency would receive a 20 percent risk weight.[15]

The agencies' general risk-based capital rules generally assign risk weights to direct exposures to sovereigns and exposures directly guaranteed by sovereigns based on whether the sovereign is a member of the Organization for Economic Co-operation and Development

[13] A U.S. government agency would be defined in the proposal as an instrumentality of the U.S. government whose obligations are fully and explicitly guaranteed as to the timely payment of principal and interest by the full faith and credit of the U.S. government.

[14] Similar to the current general risk-based capital rules, a claim would not be considered unconditionally guaranteed by a central government if the validity of the guarantee is dependent upon some affirmative action by the holder or a third party. See 12 CFR part 3, appendix A, section 1(c)(11) and 12 CFR 167.6 (OCC); 12 CFR parts 208 and 225, appendix A, section III.C.1 (Board); 12 CFR part 325, appendix A, section II.C. (footnote 35) and 12 CFR 390.466 (FDIC).

[15] Loss-sharing agreements entered into by the FDIC with acquirers of assets from failed institutions are considered conditional guarantees for risk-based capital purposes due to contractual conditions that acquirers must meet. The guaranteed portion of assets subject to a loss-sharing agreement may be assigned a 20 percent risk weight. Because the structural arrangements for these agreements vary depending on the specific terms of each agreement, institutions should consult with their primary federal supervisor to determine the appropriate risk-based capital treatment for specific loss-sharing agreements.

(OECD) and, as applicable, whether the exposure is unconditionally or conditionally guaranteed by the sovereign.[16]

Under the proposal, a sovereign would be defined as a central government (including the U.S. government) or an agency, department, ministry, or central bank of a central government. The risk weight for a sovereign exposure would be determined using OECD Country Risk Classifications (CRCs) (the CRC methodology).[17] The OECD's CRCs are an assessment of a country's credit risk, used to set interest rate charges for transactions covered by the OECD arrangement on export credits.

The agencies believe that use of CRCs in the proposal is permissible under section 939A of the Dodd-Frank Act and that section 939A was not intended to apply to assessments of creditworthiness of organizations such as the OECD. Section 939A is part of Subtitle C of Title IX of the Dodd-Frank Act, which, among other things, enhances regulation by the U.S. Securities and Exchange Commission (SEC) of credit rating agencies, including Nationally Recognized Statistical Rating Organizations (NRSROs) registered with the SEC. Section 939, in Subtitle C of Title IX, removes references to credit ratings and NRSROs from federal statutes. In the introductory "findings" section to Subtitle C, which is entitled "Improvements to the Regulation of Credit Ratings Agencies," Congress characterized credit rating agencies as organizations that play a critical "gatekeeper" role in the debt markets and perform evaluative and analytical services on behalf of clients, and whose activities are fundamentally commercial in character.[18] Furthermore, the legislative history of section 939A focuses on the conflicts of interest of credit rating agencies in providing credit ratings to their clients, and the problem of government "sanctioning" of the credit rating agencies' credit ratings by having them incorporated into federal regulations. The OECD is not a commercial entity that produces credit assessments for fee-paying clients, nor does it provide the sort of evaluative and analytical services as credit rating agencies. Additionally, the agencies note that the use of the CRCs is limited in the proposal.

The CRC methodology, established in 1999, classifies countries into categories based on the application of two basic components: the country risk assessment model (CRAM), which is an econometric model that produces a quantitative assessment of country credit risk, and the qualitative assessment of the CRAM results, which integrates political risk and other risk factors not fully captured by the CRAM. The two components of the CRC methodology are combined and result in countries being classified into one of eight risk categories (0-7), with countries assigned to the zero category having the lowest possible risk assessment and countries assigned to the 7 category having the highest possible risk assessment.

The OECD regularly updates CRCs for more than 150 countries and makes the assessments publicly available on its website.[19] Accordingly, the agencies believe that the CRC

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[16] 12 CFR part 3, appendix A, section 3 and 12 CFR 167.6 (OCC); 12 CFR parts 208 and 225, appendix A, section III.C.1 (Board); 12 CFR part 325, appendix A, section II.C and 12 CFR 390.466 (FDIC).

[17] For more information on the OECD country risk classification methodology, see OECD, "Country Risk Classification," available at http://www.oecd.org/document/49/0,3746,en_2649_34169_1901105_1_1_1_1,00.html.

[18] See Dodd-Frank Act, section 931 (15 U.S.C. 78o-7 note).

[19] See http://www.oecd.org/document/49/0,2340,en_2649_34171_1901105_1_1_1_1,00.html.

approach should not represent undue burden to banking organizations. The use of the CRC methodology is consistent with the Basel II standardized approach, which, as an alternative to credit ratings, provides for risk weights to be assigned to sovereign exposures according to country risk scores provided by export credit agencies.

The agencies recognize that CRCs have certain limitations. Although the OECD has published a general description of the methodology for CRC determinations, the methodology is largely principles-based and does not provide details regarding the specific information and data considered to support a CRC. Additionally, while the OECD reviews qualitative factors for each sovereign on a monthly basis, quantitative financial and economic information used to assign CRCs is available only annually in some cases, and payment performance is updated quarterly. Also, OECD-member sovereigns that are defined to be "high-income countries" by the World Bank are assigned a CRC of zero, the most favorable classification.[20] Despite these limitations, the agencies consider CRCs to be a reasonable alternative to credit ratings for sovereign exposures and the proposed CRC methodology to be more granular and risk sensitive than the current risk-weighting methodology based on OECD membership.

The agencies also propose to require a banking organization to apply a 150 percent risk weight to sovereign exposures immediately upon determining that an event of sovereign default has occurred or if an event of sovereign default has occurred during the previous five years. Sovereign default would be defined as a noncompliance by a sovereign with its external debt service obligations or the inability or unwillingness of a sovereign government to service an existing loan according to its original terms, as evidenced by failure to pay principal and interest timely and fully, arrearages, or restructuring. A default would include a voluntary or involuntary restructuring that results in a sovereign not servicing an existing obligation in accordance with the obligation's original terms.

The agencies are proposing to map risk weights to CRCs in a manner consistent with the Basel II standardized approach, which provides risk weights for foreign sovereigns based on country risk scores. The proposed risk weights for sovereign exposures are set forth in Table 2.

[20] OECD, "Premium and Related Conditions: Explanation of the Premium Rules of the Arrangement on Officially Supported Export Credits (the Knaepen Package)," (July 6, 2004), available at http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=TD/PG(2004)10/FINAL&docLanguage=En.

Table 2 – Proposed Risk Weights for Sovereign Exposures

		Risk Weight (in percent)
Sovereign CRC	0-1	0
	2	20
	3	50
	4-6	100
	7	150
No CRC		100
Sovereign Default		150

If a banking supervisor in a sovereign jurisdiction allows banking organizations in that jurisdiction to apply a lower risk weight to an exposure to that sovereign than Table 2 provides, a U.S. banking organization would be able to assign the lower risk weight to an exposure to that sovereign, provided the exposure is denominated in the sovereign's currency and the U.S. banking organization has at least an equivalent amount of liabilities in that foreign currency.

Question 3: The agencies solicit comment on the proposed methodology for risk weighting sovereign exposures. Are there other alternative methodologies for risk weighting sovereign exposures that would be more appropriate? Provide specific examples and supporting data.

2. Exposures to Certain Supranational Entities and Multilateral Development Banks

Under the general risk-based capital rules, exposures to certain supranational entities and multilateral development banks (MDBs) receive a 20 percent risk weight. Consistent with the Basel framework's treatment of exposures to supranational entities, the agencies propose to apply a zero percent risk weight to exposures to the Bank for International Settlements, the European Central Bank, the European Commission, and the International Monetary Fund.

Similarly, the agencies propose to apply a zero percent risk weight to exposures to an MDB in accordance with the Basel framework. The proposal would define an MDB to include the International Bank for Reconstruction and Development, the Multilateral Investment Guarantee Agency, the International Finance Corporation, the Inter-American Development

Bank, the Asian Development Bank, the African Development Bank, the European Bank for Reconstruction and Development, the European Investment Bank, the European Investment Fund, the Nordic Investment Bank, the Caribbean Development Bank, the Islamic Development Bank, the Council of Europe Development Bank, and any other multilateral lending institution or regional development bank in which the U.S. government is a shareholder or contributing member or which the primary federal supervisor determines poses comparable credit risk.

The agencies believe this treatment is appropriate in light of the generally high-credit quality of MDBs, their strong shareholder support, and a shareholder structure comprised of a significant proportion of sovereign entities with strong creditworthiness. Exposures to regional development banks and multilateral lending institutions that are not covered under the definition of MDB generally would be treated as corporate exposures.

3. Exposures to Government-sponsored Entities

The agencies are proposing to assign a 20 percent risk weight to exposures to GSEs that are not equity exposures and a 100 percent risk weight to preferred stock issued by a GSE. While this is consistent with the current treatment under the FDIC and Board's rules, it would represent a change to the OCC's general risk-based capital rules for national banks, which currently allow a banking organization to apply a 20 percent risk weight to GSE preferred stock.[21]

Although the GSEs currently are in the conservatorship of the Federal Housing Finance Agency and receive capital support from the U.S. Treasury, they remain privately owned corporations, and their obligations do not have the explicit guarantee of the full faith and credit of the United States. The agencies have long held the view that obligations of the GSEs should not be accorded the same treatment as obligations that carry the explicit guarantee of the U.S. government. Therefore, the agencies propose to continue to apply a 20 percent risk weight to debt exposures to GSEs.

4. Exposures to Depository Institutions, Foreign Banks, and Credit Unions

The general risk-based capital rules assign a 20 percent risk weight to all exposures to U.S. depository institutions and foreign banks incorporated in an OECD country. Short-term exposures to foreign banks incorporated in a non-OECD country receive a 20 percent risk weight and long-term exposures to such entities receive a 100 percent risk weight. The Basel II standardized approach allows for risk weights for a claim on a bank to be one risk weight category higher than the risk weight assigned to the sovereign exposures of a bank's home country. As described below, the agencies' propose treatment for depository institutions, foreign banks, and credit unions that is consistent with this approach.

[21] 12 CFR part 3, appendix A section 3(a)(2)(vii), and 2 CFR part 167.6(a)(1)(ii)(F) (OCC); 12 CFR part 208, and 225, appendix A, section III.C.2.b (Board); 12 CFR part 325, appendix A, section II.C, and 12 CFR part 390.466(a)(1)(ii)(F) (FDIC). GSEs include the Federal Home Loan Mortgage Corporation (FHLMC), the Federal National Mortgage Association (FNMA), the Farm Credit System, and the Federal Home Loan Bank System.

Under the proposal, exposures to U.S. depository institutions and credit unions would be assigned a 20 percent risk weight.[22] For exposures to foreign banks, the proposal would include risk weights based on the CRC applicable to the entity's home country, in accordance with Table 3.[23] Specifically, an exposure to a foreign bank would receive a risk weight one category higher than the risk weight assigned to a direct exposure to the entity's home country, as illustrated in Table 3. Exposures to a foreign bank in a country that does not have a CRC would receive a 100 percent risk weight. A banking organization would be required to assign a 150 percent risk weight to an exposure to a foreign bank immediately upon determining that an event of sovereign default has occurred in the bank's home country, or if an event of sovereign default has occurred in the foreign bank's home country during the previous five years.

Table 3 – Proposed Risk Weights for Exposures to Foreign Banks

		Risk Weight (in percent)
Sovereign CRC	0-1	20
	2	50
	3	100
	4-7	150
No CRC		100
Sovereign Default		150

Exposures to a depository institution or foreign bank that are includable in the regulatory capital of that entity would receive a risk weight of 100 percent, unless the exposure is (i) an equity exposure, (ii) a significant investment in the capital of an unconsolidated financial institution in the form of common stock under section 22 of the proposal, (iii) an exposure that

[22] A depository institution is defined in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813(c)(1)). Under this proposal, a credit union refers to an insured credit union as defined under the Federal Credit Union Act (12 U.S.C. 1752(7)).

[23] Foreign bank means a foreign bank as defined in section 211.2 of the Federal Reserve Board's Regulation K (12 CFR 211.2), that is not a depository institution. For purposes of this proposal, home country means the country where an entity is incorporated, chartered, or similarly established.

is deducted from regulatory capital under section 22 of the proposal, or (iv) an exposure that is subject to the 150 percent risk weight under section 32 of the proposal.

In 2011, the BCBS revised certain aspects of the Basel capital framework to address potential adverse effects of the framework on trade finance in low income countries.[24] In particular, the framework was revised to remove the sovereign floor for trade finance-related claims on banking organizations under the Basel II standardized approach.[25] The proposed requirements would incorporate this revision and permit a banking organization to assign a 20 percent risk weight to self-liquidating, trade-related contingent items that arise from the movement of goods and that have a maturity of three months or less.

The Basel capital framework treats exposures to securities firms that meet certain requirements like exposures to depository institutions. However, the agencies do not believe that the risk profile of these firms is sufficiently similar to depository institutions to justify that treatment. Accordingly, the agencies propose to require banking organizations to treat exposures to securities firms as corporate exposures, which parallels the treatment of bank holding companies and savings and loan holding companies, as described in section II.B.6 of this preamble.

5. Exposures to Public Sector Entities

The agencies' general risk-based capital rules assign a 20 percent risk weight to general obligations of states and other political subdivisions of OECD countries.[26] However, exposures that rely on repayment from specific projects (for example, revenue bonds) are assigned a risk weight of 50 percent. Other exposures to state and political subdivisions of OECD countries (including industrial revenue bonds) and exposures to political subdivisions of non-OECD countries receive a risk weight of 100 percent. The risk weights assigned to revenue obligations are higher than the risk weight assigned to general obligations because repayment of revenue obligations depends on specific projects, which present more risk relative to a general repayment obligation of a state or political subdivision of a sovereign.

The agencies are proposing to apply the same risk weights to exposures to U.S. states and municipalities as the general risk- based capital rules apply. Under the proposal, these political subdivisions would be included in the definition of "public sector entity" (PSE). Consistent with both the current rules and the Basel capital framework, the agencies propose to define a PSE as a state, local authority, or other governmental subdivision below the level of a sovereign. This

[24] See BCBS, "Treatment of Trade Finance under the Basel Capital Framework," (October 2011), available at http://www.bis.org/publ/bcbs205.pdf. "Low income country" is a designation used by the World Bank to classify economies (see World Bank, "How We Classify Countries," available at http://data.worldbank.org/about/country-classifications).

[25] The BCBS indicated that it removed the sovereign floor for such exposures to make access to trade finance instruments easier and less expensive for low income countries. Absent removal of the floor, the risk weight assigned to these exposures, where the issuing banking organization is incorporated in a low income country, typically would be 100 percent.

[26] Political subdivisions of the United States would include a state, county, city, town or other municipal corporation, a public authority, and generally any publicly owned entity that is an instrument of a state or municipal corporation.

definition would not include government-owned commercial companies that engage in activities involving trade, commerce, or profit that are generally conducted or performed in the private sector.

Under the proposal, a banking organization would assign a 20 percent risk weight to a general obligation exposure to a PSE that is organized under the laws of the United States or any state or political subdivision thereof and a 50 percent risk weight to a revenue obligation exposure to such a PSE. A general obligation would be defined as a bond or similar obligation that is backed by the full faith and credit of a PSE. A revenue obligation would be defined as a bond or similar obligation that is an obligation of a PSE, but which the PSE is committed to repay with revenues from a specific project financed rather than general tax funds.

Similar to the Basel framework's use of home country risk weights to assign a risk weight to a PSE exposure, the agencies propose to require a banking organization to apply a risk weight to an exposure to a non-U.S. PSE based on (1) the CRC applicable to the PSE's home country and (2) whether the exposure is a general obligation or a revenue obligation, in accordance with Table 4.

The risk weights assigned to revenue obligations would be higher than the risk weights assigned to a general obligation issued by the same PSE, as set forth in Table 4. Similar to exposures to a foreign bank, exposures to a non-U.S. PSE in a country that does not have a CRC rating would receive a 100 percent risk weight. Exposures to a non-U.S. PSE in a country that has defaulted on any outstanding sovereign exposure or that has defaulted on any sovereign exposure during the previous five years would receive a 150 percent risk weight. Table 4 illustrates the proposed risk weights for exposures to non-U.S. PSEs.

Table 4 – Proposed Risk Weights for Exposures to Non-U.S. PSE General Obligations and Revenue Obligations (in percent)

		Risk Weight for Exposures to Non-U.S. PSE General Obligations	Risk Weight for Exposures to Non-U.S. PSE Revenue Obligations
Sovereign CRC	0-1	20	50
	2	50	100
	3	100	100
	4-7	150	150
No CRC		100	100
Sovereign Default		150	150

In certain cases, under the general risk-based capital rules, the agencies have allowed a banking organization to rely on the risk weight that a foreign banking supervisor allows to assign to PSEs in that supervisor's country. Consistent with that approach, the agencies propose to allow a banking organization to apply a risk weight to an exposure to a non-U.S. PSE according to the risk weight that the foreign banking organization supervisor allows to assign to it. In no event, however, may the risk weight for an exposure to a non-U.S. PSE be lower than the risk weight assigned to direct exposures to that PSE's home country.

Question 4: The agencies request comment on the proposed treatment of exposures to PSEs.

6. Corporate Exposures

Under the agencies' general risk-based capital rules, credit exposures to companies that are not depository institutions or securitization vehicles generally are assigned to the 100 percent risk weight category. A 20 percent risk weight is assigned to claims on, or guaranteed by, a securities firm incorporated in an OECD country, that satisfy certain conditions.

The proposed requirements would be generally consistent with the general risk-based capital rules and require banking organizations to assign a 100 percent risk weight to all corporate exposures. The proposal would define a corporate exposure as an exposure to a company that is not an exposure to a sovereign, the Bank for International Settlements, the European Central Bank, the European Commission, the International Monetary Fund, an MDB, a depository institution, a foreign bank, or a credit union, a PSE, a GSE, a residential mortgage exposure, a pre-sold construction loan, a statutory multifamily mortgage, an HVCRE exposure, a cleared transaction, a default fund contribution, a securitization exposure, an equity exposure, or an unsettled transaction. In contrast to the agencies' general risk-based capital rules, securities firms would be subject to the same treatment as corporate exposures.

The agencies evaluated a number of alternatives to credit ratings to provide a more granular risk weight treatment for corporate exposures.[27] However, each of these alternatives was viewed as either having significant drawbacks, being too operationally complex, or as not being sufficiently developed to be proposed in this NPR.

7. Residential Mortgage Exposures

The general risk-based capital rules assign exposures secured by one-to-four family residential properties to either the 50 percent or the 100 percent risk-weight category. Exposures secured by a first lien on a one-to-four family residential property that meet certain prudential underwriting criteria and that are paying according to their terms generally receive a 50 percent risk weight.[28] The Basel II standardized approach similarly applies a broad treatment to residential mortgages, assigning a risk weight of 35 percent for most first-lien residential mortgage exposures that meet certain prudential criteria, such as the existence of a substantial margin of additional security over the amount of the loan.

During the recent market turmoil, the U.S. housing market experienced significant deterioration and unprecedented levels of mortgage loan defaults and home foreclosures. The causes for the significant increase in loan defaults and home foreclosures included inadequate underwriting standards; the proliferation of high-risk mortgage products, such as so-called pay-option adjustable rate mortgages, which provide for negative amortization and significant payment shock to the borrower; the practice of issuing mortgage loans to borrowers with unverified or undocumented income; and a precipitous decline in housing prices coupled with a rise in unemployment. Given the characteristics of the U.S. residential mortgage market and this recent experience, the agencies believe that a wider range of risk weights based on key risk factors is more appropriate for the U.S. residential mortgage market. Therefore, the agencies are proposing a risk-weight framework that is different from both the general risk-based capital rules and the Basel capital framework.

a. Categorization of residential mortgage exposures; loan-to-value.

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[27] See, for example, 76 FR 73526 (Nov. 29, 2011) and 76 FR 73777 (Nov. 29, 2011).

[28] See 12 CFR part 3, appendix A, section 3(c)(iii) and 12 CFR part 167.6(a)(1)(iii) (OCC); 12 CFR parts 208 and 225, appendix A, section III.C.3(Board); 12 CFR part 325, appendix A, section II.C.3 and 12 CFR 390.461 (definition of "qualifying mortgage loan") (FDIC).

The proposed definition of a residential mortgage exposure would be an exposure that is primarily secured by a first or subsequent lien on one-to-four family residential property (and not a securitization exposure, equity exposure, statutory multifamily mortgage, or presold construction loan). The definition of residential mortgage exposure also would include an exposure that is primarily secured by a first or subsequent lien on residential property that is not one-to-four family if the original and outstanding amount of the exposure is $1 million or less. A first-lien residential mortgage exposure would be a residential mortgage exposure secured by a first lien or by first and junior lien(s) where no other party holds an intervening lien. A junior-lien residential mortgage exposure would be a residential mortgage exposure that is not a first-lien residential mortgage exposure.

The NPR would maintain the current risk-based capital treatment for residential mortgage exposures that are guaranteed by the U.S. government or its agency. Accordingly, residential mortgage exposures that are unconditionally guaranteed by the U.S. government or a U.S. agency would receive a zero percent risk weight, and residential mortgage exposures that are conditionally guaranteed by the U.S. government or a U.S. agency would receive a 20 percent risk weight.

Under the NPR, a banking organization would divide residential mortgage exposures that are not guaranteed by the U.S. government or one of its agencies into two categories. The agencies propose to apply relatively low risk weights for residential mortgage exposures that do not have product features associated with higher credit risk, and higher risk weights for nontraditional loans that present greater risk. As described further below, the risk weight assigned to a residential mortgage exposure will also depend on the loan's loan-to-value ratio.

Under the proposal, a category 1 residential mortgage exposure would be defined as a residential mortgage exposure with the following characteristics:

(1) The duration of the mortgage exposure does not exceed 30 years;

(2) The terms of the mortgage exposure provide for regular periodic payments that do not: (i) result in an increase of the principal balance; (ii) allow the borrower to defer repayment of principal of the residential mortgage exposure; or (iii) result in a balloon payment;

(3) The standards used to underwrite the residential mortgage exposure: (i) took into account all of the borrower's obligations, including for mortgage obligations, principal, interest, taxes, insurance (including mortgage guarantee insurance), and assessments; and (ii) resulted in a conclusion that the borrower is able to repay the exposure using: (A) the maximum interest rate that may apply during the first five years after the date of the closing of the residential mortgage exposure transaction; and (B) the amount of the residential mortgage exposure is the maximum possible contractual exposure over the life of the mortgage as of the date of the closing of the transaction;

(4) The terms of the residential mortgage exposure allow the annual rate of interest to increase no more than two percentage points in any twelve month period and no more than six percentage points over the life of the exposure;

(5) For a first-lien home equity line of credit (HELOC), the borrower must be qualified using the principal and interest payments based on the maximum contractual exposure under the terms of the HELOC;

(6) The determination of the borrower's ability to repay is based on documented, verified income;

(7) The residential mortgage exposure is not 90 days or more past due or on non-accrual status; and

(8) The residential mortgage exposure is (i) not a junior-lien residential mortgage exposure and (ii) if the residential mortgage exposure is a first-lien residential mortgage exposure held by a single banking organization and secured by first and junior lien(s) where no other party holds an intervening lien, each residential mortgage exposure must have the characteristics of a category 1 residential mortgage exposure as set forth in this definition.

In addition, notwithstanding whether the residential mortgage exposure meets the aforementioned criteria, the primary federal supervisor may determine that the loan is not prudently underwritten, and therefore does not qualify as category 1 residential mortgage exposure.

A residential mortgage exposure that does not meet the criteria for category 1 would be a category 2 residential mortgage exposure. The standards for category 1 residential mortgage exposures reflect those underwriting and product features that have demonstrated a lower risk of default both through supervisory experience and observations from the recent foreclosure crisis. The agencies believe that the proposed divergence in risk weights for category 1 and category 2 residential mortgage exposures appropriately reflects differences in risk between mortgages in the two categories. Because category 2 residential mortgage exposures generally are of higher risk than category 1 residential mortgage exposures, the minimum proposed risk weight for a category 2 residential mortgage exposure is 100 percent.

Under the general risk-based capital rules, a banking organization must assign a minimum 100 percent risk weight to an exposure secured by a junior lien on residential property, unless the banking organization also holds the first lien and there are no intervening liens. The agencies also propose to require a banking organization that holds both a first and junior lien on the same property to combine the exposures into one first-lien residential mortgage exposure for purposes of determining the loan-to-value (LTV) and risk weight for the combined exposure. However, a banking organization could only categorize the combined exposure as a category 1 residential mortgage exposure if the terms and characteristics of both mortgages meet all of the criteria for category 1 residential mortgage exposures. This requirement would ensure that no residential mortgage products associated with higher risk may be categorized as category 1 residential mortgage exposures.

Except as described in the preceding paragraph, under this NPR, a banking organization would classify all junior-lien residential mortgage exposures as category 2 residential mortgage exposures in light of the increased risk associated with junior liens demonstrated in the recent foreclosure crisis.

The proposed risk weighting would depend on not only on the mortgage exposure's status as a category 1 or category 2 residential mortgage exposure, but also on the mortgage exposure's LTV ratio. The amount of equity a borrower has in a residential property is highly correlated with default risk, and the agencies believe that it is appropriate that LTV be an important component in assigning risk weights to residential mortgage exposures. However, the agencies stress that the use of LTV ratios to assign risk weights to residential mortgage exposures is not a substitute for, and does not otherwise release a banking organization from, its responsibility to have prudent loan underwriting and risk management practices consistent with the size, type, and risk of its mortgage business.[29]

The agencies are proposing in this NPR to require a banking organization to calculate the LTV ratios of a residential mortgage exposure as follows. The denominator of the LTV ratio, that is, the value of the property, would be equal to the lesser of the actual acquisition cost for the property (for a purchase transaction) or the estimate of a property's value at the origination of the loan or at the time of restructuring or modification. The estimate of value would be based on an appraisal or evaluation of the property in conformance with the agencies' appraisal regulations[30] and should conform to the "Interagency Appraisal and Evaluation Guideline" and the "Real Estate Lending Guidelines."[31] If a banking organization's first-lien residential mortgage exposure consists of both first and junior liens on a property, a banking organization would update the estimate of value at the origination of the junior-lien mortgage.

The loan amount for a first-lien residential mortgage exposure is the unpaid principal balance of the loan unless the first-lien residential mortgage exposure was a combination of a first and junior lien. In that case, the loan amount would be the sum of the unpaid principal balance of the first lien and the maximum contractual principal amount of the junior lien. The loan amount of a junior-lien residential mortgage exposure is the maximum contractual principal amount of the exposure, plus the maximum contractual principal amounts of all senior exposures secured by the same residential property on the date of origination of the junior-lien residential mortgage exposure.

As proposed, a banking organization would not calculate a separate risk-weighted asset amount for the funded and unfunded portions of a residential mortgage exposure. Instead, the proposal would require only the calculation of a single LTV ratio representing a combined funded and unfunded amount when calculating the LTV ratio. Thus, the loan amount of a first-lien residential mortgage exposure would equal the funded principal amount (or combined exposures provided there is no intervening lien) plus the exposure amount of any unfunded commitment (that is, the unfunded amount of the maximum contractual amount of any

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[29] See, for example, "Interagency Guidance on Nontraditional Mortgage Product Risks," 71 FR 58609 (Oct. 4, 2006) and "Statement on Subprime Mortgage Lending," 72 FR 37569 (July 10, 2007). In addition, there is ongoing implementation of certain aspects of the mortgage reform initiatives under various sections of the Dodd-Frank Act. For example, section 1141 of the Dodd-Frank Act amended the Truth in Lending Act to prohibit creditors from making mortgage loans without regard to a consumer's repayment ability. See 15 U.S.C. 1639c.

[30] 12 CFR part 34, subpart C (OCC); 12 CFR part 208, subpart E and 12 CFR part 225, subpart G (Board); 12 CFR part 323 and 12 CFR part 390, subpart X (FDIC).

[31] 12 CFR part 34, subpart D and 12 CFR part 160 (OCC); 12 CFR part 208, subpart E (Board); 12 CFR part 323 and 12 CFR 390.442 (FDIC).

commitment multiplied by the appropriate CCF). The loan amount of a junior-lien residential mortgage exposure would equal the sum of: (1) the funded principal amount of the exposure, (2) the exposure amount of any undrawn commitment associated with the junior-lien exposure, and (3) the exposure amount of any senior exposure held by a third party on the date of origination of the junior-lien exposure. If a senior exposure held by a third party includes an undrawn commitment, such as a HELOC or a negative amortization feature, the loan amount for a junior-lien residential mortgage exposure would include the maximum contractual amount of that commitment.

The agencies believe that the LTV information should be readily available from the mortgage loan documents and thus should not present an issue for banking organizations in calculating the risk-based capital under the proposed requirements.

A banking organization would not be able to recognize private mortgage insurance (PMI) when calculating the LTV ratio of a residential mortgage exposure. The agencies believe that, due to the varying degree of financial strength of mortgage providers, it would not be prudent to recognize PMI for purposes of the general risk-based capital rules.

Question 5: The agencies solicit comments on all aspects of this NPR for determining the risk weights of residential mortgage loans, including the use of the LTV ratio to determine the risk-based capital treatment. What alternative criteria or approaches to categorizing mortgage loans would enable the agencies to appropriately and consistently differentiate among the levels of risk inherent in different mortgage exposures? For example, should all residential mortgages that meet the "qualified mortgage" criteria to be established for the purposes of the Truth in Lending Act pursuant to section 1412 of the Dodd-Frank Act be included in category 1? For category 1 residential mortgage exposures with interest rates that adjust or reset, would a proposed limit based directly on the amount the mortgage payment increases rather than on a change in interest rate be more appropriate? Why or why not? Does this proposal appropriately address loans with balloon payments and the risk of reverse mortgage loans? Why or why not? Provide detailed explanations and supporting data wherever possible.

Question 6: The agencies solicit comment on whether to allow banking organizations to recognize mortgage insurance for purposes of calculating the LTV ratio of a residential mortgage exposure under the standardized approach. What criteria could the agencies use to ensure that only financially sound PMI providers are recognized?

b. Risk weights for residential mortgage exposures.

As proposed, a banking organization would determine the risk weight for a residential mortgage exposure using Table 5 based on the loan's LTV ratio and whether it is a category 1 or category 2 residential mortgage exposure.

Table 5 – Proposed Risk Weights for Residential Mortgage Exposures

Loan-to-value ratio (in percent)	Category 1 residential mortgage exposure (in percent)	Category 2 residential mortgage exposure (in percent)
Less than or equal to 60	35	100
Greater than 60 and less than or equal to 80	50	100
Greater than 80 and less than or equal to 90	75	150
Greater than 90	100	200

As an example risk weight calculation, a category 1 residential mortgage loan that has a loan amount of $100,000 and a property value of $125,000 at origination would result in an LTV of 80 percent and would be assigned a risk weight of 50 percent. If, at the time of restructuring the loan at a later date, the loan amount is $92,000 and the value of the property is determined to be $110,000, the LTV would be 84 percent and the applicable risk weight would be 75 percent.

c. Modified or restructured residential mortgage exposures.

Under the current general risk-based capital rules, a residential mortgage may be assigned to the 50 percent risk weight category only if it is performing in accordance with its original terms or not restructured. The recent crises and ongoing problems in the housing market have demonstrated the profound negative effect foreclosures have on homeowners and their communities. Where practicable, modification or restructuring of a residential mortgage can be an effective means for a borrower to avoid default and foreclosure and for a banking organization to reduce risk of loss.

The agencies have recognized the importance of the prudent use of mortgage restructuring and modification in a banking organization's risk management and believe that restructuring or modification can reduce the risk of a residential mortgage exposure. Therefore, in this NPR, the agencies are not proposing to automatically raise the risk weight for a residential mortgage exposure if it is restructured or modified. Instead, under this NPR, a banking organization would categorize a modified or restructured residential mortgage exposure as a category 1 or category 2 residential mortgage exposure in accordance with the terms and characteristics of the exposure after the modification or restructuring.

Additionally, to ensure that the banking organization applies a risk weight to a restructured or modified mortgage that most accurately reflects its risk profile, a banking organization could only apply (1) a risk weight lower than 100 percent to a category 1 residential

mortgage exposure or (2) a risk weight lower than 200 percent to a category 2 residential mortgage exposure if the banking organization updated the LTV ratio of the exposure at the time of the modification or restructuring.

In further recognition of the importance of residential mortgage modifications and restructuring, a residential mortgage exposure modified or restructured on a permanent or trial basis solely pursuant to the U.S. Treasury's Home Affordable Mortgage program (HAMP) would not be restructured or modified under the proposed requirements and would receive the risk weight provided in Table 5.

The agencies believe that treating mortgage loans modified pursuant to HAMP in this manner is appropriate in light of the special and unique incentive features of HAMP, and the fact that the program is offered by the U.S. government to achieve the public policy objective of promoting sustainable loan modifications for homeowners at risk of foreclosure in a way that balances the interests of borrowers, servicers, and lenders. The program includes specific debt-to-income ratio requirements, which should better ensure the borrower's ability to repay the modified loan, and it provides for the U.S. Treasury Department to match reductions in monthly payments dollar-for-dollar to reduce the borrower's front-end debt-to-income ratio.

Additionally, the program provides financial incentives for servicers and lenders to take actions to reduce the likelihood of defaults, as well as for servicers and borrowers designed to help borrowers remain current on modified loans. The structure and amount of these cash payments align the financial incentives of servicers, lenders, and borrowers to encourage and increase the likelihood of participating borrowers remaining current on their mortgages. Each of these incentives is important to the agencies' determination with respect to the appropriate regulatory capital treatment of mortgage loans modified under HAMP.

Question 7: The agencies request comment on whether loan modifications made pursuant to other federal or state housing programs warrant specific provisions in the agencies' risk-based capital regulations at all, and if they do what criteria should be considered when determining the appropriate risk-based capital treatment for modified residential mortgages, given the risk characteristics of loans that require modification.

8. Pre-sold Construction Loans and Statutory Multifamily Mortgages

The general risk-based capital rules assign either a 50 percent or a 100 percent risk weight to certain one-to-four family residential pre-sold construction loans and to multifamily residential loans, consistent with the Resolution Trust Corporation Refinancing, Restructuring, and Improvement Act of 1991 (RTCRRI Act).[32] This NPR would maintain this general treatment while clarifying and updating the way the general risk-based capital rules define these exposures.

[32] The RTCRRI Act mandates that each agency provide in its capital regulations (i) a 50 percent risk weight for certain one-to-four-family residential pre-sold construction loans and multifamily residential loans that meet specific statutory criteria in the RTCRRI Act and any other underwriting criteria imposed by the agencies, and (ii) a 100 percent risk weight for one-to-four-family residential pre-sold construction loans for residences for which the purchase contract is cancelled. 12 U.S.C. 1831n, note.

Under this NPR, a pre-sold construction loan would be subject to a 50 percent risk weight unless the purchase contract is cancelled. This NPR would define a pre-sold construction loan as any one-to-four family residential construction loan to a builder that meets the requirements of section 618(a)(1) or (2) of the RTCRRI Act and the following criteria:

(1) The loan is made in accordance with prudent underwriting standards;

(2) The purchaser is an individual(s) that intends to occupy the residence and is not a partnership, joint venture, trust, corporation, or any other entity (including an entity acting as a sole proprietorship) that is purchasing one or more of the residences for speculative purposes;

(3) The purchaser has entered into a legally binding written sales contract for the residence;

(4) The purchaser has not terminated the contract; however, if the purchaser terminates the sales contract the banking organization must immediately apply a 100 percent risk weight to the loan and report the revised risk weight in the banking organization's next quarterly regulatory report;

(5) The purchaser of the residence has a firm written commitment for permanent financing of the residence upon completion;

(6) The purchaser has made a substantial earnest money deposit of no less than 3 percent of the sales price, which is subject to forfeiture if the purchaser terminates the sales contract; provided that, the earnest money deposit shall not be subject to forfeiture by reason of breach or termination of the sales contract on the part of the builder;

(7) The earnest money deposit must be held in escrow by the banking organization or an independent party in a fiduciary capacity, and the escrow agreement must provide that in the event of default the escrow funds shall be used to defray any cost incurred by the banking organization relating to any cancellation of the sales contract by the purchaser of the residence;

(8) The builder must incur at least the first 10 percent of the direct costs of construction of the residence (that is, actual costs of the land, labor, and material) before any drawdown is made under the loan;

(9) The loan may not exceed 80 percent of the sales price of the presold residence; and

(10) The loan is not more than 90 days past due, or on nonaccrual.

A statutory multifamily mortgage would continue to receive a 50 percent risk weight. The NPR would define statutory multifamily mortgage as a loan secured by a multifamily residential property that meets the requirements under section 618(b)(1) of the RTCRRI Act and the following criteria:

(1) The loan is made in accordance with prudent underwriting standards;

(2) The LTV ratio of the loan, calculated in accordance with section 32(g)(3) of the proposal, does not exceed 80 percent (or 75 percent if the loan is based on an interest rate that changes over the term of the loan);

(3) All principal and interest payments on the loan must have been made on time for at least one year prior to applying a 50 percent risk weight to the loan, or in the case where an existing owner is refinancing a loan on the property, all principal and interest payments on the loan being refinanced must have been made on time for at least one year prior to applying a 50 percent risk weight to the loan;

(4) Amortization of principal and interest on the loan must occur over a period of not more than 30 years and the minimum original maturity for repayment of principal must not be less than 7 years;

(5) Annual net operating income (before debt service on the loan) generated by the property securing the loan during its most recent fiscal year must not be less than 120 percent of the loan's current annual debt service (or 115 percent of current annual debt service if the loan is based on an interest rate that changes over the term of the loan) or, in the case of a cooperative or other not-for-profit housing project, the property must generate sufficient cash flow to provide comparable protection to the banking organization; and

(6) The loan is not more than 90 days past due, or on nonaccrual.[33]

A multifamily mortgage that does not meet the proposed definition of a statutory multifamily mortgage would be treated as a corporate exposure.

9. High Volatility Commercial Real Estate Exposures

In this NPR, the agencies are including a new risk-based capital treatment for certain commercial real estate exposures that currently receive a 100 percent risk weight under the general risk-based capital rules. Supervisory experience has demonstrated that certain acquisition, development, and construction loans exposures present unique risks for which the agencies believe banking organizations should hold additional capital. Accordingly, the agencies propose to require banking organizations to assign a 150 percent risk weight to any High Volatility Commercial Real Estate Exposure (HVCRE). The proposed definition of an HVCRE would be a credit facility that finances or has financed the acquisition, development, or construction (ADC) of real property, unless the facility finances:

(1) One- to four-family residential property; or

(2) Commercial real estate projects in which:

(i) The LTV ratio is less than or equal to the applicable maximum supervisory LTV ratio in the agencies' real estate lending standards;

(ii) The borrower has contributed capital to the project in the form of cash or unencumbered readily marketable assets (or has paid development expenses out-of-pocket) of at least 15 percent of the real estate's appraised "as completed" value; and

(iii) The borrower contributed the amount of capital required under paragraph 2(ii) of this definition before the banking organization advances funds under the credit facility, and the capital contributed by the borrower, or internally generated by the project, is contractually required to remain in the project throughout the life of the project. The life of a project concludes only when the credit facility is converted to permanent financing or is sold or paid in full. Permanent financing may be provided by the banking organization that provided the ADC facility as long as the permanent financing is subject to the banking organization's underwriting criteria for long-term mortgage loans.

[33] A pre-sold construction loan or statutory multifamily mortgage that is 90 days or more past due or on nonaccrual would be accorded the general treatment for past due loans.

A commercial real estate loan that is not an HVCRE exposure would be treated as a corporate exposure.

Question 8: The agencies solicit comment on the proposed treatment for HVCRE exposures.

10. Past Due Exposures

Under the general risk-based capital rules, the risk weight of a loan does not change if the loan becomes past due, with the exception of certain residential mortgage loans. The Basel II standardized approach provides risk weights ranging from 50 to 150 percent for loans that are more than 90 days past due to reflect the increased risk of loss. The agencies believe that a higher risk is appropriate for past due exposures to reflect the increased risk associated with such exposures

Accordingly, consistent with the Basel capital framework and to reflect impaired credit quality of such exposures, the agencies propose that a banking organization assign a risk weight of 150 percent to an exposure that is not guaranteed or not secured (and that is not a sovereign exposure or a residential mortgage exposure) if it is 90 days or more past due or on nonaccrual. A banking organization may assign a risk weight to the collateralized or guaranteed portion of the past due exposure if the collateral, guarantee, or credit derivative meets the proposed requirements for recognition described in sections 36 and 37.

Question 9: The agencies solicit comments on the proposed treatment of past due exposures.

11. Other Assets

In this NPR, the agencies propose to apply the following risk weights for exposures not otherwise assigned to a specific risk weight category, which are generally consistent with the risk weights in the general risk-based capital rules:

(1) A zero percent risk weight to cash owned and held in all of a banking organization's offices or in transit; gold bullion held in the banking organization's own vaults, or held in another depository institution's vaults on an allocated basis to the extent gold bullion assets are offset by gold bullion liabilities; and to exposures that arise from the settlement of cash transactions (such as equities, fixed income, spot foreign exchange and spot commodities) with a central counterparty where there is no assumption of ongoing counterparty credit risk by the central counterparty after settlement of the trade and associated default fund contributions;

(2) A 20 percent risk weight to cash items in the process of collection; and

(3) A 100 percent risk weight to all assets not specifically assigned a different risk weight under this NPR (other than exposures that would be deducted from tier 1 or tier 2 capital).

In addition, subject to proposed transition arrangements, a banking organization would assign:

(1) A 100 percent risk weight to DTAs arising from temporary differences that the banking organization could realize through net operating loss carrybacks; and

(2) A 250 percent risk weight to MSAs and DTAs arising from temporary differences that the banking organization could not realize through net operating loss carrybacks that are not deducted from common equity tier 1 capital pursuant to section 22(d) of the proposal.

The proposed requirements would provide limited flexibility to address situations where exposures of a depository institution holding company or nonbank financial company supervised by the Board, that are not exposures typically held by depository institutions, do not fit wholly within the terms of another risk-weight category. Under the proposal, such exposures could be assigned to the risk weight category applicable under the capital rules for bank holding companies, provided that (1) the depository institution holding company or nonbank financial company is not authorized to hold the asset under applicable law other than debt previously contracted or similar authority; and (2) the risks associated with the asset are substantially similar to the risks of assets that are otherwise assigned to a risk weight category of less than 100 percent under subpart D of the proposal.

C. Off-balance Sheet Items

Under this NPR, as under the general risk-based capital rules, a banking organization would calculate the exposure amount of an off-balance sheet item by multiplying the off-balance sheet component, which is usually the notional amount, by the applicable credit conversion factor (CCF). This treatment would be applied to off-balance sheet items, such as commitments, contingent items, guarantees, certain repo-style transactions, financial standby letters of credit, and forward agreements.

Also similar to the general risk-based capital rules, a banking organization would apply a zero percent CCF to the unused portion of commitments that are unconditionally cancelable by the banking organization. For purposes of this NPR, a commitment would mean any legally binding arrangement that obligates a banking organization to extend credit or to purchase assets. Unconditionally cancelable would mean a commitment that a banking organization may, at any time, with or without cause, refuse to extend credit under the commitment (to the extent permitted under applicable law). In the case of a residential mortgage exposure that is a line of credit, a banking organization would be deemed able to unconditionally cancel the commitment if it can, at its option, prohibit additional extensions of credit, reduce the credit line, and terminate the commitment to the full extent permitted by applicable law. If a banking organization provides a commitment that is structured as a syndication, it would only be required to calculate the exposure amount for its pro rata share of the commitment.

The agencies propose to increase a CCF from zero percent to 20 percent for commitments with an original maturity of one year or less that are not unconditionally cancelable by a banking organization, as consistent with the Basel II standardized approach. The proposed requirements would maintain the 20 percent CCF for self-liquidating, trade-related contingent items that arise from the movement of goods with an original maturity of one year or less.

As under the general risk-based capital rules, a banking organization would apply a 50 percent CCF to commitments with an original maturity of more than one year that are not unconditionally cancelable by the banking organization; and to transaction-related contingent items, including performance bonds, bid bonds, warranties, and performance standby letters of credit.

Under this NPR, a banking organization would be required to apply a 100 percent CCF to off-balance sheet guarantees, repurchase agreements, securities lending or borrowing transactions, financial standby letters of credit; forward agreements, and other similar exposures. The off-balance sheet component of a repurchase agreement would equal the sum of the current market values of all positions the banking organization has sold subject to repurchase. The off-balance sheet component of a securities lending transaction would be the sum of the current market values of all positions the banking organization has lent under the transaction. For securities borrowing transactions, the off-balance sheet component would be the sum of the current market values of all non-cash positions the banking organization has posted as collateral under the transaction. In certain circumstances, a banking organization may instead determine the exposure amount of the transaction as described in section II.F.2 of this preamble and section 37 of the proposal.

The calculation of the off-balance sheet component for repurchase agreements, and securities lending and borrowing transactions described above represents a change to the general risk-based capital treatment for such transactions. Under the general risk-based capital rules, capital is required for any on-balance sheet exposure that arises from a repo-style transaction (that is, a repurchase agreement, reverse repurchase agreement, securities lending transaction, and securities borrowing transaction). For example, capital is required against the cash receivable that a banking organization generates when it borrows a security and posts cash collateral to obtain the security. However, a banking organization faces counterparty credit risk on a repo-style transaction, regardless of whether the transaction generates an on-balance sheet exposure. Therefore, in contrast to the general risk-based capital rules, this NPR would require a banking organization to hold risk-based capital against all repo-style transactions, regardless of whether they generate on-balance sheet exposures, as described in the section 37 of the proposal.

Under the general risk-based capital rules, a banking organization is subject to a risk-based capital requirement when it provides credit-enhancing representations and warranties on assets sold or otherwise transferred to third parties as such positions are considered recourse arrangements.[34] However, the general risk-based capital rules do not impose a risk-based capital requirement on assets sold or transferred with representations and warranties that contain (1) certain early default clauses, (2) certain premium refund clauses that cover assets guaranteed, in whole or in part, by the U.S. government, a U.S. government agency, or a U.S. GSE; or

[34] 12 CFR 3, appendix A, section 4(a)(11) and 12 CFR 167.6(b) (OCC); 12 CFR parts 208 and 225 appendix A, section III.B.3.a.xii (Board); 12 CFR part 325, appendix A, section II.B.5(a) and 12 CFR 390.466(b) (FDIC).

(3) warranties that permit the return of assets in instances of fraud, misrepresentation, or incomplete documentation.[35]

Under this NPR, if a banking organization provides a credit enhancing representation or warranty on assets it sold or otherwise transferred to third parties, including in cases of early default clauses or premium-refund clauses, the banking organization would treat such an arrangement as an off-balance sheet guarantee and apply a 100 percent credit conversion factor to the exposure amount. The agencies are proposing a different treatment than the one under the general risk-based capital rules because the agencies believe that a banking organization should hold capital for such exposures while credit-enhancing representations and warranties are in place.

Question 10: The agencies solicit comment on the proposed treatment of credit enhancing representations and warranties.

The proposed risk-based capital treatment for off-balance sheet items is consistent with section 165(k) of the Dodd-Frank Act which provides that, in the case of a bank holding company with $50 billion or more in total consolidated assets the computation of capital for purposes of meeting capital requirements shall take into account any off-balance-sheet activities of the company.[36] The proposal complies with the requirements of section 165(k) of the Dodd-Frank Act by requiring a bank holding company to hold risk-based capital for its off-balance sheet exposures, as described in sections 31, 33, 34 and 35 of the proposal.

D. Over-the-counter Derivative Contracts

In this NPR, the agencies propose generally to retain the treatment of over-the-counter (OTC) derivatives provided under the general risk-based capital rules, which is similar to the current exposure method for determining the exposure amount for OTC derivative contracts contained in the Basel II standardized approach.[37] The proposed revisions to the treatment of the OTC derivative contracts include an updated definition of an OTC derivative contract, a revised conversion factor matrix for calculating the potential future exposure (PFE), a revision of the

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[35] 12 CFR part 3, appendix A, section 4(a)(8) and 12 CFR 167.6(b) (OCC); 12 CFR part 208, appendix A, section II.B.3.a.ii.1 and 12 CFR part 225, appendix A, section III.B.3.a. ii.(1) (Board); and 12 CFR part 325, appendix A, section II.B.5(a) and 12 CFR part 390.466(b) (FDIC).

[36] Section 165(k) of the Dodd-Frank Act (12 U.S.C. 5365(k)). This section defines an off-balance sheet activity as an existing liability of a company that is not currently a balance sheet liability, but may become one upon the happening of some future event. Such transactions may include direct credit substitutes in which a banking organization substitutes its own credit for a third party; irrevocable letters of credit; risk participations in bankers' acceptances; sale and repurchase agreements; asset sales with recourse against the seller; interest rate swaps; credit swaps; commodities contracts; forward contracts; securities contracts; and such other activities or transactions as the Board may define through a rulemaking.

[37] The general risk-based capital rules for savings associations regarding the calculation of credit equivalent amounts for derivative contracts differ from the rules for other banking organizations. (See 12 CFR 167(a)(2) (federal savings associations) and 12 CFR 390.466(a)(2) (state savings associations)). The savings association rules address only interest rate and foreign exchange rate contracts and include certain other differences. Accordingly, the description of the general risk-based capital rules in this preamble primarily reflects the rules applicable to state and national banks and bank holding companies.

criteria for recognizing the netting benefits of qualifying master netting agreements and of financial collateral, and the removal of the 50 percent risk weight limit for OTC derivative contracts.

Under the proposed requirements, as under the general risk-based capital rules, a banking organization would be required to hold risk-based capital for counterparty credit risk for OTC derivative contracts. As defined in this NPR, a derivative contract is a financial contract whose value is derived from the values of one or more underlying assets, reference rates, or indices of asset values or reference rates. A derivative contract would include an interest rate, exchange rate, equity, or a commodity derivative contract, a credit derivative, and any other instrument that poses similar counterparty credit risks. Under the proposal, derivative contracts also would include unsettled securities, commodities, and foreign exchange transactions with a contractual settlement or delivery lag that is longer than the lesser of the market standard for the particular instrument or five business days. This applies, for example, to mortgage-backed securities transactions that the GSEs conduct in the To-Be-Announced market.

An OTC derivative contract would not include a derivative contract that is a cleared transaction, which would be subject to a specific treatment as described in section II.E of this preamble. OTC derivative contracts would, however, include an exposure of a banking organization that is a clearing member to its clearing member client where the banking organization is either acting as a financial intermediary and enters into an offsetting transaction with a central counterparty (CCP) or where the banking organization provides a guarantee to the CCP on the performance of the client. These transactions may not be treated as cleared transactions because the banking organization remains exposed directly to the risk of the individual counterparty.

To determine the risk-weighted asset amount for an OTC derivative contract under the proposal, a banking organization would first determine its exposure amount for the contract and then apply to that amount a risk weight based on the counterparty, eligible guarantor, or recognized collateral.

For a single OTC derivative contract that is not subject to a qualifying master netting agreement (as defined further below in this section), the exposure amount would be the sum of (1) the banking organization's current credit exposure, which would be the greater of the mark-to-market value or zero, and (2) PFE, which would be calculated by multiplying the notional principal amount of the OTC derivative contract by the appropriate conversion factor, in accordance with Table 6 below.

Under this NPR, the conversion factor matrix would be revised to include the additional categories of OTC derivative contracts as illustrated in Table 6. For an OTC derivative contract that does not fall within one of the specified categories in Table 6, the PFE would be calculated using the appropriate "other" conversion factor:

TABLE 6 – CONVERSION FACTOR MATRIX FOR OTC DERIVATIVE CONTRACTS [38]

Remaining maturity[39]	Interest rate	Foreign exchange rate and gold	Credit (investment-grade reference asset)[40]	Credit (non-investment-grade reference asset)	Equity	Precious metals (except gold)	Other
One year or less	0.00	0.01	0.05	0.10	0.06	0.07	0.10
Greater than one year and less than or equal to five years	0.005	0.05	0.05	0.10	0.08	0.07	0.12
Greater than five years	0.015	0.075	0.05	0.10	0.10	0.08	0.15

For multiple OTC derivative contracts subject to a qualifying master netting agreement, the exposure amount would be calculated by adding the net current credit exposure and the adjusted sum of the PFE amounts for all OTC derivative contracts subject to the qualifying master netting agreement. The net current credit exposure would be the greater of zero and the net sum of all positive and negative mark-to-market values of the individual OTC derivative contracts subject to the qualifying master netting agreement. The adjusted sum of the PFE amounts would be calculated as described in section 34(a)(2)(ii) of the proposal.

Under the general risk-based capital rules, a banking organization must enter into a bilateral master netting agreement with its counterparty and obtain a written and well-reasoned legal opinion of the enforceability of the netting agreement for each of its netting agreements that cover OTC derivative contracts to recognize the netting benefit. Similarly, under this NPR, to recognize netting of multiple OTC derivative contracts, the contracts would be required to be subject to a qualifying master netting agreement; however, for most transactions, a banking organization may rely on sufficient legal review instead of an opinion on the enforceability of the

[38] For a derivative contract with multiple exchanges of principal, the conversion factor is multiplied by the number of remaining payments in the derivative contract.

[39] For a derivative contract that is structured such that on specified dates any outstanding exposure is settled and the terms are reset so that the market value of the contract is zero, the remaining maturity equals the time until the next reset date. For an interest rate derivative contract with a remaining maturity of greater than one year that meets these criteria, the minimum conversion factor is 0.005.

[40] A banking organization would use the column labeled "Credit (investment-grade reference asset)" for a credit derivative whose reference asset is an outstanding unsecured long-term debt security without credit enhancement that is investment grade. A banking organization would use the column labeled "Credit (non-investment-grade reference asset)" for all other credit derivatives.

netting agreement as described below. Under this NPR, a qualifying master netting agreement would be defined as any written, legally enforceable netting agreement, provided that:

(1) The agreement creates a single legal obligation for all individual transactions covered by the agreement upon an event of default, including receivership, insolvency, liquidation, or similar proceeding, of the counterparty;

(2) The agreement provides the banking organization the right to accelerate, terminate, and close-out on a net basis all transactions under the agreement and to liquidate or set-off collateral promptly upon an event of default, including upon an event of receivership, insolvency, liquidation, or similar proceeding, of the counterparty, provided that, in any such case, any exercise of rights under the agreement will not be stayed or avoided under applicable law in the relevant jurisdictions, other than in receivership, conservatorship, resolution under the Federal Deposit Insurance Act or Title II of the Dodd-Frank Act, or under any similar insolvency law applicable to GSEs;

(3) The banking organization has conducted sufficient legal review to conclude with a well-founded basis (and maintains sufficient written documentation of that legal review) that:

(i) The agreement meets the requirements of paragraph (2) of this definition; and

(ii) In the event of a legal challenge (including one resulting from default or from a receivership, insolvency, liquidation, or similar proceeding) the relevant court and administrative authorities would find the agreement to be legal, valid, binding, and enforceable under the law of the relevant jurisdictions;

(iii) The banking organization establishes and maintains procedures to monitor possible changes in relevant law and to ensure that the agreement continues to satisfy the requirements of this definition; and

(iv) The agreement does not contain a walkaway clause (that is, a provision that permits a non-defaulting counterparty to make a lower payment than it otherwise would make under the agreement, or no payment at all, to a defaulter or the estate of a defaulter, even if the defaulter or the estate of the defaulter is a net creditor under the agreement).

In some cases, the legal review requirement could be met by reasoned reliance on a commissioned legal opinion or an in-house counsel analysis. In other cases, for example, those involving certain new derivative transactions or derivative counterparties in jurisdictions where a banking organization has little experience, the banking organization would be expected to obtain an explicit, written legal opinion from external or internal legal counsel addressing the particular situation.

If an OTC derivative contract is collateralized by financial collateral, a banking organization would first determine the exposure amount of the OTC derivative contract as described in this section. Next, to recognize the credit risk mitigation benefits of the financial collateral, a banking organization could use the simple approach for collateralized transactions as described in section 37(b) of the proposal. Alternatively, if the financial collateral is marked-to-market on a daily basis and subject to a daily margin maintenance requirement, a banking

organization could adjust the exposure amount of the contract using the collateral haircut approach described in section 37(c) of the proposal.

Under this NPR, a banking organization would be required to treat an equity derivative contract as an equity exposure and compute its risk-weighted asset amount according to the proposed calculation requirements described in section 52 (unless the contract is a covered position under subpart F of the proposal). If the banking organization risk weights a contract under the Simple Risk-Weight Approach described in section 52, it may choose not to hold risk-based capital against the counterparty risk of the equity contract, so long as it does so for all such contracts. Where the OTC equity contracts are subject to a qualified master netting agreement, a banking organization would either include or exclude all of the contracts from any measure used to determine counterparty credit risk exposures. If the banking organization is treating an OTC equity derivative contract as a covered position under subpart F, it would calculate a risk-based capital requirement for counterparty credit risk of the contract under section 34.

Similarly, if a banking organization purchases a credit derivative that is recognized under section 36 of the proposal as a credit risk mitigant for an exposure that is not a covered position under subpart F of the proposal, it would not be required to compute a separate counterparty credit risk capital requirement for the credit derivative, provided it does so consistently for all such credit derivative contracts. Further, where these credit derivative contracts are subject to a qualifying master netting agreement, the banking organization would either include them all or exclude them all from any measure used to determine the counterparty credit risk exposure to all relevant counterparties for risk-based capital purposes.

In addition, if a banking organization provides protection through a credit derivative that is not a covered position under subpart F of the proposal, it would treat the credit derivative as an exposure to the underlying reference asset and compute a risk-weighted asset amount for the credit derivative under section 32 of the proposal. The banking organization would not be required to compute a counterparty credit risk capital requirement for the credit derivative, as long as it does so consistently and either includes all or excludes all such credit derivatives that are subject to a qualifying master netting contract from any measure used to determine counterparty credit risk exposure to all relevant counterparties for risk-based capital purposes.

Where the banking organization provides protection through a credit derivative treated as a covered position under subpart F of the proposal, it would compute a supplemental counterparty credit risk capital requirement using an amount determined under section 34 for OTC credit derivatives or section 35 for credit derivatives that are cleared transactions. In either case, the PFE of the protection provider would be capped at the net present value of the amount of unpaid premiums.

Under the general risk-based capital rules, the risk weight applied to an OTC derivative contract is limited to 50 percent even if the counterparty or guarantor would otherwise receive a higher risk weight. Under this NPR, the risk weight for OTC derivative transactions would not be subject to any specific ceiling, consistent with the Basel capital framework. The agencies believe that as the market for derivatives has developed, the types of counterparties acceptable to participants have expanded to include counterparties that merit a risk weight greater than 50 percent.

Question 11: The agencies solicit comment on the proposed risk-based capital treatment for OTC derivatives, including the definition of an OTC derivative and the removal of the 50 percent cap on risk-weighting for OTC derivative contracts.

E. Cleared Transactions

1. Overview

The BCBS and the agencies support clearing derivative and repo-style transactions[41] through a central counterparty (CCP) wherever possible in order to promote transparency, multilateral netting, and robust risk management practices.[42]

In general, CCPs help improve the safety and soundness of the derivatives market through the multilateral netting of exposures, establishment and enforcement of collateral requirements, and promoting market transparency. Under Basel II, exposures to a CCP arising from cleared transactions, posted collateral, clearing deposits or guaranty funds could be assigned an exposure amount of zero. However, when developing Basel III, the BCBS recognized that as more transactions move to central clearing, the potential for risk concentration and systemic risk increases. To address these concerns, the BCBS has sought comment on a more risk-sensitive approach for determining a capital requirement for a banking organization's exposures to a CCP. In addition, to encourage CCPs to maintain strong risk management procedures, the BCBS sought comment on for lower risk-based capital requirements for derivative and repo-style transaction exposures to CCPs that meet the standards established by the Committee on Payment and Settlement Systems (CPSS) and International Organization of Securities Commissions (IOSCO).[43]

Consistent with the proposals the Basel Committee has made on these issues and the IOSCO standards, the agencies are seeking comment on specific risk-based capital requirements for derivative and repo-style transactions that are cleared on CCPs designed to incentivize the use of CCPs, help reduce counterparty credit risk, and promote strong risk management of CCPs to mitigate their potential for systemic risk. In contrast to the general risk-based capital rules, which permit a banking organization to exclude certain derivative contracts traded on an exchange from the risk-based capital calculation, the agencies would require a banking organization to hold risk-based capital for an outstanding derivative contract or a repo-style transaction that has been entered into with all CCPs, including exchanges. Specifically, the proposal would define a cleared transaction as an outstanding derivative contract or repo-style transaction that a banking organization or clearing member has entered into with a central

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[41] See section II.F.2d of this preamble for a discussion of the proposed definition of a repo-style transaction.

[42] See, "Capitalisation of Banking Organization Exposures to Central Counterparties" (November 2011) (CCP consultative release), available at http://www.bis.org/publ/bcbs206.pdf. Once the CCP consultative release is finalized, the agencies expect to take into account the BCBS revisions and incorporate them into the agencies' capital rules through the regular rulemaking process, as appropriate.

[43] See CPSS, "Recommendations for Central Counterparties" (November 2004), available at http://www.bis.org/publ/cpss64.pdf?noframes=1.

counterparty (that is, a transaction that a central counterparty has accepted).[44] Under the proposal, a banking organization would be required to hold risk-based capital for all of its cleared transactions, whether the banking organization acts as a clearing member (defined as a member of, or direct participant in, a CCP that is entitled to enter into transactions with the CCP) or a clearing member client (defined as a party to a cleared transaction associated with a CCP in which a clearing member acts either as a financial intermediary with respect to the party or guarantees the performance of the party to the CCP).

Derivative transactions that are not cleared transactions would be OTC derivative transactions. In addition, if a transaction submitted to a CCP is not accepted by a CCP because the terms of the transaction do not match or other operational issues were identified by the CCP, the transaction would not meet the definition of a cleared transaction and would be an OTC derivative transaction. If the counterparties to the transaction resolved the issues and resubmit the transaction, and if it is accepted, the transaction could then be a cleared transaction if it satisfies all the criteria described above.

Under the proposal, there are four categories of cleared transactions:

(1) A transaction between a CCP and a banking organization that is a clearing member of the CCP where the banking organization enters into the transaction with the CCP for the banking organization's own account;

(2) A transaction between a CCP and a banking organization that is a clearing member of the CCP where the banking organization is acting as a financial intermediary on behalf of a clearing member client and the transaction offsets a transaction that satisfies the requirements of paragraph (3) of this definition;

(3) A transaction between a clearing member client banking organization and a clearing member where the clearing member acts as a financial intermediary on behalf of the clearing member client and enters into an offsetting transaction with a CCP provided that certain conditions are met;[45] and

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[44] For example, the agencies expect that a transaction with a derivatives clearing organization (DCO) would meet the proposed criteria for a cleared transaction. A DCO is a clearinghouse, clearing association, clearing corporation, or similar entity that enables each party to an agreement, contract, or transaction to substitute, through novation or otherwise, the credit of the DCO for the credit of the parties; arranges or provides, on a multilateral basis, for the settlement or netting of obligations; or otherwise provides clearing services or arrangements that mutualize or transfer credit risk among participants. To qualify as a DCO, an entity must be registered with the U.S. Commodity Futures Trading Commission and comply with all relevant laws and procedures.

[45] Specifically, the proposed condition include: (1) the clearing member's offsetting transaction with the CCP would be identified by the CCP as a transaction for the clearing member client; (2) the collateral supporting the transaction would be held in a manner that prevents the clearing member client from facing any loss due to the default, receivership, or insolvency of either the clearing member or the clearing member's other clients; (3) the banking organization would have conducted sufficient legal review to conclude with a well-founded basis (and maintains sufficient written documentation of that legal review) that in the event of a legal challenge (including one resulting from a default or receivership, insolvency, liquidation, or similar proceeding) the relevant court and administrative authorities would find the collateral arrangements to be legal, valid, binding and enforceable under the law of the relevant jurisdictions; and (4) the offsetting transaction with a clearing member is transferable under the transaction

(4) A transaction between a clearing member client and a CCP where a clearing member guarantees the performance of the clearing member client to the CCP and certain criteria are met.[46]

Under the proposal, a cleared transaction would not include an exposure of a banking organization that is a clearing member to its clearing member client where the banking organization is either acting as a financial intermediary and enters into an offsetting transaction with a CCP or where the banking organization provides a guarantee to the CCP on the performance of the client. Such a transaction would be treated as an OTC derivative transaction with the exposure amount calculated according to section 34 of the proposal. However, the agencies recognize that this treatment may create a disincentive for banking organizations to act as intermediaries and provide access to CCPs for clients. As a result, the agencies are considering approaches that could address this disincentive while at the same time appropriately reflect the risks of these transactions. For example, one approach would allow banking organizations that are clearing members to adjust the exposure amount calculated under section 34 downward by a certain percentage or, for advanced approaches banking organizations using the internal models method, to adjust the margin period of risk. The international discussions are ongoing on this issue and the agencies expect to revisit this issue once the Basel capital framework is revised.

Question 12: The agencies request comment on whether the proposal provides an appropriately risk sensitive treatment of (1) a transaction between a banking organization that is clearing member and its client and (2) a clearing member's guarantee of its client's transaction with a CCP by treating these exposures as OTC derivative contracts. The agencies also request comment on whether the adjustment of the exposure amount would address possible disincentives for banking organizations that are clearing members to facilitate the clearing of their clients' transactions. What other approaches should the agencies consider?

2. Risk-weighted Asset Amount for Clearing Member Clients and Clearing Members

As proposed in this NPR, to determine the risk-weighted asset amount for a cleared transaction, a clearing member client or a clearing member would multiply the trade exposure amount for the cleared transaction by the appropriate risk weight, determined as described below. The trade exposure amount would be calculated as follows:

(1) For a derivative contract that is a cleared transaction, the trade exposure amount would equal the exposure amount for the derivative contract, calculated using the current exposure methodology for OTC derivative contracts under section 34 of the proposal, plus the fair value of the collateral posted by the clearing member banking organization that is held by the CCP in a manner that is not bankruptcy remote; and

(2) For a repo-style transaction that is a cleared transaction, the trade exposure amount would equal the exposure amount calculated under the collateral haircut approach (described in

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documents or applicable laws in the relevant jurisdiction(s) to another clearing member should the clearing member default, become insolvent, or enter receivership, liquidation or similar proceeding.

[46] See id., criteria (2) and (3).

section 37(c) of the proposal) plus the fair value of the collateral posted by the clearing member client banking organization that is held by the CCP in a manner that is not bankruptcy remote.[47]

The trade exposure amount would not include any collateral posted by a clearing member banking organization that is held by a custodian in a manner that is bankruptcy remote from the CCP or any collateral posted by a clearing member client that is held by a custodian in a manner that is bankruptcy remote from the CCP, clearing members and other counterparties of the clearing member. In addition to the capital requirement for the cleared transaction, the banking organization would remain subject to a capital requirement for any collateral provided to a CCP, a clearing member, or a custodian in connection with a cleared transaction in accordance with section 32.

Consistent with the Basel capital framework, the agencies propose that the risk weight for a cleared transaction depend on whether the CCP is a qualifying CCP (QCCP). As proposed, a QCCP would be a central counterparty that:

(1) Is a designated financial market utility (FMU) under Title VIII of the Dodd-Frank Act;

(2) If not located in the United States, is regulated and supervised in a manner equivalent to a designated FMU; or

(3) Meets the following standards:

(i) The central counterparty requires all parties to contracts cleared by the counterparty to be fully collateralized on a daily basis;

(ii) The banking organization demonstrates to the satisfaction of the primary federal supervisor that the central counterparty:

(A) Is in sound financial condition;

(B) Is subject to supervision by the Board, the Commodities Futures Trading Commission (CFTC) or the SEC, or if the central counterparty is not located in the United States, is subject to effective oversight by a national supervisory authority in its home country; and

(C) Meets or exceeds (1) the risk-management standards for CCPs set forth in regulations established by the Board, the CFTC, or the SEC under Title VII or Title VIII of the Dodd-Frank Act, or (2) if the central counterparty is not located in the United States, similar risk-management standards established under the law of its home country that are consistent with international standards for central counterparty risk management as established by the relevant standard setting body of the Bank of International Settlements;[48]

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[47] Under this proposal, bankruptcy remote, with respect to entity or asset, would mean that the entity or asset would be excluded from an insolvent entity's estate in a receivership, insolvency, liquidation, or similar proceeding.

[48] Generally, the relevant international risk management standards would be those issued by the CPSS and the Technical Committee of the IOSCO.

(4) Provides the banking organization with the CCP's hypothetical capital requirement or the information necessary to calculate such hypothetical capital requirement, and other information the banking organization is required to obtain under section 35(d)(3);

(5) Makes available to the primary federal supervisor and the CCP's regulator the information described in paragraph (4) of this definition;

(6) Has not otherwise been determined by the primary federal supervisor to not be a QCCP due to its financial condition, risk profile, failure to meet supervisory risk management standards, or other weaknesses or supervisory concerns that are inconsistent with the risk weight assigned to QCCPs under section 35; and

(7) If a banking organization determines that a CCP ceases to be a QCCP due the failure of the CCP to satisfy one or more of the requirements set forth at paragraphs (1) through (5), the banking organization may continue to treat the CCP as a QCCP for up to three months following the determination.

If the CCP fails to remedy the relevant deficiency within three months after the initial determination, or the CCP fails to satisfy the requirements set forth in paragraphs (1) through (5) continuously for a three month period after remedying the relevant deficiency, a banking organization may not treat the CCP as a QCCP for the purposes of the proposed requirements until after the banking organization has determined that the CCP has satisfied the requirements in paragraphs (1) through (5) for three continuous months.

Under the proposal, a clearing member banking organization would apply a 2 percent risk weight to its trade exposure amount with a QCCP. A banking organization that is a clearing member client would apply a 2 percent risk weight to the trade exposure amount only if:

(1) The collateral posted by the banking organization to the QCCP or clearing member is subject to an arrangement that prevents any losses to the clearing member due to the joint default or a concurrent insolvency, liquidation, or receivership proceeding of the clearing member and any other clearing member clients of the clearing member, and

(2) The clearing member client banking organization has conducted sufficient legal review to conclude with a well-founded basis (and maintains sufficient written documentation of that legal review) that in the event of a legal challenge (including one resulting from default or a liquidation, insolvency, or receivership proceeding) the relevant court and administrative authorities would find the arrangements to be legal, valid, binding, and enforceable under the law of the relevant jurisdiction.

The agencies believe that omnibus accounts (that is, accounts that are generally set up by clearing entities for non-clearing members) in the United States would satisfy these requirements because of the protections afforded client accounts under certain regulations of the SEC[49] and

[49] See 15 U.S.C 78aaa – 78lll and 17 CFR part 300.

CFTC.[50] If the criteria above are not met, a banking organization that is clearing member client would apply a risk weight of 4 percent to the trade exposure amount.

For a cleared transaction with a CCP that is not a QCCP, a clearing member and a banking organization that is a clearing member client would risk weight the trade exposure amount to the CCP according to the treatment for the CCP under section 32 of the proposal. In addition, collateral posted by a clearing member banking organization that is held by a custodian in a manner that is bankruptcy remote from the CCP would not be subject to a capital requirement for counterparty credit risk. Collateral posted by a clearing member client that is held by a custodian in a manner that is bankruptcy remote from the CCP, clearing member, and other clearing member clients of the clearing member would not be subject to a capital requirement for counterparty credit risk.

3. Default Fund Contribution

One of the benefits of clearing a transaction through a CCP is the protection provided to the CCP clearing members by the margin requirements imposed by the CCP, as well as by the CCP members' default fund contributions, and the CCP's own capital and contribution to the default fund. Default funds make CCPs safer and are an important source of collateral in case of counterparty default. However, CCPs independently determine default fund contributions from members. The BCBS therefore has proposed to establish a risk-sensitive approach for risk weighting a banking organization's exposure to a default fund.

Consistent with the CCP consultative release, the agencies are proposing to require a banking organization that is a clearing member of a CCP to calculate the risk-weighted asset amount for its default fund contributions at least quarterly or more frequently if there is a material change, in the opinion of the banking organization or the primary federal supervisor, in the financial condition of the CCP. A default fund contribution would mean the funds contributed or commitments made by a clearing member to a CCP's mutualized loss sharing arrangement.[51] Under this proposal, a banking organization would assign a 1,250 percent risk weight to its default fund contribution to a CCP that is not a QCCP.

As under the CCP consultative release, a banking organization would calculate a risk-weighted asset amount for its default fund contribution to a QCCP by using a three-step process. The first step is to calculate the QCCP's hypothetical capital requirement (K_{CCP}), unless the QCCP has already disclosed it. K_{CCP} is the capital that a QCCP would be required to hold if it were a banking organization, and it is calculated using the current exposure methodology for OTC derivatives and recognizing the risk-mitigating effects of collateral posted by and default fund contributions received from the QCCP clearing members.

As a first step, for purposes of calculating K_{CCP}, the agencies are proposing several modifications to the current exposure methodology to adjust for certain features that are unique to QCCPs. First, a clearing member would be permitted to offset its exposure to a QCCP with actual default fund contributions. Second, greater recognition of netting would be allowed when

[50] See 17 CFR part 190.

[51] Default funds are also known as clearing deposits or guaranty funds.

calculating K_{CCP}. Specifically, the formula used to calculate the adjusted sum of the PFE amounts in section 34 (the Anet formula) would be changed from Anet = (0.4 x Agross) + (0.6 x NGR x Agross) to Anet = (0.3 x Agross) + (0.7 x NGR x Agross).[52] Third, the risk weight of all clearing members would be set at 20 percent, except when a banking organization's primary federal supervisor has determined that a higher risk weight is appropriate based on the specific characteristics of the QCCP and its clearing members. Finally, for derivative contracts that are options, the PFE amount calculation would be adjusted by multiplying the notional principal amount of the derivative contract by the appropriate conversion factor and the absolute value of the option's delta (that is, the ratio of the change in the value of the derivative contract to the corresponding change in the price of the underlying asset).

In the second step, K_{CCP} is compared to the funded portion of the default fund of a QCCP and the total of all the clearing members' capital requirement (K_{cm}^{*}) is calculated. If the total funded default fund of a QCCP is less than K_{CCP}, additional capital would be assessed against the shortfall because of the small size of the funded portion of the default fund relative to $K_{CCP.}$ If the total funded default fund of a QCCP is greater than K_{CCP}, but the QCCP's own funded contributions to the default fund are less than K_{CCP} (so that the clearing members' default fund contributions are required to achieve $K_{CCP),}$ the clearing members' default fund contributions up to K_{CCP} would be risk-weighted at 100 percent and a decreasing capital factor, between 0.16 percent and 1.6 percent, would be applied to the clearing members' funded default fund contributions above K_{CCP}. If the QCCP's own contribution to the default fund is greater than $K_{CCP,}$ then only the decreasing capital factor would be applied to the clearing members' default fund contributions.

In the third step, the total of all the clearing members' capital requirement (K_{cm}^{*}) is allocated back to each individual clearing member. This allocation is proportional to each clearing member's contribution to the default fund but adjusted to reflect the impact of two average-size clearing members defaulting as well as to account for the concentration of exposure among clearing members.

Question 13: The agencies are seeking comment on the proposed calculation of the risk-based capital for cleared transactions, including the proposed risk-based capital requirements for exposures to a QCCP. Are there specific types of exposures to certain QCCPs that would warrant an alternative risk-based capital approach? Please provide a detailed description of such transactions or exposures, the mechanics of the alternative risk-based approach, and the supporting rationale.

F. Credit Risk Mitigation

Banking organizations use a number of techniques to mitigate credit risks. For example, a banking organization may collateralize exposures with first-priority claims, cash or securities; a third party may guarantee a loan exposure; a banking organization may buy a credit derivative to

[52] NGR is defined as the net to gross ratio (that is, the ratio of the net current credit exposure to the gross current credit exposure). If a banking organization cannot calculate the NGR, the banking organization may use a value of 0.30 until March 31, 2013. If the CCP does not provide the NGR to the banking organization or data needed to calculate the NGR after that date, the CCP no longer meets the criteria for a QCCP.

offset an exposure's credit risk; or a banking organization may net exposures with a counterparty under a netting agreement. The general risk-based capital rules recognize these techniques to some extent. This section describes how a banking organization would recognize the risk-mitigation effects of guarantees, credit derivatives, and collateral for risk-based capital purposes under the proposal. Similar to the general risk-based capital rules, a banking organization that is not engaged in complex financial activities generally would be able to use a substitution approach to recognize the credit risk mitigation effect of an eligible guarantee from an eligible guarantor and the simple approach to recognize the effect of collateral.

To recognize credit risk mitigants, all banking organizations should have operational procedures and risk management processes that ensure that all documentation used in collateralizing or guaranteeing a transaction is legal, valid, binding, and enforceable under applicable law in the relevant jurisdictions. A banking organization should conduct sufficient legal review to reach a well-founded conclusion that the documentation meets this standard as well as conduct additional reviews as necessary to ensure continuing enforceability.

Although the use of credit risk mitigants may reduce or transfer credit risk, it simultaneously may increase other risks, including operational, liquidity, or market risk. Accordingly, a banking organization should employ robust procedures and processes to control risks, including roll-off and concentration risks, and monitor the implications of using credit risk mitigants for the banking organization's overall credit risk profile.

1. Guarantees and Credit Derivatives

a. Eligibility Requirements

The general risk-based capital rules generally recognize third-party guarantees provided by central governments, GSEs, PSEs in the OECD countries, multilateral lending institutions and regional development banking organizations, U.S. depository institutions, foreign banks, and qualifying securities firms in OECD countries.[53] Consistent with the Basel capital framework, the agencies propose to recognize a wider range of eligible guarantors, including:

(1) A sovereign, the Bank for International Settlements, the International Monetary Fund, the European Central Bank, the European Commission, a Federal Home Loan Bank, Federal Agricultural Mortgage Corporation (Farmer Mac), an MDB, a depository institution, a bank holding company, a savings and loan holding company, a credit union, or a foreign bank;

(2) An entity (other than a special purpose entity) (i) that at the time the guarantee is issued, or anytime thereafter, has issued and outstanding an unsecured debt security without credit enhancement that is investment grade; (ii) whose creditworthiness is not positively correlated with the credit risk of the exposures for which it has provided guarantees, and (iii) that

[53] 12 CFR part 3, appendix A and 12 CFR part 167.6 (OCC); 12 CFR parts 208 and 225, appendix A, section III.B.2 (Board); 12 CFR part 325, appendix A, section II.B.3 and 12 CFR 390.466 (FDIC).

is not an insurance company engaged predominately in the business of providing credit protection (such as a monoline bond insurer or re-insurer).[54]

Under this NPR, guarantees and credit derivatives would be required to meet specific eligibility requirements to be recognized for credit risk mitigation purposes. Specifically, the proposal defines an eligible guarantee as a guarantee from an eligible guarantor that:

(1) Is written;

(2) Is either (i) unconditional, or (ii) a contingent obligation of the U.S. government or its agencies, the enforceability of which is dependent upon some affirmative action on the part of the beneficiary of the guarantee or a third party (for example, meeting servicing requirements);

(3) Covers all or a pro rata portion of all contractual payments of the obligated party on the reference exposure;

(4) Gives the beneficiary a direct claim against the protection provider;

(5) Is not unilaterally cancelable by the protection provider for reasons other than the breach of the contract by the beneficiary;

(6) Except for a guarantee by a sovereign, is legally enforceable against the protection provider in a jurisdiction where the protection provider has sufficient assets against which a judgment may be attached and enforced;

(7) Requires the protection provider to make payment to the beneficiary on the occurrence of a default (as defined in the guarantee) of the obligated party on the reference exposure in a timely manner without the beneficiary first having to take legal action to pursue the counterparty for payment;

(8) Does not increase the beneficiary's cost of credit protection on the guarantee in response to deterioration in the credit quality of the reference exposure; and

(9) Is not provided by an affiliate of a banking organization, unless the affiliate is an insured depository institution, foreign bank, securities broker-dealer, or insurance company that (i) does not control the banking organization, and (ii) is subject to consolidated supervision and regulation comparable to that imposed on U.S. depository institutions, securities broker-dealers, or insurance companies (as the case may be).

An eligible credit derivative would be defined as a credit derivative in the form of a credit default swap, n^{th}-to-default swap, total return swap, or any other form of credit derivative approved by the primary federal supervisor, provided that:

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[54] As proposed, "investment grade" would mean that the entity to which the banking organization is exposed through a loan or security, or the reference entity with respect to a credit derivative, has adequate capacity to meet financial commitments for the projected life of the asset or exposure. Such an entity or reference entity has adequate capacity to meet financial commitments if the risk of its default is low and the full and timely repayment of principal and interest is expected.

(1) The contract meets the requirements of an eligible guarantee and has been confirmed by the protection purchaser and the protection provider;

(2) Any assignment of the contract has been confirmed by all relevant parties;

(3) If the credit derivative is a credit default swap or n^{th}-to-default swap, the contract includes the following credit events: (i) failure to pay any amount due under the terms of the reference exposure, subject to any applicable minimal payment threshold that is consistent with standard market practice and with a grace period that is closely in line with the grace period of the reference exposure; and (ii) receivership, insolvency, liquidation, conservatorship, or inability of the obligated party on the reference exposure to pay its debts, or its failure or admission in writing of its inability generally to pay its debts as they become due, and similar events;

(4) The terms and conditions dictating the manner in which the contract is to be settled are incorporated into the contract;

(5) If the contract allows for cash settlement, the contract incorporates a robust valuation process to estimate loss reliably and specifies a reasonable period for obtaining post-credit event valuations of the reference exposure;

(6) If the contract requires the protection purchaser to transfer an exposure to the protection provider at settlement, the terms of at least one of the exposures that is permitted to be transferred under the contract must provide that any required consent to transfer may not be unreasonably withheld;

(7) If the credit derivative is a credit default swap or n^{th}-to-default swap, the contract clearly identifies the parties responsible for determining whether a credit event has occurred, specifies that this determination is not the sole responsibility of the protection provider, and gives the protection purchaser the right to notify the protection provider of the occurrence of a credit event; and

(8) If the credit derivative is a total return swap and the banking organization records net payments received on the swap as net income, the banking organization records offsetting deterioration in the value of the hedged exposure (either through reductions in fair value or by an addition to reserves).

Under this NPR, a banking organization would be permitted to recognize the credit risk mitigation benefits of an eligible credit derivative that hedges an exposure that is different from the credit derivative's reference exposure used for determining the derivative's cash settlement value, deliverable obligation, or occurrence of a credit event if (1) the reference exposure ranks pari passu with or is subordinated to the hedged exposure; and (2) the reference exposure and the hedged exposure are to the same legal entity, and legally enforceable cross-default or cross-acceleration clauses are in place to assure payments under the credit derivative are triggered when the issuer fails to pay under the terms of the hedged exposure.

When a banking organization has a group of hedged exposures with different residual maturities that are covered by a single eligible guarantee or eligible credit derivative, a banking

organization would treat each hedged exposure as if it were fully covered by a separate eligible guarantee or eligible credit derivative.

b. Substitution Approach

Under the proposed substitution approach, if the protection amount (as defined below) of an eligible guarantee or eligible credit derivative is greater than or equal to the exposure amount of the hedged exposure, a banking organization would substitute the risk weight applicable to the guarantor or credit derivative protection provider for the risk weight assigned to the hedged exposure.

If the protection amount of the eligible guarantee or eligible credit derivative is less than the exposure amount of the hedged exposure, a banking organization would treat the hedged exposure as two separate exposures (protected and unprotected) to recognize the credit risk mitigation benefit of the guarantee or credit derivative. In such cases, a banking organization would calculate the risk-weighted asset amount for the protected exposure under section 36 (using a risk weight applicable to the guarantor or credit derivative protection provider and an exposure amount equal to the protection amount of the guarantee or credit derivative). The banking organization would calculate its risk-weighted asset amount for the unprotected exposure under section 36 of the proposal (using the risk weight assigned to the exposure and an exposure amount equal to the exposure amount of the original hedged exposure minus the protection amount of the guarantee or credit derivative).

The protection amount of an eligible guarantee or eligible credit derivative would mean the effective notional amount of the guarantee or credit derivative (reduced to reflect any currency mismatch, maturity mismatch, or lack of restructuring coverage, as described in this section below). The effective notional amount for an eligible guarantee or eligible credit derivative would be the lesser of the contractual notional amount of the credit risk mitigant and the exposure amount of the hedged exposure, multiplied by the percentage coverage of the credit risk mitigant. For example, the effective notional amount of a guarantee that covers, on a pro rata basis, 40 percent of any losses on a $100 bond would be $40.

The following sections addresses credit risk mitigants with maturity mismatches, lack of restructuring coverage, currency mismatches, and multiple credit risk mitigants. A banking organization that is not engaged in complex financial transactions is unlikely to have credit risk mitigant with a currency mismatch, maturity mismatch, or lack of restructuring coverage, or multiple credit risk mitigants. In such a case, a banking organization should refer to section II.F.2 below which describes the treatment of collateralized transactions.

c. Maturity Mismatch Haircut

Under the proposed requirements, a banking organization that recognizes an eligible guarantee or eligible credit derivative to adjust the effective notional amount of the credit risk mitigant to reflect any maturity mismatch between the hedged exposure and the credit risk

mitigant. A maturity mismatch occurs when the residual maturity of a credit risk mitigant is less than that of the hedged exposure(s).[55]

The residual maturity of a hedged exposure would be the longest possible remaining time before the obligated party of the hedged exposure is scheduled to fulfil its obligation on the hedged exposure. A banking organization would be required to take into account any embedded options that may reduce the term of the credit risk mitigant so that the shortest possible residual maturity for the credit risk mitigant would be used to determine the potential maturity mismatch. If a call is at the discretion of the protection provider, the residual maturity of the credit risk mitigant would be at the first call date. If the call is at the discretion of the banking organization purchasing the protection, but the terms of the arrangement at origination of the credit risk mitigant contain a positive incentive for the banking organization to call the transaction before contractual maturity, the remaining time to the first call date would be the residual maturity of the credit risk mitigant. For example, if there is a step-up in the cost of credit protection in conjunction with a call feature or if the effective cost of protection increases over time even if credit quality remains the same or improves, the residual maturity of the credit risk mitigant would be the remaining time to the first call date. Under this NPR, a banking organization would be permitted to recognize a credit risk mitigant with a maturity mismatch only if its original maturity is greater than or equal to one year and the residual maturity is greater than three months.

Assuming that the credit risk mitigant may be recognized, a banking organization would be required to apply the following adjustment to reduce the effective notional amount of the credit risk mitigant: $Pm = E \times [(t-0.25)/(T-0.25)]$, where:

(1) Pm = effective notional amount of the credit risk mitigant, adjusted for maturity mismatch;

(2) E = effective notional amount of the credit risk mitigant;

(3) t = the lesser of T or residual maturity of the credit risk mitigant, expressed in years; and

(4)T = the lesser of five or the residual maturity of the hedged exposure, expressed in years.

d. Adjustment for Credit Derivatives without Restructuring as a Credit Event

Under the proposal, a banking organization that seeks to recognize an eligible credit derivative that does not include a restructuring of the hedged exposure as a credit event under the

[55] As noted above, when a banking organization has a group of hedged exposures with different residual maturities that are covered by a single eligible guarantee or eligible credit derivative, a banking organization would treat each hedged exposure as if it were fully covered by a separate eligible guarantee or eligible credit derivative. To determine whether any of the hedged exposures has a maturity mismatch with the eligible guarantee or credit derivative, the banking organization would assess whether the residual maturity of the eligible guarantee or eligible credit derivative is less than that of the hedged exposure.

derivative would have to reduce the effective notional amount of the credit derivative recognized for credit risk mitigation purposes by 40 percent. For purposes of the proposed credit risk mitigation framework, a restructuring would involve forgiveness or postponement of principal, interest, or fees that result in a credit loss event (that is, a charge-off, specific provision, or other similar debit to the profit and loss account). In these instances, the banking organization would be required to apply the following adjustment to reduce the effective notional amount of the credit derivative: Pr = Pm x 0.60, where:

(1) Pr = effective notional amount of the credit risk mitigant, adjusted for lack of a restructuring event (and maturity mismatch, if applicable); and

(2) Pm = effective notional amount of the credit risk mitigant (adjusted for maturity mismatch, if applicable).

e. Currency Mismatch Adjustment

Under this proposal, if a banking organization recognizes an eligible guarantee or eligible credit derivative that is denominated in a currency different from that in which the hedged exposure is denominated, the banking organization would apply the following formula to the effective notional amount of the guarantee or credit derivative: $P_C = Pr \times (1-H_{FX})$, where:

(1) Pc = effective notional amount of the credit risk mitigant, adjusted for currency mismatch (and maturity mismatch and lack of restructuring event, if applicable);

(2) Pr = effective notional amount of the credit risk mitigant (adjusted for maturity mismatch and lack of restructuring event, if applicable); and

(3) H_{FX} = haircut appropriate for the currency mismatch between the credit risk mitigant and the hedged exposure.

A banking organization would be required to use a standard supervisory haircut of 8 percent for H_{FX} (based on a ten-business day holding period and daily marking-to-market and remargining). Alternatively, a banking organization would be able to use internally estimated haircuts of H_{FX} based on a ten-business-day holding period and daily marking-to-market if the banking organization qualifies to use the own-estimates of haircuts in section 37(c)(4) of the proposal. In either case, the banking organization is required to scale the haircuts up using the square root of time formula if the banking organization revalues the guarantee or credit derivative less frequently than once every 10 business days. The applicable haircut (H_M) is calculated using the following square root of time formula:

$$H_M = 8\% \sqrt{\frac{T_M}{10}},$$

where T_M = equals the greater of 10 or the number of days between revaluation.

f. Multiple Credit Risk Mitigants

If multiple credit risk mitigants (for example, two eligible guarantees) cover a single exposure, the agencies propose to permit a banking organization disaggregate the exposure into portions covered by each credit risk mitigant (for example, the portion covered by each guarantee) and calculate separately a risk-based capital requirement for each portion, consistent with the Basel capital framework. In addition, when credit risk mitigants provided by a single protection provider have differing maturities, the mitigants should be subdivided into separate layers of protection.

2. Collateralized Transactions

a. Eligible Collateral

The general risk-based capital rules recognize limited types of collateral, such as cash on deposit; securities issued or guaranteed by central governments of the OECD countries; securities issued or guaranteed by the U.S. government or its agencies; and securities issued by certain multilateral development banks.[56] Given the fact that the general risk-based capital rules for collateral are restrictive and, in some cases, do not take into account market practices, the agencies propose to recognize the credit risk mitigating impact of an expanded range of financial collateral, consistent with the Basel capital framework.

As proposed, financial collateral would mean collateral in the form of: (1) cash on deposit with the banking organization (including cash held for the banking organization by a third-party custodian or trustee); (2) gold bullion; (3) short- and long-term debt securities that are not resecuritization exposures and that are investment grade; (4) equity securities that are publicly traded; (5) convertible bonds that are publicly traded; or (6) money market fund shares and other mutual fund shares if a price for the shares is publicly quoted daily. With the exception of cash on deposit, the banking organization would also be required to have a perfected, first-priority security interest or, outside of the United States, the legal equivalent thereof, notwithstanding the prior security interest of any custodial agent. A banking organization would be permitted to recognize partial collateralization of an exposure.

Under this NPR, a banking organization would be able to recognize the risk-mitigating effects of financial collateral using the simple approach, described in section II.F.2(c) below, for any exposure where the collateral is subject to a collateral agreement for at least the life of the exposure; the collateral must be revalued at least every six months; and the collateral (other than gold) and the exposure must be denominated in the same currency. For repo-style transactions, eligible margin loans, collateralized derivative contracts, and single-product netting sets of such transactions, a banking organization could alternatively use the collateral haircut approach described in section II.F.2(d) below. A banking organization would be required to use the same approach for similar exposures or transactions.

[56] The agencies' rules for collateral transactions differ somewhat as described in the agencies' joint report to Congress. See "Joint Report: Differences in Accounting and Capital Standards among the Federal Banking Agencies; Report to Congressional Committees," 75 FR 47900 (August 9, 2010).

b. Risk Management Guidance for Recognizing Collateral

Before a banking organization recognizes collateral for credit risk mitigation purposes, it should: (1) conduct sufficient legal review to ensure, at the inception of the collateralized transaction and on an ongoing basis, that all documentation used in the transaction is binding on all parties and legally enforceable in all relevant jurisdictions; (2) consider the correlation between risk of the underlying direct exposure and collateral risk in the transaction; and (3) fully take into account the time and cost needed to realize the liquidation proceeds and the potential for a decline in collateral value over this time period.

A banking organization also should ensure that the legal mechanism under which the collateral is pledged or transferred ensures that the banking organization has the right to liquidate or take legal possession of the collateral in a timely manner in the event of the default, insolvency, or bankruptcy (or other defined credit event) of the counterparty and, where applicable, the custodian holding the collateral.

In addition, a banking organization should ensure that it (1) has taken all steps necessary to fulfill any legal requirements to secure its interest in the collateral so that it has and maintains an enforceable security interest; (2) has set up clear and robust procedures to ensure observation of any legal conditions required for declaring the default of the borrower and prompt liquidation of the collateral in the event of default; (3) has established procedures and practices for conservatively estimating, on a regular ongoing basis, the fair value of the collateral, taking into account factors that could affect that value (for example, the liquidity of the market for the collateral and obsolescence or deterioration of the collateral); and (4) has in place systems for promptly requesting and receiving additional collateral for transactions whose terms require maintenance of collateral values at specified thresholds.

c. Simple Approach

Under the proposed simple approach, which is similar to the general risk-based capital rules, the collateralized portion of the exposure would receive the risk weight applicable to the collateral. The collateral would be required to meet the definition of financial collateral, provided that a banking organization could recognize any collateral for a repo-style transaction that is included in the banking organization's Value at Risk (VaR) based measure under the market risk capital rule. For repurchase agreements, reverse repurchase agreements, and securities lending and borrowing transactions, the collateral would be the instruments, gold, and cash that a banking organization has borrowed, purchased subject to resale, or taken as collateral from the counterparty under the transaction. As noted above, in all cases, (1) the terms of the collateral agreement would be required to be equal to or greater than the life of the exposure; (2) the banking organization would be required to revalue the collateral at least every six months; and (3) the collateral (other than gold) and the exposure would be required to be denominated in the same currency.

Generally, the risk weight assigned to the collateralized portion of the exposure would be no less than 20 percent. However, the collateralized portion of an exposure could be assigned a risk weight of less than 20 percent for the following exposures. OTC derivative contracts that are marked-to-market on a daily basis and subject to a daily margin maintenance agreement, which

would receive (1) a zero percent risk weight to the extent that they are collateralized by cash on deposit, or (2) a 10 percent risk weight to the extent that the contracts are collateralized by an exposure to a sovereign or a PSE that qualifies for a zero percent risk weight under section 32 of the proposal. In addition, a banking organization may assign a zero percent risk weight to the collateralized portion of an exposure where the financial collateral is cash on deposit; or the financial collateral is an exposure to a sovereign that qualifies for a zero percent risk weight under section 32 of the proposal, and the banking organization has discounted the market value of the collateral by 20 percent.

d. Collateral Haircut Approach

The agencies would permit a banking organization to use a collateral haircut approach with supervisory haircuts or, with prior written approval of the primary federal supervisor, its own estimates of haircuts to recognize the risk mitigating effect of financial collateral that secures an eligible margin loan, a repo-style transaction, collateralized derivative contract, or single-product netting set of such transactions, as well as any collateral that secures a repo-style transaction that is included in the banking organization's VaR-based measure under the market risk capital rule. A netting set would refer to a group of transactions with a single counterparty that are subject to a qualifying master netting agreement or a qualifying cross-product master netting agreement.

The proposal would define a repo-style transaction as a repurchase or reverse repurchase transaction, or a securities borrowing or securities lending transaction (including a transaction in which a banking organization acts as agent for a customer and indemnifies the customer against loss), provided that:

(1) The transaction is based solely on liquid and readily marketable securities, cash, or gold;

(2) The transaction is marked-to-market daily and subject to daily margin maintenance requirements;

(3)(i) The transaction is a "securities contract" or "repurchase agreement" under section 555 or 559, respectively, of the Bankruptcy Code (11 U.S.C. 555 or 559), a qualified financial contract under section 11(e)(8) of the Federal Deposit Insurance Act (12 U.S.C. 1821(e)(8)), or a netting contract between or among financial institutions under sections 401-407 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (12 U.S.C. 4401-4407) or the Federal Reserve Board's Regulation EE (12 CFR part 231); or

(ii) If the transaction does not meet the criteria in paragraph (3)(i) of this definition, then either:

(A) The transaction is executed under an agreement that provides a banking organization the right to accelerate, terminate, and close-out the transaction on a net basis and to liquidate or set off collateral promptly upon an event of default (including upon an event of a receivership, insolvency, liquidation, or similar proceeding) of the counterparty, provided that, in any such case, any exercise of rights under the agreement will not be stayed or avoided under applicable law in the relevant jurisdictions, other than in receivership, conservatorship, resolution under the

Federal Deposit Insurance Act, Title II of the Dodd-Frank Act, or under any similar insolvency law applicable to GSEs; or

(B) The transaction is (1) either overnight or unconditionally cancelable at any time by the banking organization; and (2) executed under an agreement that provides the banking organization the right to accelerate, terminate, and close-out the transaction on a net basis and to liquidate or set off collateral promptly upon an event of counterparty default; and

(4) The banking organization has conducted sufficient legal review to conclude with a well-founded basis (and maintains sufficient written documentation of that legal review) that the agreement meets the requirements of paragraph (3) of this definition and is legal, valid, binding, and enforceable under applicable law in the relevant jurisdictions.

An eligible margin loan would be defined as an extension of credit where:

(1) The extension of credit is collateralized exclusively by liquid and readily marketable debt or equity securities, or gold;

(2) The collateral is marked-to-market daily, and the transaction is subject to daily margin maintenance calls;

(3) The extension of credit is conducted under an agreement that provides a banking organization the right to accelerate and terminate the extension of credit and to liquidate or set-off collateral promptly upon an event of default (including an event of a receivership, insolvency, liquidation, conservatorship, or similar proceeding) of the counterparty, provided that, in any such case, any exercise of rights under the agreement will not be stayed or avoided under applicable law in the relevant jurisdictions;[57] and

(4) The banking organization has conducted sufficient legal review to conclude with a well-founded basis (and maintains sufficient written documentation of that legal review) that the agreement meets the requirements of paragraph (3) of this definition and is legal, valid, binding, and enforceable under applicable law in the relevant jurisdictions, other than in receivership, conservatorship, resolution under the Federal Deposit Insurance Act, Title II of the Dodd-Frank Act, or under any similar insolvency law applicable to GSEs.

Under the collateral haircut approach, a banking organization would determine the exposure amount using standard supervisory haircuts or its own estimates of haircuts and risk weight the exposure amount according to the counterparty or guarantor if applicable. A banking organization would set the exposure amount for an eligible margin loan, repo-style transaction, collateralized derivative contract, or a netting set of such transactions equal to the greater of zero and the sum of the following three quantities:

[57] This requirement is met where all transactions under the agreement are (1) executed under U.S. law and (2) constitute "securities contracts" under section 555 of the Bankruptcy Code (11 U.S.C. 555), qualified financial contracts under section 11(e)(8) of the Federal Deposit Insurance Act (12 U.S.C. 1821(e)(8)), or netting contracts between or among financial institutions under sections 401-407 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (12 U.S.C. 4401-4407) or the Federal Reserve Board's Regulation EE (12 CFR part 231).

(1) The value of the exposure less the value of the collateral. For eligible margin loans, repo-style transactions and netting sets thereof, the value of the exposure is the sum of the current market values of all instruments, gold, and cash the banking organization has lent, sold subject to repurchase, or posted as collateral to the counterparty under the transaction or netting set. For collateralized OTC derivative contracts and netting sets thereof, the value of the exposure is the exposure amount that is calculated under section 34 of the proposal. The value of the collateral would equal the sum of the current market values of all instruments, gold and cash the banking organization has borrowed, purchased subject to resale, or taken as collateral from the counterparty under the transaction or netting set;

(2) The absolute value of the net position in a given instrument or in gold (where the net position in a given instrument or in gold equals the sum of the current market values of the instrument or gold the banking organization has lent, sold subject to repurchase, or posted as collateral to the counterparty minus the sum of the current market values of that same instrument or gold that the banking organization has borrowed, purchased subject to resale, or taken as collateral from the counterparty) multiplied by the market price volatility haircut appropriate to the instrument or gold; and

(3) The absolute values of the net position of instruments and cash in a currency that is different from the settlement currency (where the net position in a given currency equals the sum of the current market values of any instruments or cash in the currency the banking organization has lent, sold subject to repurchase, or posted as collateral to the counterparty minus the sum of the current market values of any instruments or cash in the currency the banking organization has borrowed, purchased subject to resale, or taken as collateral from the counterparty) multiplied by the haircut appropriate to the currency mismatch.

For purposes of the collateral haircut approach, a given instrument would include, for example, all securities with a single Committee on Uniform Securities Identification Procedures (CUSIP) number and would not include securities with different CUSIP numbers, even if issued by the same issuer with the same maturity date.

e. Standard Supervisory Haircuts

Under this NPR, a banking organization would use an 8 percent haircut for each currency mismatch and would use the market price volatility haircut appropriate to each security as provided in Table 7. The market price volatility haircuts are based on the ten-business-day holding period for eligible margin loans and derivative contracts and may be multiplied by the square root of ½ (which equals 0.707107) to convert the standard supervisory haircuts to the five-business-day minimum holding period for repo-style transactions.

Table 7 - Standard Supervisory Market Price Volatility Haircuts [58]

Residual maturity	Sovereign issuers that receive a zero percent risk weight under section 32 (percent)	Sovereign issuers that receive a 20 percent or 50 percent risk weight under section 32 (percent)	Sovereign issuers that receive a 100 percent risk weight under section 32 (percent)	Other issuers that receive a 20 percent risk weight under section 32 (percent)	Other issuers that receive a 50 percent risk weight under section 32 (percent)	Other issuers that receive a 100 percent risk weight under section 32 (percent)	Securitization exposures that are investment grade (percent)
Less than 1 year	0.5	1.0	15.0	1.0	2.0	25.0	4.0
Greater than 1 year and less than or equal to 5 years	2.0	3.0	15.0	4.0	6.0	25.0	12.0
Greater than 5 years	4.0	6.0	15.0	8.0	12.0	25.0	24.0
Main index equities (including convertible bonds) and gold				15.0			
Other publicly traded equities (including convertible bonds)				25.0			
Mutual funds				Highest haircut applicable to any security in which the fund can invest.			
Cash collateral held				0			

[58] The market price volatility haircuts in this table are based on a ten-business-day holding period.

For example, if a banking organization has extended an eligible margin loan of $100 that is collateralized by five-year U.S. Treasury notes with a market value of $100, the value of the exposure less the value of the collateral would be zero, and the net position in the security ($100) times the supervisory haircut (.02) would be $2. There is no currency mismatch. Therefore, the exposure amount would be $0 + $2 = $2.

During the financial crisis, many financial institutions experienced significant delays in settling or closing out collateralized transactions, such as repo-style transactions and collateralized OTC derivatives. The assumed holding period for collateral in the collateral haircut approach under Basel II proved to be inadequate for certain transactions and netting sets and did not reflect the difficulties and delays that institutions had when settling or liquidating collateral during a period of financial stress.

Accordingly, consistent with the revised Basel capital framework, for netting sets where: (1) the number of trades exceeds 5,000 at any time during the quarter; (2) one or more trades involves illiquid collateral posted by the counterparty; or (3) the netting set includes any OTC derivatives that cannot be easily replaced, this NPR would require a banking organization to assume a holding period of 20 business days for the collateral under the collateral haircut approach. When determining whether collateral is illiquid or an OTC derivative cannot be easily replaced for these purposes, a banking organization should assess whether, during a period of stressed market conditions, it could obtain multiple price quotes within two days or less for the collateral or OTC derivative that would not move the market or represent a market discount (in the case of collateral) or a premium (in the case of an OTC derivative.)

If over the two previous quarters more than two margin disputes on a netting set have occurred that lasted longer than the holding period, then the banking organization would use a holding period for that netting set that is at least two times the minimum holding period that would otherwise be used for that netting set. Margin disputes may occur when the banking organization and its counterparty do not agree on the value of collateral or on the eligibility of the collateral provided. Margin disputes also can occur when the banking organization and its counterparty disagree on the amount of margin that is required, which could result from differences in the valuation of a transaction, or from errors in the calculation of the net exposure of a portfolio, for instance, if a transaction is incorrectly included or excluded from the portfolio. In this NPR, the agencies propose to incorporate these adjustments to the holding period in the collateral haircut approach. However, consistent with the Basel capital framework, a banking organization would not be required to adjust the holding period upward for cleared transactions.

f. Own Estimates of Haircuts

In this NPR, the agencies are proposing to allow banking organizations to calculate market price volatility and foreign exchange volatility using own internal estimates with prior written approval of the banking organization's primary federal supervisor. The banking organization's primary federal supervisor would base approval to use internally estimated haircuts on the satisfaction of certain minimum qualitative and quantitative standards, including the requirements that a banking organization would: (1) use a 99^{th} percentile one-tailed confidence interval and a minimum five-business-day holding period for repo-style transactions and a minimum ten-business-day holding period for all other transactions; (2) adjust holding

periods upward where and as appropriate to take into account the illiquidity of an instrument; (3) select a historical observation period that reflects a continuous 12-month period of significant financial stress appropriate to the banking organization's current portfolio; and (4) update its data sets and compute haircuts no less frequently than quarterly, as well as any time market prices change materially. A banking organization would estimate the volatilities of each exposure, the collateral, and foreign exchange rates and not take into account the correlations between them.

Under the proposed requirements, a banking organization would be required to have policies and procedures that describe how it determines the period of significant financial stress used to calculate the bank's own internal estimates, and to be able to provide empirical support for the period used. These policies and procedures would address (1) how the banking organization links the period of significant financial stress used to calculate the own internal estimates to the composition and directional bias of the banking organization's current portfolio; and (2) the banking organization's process for selecting, reviewing, and updating the period of significant financial stress used to calculate the own internal estimates and for monitoring the appropriateness of the 12-month period in light of the bank's current portfolio. The banking organization would be required to obtain the prior approval of its primary federal supervisor for these policies and procedures and notify its primary federal supervisor if the banking organization makes any material changes to them. A banking organization's primary federal supervisor may require it to use a different period of significant financial stress in the calculation of the banking organization's own internal estimates.

Under the proposal, a banking organization would be allowed to use internally estimated haircuts for categories of debt securities under certain conditions. The banking organization would be allowed to calculate internally estimated haircuts for categories of debt securities that are investment grade exposures. The haircut for a category of securities would have to be representative of the internal volatility estimates for securities in that category that the banking organization has lent, sold subject to repurchase, posted as collateral, borrowed, purchased subject to resale, or taken as collateral.

In determining relevant categories, the banking organization would, at a minimum, take into account (1) the type of issuer of the security; (2) the investment grade of the security; (3) the maturity of the security; and (4) the interest rate sensitivity of the security. A banking organization would calculate a separate internally estimated haircut for each individual non-investment grade debt security and for each individual equity security. In addition, a banking organization would estimate a separate currency mismatch haircut for its net position in each mismatched currency based on estimated volatilities for foreign exchange rates between the mismatched currency and the settlement currency where an exposure or collateral (whether in the form of cash or securities) is denominated in a currency that differs from the settlement currency.

g. Simple Value-at-risk

Under this NPR, a banking organization would not be permitted to use the simple value-at-risk (VaR) to calculate exposure amounts for eligible margin loans, and repo-style transaction. However, the Basel standardized approach does incorporate the simple VaR approach for credit risk mitigants. Therefore, the agencies are considering whether to implement the simple VaR approach consistent with the requirements described below.

Under the simple VaR approach (which is not included in the NPR), with the prior written approval of its primary federal supervisor, a banking organization could be allowed to estimate the exposure amount for repo-style transactions and eligible margin loans subject to a single-product qualifying master netting agreement using a VaR model (simple VaR approach). Under the simple VaR approach, a banking organization's exposure amount for transactions subject to such a netting agreement would be equal to the value of the exposures minus the value of the collateral plus a VaR-based estimate of the PFE. The value of the exposures would be the sum of the current market values of all instruments, gold, and cash the banking organization has lent, sold subject to repurchase, or posted as collateral to a counterparty under the netting set. The value of the collateral would be the sum of the current market values of all instruments, gold, and cash the banking organization has borrowed, purchased subject to resale, or taken as collateral from a counterparty under the netting set. The VaR-based estimate of the PFE would be an estimate of the banking organization's maximum exposure on the netting set over a fixed time horizon with a high level of confidence.

To qualify for the simple VaR approach, a banking organization's VaR model would have to estimate the banking organization's 99th percentile, one-tailed confidence interval for an increase in the value of the exposures minus the value of the collateral ($\sum E - \sum C$) over a five-business-day holding period for repo-style transactions or over a ten-business-day holding period for eligible margin loans using a minimum one-year historical observation period of price data representing the instruments that the banking organization has lent, sold subject to repurchase, posted as collateral, borrowed, purchased subject to resale, or taken as collateral. The main ongoing qualification requirement for using a VaR model is that the banking organization would have to validate its VaR model by establishing and maintaining a rigorous and regular backtesting regime.

Question 14: The agencies solicit comments on whether banking organizations should be permitted to use the simple VaR to calculate exposure amounts for margin lending, and repo-style transactions.

h. Internal Models Methodology

The advanced approaches rule include an internal models methodology for the calculation of the exposure amount for the counterparty credit exposure for OTC derivatives, eligible margin loans, and repo-style transactions.[59] This methodology requires a risk model that captures counterparty credit risk and estimates the exposure amount at the level of a netting set. A banking organization may use the internal models methodology for OTC derivatives, eligible margin loans, and repo-style transactions. In the companion NPR, the agencies are proposing to permit a banking organization subject to the advanced approaches risk-based capital rules to use the internal models methodology to calculate the trade exposure amount for cleared transactions.[60]

[59] See 72 FR 69288, 69346 (December 7, 2007).

[60] The internal models methodology is fully discussed in the 2007 Federal Register notice of the advanced approaches rule, with specific references at: (1) 72 FR 69346–69349 and 69302–69321); (2) section 22(c) and other paragraphs in section 22 of the common rule text (at 72 FR 69413–69416; sections 22 (a)(2) and (3), (i), (j), and (k) (these sections establish the qualification requirements for the advanced systems in general and therefore would

Although the internal models methodology is not part of this proposal, the Basel standardized approach does incorporate an internal models methodology for credit risk mitigants. Therefore, the agencies are considering whether to implement the internal models methodology in a final rule consistent with the requirements in the advanced approaches rule as modified by the companion NPR.

Question 15: The agencies request comment on the appropriateness of including the internal models methodology for calculating exposure amounts for OTC derivatives, eligible margin loans, repo-style transactions and cleared transactions for all banking organizations. For purposes of reviewing the internal models methodology in the advanced approaches rule, commenters should substitute the term ''exposure amount'' for the term ''exposure at default'' and ''EAD'' each time these terms appear in the advanced approaches rule.)

G. Unsettled Transactions

In this NPR, the agencies propose to provide for a separate risk-based capital requirement for transactions involving securities, foreign exchange instruments, and commodities that have a risk of delayed settlement or delivery. The proposed capital requirement would not, however, apply to certain types of transactions, including: (1) cleared transactions that are marked-to-market daily and subject to daily receipt and payment of variation margin; (2) repo-style transactions, including unsettled repo-style transactions; (3) one-way cash payments on OTC derivative contracts; or (4) transactions with a contractual settlement period that is longer than the normal settlement period (which the proposal defines as the lesser of the market standard for the particular instrument or five business days).[61] Under the proposal, in the case of a system-wide failure of a settlement, clearing system, or central counterparty, the banking organization's primary federal supervisor may waive risk-based capital requirements for unsettled and failed transactions until the situation is rectified.

This NPR proposes separate treatments for delivery-versus-payment (DvP) and payment-versus-payment (PvP) transactions with a normal settlement period, and non-DvP/non-PvP transactions with a normal settlement period. A DvP transaction would refer to a securities or commodities transaction in which the buyer is obligated to make payment only if the seller has made delivery of the securities or commodities and the seller is obligated to deliver the securities or commodities only if the buyer has made payment. A PvP transaction would mean a foreign exchange transaction in which each counterparty is obligated to make a final transfer of one or more currencies only if the other counterparty has made a final transfer of one or more currencies. A transaction would be considered to have a normal settlement period if the contractual settlement period for the transaction is equal to or less than the market standard for the instrument underlying the transaction and equal to or less than five business days.

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apply to the expected positive exposure modeling approach as part of the internal models methodology); (3) sections 32(c) and (d) of the common rule text (at 72 FR 69413–69416); (4) applicable definitions in section 2 of the common rule text (at 72 FR 69397–69405); and (5) applicable disclosure requirements in Tables 11.6 and 11.7 of the common rule text (at 72 FR 69443). In addition, the Advanced Approaches and Market Risk NPR proposes modifications to the internal models methodology.

[61] Such transactions would be treated as derivative contracts as provided in sections 34 or section 35 of the proposal.

A banking organization would be required to hold risk-based capital against a DvP or PvP transaction with a normal settlement period if the banking organization's counterparty has not made delivery or payment within five business days after the settlement date. The banking organization would determine its risk-weighted asset amount for such a transaction by multiplying the positive current exposure of the transaction for the banking organization by the appropriate risk weight in Table 8. The positive current exposure from an unsettled transaction of a banking organization would be the difference between the transaction value at the agreed settlement price and the current market price of the transaction, if the difference results in a credit exposure of the banking organization to the counterparty.

Table 8 – Proposed Risk Weights for Unsettled DvP and PvP Transactions

Number of business days after contractual settlement date	**Risk weight to be applied to positive current exposure (in percent)**
From 5 to 15	100.0
From 16 to 30	625.0
From 31 to 45	937.5
46 or more	1,250.0

A banking organization would hold risk-based capital against any non-DvP/non-PvP transaction with a normal settlement period if the banking organization delivered cash, securities, commodities, or currencies to its counterparty but has not received its corresponding deliverables by the end of the same business day. The banking organization would continue to hold risk-based capital against the transaction until it has received the corresponding deliverables. From the business day after the banking organization has made its delivery until five business days after the counterparty delivery is due, the banking organization would calculate the risk-weighted asset amount for the transaction by risk weighting the current market value of the deliverables owed to the banking organization, using the risk weight appropriate for an exposure to the counterparty in accordance with section 32. If a banking organization has not received its deliverables by the fifth business day after the counterparty delivery due date, the banking organization would assign a 1,250 percent risk weight to the current market value of the deliverables owed.

Question 16: Are there other transactions with a CCP that the agencies should consider excluding from the treatment for unsettled transactions? If so, what are the specific transaction types that should be excluded and why would exclusion be appropriate?

H. Risk-weighted Assets for Securitization Exposures

Under the general risk-based capital rules, a banking organization may use external ratings issued by NRSROs to assign risk weights to certain recourse obligations, residual interests, direct credit substitutes, and asset- and mortgage-backed securities. Such exposures to securitization transactions may also be subject to capital requirements that can result in effective risk weights of 1,250 percent, or a dollar-for-dollar capital requirement. A banking organization must deduct certain credit-enhancing interest-only strips (CEIOs) from tier 1 capital.[62] In this NPR, the agencies are updating the terminology of the securitization framework and proposing a broader definition of a securitization exposure to encompass a wider range of exposures with similar risk characteristics.

As noted in the introduction section of this preamble, the Basel capital framework has maintained the use and reliance on credit ratings in the securitization framework. In accordance with the Dodd-Frank Act requirement to remove references to and reliance on credit ratings, the agencies have developed alternative standards of creditworthiness for use in the securitization framework that, where possible and to the extent appropriate, have been designed to be similar to the requirements prescribed by the BCBS. These proposed alternative standards are also consistent with those incorporated into the market risk capital rules, under the agencies' final rule.[63]

1. Overview of the Securitization Framework and Definitions

The proposed securitization framework is designed to address the credit risk of exposures that involve the tranching of the credit risk of one or more underlying financial exposures. The agencies believe that requiring all or substantially all of the underlying exposures of a securitization be financial exposures creates an important boundary between the general credit risk framework and the securitization framework. Examples of financial exposures include loans, commitments, credit derivatives, guarantees, receivables, asset-backed securities, mortgage-backed securities, other debt securities, or equity securities. Based on their cash flow characteristics, for purposes of this proposal, the agencies also would consider asset classes such as lease residuals and entertainment royalties to be financial assets.

The securitization framework is designed to address the tranching of the credit risk of financial exposures and is not designed, for example, to apply to tranched credit exposures to commercial or industrial companies or nonfinancial assets. Accordingly, under this NPR, a specialized loan to finance the construction or acquisition of large-scale projects (for example, airports or power plants), objects (for example, ships, aircraft, or satellites), or commodities (for example, reserves, inventories, precious metals, oil, or natural gas) generally would not be a securitization exposure because the assets backing the loan typically are nonfinancial assets (the facility, object, or commodity being financed).

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[62] See 12 CFR part 3, appendix A, section 4 and 12 CFR part 167.12 (OCC); 12 CFR parts 208 and 225 appendix A, section III.B.3 (Board); 12 CFR part 325, appendix A section II.B.1 and 12 CFR 390.471 (FDIC). The agencies also have published a significant amount of supervisory guidance to assist banking organizations with the capital treatment of securitization exposures. In general, the agencies expect banking organizations to continue to use this guidance, most of which would remain applicable to the securitization framework proposed in this NPR.

[63] See "Risk-Based Capital Guidelines: Market Risk," June 7, 2012 (Federal Register publication forthcoming).

The proposal defines a securitization exposure as (i) an on- or off-balance sheet credit exposure (including credit-enhancing representations and warranties) that arises from a traditional or synthetic securitization (including a resecuritization), or (ii) an exposure that directly or indirectly references a securitization exposure described in the first part of the proposed definition. A traditional securitization means a transaction in which:

(1) All or a portion of the credit risk of one or more underlying exposures is transferred to one or more third parties other than through the use of credit derivatives or guarantees;

(2) The credit risk associated with the underlying exposures has been separated into at least two tranches reflecting different levels of seniority;

(3) Performance of the securitization exposures depends upon the performance of the underlying exposures;

(4) All or substantially all of the underlying exposures are financial exposures (such as loans, commitments, credit derivatives, guarantees, receivables, asset-backed securities, mortgage-backed securities, other debt securities, or equity securities);

(5) The underlying exposures are not owned by an operating company;

(6) The underlying exposures are not owned by a small business investment company described in section 302 of the Small Business Investment Act;

(7) The underlying exposures are not owned by a firm an investment in which qualifies as a community development investment under section 24 (Eleventh) of the National Bank Act;

(8) The primary federal supervisor may determine that a transaction in which the underlying exposures are owned by an investment firm that exercises substantially unfettered control over the size and composition of its assets, liabilities, and off-balance sheet exposures is not a traditional securitization based on the transaction's leverage, risk profile, or economic substance;

(9) The primary federal supervisor may deem a transaction that meets the definition of a traditional securitization, notwithstanding paragraphs (5), (6), or (7) of this definition, to be a traditional securitization based on the transaction's leverage, risk profile, or economic substance; and

(10) The transaction is not: (i) an investment fund; (ii) a collective investment fund (as defined in 12 CFR 208.34 (Board), 12 CFR 9.18 (OCC), and 12 CFR 344.3 (FDIC); (iii) a pension fund regulated under the ERISA or a foreign equivalent thereof; or (iv) regulated under the Investment Company Act of 1940 (15 U.S.C. 80a-1) or a foreign equivalent thereof.

The specific exemptions provided in paragraph (10) of the definition of traditional securitization serve to narrow the potential scope of the securitization framework. Investment funds, collective investment funds, pension funds regulated under ERISA and their foreign equivalents, and transactions regulated under the Investment Company Act of 1940 and their foreign equivalents are exempted from the definition because these entities and transactions are

tightly regulated and subject to strict leverage requirements. For purposes of this proposal, an investment fund is a company (1) where all or substantially all of the assets of the fund are financial assets; and (2) that has no material liabilities. In addition, the agencies believe that the capital requirements for an extension of credit to, or an equity holding in these transactions are more appropriately calculated under the rules for corporate and equity exposures, and that the securitization framework was not intended to apply to such transactions.

Under the proposal, an operating company would not fall under the definition of a traditional securitization (even if substantially all of its assets are financial exposures). For purposes of the proposed definition of a traditional securitization, operating companies generally would refer to companies that are set up 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. Accordingly, an equity investment in an operating company, such as a banking organization, generally would be an equity exposure under the proposal. In addition, investment firms that generally do not produce goods or provide services beyond the business of investing, reinvesting, holding, or trading in financial assets, would not be operating companies for purposes of this proposal and would not qualify for this general exclusion from the definition of traditional securitization.

To address the treatment of investment firms, the primary federal supervisor of a banking organization, under paragraph (8) of the definition of traditional securitization, would have discretion to exclude from the definition of a traditional securitization those transactions in which the underlying exposures are owned by an investment firm that exercise substantially unfettered control over the size and composition of its assets, liabilities, and off-balance sheet exposures. The agencies would consider a number of factors in the exercise of this discretion, including the assessment of the transaction's leverage, risk profile, and economic substance. This supervisory exclusion would give the primary federal supervisor discretion to distinguish structured finance transactions, to which the securitization framework was designed to apply, from those of flexible investment firms such as certain hedge funds and private equity funds. Only investment firms that can easily change the size and composition of their capital structure, as well as the size and composition of their assets and off-balance sheet exposures, would be eligible for the exclusion from the definition of traditional securitization under this provision. The agencies do not consider managed collateralized debt obligation vehicles, structured investment vehicles, and similar structures, which allow considerable management discretion regarding asset composition but are subject to substantial restrictions regarding capital structure, to have substantially unfettered control. Thus, such transactions would meet the definition of traditional securitization.

The agencies are concerned that the line between securitization exposures and non-securitization exposures may be difficult to draw in some circumstances. In addition to the supervisory exclusion from the definition of traditional securitization described above, the primary federal supervisor may scope certain transactions into the securitization framework if justified by the economics of the transaction. Similar to the analysis for excluding an investment firm from treatment as a traditional securitization, the agencies would consider the economic substance, leverage, and risk profile of transactions to ensure that the appropriate risk-based capital treatment. The agencies would consider a number of factors when assessing the economic substance of a transaction including, for example, the amount of equity in the

structure, overall leverage (whether on- or off-balance sheet), whether redemption rights attach to the equity investor, and the ability of the junior tranches to absorb losses without interrupting contractual payments to more senior tranches.

Both the designation of exposures as securitization (or resecuritization) exposures and the calculation of risk-based capital requirements for securitization exposures would be guided by the economic substance of a transaction rather than its legal form. Provided there is a tranching of credit risk, securitization exposures could include, among other things, asset-backed and mortgage-backed securities, loans, lines of credit, liquidity facilities, financial standby letters of credit, credit derivatives and guarantees, loan servicing assets, servicer cash advance facilities, reserve accounts, credit-enhancing representations and warranties, and CEIOs. Securitization exposures also could include assets sold with retained tranches. Mortgage-backed pass-through securities (for example, those guaranteed by FHLMC or FNMA) do not meet the proposed definition of a securitization exposure because they do not involve a tranching of credit risk. Only those mortgage-backed securities that involve tranching of credit risk would be securitization exposures.

Under the proposal, a synthetic securitization would mean a transaction in which: (1) all or a portion of the credit risk of one or more underlying exposures is transferred to one or more third parties through the use of one or more credit derivatives or guarantees (other than a guarantee that transfers only the credit risk of an individual retail exposure); (2) the credit risk associated with the underlying exposures has been separated into at least two tranches reflecting different levels of seniority; (3) performance of the securitization exposures depends upon the performance of the underlying exposures; and (4) all or substantially all of the underlying exposures are financial exposures (such as loans, commitments, credit derivatives, guarantees, receivables, asset-backed securities, mortgage-backed securities, other debt securities, or equity securities).

Consistent with 2009 Enhancements, this NPR would define a resecuritization exposure as an on- or off-balance sheet exposure to a resecuritization; or an exposure that directly or indirectly references a resecuritization exposure. An exposure to an asset-backed commercial paper program (ABCP) would not be a resecuritization exposure if either: (1) the program-wide credit enhancement does not meet the definition of a resecuritization exposure; or (2) the entity sponsoring the program fully supports the commercial paper through the provision of liquidity so that the commercial paper holders effectively are exposed to the default risk of the sponsor instead of the underlying exposures. A resecuritization would mean a securitization in which one or more of the underlying exposures is a securitization exposure. If a transaction involves a traditional multi-seller ABCP, also discussed in more detail below, a banking organization would need to determine whether the transaction should be considered a resecuritization exposure. For example, assume that an ABCP conduit acquires securitization exposures where the underlying assets consist of wholesale loans and no securitization exposures. As is typically the case in multi-seller ABCP conduits, each seller provides first-loss protection by over-collateralizing the conduit to which it sells its loans. To ensure that the commercial paper issued by each conduit is highly-rated, a banking organization sponsor provides either a pool-specific liquidity facility or a program-wide credit enhancement such as a guarantee to cover a portion of the losses above the seller-provided protection.

The pool-specific liquidity facility generally would not be treated as a resecuritization exposure under this proposal because the pool-specific liquidity facility represents a tranche of a single asset pool (that is, the applicable pool of wholesale exposures), which contains no securitization exposures. However, a sponsor's program-wide credit enhancement that does not cover all losses above the seller-provided credit enhancement across the various pools generally would constitute tranching of risk of a pool of multiple assets containing at least one securitization exposure, and therefore would be treated as a resecuritization exposure.

In addition, if the conduit in this example funds itself entirely with a single class of commercial paper, then the commercial paper generally would not be considered a resecuritization exposure if either (1) the program-wide credit enhancement did not meet the proposed definition of a resecuritization exposure or (2) the commercial paper was fully supported by the sponsoring banking organization. When the sponsoring banking organization fully supports the commercial paper, the commercial paper holders effectively would be exposed to default risk of the sponsor instead of the underlying exposures, and the external rating of the commercial paper would be expected to be based primarily on the credit quality of the banking organization sponsor, thus ensuring that the commercial paper does not represent a tranched risk position.

2. Operational Requirements

a. Due Diligence Requirements

During the recent financial crisis, it became apparent that many banking organizations relied exclusively on NRSRO ratings and did not perform their own credit analysis of the securitization exposures. Accordingly, and consistent with the Basel capital framework, banking organizations would be required under the proposal to satisfy specific due diligence requirements for securitization exposures. Specifically, a banking organization would be required to demonstrate, to the satisfaction of its primary federal supervisor, a comprehensive understanding of the features of a securitization exposure that would materially affect the performance of the exposure. The banking organization's analysis would be required to be commensurate with the complexity of the exposure and the materiality of the exposure in relation to capital. If the banking organization is not able to demonstrate a comprehensive understanding of a securitization exposure to the satisfaction of its primary federal supervisor, the banking organization would be required to assign a risk weight of 1,250 percent to the exposure.

Under the proposal, to demonstrate a comprehensive understanding of a securitization exposure a banking organization would have to conduct and document an analysis of the risk characteristics of the exposure prior to acquisition and periodically thereafter. This analysis would consider:

(1) Structural features of the securitization that would materially impact the performance of the exposure, for example, the contractual cash flow waterfall, waterfall-related triggers, credit enhancements, liquidity enhancements, market value triggers, the performance of organizations that service the position, and deal-specific definitions of default;

(2) Relevant information regarding the performance of the underlying credit exposure(s), for example, the percentage of loans 30, 60, and 90 days past due; default rates; prepayment rates; loans in foreclosure; property types; occupancy; average credit score or other measures of creditworthiness; average LTV ratio; and industry and geographic diversification data on the underlying exposure(s);

(3) Relevant market data of the securitization, for example, bid-ask spread, most recent sales price and historical price volatility, trading volume, implied market rating, and size, depth and concentration level of the market for the securitization; and

(4) For resecuritization exposures, performance information on the underlying securitization exposures, for example, the issuer name and credit quality, and the characteristics and performance of the exposures underlying the securitization exposures.

On an on-going basis (no less frequently than quarterly), a banking organization would be required to evaluate, review, and update as appropriate the analysis required under section 41(c)(1) for each securitization exposure.

Question 17: What, if any, are specific challenges that are involved with meeting the proposed due diligence requirements and for what types of securitization exposures? How might the agencies address these challenges while ensuring that a banking organization conducts an appropriate level of due diligence commensurate with the risks of its exposures?

b. Operational Requirements for Traditional Securitizations

In a traditional securitization, an originating banking organization typically transfers a portion of the credit risk of exposures to third parties by selling them to a securitization SPE (as defined in the proposal).[64] Under this NPR, a banking organization would be an originating banking organization if it: (1) directly or indirectly originated or securitized the underlying exposures included in the securitization; or (2) serves as an ABCP program sponsor to the securitization.

Under the proposal, a banking organization that transfers exposures it has originated or purchased to a securitization SPE or other third party in connection with a traditional securitization may exclude the underlying exposures from the calculation of risk-weighted assets only if each of the following conditions are met: (1) the exposures are not reported on the banking organization's consolidated balance sheet under GAAP; (2) the banking organization has transferred to one or more third parties credit risk associated with the underlying exposures; and (3) any clean-up calls relating to the securitization are eligible clean-up calls (as discussed below). An originating banking organization that meets these conditions would hold risk-based capital against any securitization exposures it retains in connection with the securitization. An originating banking organization that fails to meet these conditions would be required to hold risk-based capital against the transferred exposures as if they had not been securitized and would

[64] The proposal would define a securitization SPE as a corporation, trust, or other entity organized for the specific purpose of holding underlying exposures of a securitization, the activities of which are limited to those appropriate to accomplish this purpose, and the structure of which is intended to isolate the underlying exposures held by the entity from the credit risk of the seller of the underlying exposures to the entity.

deduct from common equity tier 1 capital any after-tax gain-on-sale resulting from the transaction.

In addition, if a securitization includes one or more underlying exposures in which (1) the borrower is permitted to vary the drawn amount within an agreed limit under a line of credit, and (2) contains an early amortization provision, the originating banking organization would be required to hold risk-based capital against the transferred exposures as if they had not been securitized and deduct from common equity tier 1 capital any after-tax gain-on-sale resulting from the transaction.[65] The agencies believe that this treatment is appropriate given the lack of risk transference in securitizations that contain early amortization provisions.

c. Operational Requirements for Synthetic Securitizations

In general, the proposal's treatment of synthetic securitizations is similar to that of traditional securitizations. The operational requirements for synthetic securitizations, however, are more rigorous to ensure that the originating banking organization has truly transferred credit risk of the underlying exposures to one or more third parties.

For synthetic securitizations, an originating banking organization would recognize for risk-based capital purposes the use of a credit risk mitigant to hedge underlying exposures only if each of the following conditions is satisfied:

(1) The credit risk mitigant is financial collateral, an eligible credit derivative, or an eligible guarantee;

(2) The banking organization transfers credit risk associated with the underlying exposures to one or more third parties, and the terms and conditions in the credit risk mitigants employed do not include provisions that:

(i) Allow for the termination of the credit protection due to deterioration in the credit quality of the underlying exposures;

(ii) Require the banking organization to alter or replace the underlying exposures to improve the credit quality of the pool of underlying exposures;

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[65] Many securitizations of revolving credit facilities (for example, credit card receivables) contain provisions that require the securitization to be wound down and investors to be repaid if the excess spread falls below a certain threshold. This decrease in excess spread may, in some cases, be caused by deterioration in the credit quality of the underlying exposures. An early amortization event can increase a banking organization's capital needs if new draws on the revolving credit facilities need to be financed by the banking organization using on-balance sheet sources of funding. The payment allocations used to distribute principal and finance charge collections during the amortization phase of these transactions also can expose a banking organization to a greater risk of loss than in other securitization transactions. The proposed rule would define early amortization as a provision in a securitization's governing documentation that, when triggered, causes investors in the securitization exposures to be repaid before the original stated maturity of the securitization exposure, unless the provision is solely triggered by events not related to the performance of the underlying exposures or the originating banking organization (such as material changes in tax laws or regulations).

(iii) Increase the banking organization's cost of credit protection in response to deterioration in the credit quality of the underlying exposures;

(iv) Increase the yield payable to parties other than the banking organization in response to a deterioration in the credit quality of the underlying exposures; or

(v) Provide for increases in a retained first loss position or credit enhancement provided by the banking organization after the inception of the securitization;

(3) The banking organization obtains a well-reasoned opinion from legal counsel that confirms the enforceability of the credit risk mitigant in all relevant jurisdictions; and

(4) Any clean-up calls relating to the securitization are eligible clean-up calls.

Failure to meet these operational requirements for a synthetic securitization would prevent a banking organization from using the proposed securitization framework and would require the banking organization to hold risk-based capital against the underlying exposures as if they had not been synthetically securitized. A banking organization that provides credit protection to a synthetic securitization would use the securitization framework to compute risk-based capital requirements for its exposures to the synthetic securitization even if the originating banking organization failed to meet one or more of the operational requirements for a synthetic securitization.

d. Clean-Up Calls

To satisfy the operational requirements for securitizations and enable an originating banking organization to exclude the underlying exposures from the calculation of its risk-based capital requirements, any clean-up call associated with a securitization would need to be an eligible clean-up call. The proposal would define a clean-up call as a contractual provision that permits an originating banking organization or servicer to call securitization exposures before their stated maturity or call date. In the case of a traditional securitization, a clean-up call generally is accomplished by repurchasing the remaining securitization exposures once the amount of underlying exposures or outstanding securitization exposures falls below a specified level. In the case of a synthetic securitization, the clean-up call may take the form of a clause that extinguishes the credit protection once the amount of underlying exposures has fallen below a specified level.

Under the proposal, an eligible clean-up call would be a clean-up call that (1) is exercisable solely at the discretion of the originating banking organization or servicer; (2) is not structured to avoid allocating losses to securitization exposures held by investors or otherwise structured to provide credit enhancement to the securitization (for example, to purchase non-performing underlying exposures); and (3) for a traditional securitization, is only exercisable when 10 percent or less of the principal amount of the underlying exposures or securitization exposures (determined as of the inception of the securitization) is outstanding; or, for a synthetic securitization, is only exercisable when 10 percent or less of the principal amount of the reference portfolio of underlying exposures (determined as of the inception of the securitization) is outstanding. Where a securitization SPE is structured as a master trust, a clean-up call with respect to a particular series or tranche issued by the master trust would meet criteria (3) of the

definition of "eligible clean-up call" as long as the outstanding principal amount in that series was 10 percent or less of its original amount at the inception of the series.

3. Risk-weighted Asset Amounts for Securitization Exposures

Under the proposed securitization framework, a banking organization generally would calculate a risk-weighted asset amount for a securitization exposure by applying either (1) the simplified supervisory formula approach (SSFA), described in section II.H.4 of this preamble, or (2) for banking organizations that are not subject to the market risk rule, a gross-up approach similar to an approach provided under the general risk-based capital rules. A banking organization would be required to apply either the gross-up approach or the SSFA consistently across all of its securitization exposures. Alternatively, a banking organization may choose to apply a 1,250 percent risk weight to any of its securitization exposures. In addition, the proposal provides for alternative treatment of securitization exposures to ABCP liquidity facilities and certain gains-on-sales and CEIO exposures. The proposed requirements, similar to the general risk-based capital rules, would include exceptions for interest-only mortgage-backed securities, certain statutorily exempted assets, and certain derivatives as described below. In all cases, the minimum risk weight for securitization exposures would be 20 percent.

For synthetic securitizations, which typically employ credit derivatives, a banking organization would apply the securitization framework when calculating risk-based capital requirements. Under this NPR, a banking organization may use the securitization CRM rules to adjust the capital requirement under the securitization framework for an exposure to reflect the CRM technique used in the transaction.

a. Exposure Amount of a Securitization Exposure

Under this proposal, the exposure amount of an on-balance sheet securitization exposure that is not a repo-style transaction, eligible margin loan, OTC derivative contract or derivative that is a cleared transaction (other than a credit derivative) would be the banking organization's carrying value of the exposure. The exposure amount of an off-balance sheet securitization exposure that is not an eligible ABCP liquidity facility, a repo-style transaction, eligible margin loan, an OTC derivative contract, or a derivative that is a cleared transaction (other than a credit derivative) would be the notional amount of the exposure.

For purposes of calculating the exposure amount of off-balance sheet exposure to an ABCP securitization exposure, such as a liquidity facility, the notional amount may be reduced to the maximum potential amount that the banking organization could be required to fund given the ABCP program's current underlying assets (calculated without regard to the current credit quality of those assets). Thus, if $100 is the maximum amount that could be drawn given the current volume and current credit quality of the program's assets, but the maximum potential draw against these same assets could increase to as much as $200 under some scenarios if their credit quality were to deteriorate, then the exposure amount is $200. This NPR would define an ABCP program as a program established primarily for the purpose of issuing commercial paper that is investment grade and backed by underlying exposures held in a securitization SPE. An eligible ABCP liquidity facility would be defined as a liquidity facility supporting ABCP, in form or in substance, that is subject to an asset quality test at the time of draw that precludes

funding against assets that are 90 days or more past due or in default. Notwithstanding these eligibility requirements, a liquidity facility would be an eligible ABCP liquidity facility if the assets or exposures funded under the liquidity facility that do not meet the eligibility requirements are guaranteed by a sovereign entity that qualifies for a 20 percent risk weight or lower.

The exposure amount of an eligible ABCP liquidity facility that is subject to the SSFA would be the notional amount of the exposure multiplied by a 50 percent CCF. The exposure amount of an eligible ABCP liquidity facility that is not subject to the SSFA would be the notional amount of the exposure multiplied by a 100 percent CCF. The proposed CCF for eligible ABCP liquidity facilities with an original maturity of less than one year is greater than the 10 percent CCF prescribed under the general risk-based capital rules.

The exposure amount of a securitization exposure that is a repo-style transaction, eligible margin loan, an OTC derivative or derivative that is a cleared transaction (other than a credit derivative) would be the exposure amount of the transaction as calculated in section 34 or section 37 as applicable.

b. Gains-On-Sale and Credit-enhancing Interest-only Strips

Under this NPR and the Basel III NPR, a banking organization would deduct from common equity tier 1 capital any after-tax gain-on-sale resulting from a securitization and would apply a 1,250 percent risk weight to the portion of a credit-enhancing interest-only strip (CEIO) that does not constitute an after-tax gain-on-sale. The agencies believe this treatment is appropriate given historical supervisory concerns with the subjectivity involved in valuations of gains-on-sale and CEIOs. Furthermore, although the treatments for gains-on-sale and CEIOs can increase an originating banking organization's risk-based capital requirement following a securitization, the agencies believe that such anomalies would be rare where a securitization transfers significant credit risk from the originating banking organization to third parties.

c. Exceptions under the Securitization Framework

There are several exceptions to the general provisions in the securitization framework that parallel the general risk-based capital rules. First, a banking organization would be required to assign a risk weight of at least 100 percent to an interest-only mortgage-backed security. The agencies believe that a minimum risk weight of 100 percent is prudent in light of the uncertainty implied by the substantial price volatility of these securities. Second, as required by federal statute, a special set of rules would continue to apply to securitizations of small-business loans and leases on personal property transferred with retained contractual exposure by well-capitalized depository institutions.[66] Finally, under this NPR, if a securitization exposure is an OTC derivative contract or derivative contract that is a cleared transaction (other than a credit derivative) that has a first priority claim on the cash flows from the underlying exposures

[66] See 12 U.S.C. 1835. This provision places a cap on the risk-based capital requirement applicable to a well-capitalized depository institution that transfers small-business loans with recourse. This NPR does not expressly provide that the agencies may permit adequately capitalized banking organizations to use the small business recourse rule on a case-by-case basis because the agencies may make such a determination under the general reservation of authority in section 1 of the proposal.

(notwithstanding amounts due under interest rate or currency derivative contracts, fees due, or other similar payments), a banking organization may choose to set the risk-weighted asset amount of the exposure equal to the amount of the exposure. This treatment would be subject to supervisory approval.

d. Overlapping Exposures

This NPR includes provisions to limit the double counting of risks in situations involving overlapping securitization exposures. If a banking organization has multiple securitization exposures that provide duplicative coverage to the underlying exposures of a securitization (such as when a banking organization provides a program-wide credit enhancement and multiple pool-specific liquidity facilities to an ABCP program), the banking organization would not be required to hold duplicative risk-based capital against the overlapping position. Instead, the banking organization would apply to the overlapping position the applicable risk-based capital treatment under the securitization framework that results in the highest risk-based capital requirement.

e. Servicer Cash Advances

A traditional securitization typically employs a servicing banking organization that, on a day-to-day basis, collects principal, interest, and other payments from the underlying exposures of the securitization and forwards such payments to the securitization SPE or to investors in the securitization. Servicing banking organizations often provide a facility to the securitization under which the servicing banking organization may advance cash to ensure an uninterrupted flow of payments to investors in the securitization, including advances made to cover foreclosure costs or other expenses to facilitate the timely collection of the underlying exposures. These servicer cash advance facilities are securitization exposures.

A banking organization would either apply the SSFA or the gross-up approach, as described below, or a 1,250 percent risk weight to its exposure under the facility. The treatment of the undrawn portion of the facility would depend on whether the facility is an eligible servicer cash advance facility. An eligible servicer cash advance facility would be defined as a servicer cash advance facility in which: (1) the servicer is entitled to full reimbursement of advances, except that a servicer may be obligated to make non-reimbursable advances for a particular underlying exposure if any such advance is contractually limited to an insignificant amount of the outstanding principal balance of that exposure; (2) the servicer's right to reimbursement is senior in right of payment to all other claims on the cash flows from the underlying exposures of the securitization; and (3) the servicer has no legal obligation to, and does not make, advances to the securitization if the servicer concludes the advances are unlikely to be repaid.

Consistent with the general risk-based capital rules with respect to the treatment of residential mortgage servicer cash advances, a servicing banking organization would not be required to hold risk-based capital against the undrawn portion of an eligible servicer cash advance facility. A banking organization that provides a non-eligible servicer cash advance facility would determine its risk-based capital requirement for the notional amount of the undrawn portion of the facility in the same manner as the banking organization would determine its risk-based capital requirement for any other off-balance sheet securitization exposure.

f. Implicit Support

This NPR specifies consequence for a banking organization's risk-based capital requirements if the banking organization provides support to a securitization in excess of the banking organization's predetermined contractual obligation (implicit support). First, similar to the general risk-based capital rules, a banking organization that provides such implicit support would include in risk-weighted assets all of the underlying exposures associated with the securitization as if the exposures had not been securitized, and deduct from common equity tier 1 capital any after-tax gain-on-sale resulting from the securitization.[67] Second, the banking organization would disclose publicly (i) that it has provided implicit support to the securitization, and (ii) the risk-based capital impact to the banking organization of providing such implicit support. Under the proposed reservations of authority, the banking organization's primary federal supervisor also could require the banking organization to hold risk-based capital against all the underlying exposures associated with some or all the banking organization's other securitizations as if the exposures had not been securitized, and to deduct from common equity tier 1 capital any after-tax gain-on-sale resulting from such securitizations.

4. Simplified Supervisory Formula Approach

For purposes of this proposal, and consistent with the approach provided for assigning specific risk-weighting factors to securitization exposures under subpart F, the agencies have developed a simplified version of the advanced approaches supervisory formula approach (SFA) to assign risk weights to securitization exposures.[68] This approach is referred to as the simplified supervisory formula approach (SSFA). Banking organizations may choose to use the alternative gross-up approach described in section II.5 below, provided that it applies the gross-up approach to all of its securitization exposures.

Similar to the SFA under the advanced approaches rule, the proposed SSFA is a formula that starts with a baseline derived from the capital requirements that apply to all exposures underlying a securitization and then assigns risk weights based on the subordination level of an exposure. The proposed SSFA was designed to apply relatively higher capital requirements to the more risky junior tranches of a securitization that are the first to absorb losses, and relatively lower requirements to the most senior exposures.

The SSFA methodology begins with "K_G" the weighted-average risk weight of the underlying exposures, calculated using the risk-weighted asset amounts in the standardized approach of subpart D, as proposed in this NPR. In addition, the SSFA also uses the attachment and detachment points of the particular securitization positions, and the current amount of delinquencies within the underlying exposures of the securitization. In terms of enhancements,

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[67] "Interagency Guidance on Implicit Recourse in Asset Securitizations," (May 23, 2002). OCC Bulletin 2002-20; CEO Memo No. 162 (OCC); SR letter 02-15 (Board); and FIL-52-2002 (FDIC).

[68] When using the SFA, a banking organization must meet minimum requirements under the Basel internal ratings-based approach to estimate probability of default and loss given default for the underlying exposures. Under the agencies' current risk-based capital rules, the SFA is available only to banking organizations that have been approved to use the advanced approaches.

the agencies note that the relative seniority of the exposure, as well as all cash funded enhancements, are recognized as part of the SSFA calculation.

The SSFA as proposed would apply a 1,250 percent risk weight to securitization exposures that absorb losses up to the amount of capital that would be required for the underlying exposures under subpart D had those exposures been held directly by a banking organization. In addition, agencies are proposing a supervisory risk-weight floor or minimum risk-weight for a given securitization of 20 percent. The agencies believe that a 20 percent floor is reasonably prudent given recent performance of securitization structures during times of stress, and will maintain this floor in the final rule.

At the inception of a securitization, the SSFA as proposed would require more capital on a transaction-wide basis than would be required if the pool of assets had not been securitized. That is, if the banking organization held every tranche of a securitization, its overall capital charge would be greater than if the banking organization held the underlying assets in portfolio. The agencies believe this overall outcome is important in reducing the likelihood of regulatory capital arbitrage through securitizations.

To make the SSFA risk sensitive and forward-looking, the agencies are proposing to adjust K_G based on delinquencies among the underlying assets of the securitization structure. Specifically, the parameter K_G is modified and the resulting adjusted parameter is labeled K_A. K_A is set equal to the weighted average of the K_G value and a fixed parameter equal to 0.5.

$$K_A = (1 - W) \cdot K_G + (W) \cdot 0.5$$

K_G would be the weighted-average total capital requirement of the underlying exposures, calculated using the standardized risk weighting methodologies in subpart D, as proposed in this NPR. The agencies believe it is important to calibrate risk weights for securitization exposures around the risk associated with the underlying assets of the securitization in this proposal, in order to reduce complexity and promote consistency between the different frameworks for calculating risk-weighted asset amounts in the standardized approach.

In the proposal, K_G is expressed as a decimal value between zero and 1 (that is, an average risk weight of 100 percent means that K_G would equal 0.08). The variable W would equal the ratio of the sum of the dollar amounts of any underlying exposures within the securitized pool that are "delinquent" to the ending balance, measured in dollars, of underlying exposures. "Delinquent" would be defined as the sum of exposures that are 90 days or more past due, subject to a bankruptcy or insolvency proceeding, in the process of foreclosure, held as real estate owned, or are in default.

The agencies believe that, with the delinquent exposure calibration parameter set equal to 0.5, the overall capital requirement would be sufficiently responsive and prudent to ensure sufficient capital for pools that demonstrate credit weakness. The entire specification of the SSFA in the final rule is as follows:

$$K_{SSFA} = \frac{e^{a \cdot u} - e^{a \cdot l}}{a(u - l)} .$$

K_{SSFA} is the risk based capital requirement for the securitization exposure and is a function of three variables, labeled a, u, and l. The constant e is the base of the natural logarithms (which equals 2.71828). The variables a, u, and l have the following definitions:

$$a = -\frac{1}{p \cdot K_A}$$

$$u = D - K_A$$

$$l = A - K_A$$

The values of A and D denote the attachment and detachment points, respectively, for the tranche. Specifically, A is the attachment point for the tranche that contains the securitization exposure and represents the threshold at which credit losses will first be allocated to the exposure. This input is the ratio, as expressed as a decimal value between zero and one, of the dollar amount of the securitization exposures that are subordinated to the tranche that contains the securitization exposure of the banking organization to the current dollar amount of all underlying exposures. D is the detachment point for the tranche that contains the securitization exposure and represents the threshold at which credit losses of principal allocated to the securitization exposure would result in a total loss of principal. This input, which is a decimal value between zero and one, equals the value of A plus the ratio of the dollar amount of the exposures and all pari passu exposures to the dollar amount of all underlying exposures. The SSFA specification is completed by the constant term p, which is set equal to 0.5 for securitization exposures that are not resecuritizations, or 1.5 for resecuritization exposures, and the variable K_A, which is described above. The risk weight for the exposure (expressed as a percent) is equal to K_{SSFA} times 1,250.

When D for a securitization exposure is less than or equal to K_A, the exposure must be assigned a risk weight of 1,250 percent. When A for a securitization exposure is greater than or equal to K_A, the risk weight of the exposure, expressed as a percent, would equal K_{SSFA} times 1,250. When A is less than K_A and D is greater than K_A , the applicable risk weight is a weighted average of 1,250 percent and 1,250 percent times K_{SSFA}. The risk weight would be set according to the following formula:

$$RW = \left[\left(\frac{K_A - A}{D - A}\right) \times 1{,}250\ percent\right] + \left[\left(\frac{D - K_A}{D - A}\right) \times 1{,}250\ percent \times K_{SSFA}\right]$$

For resecuritizations, the agencies expect banking organizations to use the SSFA to measure that asset's contribution to K_G. For example, consider a hypothetical securitization tranche that has an attachment point at 0.06 and a detachment point at 0.07. Then assume that 90 percent of the underlying pool of assets of the re-securitization were mortgage loans that qualified for a 50 percent risk weight and that the remaining 10 percent of the pool was a single tranche of a prior securitization (where those underlying mortgages also qualified for a 50 percent weight), thus qualifying this as a resecuritization. Next, assume that the attachment point A of the securitization that is the 10 percent share of the re-securitization is 0.06 and the detachment point D is 0.08. Finally, assume that there are zero delinquent exposures in both the securitization and re-securitization pools.

The value of K_G for the re-securitization exposure would equal the weighted average of the two distinct K_G values. For the mortgages that qualify for the 50 percent risk weight and represent 90 percent of the re-securitization, K_G equals 0.04 (i.e., 50 percent of the 8 percent risk-based capital standard).

$$K_{G,re-securitization} = (0.9 \cdot 0.04) + \left(0.1 \cdot K_{G,securitization}\right)$$

To calculate the value of $K_{G,securitization}$ a banking organization would use the attachment and detachment points of 0.06 and 0.08, respectively. Applying those input parameters to the SSFA (together with p = 0.5 and K_G = 0.04) results in a $K_{G,securitization}$ equal to 0.2325.

Substituting this value into the equation yields:

$$K_{G,re-securitization} = (0.9 \cdot 0.04) + (0.1 \cdot 0.2325) = 0.05925$$

This value of 0.05925 for $K_{G,re-securitization}$, would then be used in the calculation of the risk-based capital requirement for the tranche of the re-securitization (where $A = 0.06$, $B = 0.07$, and $p = 1.5$). The result is a risk-weight of 1,172 percent for the tranche that runs from 0.06 to 0.07. Given that the attachment point is very close to the value of $K_{G,re-securitization}$, the capital charge is nearly equal to the maximum risk weight of 1,250 percent.

5. Gross-up Approach

As an alternative to the SSFA, banking organizations that are not subject to subpart F may assign risk-based capital requirements to securitization exposures by implementing a gross-up approach described in section 43 of the proposal, which is similar to an approach provided under the general risk-based capital rules. If the banking organization chooses to apply the gross-up approach, it would be required to apply this approach to all of its securitization exposures, except as otherwise provided for certain securitization exposures under sections 44 and 45 of the proposal.

The gross-up approach assigns risk-based capital requirements based on the full amount of the credit-enhanced assets for which the banking organization directly or indirectly assumes credit risk. To calculate risk-weighted assets under the gross-up approach, a banking organization would determine four inputs: the pro rata share, the exposure amount, the enhanced amount, and the applicable risk weight. The pro rata share is the par value of the banking organization's exposure as a percentage of the par value of the tranche in which the securitization exposure resides. The enhanced amount is the value of all the tranches that are more senior to the tranche in which the exposure resides. The applicable risk weight is the weighted-average risk weight of the underlying exposures in the securitization pool as calculated under subpart D.

Under the gross-up approach, a banking organization would be required to calculate the credit equivalent amount, which equals the sum of the exposure of the banking organization's securitization exposure and the pro rata share multiplied by the enhanced amount. To calculate risk-weighted assets for a securitization exposure under the gross-up approach, a banking organization would be required to assign the applicable risk weight to the gross up credit equivalent amount. As noted above, in all cases, the minimum risk weight for securitization exposures would be 20 percent.

Question 18: The agencies solicit commenters' views on the proposed gross-up approach.

6. Alternative Treatments for Certain Types of Securitization Exposures

Under the NPR, a banking organization generally would assign a 1,250 percent risk weight to all securitization exposures to which the banking organization does not apply the SSFA or the gross-up approach. However, the NPR provides alternative treatments for certain types of securitization exposures described below, provided that the banking organization knows the composition of the underlying exposures at all times:

a. Eligible ABCP Liquidity Facilities

In this NPR, consistent with the Basel capital framework, a banking organization would be permitted to determine the exposure amount of an eligible asset-backed commercial paper (ABCP) liquidity facility by multiplying the exposure amount by the highest risk weight applicable to any of the individual underlying exposures covered by the facility. The proposal would define an eligible asset-backed commercial paper liquidity facility to mean a liquidity facility supporting ABCP, in form or in substance, that is subject to an asset quality test at the time of draw that precludes funding against assets that are 90 days or more past due or in default. Notwithstanding the preceding sentence, a liquidity facility is an eligible ABCP liquidity facility if the assets or exposures funded under the liquidity facility that do not meet the eligibility requirements are guaranteed by a sovereign that qualifies for a 20 percent risk weight or lower.

b. A Securitization Exposures in a Second Loss Position or Better to an ABCP Program

Under the proposal, a banking organization may determine the risk-weighted asset amount of a securitization exposure that is in a second loss position or better to an ABCP program by multiplying the exposure amount by the higher of 100 percent and the highest risk weight applicable to any of the individual underlying exposures of the ABCP program,[69] provided the exposure meets the following criteria:

(1) The exposure is not a first priority securitization exposure or an eligible ABCP liquidity facility;

(2) The exposure is economically in a second loss position or better, and the first loss position provides significant credit protection to the second loss position;

(3) The exposure qualifies as investment grade; and

(4) The banking organization holding the exposure does not retain or provide protection for the first-loss position.

[69] The proposal would define an ABCP program as a program that primarily issues commercial paper that is investment grade and backed by underlying exposures held in a bankruptcy-remote manner.

The agencies believe that this approach, which is consistent with the Basel capital framework, appropriately and conservatively assesses the credit risk of non-first-loss exposures to ABCP programs.

7. Credit Risk Mitigation for Securitization Exposures

As proposed, the treatment of credit risk mitigation for securitization exposures would differ slightly from the treatment for other exposures. In general, to recognize the risk mitigating effects of financial collateral or an eligible guarantee or an eligible credit derivative from an eligible guarantor, a banking organization would use the approaches for collateralized transactions under section 37 of the proposal, the substitution treatment for guarantees and credit derivatives described in section 36 of the proposal.

Under section 45 of the proposal, a banking organization would be permitted to recognize an eligible guarantee or eligible credit derivative only from an eligible guarantor. In addition, when an eligible guarantee or eligible credit derivative covers multiple hedged exposures that have different residual maturities, the banking organization would be required to use the longest residual maturity of any of the hedged exposures as the residual maturity of all the hedged exposures.

8. Nth-to-default Credit Derivatives

The agencies propose that the capital requirement for protection purchased through an nth-to-default derivative be determined either by using the SSFA, or applying a 1,250 percent risk weight. A banking organization would determine its exposure in the n^{th}-to-default credit derivative as the largest notional amount of all the underlying exposures.

When applying the SSFA, the attachment point (parameter A) is the ratio of the sum of the notional amounts of all underlying exposures that are subordinated to the banking organization's exposure to the total notional amount of all underlying exposures. In the case of a first-to-default credit derivative, there are no underlying exposures that are subordinated to the banking organization's exposure. In the case of a second-or-subsequent-to default credit derivative, the smallest (n-1) underlying exposure(s) are subordinated to the banking organization's exposure.

Under the SSFA, the detachment point (parameter D) is the sum of the attachment point and the ratio of the notional amount of the banking organization's exposure to the total notional amount of the underlying exposures. A banking organization that does not use the SSFA to calculate a risk weight for an n^{th}-to-default credit derivative would assign a risk weight of 1,250 percent to the exposure.

For protection purchased through a first-to-default derivative, a banking organization that obtains credit protection on a group of underlying exposures through a first-to-default credit derivative that meets the rules of recognition for guarantees and credit derivatives under section 36(b) would determine its risk-based capital requirement for the underlying exposures as if the banking organization synthetically securitized the underlying exposure with the smallest risk-weighted asset amount and had obtained no credit risk mitigant on the other underlying exposures. A banking organization must calculate a risk-based capital requirement for

counterparty credit risk according to section 34 for a first-to-default credit derivative that does not meet the rules of recognition of section 36(b).

For second-or-subsequent-to default credit derivatives, a banking organization that obtains credit protection on a group of underlying exposures through a nth -to-default credit derivative that meets the rules of recognition of section 36(b) (other than a first-to-default credit derivative) may recognize the credit risk mitigation benefits of the derivative only if the banking organization also has obtained credit protection on the same underlying exposures in the form of first-through-(n-1)-to-default credit derivatives; or if n-1 of the underlying exposures have already defaulted. If a banking organization satisfies these requirements, the banking organization would determine its risk-based capital requirement for the underlying exposures as if the banking organization had only synthetically securitized the underlying exposure with the smallest risk-weighted asset amount. For a nth-to-default credit derivative that does not meet the rules of recognition of section 36(b), a banking organization would calculate a risk-based capital requirement for counterparty credit risk according to the treatment of OTC derivatives under section 34.

I. Equity Exposures

1. Introduction

Under the general risk-based capital rules, a banking organization must deduct a portion of non-financial equity investments from tier 1 capital, based on the aggregate adjusted carrying value of all non-financial equity investments held directly or indirectly by the banking organization as a percentage of its tier 1 capital.[70] For those equity exposures that are not deducted, a banking organization generally must assign a 100 percent risk weight.

Consistent with the Basel capital framework, in this NPR, the agencies are proposing to require a banking organization to apply the simple risk-weight approach (SRWA) for equity exposures that are not exposures to an investment fund and apply certain look-through approaches to assign risk-weighted asset amounts to equity exposures to an investment fund. In some cases, such as equity exposures to the Federal Home Loan Bank, the treatment under the proposal would remain unchanged from the general risk-based capital rules. However, this NPR introduces changes to the treatment of equity exposures, which are consistent with the treatment for equity exposures under the advanced approaches rule, to improve risk sensitivity of the general risk-based capital requirements. For example, the proposal would differentiate between publicly traded and non- publicly traded equity exposures, while the general risk-based capital rules do not make such a distinction.

This NPR would define an equity exposure as:

(1) A security or instrument (whether voting or non-voting) that represents a direct or indirect ownership interest in, and is a residual claim on, the assets and income of a company,

[70] In contrast, the current rules for state and federal savings associations require the deduction of most equity securities from total capital. See 12 CFR part 167.5(c)(2)(ii) (federal savings associations) and 12 CFR 390.465(c)(2)(ii) (state savings associations).

unless: (i) the issuing company is consolidated with the banking organization under GAAP; (ii) the banking organization is required to deduct the ownership interest from tier 1 or tier 2 capital under the proposed requirements; (iii) the ownership interest incorporates a payment or other similar obligation on the part of the issuing company (such as an obligation to make periodic payments); or (iv) the ownership interest is a securitization exposure;

(2) A security or instrument that is mandatorily convertible into a security or instrument described in paragraph (1) of this definition;

(3) An option or warrant that is exercisable for a security or instrument described in paragraph (1) of this definition; or

(4) Any other security or instrument (other than a securitization exposure) to the extent the return on the security or instrument is based on the performance of a security or instrument described in paragraph (1) of this definition.

2. Exposure Measurement

Under the proposal, a banking organization would be required to determine the adjusted carrying value for each equity exposure based on the approaches described below. For the on-balance sheet component of an equity exposure, the adjusted carrying value would be a banking organization's carrying value of the exposure. For a commitment to acquire an equity exposure that is unconditional, the adjusted carrying value would be the effective notional principal amount of the exposure multiplied by a 100 percent conversion factor. For a commitment to acquire an equity exposure that is conditional, the adjusted carrying value would be the effective notional principal amount of the commitment multiplied by (1) a 20 percent conversion factor, for a commitment with an original maturity of one year or less or (2) a 50 percent conversion factor, for a commitment with an original maturity of over one year. For the off-balance sheet component of an equity exposure that is not an equity commitment, the adjusted carrying value would be the effective notional principal amount of the exposure, the size of which is equivalent to a hypothetical on-balance sheet position in the underlying equity instrument that would evidence the same change in fair value (measured in dollars) for a given small change in the price of the underlying equity instrument, minus the adjusted carrying value of the on-balance sheet component of the exposure.

As described in the hedged transactions section below, exposure amounts may have different treatments in the case of hedged equity exposures. The agencies created the concept of the effective notional principal amount of the off-balance sheet portion of an equity exposure to provide a uniform method for banking organizations to measure the on-balance sheet equivalent of an off-balance sheet exposure. For example, if the value of a derivative contract referencing the common stock of company X changes the same amount as the value of 150 shares of common stock of company X, for a small change (for example, 1.0 percent) in the value of the common stock of company X, the effective notional principal amount of the derivative contract is the current value of 150 shares of common stock of company X, regardless of the number of shares the derivative contract references. The adjusted carrying value of the off-balance sheet component of the derivative is the current value of 150 shares of common stock of company X minus the adjusted carrying value of any on-balance sheet amount associated with the derivative.

3. Equity Exposure Risk Weights

Under the proposed SRWA, set forth in section 52 of the proposal, a banking organization would determine the risk-weighted asset amount for each equity exposure, other than an equity exposure to an investment fund, by multiplying the adjusted carrying value of the equity exposure, or the effective portion and ineffective portion of a hedge pair as described below, by the lowest applicable risk weight in Table 9. A banking organization would determine the risk-weighted asset amount for an equity exposure to an investment fund under section 53 of the proposal. A banking organization would sum risk weighted asset amounts for all of its equity exposures to calculate its aggregate risk-weighted asset amount for its equity exposures.

The proposed SRWA is summarized in Table 9 and described in more detail below:

Table 9 - Simple Risk-weight Approach (SRWA)

Risk weight (in percent)	Equity exposure
0	An equity exposure to a sovereign, the Bank for International Settlements, the European Central Bank, the European Commission, the International Monetary Fund, an MDB, and any other entity whose credit exposures receive a zero percent risk weight under section 32 of the proposal.
20	An equity exposure to a PSE, Federal Home Loan Bank or the Federal Agricultural Mortgage Corporation (Farmer Mac).
100	• Community development equity exposures[71] • The effective portion of a hedge pair • Non-significant equity exposures to the extent that the aggregate adjusted carrying value of the exposures does not exceed 10 percent of tier 1 capital plus tier 2 capital
250	A significant investment in the capital of an unconsolidated financial institution that is not deducted under section 22 of the proposal.

[71] The proposed rule generally defines these exposures as exposures that would qualify as community development investments under 12 U.S.C. 24 (Eleventh), excluding equity exposures to an unconsolidated small business investment company and equity exposures held through a consolidated small business investment company described in section 302 of the Small Business Investment Act of 1958 (15 U.S.C. 682). For savings associations, community development investments would be defined to mean equity investments that are designed primarily to promote community welfare, including the welfare of low- and moderate-income communities or families, such as by providing services or jobs, and excluding equity exposures to an unconsolidated small business investment company and equity exposures held through a consolidated small business investment company described in section 302 of the Small Business Investment Act of 1958 (15 U.S.C. 682).

300	A publicly traded equity exposure (other than an equity exposure that receives a 600 percent risk weight and including the ineffective portion of a hedge pair).
400	An equity exposure that is not publicly traded (other than an equity exposure that receives a 600 percent risk weight).
600	An equity exposure to an investment firm that (i) would meet the definition of a traditional securitization were it not for the primary federal supervisor's application of paragraph (8) of that definition and (ii) has greater than immaterial leverage.

Under the proposal, equity exposures to sovereign, supranational entities, MDBs, and PSEs would receive a risk weight of zero percent, 20 percent, or 100 percent, as described in section 52 of the proposal. Certain community development equity exposures, the effective portion of hedged pairs, and, up to certain limits, non-significant equity exposures would receive a 100 percent risk weight. In addition, a banking organization generally would assign a 250 percent risk weight to an equity exposure related to a significant investment in the capital of unconsolidated financial institutions that is not deducted under section 22; a 300 percent risk weight to a publicly traded equity exposure; and a 400 percent risk weight to a non-publicly traded equity exposure.

This proposal defines publicly-traded as traded on: (1) any exchange registered with the SEC as a national securities exchange under section 6 of the Securities Exchange Act of 1934 (15 U.S.C. 78f); or (2) any non-U.S.-based securities exchange that is registered with, or approved by, a national securities regulatory authority and that provides a liquid, two-way market for the instrument in question. A two-way market would refer to a market where there are independent bona fide offers to buy and sell so that a price reasonably related to the last sales price or current bona fide competitive bid and offer quotations can be determined within one day and settled at that price within a relatively short time frame conforming to trade custom.

The proposal would require banking organizations to assign a 600 percent risk weight to an equity exposure to an investment firm, provided that the investment firm (1) would meet the definition of a traditional securitization were it not for the primary federal supervisor's application of paragraph (8) of that definition and (2) has greater than immaterial leverage. As discussed in the securitizations section, the agencies would have discretion under this proposal to exclude from the definition of a traditional securitization those investment firms that exercise substantially unfettered control over the size and composition of their assets, liabilities, and off-balance sheet exposures. Equity exposures to investment firms that would otherwise be traditional securitizations were it not for the specific primary federal supervisor's exclusion are leveraged exposures to the underlying financial assets of the investment firm. The agencies believe that equity exposure to such firms with greater than immaterial leverage warrant a 600 percent risk weight under the SRWA, due to their particularly high risk. Moreover, the agencies believe that the 100 percent risk weight assigned to non-significant equity exposures is inappropriate for equity exposures to investment firms with greater than immaterial leverage.

4. Non-significant Equity Exposures

Under this NPR, a banking organization would be permitted to apply a 100 percent risk weight to certain equity exposures deemed non-significant. Non-significant equity exposures would mean an equity exposure to the extent that the aggregate adjusted carrying value of the exposures does not exceed 10 percent of the banking organization's total capital.[72]

To compute the aggregate adjusted carrying value of a banking organization's equity exposures for determining their non-significance, this proposal provides that the banking organization may exclude (1) equity exposures that receive less than a 300 percent risk weight under the SRWA (other than equity exposures determined to be non-significant); (2) the equity exposure in a hedge pair with the smaller adjusted carrying value; and (3) a proportion of each equity exposure to an investment fund equal to the proportion of the assets of the investment fund that are not equity exposures or (4) exposures that qualify as community development equity exposures. If a banking organization does not know the actual holdings of the investment fund, the banking organization may calculate the proportion of the assets of the fund that are not equity exposures based on the terms of the prospectus, partnership agreement, or similar contract that defines the fund's permissible investments. If the sum of the investment limits for all exposure classes within the fund exceeds 100 percent, the banking organization would assume that the investment fund invests to the maximum extent possible in equity exposures.

To determine which of a banking organization's equity exposures qualify for a 100 percent risk weight based on non-significance, the banking organization first would include equity exposures to unconsolidated small business investment companies, or those held through consolidated small business investment companies described in section 302 of the Small Business Investment Act of 1958. Next, it would include publicly-traded equity exposures (including those held indirectly through investment funds), and then it would include non publicly-traded equity exposures (including those held indirectly through investment funds).[73]

The treatment of non-significant equity exposures in this proposal is consistent with the advanced approaches rule. However, in light of significant volatility in equity values since publication of the advanced approaches rule in 2007, and the BCBS revisions to the Basel capital framework, the agencies are considering whether a more simple treatment of banking organizations' non-significant equity exposures is appropriate.

One alternative would assign a 100 percent risk weight to a banking organization's equity exposures to small business investment companies and to stock that a banking organization acquires in satisfaction of debts previously contracted (DPC), consistent with the proposed treatment of community development investments and the effective portion of hedge pairs. The full amount of a banking organization's equity exposure to a small business investment company and the full amount of its DPC equity exposures (together with community

[72] The definition would exclude exposures to an investment firm that (1) would meet the definition of traditional securitization were it not for the primary federal supervisor's application of paragraph (8) of the definition of a traditional securitization and (2) has greater than immaterial leverage.

[73] See 15 U.S.C. 682.

development investments and the effective portion of hedge pairs) would receive a 100 percent risk weight, not just the "non-significant" portion of such equity exposures.

If the agencies assign a 100 percent risk weight to equity exposures to a small business investment company and to DPC equity exposures, the agencies would consider what other types of equity exposures, if any, would continue to be exempt from the calculation of the "non-significant" amount of equity exposures for risk-based capital purposes and what capital treatment would be appropriate for such exposures. For example, the agencies could reduce the threshold for non-significant equity exposure calculation from 10 percent of tier 1 capital and tier 2 capital to 5 percent of tier 1 and tier 2 capital.

Question 19: The agencies solicit comment on an alternative proposal to simplify the risk-based capital treatment of banking organizations' non-significant equity exposures by assigning a 100 percent risk weight to equity exposures to small business investment companies and to DPC equity exposures, consistent with the treatment of community development investments and the effective portion of hedged pairs. What other types of equity exposures (excluding exposures to small business investment companies and equities taken for DPC) should be excluded from the non-significant equity exposure calculation under the alternative approach and what is the approximate amount of these exposures in relation to banking organizations' total capital? What would be an appropriate measure or level for determining whether equity exposures in the aggregate are "non-significant" for a banking organization?

5. Hedged Transactions

In this NPR, the agencies are proposing the following treatment for recognizing hedged equity exposures. For purposes of determining risk-weighted assets under the SRWA, a banking organization could identify hedge pairs. Hedge pairs would be defined as two equity exposures that form an effective hedge, as long as each equity exposure is publicly-traded or has a return that is primarily based on a publicly traded equity exposure. Under the NPR, a banking organization may risk weight only the effective and ineffective portions of a hedge pair rather than the entire adjusted carrying value of each exposure that makes up the pair.

Two equity exposures form an effective hedge if the exposures either have the same remaining maturity or each has a remaining maturity of at least three months; the hedge relationship is formally documented in a prospective manner (that is, before the banking organization acquires at least one of the equity exposures); the documentation specifies the measure of effectiveness (E) the banking organization would use for the hedge relationship throughout the life of the transaction; and the hedge relationship has an E greater than or equal to 0.8. A banking organization would measure E at least quarterly and would use one of three measures of E described in the next section: the dollar-offset method, the variability-reduction method, or the regression method.

It is possible that only part of a banking organization's exposure to a particular equity instrument is part of a hedge pair. For example, assume a banking organization has equity exposure A with a $300 adjusted carrying value and chooses to hedge a portion of that exposure with equity exposure B with an adjusted carrying value of $100. Also assume that the combination of equity exposure B and $100 of the adjusted carrying value of equity exposure A

form an effective hedge with an E of 0.8. In this situation, the banking organization would treat $100 of equity exposure A and $100 of equity exposure B as a hedge pair, and the remaining $200 of its equity exposure A as a separate, stand-alone equity position. The effective portion of a hedge pair would be calculated as E multiplied by the greater of the adjusted carrying values of the equity exposures forming the hedge pair. The ineffective portion of a hedge pair would be calculated as (1-E) multiplied by the greater of the adjusted carrying values of the equity exposures forming the hedge pair. In the above example, the effective portion of the hedge pair would be 0.8 x $100 = $80, and the ineffective portion of the hedge pair would be (1 – 0.8) x $100 = $20.

6. Measures of Hedge Effectiveness

As stated above, a banking organization could determine effectiveness using any one of three methods: the dollar-offset method, the variability-reduction method, or the regression method. Under the dollar-offset method, a banking organization would determine the ratio of the cumulative sum of the changes in value of one equity exposure to the cumulative sum of the changes in value of the other equity exposure, termed the ratio of value change (RVC). If the changes in the values of the two exposures perfectly offset each other, the RVC would be -1. If RVC is positive, implying that the values of the two equity exposures move in the same direction, the hedge is not effective and E equals 0. If RVC is negative and greater than or equal to -1 (that is, between zero and -1), then E would equal the absolute value of RVC. If RVC is negative and less than -1, then E would equal 2 plus RVC.

The variability-reduction method of measuring effectiveness compares changes in the value of the combined position of the two equity exposures in the hedge pair (labeled X in the equation below) to changes in the value of one exposure as though that one exposure were not hedged (labeled A). This measure of E expresses the time-series variability in X as a proportion of the variability of A. As the variability described by the numerator becomes small relative to the variability described by the denominator, the measure of effectiveness improves, but is bounded from above by a value of one. E would be computed as:

$$E = 1 - \frac{\sum_{t=1}^{T} \left(X_t - X_{t-1} \right)^2}{\sum_{t=1}^{T} \left(A_t - A_{t-1} \right)^2}, \text{ where}$$

$X_t = A_t - B_t$

$A_t =$ the value at time t of the one exposure in a hedge pair, and

$B_t =$ the value at time t of the other exposure in the hedge pair.

The value of t would range from zero to T, where T is the length of the observation period for the values of A and B, and is comprised of shorter values each labeled t.

The regression method of measuring effectiveness is based on a regression in which the change in value of one exposure in a hedge pair is the dependent variable and the change in value of the other exposure in the hedge pair is the independent variable. E would equal the coefficient of determination of this regression, which is the proportion of the variation in the dependent variable explained by variation in the independent variable. However, if the estimated regression coefficient is positive, then the value of E is zero. The closer the relationship between the values of the two exposures, the higher E would be.

7. Equity Exposures to Investment Funds

Under the general risk-based capital rules, exposures to investments funds are captured through one of two methods. These methods are similar to the alternative modified look-through approach and the simple modified look-through approach described below. The agencies propose an additional option in this NPR, the full look-through approach.

The agencies propose a separate treatment for equity exposures to an investment fund to ensure that banking organizations do not receive a punitive risk-based capital requirement for equity exposures to investment funds that hold only low-risk assets, and to prevent banking organizations from arbitraging the proposed risk-based capital requirements for certain high-risk exposures.

As proposed, a banking organization would determine the risk-weighted asset amount for equity exposures to investment funds using one of three approaches: the full look-through approach, the simple modified look-through approach, or the alternative modified look-through approach, unless the equity exposure to an investment fund is a community development equity exposure. Such community development equity exposures would be subject to a 100 percent risk weight. If an equity exposure to an investment fund is part of a hedge pair, a banking organization would use the ineffective portion of the hedge pair as the adjusted carrying value for the equity exposure to the investment fund. The risk-weighted asset amount of the effective portion of the hedge pair would be equal to its adjusted carrying value. A banking organization could choose which approach to apply for each equity exposure to an investment fund.

a. Full Look-through Approach

A banking organization may use the full look-through approach only if the banking organization is able to calculate a risk-weighted asset amount for each of the exposures held by the investment fund. Under the proposal, a banking organization would be required to calculate the risk-weighted asset amount for each of the exposures held by the investment fund (as calculated under subpart D of the proposal) as if the exposures were held directly by the banking organization. The banking organization's risk-weighted asset amount for the fund would be equal to the aggregate risk-weighted asset amount of the exposures held by the fund as if they were held directly by the banking organization multiplied by the banking organization's proportional ownership share of the fund.

b. Simple Modified Look-through Approach

Under the proposed simple modified look-through approach, a banking organization would set the risk-weighted asset amount for its equity exposure to an investment fund equal to the adjusted carrying value of the equity exposure multiplied by the highest risk weight assigned according to subpart D of the proposal that applies to any exposure the fund is permitted to hold under the prospectus, partnership agreement, or similar agreement that defines the fund's permissible investments. The banking organization may exclude derivative contracts held by the fund that are used for hedging, rather than for speculative purposes, and do not constitute a material portion of the fund's exposures.

c. Alternative Modified Look-through Approach

Under the proposed alternative modified look-through approach, a banking organization may assign the adjusted carrying value of an equity exposure to an investment fund on a pro rata basis to different risk weight categories under subpart D of the proposal based on the investment limits in the fund's prospectus, partnership agreement, or similar contract that defines the fund's permissible investments.

The risk-weighted asset amount for the banking organization's equity exposure to the investment fund would be equal to the sum of each portion of the adjusted carrying value assigned to an exposure type multiplied by the applicable risk weight. If the sum of the investment limits for all exposures within the fund exceeds 100 percent, the banking organization would assume that the fund invests to the maximum extent permitted under its investment limits in the exposure type with the highest applicable risk weight under the proposed requirements and continues to make investments in the order of the exposure category with the next highest risk weight until the maximum total investment level is reached. If more than one exposure category applies to an exposure, the banking organization would use the highest applicable risk weight. A banking organization may exclude derivative contracts held by the fund that are used for hedging, rather than for speculative, purposes and do not constitute a material portion of the fund's exposures.

III. Insurance-related Activities

The agencies propose to apply consolidated capital requirements to savings and loan holding companies, consistent with the transfer of supervisory responsibilities to the Board under Title III of the Dodd-Frank Act, as well as the requirements in section 171 of the Dodd-Frank Act. Savings and loan holding companies have not been subject to consolidated quantitative capital requirements prior to this proposal.

In the Notice of Intent published in April 2011 (2011 notice of intent), the Board discussed the possibility of applying to savings and loan holding companies the same consolidated risk-based and leverage capital requirements as those proposed for bank holding companies.[74] The Board requested comment on unique characteristics, risks, or specific activities of savings and loan holding companies that should be taken into consideration when developing consolidated capital requirements for these entities. The Board also sought specific comment on instruments that are currently included in savings and loan holding companies' regulatory capital

[74] See 76 FR 22662 (April 22, 2011).

that would be excluded or strictly limited under Basel III, as well as the appropriate transition provisions.

The Board received comment letters on the 2011 notice of intent as well as on other notices issued in 2011 pertaining to savings and loan companies.[75] In addition, Board staff met with a number of industry participants, regulators, and trade groups to further the discussion of relevant considerations. The main themes raised by commenters relevant to this proposal were the appropriateness of requiring savings and loan holding companies to apply "bank-centric" consolidated capital standards; the need to appropriately address certain instruments and assets unique to savings and loan holding companies; the need for appropriate transition periods; and the degree of regulatory burden (particularly for those savings and loan holding companies that are insurance companies that only prepare financial statements according to Statutory Accounting Principles).

A number of commenters suggested that the Board defer its oversight of savings and loan holding companies, in part or in whole, to functional regulators or impose the same capital standards required by insurance regulators. Other commenters suggested that certain savings and loan holding companies should be exempt from the Board's regulatory capital requirements in cases where depository institution activity constitutes only a small part of the consolidated organization's assets and revenues. The Board believes both of these approaches would be would be inconsistent with the requirements set out in section 171 of the Dodd-Frank Act. Further, the Board believes it is important to apply consolidated risk-based and leverage capital requirements to insurance-based holding companies because the insurance risk-based capital requirements are not imposed on a consolidated basis and are based on different considerations, such as solvency concerns, rather than broad categories of credit risk.

The Board considered all the comments received and believes that the proposed requirements for savings and loan holding companies appropriately take into consideration their unique characteristics, risks, and activities while ensuring compliance with the requirements of the Dodd-Frank Act. Further, a uniform approach for all holding companies would mitigate potential competitive equity issues, limit opportunities for regulatory arbitrage, and facilitate comparable treatment of similar risks.

In 2011, the agencies amended the general risk-based capital rules to provide that low-risk assets not held by depository institutions may receive the capital treatment applicable under the capital guidelines for bank holding companies under limited circumstances.[76] This provision provides appropriate capital requirements for certain low risk exposures that generally are not held by depository institutions and brings the regulations applicable to bank holding companies into compliance with section 171 of the Dodd-Frank Act, which requires that bank holding companies be subject to capital requirements that are no less stringent than those applied to

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[75] See, for example, "Agency Information Collection Activities Regarding Savings and Loan Holding Companies," available at http://www.gpo.gov/fdsys/pkg/FR-2011-12-29/pdf/2011-33432.pdf; "Proposed Agency Information Collection Activities; Comment Request," available at http://www.gpo.gov/fdsys/pkg/FR-2011-08-25/pdf/2011-21736.pdf.

[76] See 76 FR 37620 (June 28, 2011).

insured depository institutions. The agencies propose to continue this approach for purposes of this NPR.

The proposed requirements that are unique to savings and loan holding companies or bank holding companies are discussed below, including provisions pertaining the determination of risk-weighted assets for nonbanking exposures unique to insurance underwriting activities (whether conducted by a bank holding company or savings and loan holding company).

Policy Loans

A policy loan would be defined as a loan to policyholders under the provisions of an insurance contract that are secured by the cash surrender value or collateral assignment of the related policy or contract. A policy loan would include: (1) a cash loan, including a loan resulting from early payment or accelerated payment benefits, on an insurance contract when the terms of contract specify that the payment is a policy loan secured by the policy; and (2) an automatic premium loan, which is a loan made in accordance with policy provisions which provide that delinquent premium payments are automatically paid from the cash value at the end of the established grace period for premium payments.

Under the proposal, a policy loan would be assigned a 20 percent risk. Such treatment is similar to the treatment of a cash-secured loan. The Board believes this treatment is appropriate in light of the fact that should a borrower default, the resulting loss to the insurance company is mitigated by the right to access the cash surrender value or collateral assignment of the related policy.

Separate Accounts

A separate account is a legally segregated pool of assets owned and held by an insurance company and maintained separately from its general account assets for the benefit of an individual contract holder, subject to certain conditions. To qualify as a separate account, the following conditions generally must be met: (1) the account must be legally recognized under applicable law; (2) the assets in the account must be insulated from general liabilities of the insurance company under applicable law and protected from the insurance company's general creditors in the event of the insurer's insolvency; (3) the insurance company must invest the funds within the account as directed by the contract holder in designated investment alternatives or in accordance with specific investment objectives or policies; and (4) all investment performance, net of contract fees and assessments, must be passed through to the contract holder, provided that contracts may specify conditions under which there may be a minimum guarantee, but not a ceiling.

Under the general risk-based capital rules, assets held in separate accounts are assigned to risk-weight categories based on the risk weight of the underlying assets. However, the agencies propose to assign a zero risk weight to assets held in non-guaranteed separate accounts where all the losses are passed on to the contract holders. To qualify as a non-guaranteed separate account, the insurance company could not contractually guarantee a minimum return or account value to the contract holder, and the insurance company would not be required to hold reserves for these separate account assets pursuant to its contractual obligations on an associated policy. The

proposal would maintain the current risk-weighting treatment for assets held in a separate account that does not qualify as a non-guaranteed separate account.

The agencies believe the proposed treatment for non-guaranteed separate account assets is appropriate, even though the proposed definition of non-guaranteed separate accounts is more restrictive than the one used by insurance regulators. The proposed criteria for non-guaranteed separate accounts are designed to ensure that a zero percent risk weight is applied only to the assets for which contract holders, and not an insurance company, would bear all the losses.

Question 20: The agencies request comment on how the proposed definition of a separate account interacts with state law. What are the significant differences and what is the nature of the implications of these differences?

Deferred Acquisition Costs and Value of Business Acquired

Deferred acquisition costs (DAC) represent certain costs incurred in the acquisition of a new contract or renewal insurance contract that are capitalized pursuant to GAAP. Value of business acquired (VOBA) refer to assets that reflect revenue streams from insurance policies purchased by an insurance company. The Board proposes to risk weight these assets at 100 percent, similar to other assets not specifically assigned a different risk weight under this NPR.

Surplus Notes

A surplus note is a financial instrument issued by an insurance company that is included in surplus for statutory accounting purposes as prescribed or permitted by state laws and regulations. A surplus note generally has the following features: (1) the applicable state insurance regulator approves in advance the form and content of the note; (2) the instrument is subordinated to policyholders, to claimant and beneficiary claims, and to all other classes of creditors other than surplus note holders; and (3) the applicable state insurance regulator is required to approve in advance any interest payments and principal repayments on the instrument.

The Board believes that surplus notes do not meet the proposal's eligibility criteria for tier 1 capital. In particular, surplus notes are not perpetual instruments but represent debt instruments that are treated as equity for insurance regulatory capital purposes. Surplus notes are long-term, unsecured obligations, subordinated to all senior debt holders and policy claims. The main equity characteristics of surplus notes are the loss absorbency feature and the need to obtain prior approval from insurance regulators before issuance.

Some commenters on the Board's savings and loan holding company-related proposals issued in 2011 recommended that all outstanding surplus note issuances should be grandfathered and considered eligible as additional tier 1 capital instruments. Other commenters believed the Basel III framework provided sufficient flexibility to include surplus notes in tier 1 capital given the BCBS's recognition that Basel III should accommodate the specific needs of non-joint stock companies, such as mutual and cooperatives, which are unable to issue common stock. The Board believes generally that including surplus notes in tier 1 capital would be inconsistent with the proposed eligibility criteria for regulatory capital instruments and with overall safety and soundness concerns because surplus notes generally do not reflect the required loss absorbency

characteristics of tier 1 instruments under the proposal. A surplus note could be eligible for inclusion in tier 2 capital provided the note meets the proposed tier 2 capital eligibility criteria. The Board has sought to incorporate reasonable transition provisions in the first NPR for instruments that would no longer meet the eligibility criteria for tier 2 capital.

Additional Deductions -- Insurance Underwriting Subsidiaries

Consistent with the current treatment under the advanced approaches rule, the Basel III NPR would require bank holding companies and savings and loan holding companies to consolidate and deduct the minimum regulatory capital requirement of insurance underwriting subsidiaries (generally 200 percent of the subsidiary's authorized control level as established by the appropriate state insurance regulator) from total capital to reflect the capital needed to cover insurance risks. The proposed deduction treatment recognizes that capital requirements imposed by the functional regulator to cover the various risks that insurance risk-based capital captures reflect capital needs at the particular subsidiary and that this capital is therefore not generally available to absorb losses in other parts of the organization. The deduction would be 50 percent from tier 1 capital and 50 percent from tier 2 capital.

Question 21: The agencies solicit comment on all aspects of the proposed treatment of insurance underwriting activities.

Question 22: What are the specific terms and features of capital instruments (including surplus notes) unique to insurance companies that diverge from current eligibility requirements under the proposal? Are there ways in which such terms and features might be modified in order to bring the instruments into compliance with the proposal?

Question 23: The agencies seek data on the amount and issuers of surplus notes currently outstanding. What proportion of insurance company capital is comprised of surplus notes?

IV. Market Discipline and Disclosure Requirements

A. Proposed Disclosure Requirements

The agencies have long supported meaningful public disclosure by banking organizations with the objective of improving market discipline and encouraging sound risk management practices. As noted above, the BCBS introduced public disclosure requirements under Pillar 3 of Basel II, which is designed to complement the minimum capital requirements and the supervisory review process by encouraging market discipline through enhanced and meaningful public disclosure.[77] The BCBS introduced additional disclosure requirements in Basel III, which the agencies are proposing to apply to banking organizations as discussed herein.[78]

[77] The agencies incorporated the BCBS disclosure requirements into the advanced approaches rule in 2007. See 72 FR 69288, 69432 (December 7, 2007).

[78] In December 2011, the BCBS proposed additional Pillar 3 disclosure requirements in a consultative paper titled "Definition of Capital Disclosure Requirements," available at http://www.bis.org/publ/bcbs212.pdf. The agencies anticipate incorporating these disclosure requirements for banking organizations with more than $50 billion in total assets through a separate rulemaking once the BCBS finalizes these disclosure requirements.

The public disclosure requirements under this NPR would apply only to banking organizations representing the top consolidated level of the banking group with $50 billion or more in total consolidated assets.[79] The agencies note that the asset threshold of $50 billion is consistent with the threshold established by section 165 of the Dodd-Frank Act relating to enhanced supervision and prudential standards for certain banking organizations.[80] In addition, the agencies are trying to strike an appropriate balance between the market benefits of disclosure and the additional burden to a banking organization that provides disclosures. A banking organization may be able to fulfill some of the proposed disclosure requirements by relying on similar disclosures made in accordance with accounting standards or SEC mandates. In addition, a banking organization could use information provided in regulatory reports to fulfill the disclosure requirements. In these situations, a banking organization would be required to explain any material differences between the accounting or other disclosures and the disclosures required under this proposal.

A banking organization's exposure to risks and the techniques that it uses to identify, measure, monitor, and control those risks are important factors that market participants consider in their assessment of the banking organization. Accordingly, as proposed, a banking organization would have a formal disclosure policy approved by its board of directors that addresses the banking organization's approach for determining the disclosures it should make. The policy should address the associated internal controls, disclosure controls, and procedures. The board of directors and senior management would ensure the appropriate review of the disclosures and that effective internal controls, disclosure controls, and procedures are maintained. One or more senior officers of the banking organization must attest that the disclosures meet the requirements of this proposal.

A banking organization would decide the relevant disclosures based on a materiality concept. Information would be regarded as material if its omission or misstatement could change or influence the assessment or decision of a user relying on that information for the purpose of making investment decisions.

B. Frequency of Disclosures

Consistent with the agencies' longstanding requirements for robust quarterly disclosures in regulatory reports, and considering the potential for rapid changes in risk profiles, this NPR would require that quantitative disclosures are made quarterly. However, qualitative disclosures that provide a general summary of a banking organization's risk management objectives and policies, reporting system, and definitions may be disclosed annually, provided any significant changes are disclosed in the interim.

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[79] Advanced approaches banking organizations would be subject to the disclosure requirements described in the Advanced Approaches and Market Risk NPR.

[80] See section 165(a) of the Dodd-Frank Act (12 U.S.C. 5365(a)). The Dodd-Frank Act provides that the Board may, upon the recommendation of the Financial Stability Oversight Council, increase the $50 billion asset threshold for the application of the resolution plan, concentration limit, and credit exposure report requirements. See 12 U.S.C. 5365(a)(2)(B).

The proposal would require that the disclosures are timely. The agencies acknowledge that the timing of disclosures under the federal banking laws may not always coincide with the timing of disclosures required under other federal laws, including disclosures required under the federal securities laws and their implementing regulations by the SEC. For calendar quarters that do not correspond to fiscal year-end, the agencies would consider those disclosures that are made within 45 days as timely. In general, where a banking organization's fiscal year end coincides with the end of a calendar quarter, the agencies would consider disclosures to be timely if they are made no later than the applicable SEC disclosure deadline for the corresponding Form 10-K annual report. In cases where an institution's fiscal year-end does not coincide with the end of a calendar quarter, the primary federal supervisor would consider the timeliness of disclosures on a case-by-case basis. In some cases, management may determine that a significant change has occurred, such that the most recent reported amounts do not reflect the banking organization's capital adequacy and risk profile. In those cases, a banking organization would need to disclose the general nature of these changes and briefly describe how they are likely to affect public disclosures going forward. A banking organization would make these interim disclosures as soon as practicable after the determination that a significant change has occurred.

C. Location of Disclosures and Audit Requirements

The disclosures required by the proposal would have to be publicly available (for example, included on a public website) for each of the last three years or such shorter time period beginning when the proposal comes into effect. Except as discussed below, management would have some discretion to determine the appropriate medium and location of the disclosure. Furthermore, a banking organization would have flexibility in formatting its public disclosures.

The agencies encourage management to provide all of the required disclosures in one place on the entity's public website and the agencies anticipate that the public website address would be reported in a banking organization's regulatory report. Alternatively, banking organizations would be permitted to provide the disclosures in more than one place, as some of them may be included in public financial reports (for example, in Management's Discussion and Analysis included in SEC filings) or other regulatory reports. The agencies would encourage such banking organizations to provide a summary table on their public website that specifically indicates where all the disclosures may be found (for example, regulatory report schedules, page numbers in annual reports).

Disclosures of common equity tier 1, tier 1, and total capital ratios would be tested by external auditors as part of the financial statement audit. Disclosures that are not included in the footnotes to the audited financial statements are not subject to external audit reports for financial statements or internal control reports from management and the external auditor.

D. Proprietary and Confidential Information

The agencies believe that the proposed requirements strike an appropriate balance between the need for meaningful disclosure and the protection of proprietary and confidential information.[81] Accordingly, the agencies believe that banking organizations would be able to

[81] Proprietary information encompasses information that, if shared with competitors, would render a banking organization's investment in these products/systems less valuable, and, hence, could undermine its competitive

provide all of these disclosures without revealing proprietary and confidential information. Only in rare circumstances might disclosure of certain items of information required by the proposal compel a banking organization to reveal confidential and proprietary information. In these unusual situations, the agencies propose that if a banking organization believes that disclosure of specific commercial or financial information would compromise its position by making public information that is either proprietary or confidential in nature, the banking organization need not disclose those specific items. Instead, the banking organization must disclose more general information about the subject matter of the requirement, together with the fact that, and the reason why, the specific items of information have not been disclosed. This provision would apply only to those disclosures included in this NPR and does not apply to disclosure requirements imposed by accounting standards or other regulatory agencies.

Question 24: The agencies seek commenters' views on all of the elements of the proposed public disclosure requirements. In particular, the agencies seek views on specific disclosure requirements that are problematic, and why.

E. Specific Public Disclosure Requirements

The public disclosure requirements are designed to provide important information to market participants on the scope of application, capital, risk exposures, risk assessment processes, and, thus, the capital adequacy of the institution. The agencies note that the substantive content of the tables is the focus of the disclosure requirements, not the tables themselves. The table numbers below refer to the table numbers in the proposal.

A banking organization would make the disclosures described in Tables 14.1 through 14.10. The banking organization would make these disclosures publicly available for each of the last three years or such shorter time period beginning when the proposed requirements come into effect.[82]

Table 14.1 disclosures, "Scope of Application," would name the top corporate entity in the group to which subpart D of the proposal would apply; include a brief description of the differences in the basis for consolidating entities for accounting and regulatory purposes, as well as a description of any restrictions, or other major impediments, on transfer of funds or total capital within the group. These disclosures provide the basic context underlying regulatory capital calculations.

Table 14.2 disclosures, "Capital Structure," would provide summary information on the terms and conditions of the main features of regulatory capital instruments, which would allow for an evaluation of the quality of the capital available to absorb losses within a banking organization. A banking organization also would disclose the total amount of common equity tier 1, tier 1 and total capital, with separate disclosures for deductions and adjustments to capital.

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position. Information about customers is often confidential, in that it is provided under the terms of a legal agreement or counterparty relationship.

[82] Other public disclosure requirements would continue to apply, such as federal securities law, and regulatory reporting requirements for banking organizations.

The agencies expect that many of these disclosure requirements would be captured in revised regulatory reports.

Table 14.3 disclosures, "Capital Adequacy," would provide information on a banking organization's approach for categorizing and risk-weighting its exposures, as well as the amount of total risk-weighted assets. The table would also include common equity tier 1, and tier 1 and total risk-based capital ratios for the top consolidated group; and for each depository institution subsidiary.

Table 14.4 disclosures, "Capital Conservation Buffer," would require a banking organization to disclose the capital conservation buffer, the eligible retained income and any limitations on capital distributions and certain discretionary bonus payments, as applicable.

Tables 14.5, 14.6 and 14.7 disclosures, related to credit risk, counterparty credit risk and credit risk mitigation, respectively, would provide market participants with insight into different types and concentrations of credit risk to which a banking organization is exposed and the techniques it uses to measure, monitor, and mitigate those risks. These disclosures are intended to enable market participants to assess the credit risk exposures of the banking organization without revealing proprietary information.

Table 14.8 disclosures, "Securitization," would provide information to market participants on the amount of credit risk transferred and retained by a banking organization through securitization transactions, the types of products securitized by the organization, the risks inherent in the organization's securitized assets, the organization's policies regarding credit risk mitigation, and the names of any entities that provide external credit assessments of a securitization. These disclosures would provide a better understanding of how securitization transactions impact the credit risk of a bank. For purposes of these disclosures, "exposures securitized" include underlying exposures originated by a banking organization, whether generated by the banking organization or purchased from third parties, and third-party exposures included in sponsored programs. Securitization transactions in which the originating banking organization does not retain any securitization exposure would be shown separately and would only be reported for the year of inception.

Table 14.9 disclosures, "Equities Not Subject to Subpart F of the [proposal]," would provide market participants with an understanding of the types of equity securities held by the banking organization and how they are valued. The table would also provide information on the capital allocated to different equity products and the amount of unrealized gains and losses.

Table 14.10 disclosures, "Interest Rate Risk for Non-trading Activities," would require banking organization to provide certain quantitative and qualitative disclosures regarding the banking organization's management of interest rate risks.

V. List of Acronyms that Appear in the Proposal

ABCP Asset-Backed Commercial Paper

ABS Asset Backed Security

ADC Acquisition, Development, or Construction

AFS Available For Sale

ALLL Allowance for Loan and Lease Losses

AOCI Accumulated Other Comprehensive Income

BCBS Basel Committee on Banking Supervision

BHC Bank Holding Company

BIS Bank for International Settlements

CAMELS Capital adequacy, Asset quality, Management, Earnings, Liquidity, and Sensitivity to market risk

CCF Credit Conversion Factor

CCP Central Counterparty

CDC Community Development Corporation

CDFI Community Development Financial Institution

CDO Collateralized Debt Obligation

CDS Credit Default Swap

CDSind Index Credit Default Swap

CEIO Credit-Enhancing Interest-Only Strip

CF Conversion Factor

CFR Code of Federal Regulations

CFTC Commodity Futures Trading Commission

CMBS Commercial Mortgage Backed Security

CPSS Committee on Payment and Settlement Systems

CRC Country Risk Classifications

CRAM Country Risk Assessment Model

CRM Credit Risk Mitigation

CUSIP Committee on Uniform Securities Identification Procedures

DAC Deferred Acquisition Costs

DCO Derivatives Clearing Organizations

DFA Dodd-Frank Act

DI Depository Institution

DPC Debts Previously Contracted

DTA Deferred Tax Asset

DTL Deferred Tax Liability

DVA Debit Valuation Adjustment

DvP Delivery-versus-Payment

E Measure of Effectiveness

EAD Exposure at Default

ECL Expected Credit Loss

EE Expected Exposure

E.O. Executive Order

EPE Expected Positive Exposure

FASB Financial Accounting Standards Board

FDIC Federal Deposit Insurance Corporation

FFIEC Federal Financial Institutions Examination Council

FHLMC Federal Home Loan Mortgage Corporation

FMU Financial Market Utility

FNMA Federal National Mortgage Association

FR Federal Register

GAAP Generally Accepted Accounting Principles

GDP Gross Domestic Product

GLBA Gramm-Leach-Bliley Act

GSE Government-Sponsored Entity

HAMP Home Affordable Mortgage Program

HELOC Home Equity Line of Credit

HOLA Home Owners' Loan Act

HVCRE High-Volatility Commercial Real Estate

IAA Internal Assessment Approach

IFRS International Reporting Standards

IMM Internal Models Methodology

I/O Interest-Only

IOSCO International Organization of Securities Commissions

LTV Loan-to-Value Ratio

M Effective Maturity

MDB Multilateral Development Banks

MSA Mortgage Servicing Assets

NGR Net-to-Gross Ratio

NPR Notice of Proposed Rulemaking

NRSRO Nationally Recognized Statistical Rating Organization

OCC Office of the Comptroller of the Currency

OECD Organization for Economic Co-operation and Development

OIRA Office of Information and Regulatory Affairs

OMB Office of Management and Budget

OTC Over-the-Counter

OTTI Other Than Temporary Impairment

PCA Prompt Corrective Action

PCCR Purchased Credit Card Relationships

PFE Potential Future Exposure

PMI Private Mortgage Insurance

PSE Public Sector Entities

PvP Payment-versus-payment

QCCP Qualifying Central Counterparty

REIT Real Estate Investment Trust

RFA Regulatory Flexibility Act

RMBS Residential Mortgage Backed Security

RTCRRI Act Resolution Trust Corporation Refinancing, Restructuring, and Improvement Act of 1991

RVC Ratio of Value Change

RWA Risk-Weighted Asset

SEC Securities and Exchange Commission

SFA Supervisory Formula Approach

SFT Securities Financing Transactions

SLHC Savings and Loan Holding Company

SPE Special Purpose Entity

SPV Special Purpose Vehicle

SR Supervision and Regulation Letter

SRWA Simple Risk-Weight Approach

SSFA Simplified Supervisory Formula Approach

UMRA Unfunded Mandates Reform Act of 1995

U.S. United States

U.S.C. United States Code

VaR Value-at-Risk

VOBA Value of Business Acquired

VI. Regulatory Flexibility Act

The Regulatory Flexibility Act, 5 U.S.C. 601 et seq. (RFA) requires an agency to provide an initial regulatory flexibility analysis with a proposed rule or to certify that the rule will not have a significant economic impact on a substantial number of small entities (defined for purposes of the RFA to include banking entities with assets less than or equal to $175 million) and publish its certification and a short, explanatory statement in the Federal Register along with the proposed rule.

The agencies are separately publishing initial regulatory flexibility analyses for the proposals as set forth in this NPR.

Board

A. Statement of the Objectives of the Proposal; Legal Basis

As discussed in the Supplementary Information above, the Board is proposing to revise its capital requirements to promote safe and sound banking practices, implement Basel III and other aspects of the Basel capital framework, and codify its capital requirements.

The proposals in this NPR and the Basel III NPR would implement provisions consistent with certain requirements of the Dodd-Frank Act because they would (1) revise regulatory capital requirements to remove all references to, and requirements of reliance on, credit ratings,[83] and (2) impose new or revised minimum capital requirements on certain depository institution holding companies.[84]

Additionally, under section 38(c)(1) of the Federal Deposit Insurance Act, the agencies may prescribe capital standards for depository institutions that they regulate.[85] In addition, among other authorities, the Board may establish capital requirements for state member banks under the Federal Reserve Act,[86] for state member banks and bank holding companies under the

[83] See 15 U.S.C. 78o-7, note.

[84] See 12 U.S.C. 5371.

[85] See 12 U.S.C. 1831o(c).

[86] See 12 U.S.C. 321-338.

International Lending Supervision Act and Bank Holding Company Act,[87] and for savings and loan holding companies under the Home Owners Loan Act.[88]

B. Small Entities Potentially Affected by the Proposal.

Under regulations issued by the Small Business Administration,[89] a small entity includes a depository institution, bank holding company, or savings and loan holding company with total assets of $175 million or less (a small banking organization). As of March 31, 2012 there were 373 small state member banks. As of December 31, 2011, there were approximately 128 small savings and loan holding companies and 2,385 small bank holding companies.[90]

The proposed requirements would not apply to small bank holding companies that are not engaged in significant nonbanking activities, do not conduct significant off-balance sheet activities, and do not have a material amount of debt or equity securities outstanding that are registered with the SEC. These small bank holding companies remain subject to the Board's Small Bank Holding Company Policy Statement (Policy Statement).[91]

Small state member banks and small savings and loan holding companies (covered small banking organizations) would be subject to the proposals in this NPR.

C. Impact on Covered Small Banking Organizations

The proposed requirements in the Basel III NPR and this NPR may impact covered small banking organizations in several ways, including both recordkeeping and compliance requirements. As explained in the Basel III NPR, the proposals therein would change the minimum capital ratios and qualifying criteria for regulatory capital, including required deductions and adjustments. The proposals in this NPR would modify the risk weight treatment for some exposures.

Most small state member banks already hold capital in excess of the proposed minimum risk-based regulatory ratios. Therefore, the proposed requirements are not expected to significantly impact the capital structure of most covered small state member banks. Comparing the capital requirements proposed in this NPR and the Basel III NPR on a fully phased-in basis to minimum requirements of the current rules, the capital ratios of approximately 1-2 percent of small state member banks would fall below at least one of the proposed minimum risk-based capital requirements. Thus, the Board believes that the proposals in this NPR and the Basel III NPR would affect an insubstantial number of small state member banks.

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[87] See 12 U.S.C. 3907; 12 U.S.C. 1844.

[88] See 12 U.S.C. 1467a(g)(1).

[89] See 13 CFR 121.201.

[90] The December 31, 2011 data are the most recent available data on small savings and loan holding companies and small bank holding companies.

[91] See 12 CFR part 225, appendix C. Section 171 of the Dodd-Frank provides an exemption from its requirements for bank holding companies subject to the Policy Statement (as in effect on May 19, 2010). Section 171 does not provide a similar exemption for small savings and loan holding companies and they are therefore subject to the proposed rules. 12 U.S.C. § 5371(b)(5)(C).

Because the Board has not fully implemented reporting requirements for savings and loan holding companies, it is unable to determine the impact of the proposed requirements on small savings and loan holding companies. The Board seeks comment on the potential impact of the proposed requirements on small savings and loan holding companies.

Covered small banking organizations that would have to raise additional capital to comply with the requirements of the proposal may incur certain costs, including costs associated with issuance of regulatory capital instruments. The Board has sought to minimize the burden of raising additional capital by providing for transitional arrangements that phase-in the new capital requirements over several years, allowing banking organizations time to accumulate additional capital through retained earnings as well as raising capital in the market.

As discussed above, the proposed requirements would modify risk weights for exposures, as well as calculation of the leverage ratio. Accordingly, covered small banking organizations would be required to change their internal reporting processes to comply with these changes. These changes may require some additional personnel training and expenses related to new systems (or modification of existing systems) for calculating regulatory capital ratios.

Additionally, covered small banking organizations that hold certain exposures would be required to obtain additional information under the proposed rules in order to determine the applicable risk weights. Covered small banking organizations that hold exposures to sovereign entities other than the United States, foreign depository institutions, or foreign public sector entities would have to acquire Country Risk Classification ratings produced by the OECD to determine the applicable risk weights. Covered small banking organizations that hold residential mortgage exposures would need to have and maintain information about certain underwriting features of the mortgage as well as the LTV ratio in order to determine the applicable risk weight. Generally, covered small banking organizations that hold securitization exposures would need to obtain sufficient information about the underlying exposures to satisfy due diligence requirements and apply the simplified supervisory formula described above to calculate the appropriate risk weight, or be required to assign a 1,250 percent risk weight to the exposure.

Covered small banking organizations typically do not hold significant exposures to foreign entities or securitization exposures, and the Board expects any additional burden related to calculating risk weights for these exposures, or holding capital against these exposures, would be modest. Some covered small banking organizations may hold significant residential mortgage exposures. However, if the small banking organization originated the exposure, it should have sufficient information to determine the applicable risk weight under the proposal. If the small banking organization acquired the exposure from another institution, the information it would need to determine the applicable risk weight is consistent with information that it should normally collect for portfolio monitoring purposes and internal risk management.

Covered small banking organizations would not be subject to the disclosure requirements in subpart D of the proposal. However, the Board expects to modify regulatory reporting requirements that apply to covered small banking organizations to reflect the changes made to the Board's capital requirements in the proposal. The Board expects to propose these changes to the relevant reporting forms in a separate notice.

For small savings and loan holding companies, the compliance burdens described above may be greater than for those of other covered small banking organizations. Small savings and loan holding companies previously were not subject to regulatory capital requirements and reporting requirements tied regulatory capital requirements. Small savings and loan holding companies may therefore need to invest additional resources in establishing internal systems (including purchasing software or hiring personnel) or raising capital to come into compliance with the proposed rules.

D. Transitional Arrangements to Ease Compliance Burden

For those covered small banking organizations that would not immediately meet the proposed minimum requirements, the NPR provides transitional arrangements for banking organizations to make adjustments and to come into compliance. Small covered banking organizations would be required to meet the proposed minimum capital ratio requirements beginning on January 1, 2013 thorough to December 31, 2014. On January 1, 2015, small covered banking organizations would be required to comply with the new Prompt Corrective Action capital ratio requirements proposed in the Basel III NPR. January 1, 2015 is also the proposed effective date for small covered companies to begin calculating risk-weighted assets according to the methodologies in this NPR.

E. Identification of Duplicative, Overlapping, or Conflicting Federal Rules

The Board is unaware of any duplicative, overlapping, or conflicting federal rules. As noted above, the Board anticipates issuing a separate proposal to implement reporting requirements that are tied to (but do not overlap or duplicate) the requirements of the proposed rules. The Board seeks comments and information regarding any such rules that are duplicative, overlapping, or otherwise in conflict with the proposed rules.

F. Discussion of Significant Alternatives

The Board has sought to incorporate flexibility into the proposals in this NPR and provide alternative treatments to lessen burden and complexity for smaller banking organizations wherever possible, consistent with safety and soundness and applicable law, including the Dodd-Frank Act. These alternatives and flexibility features include the following:

- Covered small banking organizations would not be subject to the enhanced disclosure requirements of the proposed rules.

- Covered small banking organizations could choose to apply the gross-up approach for securitization exposures rather than the SSFA.

The proposal also offers covered small banking organizations a choice between a simpler and more complex methods of risk weighting equity exposures to investment funds.

The Board welcomes comment on any significant alternatives to the proposed rules applicable to covered small banking organizations that would minimize their impact on those entities, as well as on all other aspects of its analysis. A final regulatory flexibility analysis will be conducted after consideration of comments received during the public comment period.

OCC

In accordance with section 3(a) of the Regulatory Flexibility Act (5 U.S.C. 601 et seq.) (RFA), the OCC is publishing this summary of its Initial Regulatory Flexibility Analysis (IRFA) for this NPR. The RFA requires an agency to publish in the Federal Register its IRFA or a summary of its IRFA at the time of the publication of its general notice of proposed rulemaking[92] or to certify that the proposed rule will not have a significant economic impact on a substantial number of small entities.[93] For its IRFA, the OCC analyzed the potential economic impact of this NPR on the small entities that it regulates.

The OCC welcomes comment on all aspects of the summary of its IRFA. A final regulatory flexibility analysis will be conducted after consideration of comments received during the public comment period.

A. Reasons Why the Proposed Rule is Being Considered by the Agencies; Statement of the Objectives of the Proposed Rule; and Legal Basis

As discussed in the Supplementary Information section above, the agencies are proposing to revise their capital requirements to promote safe and sound banking practices, implement Basel III, and harmonize capital requirements across charter type. This NPR also satisfies certain requirements under the Dodd-Frank Act by revising regulatory capital requirements to remove all references to, and requirements of reliance on, credit ratings. Federal law authorizes each of the agencies to prescribe capital standards for the banking organizations it regulates.[94]

B. Small Entities Affected by the Proposal.

Under regulations issued by the Small Business Administration,[95] a small entity includes a depository institution or bank holding company with total assets of $175 million or less (a small banking organization). As of As of March 31, 2012, there were approximately 599 small national banks and 284 small federally chartered savings associations.

C. Projected Reporting, Recordkeeping, and Other Compliance Requirements

This NPR includes changes to the general risk-based capital requirements that address the calculation of risk-weighted assets and affect small banking organizations. The proposed rules in this NPR that would affect small banking organizations include:

1. Changing the denominator of the risk-based capital ratios by revising the asset risk weights;

2. Revising the treatment of counterparty credit risk;

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[92] 5 U.S.C. 603(a).
[93] 5 U.S.C. 605(b).
[94] See, e.g., 12 U.S.C. 1467a(g)(1); 12 U.S.C. 1831o(c)(1); 12 U.S.C. 1844; 12 U.S.C. 3907; and 12 U.S.C. 5371.
[95] See 13 CFR 121.201.

3. Replacing references to credit ratings with alternative measures of creditworthiness;

4. Providing more comprehensive recognition of collateral and guarantees; and

5. Providing a more favorable capital treatment for transactions cleared through qualifying central counterparties.

These changes are designed to enhance the risk-sensitivity of the calculation of risk-weighted assets. Therefore, capital requirements may go down for some assets and up for others. For those assets with a higher risk weight under this NPR, however, that increase may be large in some instances, e.g., requiring the equivalent of a dollar-for-dollar capital charge for some securitization exposures.

The Basel Committee on Banking Supervision has been conducting periodic reviews of the potential quantitative impact of the Basel III framework.[96] Although these reviews monitor the impact of implementing the Basel III framework rather than the proposed rule, the OCC is using estimates consistent with the Basel Committee's analysis, including a conservative estimate of a 20 percent increase in risk-weighted assets, to gauge the impact of this NPR on risk-weighted assets. Using this assumption, the OCC estimates that a total of 56 small national banks and federally chartered savings associations will need to raise additional capital to meet their regulatory minimums. The OCC estimates that this total projected shortfall will be $143 million and that the cost of lost tax benefits associated with increasing total capital by $143 million will be approximately $0.8 million per year. Averaged across the 56 affected institutions, the cost is approximately $14,000 per institution per year.

To comply with the proposed rules in this NPR, covered small banking organizations would be required to change their internal reporting processes. These changes would require some additional personnel training and expenses related to new systems (or modification of existing systems) for calculating regulatory capital ratios.

Additionally, covered small banking organizations that hold certain exposures would be required to obtain additional information under the proposed rules in order to determine the applicable risk weights. Covered small banking organizations that hold exposures to sovereign entities other than the United States, foreign depository institutions, or foreign public sector entities would have to acquire Country Risk Classification ratings produced by the OECD to determine the applicable risk weights. Covered small banking organizations that hold residential mortgage exposures would need to have and maintain information about certain underwriting features of the mortgage as well as the LTV ratio in order to determine the applicable risk weight. Generally, covered small banking organizations that hold securitization exposures would need to obtain sufficient information about the underlying exposures to satisfy due diligence requirements and apply either the simplified supervisory formula or the gross-up approach described in section __.43 of this NPR to calculate the appropriate risk weight, or be required to assign a 1,250 percent risk weight to the exposure.

[96] See, "Update on Basel III Implementation Monitoring," Quantitative Impact Study Working Group, January 28, 2012.

Covered small banking organizations typically do not hold significant exposures to foreign entities or securitization exposures, and the agencies expect any additional burden related to calculating risk weights for these exposures, or holding capital against these exposures, would be relatively modest. The OCC estimates that, for small national banks and federal savings associations, the cost of implementing the alternative measures of creditworthiness will be approximately $36,125 per institution.

Some covered small banking organizations may hold significant residential mortgage exposures. However, if the small banking organization originated the exposure, it should have sufficient information to determine the applicable risk weight under the proposed rule. If the small banking organization acquired the exposure from another institution, the information it would need to determine the applicable risk weight is consistent with information that it should normally collect for portfolio monitoring purposes and internal risk management.

Covered small banking organizations would not be subject to the disclosure requirements in subpart D of the proposed rule. However, the agencies expect to modify regulatory reporting requirements that apply to covered small banking organizations to reflect the changes made to the agencies' capital requirements in the proposed rules. The agencies expect to propose these changes to the relevant reporting forms in a separate notice.

To determine if a proposed rule has a significant economic impact on small entities we compared the estimated annual cost with annual noninterest expense and annual salaries and employee benefits for each small entity. If the estimated annual cost was greater than or equal to 2.5 percent of total noninterest expense or 5 percent of annual salaries and employee benefits we classified the impact as significant. The OCC has concluded that the proposals included in this NPR would exceed this threshold for 500 small national banks and 253 small federally chartered private savings institutions. Accordingly, for the purposes of this IRFA, the OCC has concluded that the changes proposed in this NPR, when considered without regard to other changes to the capital requirements that the agencies simultaneously are proposing, would have a significant economic impact on a substantial number of small entities.

Additionally, as discussed in the Supplementary Information section above, the changes proposed in this NPR should be considered together with changes proposed in the separate Basel III NPR also published in today's Federal Register. The changes described in the Basel III NPR include changes to minimum capital requirements that would impact small national banks and federal savings associations. These include a more conservative definition of regulatory capital, a new common equity tier 1 capital ratio, a higher minimum tier 1 capital ratio, new thresholds for prompt corrective action purposes, and a new capital conservation buffer. To estimate the impact of the Basel III NPR on national banks' and federal savings' association capital needs, the OCC estimated the amount of capital the banks will need to raise to meet the new minimum standards relative to the amount of capital they currently hold. To estimate new capital ratios and requirements, the OCC used currently available data from banks' quarterly Consolidated Report of Condition and Income (Call Reports) to approximate capital under the proposed rule, which shows that most banks have raised their capital levels well above the existing minimum requirements. After comparing existing levels with the proposed new requirements, the OCC determined that 28 small institutions that it regulates would fall short of the proposed increased capital requirements. Together, those institutions would need to raise approximately $82 million

in regulatory capital to meet the proposed minimum requirements set forth in the Basel III NPR. The OCC estimates that the cost of lost tax benefits associated with increasing total capital by $82 million will be approximately $0.5 million per year. Averaged across the 28 affected institutions, the cost attributed to the Basel III NPR is approximately $18,000 per institution per year. The OCC concluded for purposes of its IRFA for the Basel III NPR that the changes described in the Basel III NPR, when considered without regard to changes in this NPR, would not result in a significant economic impact on a substantial number of small entities. However, the OCC has concluded that the proposed changes in this NPR would result in a significant economic impact on a substantial number of small entities. Therefore, considered together, this NPR and the Basel III NPR would have a significant economic impact on a substantial number of small entities.

D. Identification of Duplicative, Overlapping, or Conflicting Federal Rules

The OCC is unaware of any duplicative, overlapping, or conflicting federal rules. As noted previously, the OCC anticipates issuing a separate proposal to implement reporting requirements that are tied to (but do not overlap or duplicate) the requirements of the proposed rules. The OCC seeks comments and information regarding any such federal rules that are duplicative, overlapping, or otherwise in conflict with the proposed rule.

E. Discussion of Significant Alternatives to the Proposed Rule

The agencies have sought to incorporate flexibility into the proposed rule and lessen burden and complexity for smaller banking organizations wherever possible, consistent with safety and soundness and applicable law, including the Dodd-Frank Act. The agencies are requesting comment on potential options for simplifying the rule and reducing burden, including whether to permit certain small banking organizations to continue using portions of the current general risk-based capital rules to calculate risk-weighted assets. Additionally, the agencies proposed the following alternatives and flexibility features:

- Covered small banking organizations are not subject to the enhanced disclosure requirements of the proposed rules.

- Covered small banking organizations would continue to apply a 100 percent risk weight to corporate exposures (as described in section __.32 of this NPR).

- Covered small banking organizations may choose to apply the simpler gross-up method for securitization exposures rather than the Simplified Supervisory Formula Approach (SSFA) (as described in section __.43 of this NPR).

- The proposed rule offers covered small banking organizations a choice between a simpler and more complex methods of risk weighting equity exposures to investment funds (as described in section __.53 of this NPR).

The agencies welcome comment on any significant alternatives to the proposed rules applicable to covered small banking organizations that would minimize their impact on those entities.

FDIC

[To come]

VII. Paperwork Reduction Act

A. Request for Comment on Proposed Information Collection

In accordance with the requirements of the Paperwork Reduction Act (PRA) of 1995, the Agencies may not conduct or sponsor, and the respondent is not required to respond to, an information collection unless it displays a currently valid Office of Management and Budget (OMB) control number. The Agencies are requesting comment on a proposed information collection.

The information collection requirements contained in this joint notice of proposed rulemaking (NPRs) have been submitted by the OCC and FDIC to OMB for review under the PRA, under OMB Control Nos. 1557-0234 and 3064-0153. In accordance with the PRA (44 U.S.C. 3506; 5 CFR part 1320, Appendix A.1), the Board has reviewed the NPR under the authority delegated by OMB. The Board's OMB Control No. is 7100-0313. The requirements are found in §§ __.35, __.37, __.41, __.42, __.62, and __.63.

The Agencies have published two other NPRs in this issue of the Federal Register. Please see the NPRs entitled "Regulatory Capital Rules: Regulatory Capital, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions" and "Regulatory Capital Rules: Advanced Approaches Risk-based Capital Rules; Market Risk Capital Rule." While the three NPRs together comprise an integrated capital framework, the PRA burden has been divided among the three NPRs and a PRA statement has been provided in each.

Comments are invited on:

(a) Whether the collection of information is necessary for the proper performance of the Agencies' functions, including whether the information has practical utility;

(b) The accuracy of the estimates of the burden of the information collection, including the validity of the methodology and assumptions used;

(c) Ways to enhance the quality, utility, and clarity of the information to be collected;

(d) Ways to minimize the burden of the information collection on respondents, including through the use of automated collection techniques or other forms of information technology; and

(e) Estimates of capital or start up costs and costs of operation, maintenance, and purchase of services to provide information.

All comments will become a matter of public record.
Comments should be addressed to:

OCC: Communications Division, Office of the Comptroller of the Currency, Public Information Room, Mail stop 1-5, Attention: 1557-NEW, 250 E Street, SW., Washington, DC 20219. In addition, comments may be sent by fax to 202-874-4448, or by electronic mail to regs.comments@occ.treas.gov. You can inspect and photocopy the comments at the OCC's Public Information Room, 250 E Street, SW., Washington, DC 20219. You can make an appointment to inspect the comments by calling 202-874-5043.

Board: You may submit comments, identified by R-1255, by any of the following methods:

• Agency Web Site: http://www.federalreserve.gov. Follow the instructions for submitting comments on the http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm.

• Federal eRulemaking Portal: http://www.regulations.gov. Follow the instructions for submitting comments.

• E-mail: regs.comments@federalreserve.gov. Include docket number in the subject line of the message.

• FAX: 202-452-3819 or 202-452-3102.

• Mail: Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, NW, Washington, DC 20551.

All public comments are available from the Board's Web site at http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm as submitted, unless modified for technical reasons. Accordingly, your comments will not be edited to remove any identifying or contact information. Public comments may also be viewed electronically or in paper in Room MP-500 of the Board's Martin Building (20th and C Streets, NW.) between 9 a.m. and 5 p.m. on weekdays.

FDIC: You may submit written comments, which should refer to 3064-____, by any of the following methods:

• Agency Web Site: http://www.fdic.gov/regulations/laws/federal/propose.html. Follow the instructions for submitting comments on the FDIC Web site.

• Federal eRulemaking Portal: http://www.regulations.gov. Follow the instructions for submitting comments.

• E-mail: Comments@FDIC.gov.

• Mail: Robert E. Feldman, Executive Secretary, Attention: Comments, FDIC, 550 17th Street, NW., Washington, DC 20429.

• Hand Delivery/Courier: Guard station at the rear of the 550 17th Street Building (located on F Street) on business days between 7 a.m. and 5 p.m.

Public Inspection: All comments received will be posted without change to http://www.fdic.gov/regulations/laws/federal/propose/html including any personal information provided. Comments may be inspected at the FDIC Public Information Center, Room 100, 801 17th Street, NW., Washington, DC, between 9 a.m. and 4:30 p.m. on business days.

B. Proposed Information Collection

Title of Information Collection: Basel III, Part II.

Frequency of Response: On occasion and quarterly

Affected Public:

OCC: National banks and federally chartered savings associations.

Board: State member banks, bank holding companies, and savings and loan holding companies.

FDIC: Insured state nonmember banks and certain subsidiaries of these entities.

Estimated Burden:

OCC

Estimated Number of Respondents: 775.

Estimated Burden per Respondent: One-time recordkeeping, 122 hours; ongoing recordkeeping, 20 hours; one-time disclosures, 226.25 hours; ongoing disclosures, 131.25 hours.

Total Estimated Annual Burden: __ hours.

Board

Estimated Number of Respondents: SMBs, 831; BHCs, 933; SLHCs, 438.

Estimated Burden per Respondent: One-time recordkeeping, 122 hours; ongoing recordkeeping, 20 hours; one-time disclosures, 226.25 hours; ongoing disclosures, 131.25 hours.

Total Estimated Annual Burden: One-time recordkeeping and disclosures, 279,277.75 hours; ongoing recordkeeping and disclosures 68,715.

FDIC

Estimated Number of Respondents: __.

Estimated Burden per Respondent: __ hours.

Total Estimated Annual Burden: __ hours.

Abstract:

The recordkeeping requirements are found in sections _.35, _.37, _and .41. The disclosure requirements are found in sections _.42, _.62, and _.63. These recordkeeping and disclosure requirements are necessary for the agencies' assessment and monitoring of the risk-sensitivity of the calculation of a banking organization's total risk-weighted assets and for general safety and soundness purposes.

Section-by-section Analysis

Recordkeeping

Section _.35 sets forth requirements for cleared transactions. Section _.35(b)(3)(i)(A) would require for a cleared transaction with a qualified central counterparty (QCCP) that a client bank apply a risk weight of 2 percent, provided that the collateral posted by the bank to the QCCP is subject to certain arrangements and the client bank has conducted a sufficient legal review (and maintains sufficient written documentation of the legal review) to conclude with a well-founded basis that the arrangements, in the event of a legal challenge, would be found to be legal, valid, binding and enforceable under the law of the relevant jurisdictions. The agencies estimate that respondents would take on average 2 hours to reprogram and update systems with the requirements outlined in this section. In addition, the agencies estimate that, on a continuing basis, respondents would take on average 2 hours annually to maintain their internal systems.

Section _.37 addresses requirements for collateralized transactions. Section _.37(c)(4)(i)(E) would require that a bank have policies and procedures describing how it determines the period of significant financial stress used to calculate its own internal estimates for haircuts and be able to provide empirical support for the period used. The agencies estimate that respondents would take on average 80 hours (two business weeks) to reprogram and update systems with the requirements outlined in this section. In addition, the agencies estimate that, on a continuing basis, respondents would take on average 16 hours annually to maintain their internal systems.

Section _.41 addresses operational requirements for securitization exposures. Section _.41(b)(3) would allow for synthetic securitizations a bank's recognition, for risk-based capital purposes, of a credit risk mitigant to hedge underlying exposures if certain conditions are met, including the bank's having obtained a well-reasoned opinion from legal counsel that confirms the enforceability of the credit risk mitigant in all relevant jurisdictions. Section _.41(c)(2)(i) would require that a bank support a demonstration of its comprehensive understanding of a securitization exposure by conducting and documenting an analysis of the risk characteristics of each securitization exposure prior to its acquisition, taking into account a number of specified considerations. The agencies estimate that respondents would take on average 40 hours (one business week) to reprogram and update systems with the requirements outlined in this section. In addition, the agencies estimate that, on a continuing basis, respondents would take on average 2 hours annually to maintain their internal systems.

Disclosures

Section _.42 addresses risk-weighted assets for securitization exposures. Section _.42(e)(2) would require that a bank publicly disclose that is has provided implicit support to the securitization and the risk-based capital impact to the bank of providing such implicit support.

Section _.62 sets forth disclosure requirements related to a bank's capital requirements. Section _.62(a) specifies a quarterly frequency for the disclosure of information in the applicable tables set out in section 63 and, if a significant change occurs, such that the most recent reported amounts are no longer reflective of the bank's capital adequacy and risk profile, section _.62(a)

also would require the bank to disclose as soon as practicable thereafter, a brief discussion of the change and its likely impact. Section 62(a) would allow for annual disclosure of qualitative information that typically does not change each quarter, provided that any significant changes are disclosed in the interim. Section _.62(b) would require that a bank have a formal disclosure policy approved by the board of directors that addresses its approach for determining the disclosures it makes. The policy would be required to address the associated internal controls and disclosure controls and procedures. Section 62(c) would require a bank with total consolidated assets of $50 billion or more that is not an advanced approaches bank, if it concludes that specific commercial or financial information required to be disclosed under section _.62 would be exempt from disclosure by the agency under the Freedom of Information Act (5 U.S.C. 552), to disclose more general information about the subject matter of the requirement and the reason the specific items of information have not been disclosed.

Section _.63 sets forth disclosure requirements for banks with total consolidated assets of $50 billion or more that are not advanced approaches banks. Section _.63(a) would require a bank to make the disclosures in Tables 14.1 through 14.10 and in section _.63(b) for each of the last three years beginning on the effective date of the rule. Section _.63(b) would require quarterly disclosure of a bank's common equity tier 1 capital, additional tier 1 capital, tier 2 capital, tier 1 and total capital ratios, including the regulatory capital elements and all the regulatory adjustments and deductions needed to calculate the numerator of such ratios; total risk-weighted assets, including the different regulatory adjustments and deductions needed to calculate total risk-weighted assets; regulatory capital ratios during any transition periods, including a description of all the regulatory capital elements and all regulatory adjustments and deductions needed to calculate the numerator and denominator of each capital ratio during any transition period; and a reconciliation of regulatory capital elements as they relate to its balance sheet in any audited consolidated financial statements. Table 14.1 sets forth scope of application qualitative and quantitative disclosure requirements; Table 14.2 sets forth capital structure qualitative and quantitative disclosure requirements; Table 14.3 sets forth capital adequacy qualitative and quantitative disclosure requirements; Table 14.4 sets forth capital conservation buffer qualitative and quantitative disclosure requirements; Table 14.5 sets forth general qualitative and quantitative disclosure requirements for credit risk; Table 14.6 sets forth general qualitative and quantitative disclosure requirements for counterparty credit risk-related exposures; Table 14.7 sets forth qualitative and quantitative disclosure requirements for credit risk mitigation; Table 14.8 sets forth qualitative and quantitative disclosure requirements for securitizations; Table 14.9 sets forth qualitative and quantitative disclosure requirements for equities not subject to Subpart F of the rule; and Table 14.10 sets forth qualitative and quantitative disclosure requirements for interest rate risk for non-trading activities.

The agencies estimate that respondents would take on average 226.25 hours to reprogram and update systems with the requirements outlined in these sections. In addition, the agencies estimate that, on a continuing basis, respondents would take on average 131.25 hours annually to maintain their internal systems.

VIII. Plain Language

Section 722 of the Gramm-Leach-Bliley Act requires the Federal banking agencies to use plain language in all proposed and final rules published after January 1, 2000. The agencies

invited comment on whether the proposed rule was written plainly and clearly or whether there were ways the agencies could make the rule easier to understand. The agencies received no comments on these matters and believe that the final rule is written plainly and clearly in conjunction with the agencies' risk-based capital rules.

IX. OCC Unfunded Mandates Reform Act of 1995 Determination

Section 202 of the Unfunded Mandates Reform Act of 1995 (UMRA) (2 U.S.C. 1532 et seq.) requires that an agency prepare a written statement before promulgating a rule that includes a Federal mandate that may result in the expenditure by State, local, and Tribal governments, in the aggregate, or by the private sector of $100 million or more (adjusted annually for inflation) in any one year. If a written statement is required, the UMRA (2 U.S.C. 1535) also requires an agency to identify and consider a reasonable number of regulatory alternatives before promulgating a rule and from those alternatives, either select the least costly, most cost-effective or least burdensome alternative that achieves the objectives of the rule, or provide a statement with the rule explaining why such an option was not chosen.

Under this NPR, the OCC is proposing changes to their minimum capital requirements that address the calculation of risk-weighted assets. The proposed rule would:

1. Change denominator of the risk-based capital ratios by revising the methodologies for calculating risk weights;

2. Revise the treatment of counterparty credit risk;

3. Replace references to credit ratings with alternative measures of creditworthiness;

4. Provide more comprehensive recognition of collateral and guarantees;

5. Provide a more favorable capital treatment for transactions cleared through qualifying central counterparties; and

6. Introduce disclosure requirements for banking organizations with assets of $50 billion or more.

To estimate the impact of this NPR on national banks and federal savings associations, the OCC estimated the amount of capital banks will need to raise to meet the new minimum standards relative to the amount of capital they currently hold, as well as the compliance costs associated with establishing the infrastructure to determine correct risk weights using the new alternative measures of creditworthiness and the compliance costs associated with new disclosure requirements. The OCC has determined that its NPR will not result in expenditures by State, local, and Tribal governments, or by the private sector, of $100 million or more (adjusted annually for inflation). Accordingly, the UMRA does not require that a written statement accompany this NPR.

Addendum 1: Summary of this NPR for Community Banking Organizations

Overview

The agencies are issuing a notice of proposed rulemaking (NPR, proposal, or proposed rule) to harmonize and address shortcomings in the measurement of risk-weighted assets that became apparent during the recent financial crisis, in part by implementing in the United States changes made by the Basel Committee on Banking Supervision (BCBS) to international regulatory capital standards and by implementing aspects of the Dodd-Frank Act. Among other things, the proposed rule would:

- revise risk weights for residential mortgages based on loan-to-value ratios and certain product and underwriting features;
- increase capital requirements for past-due loans, high volatility commercial real estate exposures, and certain short-term loan commitments;
- expand the recognition of collateral and guarantors in determining risk-weighted assets;
- remove references to credit ratings; and
- establish due diligence requirements for securitization exposures.

This addendum presents a summary of the proposal in this NPR that is most relevant for smaller, less complex banking organizations banking organization that are <u>not</u> subject to the market risk capital rule or the advanced approaches capital rule, and that have under $50 billion in total assets. The agencies intend for this addendum to act as a guide for these banking organizations, helping them to navigate the proposed rule and identify the changes most relevant to them. The addendum does not, however, by itself provide a complete understanding of the proposed rules and the agencies expect and encourage all institutions to review the proposed rule in its entirety.

<u>A. Zero Percent Risk-weighted Items</u>

The following exposures would receive a zero percent risk weight under the proposal:

- Cash;
- Gold bullion;
- Direct and unconditional claims on the U.S. government, its central bank, or a U.S. government agency;
- Exposures unconditionally guaranteed by the U.S. government, its central bank, or a U.S. government agency;
- Claims on certain supranational entities (such as the International Monetary Fund) and certain multilateral development banking organizations

- Claims on and exposures unconditionally guaranteed by sovereign entities that meet certain criteria (as discussed below).

For more information, please refer to sections 32(a) and 37(b)(3)(iii) of the proposal. For exposures to foreign governments and their central banks, see section L below.

B. 20 Percent Risk Weighted Items

The following exposures would receive a twenty percent risk weight under the proposal:

- Cash items in the process of collection;
- Exposures conditionally guaranteed by the U.S. government, its central bank, or a U.S. government agency;
- Claims on government sponsored entities (GSEs);
- Claims on U.S. depository institutions and NCUA-insured credit unions;
- General obligation claims on, and claims guaranteed by the full faith and credit of state and local governments (and any other public sector entity, as defined in the proposal) in the United States;
- Claims on and exposures guaranteed by foreign banks and public sector entities if the sovereign of incorporation of the foreign bank or public sector entity meets certain criteria (as described below).

A conditional guarantee is one that requires the satisfaction of certain conditions, for example servicing requirements.

For more information, please refer to sections 32(a) through 32(e), and section 32(l) of the proposal. For exposures to foreign banks and public sector entities, see section L below.

C. 50 Percent Risk-weighted Exposures

The following exposures would receive a 50 percent risk weight under the proposal:

- "Statutory" multifamily mortgage loans meeting certain criteria;
- Presold residential construction loans meeting certain criteria;
- Revenue bonds issued by state and local governments in the United States.
- Claims on and exposures guaranteed by sovereign entities, foreign banks, and foreign public sector entities that meet certain criteria (as described below).

The criteria for multifamily loans and presold residential construction loans are generally the same as in the existing general risk-based capital rules. These criteria are required under federal

law.[97] Consistent with the general risk-based capital rules and requirements of the statute, the proposal would assign a 100 percent risk weight to pre-sold construction loans where the contract is cancelled.

For more information, please refer to sections 32(e), 32(h), and 32(i) of the proposal. Also refer to section 2 of the proposal for relevant definitions:

- *Pre-sold construction loan*

- *Revenue obligation*

- *Statutory multifamily mortgage*

D. 1-4 Family Residential Mortgage Loans

Under the proposed rule, 1-4 family residential mortgages would be separated into two risk categories ("category 1 residential mortgage exposures" and "category 2 residential mortgage exposures") based on certain product and underwriting characteristics. The proposed definition of category 1 residential mortgage exposures would generally include traditional, first-lien, prudently underwritten mortgage loans. The proposed definition of category 2 residential mortgage exposures would generally include junior-liens and non-traditional mortgage products.

The proposal would *not* recognize private mortgage insurance (PMI) for purposes of calculating the LTV ratio. Therefore, the LTV levels in the table below represent only the borrower's equity in the mortgaged property.

The table below shows the proposed risk weights for 1-4 family residential mortgage loans, based on the LTV ratio and risk category of the exposure:

LTV ratio (in percent)	Risk weight for category 1 residential mortgage exposures (percent)	Risk weight for category 2 residential mortgage exposures (percent)
Less than or equal to 60	35	100
Greater than 60 and less than or equal to 80	50	100
Greater than 80 and less than or equal to 90	75	150
Greater than 90	100	200

[97] See sections 618(a)(1) or (2) and 618(b)(1) of the Resolution Trust Corporation Refinancing, Restructuring, and Improvement Act of 1991.

Definitions:

Category 1 residential mortgage exposure would mean a residential mortgage exposure with the following characteristics:

- The term of the mortgage loan does not exceed 30 years;

- The terms of the mortgage loan provide for regular periodic payments that do not:

    - Result in an increase of the principal balance;
    - Allow the borrower to defer repayment of principal of the residential mortgage exposure; or,
    - Result in a balloon payment;

- The standards used to underwrite the residential mortgage loan:

    - Took into account all of the borrower's obligations, including for mortgage obligations, principal, interest, taxes, insurance, and assessments; and
    - Resulted in a conclusion that the borrower is able to repay the loan using:
        - The maximum interest rate that may apply during the first five years after the date of the closing of the residential mortgage loan; and
        - The amount of the residential mortgage loan as of the date of the closing of the transaction;

- The terms of the residential mortgage loan allow the annual rate of interest to increase no more than two percentage points in any twelve month period and no more than six percentage points over the life of the loan;

- For a first-lien home equity line of credit (HELOC), the borrower must be qualified using the principal and interest payments based on the maximum contractual exposure under the terms of the HELOC;

- The determination of the borrower's ability to repay is based on documented, verified income;

- The residential mortgage loan is not 90 days or more past due or on non-accrual status; and

- The residential mortgage loan is not a junior-lien residential mortgage exposure.

Category 2 residential mortgage exposure would mean a residential mortgage exposure that is not a Category 1 residential mortgage exposure and is not guaranteed by the U.S. government.

LTV ratio would equal the loan amount divided by the value of the property.

Loan Amount:

- For a first-lien residential mortgage, the loan amount would be the maximum contractual principal amount of the loan. For a traditional mortgage loan where the loan balance will not increase under the terms of the mortgage, the loan amount is the current loan balance.

However, for a loan whose balance may increase under the terms of the mortgage, such as pay-option adjustable loan that can negatively amortize or for a HELOC, the loan amount is the maximum contractual principal amount of the loan.

- For a junior-lien mortgage, the loan amount would be the maximum contractual principal amount of the loan plus the maximum contractual principal amounts of all more senior loans secured by the same residential property on the date of origination of the junior-lien residential mortgage.

The *value* of the property is the lesser of the acquisition cost (for a purchase transaction) or the estimate of the property's value at the origination of the loan or the time of restructuring. The banking organization must base all estimates of a property's value on an appraisal or evaluation of the property that meets the requirements of the primary federal supervisor's appraisal regulations.[98]

If a banking organization holds a first mortgage and junior-lien mortgage on the same residential property and there is no intervening lien, the proposal treats the combined exposure as a single first-lien mortgage exposure.

If a banking organization holds two or more mortgage loans on the same residential property, and one of the loans is category 2, then the banking organization would be required to treat all of the loans on the property as category 2.

Additional Notes:

- FHA and VA loans would continue to receive zero percent risk weight due to their unconditional government guarantee.

- 1-4 family mortgage loans sold with recourse are converted to an on-balance sheet credit equivalent amount using a 100 percent conversion factor. There is no grace period, such as the 120-day exception under the current general risk-based capital rules.

- Restructured and modified mortgages would be assigned risk weights based on their LTVs and classification as category 1 or category 2 residential mortgage exposures based on the modified contractual terms. If the LTV is not updated at the time of modification or restructuring, a category 1 residential mortgage would receive a risk weight of 100 percent and a category 2 residential mortgage would receive a risk weight of 200 percent.

- Similar to the current capital rules, loans modified or restructured under the Treasury's HAMP program would not be considered modified or restructured for the purposes of the proposal.

For more information, please refer to section 32(g) of the proposal. Also refer to section 2 for relevant definitions:

- *Category 1 residential mortgage exposure*

[98] The appraisal or evaluation must satisfy the requirements of 12 CFR part 34, subpart C, 12 CFR part 164 (OCC); 12 CFR part 208, subpart E (Board); 12 CFR part 323, 12 CFR 390.442 (FDIC).

- *Category 2 residential mortgage exposure*

- *First lien residential mortgage exposure*

- *Junior-lien residential mortgage*

- *Residential mortgage exposure*

E. Past Due Exposures

The proposal would assign a 150 percent risk weight to loans and other exposures that are 90 days or more past due. This applies to all exposure categories *except for* the following:

- 1-4 family residential exposures (1-4 family loans over 90 days past due and are in Category 2 and would be risk weighted as described in Section D.)

- A sovereign exposure where the sovereign has experienced a sovereign default.

For more information, please refer to section 32(k) of the proposal.

F. High Volatility Commercial Real Estate Loans (HVCRE)

The proposal would assign a 150 percent risk weight to HVCRE exposures. The proposal defines an HVCRE exposure as a credit facility that finances or has financed the acquisition, development, or construction (ADC) of real property, *unless* the facility finances:

- One- to four-family residential properties; or

- Commercial real estate projects in which:

    - The LTV ratio is less than or equal to the applicable maximum supervisory LTV ratio;
    - The borrower has contributed capital to the project in the form of cash or unencumbered readily marketable assets (or has paid development expenses out-of-pocket) of at least 15 percent of the real estate's appraised "as completed" value; and
    - The borrower contributed the amount of capital required by this definition before the banking organization advances funds under the credit facility, and the capital contributed by the borrower, or internally generated by the project, is contractually required to remain in the project throughout the life of the project. The life of a project concludes only when the credit facility is converted to permanent financing or is sold or paid in full. Permanent financing may be provided by the banking organization that provided the ADC facility as long as the permanent financing conforms with the banking organization's underwriting criteria for long-term mortgage loans.

For more information please refer to section 32 of the proposal. Also refer to section 2 for relevant definitions:

- *High volatility commercial real estate exposure (HVCRE)*

G. Commercial Loans / Corporate Exposures

The proposal would assign a 100 percent risk weight to all corporate exposures. The definition of a corporate exposure would exclude exposures that are specifically covered elsewhere in the proposal, such as HVCRE, pre-sold residential construction loans, and statutory multifamily mortgages.

For more information please refer to section 32(f) of the proposal, and section 33 for off-balance sheet exposures.

H. Consumer Loans and Credit Cards

Under the proposed rule, consumer loans and credit cards would continue to receive a 100 percent risk weight. The proposal does not specifically list these assets, but they fall into the "other assets" category that would receive a 100 percent risk weight.

For more information, please refer to section 32(l) of the proposal.

I. Basel III risk weight items

As described in the Basel III NPR, the amounts of the threshold deduction items (mortgage servicing assets, certain deferred tax assets, and investments in the common equity of financial institutions) that are not deducted would be assigned a risk weight of 250 percent. In addition, certain high-risk exposures such as credit enhancing interest-only strips would receive 1,250 percent risk weight.

J. Other Assets and Exposures

Where the proposal does not assign a specific risk weight to an asset or exposure type, the applicable risk weight would be 100 percent. For example, premises, fixed assets, and other real estate owned receive a risk weight of 100 percent. Section 32(m) of the proposal for bank holding companies and savings and loan holding companies provides specific risk weights for certain insurance-related assets.

For more information, please refer to section 32(l) of the proposal.

K. Conversion Factors for Off-balance Sheet Items

Similar to the current rules, under the proposal, a banking organization would be required to calculate the exposure amount of an off-balance sheet exposure using the credit conversion factors (CCFs) below. The proposal increases the CCR for commitments with an original maturity of one year or less from zero percent to 20 percent.

- Zero percent CCF. A banking organization would apply a zero percent CCF to the unused portion of commitments that are unconditionally cancelable by the banking organization.

- 20 percent CCF. A banking organization would apply a 20 percent CCF to:

    - Commitments with an original maturity of one year or less that are not unconditionally cancelable by the banking organization.
    - Self-liquidating, trade-related contingent items that arise from the movement of goods, with an original maturity of one year or less.

- 50 percent CCF. A banking organization would apply a 50 percent CCF to:

    - Commitments with an original maturity of more than one year that are not unconditionally cancelable by the banking organization.
    - Transaction-related contingent items, including performance bonds, bid bonds, warranties, and performance standby letters of credit.

- 100 percent CCF. A banking organization would apply a 100 percent CCF to the following off-balance-sheet items and other similar transactions:

    - Guarantees;
    - Repurchase agreements (the off-balance sheet component of which equals the sum of the current market values of all positions the banking organization has sold subject to repurchase);
    - Off-balance sheet securities lending transactions (the off-balance sheet component of which equals the sum of the current market values of all positions the banking organization has lent under the transaction);
    - Off-balance sheet securities borrowing transactions (the off-balance sheet component of which equals the sum of the current market values of all non-cash positions the banking organization has posted as collateral under the transaction);
    - Financial standby letters of credit; and
    - Forward agreements.

For more information please refer to section 33 of the proposal. Also refer to section 2 the definition of unconditionally cancellable.

L. Over-the-Counter (OTC) Derivative Contracts

The proposal provides a method for determining the risk-based capital requirement for a derivative contract that is similar to the general risk-based capital rules. Under the proposed rule, the banking organization would determine the exposure amount and then assign a risk weight based on the counterparty or collateral. The exposure amount is the sum of current exposure plus potential future credit exposure (PFE). In contrast to the general risk-based capital rules, which place a 50 percent risk weight cap on derivatives, the proposal does not include a risk weight cap and introduces specific credit conversion factors for credit derivatives.

The current credit exposure is the greater of zero or the mark-to-market value of the derivative contract.

The PFE is generally the notional amount of the derivative contract multiplied by a credit conversion factor for the type of derivative contract. The table below shows the credit conversion factors for derivative contracts:

Remaining maturity[2]	Interest rate	Foreign exchange rate and gold	Credit (investment grade reference asset)[399]	Credit (non-investment-grade reference asset)	Equity	Precious metals (except gold)	Other
One year or less	0.0 percent	1.0 percent	5.0 percent	10.0 percent	6.0 percent	7.0 percent	10.0 percent
Greater than one year and less than or equal to five years	0.5 percent	5.0 percent	5.0 percent	10.0 percent	8.0 percent	7.0 percent	12.0 percent
Greater than five years	1.5 percent	7.5 percent	5.0 percent	10.0 percent	10.0 percent	8.0 percent	15.0 percent

For more information please refer to section 34 of the proposal. Also refer to section 2 for relevant definitions:

- *Effective notional amount*
- *Eligible credit derivative*
- *Eligible derivative contract*
- *Exposure amount*
- *Interest rate derivative contract*

[99] As proposed, "investment grade" would mean that the entity to which the banking organization is exposed through a loan or security, or the reference entity with respect to a credit derivative, has adequate capacity to meet financial commitments for the projected life of the asset or exposure. Such an entity or reference entity has adequate capacity to meet financial commitments if the risk of its default is low and the full and timely repayment of principal and interest is expected.

M. Securitization Exposures

Section 42 of the proposal introduces due diligence requirements for banking organizations that own, originate or purchase securitization exposures and introduces a new definition of securitization exposure. If a banking organization is unable to demonstrate to the satisfaction of its primary federal supervisor a comprehensive understanding of the features of a securitization exposure that would materially affect the performance of the exposure, the banking organization would be required to assign the securitization exposure a risk weight of 1,250 percent. The banking organization's analysis would be required to be commensurate with the complexity of the securitization exposure and the materiality of the exposure in relation to capital.

Note that mortgage-backed pass-through securities (for example, those guaranteed by FHLMC or FNMA) do not meet the proposed definition of a securitization exposure because they do not involve a tranching of credit risk. Rather, only those mortgage-backed securities that involve tranching of credit risk would be securitization exposures. For securitization exposures guaranteed by the U.S. Government or GSEs, there are no changes relative to the existing treatment:

- The Government National Mortgage Association (Ginnie Mae) securities receive a zero percent risk-weight to the extent they are unconditionally guaranteed.

- The Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) guaranteed securities receive a 20 percent risk weight.

- Fannie Mae and Freddie Mac non-credit enhancing IO securities receive a 100 percent risk weight.

The risk-based capital requirements for securitizations under the proposed rule would be as follows:

- A banking organization would deduct any after-tax gain-on-sale of a securitization. (This requirement would usually pertain to banking organizations that are securitizers rather than purchasers of securitization exposures);

- A banking organization would assign a 1,250 percent risk weight to a credit-enhancing interest-only strip (CEIO).

- A banking organization would assign a 100 percent risk weight to non-credit enhancing interest-only mortgage-backed securities (IOs).

For privately-issued mortgage securities and all other securitization exposures, a banking organization would be able choose among the following approaches, provided that the banking organization consistently applies such approach to all securitization exposures:[100]

- A banking organization may use the existing gross-up approach to risk weight all of its securitizations. Under the existing gross-up approach, senior securitization tranches are

[100] The ratings-based approach for externally rated positions would no longer be available.

assigned the risk weight associated with the underlying exposures. A banking organization must hold capital for the senior tranche based on the risk weight of the underlying exposures. For subordinate securitization tranches, a banking organization must hold capital for the subordinate tranche, as well as all more senior tranches for which the subordinate tranche provides credit support.

- A banking organization may determine the risk weight for the securitization exposure using the simplified supervisory formula approach (SSFA) described in section 43 of the proposal. The SSFA formula would require a banking organization to apply a supervisory formula that requires various data inputs including the risk weight applicable to the underlying exposures; the attachment and detachment points of the securitization tranche, which is the relative position of the securitization position in the structure (subordination); and the current percentage of the underlying exposures that are 90 days or more past due, in default, or in foreclosure. Banking organizations considering the SSFA approach should carefully read and consider section 43 of the proposal.

Alternatively, a banking organization may apply a 1,250 percent risk weight to any of its securitization exposures.

For more information, please refer to sections 42-45 of the proposal. Also refer to section 2 for the following definitions:

- *Credit-enhancing interest-only strip*
- *Gain-on-sale*
- *Resecuritization*
- *Resecuritization exposure*
- *Securitization exposure*
- *Securitization special purpose entity (securitization SPE)*
- *Synthetic securitization*
- *Traditional securitization*
- *Underlying exposure*

N. Equity Exposures

Under section 52 of the proposal, a banking organization would apply a simple risk-weight approach (SRWA) to determine the risk weight for equity exposures that are not exposures to an investment fund. The following table indicates the risk weights that would apply to equity exposures under the SRWA:

Risk weight (in percent)	Equity exposure
0	An equity exposure to a sovereign entity, the Bank for International Settlements, the European Central Bank, the European Commission, the International Monetary Fund, a MDB, and any other entity whose credit exposures receive a zero percent risk weight under section 32 of this proposed rule
20	An equity exposure to a public sector entity, Federal Home Loan Bank or the Federal Agricultural Mortgage Corporation (Farmer Mac)
100	• Community development equity exposures[101] • The effective portion of a hedge pair • Non-significant equity exposures to the extent that the aggregate adjusted carrying value of the exposures does not exceed 10 percent of tier 1capital plus tier 2 capital
250	A significant investment in the capital of an unconsolidated financial institution that is not deducted under section 22.
300	A publicly traded equity exposure (other than an equity exposure that receives a 600 percent risk weight and including the ineffective portion of a hedge pair)
400	An equity exposure that is not publicly traded (other than an equity exposure that receives a 600 percent risk weight)
600	An equity exposure to a hedge fund or other investment firm that has greater than immaterial leverage

[101] The proposed rule generally defines Community Development Exposures as exposures that would qualify as community development investments under 12 U.S.C. 24(Eleventh), excluding equity exposures to an unconsolidated small business investment company and equity exposures held through a consolidated small business investment company described in section 302 of the Small Business Investment Act of 1958 (15 U.S.C. 682). For savings associations, community development investments would be defined to mean equity investments that are designed primarily to promote community welfare, including the welfare of low- and moderate-income communities or families, such as by providing services or jobs, and excluding equity exposures to an unconsolidated small business investment company and equity exposures held through a consolidated small business investment company described in section 302 of the Small Business Investment Act of 1958 (15 U.S.C. 682).

For more information, please refer to sections 51 and 52 of the proposal, and any related definitions in section 2:

- *Equity exposure*

- *Equity derivative contract*

O. Equity Exposures to Investment Funds

The proposals described in this section would apply to equity exposures to investment funds such as mutual funds, but not to hedge funds or other leveraged investment funds (refer to section above). For exposures to investment funds other than community development exposures, a banking organization must use one of three risk-weighting approaches described below:

1. Full look-through approach:

For this two-step approach, a banking organization would be required to obtain information regarding the asset pool underlying the investment fund as of the date of the calculation, as well as the banking organization's proportional share of ownership in the fund. For the first step the banking organization would assign risk weights to the assets of the entire investment fund and calculates the sum of those risk-weighted assets. For the second step, the banking organization would multiply the sum of the fund's risk-weighted assets by the banking organization's proportional ownership in the fund.

2. Simple modified look-through approach:

Similar to the current capital rules, under this approach a banking organization would multiply the adjusted carrying value of its investment in the fund by the highest risk weight that applies to any exposure the fund is permitted to hold as described in the prospectus or fund documents.

3. Alternative modified look-through approach:

Similar to the current capital rules, under this approach a banking organization would assign the adjusted carrying value of an equity exposure to an investment fund on a pro rata basis to different risk weight categories based on the investment limits described in the fund's prospectus. The banking organization's risk-weighted asset amount is the sum of each portion of the adjusted carrying value assigned to an exposure type multiplied by the applicable risk weight under section 32 of the proposal. For purposes of the calculation the banking organization must assume the fund is invested in assets with the highest risk weight permitted by its prospectus and to the maximum amounts permitted.

For community development exposures, a banking organization's risk-weighted asset amount is equal to its adjusted carrying value for the fund.

For more information please refer to section 53 of the proposal. Also refer to section 2 for relevant definitions:

- *Adjusted carrying value*

- *Investment fund*

P. Treatment of Guarantees

The proposal would allow a banking organization to substitute the risk weight of an eligible guarantor for the risk weight otherwise applicable to the guaranteed exposure. This treatment would apply only to eligible guarantees and eligible credit derivatives, and would provide certain adjustments for maturity mismatches, currency mismatches, and situations where restructuring is not treated as a credit event.

Under the proposal, eligible guarantors would include sovereign entities, certain supranational entities such as the International Monetary Fund, Federal Home Loan Banks, Farmer Mac, a multilateral development bank, a depository institution, a bank holding company, a savings and loan holding company, a foreign bank, or an entity that has investment grade debt, whose creditworthiness is not positively correlated with the credit risk of the exposures for which it provides guarantees. Eligible guarantors *would not* include monoline insurers, re-insurers, or special purpose entities.

To be an eligible guarantee, the guarantee would be required to be from an eligible guarantor and must meet the requirements of the proposal, including that the guarantee must:

- Be written;

- Be either:

    - Unconditional, or
    - A contingent obligation of the U.S. government or its agencies, the enforceability of which to the beneficiary is dependent upon some affirmative action on the part of the beneficiary of the guarantee or a third party (for example, servicing requirements);

- Cover all or a pro rata portion of all contractual payments of the obligor on the reference exposure;

- Give the beneficiary a direct claim against the protection provider;

- And meet other requirements of the rule.

For more information please refer to section 36 of the proposal. Also refer to section 2 for relevant definitions:

- *Eligible guarantee*

- *Eligible guarantor*

Q. Treatment of Collateralized Transactions

The proposal allows banking organizations to recognize the risk mitigating benefits of financial collateral in risk-weighted assets, and defines financial collateral to include:

- cash on deposit at the bank or third-party custodian;

- gold;

- investment grade long-term securities (excluding resecuritizations);

- investment grade short-term instruments (excluding resecuritizations);

- publicly-traded equity securities;

- publicly-traded convertible bonds; and,

- money market mutual fund shares; and other mutual fund shares if a price is quoted daily.

In all cases the banking organization would be required to have a perfected, first priority interest in the financial collateral.

1. Simple approach: A banking organization may apply a risk weight to the portion of an exposure that is secured by the market value of financial collateral by using the risk weight of the collateral – subject to a risk weight floor of 20 percent. To apply the simple approach, the collateral must be subject to a collateral agreement for at least the life of the exposure; the collateral must be revalued at least every 6 months; and the collateral (other than gold) must be in the same currency. There would be a few limited exceptions to the 20 percent risk weight floor:

- A banking organization may assign a zero percent risk weight to the collateralized portion of an exposure where:

    - The financial collateral is cash on deposit; or
    - The financial collateral is an exposure to a sovereign that qualifies for a zero percent risk weight (including the United States) and the banking organization has discounted the market value of the collateral by 20 percent.

- A banking organization would be permitted to assign a zero percent risk weight to an exposure to an OTC derivative contract that is marked to market on a daily basis and subject to a daily margin maintenance requirement, to the extent the contract is collateralized by cash on deposit.

- A banking organization would be permitted to assign a 10 percent risk weight to an exposure to an OTC derivative contract that is marked to market on a daily basis and subject to a daily margin maintenance requirement, to the extent the contract is collateralized by U.S. government securities or an exposure to a sovereign that qualifies for a zero percent risk weight under the proposal.

2. Collateral Haircut Approach: For an eligible margin loan, a repo-style transaction, a collateralized derivative contract, or a single-product netting set of such transactions, a banking organization *may* instead decide to use the collateral haircut approach to recognize the credit risk mitigation benefits of eligible collateral by reducing the amount of the exposure to be risk weighted rather than by substituting the risk weight of the collateral. Banking organizations considering the collateral haircut approach should carefully read section 37 of the proposal. The collateral haircut approach takes into account the value of the banking organization's exposure, the value of the collateral, and haircuts to account for potential volatility in position values and foreign exchange rates. The haircuts may be determined using one of two methodologies.

A banking organization may use standard haircuts based on the table below and a standard foreign exchange rate haircut of 8 percent.

STANDARD SUPERVISORY MARKET PRICE VOLATILITY HAIRCUTS

Residual Maturity	Sovereign Issuers that receive a zero percent risk weight under section 32 (in percent)	Sovereign Issuers that receive a 20 percent or 50 percent risk weight under section 32 (in percent)	Sovereign Issuers that receive a risk weight equal to 100 percent under section 32 (in percent)	Non-sovereign Issuers that receive a 20 percent risk weight under section 32 (in percent)	Non-sovereign Issuers that receive a 50 percent risk weight under section 32 (in percent)	Non-sovereign Issuers that receive a 100 percent risk weight under section 32 (in percent)	Securitization Exposures that are investment grade (in percent)
Less than 1 year	0.5	1.0	15.0	1.0	2.0	25.0	4.0
Greater than 1 year and less than or equal to 5 years	2.0	3.0	15.0	4.0	6.0	25.0	12.0
Greater than 5 years	4.0	6.0	15.0	8.0	12.0	25.0	24.0
Main index equities (including convertible bonds) and gold				15.0			
Other publicly traded equities (including convertible bonds)				25.0			
Mutual funds				Highest haircut applicable to any security in which the fund can invest.			
Cash collateral held				0			

Alternatively, a banking organization may, with supervisory approval, use own estimates of collateral haircuts when calculating the appropriate capital charge for an eligible margin loan, a repo-style transaction, or a collateralized derivative contract. Section 37 of the proposal provides the requirements for calculating own estimates, including the requirement that such estimates be determined based on an period of market stress appropriate for the collateral under this approach.

For more information, please refer to section 37 of the proposal. Also refer to section 2 for relevant definitions:

- *Financial collateral*

- *Repo-style transaction*

R. Treatment of Cleared Transactions

The proposal introduces a specific capital treatment for exposures to central counterparties (CCPs), including certain transactions conducted through clearing members by banking organizations that are not themselves clearing members of a CCP. Section 35 of the proposal describes the capital treatment of cleared transactions and of default fund exposures to CCPs, including more favorable capital treatment for cleared transactions through CCPs that meet certain criteria.

S. Unsettled Transactions

The proposal provides for a separate risk-based capital requirement for transactions involving securities, foreign exchange instruments, and commodities that have a risk of delayed settlement or delivery. The proposed capital requirement would not, however, apply to certain types of transactions, including cleared transactions that are marked-to-market daily and subject to daily receipt and payment of variation margin. The proposal contains separate treatments for delivery-versus-payment (DvP) and payment-versus-payment (PvP) transactions with a normal settlement period, and non-DvP/non-PvP transactions with a normal settlement period.

T. Foreign Exposures

Under the proposal a banking organization would risk weight an exposure to a foreign government, foreign public sector entity (PSE), and a foreign bank based on the Country Risk Classification (CRC) that is applicable to the foreign government, or the home country of the foreign PSE or foreign bank.

Country risk classification (CRC) for a sovereign means the CRC published by the Organization for Economic Cooperation and Development.

The risk weights for foreign sovereigns, foreign banks, and foreign PSEs are shown in the tables below:

TABLE 1 – RISK WEIGHTS FOR FOREIGN SOVEREIGN EXPOSURES		
		Risk Weight (in percent)
Sovereign CRC	0-1	0
	2	20
	3	50
	4-6	100
	7	150
No CRC		100
Sovereign Default		150

- A sovereign exposure would be assigned a 150 percent risk weight immediately upon determining that an event of sovereign default has occurred, or if an event of sovereign default has occurred during the previous five years.

TABLE 2 – RISK WEIGHTS FOR EXPOSURES TO FOREIGN BANKS		
		Risk Weight (in percent)
Sovereign CRC	0-1	20
	2	50
	3	100
	4-7	150
No CRC		100
Sovereign Default		150

TABLE 3 – RISK WEIGHTS FOR FOREIGN PSE GENERAL OBLIGATIONS		
		Risk Weight (in percent)
Sovereign CRC	0-1	20
	2	50
	3	100
	4-7	150
No CRC		100
Sovereign Default		150

TABLE 4 – RISK WEIGHTS FOR FOREIGN PSE REVENUE OBLIGATIONS		
		Risk Weight (in percent)
Sovereign CRC	0-1	50
	2-3	100
	4-7	150
No CRC		100
Sovereign Default		150

For more information, please refer to section 32(a), 32(d), and 32(e) of the proposal. Also refer to section 2 for relevant definitions:

- *Home country*
- *Public sector entity (PSE)*
- *Sovereign*
- *Sovereign exposure*

Attached is a table summarizing the proposed changes to the general risk-based capital rules for risk weighting assets.

Attachment Comparison of Current Rules vs. Proposal

Category	Current Risk Weight (in general)	Proposal	Comments
Risk Weights for On-Balance Sheet Exposures Under Current and Proposed Rules			
Cash	0%	0%	
Direct and unconditional claims on the U.S. Government, its agencies, and the Federal Reserve	0%	0%	
Claims on certain supranational entities and multilateral development banks	20%	0%	Claims on supranational entities include, for example, claims on the International Monetary Fund.
Cash items in the process of collection	20%	20%	
Conditional claims on the U.S. government	20%	20%	A conditional claim is one that requires the satisfaction of certain

			conditions, for example, servicing requirements.
Claims on government sponsored entities (GSEs)	20% 100% on GSE preferred stock (20% for national banks).	20% on exposures other than equity exposures.	
Claims on U.S. depository institutions and NCUA-insured credit unions	20% 100% risk weight for an instrument included in the depository institution's regulatory capital	20% 100% risk weight for an instrument included in the depository institution's regulatory capital (unless that instrument is an equity exposure or is deducted – see Addendum I).	Instruments included in the capital of the depository institution may be deducted (refer to Addendum I on the definition of capital) or treated under the equities section below.
Claims on U.S. public sector entities (PSEs)	20% for general obligations. 50% for revenue obligations.	20% for general obligations. 50% for revenue obligations.	
Industrial development	100%	100%	

bonds			
Claims on qualifying securities firms	20% in general;	100% See commercial loans and corporate exposures to financial companies section below.	Instruments included in the capital of the securities firm may be deducted (refer to Addendum 1 on the definition of capital) or treated under the equities section below.
1-4 family loans	50% if first lien, prudently underwritten, owner occupied or rented, current or <90 days past due; 100% otherwise.	Category 1: 35%, 50%,75%,100% depending on LTV. Category 2: 100%, 150%,200% depending on LTV.	Category 1 is defined to include first-lien mortgage products that meet certain underwriting characteristics. Category 2 is defined to include junior-liens and mortgages that do not meet the category 1 criteria.
1-4 family loans modified under HAMP	50% and 100% The banking organization must use the same risk weight assigned to the loan prior to the modification so long as the loan continues	35% to 200% The banking organization must determine whether the modified terms make the loan a	Under the proposal (as under current rules) HAMP loans are not treated as restructured

	to meet other applicable prudential criteria.	Category 1 or a Category 2 mortgage.	loans.
Loans to builders secured by 1-4 family properties presold under firm contracts	50% if the loan meets all criteria in the regulation; 100% if the contract is cancelled; 100% for loans not meeting the criteria.	50% if the loan meets all criteria in the regulation; 100% if the contract is cancelled; 100% for loans not meeting the criteria.	
Loans on multifamily properties	50% if the loan meets all the criteria in the regulation; 100% otherwise.	50% if the loan meets all the criteria in the regulation; 100% otherwise.	
Corporate exposures	100%	100% However, if the exposure is an instrument included in the capital of the financial company, deduction treatment may apply (see Appendix I).	
High volatility commercial real estate (HVCRE) loans	100%	150%	The proposed treatment would apply to certain facilities that finance the acquisition, development or construction of real property other than 1-4 family residential

			property.
Consumer loans	100%	100%	This is not a specific category under the proposal. Therefore the default risk weight of 100% applies.
Past due exposures	Generally the risk weight does not change when the loan is past due; However, 1-4 family loans that are past due 90 days or more are 100% risk weight.	150% for the portion that is not guaranteed or secured (does not apply to sovereign exposures or 1-4 family residential mortgage exposures).	
Assets not assigned to a risk weight category, including fixed assets, premises, and other real estate owned	100%	100%	
Claims on foreign governments and their central banks	0% for direct and unconditional claims on OECD governments; 20% for conditional claims on OECD governments; 100% for claims on non-OECD governments that entail some degree of transfer risk.	Risk weight depends on Country Risk Classification (CRC) applicable to the sovereign and ranges between 0% and 150%; 100% for	Under the current and proposed rules, a banking organization may apply a lower risk weight to an exposure denominated in the sovereign's own currency if the banking

		sovereigns that do not have a CRC; 150% for a sovereign that has defaulted within the previous 5 years.	organization has at least an equivalent amount of liabilities in that currency.
Claims on foreign banks	20% for claims on banks in OECD countries; 20% for short-term claims on banks in non-OECD countries; 100% for long-term claims on banks in non-OECD countries.	Risk weight depends on home country's CRC rating and ranges between 20% and 50%. 100% for foreign bank whose home country does not have a CRC; 150% in the case of a sovereign default in the bank's home country; 100% for an instrument included in a bank's regulatory capital (unless that instrument is an equity exposure or is deducted (see Addendum I)).	Under the proposed rule, instruments included in the capital of a foreign bank would be deducted (refer to Addendum 1 on the definition of capital) or treated under the equities section below.

Claims on foreign PSEs	20% for general obligations of states and political subdivisions of OECD countries; 50% for revenue obligations of states and political subdivisions of OECD countries; 100% for all obligations of states and political subdivisions of non-OECD countries.	Risk weight depends on the home country's CRC and ranges between 20% and 150% for general obligations; and between 50% and 150% for revenue obligations . 100% for exposures to a PSE in a home country that does not have a CRC; 150% for a PSE in a home country with a sovereign default.	
MBS, ABS, and structured securities	<u>Ratings Based Approach</u>: - 20%:AAA&AA; - 50%:A-rated - 100%:BBB - 200%:BB-rated [Securitizations with short-term ratings – 20, 50, 100, and for unrated positions, where the banking organization determines the credit rating – 100 or 200];	Deduction for the after-tax gain-on-sale of a securitization; 1,250% risk weight for a CEIO; 100% for interest-only MBS that are not credit-enhancing; Banking organizations may elect to follow a	

	Gross-up approach the risk-weighted asset amount is calculated using the risk weight of the underlying assets amount of the position and the full amount of the assets supported by the position (that is, all of the more senior positions); Dollar for dollar capital for residual interests; Deduction for CEIO strips over concentration limit; 100% for stripped MBS (IOs and POs) that are not credit enhancing.	gross up approach, similar to existing rules. SSFA – the risk weight for a position is determined by a formula and is based on the risk weight applicable to the underlying exposures, the relative position of the securitization position in the structure (subordination), and measures of delinquency and loss on the securitized assets; 1250% otherwise.	
Unsettled transactions	Not addressed.	100%, 625%, 937.5%, and 1,250% for DvP or PvP transactions depending on the number of business days past the settlement date; 1,250% for non-DvP, non-PvP	DvP (delivery vs. payment) and PvP (payment vs. payment) are defined below.

		transactions more than 5 days past the settlement date. The proposed capital requirement for unsettled transactions would not apply to cleared transactions that are marked-to-market daily and subject to daily receipt and payment of variation margin.	
Equity Exposures	100% or incremental deduction approach for nonfinancial equity investments.	0% risk weight: equity exposures to a sovereign, certain supranational entities, or an MDB whose debt exposures are eligible for 0% risk weight; 20%: Equity exposures to a PSE, a FHLB, or Farmer Mac; 100%: Equity exposures to community development investments and small business investment companies and non-significant equity	MDB = multilateral development bank.

		investments; 250%: Significant investments in the capital of unconsolidated financial institutions that are not deducted from capital pursuant to section 22. 300%: Most publicly traded equity exposures; 400%: Equity exposures that are not publicly traded; 600%: Equity exposures to certain investment funds.	
Equity exposures to investment funds	There is a 20% risk weight floor on mutual fund holdings. General rule: Risk weight is the same as the highest risk weight investment the fund is permitted to hold. Option: A banking	<u>Full look-through</u>: Risk weight the assets of the fund (as if owned directly) *multiplied by* the banking organization's proportional ownership in the fund. <u>Simple modified</u>	

	organization may assign risk weights pro rata according to the investment limits in the fund's prospectus.	look-through: Multiply the banking organization's exposure by the risk weight of the highest risk weight asset in the fund. Alternative modified look-through: Assign risk weight on a pro rata basis based on the investment limits in the fund's prospectus. For community development exposures, risk-weighted asset amount = adjusted carrying value.	
Credit Conversion Factors Under the Current and Proposed Rules			
Conversion Factors for off-balance sheet items	0% for the unused portion of a commitment with an original maturity of one year or less, or which unconditionally cancellable at any time; 10% for unused portions of eligible ABCP liquidity facilities with an original maturity of one year or less;	0% for the unused portion of a commitment that is unconditionally cancellable by the banking organization; 20% for the unused portion of a commitment with an original maturity	

	20% for self-liquidating, trade-related contingent items; 50% for the unused portion of a commitment with an original maturity of more than one year that are not unconditionally cancellable; 50% for transaction-related contingent items (performance bonds, bid bonds, warranties, and standby letters of credit); 100% for guarantees, repurchase agreements, securities lending and borrowing transactions, financial standby letters of credit, and forward agreements;	of one year or less that is not unconditionally cancellable; 20% for self-liquidating trade-related contingent items; 50% for the unused portion of a commitment over one year that are not unconditionally cancellable; 50% for transaction-related contingent items (performance bonds, bid bonds, warranties, and standby letters of credit); 100% for guarantees, repurchase agreements, securities lending and borrowing transactions, financial standby letters of credit, and forward agreements;	

Derivative contracts	Conversion to an on-balance sheet amount based on current exposure plus potential future exposure and a set of conversion factors. *50% risk weight cap*	Conversion to an on-balance sheet amount based on current exposure plus potential future exposure and a set of conversion factors. *No risk weight cap.*	
Credit Risk Mitigation Under the Current and Proposed Rules			
Guarantees	Generally recognizes guarantees provided by central governments, GSEs, PSEs in OECD countries, multilateral lending institutions, regional development banking organizations, U.S. depository institutions, foreign banks, and qualifying securities firms in OECD countries. Substitution approach that allows the banking organization to substitute the risk weight of the protection provider for the risk weight ordinarily assigned to the exposure.	Recognizes guarantees from eligible guarantors: sovereign entities, BIS, IMF, ECB, European Commission, FHLBs, Farmer Mac, a multilateral development bank, a depository institution, a bank holding company, a savings and loan holding company, a foreign bank, or an entity other than a SPE that has investment grade debt, whose creditworthiness is not positively correlated with the credit risk of the exposures for which it provides guarantees and is not a monoline insurer or re-insurer.	Claims conditionally guaranteed by the U.S. government receive a risk weight of 20 percent under the standardized approach.

		Substitution treatment allows the banking organization to substitute the risk weight of the protection provider for the risk weight ordinarily assigned to the exposure. Applies only to eligible guarantees and eligible credit derivatives, and adjusts for maturity mismatches, currency mismatches, and where restructuring is not treated as a credit event.	
Collateralized transactions	Recognize only cash on deposit, securities issued or guaranteed by OECD countries, securities issued or guaranteed by the U.S. government or a U.S. government agency, and securities issued by certain multilateral development banks. Substitute risk weight of collateral for risk weight of exposure, sometimes with a 20% risk weight floor.	For financial collateral only, the proposal provides two approaches: 1. Simple approach: A banking organization may apply a risk weight to the portion of an exposure that is secured by the market value of collateral by using the risk weight of the collateral – with a general risk weight floor of	Financial collateral: cash on deposit at the banking organization (or 3rd party custodian); gold; investment grade securities (excluding resecuritizations); publicly traded equity securities; publicly traded convertible bonds; money market mutual fund shares; and other mutual fund shares if a price is quoted daily.

		20%. 2. Collateral haircut approach using standard supervisory haircuts or own estimates of haircuts for eligible margin loans, repo-style transactions, collateralized derivative contracts.	In all cases the banking organization must have a perfected, 1st priority interest. For the simple approach there must be a collateral agreement for at least the life of the exposure; collateral must be revalued at least every 6 months; collateral other than gold must be in the same currency.

Addendum 2: Definitions used in the Proposal

Additional tier 1 capital is defined in §___.20 of subpart C.

Advanced approaches [BANK] means a [BANK] that is described in §___.100(b)(1) of subpart E.

Advanced approaches total risk-weighted assets means: (1) the sum of:

(i) Credit-risk-weighted assets;
(ii) Credit Valuation Adjustment (CVA) risk-weighted assets;
(iii) Risk-weighted assets for operational risk; and

(iv) For a market risk [BANK] only, advanced market risk-weighted assets; minus

(2) Excess eligible credit reserves not included in the [BANK]'s tier 2 capital.

Advanced market risk-weighted assets means the advanced measure for market risk calculated under §___.204 of subpart F multiplied by 12.5.

Affiliate with respect to a company means any company that controls, is controlled by, or is under common control with, the company.

Allocated transfer risk reserves means reserves that have been established in accordance with Section 905(a) of the International Lending Supervision Act, against certain assets whose value U.S. supervisory authorities have found to be significantly impaired by protracted transfer risk problems.

Allowances for loan and lease losses (ALLL) means reserves that have been established through a charge against earnings to absorb future losses on loans, lease financing receivables or other extensions of credit. ALLL excludes "allocated transfer risk reserves." For purposes of this [PART], ALLL includes reserves that have been established through a charge against earnings to absorb future credit losses associated with off-balance sheet exposures.

Asset-backed commercial paper (ABCP) program means a program established primarily for the purpose of issuing commercial paper that is investment grade and backed by underlying exposures held in a bankruptcy-remote special purpose entity (SPE).

Asset-backed commercial paper (ABCP) program sponsor means a [BANK] that:

(1) Establishes an ABCP program;

(2) Approves the sellers permitted to participate in an ABCP program;

(3) Approves the exposures to be purchased by an ABCP program; or

(4) Administers the ABCP program by monitoring the underlying exposures, underwriting or otherwise arranging for the placement of debt or other obligations issued by the

program, compiling monthly reports, or ensuring compliance with the program documents and with the program's credit and investment policy.

Bank holding company means a bank holding company as defined in section 2 of the Bank Holding Company Act.

Bank Holding Company Act means the Bank Holding Company Act of 1956, as amended (12 U.S.C. 1841).

Bankruptcy remote means, with respect to an entity or asset, that the entity or asset would be excluded from an insolvent entity's estate in receivership, insolvency, liquidation, or similar proceeding.

Capital distribution means:

(1) A reduction of tier 1 capital through the repurchase of a tier 1 capital instrument or by other means;

(2) A reduction of tier 2 capital through the repurchase, or redemption prior to maturity, of a tier 2 capital instrument or by other means;

(3) A dividend declaration on any tier 1 capital instrument;

(4) A dividend declaration or interest payment on any tier 2 capital instrument if such dividend declaration or interest payment may be temporarily or permanently suspended at the discretion of the [BANK]; or

(5) Any similar transaction that the [AGENCY] determines to be in substance a distribution of capital.

Carrying value means, with respect to an asset, the value of the asset on the balance sheet of the [BANK], determined in accordance with generally accepted accounting principles (GAAP).

Category 1 residential mortgage exposure means a residential mortgage exposure with the following characteristics:

(1) The duration of the mortgage exposure does not exceed 30 years;

(2) The terms of the mortgage exposure provide for regular periodic payments that do not:

(i) Result in an increase of the principal balance;

(ii) Allow the borrower to defer repayment of principal of the residential mortgage exposure; or

(iii) Result in a balloon payment;

(3) The standards used to underwrite the residential mortgage exposure:

(i) Took into account all of the borrower's obligations, including for mortgage obligations, principal, interest, taxes, insurance (including mortgage guarantee insurance), and assessments; and

(ii) Resulted in a conclusion that the borrower is able to repay the exposure using:

(A) The maximum interest rate that may apply during the first five years after the date of the closing of the residential mortgage exposure transaction; and

(B) The amount of the residential mortgage exposure is the maximum possible contractual exposure over the life of the mortgage as of the date of the closing of the transaction;

(4) The terms of the residential mortgage exposure allow the annual rate of interest to increase no more than two percentage points in any twelve-month period and no more than six percentage points over the life of the exposure;

(5) For a first-lien home equity line of credit (HELOC), the borrower must be qualified using the principal and interest payments based on the maximum contractual exposure under the terms of the HELOC;

(6) The determination of the borrower's ability to repay is based on documented, verified income;

(7) The residential mortgage exposure is not 90 days or more past due or on non-accrual status; and

(8) The residential mortgage exposure is

(i) not a junior-lien residential mortgage exposure, and

(ii) if the residential mortgage exposure is a first-lien residential mortgage exposure held by a single banking organization and secured by first and junior lien(s) where no other party holds an intervening lien, each residential mortgage exposure must have the characteristics of a category 1 residential mortgage exposure as set forth in this definition.

Notwithstanding paragraphs (1) through (8), the [AGENCY] may determine that a residential mortgage exposure that is not prudently underwritten does not qualify as a category 1 residential mortgage exposure.

Category 2 residential mortgage exposure means a residential mortgage exposure that is not a Category 1 residential mortgage exposure.

Central counterparty (CCP) means a counterparty (for example, a clearing house) that facilitates trades between counterparties in one or more financial markets by either guaranteeing trades or novating contracts.

CFTC means the U.S. Commodity Futures Trading Commission.

Clean-up call means a contractual provision that permits an originating [BANK] or servicer to call securitization exposures before their stated maturity or call date.

Cleared transaction means an outstanding derivative contract or repo-style transaction that a [BANK] or clearing member has entered into with a central counterparty (that is, a transaction that a central counterparty has accepted). A cleared transaction includes:

(1) A transaction between a CCP and a [BANK] that is a clearing member of the CCP where the [BANK] enters into the transaction with the CCP for the [BANK]'s own account;

(2) A transaction between a CCP and a [BANK] that is a clearing member of the CCP where the [BANK] is acting as a financial intermediary on behalf of a clearing member client and the transaction offsets a transaction that satisfies the requirements of paragraph (3) below of this definition.

(3) A transaction between a clearing member client [BANK] and a clearing member where the clearing member acts as a financial intermediary on behalf of the clearing member client and enters into an offsetting transaction with a CCP provided that:

(i) The offsetting transaction is identified by the CCP as a transaction for the clearing member client;

(ii) The collateral supporting the transaction is held in a manner that prevents the [BANK] from facing any loss due to the default, receivership, or insolvency of either the clearing member or the clearing member's other clients;

(iii) The [BANK] has conducted sufficient legal review to conclude with a well-founded basis (and maintains sufficient written documentation of that legal review) that in the event of a legal challenge (including one resulting from a default or receivership, insolvency, liquidation, or similar proceeding) the relevant court and administrative authorities would find the arrangements of paragraph (ii) to be legal, valid, binding and enforceable under the law of the relevant jurisdictions; and

(iv) The offsetting transaction with a clearing member is transferable under the transaction documents or applicable laws in the relevant jurisdiction(s) to another clearing member should the clearing member default, become insolvent, or enter receivership, insolvency, liquidation, or similar proceeding.

(4) A transaction between a clearing member client and a CCP where a clearing member guarantees the performance of the clearing member client to the CCP.

(5) A cleared transaction does not include the exposure of a [BANK] that is a clearing member to its clearing member client where the [BANK] is either acting as a financial intermediary and enters into an offsetting transaction with a CCP or where the [BANK] provides a guarantee to the CCP on the performance of the client.

Clearing member means a member of, or direct participant in, a CCP that is entitled to enter into transactions with the CCP.

Clearing member client means a party to a cleared transaction associated with a CCP in which a clearing member acts either as a financial intermediary with respect to the party or guarantees the performance of the party to the CCP.

Collateral agreement means a legal contract that specifies the time when, and circumstances under which, a counterparty is required to pledge collateral to a [BANK] for a single financial contract or for all financial contracts in a netting set and confers upon the [BANK] a perfected, first-priority security interest (notwithstanding the prior security interest of any custodial agent), or the legal equivalent thereof, in the collateral posted by the counterparty under the agreement. This security interest must provide the [BANK] with a right to close out the financial positions and liquidate the collateral upon an event of default of, or failure to perform by, the counterparty under the collateral agreement. A contract would not satisfy this requirement if the [BANK]'s exercise of rights under the agreement may be stayed or avoided under applicable law in the relevant jurisdictions, other than in receivership, conservatorship, resolution under the Federal Deposit Insurance Act, Title II of the Dodd-Frank Act, or under any similar insolvency law applicable to GSEs.

Commitment means any legally binding arrangement that obligates a [BANK] to extend credit or to purchase assets.

Commodity derivative contract means a commodity-linked swap, purchased commodity-linked option, forward commodity-linked contract, or any other instrument linked to commodities that gives rise to similar counterparty credit risks.

Common equity tier 1 capital is defined in §___.20 of subpart C.

Common equity tier 1 minority interest means the common equity tier 1 capital of a depository institution or foreign bank that is (i) a consolidated subsidiary of a [BANK], and (ii) not owned by the [BANK].

Company means a corporation, partnership, limited liability company, depository institution, business trust, special purpose entity, association, or similar organization.

Control. A person or company controls a company if it:

(1) Owns, controls, or holds with power to vote 25 percent or more of a class of voting securities of the company; or

(2) Consolidates the company for financial reporting purposes.

Corporate exposure means an exposure to a company that is not:

(1) An exposure to a sovereign, the Bank for International Settlements, the European Central Bank, the European Commission, the International Monetary Fund, a multi-lateral development bank (MDB), a depository institution, a foreign bank, a credit union, or a public sector entity (PSE);

(2) An exposure to a government-sponsored entity (GSE);

(3) A residential mortgage exposure;

(4) A pre-sold construction loan;

(5) A statutory multifamily mortgage;

(6) A high volatility commercial real estate (HVCRE) exposure;

(7) A cleared transaction;

(8) A default fund contribution;

(9) A securitization exposure;

(10) An equity exposure; or

(11) An unsettled transaction.

Country risk classification (CRC) with respect to a sovereign means the most recent consensus CRC published by the Organization for Economic Cooperation and Development (OECD) as of December 31st of the prior calendar year that provides a view of the likelihood that the sovereign will service its external debt.

Credit derivative means a financial contract executed under standard industry credit derivative documentation that allows one party (the protection purchaser) to transfer the credit risk of one or more exposures (reference exposure(s)) to another party (the protection provider) for a certain period of time.

Credit-enhancing interest-only strip (CEIO) means an on-balance sheet asset that, in form or in substance:

(1) Represents a contractual right to receive some or all of the interest and no more than a minimal amount of principal due on the underlying exposures of a securitization; and

(2) Exposes the holder of the CEIO to credit risk directly or indirectly associated with the underlying exposures that exceeds a pro rata share of the holder's claim on the underlying exposures, whether through subordination provisions or other credit-enhancement techniques.

Credit-enhancing representations and warranties means representations and warranties that are made or assumed in connection with a transfer of underlying exposures (including loan servicing assets) and that obligate a [BANK] to protect another party from losses arising from the credit risk of the underlying exposures. Credit enhancing representations and warranties include provisions to protect a party from losses resulting from the default or nonperformance of the counterparties of the underlying exposures or from an insufficiency in the value of the collateral backing the underlying exposures. Credit enhancing representations and warranties do not include warranties that permit the return of underlying exposures in instances of misrepresentation, fraud, or incomplete documentation.

Credit risk mitigant means collateral, a credit derivative, or a guarantee.

Credit-risk-weighted assets means 1.06 multiplied by the sum of:

(1) Total wholesale and retail risk-weighted assets;

(2) Risk-weighted assets for securitization exposures; and

(3) Risk-weighted assets for equity exposures.

Credit union means an insured credit union as defined under the Federal Credit Union Act (12 U.S.C. 1752).

Current exposure means, with respect to a netting set, the larger of zero or the market value of a transaction or portfolio of transactions within the netting set that would be lost upon default of the counterparty, assuming no recovery on the value of the transactions. Current exposure is also called replacement cost.

Custodian means a financial institution that has legal custody of collateral provided to a CCP.

Debt-to-assets ratio means the ratio calculated by dividing a public company's total liabilities by its equity market value (as defined herein) plus total liabilities as reported as of the end of the most recently reported calendar quarter.

Default fund contribution means the funds contributed or commitments made by a clearing member to a CCP's mutualized loss sharing arrangement.

Depository institution means a depository institution as defined in section 3 of the Federal Deposit Insurance Act.

Depository institution holding company means a bank holding company or savings and loan holding company.

Derivative contract means a financial contract whose value is derived from the values of one or more underlying assets, reference rates, or indices of asset values or reference rates. Derivative contracts include interest rate derivative contracts, exchange rate derivative contracts, equity derivative contracts, commodity derivative contracts, credit derivative contracts, and any other instrument that poses similar counterparty credit risks. Derivative contracts also include unsettled securities, commodities, and foreign exchange transactions with a contractual settlement or delivery lag that is longer than the lesser of the market standard for the particular instrument or five business days.

Discretionary bonus payment means a payment made to an executive officer of a [BANK], where:

(1) The [BANK] retains discretion as to whether to make, and the amount of, the payment until the payment is awarded to the executive officer;

(2) The amount paid is determined by the [BANK] without prior promise to, or agreement with, the executive officer; and

(3) The executive officer has no contractual right, whether express or implied, to the bonus payment.

Dodd-Frank Act means the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Pub. L. 111-203, 124 Stat. 1376).

Early amortization provision means a provision in the documentation governing a securitization that, when triggered, causes investors in the securitization exposures to be repaid before the original stated maturity of the securitization exposures, unless the provision:

(1) Is triggered solely by events not directly related to the performance of the underlying exposures or the originating [BANK] (such as material changes in tax laws or regulations); or

(2) Leaves investors fully exposed to future draws by borrowers on the underlying exposures even after the provision is triggered.

Effective notional amount means for an eligible guarantee or eligible credit derivative, the lesser of the contractual notional amount of the credit risk mitigant and the exposure amount of the hedged exposure, multiplied by the percentage coverage of the credit risk mitigant.

Eligible asset-backed commercial paper (ABCP) liquidity facility means a liquidity facility supporting ABCP, in form or in substance, that is subject to an asset quality test at the time of draw that precludes funding against assets that are 90 days or more past due or in default. Notwithstanding the preceding sentence, a liquidity facility is an eligible ABCP liquidity facility if the assets or exposures funded under the liquidity facility that do not meet the eligibility requirements are guaranteed by a sovereign that qualifies for a 20 percent risk weight or lower.

Eligible clean-up call means a clean-up call that:

(1) Is exercisable solely at the discretion of the originating [BANK] or servicer;

(2) Is not structured to avoid allocating losses to securitization exposures held by investors or otherwise structured to provide credit enhancement to the securitization; and

(3)(i) For a traditional securitization, is only exercisable when 10 percent or less of the principal amount of the underlying exposures or securitization exposures (determined as of the inception of the securitization) is outstanding; or

(ii) For a synthetic securitization, is only exercisable when 10 percent or less of the principal amount of the reference portfolio of underlying exposures (determined as of the inception of the securitization) is outstanding.

Eligible credit derivative means a credit derivative in the form of a credit default swap, n^{th}-to-default swap, total return swap, or any other form of credit derivative approved by the [AGENCY], provided that:

(1) The contract meets the requirements of an eligible guarantee and has been confirmed by the protection purchaser and the protection provider;

(2) Any assignment of the contract has been confirmed by all relevant parties;

(3) If the credit derivative is a credit default swap or n^{th}-to-default swap, the contract includes the following credit events:

(i) Failure to pay any amount due under the terms of the reference exposure, subject to any applicable minimal payment threshold that is consistent with standard market practice and with a grace period that is closely in line with the grace period of the reference exposure; and

(ii) Receivership, insolvency, liquidation, conservatorship or inability of the reference exposure issuer to pay its debts, or its failure or admission in writing of its inability generally to pay its debts as they become due, and similar events;

(4) The terms and conditions dictating the manner in which the contract is to be settled are incorporated into the contract;

(5) If the contract allows for cash settlement, the contract incorporates a robust valuation process to estimate loss reliably and specifies a reasonable period for obtaining post-credit event valuations of the reference exposure;

(6) If the contract requires the protection purchaser to transfer an exposure to the protection provider at settlement, the terms of at least one of the exposures that is permitted to be transferred under the contract provide that any required consent to transfer may not be unreasonably withheld;

(7) If the credit derivative is a credit default swap or n^{th}-to-default swap, the contract clearly identifies the parties responsible for determining whether a credit event has occurred, specifies that this determination is not the sole responsibility of the protection provider, and gives the protection purchaser the right to notify the protection provider of the occurrence of a credit event; and

(8) If the credit derivative is a total return swap and the [BANK] records net payments received on the swap as net income, the [BANK] records offsetting deterioration in the value of the hedged exposure (either through reductions in fair value or by an addition to reserves).

Eligible credit reserves means all general allowances that have been established through a charge against earnings to absorb credit losses associated with on- or off-balance sheet wholesale and retail exposures, including the allowance for loan and lease losses (ALLL) associated with such exposures but excluding allocated transfer risk reserves established pursuant to 12 U.S.C. 3904 and other specific reserves created against recognized losses.

Eligible guarantee means a guarantee from an eligible guarantor that:

(1) Is written;

(2) Is either:

(i) Unconditional, or

(ii) A contingent obligation of the U.S. government or its agencies, the enforceability of which is dependent upon some affirmative action on the part of the beneficiary of the guarantee or a third party (for example, meeting servicing requirements);

(3) Covers all or a pro rata portion of all contractual payments of the obligated party on the reference exposure;

(4) Gives the beneficiary a direct claim against the protection provider;

(5) Is not unilaterally cancelable by the protection provider for reasons other than the breach of the contract by the beneficiary;

(6) Except for a guarantee by a sovereign, is legally enforceable against the protection provider in a jurisdiction where the protection provider has sufficient assets against which a judgment may be attached and enforced;

(7) Requires the protection provider to make payment to the beneficiary on the occurrence of a default (as defined in the guarantee) of the obligated party on the reference exposure in a timely manner without the beneficiary first having to take legal actions to pursue the obligor for payment;

(8) Does not increase the beneficiary's cost of credit protection on the guarantee in response to deterioration in the credit quality of the reference exposure; and

(9) Is not provided by an affiliate of the [BANK], unless the affiliate is an insured depository institution, foreign bank, securities broker or dealer, or insurance company that:

(i) Does not control the [BANK]; and

(ii) Is subject to consolidated supervision and regulation comparable to that imposed on depository institutions, U.S. securities broker-dealers, or U.S. insurance companies (as the case may be).

Eligible guarantor means:

(1) A sovereign, the Bank for International Settlements, the International Monetary Fund, the European Central Bank, the European Commission, a Federal Home Loan Bank, Federal Agricultural Mortgage Corporation (Farmer Mac), a multilateral development bank (MDB), a depository institution, a bank holding company, a savings and loan holding company, a credit union, or a foreign bank; or

(2) An entity (other than a special purpose entity):

(i) That at the time the guarantee is issued or anytime thereafter, has issued and outstanding an unsecured debt security without credit enhancement that is investment grade;

(ii) Whose creditworthiness is not positively correlated with the credit risk of the exposures for which it has provided guarantees; and

(iii) That is not an insurance company engaged predominately in the business of providing credit protection (such as a monoline bond insurer or re-insurer).

Eligible margin loan means an extension of credit where:

(1) The extension of credit is collateralized exclusively by liquid and readily marketable debt or equity securities, or gold;

(2) The collateral is marked-to-market daily, and the transaction is subject to daily margin maintenance requirements;

(3) The extension of credit is conducted under an agreement that provides the [BANK] the right to accelerate and terminate the extension of credit and to liquidate or set-off collateral promptly upon an event of default (including upon an event of receivership, insolvency, liquidation, conservatorship, or similar proceeding) of the counterparty, provided that, in any such case, any exercise of rights under the agreement will not be stayed or avoided under applicable law in the relevant jurisdictions;[1] and

(4) The [BANK] has conducted sufficient legal review to conclude with a well-founded basis (and maintains sufficient written documentation of that legal review) that the agreement meets the requirements of paragraph (3) of this definition and is legal, valid, binding, and enforceable under applicable law in the relevant jurisdictions, other than in receivership, conservatorship, resolution under the Federal Deposit Insurance Act, Title II of the Dodd-Frank Act, or under any similar insolvency law applicable to GSEs.

Eligible servicer cash advance facility means a servicer cash advance facility in which:

(1) The servicer is entitled to full reimbursement of advances, except that a servicer may be obligated to make non-reimbursable advances for a particular underlying exposure if any such advance is contractually limited to an insignificant amount of the outstanding principal balance of that exposure;

(2) The servicer's right to reimbursement is senior in right of payment to all other claims on the cash flows from the underlying exposures of the securitization; and

[1] This requirement is met where all transactions under the agreement are (i) executed under U.S. law and (ii) constitute "securities contracts" under section 555 of the Bankruptcy Code (11 U.S.C. 555), qualified financial contracts under section 11(e)(8) of the Federal Deposit Insurance Act, or netting contracts between or among financial institutions under sections 401-407 of the Federal Deposit Insurance Corporation Improvement Act or the Federal Reserve Board's Regulation EE (12 CFR part 231).

(3) The servicer has no legal obligation to, and does not make advances to the securitization if the servicer concludes the advances are unlikely to be repaid.

Equity derivative contract means an equity-linked swap, purchased equity-linked option, forward equity-linked contract, or any other instrument linked to equities that gives rise to similar counterparty credit risks.

Equity exposure means:

(1) A security or instrument (whether voting or non-voting) that represents a direct or an indirect ownership interest in, and is a residual claim on, the assets and income of a company, unless:

(i) The issuing company is consolidated with the [BANK] under GAAP;

(ii) The [BANK] is required to deduct the ownership interest from tier 1 or tier 2 capital under this [PART];

(iii) The ownership interest incorporates a payment or other similar obligation on the part of the issuing company (such as an obligation to make periodic payments); or

(iv) The ownership interest is a securitization exposure;

(2) A security or instrument that is mandatorily convertible into a security or instrument described in paragraph (1) of this definition;

(3) An option or warrant that is exercisable for a security or instrument described in paragraph (1) of this definition; or

(4) Any other security or instrument (other than a securitization exposure) to the extent the return on the security or instrument is based on the performance of a security or instrument described in paragraph (1) of this definition.

ERISA means the Employee Retirement Income and Security Act of 1974 (29 U.S.C. 1002).

Exchange rate derivative contract means a cross-currency interest rate swap, forward foreign-exchange contract, currency option purchased, or any other instrument linked to exchange rates that gives rise to similar counterparty credit risks.

Executive officer means a person who holds the title or, without regard to title, salary, or compensation, performs the function of one or more of the following positions: president, chief executive officer, executive chairman, chief operating officer, chief financial officer, chief investment officer, chief legal officer, chief lending officer, chief risk officer, or head of a major business line, and other staff that the board of directors of the [BANK] deems to have equivalent responsibility.

Expected credit loss (ECL) means:

(1) For a wholesale exposure to a non-defaulted obligor or segment of non-defaulted retail exposures that is carried at fair value with gains and losses flowing through earnings or that is classified as held-for-sale and is carried at the lower of cost or fair value with losses flowing through earnings, zero.

(2) For all other wholesale exposures to non-defaulted obligors or segments of non-defaulted retail exposures, the product of the probability of default (PD) times the loss given default (LGD) times the exposure at default (EAD) for the exposure or segment.

(3) For a wholesale exposure to a defaulted obligor or segment of defaulted retail exposures, the [BANK]'s impairment estimate for allowance purposes for the exposure or segment.

(4) Total ECL is the sum of expected credit losses for all wholesale and retail exposures other than exposures for which the [BANK] has applied the double default treatment in §___.135.

Exposure amount means:

(1) For the on-balance sheet component of an exposure (other than an OTC derivative contract; a repo-style transaction or an eligible margin loan for which the [BANK] determines the exposure amount under §___.37 of subpart D; cleared transaction; default fund contribution; or a securitization exposure), exposure amount means the [BANK]'s carrying value of the exposure.

(2) For the off-balance sheet component of an exposure (other than an OTC derivative contract; a repo-style transaction or an eligible margin loan for which the [BANK] calculates the exposure amount under §___.37 of subpart D; cleared transaction, default fund contribution or a securitization exposure), exposure amount means the notional amount of the off-balance sheet component multiplied by the appropriate credit conversion factor (CCF) in §___.33 of subpart D.

(3) If the exposure is an OTC derivative contract or derivative contract that is a cleared transaction, the exposure amount determined under §___.34 of subpart D.

(4) If the exposure is an eligible margin loan or repo-style transaction (including a cleared transaction) for which the [BANK] calculates the exposure amount as provided in §___.37 of subpart D, the exposure amount determined under §___.37 of subpart D.

(5) If the exposure is a securitization exposure, the exposure amount determined under §___.42 of subpart D.

Federal Deposit Insurance Act means the Federal Deposit Insurance Act (12 U.S.C. 1813).

Federal Deposit Insurance Corporation Improvement Act means the Federal Deposit Insurance Corporation Improvement Act of 1991 (12 U.S.C. 4401).

Financial collateral means collateral:

(1) In the form of:

(i) Cash on deposit with the [BANK] (including cash held for the [BANK] by a third-party custodian or trustee);

(ii) Gold bullion;

(iii) Long-term debt securities that are not resecuritization exposures and that are investment grade;

(iv) Short-term debt instruments that are not resecuritization exposures and that are investment grade;

(v) Equity securities that are publicly-traded;

(vi) Convertible bonds that are publicly-traded; or

(vii) Money market fund shares and other mutual fund shares if a price for the shares is publicly quoted daily; and

(2) In which the [BANK] has a perfected, first-priority security interest or, outside of the United States, the legal equivalent thereof (with the exception of cash on deposit and notwithstanding the prior security interest of any custodial agent).

Financial institution means:

(1)(i) A bank holding company, savings and loan holding company, nonbank financial institution supervised by the Board under Title I of the Dodd-Frank Act, depository institution, foreign bank, credit union, insurance company, or securities firm;

(ii) A commodity pool as defined in section 1a(10) of the Commodity Exchange Act (7 U.S.C. 1a(10));

(iii) An entity that is a covered fund for purposes of section 13 of the Bank Holding Company Act (12 U.S.C. 1851(h)(2)) and regulations issued thereunder;

(iv) An employee benefit plan as defined in paragraphs (3) and (32) of section 3 of the Employee Retirement Income and Security Act of 1974 (29 U.S.C. 1002) (other than an employee benefit plan established by [BANK] for the benefit of its employees or the employees of its affiliates);

(v) Any other company predominantly engaged in the following activities:

(A) Lending money, securities or other financial instruments, including servicing loans;

(B) Insuring, guaranteeing, or indemnifying against loss, harm, damage, illness, disability, or death, or issuing annuities;

(C) Underwriting, dealing in, making a market in, or investing as principal in securities or other financial instruments;

(D) Asset management activities (not including investment or financial advisory activities); or

(E) Acting as a futures commission merchant.

(vi) Any entity not domiciled in the United States (or a political subdivision thereof) that would be covered by any of paragraphs (1)(i) through (v) if such entity were domiciled in the United States; or

(vii) Any other company that the [AGENCY] may determine is a financial institution based on the nature and scope of its activities.

(2) For the purposes of this definition, a company is "predominantly engaged" in an activity or activities if:

(i) 85 percent or more of the total consolidated annual gross revenues (as determined in accordance with applicable accounting standards) of the company in either of the two most recent calendar years were derived, directly or indirectly, by the company on a consolidated basis from the activities; or

(ii) 85 percent or more of the company's consolidated total assets (as determined in accordance with applicable accounting standards) as of the end of either of the two most recent calendar years were related to the activities.

(3) For the purpose of this [PART], "financial institution" does not include the following entities:

(i) GSEs;

(ii) Entities described in section 13(d)(1)(E) of the Bank Holding Company Act (12 U.S.C. 1851(d)(1)(E)) and regulations issued thereunder (exempted entities) and entities that are predominantly engaged in providing advisory and related services to exempted entities; and

(iii) Entities designated as Community Development Financial Institutions (CDFIs) under 12 U.S.C. 4701 et seq. and 12 CFR part 1805.

First-lien residential mortgage exposure means a residential mortgage exposure secured by a first lien or a residential mortgage exposure secured by first and junior lien(s) where no other party holds an intervening lien.

Foreign bank means a foreign bank as defined in section 211.2 of the Federal Reserve Board's Regulation K (12 CFR 211.2) (other than a depository institution).

Forward agreement means a legally binding contractual obligation to purchase assets with certain drawdown at a specified future date, not including commitments to make residential mortgage loans or forward foreign exchange contracts.

GAAP means generally accepted accounting principles as used in the United States.

Gain-on-sale means an increase in the equity capital of a [BANK] (as reported on Schedule RC of the Call Report or Schedule HC of the FR Y–9C) resulting from a securitization (other than an increase in equity capital resulting from the [BANK]'s receipt of cash in connection with the securitization).

General obligation means a bond or similar obligation that is backed by the full faith and credit of a public sector entity (PSE).

Government-sponsored entity (GSE) means an entity established or chartered by the U.S. government to serve public purposes specified by the U.S. Congress but whose debt obligations are not explicitly guaranteed by the full faith and credit of the U.S. government.

Guarantee means a financial guarantee, letter of credit, insurance, or other similar financial instrument (other than a credit derivative) that allows one party (beneficiary) to transfer the credit risk of one or more specific exposures (reference exposure) to another party (protection provider).

High volatility commercial real estate (HVCRE) exposure means a credit facility that finances or has financed the acquisition, development, or construction (ADC) of real property, unless the facility finances:

(1) One- to four-family residential properties; or

(2) Commercial real estate projects in which:

(i) The loan-to-value ratio is less than or equal to the applicable maximum supervisory loan-to-value ratio in the [AGENCY]'s real estate lending standards at 12 CFR part 34, subpart D and 12 CFR part 160, subparts A and B (OCC); 12 CFR part 208, Appendix C (Board); 12 CFR part 365, subpart D and 12 CFR 390.264-390.265 (FDIC);

(ii) The borrower has contributed capital to the project in the form of cash or unencumbered readily marketable assets (or has paid development expenses out-of-pocket) of at least 15 percent of the real estate's appraised "as completed" value; and

(iii) The borrower contributed the amount of capital required by paragraph (2)(ii) of this definition before the [BANK] advances funds under the credit facility, and the capital contributed by the borrower, or internally generated by the project, is contractually required to remain in the project throughout the life of the project. The life of a project concludes only when the credit facility is converted to permanent financing or is sold or paid in full. Permanent financing may be provided by the [BANK] that provided the ADC facility as long as the permanent financing is subject to the [BANK]'s underwriting criteria for long-term mortgage loans.

Home country means the country where an entity is incorporated, chartered, or similarly established.

Interest rate derivative contract means a single-currency interest rate swap, basis swap, forward rate agreement, purchased interest rate option, when-issued securities, or any other instrument linked to interest rates that gives rise to similar counterparty credit risks.

International Lending Supervision Act means the International Lending Supervision Act of 1983 (12 U.S.C. 3907).

Investing bank means, with respect to a securitization, a [BANK] that assumes the credit risk of a securitization exposure (other than an originating [BANK] of the securitization). In the typical synthetic securitization, the investing [BANK] sells credit protection on a pool of underlying exposures to the originating [BANK].

Investment fund means a company:

(1) Where all or substantially all of the assets of the company are financial assets; and

(2) That has no material liabilities.

Investment grade means that the entity to which the [BANK] is exposed through a loan or security, or the reference entity with respect to a credit derivative, has adequate capacity to meet financial commitments for the projected life of the asset or exposure. Such an entity or reference entity has adequate capacity to meet financial commitments if the risk of its default is low and the full and timely repayment of principal and interest is expected.

Investment in the capital of an unconsolidated financial institution means a net long position in an instrument that is recognized as capital for regulatory purposes by the primary supervisor of an unconsolidated regulated financial institutions and in an instrument that is part of the GAAP equity of an unconsolidated unregulated financial institution, including direct, indirect, and synthetic exposures to capital instruments, excluding underwriting positions held by the [BANK] for five business days or less.[2] An indirect exposure results from the [BANK]'s investment in an unconsolidated entity that has an exposure to a capital instrument of a financial institution. A synthetic exposure results from the [BANK]'s investment in an instrument where the value of such instrument is linked to the value of a capital instrument of a financial institution. For purposes of this definition, the amount of the exposure resulting from the investment in the capital of an unconsolidated financial institution is the [BANK]'s loss on such exposure should the underlying capital instrument have a value of zero. In addition, for purposes of this definition:

(1) The net long position is the gross long position in the exposure to the capital of the financial institution (including covered positions under subpart F) net of short positions in the same exposure where the maturity of the short position either matches the maturity of the long position or has a residual maturity of at least one year;

(2) Long and short positions in the same index without a maturity date are considered to have matching maturity. Gross long positions in investments in the capital instruments of

[2] If the [BANK] is an underwriter of a failed underwriting, the [BANK] can request approval from its primary federal supervisor to exclude underwriting positions related to such failed underwriting for a longer period of time.

unconsolidated financial institutions resulting from holdings of index securities may be netted against short positions in the same underlying index. However, short positions in indexes that are hedging long cash or synthetic positions can be decomposed to provide recognition of the hedge. More specifically, the portion of the index that is composed of the same underlying exposure that is being hedged may be used to offset the long position as long as both the exposure being hedged and the short position in the index are positions subject to the market risk rule, the positions are fair valued on the banking organization's balance sheet, and the hedge is deemed effective by the banking organization's internal control processes assessed by the primary supervisor of the banking organization; and

(3) Instead of looking through and monitoring its exact exposure to the capital of unconsolidated financial institutions included in an index security, a [BANK] may, with the prior approval of the [AGENCY], use a conservative estimate of the amount of its investment in the capital of unconsolidated financial institutions held through the index security.

Junior-lien residential mortgage exposure means a residential mortgage exposure that is not a first-lien residential mortgage exposure.

Main index means the Standard & Poor's 500 Index, the FTSE All-World Index, and any other index for which the [BANK] can demonstrate to the satisfaction of the [AGENCY] that the equities represented in the index have comparable liquidity, depth of market, and size of bid-ask spreads as equities in the Standard & Poor's 500 Index and FTSE All-World Index.

Market risk [BANK] means a [BANK] that is described in §___.201(b) of subpart F.

Money market fund means an investment fund that is subject to 17 CFR 270.2a-7 or any foreign equivalent thereof.

Mortgage servicing assets (MSAs) means the contractual rights owned by a [BANK] to service for a fee mortgage loans that are owned by others.

Multilateral development bank (MDB) means the International Bank for Reconstruction and Development, the Multilateral Investment Guarantee Agency, the International Finance Corporation, the Inter-American Development Bank, the Asian Development Bank, the African Development Bank, the European Bank for Reconstruction and Development, the European Investment Bank, the European Investment Fund, the Nordic Investment Bank, the Caribbean Development Bank, the Islamic Development Bank, the Council of Europe Development Bank, and any other multilateral lending institution or regional development bank in which the U.S. government is a shareholder or contributing member or which the [AGENCY] determines poses comparable credit risk.

National Bank Act means the National Bank Act (12 U.S.C. 24).

Netting set means a group of transactions with a single counterparty that are subject to a qualifying master netting agreement or a qualifying cross-product master netting agreement. For purposes of calculating risk-based capital requirements using the internal models methodology in subpart E, a transaction (1) that is not subject to such a master netting agreement or (2) where the [BANK] has identified specific wrong-way risk is its own netting set.

Non-significant investment in the capital of an unconsolidated financial institution means an investment where the [BANK] owns 10 percent or less of the issued and outstanding common shares of the unconsolidated financial institution.

N^{th}-to-default credit derivative means a credit derivative that provides credit protection only for the n^{th}-defaulting reference exposure in a group of reference exposures.

Operating entity means a company established to conduct business with clients with the intention of earning a profit in its own right.

Original maturity with respect to an off-balance sheet commitment means the length of time between the date a commitment is issued and:

(1) For a commitment that is not subject to extension or renewal, the stated expiration date of the commitment; or

(2) For a commitment that is subject to extension or renewal, the earliest date on which the [BANK] can, at its option, unconditionally cancel the commitment.

Originating [BANK], with respect to a securitization, means a [BANK] that:

(1) Directly or indirectly originated or securitized the underlying exposures included in the securitization; or

(2) Serves as an ABCP program sponsor to the securitization.

Over-the-counter (OTC) derivative contract means a derivative contract that is not a cleared transaction. An OTC derivative includes a transaction:

(1) Between a [BANK] that is a clearing member and a counterparty where the [BANK] is acting as a financial intermediary and enters into a cleared transaction with a CCP that offsets the transaction with the counterparty; or

(2) In which a [BANK] that is a clearing member provides a CCP a guarantee on the performance of the counterparty to the transaction.

Performance standby letter of credit (or performance bond) means an irrevocable obligation of a [BANK] to pay a third-party beneficiary when a customer (account party) fails to perform on any contractual nonfinancial or commercial obligation. To the extent permitted by law or regulation, performance standby letters of credit include arrangements backing, among other things, subcontractors' and suppliers' performance, labor and materials contracts, and construction bids.

Pre-sold construction loan means any one-to-four family residential construction loan to a builder that meets the requirements of section 618(a)(1) or (2) of the Resolution Trust Corporation Refinancing, Restructuring, and Improvement Act of 1991 and the following criteria:

(1) The loan is made in accordance with prudent underwriting standards;

(2) The purchaser is an individual(s) that intends to occupy the residence and is not a partnership, joint venture, trust, corporation, or any other entity (including an entity acting as a sole proprietorship) that is purchasing one or more of the residences for speculative purposes;

(3) The purchaser has entered into a legally binding written sales contract for the residence;

(4) The purchaser has not terminated the contract; however, if the purchaser terminates the sales contract the [BANK] must immediately apply a 100 percent risk weight to the loan and report the revised risk weight in [BANK]'s next quarterly [REGULATORY REPORT];

(5) The purchaser of the residence has a firm written commitment for permanent financing of the residence upon completion;

(6) The purchaser has made a substantial earnest money deposit of no less than 3 percent of the sales price, which is subject to forfeiture if the purchaser terminates the sales contract; provided that, the earnest money deposit shall not be subject to forfeiture by reason of breach or termination of the sales contract on the part of the builder;

(7) The earnest money deposit must be held in escrow by the [BANK] or an independent party in a fiduciary capacity, and the escrow agreement must provide that in the event of default the escrow funds shall be used to defray any cost incurred by [BANK] relating to any cancellation of the sales contract by the purchaser of the residence;

(8) The builder must incur at least the first 10 percent of the direct costs of construction of the residence (that is, actual costs of the land, labor, and material) before any drawdown is made under the loan;

(9) The loan may not exceed 80 percent of the sales price of the presold residence; and

(10) The loan is not more than 90 days past due, or on nonaccrual.

Private company means a company that is not a public company.

Private sector credit exposure means an exposure to a company or an individual that is included in credit risk-weighted assets and is not an exposure to a sovereign, the Bank for International Settlements, the European Central Bank, the European Commission, the International Monetary Fund, a MDB, a PSE, or a GSE.

Protection amount (P) means, with respect to an exposure hedged by an eligible guarantee or eligible credit derivative, the effective notional amount of the guarantee or credit derivative, reduced to reflect any currency mismatch, maturity mismatch, or lack of restructuring coverage (as provided in §___.36 of subpart D or §___.134 of subpart E, as appropriate).

Public company means a company that has issued publicly-traded debt or equity.

Publicly-traded means traded on:

(1) Any exchange registered with the SEC as a national securities exchange under section 6 of the Securities Exchange Act; or

(2) Any non-U.S.-based securities exchange that:

(i) Is registered with, or approved by, a national securities regulatory authority; and

(ii) Provides a liquid, two-way market for the instrument in question.

Public sector entity (PSE) means a state, local authority, or other governmental subdivision below the sovereign level.

Qualifying central counterparty (QCCP) means a central counterparty that:

(1) Is a designated financial market utility (FMU) under Title VIII of the Dodd-Frank Act;

(2) If not located in the United States, is regulated and supervised in a manner equivalent to a designated FMU; or

(3) Meets the following standards:

(i) The central counterparty requires all parties to contracts cleared by the counterparty to be fully collateralized on a daily basis;

(ii) The [BANK] demonstrates to the satisfaction of the [AGENCY] that the central counterparty:

(A) Is in sound financial condition;

(B) Is subject to supervision by the Board, the CFTC, or the Securities Exchange Commission (SEC), or if the central counterparty is not located in the United States, is subject to effective oversight by a national supervisory authority in its home country; and

(C) Meets or exceeds (1) the risk-management standards for central counterparties set forth in regulations established by the Board, the CFTC, or the SEC under Title VII or Title VIII of the Dodd-Frank Act, or (2) if the central counterparty is not located in the United States, similar risk-management standards established under the law of its home country that are consistent with international standards for central counterparty risk management as established by the relevant standard setting body of the Bank of International Settlements;

(4) Provides the [BANK] with the central counterparty's hypothetical capital requirement or the information necessary to calculate such hypothetical capital requirement, and other information the [BANK] is required to obtain under §___.35(d)(3);

(5) Makes available to the [AGENCY] and the CCP's regulator the information described in paragraph (4) of this definition; and

(6) Has not otherwise been determined by the [AGENCY] to not be QCCP due to its financial condition, risk profile, failure to meet supervisory risk management standards, or other weaknesses or supervisory concerns that are inconsistent with the risk weight assigned to qualifying central counterparties under §___.35 of subpart D; and

(7) If a [BANK] determines that a CCP ceases to be a QCCP due to the failure of the CCP to satisfy one or more of the requirements set forth at paragraphs (1) through (6) of this definition, the [BANK] may continue to treat the CCP as a QCCP for up to three months following the determination. If the CCP fails to remedy the relevant deficiency within three months after the initial determination, or the CCP fails to satisfy the requirements set forth in paragraphs (1) through (6) continuously for a three month period after remedying the relevant deficiency, a [BANK] may not treat the CCP as a QCCP for the purposes of this [PART] until after the [BANK] has determined that the CCP has satisfied the requirements in paragraphs (1) through (6) for three continuous months.

Qualifying master netting agreement means any written, legally enforceable agreement provided that:

(1) The agreement creates a single legal obligation for all individual transactions covered by the agreement upon an event of default, including receivership, insolvency, liquidation, or similar proceeding, of the counterparty;

(2) The agreement provides the [BANK] the right to accelerate, terminate, and close-out on a net basis all transactions under the agreement and to liquidate or set-off collateral promptly upon an event of default, including upon an event of receivership, insolvency, liquidation, or similar proceeding, of the counterparty, provided that, in any such case, any exercise of rights under the agreement will not be stayed or avoided under applicable law in the relevant jurisdictions, other than in receivership, conservatorship, resolution under the Federal Deposit Insurance Act, Title II of the Dodd-Frank Act, or under any similar insolvency law applicable to GSEs;

(3) The [BANK] has conducted sufficient legal review to conclude with a well-founded basis (and maintains sufficient written documentation of that legal review) that:

(i) The agreement meets the requirements of paragraph (2) of this definition; and

(ii) In the event of a legal challenge (including one resulting from default or from receivership, insolvency, liquidation, or similar proceeding) the relevant court and administrative authorities would find the agreement to be legal, valid, binding, and enforceable under the law of the relevant jurisdictions;

(4) The [BANK] establishes and maintains procedures to monitor possible changes in relevant law and to ensure that the agreement continues to satisfy the requirements of this definition; and

(5) The agreement does not contain a walkaway clause (that is, a provision that permits a non-defaulting counterparty to make a lower payment than it otherwise would make under the

agreement, or no payment at all, to a defaulter or the estate of a defaulter, even if the defaulter or the estate of the defaulter is a net creditor under the agreement).

Regulated financial institution means a financial institution subject to consolidated supervision and regulation comparable to that imposed on the following U.S. financial institutions: depository institutions, depository institution holding companies, nonbank financial companies supervised by the Board, designated financial market utilities, securities broker-dealers, credit unions, or insurance companies.

Repo-style transaction means a repurchase or reverse repurchase transaction, or a securities borrowing or securities lending transaction, including a transaction in which the [BANK] acts as agent for a customer and indemnifies the customer against loss, provided that:

(1) The transaction is based solely on liquid and readily marketable securities, cash, or gold;

(2) The transaction is marked-to-market daily and subject to daily margin maintenance requirements;

(3)(i) The transaction is a "securities contract" or "repurchase agreement" under section 555 or 559, respectively, of the Bankruptcy Code (11 U.S.C. 555 or 559), a qualified financial contract under section 11(e)(8) of the Federal Deposit Insurance Act, or a netting contract between or among financial institutions under sections 401-407 of the Federal Deposit Insurance Corporation Improvement Act or the Federal Reserve Board's Regulation EE (12 CFR part 231); or

(ii) If the transaction does not meet the criteria set forth in paragraph (3)(i) of this definition, then either:

(A) The transaction is executed under an agreement that provides the [BANK] the right to accelerate, terminate, and close-out the transaction on a net basis and to liquidate or set-off collateral promptly upon an event of default (including upon an event of receivership, insolvency, liquidation, or similar proceeding) of the counterparty, provided that, in any such case, any exercise of rights under the agreement will not be stayed or avoided under applicable law in the relevant jurisdictions, other than in receivership, conservatorship, resolution under the Federal Deposit Insurance Act, Title II of the Dodd-Frank Act, or under any similar insolvency law applicable to GSEs; or

(B) The transaction is:

(1) Either overnight or unconditionally cancelable at any time by the [BANK]; and

(2) Executed under an agreement that provides the [BANK] the right to accelerate, terminate, and close-out the transaction on a net basis and to liquidate or set-off collateral promptly upon an event of counterparty default; and

(4) The [BANK] has conducted sufficient legal review to conclude with a well-founded basis (and maintains sufficient written documentation of that legal review) that the agreement

meets the requirements of paragraph (3) of this definition and is legal, valid, binding, and enforceable under applicable law in the relevant jurisdictions.

Resecuritization means a securitization in which one or more of the underlying exposures is a securitization exposure.

Resecuritization exposure means:

(1) an on- or off-balance sheet exposure to a resecuritization;

(2) an exposure that directly or indirectly references a resecuritization exposure.

(3) an exposure to an asset-backed commercial paper program is not a resecuritization exposure if either:

(i) the program-wide credit enhancement does not meet the definition of a resecuritization exposure; or

(ii) the entity sponsoring the program fully supports the commercial paper through the provision of liquidity so that the commercial paper holders effectively are exposed to the default risk of the sponsor instead of the underlying exposures.

Residential mortgage exposure means an exposure (other than a securitization exposure, equity exposure, statutory multifamily mortgage, or presold construction loan) that is:

(1) An exposure that is primarily secured by a first or subsequent lien on one-to-four family residential property; or

(2)(i) An exposure with an original and outstanding amount of $1 million or less that is primarily secured by a first or subsequent lien on residential property that is not one-to-four family; and

(ii) For purposes of calculating capital requirements under subpart E, is managed as part of a segment of exposures with homogeneous risk characteristics and not on an individual-exposure basis.

Revenue obligation means a bond or similar obligation that is an obligation of a PSE, but which the PSE is committed to repay with revenues from the specific project financed rather than general tax funds.

Savings and loan holding company means a savings and loan holding company as defined in section 10 of the Home Owners' Loan Act (12 U.S.C. 1467a).

Securities and Exchange Commission (SEC) means the U.S. Securities and Exchange Commission.

Securities Exchange Act means the Securities Exchange Act of 1934 (15 U.S.C. 78).

Securitization exposure means:

(1) An on-balance sheet or off-balance sheet credit exposure (including credit-enhancing representations and warranties) that arises from a traditional securitization or synthetic securitization (including a resecuritization), or

(2) An exposure that directly or indirectly references a securitization exposure described in paragraph (1) of this definition.

Securitization special purpose entity (securitization SPE) means a corporation, trust, or other entity organized for the specific purpose of holding underlying exposures of a

securitization, the activities of which are limited to those appropriate to accomplish this purpose, and the structure of which is intended to isolate the underlying exposures held by the entity from the credit risk of the seller of the underlying exposures to the entity.

Servicer cash advance facility means a facility under which the servicer of the underlying exposures of a securitization may advance cash to ensure an uninterrupted flow of payments to investors in the securitization, including advances made to cover foreclosure costs or other expenses to facilitate the timely collection of the underlying exposures.

Significant investment in the capital of unconsolidated financial institutions means an investment where the [BANK] owns more than 10 percent of the issued and outstanding common shares of the unconsolidated financial institution.

Small Business Act means the Small Business Act (15 U.S.C. 632).

Small Business Investment Act means the Small Business Investment Act of 1958 (15 U.S.C. 682)

Sovereign means a central government (including the U.S. government) or an agency, department, ministry, or central bank of a central government.

Sovereign default means noncompliance by a sovereign with its external debt service obligations or the inability or unwillingness of a sovereign government to service an existing loan according to its original terms, as evidenced by failure to pay principal and interest timely and fully, arrearages, or restructuring.

Sovereign exposure means:

(1) A direct exposure to a sovereign; or

(2) An exposure directly and unconditionally backed by the full faith and credit of a sovereign.

Specific wrong-way risk means wrong-way risk that arises when either (1) the counterparty and issuer of the collateral supporting the transaction, or (2) the counterparty and the reference asset of the transaction, are affiliates or are the same entity.

Standardized market risk-weighted assets means the standardized measure for market risk calculated under §___.204 of subpart F multiplied by 12.5.

Standardized total risk-weighted assets means:

(1) The sum of:

(i) Total risk-weighted assets for general credit risk as calculated under §___.31 of subpart D;

(ii) Total risk-weighted assets for cleared transactions and default fund contributions as calculated under §___.35 of subpart D;

(iii) Total risk-weighted assets for unsettled transactions as calculated under §___.38 of subpart D;

(iv) Total risk-weighted assets for securitization exposures as calculated under §___.42 of subpart D;

(v) Total risk-weighted assets for equity exposures as calculated under §___.52 and §___.53 of subpart D; and

(vi) For a market risk [BANK] only, standardized market risk-weighted assets; minus

(2) Any amount of the [BANK]'s allowance for loan and lease losses that is not included in tier 2 capital.

Statutory multifamily mortgage means a loan secured by a multifamily residential property that meets the requirements under section 618(b)(1) of the Resolution Trust Corporation Refinancing, Restructuring, and Improvement Act of 1991, and that meets the following criteria:

(1) The loan is made in accordance with prudent underwriting standards;

(2) The loan-to-value (LTV) ratio of the loan, calculated in accordance with §___.32(g)(3) of subpart D, does not exceed 80 percent (or 75 percent if the loan is based on an interest rate that changes over the term of the loan);

(3) All principal and interest payments on the loan must have been made on time for at least one year prior to applying a 50 percent risk weight to the loan, or in the case where an existing owner is refinancing a loan on the property, all principal and interest payments on the loan being refinanced must have been made on time for at least one year prior to applying a 50 percent risk weight to the loan;

(4) Amortization of principal and interest on the loan must occur over a period of not more than 30 years and the minimum original maturity for repayment of principal must not be less than 7 years;

(5) Annual net operating income (before debt service on the loan) generated by the property securing the loan during its most recent fiscal year must not be less than 120 percent of the loan's current annual debt service (or 115 percent of current annual debt service if the loan is based on an interest rate that changes over the term of the loan) or, in the case of a cooperative or other not-for-profit housing project, the property must generate sufficient cash flow to provide comparable protection to the [BANK]; and

(6) The loan is not more than 90 days past due, or on nonaccrual.

Subsidiary means, with respect to a company, a company controlled by that company.

Synthetic securitization means a transaction in which:

(1) All or a portion of the credit risk of one or more underlying exposures is transferred to one or more third parties through the use of one or more credit derivatives or guarantees (other than a guarantee that transfers only the credit risk of an individual retail exposure);

(2) The credit risk associated with the underlying exposures has been separated into at least two tranches reflecting different levels of seniority;

(3) Performance of the securitization exposures depends upon the performance of the underlying exposures; and

(4) All or substantially all of the underlying exposures are financial exposures (such as loans, commitments, credit derivatives, guarantees, receivables, asset-backed securities, mortgage-backed securities, other debt securities, or equity securities).

Tier 1 capital means the sum of common equity tier 1 capital and additional tier 1 capital.

Tier 1 minority interest means the tier 1 capital of a consolidated subsidiary of a [BANK] that is not owned by the [BANK].

Tier 2 capital is defined in §___.20 of subpart C.

Total capital means the sum of tier 1 capital and tier 2 capital.

Total capital minority interest means the total capital of a consolidated subsidiary of a [BANK] that is not owned by the [BANK].

Total leverage exposure means the sum of the following:

(1) The balance sheet carrying value of all of the [BANK]'s on-balance sheet assets, less amounts deducted from tier 1 capital;

(2) The potential future exposure amount for each derivative contract to which the [BANK] is a counterparty (or each single-product netting set of such transactions) determined in accordance with §___.34;

(3) 10 percent of the notional amount of unconditionally cancellable commitments made by the [BANK]; and

(4) The notional amount of all other off-balance sheet exposures of the [BANK] (excluding securities lending, securities borrowing, reverse repurchase transactions, derivatives and unconditionally cancellable commitments).

Traditional securitization means a transaction in which:

(1) All or a portion of the credit risk of one or more underlying exposures is transferred to one or more third parties other than through the use of credit derivatives or guarantees;

(2) The credit risk associated with the underlying exposures has been separated into at least two tranches reflecting different levels of seniority;

(3) Performance of the securitization exposures depends upon the performance of the underlying exposures;

(4) All or substantially all of the underlying exposures are financial exposures (such as loans, commitments, credit derivatives, guarantees, receivables, asset-backed securities, mortgage-backed securities, other debt securities, or equity securities);

(5) The underlying exposures are not owned by an operating company;

(6) The underlying exposures are not owned by a small business investment company described in section 302 of the Small Business Investment Act;

(7) The underlying exposures are not owned by a firm an investment in which qualifies as a community development investment under section 24 (Eleventh) of the National Bank Act;

(8) The [AGENCY] may determine that a transaction in which the underlying exposures are owned by an investment firm that exercises substantially unfettered control over the size and composition of its assets, liabilities, and off-balance sheet exposures is not a traditional securitization based on the transaction's leverage, risk profile, or economic substance;

(9) The [AGENCY] may deem a transaction that meets the definition of a traditional securitization, notwithstanding paragraph (5), (6), or (7) of this definition, to be a traditional securitization based on the transaction's leverage, risk profile, or economic substance; and

(10) The transaction is not: (i) an investment fund; (ii) a collective investment fund (as defined in 12 CFR 208.34 (Board), 12 CFR 9.18 (OCC), and 12 CFR 344.3 (FDIC)); (iii) a pension fund regulated under the ERISA or a foreign equivalent thereof; or (iv) regulated under the Investment Company Act of 1940 (15 U.S.C. 80a-1) or a foreign equivalent thereof.

Tranche means all securitization exposures associated with a securitization that have the same seniority level.

Two-way market means a market where there are independent bona fide offers to buy and sell so that a price reasonably related to the last sales price or current bona fide competitive bid and offer quotations can be determined within one day and settled at that price within a relatively short time frame conforming to trade custom.

Unconditionally cancelable means with respect to a commitment, that a [BANK] may, at any time, with or without cause, refuse to extend credit under the commitment (to the extent permitted under applicable law).

Underlying exposures means one or more exposures that have been securitized in a securitization transaction.

U.S. Government agency means an instrumentality of the U.S. Government whose obligations are fully and explicitly guaranteed as to the timely payment of principal and interest by the full faith and credit of the U.S. Government.

Value-at-Risk (VaR) means the estimate of the maximum amount that the value of one or more exposures could decline due to market price or rate movements during a fixed holding period within a stated confidence interval.

Wrong-way risk means the risk that arises when an exposure to a particular counterparty is positively correlated with the probability of default of such counterparty itself.

Text of Common Rule

Part ___ CAPITAL ADEQUACY OF [BANK]s

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Subpart D – Risk Weighted Assets – Standardized Approach

§___.30 Applicability

(a) A market risk [BANK] must exclude from its calculation of risk-weighted assets under this subpart the risk-weighted asset amounts of all covered positions, as defined in subpart F (except foreign exchange positions that are not trading positions, over-the-counter (OTC) derivative positions, cleared transactions, and unsettled transactions).

(b) Beginning on January 1, 2015, a [BANK] must calculate risk-weighted assets under subpart D. Until then, the [BANK] may calculate risk-weighted assets using the methodology described in the general risk-based capital rules under [12 CFR part 3, appendix A, 12 CFR 167 (OCC); 12 CFR part 208, appendix A , 12 CFR part 225, appendix A (Board); 12 CFR part 325, appendix A, and 12 CFR part 390 (FDIC)]. Notwithstanding the above, the [BANK] is subject to the transition provisions under §___.300.

RISK-WEIGHTED ASSETS FOR GENERAL CREDIT RISK

§___.31 Mechanics for Calculating Risk-Weighted Assets for General Credit Risk

(a) General risk-weighting requirements. A [BANK] must apply risk weights to its exposures as follows:

(1) A [BANK] must determine the exposure amount of each on-balance sheet exposure, each OTC derivative contract, and each off-balance sheet commitment, trade and transaction-related contingency, guarantee, repo-style transaction, financial standby letter of credit, forward agreement, or other similar transaction that is not:

(i) An unsettled transaction subject to §___.38;

(ii) A cleared transaction subject to §___.35;

(iii) A default fund contribution subject to §___.35;

(iv) A securitization exposure subject to §§___.41 through ___.45; or

(v) An equity exposure (other than an equity OTC derivative contract) subject to §§___.51 through ___.53.

(2) The [BANK] must multiply each exposure amount by the risk weight appropriate to the exposure based on the exposure type or counterparty, eligible guarantor, or financial collateral to determine the risk-weighted asset amount for each exposure.

(b) Total risk-weighted assets for general credit risk equals the sum of the risk-weighted asset amounts calculated under this section.

§___.32 General Risk Weights

(a) Sovereign exposures. (1) Exposures to the U.S. government. (i) Notwithstanding any other requirement in this subpart, a [BANK] must assign a zero percent risk weight to:

(A) An exposure to the U.S. government, its central bank, or a U.S. government agency; and

(B) The portion of an exposure that is directly and unconditionally guaranteed by the U.S. government, its central bank, or a U.S. government agency.[102]

(ii) A [BANK] must assign a 20 percent risk weight to the portion of an exposure that is conditionally guaranteed by the U.S. government, its central bank, or a U.S. government agency.

(2) Other sovereign exposures. A [BANK] must assign a risk weight to a sovereign exposure based on the Country Risk Classification (CRC) applicable to the sovereign in accordance with Table 1.

[102] Under this section, a [BANK] must assign a zero percent risk weight to a deposit, or the portion of a deposit, that is insured by the FDIC or National Credit Union Administration.

TABLE 1 – RISK WEIGHTS FOR SOVEREIGN EXPOSURES

		Risk Weight (in percent)
Sovereign CRC	0-1	0
	2	20
	3	50
	4-6	100
	7	150
No CRC		100
Sovereign Default		150

(3) Certain sovereign exposures. Notwithstanding §___.32(a)(2), a [BANK] may assign to a sovereign exposure a risk weight that is lower than the applicable risk weight in Table 1 if:

(i) The exposure is denominated in the sovereign's currency;

(ii) The [BANK] has at least an equivalent amount of liabilities in that currency; and

(iii) The risk weight is not lower than the risk weight that the sovereign allows [BANK]s under its jurisdiction to assign to the same exposures to the sovereign.

(4) Sovereign exposures with no CRC. Except as provided in §___.32(a)(5), a [BANK] must assign a 100 percent risk weight to a sovereign exposure if the sovereign does not have a CRC assigned to it.

(5) Sovereign default. A [BANK] must assign a 150 percent risk weight to a sovereign exposure immediately upon determining that an event of sovereign default has occurred, or if an event of sovereign default has occurred during the previous five years.

(b) Certain supranational entities and Multilateral Development Banks (MDBs). A [BANK] must assign a zero percent risk weight to an exposure to the Bank for International Settlements, the European Central Bank, the European Commission, the International Monetary Fund, or an MDB.

(c) Exposures to government-sponsored entities (GSEs). (1) A [BANK] must assign a 20 percent risk weight to an exposure to a GSE that is not an equity exposure.

(2) A [BANK] must assign a 100 percent risk weight to preferred stock issued by a GSE.

(d) Exposures to depository institutions, foreign banks, and credit unions. (1) Exposures to U.S. depository institutions and credit unions. A [BANK] must assign a 20 percent risk weight to an exposure to a depository institution or credit union that is organized under the laws of the United States or any state thereof, except as otherwise provided under §___.32 (d)(3).

(2) Exposures to foreign banks. (i) Except as otherwise provided under §§___.32(d)(2)(ii) and (d)(3), a [BANK] must assign a risk weight to an exposure to a foreign bank using the CRC rating that corresponds to the foreign bank's home country in accordance with Table 2.

TABLE 2 – RISK WEIGHTS FOR EXPOSURES TO FOREIGN BANKS

		Risk Weight (in percent)
Sovereign CRC	0-1	20
	2	50
	3	100
	4-7	150
No CRC		100
Sovereign Default		150

(ii) A [BANK] must assign a 100 percent risk weight to an exposure to a foreign bank whose home country does not have a CRC, with the exception of self-liquidating, trade-related contingent items that arise from the movement of goods, and that have a maturity of three months or less, which may be assigned a 20 percent risk weight.

(iii) A [BANK] must assign a 150 percent risk weight to an exposure to a foreign bank immediately upon determining that an event of sovereign default has occurred in the bank's

home country, or if an event of sovereign default has occurred in the foreign bank's home country during the previous five years.

(3) A [BANK] must assign a 100 percent risk weight to an exposure to a financial institution that is includable in that financial institution's capital unless the exposure is:

(i) An equity exposure;

(ii) A significant investment in the capital of an unconsolidated financial institution in the form of common stock pursuant to §___.22(d)(iii);

(iii) Is deducted from regulatory capital under §___.22 of the proposal; and

(iv) Subject to a 150 percent risk weight under Table 2 of §___.32(d)(2).

(e) Exposures to public sector entities (PSEs). (1) Exposures to U.S. PSEs. (i) A [BANK] must assign a 20 percent risk weight to a general obligation exposure to a PSE that is organized under the laws of the United States or any state or political subdivision thereof.

(ii) A [BANK] must assign a 50 percent risk weight to a revenue obligation exposure to a PSE that is organized under the laws of the United States or any state or political subdivision thereof.

(2) Exposures to foreign PSEs. (i) Except as provided in §§___.32(e)(1) and (e)(3), a [BANK] must assign a risk weight to a general obligation exposure to a PSE based on the CRC that corresponds to the PSE's home country, as set forth in Table 3.

(ii) Except as provided in §§___.32(e)(1) and (e)(3), a [BANK] must assign a risk weight to a revenue obligation exposure to a PSE based on the CRC that corresponds to the PSE's home country, as set forth in Table 4.

(3) A [BANK] may assign a lower risk weight than would otherwise apply under Table 3 and 4 to an exposure to a foreign PSE if:

(i) The PSE's home country allows banks under its jurisdiction to assign a lower risk weight to such exposures; and

(ii) The risk weight is not lower than the risk weight that corresponds to the PSE's home country in accordance with Table 1.

TABLE 3 – RISK WEIGHTS FOR NON-U.S. PSE GENERAL OBLIGATIONS

		Risk Weight (in percent)
Sovereign CRC	0-1	20
	2	50
	3	100
	4-7	150
No CRC		100
Sovereign Default		150

TABLE 4 – RISK WEIGHTS FOR NON-U.S. PSE REVENUE OBLIGATIONS

		Risk Weight (in percent)
Sovereign CRC	0-1	50
	2-3	100
	4-7	150
No CRC		100
Sovereign Default		150

(4) A [BANK] must assign a 100 percent risk weight to an exposure to a PSE whose home country does not have a CRC.

(5) A [BANK] must assign a 150 percent risk weight to a PSE exposure immediately upon determining that an event of sovereign default has occurred in a PSE's home country or if an event of sovereign default has occurred in the PSE's home country during the previous five years.

(f) Corporate exposures. A [BANK] must assign a 100 percent risk weight to all its corporate exposures.

(g) Residential mortgage exposures. (1) General Requirement. A [BANK] must assign to a residential mortgage exposure the applicable risk weight in Table 6, using the loan-to-value (LTV) ratio described in §___.32(g)(3).

(2) Restructured or modified mortgages. (i) If a residential mortgage exposure is restructured or modified, the [BANK] must classify the residential mortgage exposure as a category 1 residential mortgage exposure or category 2 residential mortgage exposure in accordance with the terms and characteristics of the exposure after the modification or restructuring.

(ii) A [BANK] may assign a risk weight lower than 100 percent to a category 1 residential mortgage exposure after the exposure has been modified or restructured only if (A) the residential mortgage exposure continues to meet category 1 criteria and (B) the [BANK] updates the LTV ratio at the time of restructuring, as provided under r §___.32(g)(3).

(iii) A [BANK] may assign a risk weight lower than 200 percent to a category 2 residential mortgage exposure after the exposure has been modified or restructured only if the [BANK] updates the LTV ratio at the time of restructuring as provided under §___.32 (g)(3).

TABLE 6 – RISK WEIGHTS FOR RESIDENTIAL MORTGAGE EXPOSURES

Loan-to-value ratio (in percent)	Category 1 residential mortgage exposure (in percent)	Category 2 residential mortgage exposure (in percent)
Less than or equal to 60	35	100
Greater than 60 and less than or equal to 80	50	100
Greater than 80 and less than or equal to 90	75	150
Greater than 90	100	200

(3) LTV ratio calculation. To determine the LTV ratio of a residential mortgage loan for the purpose of this section, a [BANK] must divide the loan amount by the value of the property,

as described in this section. A [BANK] must assign a risk weight to the exposure according to its respective LTV ratio.

(i) Loan amount for calculating the LTV ratio of a residential mortgage exposure. (A) First-lien residential mortgage exposure. The loan amount of a first-lien residential mortgage exposure is the unpaid principal balance of the loan. If the first-lien residential mortgage exposure is a combination of a first and junior lien, the loan amount is the maximum contractual principal amount of the exposure.

(B) Junior-lien residential mortgage exposure. The loan amount of a junior-lien residential mortgage exposure is the maximum contractual principal amount of the exposure, plus the maximum contractual principal amounts of all senior exposures secured by the same residential property on the date of origination of the junior-lien residential mortgage exposure.

(ii) Value. (A) The value of the property is the lesser of the actual acquisition cost (for a purchase transaction) or the estimate of the property's value at the origination of the loan or at the time of restructuring or modification.

(B) A [BANK] must base all estimates of a property's value on an appraisal or evaluation of the property that satisfies 12 CFR part 34, subpart C, 12 CFR part 164 (OCC); 12 CFR part 208, subpart E (Board); 12 CFR part 323, 12 CFR 390.442 (FDIC).

(4) Loans modified pursuant to the Home Affordable Mortgage Program. A loan modified or restructured on a permanent or trial basis solely pursuant to the U.S. Treasury's Home Affordable Mortgage Program is not modified or restructured for purposes of this section.

(h) Pre-sold residential construction loans. A [BANK] must assign a 50 percent risk weight to a pre-sold construction loan unless the purchase contract is cancelled. A [BANK] must assign a 100 percent risk weight to such loan if the purchase contract is cancelled.

(i) Statutory multifamily mortgages. A [BANK] must assign a 50 percent risk weight to a statutory multifamily mortgage.

(j) High-volatility commercial real estate (HVCRE) exposures. A [BANK] must assign a 150 percent risk weight to an HVCRE exposure.

(k) Past due exposures. Except for a sovereign exposure or a residential mortgage exposure, if an exposure is 90 days or more past due or on nonaccrual:

(1) A [BANK] must assign a 150 percent risk weight to the portion of the exposure that is not guaranteed or that is unsecured.

(2) A [BANK] may assign a risk weight to the collateralized portion of a past due exposure based on the risk weight that applies under §___.37 if the collateral meets the requirements of that section.

(3) A [BANK] may assign a risk weight to the guaranteed portion of a past due exposure based on the risk weight that applies under §___.36 if the guarantee or credit derivative meets the requirements of that section.

(l) Other assets. (1) A [BANK] must assign a zero percent risk weight to cash owned and held in all offices of the [BANK] or in transit; to gold bullion held in the [BANK]'s own vaults or held in another depository institution's vaults on an allocated basis, to the extent the gold bullion assets are offset by gold bullion liabilities, and to exposures that arise from the settlement of cash transactions (such as equities, fixed income, spot FX and spot commodities) with a central counterparty where there is no assumption of ongoing counterparty credit risk by the central counterparty after settlement of the trade and associated default fund contributions.

(2) A [BANK] must assign a 20 percent risk weight to cash items in the process of collection.

(3) A [BANK] must assign a 100 percent risk weight to DTAs arising from temporary differences that the [BANK] could realize through net operating loss carrybacks.

(4) A [BANK] must assign a 250 percent risk weight to MSAs and DTAs arising from temporary differences that the [BANK] could not realize through net operating loss carrybacks that are not deducted from common equity tier 1 capital pursuant to §___.22(d).

(5) A [BANK] must assign a 100 percent risk weight to all assets not specifically assigned a different risk weight under this subpart (other than exposures that are deducted from tier 1 or tier 2 capital).

(6) Notwithstanding the requirements of this section, a [BANK] may assign an asset that is not included in one of the categories provided in this section to the risk weight category applicable under the capital rules applicable to bank holding companies and savings and loan holding companies at 12 CFR 217, provided that all of the following conditions apply:

(i) The [BANK] is not authorized to hold the asset under applicable law other than debt previously contracted or similar authority; and

(ii) The risks associated with the asset are substantially similar to the risks of assets that are otherwise assigned to a risk weight category of less than 100 percent under this subpart.

§___.33 Off-balance Sheet Exposures

(a) General. (1) A [BANK] must calculate the exposure amount of an off-balance sheet exposure using the credit conversion factors (CCFs) in §___.33(b).

(2) Where a [BANK] commits to provide a commitment, the [BANK] may apply the lower of the two applicable CCFs.

(3) Where a [BANK] provides a commitment structured as a syndication or participation, the [BANK] is only required to calculate the exposure amount for its pro rata share of the commitment.

(b) Credit conversion factors. (1) Zero percent CCF. A [BANK] must apply a zero percent CCF to the unused portion of commitments that are unconditionally cancelable by the [BANK].

(2) 20 percent CCF. A [BANK] must apply a 20 percent CCF to:

(i) Commitments with an original maturity of one year or less that are not unconditionally cancelable by the [BANK].

(ii) Self-liquidating, trade-related contingent items that arise from the movement of goods, with an original maturity of one year or less.

(3) 50 percent CCF. A [BANK] must apply a 50 percent CCF to:

(i) Commitments with an original maturity of more than one year that are not unconditionally cancelable by the [BANK].

(ii) Transaction-related contingent items, including performance bonds, bid bonds, warranties, and performance standby letters of credit.

(4) 100 percent CCF. A [BANK] must apply a 100 percent CCF to the following off-balance-sheet items and other similar transactions:

(i) Guarantees;

(ii) Repurchase agreements (the off-balance sheet component of which equals the sum of the current market values of all positions the [BANK] has sold subject to repurchase);

(iii) Off-balance sheet securities lending transactions (the off-balance sheet component of which equals the sum of the current market values of all positions the [BANK] has lent under the transaction);

(iv) Off-balance sheet securities borrowing transactions (the off-balance sheet component of which equals the sum of the current market values of all non-cash positions the [BANK] has posted as collateral under the transaction);

(v) Financial standby letters of credit; and

(vi) Forward agreements.

§___. 34 OTC Derivative Contracts

(a) Exposure amount. (1) Single OTC derivative contract. Except as modified by §___. 34(b), the exposure amount for a single OTC derivative contract that is not subject to a qualifying master netting agreement is equal to the sum of the [BANK]'s current credit exposure and potential future credit exposure (PFE) on the OTC derivative contract.

(i) Current credit exposure. The current credit exposure for a single OTC derivative contract is the greater of the mark-to-market value of the OTC derivative contract or zero.

(ii) PFE. (A) The PFE for a single OTC derivative contract, including an OTC derivative contract with a negative mark-to-market value, is calculated by multiplying the notional principal amount of the OTC derivative contract by the appropriate conversion factor in Table 7.

(B) For purposes of calculating either the PFE under this paragraph or the gross PFE under §___.34(a)(2) for exchange rate contracts and other similar contracts in which the notional principal amount is equivalent to the cash flows, notional principal amount is the net receipts to each party falling due on each value date in each currency.

(C) For an OTC derivative contract that does not fall within one of the specified categories in Table 7, the PFE must be calculated using the appropriate "other" conversion factor.

(D) A [BANK] must use an OTC derivative contract's effective notional principal amount (that is, the apparent or stated notional principal amount multiplied by any multiplier in the OTC derivative contract) rather than the apparent or stated notional principal amount in calculating PFE.

(E) The PFE of the protection provider of a credit derivative is capped at the net present value of the amount of unpaid premiums.

TABLE 7 – CONVERSION FACTOR MATRIX FOR DERIVATIVE CONTRACTS[1]

Remaining maturity[2]	Interest rate	Foreign exchange rate and gold	Credit (investment grade reference asset)[3]	Credit (non-investment-grade reference asset)	Equity	Precious metals (except gold)	Other
One year or less	0.00	0.01	0.05	0.10	0.06	0.07	0.10
Greater than one year and less than or equal to five years	0.005	0.05	0.05	0.10	0.08	0.07	0.12
Greater than five years	0.015	0.075	0.05	0.10	0.10	0.08	0.15

[1] For a derivative contract with multiple exchanges of principal, the conversion factor is multiplied by the number of remaining payments in the derivative contract.

[2] For an OTC derivative contract that is structured such that on specified dates any outstanding exposure is settled and the terms are reset so that the market value of the contract is zero, the remaining maturity equals the time until the next reset date. For an interest rate derivative contract with a remaining maturity of greater than one year that meets these criteria, the minimum conversion factor is 0.005.

[3] A [BANK] must use the column labeled "Credit (investment-grade reference asset)" for a credit derivative whose reference asset is an outstanding unsecured long-term debt security without credit enhancement that is investment grade. A [BANK] must use the column labeled "Credit (non-investment-grade reference asset)" for all other credit derivatives.

(2) Multiple OTC derivative contracts subject to a qualifying master netting agreement. Except as modified by §___.34(b), the exposure amount for multiple OTC derivative contracts subject to a qualifying master netting agreement is equal to the sum of the net current credit exposure and the adjusted sum of the PFE amounts for all OTC derivative contracts subject to the qualifying master netting agreement.

(i) Net current credit exposure. The net current credit exposure is the greater of the net sum of all positive and negative mark-to-market values of the individual OTC derivative contracts subject to the qualifying master netting agreement or zero.

(ii) Adjusted sum of the PFE amounts. The adjusted sum of the PFE amounts, Anet, is calculated as Anet = (0.4×Agross) + (0.6×NGR×Agross), where:

(A) Agross = the gross PFE (that is, the sum of the PFE amounts (as determined under §___.34(a)(1)(ii) for each individual derivative contract subject to the qualifying master netting agreement); and

(B) Net-to-gross Ratio (NGR) = the net to gross ratio (that is, the ratio of the net current credit exposure to the gross current credit exposure). In calculating the NGR, the gross current credit exposure equals the sum of the positive current credit exposures (as determined under §___.34(a)(1)(i)) of all individual derivative contracts subject to the qualifying master netting agreement).

(b) Recognition of credit risk mitigation of collateralized OTC derivative contracts: (1) A [BANK] may recognize the credit risk mitigation benefits of financial collateral that secures an OTC derivative contract or multiple OTC derivative contracts subject to a qualifying master netting agreement (netting set) by using the simple approach in §___.37(b).

(2) As an alternative to the simple approach, a [BANK] may recognize the credit risk mitigation benefits of financial collateral that secures such a contract or netting set if the financial collateral is marked-to-market on a daily basis and subject to a daily margin maintenance requirement by applying a risk weight to the exposure as if it is uncollateralized and adjusting the exposure amount calculated under §___.34(a)(i) or (ii) using the collateral haircut approach in §___.37(c). The [BANK] must substitute the exposure amount calculated under §___. 34(a)(i) or (ii) for ∑E in the equation in §___.37(c)(2).

(c) Counterparty credit risk for OTC credit derivatives. (1) Protection purchasers. A [BANK] that purchases an OTC credit derivative that is recognized under §___.36 as a credit risk mitigant for an exposure that is not a covered position under subpart F is not required to compute a separate counterparty credit risk capital requirement under §___.32 provided that the [BANK] does so consistently for all such credit derivatives. The [BANK] must either include all

or exclude all such credit derivatives that are subject to a qualifying master netting agreement from any measure used to determine counterparty credit risk exposure to all relevant counterparties for risk-based capital purposes.

(2) Protection providers. (i) A [BANK] that is the protection provider under an OTC credit derivative must treat the OTC credit derivative as an exposure to the underlying reference asset. The [BANK] is not required to compute a counterparty credit risk capital requirement for the OTC credit derivative under §___.32, provided that this treatment is applied consistently for all such OTC credit derivatives. The [BANK] must either include all or exclude all such OTC credit derivatives that are subject to a qualifying master netting agreement from any measure used to determine counterparty credit risk exposure.

(ii) The provisions of §___.34(c)(2) apply to all relevant counterparties for risk-based capital purposes unless the [BANK] is treating the OTC credit derivative as a covered position under subpart F, in which case the [BANK] must compute a supplemental counterparty credit risk capital requirement under this section.

(d) Counterparty credit risk for OTC equity derivatives. (1) A [BANK] must treat an OTC equity derivative contract as an equity exposure and compute a risk-weighted asset amount for the OTC equity derivative contract under §§___.51 through ___.53 (unless the [BANK] is treating the contract as a covered position under subpart F).

(2) In addition, the [BANK] must also calculate a risk-based capital requirement for the counterparty credit risk of an OTC equity derivative contract under this section if the [BANK] is treating the contract as a covered position under subpart F.

(3) If the [BANK] risk weights the contract under the Simple Risk-Weight Approach (SRWA) in §___.52, the [BANK] may choose not to hold risk-based capital against the counterparty credit risk of the OTC equity derivative contract, as long as it does so for all such contracts. Where the OTC equity derivative contracts are subject to a qualified master netting agreement, a [BANK] using the SRWA must either include all or exclude all of the contracts from any measure used to determine counterparty credit risk exposure.

§___. 35 Cleared Transactions

(a) Requirements. (1) A [BANK] that is a clearing member client must use the methodologies described in §___.35(b) to calculate risk-weighted assets for a cleared transaction.

(2) A [BANK] that is a clearing member must use the methodologies described in §___.35(c) to calculate its risk-weighted assets for cleared transactions and §___.35(d) to calculate its risk-weighted assets for its default fund contribution to a CCP.

(b) Clearing member client [BANK]s. (1) Risk-weighted assets for cleared transactions. (i) To determine the risk-weighted asset amount for a cleared transaction, a [BANK] that is a clearing member client must multiply the trade exposure amount for the cleared transaction, calculated in accordance with §___.35(b)(2), by the risk weight appropriate for the cleared transaction, determined in accordance with §___.35(b)(3).

(ii) A clearing member client [BANK]'s total risk-weighted assets for cleared transactions is the sum of the risk-weighted asset amounts for all its cleared transactions.

(2) Trade exposure amount. (i) For a cleared transaction that is a derivative contract or netting set of derivative contracts, the trade exposure amount equals:

(A) The exposure amount for the derivative contract or netting set of derivative contracts, calculated using the methodology used to calculate exposure amount for OTC derivative contracts under §___.34, plus

(B) the fair value of the collateral posted by the clearing member client [BANK] and held by the CCP or a clearing member in a manner that is not bankruptcy remote.

(ii) For a cleared transaction that is a repo-style transaction, the trade exposure amount equals:

(A) The exposure amount for the repo-style transaction calculated using the methodologies under §___.37(c), plus

(B) The fair value of the collateral posted by the clearing member client and held by the CCP or a clearing member in a manner that is not bankruptcy remote.

(3) Cleared transaction risk weights. (i) For a cleared transaction with a QCCP, a clearing member client [BANK] must apply a risk weight of:

(A) 2 percent if the collateral posted by the [BANK] to the QCCP or clearing member is subject to an arrangement that prevents any losses to the clearing member client due to the joint default or a concurrent insolvency, liquidation, or receivership proceeding of the clearing member and any other clearing member clients of the clearing member; and the clearing member client [BANK] has conducted sufficient legal review to conclude with a well-founded basis (and maintains sufficient written documentation of that legal review) that in the event of a legal challenge (including one resulting from default or from liquidation, insolvency, or receivership proceeding) the relevant court and administrative authorities would find the arrangements to be legal, valid, binding and enforceable under the law of the relevant jurisdictions; or

(B) 4 percent in all other circumstances.

(ii) For a cleared transaction with a CCP that is not a QCCP, a clearing member client [BANK] must apply the risk weight appropriate for the CCP according to §___.32.

(4) Collateral. (i) Notwithstanding any other requirements in this section, collateral posted by a clearing member client [BANK] that is held by a custodian in a manner that is bankruptcy remote from the CCP, clearing member and other clearing member clients of the clearing member, is not subject to a capital requirement under this section.

(ii) A [BANK] must calculate a risk-weighted asset amount for any collateral provided to a CCP, clearing member or a custodian in connection with a cleared transaction in accordance with the requirements under §___.32.

(c) Clearing member [BANK]s. (1) Risk-weighted assets for cleared transactions. (i) To determine the risk-weighted asset amount for a cleared transaction, a clearing member [BANK] must multiply the trade exposure amount for the cleared transaction, calculated in accordance with §___.35(c)(2), by the risk weight appropriate for the cleared transaction, determined in accordance with §___.35(c)(3).

(ii) A clearing member [BANK]'s total risk-weighted assets for cleared transactions is the sum of the risk-weighted asset amounts for all of its cleared transactions.

(2) Trade exposure amount. A clearing member [BANK] must calculate its trade exposure amount for a cleared transaction as follows:

(i) For a derivative contract that is a cleared transaction, the trade exposure amount equals:

(A) The exposure amount for the derivative contract, calculated using the methodology to calculate exposure amount for OTC derivative contracts under §___.34, plus

(B) The fair value of the collateral posted by the clearing member [BANK] and held by the CCP in a manner that is not bankruptcy remote.

(ii) For a repo-style transaction that is a cleared transaction, trade exposure amount equals:

(A) The exposure amount for repo-style transactions calculated using methodologies under §___.37(c), plus

(B) The fair value of the collateral posted by the clearing member [BANK] and held by the CCP in a manner that is not bankruptcy remote.

(3) Cleared transaction risk weight. (i) For a cleared transaction with a QCCP, a clearing member [BANK] must apply a risk weight of 2 percent.

(ii) For a cleared transaction with a CCP that is not a QCCP, a clearing member [BANK] must apply the risk weight appropriate for the CCP according to §___.32.

(4) Collateral. (i) Notwithstanding any other requirement in this section, collateral posted by a clearing member [BANK] that is held by a custodian in a manner that is bankruptcy remote from the CCP is not subject to a capital requirement under this section.

(ii) A [BANK] must calculate a risk-weighted asset amount for any collateral provided to a CCP, clearing member or a custodian in connection with a cleared transaction in accordance with requirements under §___.32.

(d) Default fund contributions. (1) General requirement. A clearing member [BANK] must determine the risk-weighted asset amount for a default fund contribution to a CCP at least quarterly, or more frequently if, in the opinion of the [BANK] or the [AGENCY], there is a material change in the financial condition of the CCP.

(2) Risk-weighted asset amount for default fund contributions to non-qualifying CCPs. A clearing member [BANK]'s risk-weighted asset amount for default fund contributions to CCPs that are not QCCPs equals the sum of such default fund contributions multiplied by 1,250 percent.

(3) Risk-weighted asset amount for default fund contributions to QCCPs. A clearing member [BANK]'s risk-weighted asset amount for default fund contributions to QCCPs equals the sum of its capital requirement, K_{CM} for each QCCP, as calculated under §___.35(d)(3)(i), multiplied by 1,250 percent.

(i) The hypothetical capital requirement of a QCCP (K_{CCP}) equals:

$$K_{CCP} = \sum_{clearing\ member\ i} \max\left(EBRM_i - VM_i - IM_i - DF_i; 0\right) \times RW \times 0.08$$

Where

(A) $EBRM_i$ = the exposure amount for each transaction cleared through the QCCP by clearing member i, calculated in accordance with §___.34 for derivative transactions and §___.37(c)(2) for repo-style transactions, provided that:

(1) For purposes of this section, in calculating the exposure amount the [BANK] may replace the formula provided in §___.34 with the following: Anet = (0.3 x Agross) + (0.7 x NGR x Agross) or, if the [BANK] cannot calculate NGR, it may use a value of 0.30 until March 31, 2013; and

(2) For derivative contracts that are options, the PFE described in §___.34(b)(2) must be adjusted by multiplying the notional principal amount of the derivative contract by the appropriate conversion factor in Table 7 and the absolute value of the option's delta, that is, the ratio of the change in the value of the derivative contract to the corresponding change in the price of the underlying asset.

(B) VM_i = any collateral posted by clearing member i to the QCCP that it is entitled to receive from the QCCP, but has not yet received, and any collateral that the QCCP is entitled to receive from clearing member i, but has not yet received;

(C) IM_i = the collateral posted as initial margin by clearing member i to the QCCP;

(D) DF_i = the funded portion of clearing member i's default fund contribution that will be applied to reduce the QCCP's loss upon a default by clearing member i; and

(E) RW = 20 percent, except when the [AGENCY] has determined that a higher risk weight is more appropriate based on the specific characteristics of the QCCP and its clearing members.

(ii) For a [BANK] that is a clearing member of a QCCP with a default fund supported by funded commitments, K_{CM} equals:

$$K_{CM_i} = \left((1+\beta) \cdot \frac{N}{N-2} \right) \cdot \frac{DF_i}{DF_{CM}} \cdot K_{CM}^*$$

$$K_{CM}^* = \begin{cases} c_2 \cdot \mu \cdot (K_{CCP} - DF') + c_2 \cdot DF_{CM}' & if \quad DF' < K_{CCP} \quad (i) \\ c_2 \cdot (K_{CCP} - DF_{CCP}) + c_1 \cdot (DF' - K_{CCP}) & if \quad DF_{CCP} < K_{CCP} \le DF' \quad (ii) \\ c_1 \cdot DF_{CM}' & if \quad K_{CCP} \le DF_{CCP} \quad (iii) \end{cases}$$

Where

(A) $\beta = \dfrac{A_{Net,1} + A_{Net,2}}{\sum_i A_{Net,i}}$

Subscripts 1 and 2 denote the clearing members with the two largest A_{Net} values. For purposes of this paragraph, for derivatives A_{Net} is defined in §___.34(a)(2)(ii) and for repo-style transactions, A_{Net} means the exposure amount as defined in §___.37(c)(2);

(B) N =the number of clearing members in the QCCP;

(C) DF_{CCP} = the QCCP's own funds and other financial resources that would be used to cover its losses before clearing members' default fund contributions are used to cover losses;

(D) DF_{CM} = funded default fund contributions from all clearing members and any other clearing member contributed financial resources that are available to absorb mutualized QCCP losses;

(E) $DF = DF_{CCP} + DF_{CM}$ (that is, the total funded default fund contribution);

(F) $\overline{DF_i}$ = average $\overline{DF_i}$ = the average funded default fund contribution from an individual clearing member;

(G) $DF_{CM}' = DF_{CM} - 2 \cdot \overline{DF_i} = \sum_i DF_i - 2 \cdot \overline{DF_i}$ (that is, the funded default fund contribution from surviving clearing members assuming that two average clearing members have defaulted and their default fund contributions and initial margins have been used to absorb the resulting losses);

(H) $DF' = DF_{CCP} + DF_{CM}' = DF - 2 \cdot \overline{DF_i}$ (that is, the total funded default fund contributions from the QCCP and the surviving clearing members that are available to mutualize losses, assuming that two average clearing members have defaulted);

(I) ; $c_1 = Max\left\{\frac{1.6\%}{\left(DF'/K_{CCP}\right)^{0.3}};0.16\%\right\}$ (that is, a decreasing capital factor, between 0.16 percent and 1.6 percent, applied to the excess funded default funds provided by clearing members);

(J) c_2 = 100 percent; and

(K) μ= 1.2;

(iii) (A) For a [BANK] that is a clearing member of a QCCP with a default fund supported by unfunded commitments, K_{CM} equals:

$$K_{CM_i} = \frac{DF_i}{DF_{CM}} \cdot K_{CM}^*$$

Where

(1) DF_i = the [BANK]'s unfunded commitment to the default fund;

(2) DF_{CM} = the total of all clearing members' unfunded commitment to the default fund; and

(3) K_{CM}^* as defined in §___.35(d)(3)(ii).

(B) For a [BANK] that is a clearing member of a QCCP with a default fund supported by unfunded commitments and is unable to calculate K_{CM} using the methodology described in §___.35(d)(3)(iii), K_{CM} equals:

$$K_{CM_i} = \frac{IM_i}{IM_{CM}} \cdot K_{CM}^*$$

Where

(1) IM_i = the [BANK]'s initial margin posted to the QCCP;

(2) IM_{CM} = the total of initial margin posted to the QCCP; and

(3) K_{CM}^* as defined in §___.35(d)(3)(ii).

(4) Total risk-weighted assets for default fund contributions. Total risk-weighted assets for default fund contributions is the sum of a clearing member [BANK]'s risk-weighted assets for all of its default fund contributions to all CCPs of which the [BANK] is a clearing member.

§___.36 Guarantees and Credit Derivatives: Substitution Treatment

(a) Scope. (1) General. A [BANK] may recognize the credit risk mitigation benefits of an eligible guarantee or eligible credit derivative by substituting the risk weight associated with the protection provider for the risk weight assigned to an exposure, as provided under this section.

(2) This section applies to exposures for which:

(i) Credit risk is fully covered by an eligible guarantee or eligible credit derivative; or

(ii) Credit risk is covered on a pro rata basis (that is, on a basis in which the [BANK] and the protection provider share losses proportionately) by an eligible guarantee or eligible credit derivative.

(3) Exposures on which there is a tranching of credit risk (reflecting at least two different levels of seniority) generally are securitization exposures subject to §§___.41 through ___.45.

(4) If multiple eligible guarantees or eligible credit derivatives cover a single exposure described in this section, a [BANK] may treat the hedged exposure as multiple separate exposures each covered by a single eligible guarantee or eligible credit derivative and may calculate a separate risk-weighted asset amount for each separate exposure as described in §___.36(c).

(5) If a single eligible guarantee or eligible credit derivative covers multiple hedged exposures described in §___.36(a)(2), a [BANK] must treat each hedged exposure as covered by a separate eligible guarantee or eligible credit derivative and must calculate a separate risk-weighted asset amount for each exposure as described in §___.36(c).

(b) Rules of recognition. (1) A [BANK] may only recognize the credit risk mitigation benefits of eligible guarantees and eligible credit derivatives.

(2) A [BANK] may only recognize the credit risk mitigation benefits of an eligible credit derivative to hedge an exposure that is different from the credit derivative's reference exposure used for determining the derivative's cash settlement value, deliverable obligation, or occurrence of a credit event if:

(i) The reference exposure ranks pari passu with, or is subordinated to, the hedged exposure; and

(ii) The reference exposure and the hedged exposure are to the same legal entity, and legally enforceable cross-default or cross-acceleration clauses are in place to ensure payments under the credit derivative are triggered when the obligated party of the hedged exposure fails to pay under the terms of the hedged exposure.

(c) Substitution approach. (1) Full coverage. If an eligible guarantee or eligible credit derivative meets the conditions in §§___.36(a) and ___.36(b) and the protection amount (P) of the guarantee or credit derivative is greater than or equal to the exposure amount of the hedged exposure, a [BANK] may recognize the guarantee or credit derivative in determining the risk-weighted asset amount for the hedged exposure by substituting the risk weight applicable to the

guarantor or credit derivative protection provider under §___.32 for the risk weight assigned to the exposure.

(2) Partial coverage. If an eligible guarantee or eligible credit derivative meets the conditions in §§___.36(a) and ___.37(b) and the protection amount (P) of the guarantee or credit derivative is less than the exposure amount of the hedged exposure, the [BANK] must treat the hedged exposure as two separate exposures (protected and unprotected) in order to recognize the credit risk mitigation benefit of the guarantee or credit derivative.

(i) The [BANK] may calculate the risk-weighted asset amount for the protected exposure under §___.32, where the applicable risk weight is the risk weight applicable to the guarantor or credit derivative protection provider. (ii) The [BANK] must calculate the risk-weighted asset amount for the unprotected exposure under §___.32, where the applicable risk weight is that of the unprotected portion of the hedged exposure.

(ii) The treatment provided in this section is applicable when the credit risk of an exposure is covered on a partial pro rata basis and may be applicable when an adjustment is made to the effective notional amount of the guarantee or credit derivative under §§___.36(d), (e), or (f).

(d) Maturity mismatch adjustment. (1) A [BANK] that recognizes an eligible guarantee or eligible credit derivative in determining the risk-weighted asset amount for a hedged exposure must adjust the effective notional amount of the credit risk mitigant to reflect any maturity mismatch between the hedged exposure and the credit risk mitigant.

(2) A maturity mismatch occurs when the residual maturity of a credit risk mitigant is less than that of the hedged exposure(s).

(3) The residual maturity of a hedged exposure is the longest possible remaining time before the obligated party of the hedged exposure is scheduled to fulfil its obligation on the hedged exposure. If a credit risk mitigant has embedded options that may reduce its term, the [BANK] (protection purchaser) must use the shortest possible residual maturity for the credit risk mitigant. If a call is at the discretion of the protection provider, the residual maturity of the credit risk mitigant is at the first call date. If the call is at the discretion of the [BANK] (protection purchaser), but the terms of the arrangement at origination of the credit risk mitigant contain a positive incentive for the [BANK] to call the transaction before contractual maturity, the remaining time to the first call date is the residual maturity of the credit risk mitigant.

(4) A credit risk mitigant with a maturity mismatch may be recognized only if its original maturity is greater than or equal to one year and its residual maturity is greater than three months.

(5) When a maturity mismatch exists, the [BANK] must apply the following adjustment to reduce the effective notional amount of the credit risk mitigant: $Pm = E \times (t-0.25)/(T-0.25)$, where:

(i) Pm = effective notional amount of the credit risk mitigant, adjusted for maturity mismatch;

(ii) E = effective notional amount of the credit risk mitigant;

(iii) t = the lesser of T or the residual maturity of the credit risk mitigant, expressed in years; and

(iv) T = the lesser of five or the residual maturity of the hedged exposure, expressed in years.

(e) Adjustment for credit derivatives without restructuring as a credit event. If a [BANK] recognizes an eligible credit derivative that does not include as a credit event a restructuring of the hedged exposure involving forgiveness or postponement of principal, interest, or fees that results in a credit loss event (that is, a charge-off, specific provision, or other similar debit to the profit and loss account), the [BANK] must apply the following adjustment to reduce the effective notional amount of the credit derivative: Pr = Pm x 0.60, where:

(1) Pr = effective notional amount of the credit risk mitigant, adjusted for lack of restructuring event (and maturity mismatch, if applicable); and

(2) Pm = effective notional amount of the credit risk mitigant (adjusted for maturity mismatch, if applicable).

(f) Currency mismatch adjustment. (1) If a [BANK] recognizes an eligible guarantee or eligible credit derivative that is denominated in a currency different from that in which the hedged exposure is denominated, the [BANK] must apply the following formula to the effective notional amount of the guarantee or credit derivative: $Pc = Pr \times (1-H_{FX})$, where:

(i) Pc = effective notional amount of the credit risk mitigant, adjusted for currency mismatch (and maturity mismatch and lack of restructuring event, if applicable);

(ii) Pr = effective notional amount of the credit risk mitigant (adjusted for maturity mismatch and lack of restructuring event, if applicable); and

(iii) H_{FX} = haircut appropriate for the currency mismatch between the credit risk mitigant and the hedged exposure.

(2) A [BANK] must set H_{FX} equal to eight percent unless it qualifies for the use of and uses its own internal estimates of foreign exchange volatility based on a ten-business-day holding period. A [BANK] qualifies for the use of its own internal estimates of foreign exchange volatility if it qualifies for the use of its own-estimates haircuts in §___.37(c)(4).

(3) A [BANK] must adjust H_{FX} calculated in §___.36(f)(2)upward if the [BANK] revalues the guarantee or credit derivative less frequently than once every 10 business days using the following square root of time formula:

$H_M = 8\%\sqrt{\frac{T_M}{10}}$, where T_M equals the greater of 10 or the number of days between revaluation.

§___.37 Collateralized Transactions

(a) General. (1) To recognize the risk-mitigating effects of financial collateral, a [BANK] may use:

(i) The simple approach in §___.37(b) for any exposure.

(ii) The collateral haircut approach in §___.37(c) for repo-style transactions, eligible margin loans, collateralized derivative contracts, and single-product netting sets of such transactions.

(2) A [BANK] may use any approach described in this section that is valid for a particular type of exposure or transaction; however, it must use the same approach for similar exposures or transactions.

(b) The simple approach. (1) General requirements. (i) A [BANK] may recognize the credit risk mitigation benefits of financial collateral that secures any exposure.

(ii) To qualify for the simple approach, the collateral must meet the following requirements:

(A) The collateral must be subject to a collateral agreement for at least the life of the exposure;

(B) The collateral must be revalued at least every six months; and

(C) The collateral (other than gold) and the exposure must be denominated in the same currency.

(2) Risk weight substitution. (i) A [BANK] may apply a risk weight to the portion of an exposure that is secured by the market value of collateral (that meets the requirements of §___.37 (b)(1)) based on the risk weight assigned to the collateral under §___.32. For repurchase agreements, reverse repurchase agreements, and securities lending and borrowing transactions, the collateral is the instruments, gold, and cash the [BANK] has borrowed, purchased subject to resale, or taken as collateral from the counterparty under the transaction. Except as provided in §___.37(b)(3), the risk weight assigned to the collateralized portion of the exposure may not be less than 20 percent.

(ii) A [BANK] must apply a risk weight to the unsecured portion of the exposure based on the risk weight assigned to the exposure under this subpart.

(3) Exceptions to the 20 percent risk-weight floor and other requirements. Notwithstanding §___.37(b)(2)(i):

(i) A [BANK] may assign a zero percent risk weight to an exposure to an OTC derivative contract that is marked-to-market on a daily basis and subject to a daily margin maintenance requirement, to the extent the contract is collateralized by cash on deposit.

(ii) A [BANK] may assign a 10 percent risk weight to an exposure to an OTC derivative contract that is marked-to-market daily and subject to a daily margin maintenance requirement, to the extent that the contract is collateralized by an exposure to a sovereign that qualifies for a zero percent risk weight under §___.32.

(iii) A [BANK] may assign a zero percent risk weight to the collateralized portion of an exposure where:

(A) The financial collateral is cash on deposit; or

(B) The financial collateral is an exposure to a sovereign that qualifies for a zero percent risk weight under §___.32, and the [BANK] has discounted the market value of the collateral by 20 percent.

(c) Collateral haircut approach. (1) General. A [BANK] may recognize the credit risk mitigation benefits of financial collateral that secures an eligible margin loan, repo-style transaction, collateralized derivative contract, or single-product netting set of such transactions, and of any collateral that secures a repo-style transaction that is included in the [BANK]'s VaR-based measure under subpart F by using the collateral haircut approach in this section. A [BANK] may use the standard supervisory haircuts in §___.37(c)(3) or, with prior written approval of the [AGENCY], its own estimates of haircuts according to §___.37(c)(4).

(2) Exposure amount equation. A [BANK] must determine the exposure amount for an eligible margin loan, repo-style transaction, collateralized derivative contract, or a single-product netting set of such transactions by setting the exposure amount equal to max $\{0, [(\sum E - \sum C) + \sum(Es \times Hs) + \sum(Efx \times Hfx)]\}$, where:

(i)(A) For eligible margin loans and repo-style transactions and netting sets thereof, $\sum E$ equals the value of the exposure (the sum of the current market values of all instruments, gold, and cash the [BANK] has lent, sold subject to repurchase, or posted as collateral to the counterparty under the transaction (or netting set)); and

(B) For collateralized derivative contracts and netting sets thereof, $\sum E$ equals the exposure amount of the OTC derivative contract (or netting set) calculated under §§___.34 (c) or (d).

(ii) $\sum C$ equals the value of the collateral (the sum of the current market values of all instruments, gold and cash the [BANK] has borrowed, purchased subject to resale, or taken as collateral from the counterparty under the transaction (or netting set));

(iii) Es equals the absolute value of the net position in a given instrument or in gold (where the net position in the instrument or gold equals the sum of the current market values of the instrument or gold the [BANK] has lent, sold subject to repurchase, or posted as collateral to

the counterparty minus the sum of the current market values of that same instrument or gold the [BANK] has borrowed, purchased subject to resale, or taken as collateral from the counterparty);

(iv) Hs equals the market price volatility haircut appropriate to the instrument or gold referenced in Es;

(v) Efx equals the absolute value of the net position of instruments and cash in a currency that is different from the settlement currency (where the net position in a given currency equals the sum of the current market values of any instruments or cash in the currency the [BANK] has lent, sold subject to repurchase, or posted as collateral to the counterparty minus the sum of the current market values of any instruments or cash in the currency the [BANK] has borrowed, purchased subject to resale, or taken as collateral from the counterparty); and

(vi) Hfx equals the haircut appropriate to the mismatch between the currency referenced in Efx and the settlement currency.

(3) Standard supervisory haircuts. (i) A [BANK] must use the haircuts for market price volatility (Hs) provided in Table 8, as adjusted in certain circumstances in accordance with the requirements of §§___.37(c)(3)(iii) and (iv):

TABLE 8 – STANDARD SUPERVISORY MARKET PRICE VOLATILITY HAIRCUTS[1]

Residual Maturity	Sovereign Issuers that receive a zero percent risk weight under §___.32 (in percent)	Sovereign Issuers that receive a 20 percent or 50 percent risk weight under §___.32 (in percent)	Sovereign Issuers that receive a risk weight equal to 100 percent under §___.32 (in percent)	Non-sovereign Issuers that receive a 20 percent risk weight under §___.32 (in percent)	Non-sovereign Issuers that receive a 50 percent risk weight under §___.32 (in percent)	Non-sovereign Issuers that receive a 100 percent risk weight under §___.32 (in percent)	Securitization Exposures that are investment grade (in percent)
Less than 1 year	0.5	1.0	15.0	1.0	2.0	25.0	4.0
Greater than 1 year and less than or equal	2.0	3.0	15.0	4.0	6.0	25.0	12.0

to 5 years							
Greater than 5 years	4.0	6.0	15.0	8.0	12.0	25.0	24.0
Main index equities (including convertible bonds) and gold	15.0						
Other publicly-traded equities (including convertible bonds)	25.0						
Mutual funds	Highest haircut applicable to any security in which the fund can invest.						
Cash collateral held	0						

(ii) For currency mismatches, a [BANK] must use a haircut for foreign exchange rate volatility (Hfx) of 8.0 percent, as adjusted in certain circumstances under §§___.37(c)(3)(iii) and (iv).

(iii) For repo-style transactions, a [BANK] may multiply the standard supervisory haircuts provided in §§___.37(c)(3)(i) and (ii) by the square root of ½ (which equals 0.707107).

(iv) If the number of trades in a netting set exceeds 5,000 at any time during a quarter, a [BANK] must adjust the supervisory haircuts provided in §___.37(c)(3)(i) and (ii) upward on the basis of a holding period of twenty business days for the following quarter except in the calculation of the exposure amount for purposes of §___.35. If a netting set contains one or more trades involving illiquid collateral or an OTC derivative that cannot be easily replaced, a [BANK] must adjust the supervisory haircuts upward on the basis of a holding period of twenty business days. If over the two previous quarters more than two margin disputes on a netting set have occurred that lasted more than the holding period, then the [BANK] must adjust the supervisory haircuts upward for that netting set on the basis of a holding period that is at least two times the minimum holding period for that netting set. A [BANK] must adjust the standard supervisory haircuts upward using the following formula:

$$H_A = H_S \sqrt{\frac{T_M}{T_S}}$$, where,

(A) T_M equals a holding period of longer than 10 business days for eligible margin loans and derivative contracts or longer than 5 business days for repo-style transactions;

(B) H_S equals the standard supervisory haircut; and

(C) T_S equals 10 business days for eligible margin loans and derivative contracts or 5 business days for repo-style transactions.

(v) If the instrument a [BANK] has lent, sold subject to repurchase, or posted as collateral does not meet the definition of financial collateral, the [BANK] must use a 25.0 percent haircut for market price volatility (H_s).

(4) Own internal estimates for haircuts. With the prior written approval of the [AGENCY], a [BANK] may calculate haircuts (Hs and Hfx) using its own internal estimates of the volatilities of market prices and foreign exchange rates.

(i) To receive [AGENCY] approval to use its own internal estimates, a [BANK] must satisfy the following minimum standards:

(A) A [BANK] must use a 99^{th} percentile one-tailed confidence interval.

(B) The minimum holding period for a repo-style transaction is five business days and for an eligible margin loan is ten business days except for transactions or netting sets for which §___.37(c)(4)(i)(C) applies. When a [BANK] calculates an own-estimates haircut on a T_N-day holding period, which is different from the minimum holding period for the transaction type, the applicable haircut (H_M) is calculated using the following square root of time formula:

$$H_M = H_N \sqrt{\frac{T_M}{T_N}}, \text{ where}$$

(1) T_M equals 5 for repo-style transactions and 10 for eligible margin loans;

(2) T_N equals the holding period used by the [BANK] to derive H_N; and

(3) H_N equals the haircut based on the holding period T_N.

(C) If the number of trades in a netting set exceeds 5,000 at any time during a quarter, a [BANK] must calculate the haircut using a minimum holding period of twenty business days for the following quarter except in the calculation of the exposure amount for purposes of §___.35. If a netting set contains one or more trades involving illiquid collateral or an OTC derivative that cannot be easily replaced, a [BANK] must calculate the haircut using a minimum holding period of twenty business days. If over the two previous quarters more than two margin disputes on a netting set have occurred that lasted more than the holding period, then the [BANK] must calculate the haircut for transactions in that netting set on the basis of a holding period that is at least two times the minimum holding period for that netting set.

(D) A [BANK] is required to calculate its own internal estimates with inputs calibrated to historical data from a continuous 12-month period that reflects a period of significant financial stress appropriate to the security or category of securities.

(E) A [BANK] must have policies and procedures that describe how it determines the period of significant financial stress used to calculate the [BANK]'s own internal estimates for haircuts under this section and must be able to provide empirical support for the period used. The [BANK] must obtain the prior approval of the [AGENCY] for, and notify the [AGENCY] if the [BANK] makes any material changes to, these policies and procedures.

(F) Nothing in this section prevents the [AGENCY] from requiring a [BANK] to use a different period of significant financial stress in the calculation of own internal estimates for haircuts.

(G) A [BANK] must update its data sets and calculate haircuts no less frequently than quarterly and must also reassess data sets and haircuts whenever market prices change materially.

(ii) With respect to debt securities that are investment grade, a [BANK] may calculate haircuts for categories of securities. For a category of securities, the [BANK] must calculate the haircut on the basis of internal volatility estimates for securities in that category that are representative of the securities in that category that the [BANK] has lent, sold subject to repurchase, posted as collateral, borrowed, purchased subject to resale, or taken as collateral. In determining relevant categories, the [BANK] must at a minimum take into account:

(A) The type of issuer of the security;

(B) The credit quality of the security;

(C) The maturity of the security; and

(D) The interest rate sensitivity of the security.

(iii) With respect to debt securities that are not investment grade and equity securities, a [BANK] must calculate a separate haircut for each individual security.

(iv) Where an exposure or collateral (whether in the form of cash or securities) is denominated in a currency that differs from the settlement currency, the [BANK] must calculate a separate currency mismatch haircut for its net position in each mismatched currency based on estimated volatilities of foreign exchange rates between the mismatched currency and the settlement currency.

(v) A [BANK]'s own estimates of market price and foreign exchange rate volatilities may not take into account the correlations among securities and foreign exchange rates on either the exposure or collateral side of a transaction (or netting set) or the correlations among securities and foreign exchange rates between the exposure and collateral sides of the transaction (or netting set).

RISK-WEIGHTED ASSETS FOR UNSETTLED TRANSACTIONS

§___.38 Unsettled Transactions

(a) Definitions. For purposes of this section:

(1) Delivery-versus-payment (DvP) transaction means a securities or commodities transaction in which the buyer is obligated to make payment only if the seller has made delivery of the securities or commodities and the seller is obligated to deliver the securities or commodities only if the buyer has made payment.

(2) Payment-versus-payment (PvP) transaction means a foreign exchange transaction in which each counterparty is obligated to make a final transfer of one or more currencies only if the other counterparty has made a final transfer of one or more currencies.

(3) Normal settlement period: a transaction has a normal settlement period if the contractual settlement period for the transaction is equal to or less than the market standard for the instrument underlying the transaction and equal to or less than five business days.

(4) Positive current exposure of a [BANK] for a transaction is the difference between the transaction value at the agreed settlement price and the current market price of the transaction, if the difference results in a credit exposure of the [BANK] to the counterparty.

(b) Scope. This section applies to all transactions involving securities, foreign exchange instruments, and commodities that have a risk of delayed settlement or delivery. This section does not apply to:

(1) Cleared transactions that are marked-to-market daily and subject to daily receipt and payment of variation margin;

(2) Repo-style transactions, including unsettled repo-style transactions;

(3) One-way cash payments on OTC derivative contracts; or

(4) Transactions with a contractual settlement period that is longer than the normal settlement period (which are treated as OTC derivative contracts as provided in §___.34).

(c) System-wide failures. In the case of a system-wide failure of a settlement, clearing system or central counterparty, the [AGENCY] may waive risk-based capital requirements for unsettled and failed transactions until the situation is rectified.

(d) Delivery-versus-payment (DvP) and payment-versus-payment (PvP) transactions. A [BANK] must hold risk-based capital against any DvP or PvP transaction with a normal settlement period if the [BANK]'s counterparty has not made delivery or payment within five business days after the settlement date. The [BANK] must determine its risk-weighted asset amount for such a transaction by multiplying the positive current exposure of the transaction for the [BANK] by the appropriate risk weight in Table 9.

TABLE 9 – RISK WEIGHTS FOR UNSETTLED DVP AND PVP TRANSACTIONS

Number of business days after contractual settlement date	Risk weight to be applied to positive current exposure (in percent)
From 5 to 15	100.0
From 16 to 30	625.0
From 31 to 45	937.5
46 or more	1,250.0

(e) Non-DvP/non-PvP (non-delivery-versus-payment/non-payment-versus-payment) transactions. (1) A [BANK] must hold risk-based capital against any non-DvP/non-PvP transaction with a normal settlement period if the [BANK] has delivered cash, securities, commodities, or currencies to its counterparty but has not received its corresponding deliverables by the end of the same business day. The [BANK] must continue to hold risk-based capital against the transaction until the [BANK] has received its corresponding deliverables.

(2) From the business day after the [BANK] has made its delivery until five business days after the counterparty delivery is due, the [BANK] must calculate the risk-weighted asset amount for the transaction by treating the current market value of the deliverables owed to the [BANK] as an exposure to the counterparty and using the applicable counterparty risk weight under §___.32.

(3) If the [BANK] has not received its deliverables by the fifth business day after counterparty delivery was due, the [BANK] must assign a 1,250 percent risk weight to the current market value of the deliverables owed to the [BANK].

(f) Total risk-weighted assets for unsettled transactions. Total risk-weighted assets for unsettled transactions is the sum of the risk-weighted asset amounts of all DvP, PvP, and non-DvP/non-PvP transactions.

RISK-WEIGHTED ASSETS FOR SECURITIZATION EXPOSURES

§___.41 Operational Requirements for Securitization Exposures

(a) Operational criteria for traditional securitizations. A [BANK] that transfers exposures it has originated or purchased to a securitization SPE or other third party in connection with a traditional securitization may exclude the exposures from the calculation of its risk-weighted assets only if each condition in this section 41 is satisfied. A [BANK] that meets these conditions must hold risk-based capital against any credit risk it retains in connection with the securitization. A [BANK] that fails to meet these conditions must hold risk-based capital against

the transferred exposures as if they had not been securitized and must deduct from common equity tier 1 capital any after-tax gain-on-sale resulting from the transaction. The conditions are:

(1) The exposures are not reported on the [BANK]'s consolidated balance sheet under GAAP;

(2) The [BANK] has transferred to one or more third parties credit risk associated with the underlying exposures; and

(3) Any clean-up calls relating to the securitization are eligible clean-up calls.

(4) The securitization does not (i) include one or more underlying exposures in which the borrower is permitted to vary the drawn amount within an agreed limit under a line of credit; and (ii) contains an early amortization provision.

(b) Operational criteria for synthetic securitizations. For synthetic securitizations, a [BANK] may recognize for risk-based capital purposes the use of a credit risk mitigant to hedge underlying exposures only if each condition in this paragraph is satisfied. A [BANK] that meets these conditions must hold risk-based capital against any credit risk of the exposures it retains in connection with the synthetic securitization. A [BANK] that fails to meet these conditions or chooses not to recognize the credit risk mitigant for purposes of this section must instead hold risk-based capital against the underlying exposures as if they had not been synthetically securitized. The conditions are:

(1) The credit risk mitigant is financial collateral, an eligible credit derivative, or an eligible guarantee;

(2) The [BANK] transfers credit risk associated with the underlying exposures to one or more third parties, and the terms and conditions in the credit risk mitigants employed do not include provisions that:

(i) Allow for the termination of the credit protection due to deterioration in the credit quality of the underlying exposures;

(ii) Require the [BANK] to alter or replace the underlying exposures to improve the credit quality of the pool of underlying exposures;

(iii) Increase the [BANK]'s cost of credit protection in response to deterioration in the credit quality of the underlying exposures;

(iv) Increase the yield payable to parties other than the [BANK] in response to a deterioration in the credit quality of the underlying exposures; or

(v) Provide for increases in a retained first loss position or credit enhancement provided by the [BANK] after the inception of the securitization;

(3) The [BANK] obtains a well-reasoned opinion from legal counsel that confirms the enforceability of the credit risk mitigant in all relevant jurisdictions; and

(4) Any clean-up calls relating to the securitization are eligible clean-up calls.

(c) Due diligence requirements.

(1) Except for exposures that are deducted from common equity tier 1 capital, if a [BANK] is unable to demonstrate to the satisfaction of the [AGENCY] a comprehensive understanding of the features of a securitization exposure that would materially affect the performance of the exposure, the [BANK] must assign the securitization exposure a risk weight of 1,250 percent. The [BANK]'s analysis must be commensurate with the complexity of the securitization exposure and the materiality of the exposure in relation to its capital.

(2) A [BANK] must demonstrate its comprehensive understanding of a securitization exposure under §___.41(c)(1), for each securitization exposure by:

(i) Conduct an analysis of the risk characteristics of a securitization exposure prior to acquiring the exposure, and document such analysis within three business days after acquiring the exposure, considering:

(A) Structural features of the securitization that would materially impact the performance of the exposure, for example, the contractual cash flow waterfall, waterfall-related triggers, credit enhancements, liquidity enhancements, market value triggers, the performance of organizations that service the exposure, and deal-specific definitions of default;

(B) Relevant information regarding the performance of the underlying credit exposure(s), for example, the percentage of loans 30, 60, and 90 days past due; default rates; prepayment rates; loans in foreclosure; property types; occupancy; average credit score or other measures of creditworthiness; average LTV ratio; and industry and geographic diversification data on the underlying exposure(s);

(C) Relevant market data of the securitization, for example, bid-ask spread, most recent sales price and historic price volatility, trading volume, implied market rating, and size, depth and concentration level of the market for the securitization; and

(D) In addition, for resecuritization exposures, performance information on the underlying securitization exposures, for example, the issuer name and credit quality, and the characteristics and performance of the exposures underlying the securitization exposures.

(ii) On an on-going basis (no less frequently than quarterly), evaluating, reviewing, and updating as appropriate the analysis required under §___.41(c)(1) for each securitization exposure.

§___.42 Risk-weighted Assets for Securitization Exposures

(a) Securitization risk weight approaches. Except as provided elsewhere in this section or in §___.41:

(1) A [BANK] must deduct from common equity tier 1capital any after-tax gain-on-sale resulting from a securitization and apply a 1,250 percent risk weight to the portion of a CEIO that does not constitute after-tax gain-on-sale.

(2) If a securitization exposure does not require deduction under §___.42(a)(1), a [BANK] may assign a risk weight to the securitization exposure using the simplified supervisory formula approach (SSFA) in accordance with §§___.43(a) through ___.43(d). Alternatively, a [BANK] that is not subject to subpart F may assign a risk weight to the securitization exposure using the gross-up approach in accordance with §___.43(e). The [BANK] must apply either the SSFA or the gross-up approach consistently across all of its securitization exposures.

(3) If a securitization exposure does not require deduction under §___.42(a)(1) and the [BANK] cannot, or chooses not to apply the SSFA or the gross-up approach to the exposure, the [BANK] must assign a risk weight to the exposure as described in §___.44.

(4) If a securitization exposure is a derivative contract (other than a credit derivative) that has a first priority claim on the cash flows from the underlying exposures (notwithstanding amounts due under interest rate or currency derivative contracts, fees due, or other similar payments), with approval of the [AGENCY], a [BANK] may choose to set the risk-weighted asset amount of the exposure equal to the amount of the exposure as determined in section 42(c).

(b) Total risk-weighted assets for securitization exposures. A [BANK]'s total risk-weighted assets for securitization exposures equals the sum of the risk-weighted asset amount for securitization exposures that the [BANK] risk weights under §§___.41(c), ___.42(a)(1), and ___.43, ___.44, or ___.45, except as provided in §§___.42(e) through (j).

(c) Exposure amount of a securitization exposure. (1) On-balance sheet securitization exposures. The exposure amount of an on-balance sheet securitization exposure that is not a repo-style transaction, eligible margin loan, or OTC derivative contract (other than a credit derivative) is equal to the carrying value of the exposure.

(2) Off-balance sheet securitization exposures. (i) The exposure amount of an off-balance sheet securitization exposure that is not a repo-style transaction, eligible margin loan, or an OTC derivative contract (other than a credit derivative) is the notional amount of the exposure, except for an eligible asset-backed commercial paper (ABCP) liquidity facility. For an off-balance sheet securitization exposure to an ABCP program, such as an eligible ABCP liquidity facility, the notional amount may be reduced to the maximum potential amount that the [BANK] could be required to fund given the ABCP program's current underlying assets (calculated without regard to the current credit quality of those assets).

(ii) A [BANK] must determine the exposure amount of an eligible ABCP liquidity facility for which the SSFA does not apply by multiplying the notional amount of the exposure by a CCF of 50 percent.

(iii) A [BANK] must determine the exposure amount of an eligible ABCP liquidity facility for which the SSFA applies by multiplying the notional amount of the exposure by a CCF of 100 percent.

(3) Repo-style transactions, eligible margin loans, and derivative contracts. The exposure amount of a securitization exposure that is a repo-style transaction, eligible margin loan, or derivative contract (other than a credit derivative) is the exposure amount of the transaction as calculated under §___.34 or §___.37 as applicable..

(d) Overlapping exposures. If a [BANK] has multiple securitization exposures that provide duplicative coverage to the underlying exposures of a securitization (such as when a [BANK] provides a program-wide credit enhancement and multiple pool-specific liquidity facilities to an ABCP program), the [BANK] is not required to hold duplicative risk-based capital against the overlapping position. Instead, the [BANK] may apply to the overlapping position the applicable risk-based capital treatment that results in the highest risk-based capital requirement.

(e) Implicit support. If a [BANK] provides support to a securitization in excess of the [BANK]'s contractual obligation to provide credit support to the securitization (implicit support):

(1) The [BANK] must include in risk-weighted assets all of the underlying exposures associated with the securitization as if the exposures had not been securitized and must deduct from common equity tier 1 capital any after-tax gain-on-sale resulting from the securitization; and

(2) The [BANK] must disclose publicly:

(i) That it has provided implicit support to the securitization; and

(ii) The risk-based capital impact to the [BANK] of providing such implicit support.

(f) Undrawn portion of an eligible servicer cash advance facility. Regardless of any other provision of this subpart, a [BANK] is not required to hold risk-based capital against the undrawn portion of an eligible servicer cash advance facility.

(g) Interest-only mortgage-backed securities. Regardless of any other provisions of this subpart, the risk weight for a non-credit-enhancing interest-only mortgage-backed security may not be less than 100 percent.

(h) Small-business loans and leases on personal property transferred with retained contractual exposure. (1) Regardless of any other provisions of this subpart, a [BANK] that has transferred small-business loans and leases on personal property (small-business obligations) must include in risk-weighted assets only its contractual exposure to the small-business obligations if all the following conditions are met:

(i) The transaction must be treated as a sale under GAAP.

(ii) The [BANK] establishes and maintains, pursuant to GAAP, a non-capital reserve sufficient to meet the [BANK]'s reasonably estimated liability under the contractual obligation.

(iii) The small business obligations are to businesses that meet the criteria for a small-business concern established by the Small Business Administration under §3(a) of the Small Business Act.

(iv) The [BANK] is well capitalized, as defined in the [AGENCY]'s prompt corrective action regulation. For purposes of determining whether a [BANK] is well capitalized for purposes of this paragraph, the [BANK]'s capital ratios must be calculated without regard to the capital treatment for transfers of small-business obligations under this paragraph.

(2) The total outstanding amount of contractual exposure retained by a [BANK] on transfers of small-business obligations receiving the capital treatment specified in §___.42(h)(1) cannot exceed 15 percent of the [BANK]'s total capital.

(3) If a [BANK] ceases to be well capitalized or exceeds the 15 percent capital limitation provided in §___.42(h)(2), the capital treatment under §___.42(h)(1) will continue to apply to any transfers of small-business obligations with retained contractual exposure that occurred during the time that the [BANK] was well capitalized and did not exceed the capital limit.

(4) The risk-based capital ratios of the [BANK] must be calculated without regard to the capital treatment for transfers of small-business obligations specified in §___.42 (h)(1) for purposes of:

(i) Determining whether a [BANK] is adequately capitalized, undercapitalized, significantly undercapitalized, or critically undercapitalized under the [AGENCY]'s prompt corrective action regulations; and

(ii) Reclassifying a well-capitalized [BANK] to adequately capitalized and requiring an adequately capitalized [BANK] to comply with certain mandatory or discretionary supervisory actions as if the [BANK] were in the next lower prompt-corrective-action category.

(i) Nth-to-default credit derivatives. (1) Protection provider. A [BANK] may assign a risk weight using the SSFA in §___.43 to an nth-to-default credit derivative in accordance with this paragraph. A [BANK] must determine its exposure in the nth-to-default credit derivative as the largest notional dollar amount of all the underlying exposures.

(2) For purposes of determining the risk weight for an nth-to-default credit derivative using the SSFA, the [BANK] must calculate the attachment point and detachment point of its exposure as follows:

(i) The attachment point (parameter A) is the ratio of the sum of the notional amounts of all underlying exposures that are subordinated to the [BANK]'s exposure to the total notional amount of all underlying exposures. In the case of a first-to-default credit derivative, there are no underlying exposures that are subordinated to the [BANK]'s exposure. In the case of a second-or-subsequent-to-default credit derivative, the smallest (n-1) notional amounts of the underlying exposure(s) are subordinated to the [BANK]'s exposure.

(ii) The detachment point (parameter D) equals the sum of parameter A plus the ratio of the notional amount of the [BANK]'s exposure in the nth-to-default credit derivative to the total notional amount of all underlying exposures.

(3) A [BANK] that does not use the SSFA to determine a risk weight for its nth-to-default credit derivative must assign a risk weight of 1,250 percent to the exposure.

(4) Protection purchaser. (i) First-to-default credit derivatives. A [BANK] that obtains credit protection on a group of underlying exposures through a first-to-default credit derivative that meets the rules of recognition of §___.36(b) must determine its risk-based capital requirement for the underlying exposures as if the [BANK] synthetically securitized the underlying exposure with the smallest risk-weighted asset amount and had obtained no credit risk mitigant on the other underlying exposures. A [BANK] must calculate a risk-based capital requirement for counterparty credit risk according to §___.34 for a first-to-default credit derivative that does not meet the rules of recognition of §___.36(b).

(ii) Second-or-subsequent-to-default credit derivatives. (A) A [BANK] that obtains credit protection on a group of underlying exposures through a nth -to-default credit derivative that meets the rules of recognition of §___.36(b) (other than a first-to-default credit derivative) may recognize the credit risk mitigation benefits of the derivative only if:

(1) The [BANK] also has obtained credit protection on the same underlying exposures in the form of first-through-(n-1)-to-default credit derivatives; or

(2) If n-1 of the underlying exposures have already defaulted.

(B) If a [BANK] satisfies the requirements of paragraph (i)(4)(ii)(A) of this section, the [BANK] must determine its risk-based capital requirement for the underlying exposures as if the [BANK] had only synthetically securitized the underlying exposure with the smallest risk-weighted asset amount.

(C) A [BANK] must calculate a risk-based capital requirement for counterparty credit risk according to §___.34 for a nth-to-default credit derivative that does not meet the rules of recognition of §___.36(b).

(j) Guarantees and credit derivatives other than N-th to default credit derivatives. (1) Protection provider. For a guarantee or credit derivative (other than an nth-to-default credit derivative) provided by a [BANK] that covers the full amount or a pro rata share of a securitization exposure's principal and interest, the [BANK] must risk weight the guarantee or credit derivative as if it holds the portion of the reference exposure covered by the guarantee or credit derivative.

(2) Protection purchaser. (i) If a [BANK] chooses (and is able) to recognize a guarantee or credit derivative (other than an nth-to-default credit derivative) that references a securitization exposure as a credit risk mitigant, where applicable, the [BANK] must apply §___.45.

(ii) If a [BANK] cannot, or chooses not to, recognize a credit derivative that references a securitization exposure as a credit risk mitigant under §___.45, the [BANK] must determine its capital requirement only for counterparty credit risk in accordance with §___.31.

§___.43 Simplified Supervisory Formula Approach (SSFA) and the Gross-up Approach

(a) General requirements. To use the SSFA to determine the risk weight for a securitization exposure, a [BANK] must have data that enables it to assign accurately the parameters described in §___.43(b). Data used to assign the parameters described in §___.43(b) must be the most currently available data and no more than 91 calendar days old. A [BANK] that does not have the appropriate data to assign the parameters described in §___.43(b) must assign a risk weight of 1,250 percent to the exposure.

(b) SSFA parameters. To calculate the risk weight for a securitization exposure using the SSFA, a [BANK] must have accurate information on the following five inputs to the SSFA calculation:

(1) K_G is the weighted-average (with unpaid principal used as the weight for each exposure) total capital requirement of the underlying exposures calculated using this subpart. K_G is expressed as a decimal value between zero and 1 (that is, an average risk weight of 100 percent represents a value of K_G equal to .08).

(2) Parameter W is expressed as a decimal value between zero and one. Parameter W is the ratio of the sum of the dollar amounts of any underlying exposures within the securitized pool that meet any of the criteria as set forth in §§___.43(b)(2)(i) through (vi) to the ending balance, measured in dollars, of underlying exposures:

(i) Ninety days or more past due,

(ii) Subject to a bankruptcy or insolvency proceeding,

(iii) In the process of foreclosure,

(iv) Held as real estate owned;

(v) Has contractually deferred interest payments for 90 days or more; or

(vi) Is in default.

(3) Parameter A is the attachment point for the exposure, which represents the threshold at which credit losses will first be allocated to the exposure. Parameter A equals the ratio of the current dollar amount of underlying exposures that are subordinated to the exposure of the [BANK] to the current dollar amount of underlying exposures. Any reserve account funded by the accumulated cash flows from the underlying exposures that is subordinated to the [BANK]'s securitization exposure may be included in the calculation of parameter A to the extent that cash is present in the account. Parameter A is expressed as a decimal value between zero and one.

(4) Parameter D is the detachment point for the exposure, which represents the threshold at which credit losses of principal allocated to the exposure would result in a total loss of principal. Parameter D equals parameter A plus the ratio of the current dollar amount of the securitization exposures that are pari passu with the exposure (that is, have equal seniority with respect to credit risk) to the current dollar amount of the underlying exposures. Parameter D is expressed as a decimal value between zero and one.

(5) A supervisory calibration parameter, p, is qual to 0.5 for securitization exposures that are not resecuritization exposures and equal to 1.5 for resecuritization exposures.

(c) Mechanics of the SSFA. K_G and W are used to calculate K_A, the augmented value of K_G, which reflects the observed credit quality of the underlying pool of exposures. K_A is defined in §___.43(d). The values of parameters A and D, relative to K_A determine the risk weight assigned to a securitization exposure as described in §___.43(d). The risk weight assigned to a

securitization exposure, or portion of a exposure, as appropriate, is the larger of the risk weight determined in accordance with this §___.43(c) and §___.43(d) and a risk weight of 20 percent.

(1) When the detachment point, parameter D, for a securitization exposure is less than or equal to K_A, the exposure must be assigned a risk weight of 1,250 percent.

(2) When the attachment point, parameter A, for a securitization exposure is greater than or equal to K_A, the [BANK] must calculate the risk weight in accordance with §___.43(d).

(3) When A is less than K_A and D is greater than K_A, the risk weight is a weighted-average of 1,250 percent and 1,250 percent times K_{SSFA} calculated in accordance with §___.43(d), but with the parameter A revised to be set equal to K_A. For the purpose of this weighted-average calculation:

(i) The weight assigned to 1,250 percent equals $\frac{K_A - A}{D - A}$.

(ii) The weight assigned to 1,250 percent times K_{SSFA} equals $\frac{D - K_A}{D - A}$.

(iii) The risk weight will be set equal to:

$$RW = \left[\left(\frac{K_A - A}{D - A}\right) \times 1{,}250\ percent\right] + \left[\left(\frac{D - K_A}{D - A}\right) \times 1{,}250\ percent \times K_{SSFA}\right]$$

(d) SSFA equation. (1) The [BANK] must define the following parameters:

$$K_A = (1 - W) \cdot K_G + (.5 \cdot W)$$

$a = -\frac{1}{p \cdot K_A}$
$u = D - K_A$
$l = A - K_A$
$e = 2.71828$, the base of the natural logarithms.
(2) Then the [BANK] must calculate K_{SSFA} according to the following equation:
$K_{SSFA} = \frac{e^{a \cdot u} - e^{a \cdot l}}{a(u - l)}$

(3) The risk weight for the exposure (expressed as a percent) is equal to $K_{SSFA} \times 1{,}250$.

(e) Gross-up approach. (1) Applicability. A [BANK] that is not subject to subpart F may apply the gross-up approach set forth in this section instead of the SSFA to determine the risk weight of its securitization exposures, provided that it applies the gross-up approach or a 1,250 percent risk weight to all of its securitization exposures, except as otherwise provided for certain securitization exposures in §___.44 and ___.45.

(2) To use the gross-up approach, a [BANK] must calculate the following four inputs:

(i) Pro rata share, which is the par value of the [BANK]'s securitization exposure as a percent of the par value of the tranche in which the securitization exposure resides;

(ii) Enhanced amount, which is the value of tranches that are more senior to the tranche in which the [BANK]'s securitization resides;

(iii) Exposure amount of the [BANK]'s securitization exposure calculated under §___.42(c); and

(iv) Risk weight, which is the weighted-average risk weight of underlying exposures in the securitization pool as calculated under this subpart.

(3) Credit equivalent amount. The credit equivalent amount of a securitization exposure under this section equals the sum of the exposure amount of the [BANK]'s securitization exposure and the pro rata share multiplied by the enhanced amount, each calculated in accordance with §___.43(e)(2).

(4) Risk-weighted assets. To calculate risk-weighted assets for a securitization exposure under the gross-up approach, a [BANK] must apply the risk weight calculated under §___.43(e)(2) to the credit equivalent amount calculated in §___.43(e)(3).

(f) Limitations. Notwithstanding any other provision of this §___.43, a [BANK] must assign a risk weight of not less than 20 percent to a securitization exposure.

§___. 44 Securitization Exposures to which the SSFA and Gross-up Approach Do Not Apply

(a) General Requirement. A [BANK] must assign a 1,250 percent risk weight to all securitization exposures to which the [BANK] does not apply the SSFA or the gross up approach under §___.43, except as set forth in this section;

(b) Eligible ABCP liquidity facilities. A [BANK] may determine the risk-weighted asset amount of an eligible ABCP liquidity facility by multiplying the exposure amount by the highest risk weight applicable to any of the individual underlying exposures covered by the facility.

(c) A securitization exposure in a second loss position or better to an ABCP program. (1) Risk weighting. A [BANK] may determine the risk-weighted asset amount of a securitization exposure that is in a second loss position or better to an ABCP program that meets the requirements of §___.44(c)(2) by multiplying the exposure amount by the higher of the following risk weights:

(i) 100 percent; and

(ii) The highest risk weight applicable to any of the individual underlying exposures of the ABCP program.

(2) Requirements. (i) The exposure is not an eligible ABCP liquidity facility;

(ii) The exposure must be economically in a second loss position or better, and the first loss position must provide significant credit protection to the second loss position;

(iii) The exposure qualifies as investment grade; and

(iv) The [BANK] holding the exposure must not retain or provide protection to the first loss position.

§___.45 Recognition of Credit Risk Mitigants for Securitization Exposures

(a) General. (1) An originating [BANK] that has obtained a credit risk mitigant to hedge its exposure to a synthetic or traditional securitization that satisfies the operational criteria provided in §___.41 may recognize the credit risk mitigant under §§___.36 or ___.37, but only as provided in this §___.45.

(2) An investing [BANK] that has obtained a credit risk mitigant to hedge a securitization exposure may recognize the credit risk mitigant under §§___.36 or ___.37, but only as provided in this §___.45.

(b) Eligible guarantors for securitization exposures. A [BANK] may only recognize an eligible guarantee or eligible credit derivative from an eligible guarantor.

(c) Mismatches. A [BANK] must make any applicable adjustment to the protection amount of an eligible guarantee or credit derivative as required in §§___.36(d), (e), and (f) for any hedged securitization exposure. In the context of a synthetic securitization, when an eligible guarantee or eligible credit derivative covers multiple hedged exposures that have different residual maturities, the [BANK] must use the longest residual maturity of any of the hedged exposures as the residual maturity of all hedged exposures.

RISK-WEIGHTED ASSETS FOR EQUITY EXPOSURES

§___.51 Introduction and Exposure Measurement

(a) General. To calculate its risk-weighted asset amounts for equity exposures that are not equity exposures to an investment fund, a [BANK] must use the Simple Risk-Weight Approach (SRWA) provided in §___.52. A [BANK] must use the look-through approaches provided in §___.53 to calculate its risk-weighted asset amounts for equity exposures to investment funds.

(b) Adjusted carrying value. For purposes of §§___.51 through ___.53, the adjusted carrying value of an equity exposure is:

(1) For the on-balance sheet component of an equity exposure, the [BANK]'s carrying value of the exposure and

(2) For the off-balance sheet component of an equity exposure that is not an equity commitment, the effective notional principal amount of the exposure, the size of which is equivalent to a hypothetical on-balance sheet position in the underlying equity instrument that would evidence the same change in fair value (measured in dollars) given a small change in the price of the underlying equity instrument, minus the adjusted carrying value of the on-balance sheet component of the exposure as calculated in §___.51 (b)(1).

(3) For a commitment to acquire an equity exposure (an equity commitment), the effective notional principal amount of the exposure is multiplied by the following conversion factors (CFs):

(i) Conditional equity commitments with an original maturity of one year or less receive a CF of 20 percent.

(ii) Conditional equity commitments with an original maturity of over one year receive a CF of 50 percent.

(iii) Unconditional equity commitments receive a CF of 100 percent.

§___. 52 Simple Risk-Weight Approach (SRWA)

(a) General. Under the SRWA, a [BANK]'s total risk-weighted assets for equity exposures equals the sum of the risk-weighted asset amounts for each of the [BANK]'s individual equity exposures (other than equity exposures to an investment fund) as determined under this section and the risk-weighted asset amounts for each of the [BANK]'s individual equity exposures to an investment fund as determined under §___.53.

(b) SRWA computation for individual equity exposures. A [BANK] must determine the risk-weighted asset amount for an individual equity exposure (other than an equity exposure to an investment fund) by multiplying the adjusted carrying value of the equity exposure or the effective portion and ineffective portion of a hedge pair (as defined in §___.52(c)) by the lowest applicable risk weight in this paragraph.

(1) Zero percent risk weight equity exposures. An equity exposure to a sovereign, the Bank for International Settlements, the European Central Bank, the European Commission, the International Monetary Fund, an MDB, and any other entity whose credit exposures receive a zero percent risk weight under §___.32 may be assigned a zero percent risk weight.

(2) 20 percent risk weight equity exposures. An equity exposure to a PSE, Federal Home Loan Bank or the Federal Agricultural Mortgage Corporation (Farmer Mac) must be assigned a 20 percent risk weight.

(3) 100 percent risk weight equity exposures. The following equity exposures must be assigned a 100 percent risk weight:

(i) Community development equity exposures.

(A) For [BANK]s, savings and loan holding companies, and bank holding companies, an equity exposure that qualifies as a community development investment under §___.24 (Eleventh) of the National Bank Act, excluding equity exposures to an unconsolidated small business investment company and equity exposures held through a consolidated small business investment company described in §302 of the Small Business Investment Act.

(B) For savings associations, an equity exposure that is designed primarily to promote community welfare, including the welfare of low- and moderate-income communities or

families, such as by providing services or employment, and excluding equity exposures to an unconsolidated small business investment company and equity exposures held through a small business investment company described in §302 of the Small Business Investment Act.

(ii) Effective portion of hedge pairs. The effective portion of a hedge pair.

(iii) Non-significant equity exposures. Equity exposures, excluding exposures to an investment firm that would meet the definition of a traditional securitization were it not for the application of paragraph (8) of that definition and has greater than immaterial leverage, to the extent that the aggregate adjusted carrying value of the exposures does not exceed 10 percent of the [BANK]'s total capital.

(A) To compute the aggregate adjusted carrying value of a [BANK]'s equity exposures for purposes of this section, the [BANK] may exclude equity exposures described in sections §§___.52(b)(1), (b)(2), (b)(3)(i), and (b)(3)(ii), the equity exposure in a hedge pair with the smaller adjusted carrying value, and a proportion of each equity exposure to an investment fund equal to the proportion of the assets of the investment fund that are not equity exposures or that meet the criterion of §___.52(b)(3)(i). If a [BANK] does not know the actual holdings of the investment fund, the [BANK] may calculate the proportion of the assets of the fund that are not equity exposures based on the terms of the prospectus, partnership agreement, or similar contract that defines the fund's permissible investments. If the sum of the investment limits for all exposure classes within the fund exceeds 100 percent, the [BANK] must assume for purposes of this section that the investment fund invests to the maximum extent possible in equity exposures.

(B) When determining which of a [BANK]'s equity exposures qualify for a 100 percent risk weight under this paragraph, a [BANK] first must include equity exposures to unconsolidated small business investment companies or held through consolidated small business investment companies described in §302 of the Small Business Investment Act, then must include publicly-traded equity exposures (including those held indirectly through investment funds), and then must include nonpublicly-traded equity exposures (including those held indirectly through investment funds).

(4) 250 percent risk weight equity exposures. Significant investments in the capital of unconsolidated financial institutions that are not deducted from capital pursuant to §___.22(d) are assigned a 250 percent risk weight.

(5) 300 percent risk weight equity exposures. A publicly-traded equity exposure (other than an equity exposure described in §___.52(b)(7) and including the ineffective portion of a hedge pair) must be assigned a 300 percent risk weight.

(6) 400 percent risk weight equity exposures. An equity exposure (other than an equity exposure described in §___.52(b)(7)) that is not publicly-traded must be assigned a 400 percent risk weight.

(7) 600 percent risk weight equity exposures. An equity exposure to an investment firm must be assigned a 600 percent risk weight, provided that the investment firm:

(i) Would meet the definition of a traditional securitization were it not for the application of paragraph (8) of that definition; and

(ii) Has greater than immaterial leverage.

(c) Hedge transactions. (1) Hedge pair. A hedge pair is two equity exposures that form an effective hedge so long as each equity exposure is publicly-traded or has a return that is primarily based on a publicly-traded equity exposure.

(2) Effective hedge. Two equity exposures form an effective hedge if the exposures either have the same remaining maturity or each has a remaining maturity of at least three months; the hedge relationship is formally documented in a prospective manner (that is, before the [BANK] acquires at least one of the equity exposures); the documentation specifies the measure of effectiveness (E) the [BANK] will use for the hedge relationship throughout the life of the transaction; and the hedge relationship has an E greater than or equal to 0.8. A [BANK] must measure E at least quarterly and must use one of three alternative measures of E:

(i) Under the dollar-offset method of measuring effectiveness, the [BANK] must determine the ratio of value change (RVC). The RVC is the ratio of the cumulative sum of the changes in value of one equity exposure to the cumulative sum of the changes in the value of the other equity exposure. If RVC is positive, the hedge is not effective and E equals 0. If RVC is negative and greater than or equal to -1 (that is, between zero and -1), then E equals the absolute value of RVC. If RVC is negative and less than -1, then E equals 2 plus RVC.

(ii) Under the variability-reduction method of measuring effectiveness:

$$E = 1 - \frac{\sum_{t=1}^{T} \left(X_t - X_{t-1} \right)^2}{\sum_{t=1}^{T} \left(A_t - A_{t-1} \right)^2}, \text{ where}$$

(A) $X_t = A_t - B_t$;

(B) $A_t =$ the value at time t of one exposure in a hedge pair; and

(C) $B_t =$ the value at time t of the other exposure in a hedge pair.

(iii) Under the regression method of measuring effectiveness, E equals the coefficient of determination of a regression in which the change in value of one exposure in a hedge pair is the dependent variable and the change in value of the other exposure in a hedge pair is the independent variable. However, if the estimated regression coefficient is positive, then E equals zero.

(3) The effective portion of a hedge pair is E multiplied by the greater of the adjusted carrying values of the equity exposures forming a hedge pair.

(4) The ineffective portion of a hedge pair is (1-E) multiplied by the greater of the adjusted carrying values of the equity exposures forming a hedge pair.

§___.53 Equity Exposures to Investment Funds

(a) Available approaches. (1) Unless the exposure meets the requirements for a community development equity exposure under §___.52(b)(3)(i), a [BANK] must determine the risk-weighted asset amount of an equity exposure to an investment fund under the Full Look-Through Approach described in §___.53(b), the Simple Modified Look-Through Approach described in §___.53(c), or the Alterative Modified Look-Through Approach described in §___.53(d).

(2) The risk-weighted asset amount of an equity exposure to an investment fund that meets the requirements for a community development equity exposure in §___.52(b)(3)(i) is its adjusted carrying value.

(3) If an equity exposure to an investment fund is part of a hedge pair and the [BANK] does not use the Full Look-Through Approach, the [BANK] may use the ineffective portion of the hedge pair as determined under §___.52(c) as the adjusted carrying value for the equity exposure to the investment fund. The risk-weighted asset amount of the effective portion of the hedge pair is equal to its adjusted carrying value.

(b) Full Look-Through Approach. A [BANK] that is able to calculate a risk-weighted asset amount for its proportional ownership share of each exposure held by the investment fund (as calculated under this subpart as if the proportional ownership share of each exposure were held directly by the [BANK]) may set the risk-weighted asset amount of the [BANK]'s exposure to the fund equal to the product of:

(1) The aggregate risk-weighted asset amounts of the exposures held by the fund as if they were held directly by the [BANK]; and

(2) The [BANK]'s proportional ownership share of the fund.

(c) Simple Modified Look-Through Approach. Under the Simple Modified Look-Through Approach, the risk-weighted asset amount for a [BANK]'s equity exposure to an investment fund equals the adjusted carrying value of the equity exposure multiplied by the highest risk weight that applies to any exposure the fund is permitted to hold under the prospectus, partnership agreement, or similar agreement that defines the fund's permissible investments (excluding derivative contracts that are used for hedging rather than speculative purposes and that do not constitute a material portion of the fund's exposures).

(d) Alternative Modified Look-Through Approach. Under the Alternative Modified Look-Through Approach, a [BANK] may assign the adjusted carrying value of an equity exposure to an investment fund on a pro rata basis to different risk weight categories under this subpart based on the investment limits in the fund's prospectus, partnership agreement, or similar contract that defines the fund's permissible investments. The risk-weighted asset amount for the [BANK]'s equity exposure to the investment fund equals the sum of each portion of the adjusted carrying value assigned to an exposure type multiplied by the applicable risk weight under this

subpart. If the sum of the investment limits for all exposure types within the fund exceeds 100 percent, the [BANK] must assume that the fund invests to the maximum extent permitted under its investment limits in the exposure type with the highest applicable risk weight under this subpart and continues to make investments in order of the exposure type with the next highest applicable risk weight under this subpart until the maximum total investment level is reached. If more than one exposure type applies to an exposure, the [BANK] must use the highest applicable risk weight. A [BANK] may exclude derivative contracts held by the fund that are used for hedging rather than for speculative purposes and do not constitute a material portion of the fund's exposures.

DISCLOSURES

§___. 61 Purpose and Scope.

Sections ___.61-___.63 of this subpart establish public disclosure requirements related to the capital requirements described in Subpart B for a [BANK] with total consolidated assets of $50 billion or more that is not an advanced approaches [BANK]. Such a [BANK] must comply with §___.62 of this part unless it is a consolidated subsidiary of a bank holding company, savings and loan holding company, or depository institution that is subject to these disclosure requirements or a subsidiary of a non-U.S. banking organization that is subject to comparable public disclosure requirements in its home jurisdiction. For purposes of this section, total consolidated assets are determined based on the average of the [BANK]'s total consolidated assets in the four most recent quarters as reported on the [REGULATORY REPORT]; or the average of the [BANK]'s total consolidated assets in the most recent consecutive quarters as reported quarterly on the [BANK]'s [REGULATORY REPORT] if the [BANK] has not filed such a report for each of the most recent four quarters.

§___. 62 Disclosure requirements.

(a) A [BANK] described in §___.61 must provide timely public disclosures each calendar quarter of the information in the applicable tables set out in §___.63. If a significant change occurs, such that the most recent reported amounts are no longer reflective of the [BANK]'s capital adequacy and risk profile, then a brief discussion of this change and its likely impact must be disclosed as soon as practicable thereafter. Qualitative disclosures that typically do not change each quarter (for example, a general summary of the [BANK]'s risk management objectives and policies, reporting system, and definitions) may be disclosed annually, provided that any significant changes are disclosed in the interim. Management is encouraged to provide all of the disclosures required by §§___.61through ___.63 of this part in one place on the [BANK]'s public website.[103]

[103] Alternatively, a [BANK] may provide the disclosures in more than one place, as some of them may be included in public financial reports (for example, in Management's Discussion and Analysis included in SEC filings) or other regulatory reports. The [BANK] must publicly provide a summary table that specifically indicates where all the disclosures may be found (for example, regulatory report schedules, page numbers in annual reports).

(b) A [BANK] described in §___.61 must have a formal disclosure policy approved by the board of directors that addresses its approach for determining the disclosures it makes. The policy must address the associated internal controls and disclosure controls and procedures. The board of directors and senior management are responsible for establishing and maintaining an effective internal control structure over financial reporting, including the disclosures required by this subpart, and must ensure that appropriate review of the disclosures takes place. One or more senior officers of the [BANK] must attest that the disclosures meet the requirements of this subpart.

(c) If a [BANK] described in §___.61 concludes that specific commercial or financial information that it would otherwise be required to disclose under this section would be exempt from disclosure by the [AGENCY] under the Freedom of Information Act (5 U.S.C. 552), then the [BANK] is not required to disclose that specific information pursuant to this section, but must disclose more general information about the subject matter of the requirement, together with the fact that, and the reason why, the specific items of information have not been disclosed.

§___. 63 Disclosures by [BANK]s Described in §___.61

(a) Except as provided in §___.62, a [BANK] described in §___.61 must make the disclosures described in Tables 14.1 through 14.10 of this section. The [BANK] must make these disclosures publicly available for each of the last three years (that is, twelve quarters) or such shorter period beginning on the effective date of this subpart D.

(b) A [BANK] must publicly disclose each quarter the following:

(1) Common equity tier 1 capital, additional tier 1 capital, tier 2 capital, tier 1 and total capital ratios, including the regulatory capital elements and all the regulatory adjustments and deductions needed to calculate the numerator of such ratios;

(2) Total risk-weighted assets, including the different regulatory adjustments and deductions needed to calculate total risk-weighted assets;

(3) Regulatory capital ratios during any transition periods, including a description of all the regulatory capital elements and all regulatory adjustments and deductions needed to calculate the numerator and denominator of each capital ratio during any transition period; and

(4) A reconciliation of regulatory capital elements as they relate to its balance sheet in any audited consolidated financial statements.

Table 14.1 – Scope of Application

Qualitative Disclosures	(a)	The name of the top corporate entity in the group to which subpart D of this [PART] applies.
	(b)	A brief description of the differences in the basis for consolidating entities[104] for accounting and regulatory purposes, with a description of those entities: (a) that are fully consolidated; (b) that are deconsolidated and deducted from total capital; (c) for which the total capital requirement is deducted; and (d) that are neither consolidated nor deducted (for example, where the investment in the entity is assigned a risk weight in accordance with this subpart).
	(c)	Any restrictions, or other major impediments, on transfer of funds or total capital within the group.
Quantitative Disclosures	(d)	The aggregate amount of surplus capital of insurance subsidiaries included in the total capital of the consolidated group.
	(e)	The aggregate amount by which actual total capital is less than the minimum total capital requirement in all subsidiaries, with total capital requirements and the name(s) of the subsidiaries with such deficiencies.

[104] Entities include securities, insurance and other financial subsidiaries, commercial subsidiaries (where permitted), and significant minority equity investments in insurance, financial and commercial entities.

Table 14.2 – Capital Structure

Qualitative Disclosures	(a)	Summary information on the terms and conditions of the main features of all regulatory capital instruments.
Quantitative Disclosures	(b)	The amount of common equity tier 1 capital, with separate disclosure of: • Common stock and related surplus; • Retained earnings; • Common equity minority interest; • AOCI; and • Regulatory deductions and adjustments made to common equity tier 1 capital.
	(c)	The amount of tier 1 capital, with separate disclosure of: • Additional tier 1 capital elements, including additional tier 1 capital instruments and tier 1 minority interest not included in common equity tier 1 capital; and • Regulatory deductions and adjustments made to tier 1 capital.
	(d)	The amount of total capital, with separate disclosure of: • Tier 2 capital elements, including tier 2 capital instruments and total capital minority interest not included in tier 1 capital; and • Regulatory deductions and adjustments made to total capital.

Table 14.3 – Capital Adequacy

Qualitative disclosures	(a)	A summary discussion of the [BANK]'s approach to assessing the adequacy of its capital to support current and future activities.
Quantitative disclosures	(b)	Risk-weighted assets for: • Exposures to sovereign entities; • Exposures to certain supranational entities and MDBs; • Exposures to depository institutions, foreign banks, and credit unions; • Exposures to PSEs; • Corporate exposures; • Residential mortgage exposures; • Statutory multifamily mortgages and pre-sold construction loans; • HVCRE loans; • Past due loans; • Other assets; • Cleared transactions; • Default fund contributions; • Unsettled transactions; • Securitization exposures; and • Equity exposures.

	(c)	Standardized market risk-weighted assets as calculated under subpart F of this [PART].[105]
	(d)	Common equity tier 1, tier 1 and total risk-based capital ratios: • For the top consolidated group; and • For each depository institution subsidiary.
	(e)	Total risk-weighted assets.

Table 14.4 – Capital Conservation Buffer

Quantitative Disclosures	(a)	At least quarterly, the [BANK] must calculate and publicly disclose the capital conservation buffer as described under §___.11.
	(b)	At least quarterly, the [BANK] must calculate and publicly disclose the eligible retained income of the [BANK], as described under §___.11.
	(c)	At least quarterly, the [BANK] must calculate and publicly disclose any limitations it has on capital distributions and discretionary bonus payments resulting from the capital conservation buffer framework described under §___.11, including the maximum payout amount for the quarter.

General qualitative disclosure requirement

For each separate risk area described in tables 14.5 through 14.10, the [BANK] must describe its risk management objectives and policies, including: strategies and processes; the structure and organization of the relevant risk management function; the scope and nature of risk reporting and/or measurement systems; policies for hedging and/or mitigating risk and strategies and processes for monitoring the continuing effectiveness of hedges/mitigants.

[105] Standardized market risk-weighted assets determined under subpart F are to be disclosed only for the approaches used.

Table 14.5[106] – Credit Risk: General Disclosures

Qualitative Disclosures	(a)	The general qualitative disclosure requirement with respect to credit risk (excluding counterparty credit risk disclosed in accordance with Table 14.6), including the: • Policy for determining past due or delinquency status; • Policy for placing loans on nonaccrual; • Policy for returning loans to accrual status; • Definition of and policy for identifying impaired loans (for financial accounting purposes); • Description of the methodology that the [BANK] uses to estimate its allowance for loan losses, including statistical methods used where applicable; • Policy for charging-off uncollectible amounts; and • Discussion of the [BANK]'s credit risk management policy.
Quantitative Disclosures	(b)	Total credit risk exposures and average credit risk exposures, after accounting offsets in accordance with GAAP,[107] without taking into account the effects of credit risk mitigation techniques (for example, collateral and netting not permitted under GAAP), over the period categorized by major types of credit exposure. For example, [BANK]s could use categories similar to that used for financial statement purposes. Such categories might include, for instance (a) loans, off-balance sheet commitments, and other non-derivative off-balance sheet exposures, (b) debt securities, and (c) OTC derivatives.
	(c)	Geographic[108] distribution of exposures, categorized in significant areas by major types of credit exposure.
	(d)	Industry or counterparty type distribution of exposures, categorized by major types of credit exposure.

[106] Table 14.5 does not cover equity exposures.

[107] See, for example, ASC Topic 815-10 and 210-20 (formerly FASB Interpretation Numbers 37 and 41).

[108] Geographical areas may consist of individual countries, groups of countries, or regions within countries. A [BANK] might choose to define the geographical areas based on the way the [BANK]'s portfolio is geographically managed. The criteria used to allocate the loans to geographical areas must be specified.

	(e)	By major industry or counterparty type: • Amount of impaired loans for which there was a related allowance under GAAP; • Amount of impaired loans for which there was no related allowance under GAAP; • Amount of loans past due 90 days and on nonaccrual; • Amount of loans past due 90 days and still accruing;[109] • The balance in the allowance for credit losses at the end of each period, disaggregated on the basis of the [BANK]'s impairment method. To disaggregate the information required on the basis of impairment methodology, an entity shall separately disclose the amounts based on the requirements in GAAP; and • Charge-offs during the period.
	(f)	Amount of impaired loans and, if available, the amount of past due loans categorized by significant geographic areas including, if practical, the amounts of allowances related to each geographical area[110], further categorized as required by GAAP.
	(g)	Reconciliation of changes in ALLL.[111]
	(h)	Remaining contractual maturity delineation (for example, one year or less) of the whole portfolio, categorized by credit exposure.

[109] A [BANK] is encouraged also to provide an analysis of the aging of past-due loans.

[110] The portion of the general allowance that is not allocated to a geographical area should be disclosed separately.

[111] The reconciliation should include the following: a description of the allowance; the opening balance of the allowance; charge-offs taken against the allowance during the period; amounts provided (or reversed) for estimated probable loan losses during the period; any other adjustments (for example, exchange rate differences, business combinations, acquisitions and disposals of subsidiaries), including transfers between allowances; and the closing balance of the allowance. Charge-offs and recoveries that have been recorded directly to the income statement should be disclosed separately.

Table 14.6 – General Disclosure for Counterparty Credit Risk-Related Exposures

Qualitative Disclosures	(a)	The general qualitative disclosure requirement with respect to OTC derivatives, eligible margin loans, and repo-style transactions, including a discussion of: • The methodology used to assign credit limits for counterparty credit exposures; • Policies for securing collateral, valuing and managing collateral, and establishing credit reserves; • The primary types of collateral taken; and • The impact of the amount of collateral the [BANK] would have to provide given a deterioration in the [BANK]'s own creditworthiness.
Quantitative Disclosures	(b)	Gross positive fair value of contracts, collateral held (including type, for example, cash, government securities), and net unsecured credit exposure.[112] A [BANK] also must disclose the notional value of credit derivative hedges purchased for counterparty credit risk protection and the distribution of current credit exposure by exposure type.[113]
	(c)	Notional amount of purchased and sold credit derivatives, segregated between use for the [BANK]'s own credit portfolio and in its intermediation activities, including the distribution of the credit derivative products used, categorized further by protection bought and sold within each product group.

[112] Net unsecured credit exposure is the credit exposure after considering both the benefits from legally enforceable netting agreements and collateral arrangements without taking into account haircuts for price volatility, liquidity, etc.

[113] This may include interest rate derivative contracts, foreign exchange derivative contracts, equity derivative contracts, credit derivatives, commodity or other derivative contracts, repo-style transactions, and eligible margin loans.

Table 14.7 – Credit Risk Mitigation [114, 115]

Qualitative Disclosures	(a)	The general qualitative disclosure requirement with respect to credit risk mitigation, including: • Policies and processes for collateral valuation and management; • A description of the main types of collateral taken by the [BANK]; • The main types of guarantors/credit derivative counterparties and their creditworthiness; and • Information about (market or credit) risk concentrations with respect to credit risk mitigation.
Quantitative Disclosures	(b)	For each separately disclosed credit risk portfolio, the total exposure that is covered by eligible financial collateral, and after the application of haircuts.
	(c)	For each separately disclosed portfolio, the total exposure that is covered by guarantees/credit derivatives and the risk-weighted asset amount associated with that exposure.

[114] At a minimum, a [BANK] must provide the disclosures in Table 14.7 in relation to credit risk mitigation that has been recognized for the purposes of reducing capital requirements under this subpart. Where relevant, [BANK]s are encouraged to give further information about mitigants that have not been recognized for that purpose.

[115] Credit derivatives that are treated, for the purposes of this subpart, as synthetic securitization exposures should be excluded from the credit risk mitigation disclosures and included within those relating to securitization (Table 14.8).

Table 14.8 Securitization

Qualitative Disclosures	(a)	The general qualitative disclosure requirement with respect to securitization (including synthetic securitizations), including a discussion of: • The [BANK]'s objectives for securitizing assets, including the extent to which these activities transfer credit risk of the underlying exposures away from the [BANK] to other entities and including the type of risks assumed and retained with resecuritization activity;[116] • The nature of the risks (e.g. liquidity risk) inherent in the securitized assets; • The roles played by the [BANK] in the securitization process[117] and an indication of the extent of the [BANK]'s involvement in each of them; • The processes in place to monitor changes in the credit and market risk of securitization exposures including how those processes differ for resecuritization exposures; • The [BANK]'s policy for mitigating the credit risk retained through securitization and resecuritization exposures; and • The risk-based capital approaches that the [BANK] follows for its securitization exposures including the type of securitization exposure to which each approach applies.
	(b)	A list of: • The type of securitization SPEs that the [BANK], as sponsor, uses to securitize third-party exposures. The [BANK] must indicate whether it has exposure to these SPEs , either on- or off- balance sheet; and • Affiliated entities (i) that the [BANK] manages or advises and (ii) that invest either in the securitization exposures that the [BANK] has securitized or in securitization SPEs that the [BANK] sponsors.[118]

[116] The [BANK] should describe the structure of resecuritizations in which it participates; this description should be provided for the main categories of resecuritization products in which the [BANK] is active.

[117] For example, these roles may include originator, investor, servicer, provider of credit enhancement, sponsor, liquidity provider, or swap provider.

[118] Such affiliated entities may include, for example, money market funds, to be listed individually, and personal and private trusts, to be noted collectively.

	(c)	Summary of the [BANK]'s accounting policies for securitization activities, including: • Whether the transactions are treated as sales or financings; • Recognition of gain-on-sale; • Methods and key assumptions applied in valuing retained or purchased interests; • Changes in methods and key assumptions from the previous period for valuing retained interests and impact of the changes; • Treatment of synthetic securitizations; • How exposures intended to be securitized are valued and whether they are recorded under subpart D; and • Policies for recognizing liabilities on the balance sheet for arrangements that could require the [BANK] to provide financial support for securitized assets.
	(d)	An explanation of significant changes to any quantitative information since the last reporting period.
Quantitative Disclosures	(e)	The total outstanding exposures securitized[119] by the [BANK] in securitizations that meet the operational criteria provided in §___.41 (categorized into traditional and synthetic securitizations), by exposure type,[120] separately for securitizations of third-party exposures for which the bank acts only as sponsor.
	(f)	For exposures securitized by the [BANK] in securitizations that meet the operational criteria in §___.41: • Amount of securitized assets that are impaired[121]/past due categorized by exposure type; and • Losses recognized by the [BANK] during the current period categorized

[119] "Exposures securitized" include underlying exposures originated by the bank, whether generated by them or purchased, and recognized in the balance sheet, from third parties, and third-party exposures included in sponsored transactions. Securitization transactions (including underlying exposures originally on the bank's balance sheet and underlying exposures acquired by the bank from third-party entities) in which the originating bank does not retain any securitization exposure should be shown separately but need only be reported for the year of inception.

[120] Banks are required to disclose exposures regardless of whether there is a capital charge under Pillar 1.

[121] Include credit-related other than temporary impairment (OTTI).

		by exposure type. [122]
	(g)	The total amount of outstanding exposures intended to be securitized categorized by exposure type.
	(h)	Aggregate amount of: • On-balance sheet securitization exposures retained or purchased categorized by exposure type; and • Off-balance sheet securitization exposures categorized by exposure type.
	(i)	• Aggregate amount of securitization exposures retained or purchased and the associated capital requirements for these exposures, categorized between securitization and resecuritization exposures, further categorized into a meaningful number of risk weight bands and by risk-based capital approach (e.g., SSFA); and • Exposures that have been deducted entirely from tier 1 capital, credit enhancing I/Os deducted from total capital (as described in §___.42(a)(1), and other exposures deducted from total capital should be disclosed separately by exposure type.
	(j)	Summary of current year's securitization activity, including the amount of exposures securitized (by exposure type), and recognized gain or loss on sale by exposure type.
	(k)	Aggregate amount of resecuritization exposures retained or purchased categorized according to: • Exposures to which credit risk mitigation is applied and those not applied; and • Exposures to guarantors categorized according to guarantor credit worthiness categories or guarantor name.

[122] For example, charge-offs/allowances (if the assets remain on the bank's balance sheet) or credit-related OTTI of I/O strips and other retained residual interests, as well as recognition of liabilities for probable future financial support required of the bank with respect to securitized assets.

Table 14.9 – Equities Not Subject to Subpart F of this [PART]

Qualitative Disclosures	(a)	The general qualitative disclosure requirement with respect to equity risk for equities not subject to subpart F of this [PART], including: • Differentiation between holdings on which capital gains are expected and those taken under other objectives including for relationship and strategic reasons; and • Discussion of important policies covering the valuation of and accounting for equity holdings not subject to subpart F of this [PART]. This includes the accounting techniques and valuation methodologies used, including key assumptions and practices affecting valuation as well as significant changes in these practices.
Quantitative Disclosures	(b)	Value disclosed on the balance sheet of investments, as well as the fair value of those investments; for securities that are publicly-traded, a comparison to publicly-quoted share values where the share price is materially different from fair value.
	(c)	The types and nature of investments, including the amount that is: • Publicly-traded; and • Non publicly-traded.
	(d)	The cumulative realized gains (losses) arising from sales and liquidations in the reporting period.
	(e)	• Total unrealized gains (losses)[123] • Total latent revaluation gains (losses)[124] • Any amounts of the above included in tier 1 or tier 2 capital.

[123] Unrealized gains (losses) recognized on the balance sheet but not through earnings.

[124] Unrealized gains (losses) not recognized either on the balance sheet or through earnings.

	(f)	Capital requirements categorized by appropriate equity groupings, consistent with the [BANK]'s methodology, as well as the aggregate amounts and the type of equity investments subject to any supervisory transition regarding regulatory capital requirements.

Table 14.10 – Interest Rate Risk for Non-trading Activities

Qualitative disclosures	(a)	The general qualitative disclosure requirement, including the nature of interest rate risk for non-trading activities and key assumptions, including assumptions regarding loan prepayments and behavior of non-maturity deposits, and frequency of measurement of interest rate risk for non-trading activities.
Quantitative disclosures	(b)	The increase (decline) in earnings or economic value (or relevant measure used by management) for upward and downward rate shocks according to management's method for measuring interest rate risk for non-trading activities, categorized by currency (as appropriate).

[END OF COMMON RULE TEXT]

List of Subjects

12 CFR Part 3

Administrative practices and procedure, Capital, National banks, Reporting and recordkeeping requirements, Risk.

12 CFR 217

Banks, banking, Federal Reserve System, Holding companies, Reporting and recordkeeping requirements, Securities.

12 CFR Part 325

Administrative practice and procedure, Banks, banking, Capital Adequacy, Reporting and recordkeeping requirements, Savings associations, State non-member banks.

Adoption of Proposed Common Rule

The adoption of the proposed common rules by the agencies, as modified by agency-specific text, is set forth below:

DEPARTMENT OF THE TREASURY

Office of the Comptroller of the Currency

12 CFR Chapter I

Authority and Issuance

For the reasons set forth in the common preamble and under the authority of 12 U.S.C. 93a and 5412(b)(2)(B), the Office of the Comptroller of the Currency proposes to further amend part 3 of chapter I of title 12, Code of Federal Regulations as proposed to be amended elsewhere in this issue of the Federal Register under Docket IDs OCC-2012-0008 and OCC-2012-0010, as follows:

PART 3 – MINIMUM CAPITAL RATIOS; ISSUANCE OF DIRECTIVES

1. The authority citation for part 3 is revised to read as follows:

Authority: 12 U.S.C. 93a, 161, 1462, 1462a, 1463, 1464, 1818, 1828(n), 1828 note, 1831n note, 1835, 3907, 3909, and 5412(b)(2)(B).

2. Subparts A-G of part 3 are amended as set forth below:

i. Remove "[AGENCY]" and add "OCC" in its place, wherever it appears;

ii. Remove "[BANK]" and add "national bank and Federal savings association" in its place, wherever it appears in the phrase "Each [BANK]" or "each [BANK]";

iii. Remove "[BANK]" and add "national bank or Federal savings association" in its place, wherever it appears in the phrases "A [BANK]", "a [BANK]", "The [BANK]", or "the [BANK]";

iv. Remove "[BANKS]" and add "national banks and Federal savings associations" in its place, wherever it appears;

v. Remove "[PART]" and add "Part 3" in its place, wherever it appears;

vi. Remove "[AGENCY]" and add "OCC" in its place, wherever it appears; and

vii. Remove "[REGULATORY REPORT]" and add "Call Report" in its place, wherever it appears.

Board of Governors of the Federal Reserve System

12 CFR CHAPTER II

Authority and Issuance

For the reasons set forth in the common preamble, part 217 of chapter II of title 12 of the Code of Federal Regulations are proposed to be amended as follows:

PART 217 – CAPITAL ADEQUACY OF BANK HOLDING COMPANIES, SAVINGS AND LOAN HOLDING COMPANIES, AND STATE MEMBER BANKS

1. The authority citation for part [217] shall read as follows:

Authority: 12 U.S.C. 248(a), 321–338a, 481-486, 1462a, 1467a, 1818, 1828, 1831n, 1831o, 1831p–l, 1831w, 1835, 1844(b), 3904, 3906-3909, 4808, 5365, 5371.

2. Part 217 is added as set forth at the end of the common preamble.

3. Part 217 is amended as set forth below:

a. Remove "[AGENCY]" and add "Board" in its place wherever it appears.

b. Remove "[BANK]" and add "Board-regulated institution" in its place wherever it appears.

c. Remove "[REGULATORY REPORT]" wherever it appears and add in its place "Consolidated Reports of Condition and Income (Call Report), for a state member bank, or the Consolidated Financial Statements for Bank Holding Companies (FR Y–9C), for a bank holding company or savings and loan holding company, as applicable" the first time it appears and "Call Report, for a state member bank, or FR Y-9C, for a bank holding company or savings and loan holding company, as applicable" every time thereafter;

d. Remove "[PART]" and add "part" in its place wherever it appears.

e. In §___.217.32, revise paragraphs (g)(3)(ii)(B), (k), and (l)(1) and (6), and add new paragraph (m):

§ 217.32 General Risk Weights.

* * * * *

(g) * * *

(3) * * *

(ii) * * *

(B) A Board-regulated institution must base all estimates of a property's value on an appraisal or evaluation of the property that satisfies subpart E of 12 CFR part 208.

* * * * *

(k) Past due exposures. Except for an exposure to a sovereign entity or a residential mortgage exposure or a policy loan, if an exposure is 90 days or more past due or on nonaccrual:

* * * * *

(l) Other assets.

(1)(A) A bank holding company or savings and loan holding company must assign a zero percent risk weight to cash owned and held in all offices of subsidiary depository institutions or in transit, and to gold bullion held in a subsidiary depository institution's own vaults, or held in another depository institution's vaults on an allocated basis, to the extent the gold bullion assets are offset by gold bullion liabilities.

(B) A state member bank must assign a zero percent risk weight to cash owned and held in all offices of the state member bank or in transit; to gold bullion held in the state member bank's own vaults or held in another depository institution's vaults on an allocated basis, to the extent the gold bullion assets are offset by gold bullion liabilities; and to exposures that arise from the settlement of cash transactions (such as equities, fixed income, spot foreign exchange and spot commodities) with a central counterparty where there is no assumption of ongoing counterparty credit risk by the central counterparty after settlement of the trade and associated default fund contributions.

* * * * *

(6) Notwithstanding the requirements of this section, a state member bank may assign an asset that is not included in one of the categories provided in this section to the risk weight category applicable under the capital rules applicable to bank holding companies and savings and loan holding companies under this part, provided that all of the following conditions apply:

* * * * *

(m) Other--insurance assets.

(1) Assets held in a separate account. (i) A bank holding company or savings and loan holding company must risk-weight the individual assets held in a separate account that does not qualify as a non-guaranteed separate account as if the individual assets were held directly by the bank holding company or savings and loan holding company.

(ii) A bank holding company or savings and loan holding company must assign a zero percent risk weight to an asset that is held in a non-guaranteed separate account.

(2) Policy loans. A bank holding company or savings and loan holding company must assign a 20 percent risk weight to a policy loan.

* * * * *

f. In §___.217. 42, revise paragraphs (h)(1)(iv) to read as follows:

§217.42 Risk-weighted Assets for Securitization Exposures

* * * * *

(h)(1)

* * * * *

(iv) In the case of a state member bank, the bank is well capitalized, as defined in 12 CFR 208.43. For purposes of determining whether a state member bank is well capitalized for purposes of this paragraph, the state member bank's capital ratios must be calculated without regard to the capital treatment for transfers of small-business obligations under this paragraph.

(B) In the case of a bank holding company or savings and loan holding company, the bank holding company or savings and loan holding company is well capitalized, as defined in 12 CFR 225.2. For purposes of determining whether a bank holding company or savings and loan holding company is well capitalized for purposes of this paragraph, the bank holding company or savings and loan holding company's capital ratios must be calculated without regard to the capital treatment for transfers of small-business obligations with recourse specified in paragraph (k)(1) of this section.

* * * * *

g. In §___.217.52, revise paragraph (b)(3)(i) to read as follows:

§ 217.52 Simple Risk-Weight Approach (SRWA).

* * * * *

(b) * * *

(3) * * *

(i) Community development equity exposures.

(A) For state member banks and bank holding companies, an equity exposure that qualifies as a community development investment under 12 U.S.C. 24 (Eleventh), excluding equity exposures to an unconsolidated small business investment company and equity exposures held through a consolidated small business investment company described in section 302 of the Small Business Investment Act of 1958 (15 U.S.C. 682).

(B) For savings and loan holding companies, an equity exposure that is designed primarily to promote community welfare, including the welfare of low- and moderate-income

communities or families, such as by providing services or employment, and excluding equity exposures to an unconsolidated small business investment company and equity exposures held through a small business investment company described in section 302 of the Small Business Investment Act of 1958 (15 U.S.C. 682).

Federal Deposit Insurance Corporation

12 CFR CHAPTER III

Authority and Issuance

For the reasons set forth in the common preamble, the Federal Deposit Insurance Corporation proposes to amend part 324 of chapter III of title 12 of the Code of Federal Regulations as follows:

PART 324 – CAPITAL ADEQUACY

1. Remove "[Authority citations to come]" and add in its place wherever it appears: "12 U.S.C. 1815(a), 1815(b), 1816, 1818(a), 1818(b), 1818(c), 1818(t), 1819(Tenth), 1828(c), 1828(d), 1828(i), 1828(n), 1828(o), 1831o, 1835, 3907, 3909, 4808; 5371; 5412; Pub. L. 102-233, 105 Stat. 1761, 1789, 1790 (12 U.S.C. 1831n note); Pub. L. 102-242, 105 Stat. 2236, 2355, as amended by Pub. L. 103-325, 108 Stat. 2160, 2233 (12 U.S.C. 1828 note); Pub. L. 102-242, 105 Stat. 2236, 2386, as amended by Pub. L. 102-550, 106 Stat. 3672, 4089 (12 U.S.C. 1828 note); Pub. L. 111-203, 124 Stat. 1376, 1887 (15 U.S.C. 78o-7 note).";

2. Subpart D is added as set forth at the end of the common preamble.

3. Subpart D is amended as set forth below:

a. Remove "[AGENCY]" and add "FDIC" in its place, wherever it appears;

b. Remove "[banking organization]" and add "bank and state savings accociation" in its place, wherever it appears;

c. Remove "[BANK]" and add "bank and state savings association" in its place, wherever it appears in the phrase "Each [BANK]" or "each [BANK]";

d. Remove "[BANK]" and add "bank or state savings association" in its place, wherever it appears in the phrase "A [BANK]", "a [BANK]", "The [BANK]", or "the [BANK]";

e. Remove "[BANKS]" and add "banks and state savings associations" in its place, wherever it appears;

f. Remove "[PART]" and add "Part 324" in its place, wherever it appears;

g. Remove "[general and specific]" and add "general and specific"; in its place, wherever it appears; and

h. Remove “[REGULATORY REPORT]” and add “Consolidated Reports of Condition and Income (Call Report)” in its place the first time it appears, and add “Call Report” in its place, wherever it appears every time thereafter.

DEPARTMENT OF THE TREASURY
Office of the Comptroller of the Currency
12 CFR Part 3
Docket No. ID OCC-2012-0010
RIN 1557-AD46

FEDERAL RESERVE SYSTEM
12 CFR Parts 208, 217, and 225
Regulations H, Q, and Y
Docket No. R-[XX]
RIN [XX]

FEDERAL DEPOSIT INSURANCE CORPORATION
12 CFR Parts 324 and 325
RIN 3064-D97

Regulatory Capital Rules:

Advanced Approaches Risk-based Capital Rule; Market Risk Capital Rule

AGENCIES: Office of the Comptroller of the Currency, Treasury; the Board of Governors of the Federal Reserve System; and the Federal Deposit Insurance Corporation.

ACTION: Joint notice of proposed rulemaking.

SUMMARY: The Office of the Comptroller of the Currency (OCC), Board of Governors of the Federal Reserve System (Board), and the Federal Deposit Insurance Corporation (FDIC) (collectively, the agencies) are seeking comment on three notices of proposed rulemaking (NPRs) that would revise and replace the agencies' current capital rules.

In this NPR (Advanced Approaches and Market Risk NPR) the agencies are proposing to revise the advanced approaches risk-based capital rule to incorporate certain aspects of "Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems" (Basel III) that the agencies would apply only to advanced approach banking organizations. This NPR also proposes other changes to the advanced approaches rule that the agencies believe are consistent with changes by the Basel Committee on Banking Supervision (BCBS) to its "International Convergence of Capital Measurement and Capital Standards: A Revised Framework" (Basel II), as revised by the BCBS between 2006 and 2009, and recent consultative papers published by the BCBS. The agencies also propose to revise the advanced approaches risk-based capital rule to be consistent with Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act). These revisions include replacing references to credit ratings with alternative standards of creditworthiness consistent with section 939A of the Dodd-Frank Act.

Additionally, the OCC and FDIC are proposing that the market risk capital rule be applicable to federal and state savings associations, and the Board is proposing that the advanced approaches and market risk capital rules apply to top-tier savings and loan holding companies

domiciled in the United States that meet the applicable thresholds. In addition, this NPR would codify the market risk rule consistent with the proposed codification of the other regulatory capital rules across the three proposals.

In connection with the proposed changes to the agencies' capital rules in this NPR, the agencies are also seeking comment on the two related NPRs published elsewhere in today's Federal Register. In the notice titled "Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Corrective Action" (Basel III NPR) the agencies are proposing to revise their minimum risk-based capital requirements and criteria for regulatory capital, as well as establish a capital conservation buffer framework, consistent with Basel III. The Basel III NPR also includes transition provisions for banking organizations to come into compliance with its requirements.

In the notice titled "Regulatory Capital Rules: Standardized Approach for Risk-weighted Assets; Market Discipline and Disclosure Requirements" (Standardized Approach NPR), the agencies are proposing to revise and harmonize their rules for calculating risk-weighted assets to enhance risk sensitivity and address weaknesses identified over recent years, including by incorporating aspects of the standardized framework in Basel II, and providing alternatives to credit ratings, consistent with section 939A of the Dodd-Frank Act. The revisions include methodologies for determining risk-weighted assets for residential mortgages, securitization exposures, and counterparty credit risk. The Standardized Approach NPR also would introduce disclosure requirements that would apply to top-tier banking organizations domiciled in the United States with $50 billion or more in total assets, including disclosures related to regulatory capital instruments.

The proposed requirements in the Basel III NPR and Standardized Approach NPR would apply to all banking organizations that are currently subject to minimum capital requirements (including national banks, state member banks, state nonmember banks, state and federal savings associations, and top-tier bank holding companies domiciled in the United States not subject to the Board's Small Bank Holding Company Policy Statement (12 CFR part 225, appendix C)), as well as top-tier savings and loan holding companies domiciled in the United States (collectively, banking organizations).

The proposals are being published in three separate NPRs to reflect the distinct objectives of each proposal, to allow interested parties to better understand the various aspects of the overall capital framework, including which aspects of the rules would apply to which banking organizations, and to help interested parties better focus their comments on areas of particular interest.

DATES: Comments must be submitted on or before September 7, 2012.

ADDRESSES: Comments should be directed to:

OCC: Because paper mail in the Washington, D.C. area and at the OCC is subject to delay, commenters are encouraged to submit comments by the Federal eRulemaking Portal or e-mail, if possible. Please use the title "Regulatory Capital Rules: Advanced Approaches Risk-

based Capital Rule; Market Risk Capital Rule" to facilitate the organization and distribution of the comments. You may submit comments by any of the following methods:

- Federal eRulemaking Portal – "Regulations.gov": Go to http://www.regulations.gov, under the "More Search Options" tab click next to the "Advanced Docket Search" option where indicated, select "Comptroller of the Currency" from the agency drop-down menu, and then click "Submit." In the "Docket ID" column, select "OCC-2012-0010" to submit or view public comments and to view supporting and related materials for this proposed rule. The "How to Use This Site" link on the Regulations.gov home page provides information on using Regulations.gov, including instructions for submitting or viewing public comments, viewing other supporting and related materials, and viewing the docket after the close of the comment period.

- E-mail: regs.comments@occ.treas.gov.

- Mail: Office of the Comptroller of the Currency, 250 E Street, S.W., Mail Stop 2-3, Washington, DC 20219.

- Fax: (202) 874-5274.

- Hand Delivery/Courier: 250 E Street, S.W., Mail Stop 2-3, Washington, D.C. 20219.

Instructions: You must include "OCC" as the agency name and "Docket Number OCC-2012-0010]" in your comment. In general, OCC will enter all comments received into the docket and publish them on the Regulations.gov Web site without change, including any business or personal information that you provide such as name and address information, e-mail addresses, or phone numbers. Comments received, including attachments and other supporting materials, are part of the public record and subject to public disclosure. Do not enclose any information in your comment or supporting materials that you consider confidential or inappropriate for public disclosure. You may review comments and other related materials that pertain to this notice by any of the following methods:

- Viewing Comments Electronically: Go to http://www.regulations.gov. Select ''Document Type'' of ''Public Submissions,'' in ''Enter Keyword or ID Box,'' enter Docket ID ''OCC–2012–0010,'' and click ''Search.'' Comments will be listed under ''View By Relevance'' tab at bottom of screen. If comments from more than one agency are listed, the ''Agency'' column will indicate which comments were received by the OCC.

- Viewing Comments Personally: You may personally inspect and photocopy comments at the OCC, 250 E Street, S.W., Washington, D.C. For security reasons, the OCC requires that visitors make an appointment to inspect comments. You may do so by calling (202) 874-4700. Upon arrival, visitors will be required to present valid government-issued photo identification and to submit to security screening in order to inspect and photocopy comments.

- Docket: You may also view or request available background documents and project summaries using the methods described above.

Board: When submitting comments, please consider submitting your comments by e-mail or fax because paper mail in the Washington, D.C. area and at the Board may be subject to delay. You may submit comments, identified by Docket No. [XX][XX], by any of the following methods:

- Agency Web Site: http://www.federalreserve.gov. Follow the instructions for submitting comments at http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm.

- Federal eRulemaking Portal: http://www.regulations.gov. Follow the instructions for submitting comments.

- E-mail: regs.comments@federalreserve.gov. Include docket number in the subject line of the message.

- Fax: (202) 452-3819 or (202) 452-3102.

- Mail: Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, N.W., Washington, D.C. 20551.

All public comments are available from the Board's website at http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm as submitted, unless modified for technical reasons. Accordingly, your comments will not be edited to remove any identifying or contact information. Public comments may also be viewed electronically or in paper form in Room MP-500 of the Board's Martin Building (20th and C Street, N.W., Washington, D.C. 20551) between 9:00 a.m. and 5:00 p.m. on weekdays.

FDIC: You may submit comments by any of the following methods:

- Federal eRulemaking Portal: http://www.regulations.gov. Follow the instructions for submitting comments.

- Agency Web site: http://www.FDIC.gov/regulations/laws/federal/propose.html

- Mail: Robert E. Feldman, Executive Secretary, Attention: Comments/Legal ESS, Federal Deposit Insurance Corporation, 550 17th Street, N.W., Washington, D.C. 20429.

- Hand Delivered/Courier: The guard station at the rear of the 550 17th Street Building (located on F Street), on business days between 7:00 a.m. and 5:00 p.m.

- E-mail: comments@FDIC.gov.

  Instructions: Comments submitted must include "FDIC" and "RIN [xx][xx]-[xx][xx]." Comments received will be posted without change to http://www.FDIC.gov/regulations/laws/federal/propose.html, including any personal information provided.

FOR FURTHER INFORMATION CONTACT:

OCC: Margot Schwadron, Senior Risk Expert, (202) 874-6022, David Elkes, Risk Expert, (202) 874- 3846, or Mark Ginsberg, Risk Expert, (202) 927-4580, or Ron Shimabukuro, Senior Counsel, Patrick Tierney, Counsel, Carl Kaminski, Senior Attorney, or Kevin Korzeniewski, Attorney, Legislative and Regulatory Activities Division, (202) 874-5090, Office of the Comptroller of the Currency, 250 E Street, S.W., Washington, D.C. 20219.

Board: Anna Lee Hewko, Assistant Director, Capital and Regulatory Policy, (202) 530-6260, Thomas Boemio, Manager, Capital and Regulatory Policy, (202) 452-2982, or Constance M. Horsley, Manager, Capital and Regulatory Policy, (202) 452-5239, Division of Banking Supervision and Regulation; or Benjamin W. McDonough, Senior Counsel, (202) 452-2036, or April C. Snyder, Senior Counsel, (202) 452-3099, Legal Division, Board of Governors of the Federal Reserve System, 20th and C Streets, N.W., Washington, D.C. 20551. For the hearing impaired only, Telecommunication Device for the Deaf (TDD), (202) 263-4869.

FDIC: Bobby R. Bean, Associate Director, bbean@fdic.gov; Ryan Billingsley, Senior Policy Analyst, rbillingsley@fdic.gov; or Karl Reitz, Senior Policy Analyst, kreitz@fdic.gov, Capital Markets Branch, Division of Risk Management Supervision, (202) 898-6888; or Mark Handzlik, Counsel, mhandzlik@fdic.gov, Michael Phillips, Counsel, mphillips@fdic.gov; or Greg Feder, Counsel, gfeder@fdic.gov, Ryan Clougherty, Senior Attorney, rclougherty@fdic.gov; Supervision Branch, Legal Division, Federal Deposit Insurance Corporation, 550 17th Street, N.W., Washington, D.C. 20429.

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I. Introduction

The Office of the Comptroller of the Currency (OCC), Board of Governors of the Federal Reserve System (Board), and the Federal Deposit Insurance Corporation (FDIC) (collectively, the agencies) are issuing this notice of proposed rulemaking (NPR, proposal, or proposed rule) to revise the advanced approaches risk-based capital rule (advanced approaches rule) to incorporate certain aspects of Basel III: A global regulatory framework for more resilient banks and banking systems (Basel III). This NPR also proposes to revise the advanced approaches rule to incorporate other revisions to the Basel capital framework published by the Basel Committee on Banking Supervision (BCBS) in a series of documents between 2009 and 2011[1] and subsequent consultative papers. The proposal would also address relevant provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act), and incorporate certain technical amendments to the existing requirements.[2]

In this NPR, the Board also proposes applying the advanced approaches rule and the market risk rule to savings and loan holding companies, and the Board, FDIC, and OCC propose applying the market risk capital rule to savings and loan holding companies and to state and federal savings associations, respectively. In addition, this NPR would codify the market risk rule in a manner similar to the other regulatory capital rules in the three proposals. In a separate Federal Register notice, also published today, the agencies are finalizing changes to the market risk rule. As described in more detail below, the agencies are proposing changes to the advanced approaches rule in a manner consistent with the BCBS requirements, including the requirements introduced by the BCBS in "Enhancements to the Basel II framework" (2009 Enhancements) in July 2009 and in Basel III.[3] The main proposed revisions to the advanced approaches rule are related to treatment of counterparty credit risk, the securitization framework, and disclosure requirements.

Consistent with Basel III, the proposal seeks to ensure that counterparty credit risk, credit valuation adjustments (CVA), and wrong-way risk are incorporated adequately into the agencies' regulatory capital requirements. More specifically, the NPR would establish a capital requirement for the market value of counterparty credit risk; propose a more risk-sensitive approach for certain transactions with central counterparties, including the treatment of default fund contributions to central counterparties; and make certain adjustments to the methodologies used to calculate counterparty credit risk requirements. In addition, consistent with the "2009 Enhancements," the agencies propose strengthening the risk-based capital requirements for certain securitization exposures by requiring banking organizations that are subject to the

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[1] The BCBS is a committee of banking supervisory authorities, which was established by the central bank governors of the G–10 countries in 1975. It consists of senior representatives of bank supervisory authorities and central banks from Argentina, Australia, Belgium, Brazil, Canada, China, France, Germany, Hong Kong SAR, India, Indonesia, Italy, Japan, Korea, Luxembourg, Mexico, the Netherlands, Russia, Saudi Arabia, Singapore, South Africa, Sweden, Switzerland, Turkey, the United Kingdom, and the United States. Documents issued by the BCBS are available through the Bank for International Settlements Web site at http:// www.bis.org. Basel III was published in December 2010 and revised in June 2011. The text is available at http://www.bis.org/publ/bcbs189.htm.

[2] Pub. L. 111-203, 124 Stat. 1376 (July 21, 2010) (Dodd-Frank Act).

[3] See "Enhancements to the Basel II framework" (July 2009), available at http://www.bis.org/publ/bcbs157.htm.

advanced approaches rule to conduct more rigorous credit analysis of securitization exposures and enhancing the disclosure requirements related to these exposures.

In addition to the incorporation of the BCBS standards, the agencies are proposing changes to the advanced approaches rule in a manner consistent with the Dodd-Frank Act, by removing references to, or requirements of reliance on, credit ratings from their regulations.[4] Accordingly, the agencies are proposing to remove the ratings-based approach and the internal assessment approach for securitization exposures from the advanced approaches rule and require advanced approaches banking organizations to use either the supervisory formula approach (SFA) or a simplified version of the SFA when calculating capital requirements for securitization exposures. The agencies also are proposing to remove references to ratings from certain defined terms under the advanced approaches rule and replace them with alternative standards of creditworthiness. Finally, the proposed rule contains a number of proposed technical amendments that would clarify or adjust existing requirements under the advanced approaches rule.

In addition, in today's Federal Register, the agencies are publishing two separate notices of proposed rulemaking that are both relevant to the calculation of capital requirements for institutions using the advanced approaches rule. The notice titled "Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Corrective Action" (Basel III NPR), which is applicable to all banking organizations, would revise the definition of capital (the numerator of the risk-based capital ratios), establish the new minimum ratio requirements, and make other changes to the agencies' general risk-based capital rules related to regulatory capital. In addition, the Basel III NPR proposes that certain elements of Basel III apply only to institutions using the advanced approaches rule, including a supplementary Basel III leverage ratio and a countercyclical capital buffer. The Basel III NPR also includes transition provisions for banking organizations to come into compliance with the requirements of that proposed rule.

The notice titled "Regulatory Capital Rules: Standardized Approach for Risk-weighted Assets; Market Discipline and Disclosure Requirements" (Standardized Approach NPR) would also apply to all banking organizations. In the Standardized Approach NPR, the agencies are proposing to revise and harmonize their rules for calculating risk-weighted assets to enhance risk sensitivity and address weaknesses identified over recent years, including by incorporating aspects of the BCBS' Basel II standardized framework, changes proposed in recent consultative papers published by the BCBS and alternatives to credit ratings, consistent with section 939A of the Dodd-Frank Act. The revisions include methodologies for determining risk-weighted assets for residential mortgages, securitization exposures, and counterparty credit risk. The Standardized Approach NPR also would introduce disclosure requirements that would apply to top-tier banking organizations domiciled in the United States with $50 billion or more in total assets, including disclosures related to regulatory capital instruments.

The requirements proposed in the Basel III NPR and Standardized Approach NPR, as well as the market risk capital rule in this proposal, are proposed to become the "generally

[4] See section 939A of Dodd-Frank Act (15 U.S.C. 78o-7 note).

applicable" capital requirements for purposes of section 171 of the Dodd-Frank Act because they would be the capital requirements applied to insured depository institutions under section 38 of the Federal Deposit Insurance Act, without regard to asset size or foreign financial exposure. Banking organizations that are or would be subject to the advanced approaches rule (advanced approaches banking organizations) or the market risk rule should also review the Basel III NPR and Standardized Approach NPR.

II. Risk-weighted Assets – Proposed Modifications to the Advanced Approaches

A. Counterparty Credit Risk

The recent financial crisis highlighted certain aspects of the treatment of counterparty credit risk under the Basel II framework that were inadequate and of banking organizations' risk management of counterparty credit risk that were insufficient. The Basel III revisions would address both areas of weakness by ensuring that all material on- and off-balance sheet counterparty risks, including those associated with derivative-related exposures, are appropriately incorporated into banking organizations' risk-based capital ratios. In addition, new risk management requirements in Basel III strengthen the oversight of counterparty credit risk exposures. The agencies are proposing the counterparty credit risk revisions in a manner generally consistent with Basel III, modified to incorporate alternative standards to the use of credit ratings. The discussion below highlights these revisions.

1. Revisions to the Recognition of Financial Collateral

Eligible Financial Collateral

The exposure-at-default (EAD) adjustment approach under section 132 of the proposed rules permit a banking organization to recognize the credit risk mitigation benefits of eligible financial collateral by adjusting the EAD to the counterparty. Such approaches include the collateral haircut approach, simple Value-at-Risk (VaR) approach and the internal models methodology (IMM).

Consistent with Basel III, the agencies are proposing to modify the definition of financial collateral so that resecuritizations would no longer qualify as eligible financial collateral under the advanced approaches rule. Thus, resecuritization collateral could not be used to adjust the EAD of an exposure. The agencies believe that this treatment is appropriate because resecuritizations have been shown to have more market value volatility than other collateral types. During the recent financial crisis, the market volatility of resecuritization exposures made it difficult for resecuritizations to serve as a source of liquidity because banking organizations were unable to sell those positions without incurring substantial loss or to use them as collateral for secured lending transactions.

Under the proposal, a securitization in which one or more of the underlying exposures is a securitization position would be considered a resecuritization. A resecuritization position under the proposal means an on- or off-balance sheet exposure to a resecuritization, or an exposure that directly or indirectly references a resecuritization exposure.

Consistent with these changes excluding less liquid collateral from the definition of financial collateral, the agencies also propose that conforming residential mortgages no longer qualify as financial collateral under the advanced approaches rule. As a result, under this proposal, a banking organization would no longer be able to recognize the credit risk mitigation benefit of such instruments through an adjustment to EAD. In addition, also consistent with the Basel framework, the agencies propose to exclude all debt securities that are not investment grade from the definition of financial collateral. As discussed in section II (B) of this preamble, the agencies are proposing to revise the definition of "investment grade" for both the advanced approaches rule and market risk capital rule.

Revised Supervisory Haircuts

As reflected in Basel III, securitization exposures have increased levels of volatility relative to other collateral types. To address this issue, Basel III incorporates new standardized supervisory haircuts for securitization exposures in the EAD adjustment approach based on the credit rating of the exposure. Consistent with section 939A of the Dodd Frank Act, the agencies are proposing an alternative approach to assigning standard supervisory haircuts for securitization exposures, and are also proposing to amend the standard supervisory haircuts for other types of financial collateral to remove the references to credit ratings.

Under the proposal, as outlined in Table 1 below, the standard supervisory market price volatility haircuts would be revised based on the applicable risk weight of the exposure calculated under the standardized approach. Supervisory haircuts for exposures to sovereigns, government-sponsored entities, public sector entities, depository institutions, foreign banks, credit unions, and corporate issuers would be calculated based upon the risk weights for such exposures described under section 32 of Standardized Approach NPR. The proposed table for the standard supervisory market price volatility haircuts would be revised as follows:

Table 1 – Standard Supervisory Market Price Volatility Haircuts[5]

Residual Maturity	Sovereign issuers that receive a zero percent risk weight (in percent)	Sovereign issuers[6] that receive a 20 percent or 50 percent risk weight (in percent)	Sovereign issuers that receive a 100 percent risk weight (in percent)	Non-sovereign issuers that receive a 20 percent risk weight (in percent)	Non-sovereign issuers that receive a 50 percent risk weight (in percent)	Non-sovereign issuers that receive a 100 percent risk weight (in percent)	Investment grade securitization exposures (in percent)
Less than 1 year	0.5	1.0	15.0	1.0	2.0	25.0	4.0
Greater than 1 year and less than 5 years	2.0	3.0	15.0	4.0	6.0	25.0	12.0
Greater than 5 years	4.0	6.0	15.0	8.0	12.0	25.0	24.0
Main index equities (including convertible bonds) and gold				15.0			
Other publicly traded equities (including convertible bonds)				25.0			
Mutual funds				Highest haircut applicable to any security in which the fund can invest.			
Cash collateral held				0			

[5] The market price volatility haircuts in this table are based on a ten-business-day holding period. A banking organization must adjust the supervisory haircuts upward on the basis of a holding period longer than ten business days (for eligible margin loans) or five business days (for repo-style transactions) where certain conditions are met.

[6] Includes a foreign public sector entity that receives a zero percent risk weight.

The agencies are also proposing to clarify that if a banking organization lends instruments that do not meet the definition of financial collateral used in the Standardized Approach NPR and the advanced approaches rule (as modified by the proposal), such as non-investment grade corporate debt securities or resecuritization exposures, the haircut applied to the exposure would be the same as the haircut for equity that is publicly traded but which is not part of a main index.

Question 1: The agencies solicit comments on the proposed changes to the recognition of financial collateral under the advanced approaches rule.

2. Changes to Holding Periods and the Margin Period of Risk

During the financial crisis, many financial institutions experienced significant delays in settling or closing-out collateralized transactions, such as repo-style transactions and collateralized over-the-counter (OTC) derivatives. The assumed holding period for collateral in the collateral haircut and simple VaR approaches and the margin period of risk in the internal models methodology (IMM) under Basel II proved to be inadequate for certain transactions and netting sets.[7] It also did not reflect the difficulties and delays experienced by institutions when settling or liquidating collateral during a period of financial stress.

Under Basel II, the minimum assumed holding period for collateral and margin period of risk are five days for repo-style transactions, and ten days for other collateralized transactions where liquid financial collateral is posted under a daily margin maintenance requirement. Under Basel III, a banking organization must assume a holding period of 20 business days under the collateral haircut or simple VaR approaches, or must assume a margin period of risk under the IMM of 20 business days for netting sets where: (1) the number of trades exceeds 5,000 at any time during the quarter (except if the counterparty is a central counterparty (CCP) or the netting set consists of cleared transactions with a clearing member); (2) one or more trades involves illiquid collateral posted by the counterparty; or (3) the netting set includes any OTC derivatives that cannot be easily replaced.

For purposes of determining whether collateral is illiquid or an OTC derivative cannot be easily replaced for these purposes, a banking organization could, for example, assess whether, during a period of stressed market conditions, it could obtain multiple price quotes within two days or less for the collateral or OTC derivative that would not move the market or represent a market discount (in the case of collateral) or a premium (in the case of an OTC derivative).

[7] Under the advanced approaches rule, the margin period of risk means, with respect to a netting set subject to a collateral agreement, the time period from the most recent exchange of collateral with a counterparty until the next required exchange of collateral plus the period of time required to sell and realize the proceeds of the least liquid collateral that can be delivered under the terms of the collateral agreement and, where applicable, the period of time required to re-hedge the resulting market risk, upon the default of the counterparty. See 12 CFR part 3, appendix C, and part 167, appendix C (OCC); 12 CFR part 208, appendix F, and 12 CFR part 225, appendix G (Board); 12 CFR part 325, appendix D, and 12 CFR part 390, subpart Z, appendix A (FDIC).

If, over the two previous quarters, more than two margin disputes on a netting set have occurred that lasted longer than the holding period or margin period of risk used in the EAD calculation, then a banking organization would use a holding period or a margin period of risk for that netting set that is at least two times the minimum holding period that would otherwise be used for that netting set. Margin disputes occur when the banking organization and its counterparty do not agree on the value of collateral or on the eligibility of the collateral provided. In addition, such disputes also can occur when a banking organization and its counterparty disagree on the amount of margin that is required, which could result from differences in the valuation of a transaction, or from errors in the calculation of the net exposure of a portfolio (for instance, if a transaction is incorrectly included or excluded from the portfolio).

Consistent with Basel III, the agencies propose to amend the advanced approaches rule to incorporate these adjustments to the holding period in the collateral haircut and simple VaR approaches, and to the margin period of risk in the IMM that a banking organization may use to determine its capital requirement for repo-style transactions, OTC derivative transactions, or eligible margin loans. For cleared transactions, which are discussed below, the agencies propose that a banking organization not be required to adjust the holding period or margin period of risk upward when determining the capital requirement for its counterparty credit risk exposures to the central counterparty, which is also consistent with Basel III.

Question 2: The agencies solicit comments on the proposed changes to holding periods and margin periods of risk.

3. Changes to the Internal Models Methodology (IMM)

During the recent financial crisis, increased volatility in the value of derivative positions and collateral led to higher counterparty exposures than amounts estimated by banking organizations' internal models. To address this issue, under Basel III, when using the IMM, banking organizations are required to determine their capital requirements for counterparty credit risk using stressed inputs. Consistent with Basel III, the agencies propose to amend the advanced approaches rule so that the capital requirement for IMM exposures would be equal to the larger of the capital requirement for those exposures calculated using data from the most recent three-year period and data from a three-year period that contains a period of stress reflected in the credit default spreads of the banking organization's counterparties.

Under the proposal, an IMM exposure would be defined as a repo-style transaction, eligible margin loan, or OTC derivative for which a banking organization calculates its EAD using the IMM. A banking organization would be required to demonstrate to the satisfaction of the banking organization's primary federal supervisor at least quarterly that the stress period coincides with increased credit default swap (CDS) spreads, or other credit spreads of its counterparties and have procedures to evaluate the effectiveness of its stress calibration. These procedures would be required to include a process for using benchmark portfolios that are vulnerable to the same risk factors as the banking organization's portfolio. In addition, the primary federal supervisor could require a banking organization to modify its stress calibration if the primary federal supervisor believes that another calibration would better reflect the actual historic losses of the portfolio.

Consistent with Basel III, the agencies are proposing to require banking organizations to subject its internal models to an initial validation and annual model review process. As part of the model review process, the agencies propose that a banking organization would need to have a back-testing program for its model that includes a process by which unacceptable model performance would be identified and remedied. In addition, the agencies propose that when a banking organization multiplies expected positive exposure (EPE) by the default scaling factor alpha of 1.4 when calculating EAD, the primary federal supervisor may require the banking organization to set that alpha higher based on the performance of the banking organization's internal model.

The agencies also are proposing to require a banking organization to have policies for the measurement, management, and control of collateral, including the reuse of collateral and margin amounts, as a condition of using the IMM. Under the proposal, a banking organization would be required to have a comprehensive stress testing program that captures all credit exposures to counterparties and incorporates stress testing of principal market risk factors and the creditworthiness of its counterparties.

Under Basel II, a banking organization was permitted to capture within its internal model the effect on EAD of a collateral agreement that requires receipt of collateral when the exposure to the counterparty increases. Basel II also contained a "shortcut" method to provide a banking organization whose internal model did not capture the effects of collateral agreements with a method to recognize some benefit from the collateral agreement. Basel III modifies that "shortcut" method by setting effective EPE to a counterparty as the lesser of the following two exposure calculations: (1) the exposure without any held or posted margining collateral, plus any collateral posted to the counterparty independent of the daily valuation and margining process or current exposure, or (2) an add-on that reflects the potential increase of exposure over the margin period of risk plus the larger of (i) the current exposure of the netting set reflecting all collateral received or posted by the banking organization excluding any collateral called or in dispute; or (ii) the largest net exposure (including all collateral held or posted under the margin agreement) that would not trigger a collateral call. The add-on would be computed as the largest expected increase in the netting set's exposure over any margin period of risk in the next year. The agencies propose to include the Basel III modification of the "shortcut" method in this NPR.

Recognition of Wrong-way Risk

The financial crisis also highlighted the interconnectedness of large financial institutions through an array of complex transactions. To recognize this interconnectedness and to mitigate the risk of contagion from the banking sector to the broader financial system and the general economy, Basel III includes enhanced requirements for the recognition and treatment of wrong-way risk in the IMM. The proposed rule would define wrong-way risk as the risk that arises when an exposure to a particular counterparty is positively correlated with the probability of default of such counterparty itself.

The agencies are proposing enhancements to the advanced approaches rule that would require banking organizations' risk management procedures to identify, monitor, and control wrong-way risk throughout the life of an exposure. These risk management procedures should include the use of stress testing and scenario analysis. In addition, where a banking organization

has identified an IMM exposure with specific wrong-way risk, the banking organization would be required to treat that transaction as its own netting set. Specific wrong-way risk is a type of wrong way risk that arises when either the counterparty and issuer of the collateral supporting the transaction, or the counterparty and the reference asset of the transaction, are affiliates or are the same entity.

In addition, where a banking organization has identified an OTC derivative transaction, repo-style transaction, or eligible margin loan with specific wrong-way risk for which the banking organization would otherwise apply the IMM, the banking organization would insert the probability of default (PD) of the counterparty and a loss given default (LGD) equal to 100 percent into the appropriate risk-based capital formula specified in table 1 of section 131 of the proposed rule, then multiply the output of the formula (K) by an alternative EAD based on the transaction type, as follows:

(1) For a purchased credit derivative, EAD would be the fair value of the underlying reference asset of the credit derivative contract;

(2) For an OTC equity derivative,[8] EAD would be the maximum amount that the banking organization could lose if the fair value of the underlying reference asset decreased to zero;

(3) For an OTC bond derivative (that is, a bond option, bond future, or any other instrument linked to a bond that gives rise to similar counterparty credit risks), EAD would be the smaller of the notional amount of the underlying reference asset and the maximum amount that the banking organization could lose if the fair value of the underlying reference asset decreased to zero; and

(4) For repo-style transactions and eligible margin loans, EAD would be calculated using the formula in the collateral haircut approach of section 132 and with the estimated value of the collateral substituted for the parameter C in the equation.

Question 3: The agencies solicit comment on the appropriateness of the proposed calculation of capital requirements for OTC equity or bond derivatives with specific wrong-way risk. What alternatives should be made available to banking organizations in order to calculate the EAD in such cases? What challenges would a banking organization face in estimating the EAD for OTC derivative transactions with specific wrong-way risk if the agencies were to permit a banking organization to use its incremental risk model that meets the requirements of section 8 of the market risk rule instead of the proposed alternatives?

Increased Asset Value Correlation Factor

To recognize the correlation of financial institutions' creditworthiness attributable to similar sensitivities to common risk factors, the agencies are proposing to incorporate the Basel III increase in the correlation factor used in the formula provided in table 1 of section 131

[8] Equity derivatives that are call options are not subject to a counterparty credit risk capital requirement for specific wrong-way risk.

of the proposed rule for certain wholesale exposures. Under the proposed rule, banking organizations would apply a multiplier of 1.25 to the correlation factor for wholesale exposures to unregulated financial institutions that generate a majority of their revenue from financial activities, regardless of asset size. This category would include highly leveraged entities such as hedge funds and financial guarantors. In addition, banking organizations would apply a multiplier of 1.25 to the correlation factor for wholesale exposures to regulated financial institutions with consolidated assets of greater than or equal to $100 billion.

The proposed definitions of "financial institution" and "regulated financial institution" are set forth and discussed in the Basel III NPR.

4. Credit Valuation Adjustments

CVA is the fair value adjustment to reflect counterparty credit risk in the valuation of an OTC derivative contract. The BCBS reviewed the treatment of counterparty credit risk and found that roughly two-thirds of counterparty credit risk losses during the crisis were due to mark-to-market losses from CVA, while one-third of counterparty credit risk losses resulted from actual defaults. Basel II addressed counterparty credit risk as a combination of default risk and credit migration risk. Credit migration risk accounts for market value losses resulting from deterioration of counterparties' credit quality short of default and is addressed in Basel II via the maturity adjustment multiplier. However, the maturity adjustment multiplier in Basel II was calibrated for loan portfolios and may not be suitable for addressing CVA risk. Accordingly, Basel III requires banking organizations to directly reflect CVA risk through an additional capital requirement.

The Basel III CVA capital requirement would reflect the CVA due to changes of counterparties' credit spreads, assuming fixed expected exposure (EE) profiles. Basel III provides two approaches for calculating the CVA capital requirement: the simple approach and the advanced CVA approach. The agencies are proposing both approaches for calculating the CVA capital requirement (subject to certain requirements discussed below), but without references to credit ratings.

Only a banking organization that is subject to the market risk capital rule and has obtained prior approval from its primary federal supervisor to calculate both the EAD for OTC derivative contracts using the IMM described in section 132 of the proposed rule, and the specific risk add-on for debt positions using a specific risk model described in section 207(b) of subpart F would be eligible to use the advanced CVA approach. A banking organization that receives such approval would continue to use the advanced CVA approach until it notifies its primary federal supervisor in writing that it expects to begin calculating its CVA capital requirement using the simple CVA approach. The notice would include an explanation from the banking organization as to why it is choosing to use the simple CVA approach and the date when the banking organization would begin to calculate its CVA capital requirement using the simple CVA approach.

Under the proposal, when calculating a CVA capital requirement, a banking organization would be permitted to recognize the hedging benefits of single name CDS, single name contingent CDS, index CDS (CDS_{ind}), and any other equivalent hedging instrument that

references the counterparty directly, provided that the equivalent hedging instrument is managed as a CVA hedge in accordance with the banking organization's hedging policies. Consistent with Basel III, under this NPR, a tranched or nth-to-default CDS would not qualify as a CVA hedge. In addition, the agencies propose that any position that is recognized as a CVA hedge would not be a covered position under the market risk capital rule, except in the case where the banking organization is using the advanced CVA approach, the hedge is a CDS_{ind}, and the VaR model does not capture the basis between the spreads of the index that is used as the hedging instrument and the hedged counterparty exposure over various time periods, as discussed in further detail below.

To convert the CVA capital requirement to a risk-weighted asset amount, a banking organization would multiply its CVA capital requirement by 12.5. Under the proposal, because the CVA capital requirement reflects market risk, the CVA risk-weighted asset amount would not be a component of credit risk-weighted assets and therefore would not be subject to the 1.06 multiplier for credit risk-weighted assets.

Simple CVA Approach

The agencies are proposing the Basel III formula for the simple CVA approach to calculate the CVA capital requirement (K_{CVA}), with a modification in a manner consistent with section 939A of the Dodd-Frank Act. A banking organization would use the formula below to calculate its CVA capital requirement for OTC derivative transactions. The banking organization would calculate K_{CVA} as the square root of the sum of the capital requirement for each of its OTC derivative counterparties multiplied by 2.33. The simple CVA approach is based on an analytical approximation derived from a general CVA VaR formulation under a set of simplifying assumptions:

- All credit spreads have a flat term structure;
- All credit spreads at the time horizon have a lognormal distribution;
- Each single name credit spread is driven by the combination of a single systematic factor and an idiosyncratic factor;
- The correlation between any single name credit spread and the systematic factor is equal to 0.5;
- All credit indexes are driven by the single systematic factor; and
- The time horizon is short (the square root of time scaling to 1 year is applied in the end).

The approximation is based on the linearization of the dependence of both CVA and CDS hedges on credit spreads. Given the assumptions listed above (most notably, the single-factor assumption), CVA VaR can be expressed using an analytical formula. The formula of the simple CVA approach is obtained by applying certain standardizations, conservative adjustments, and scaling to the analytical CVA VaR result.

A banking organization would calculate K_{CVA}, where:

Formula 1

$$K_{CVA} = 2.33 \times \sqrt{\left(\sum_i 0.5 \times w_i \times \left(M_i \times EAD_i^{total} - M_i^{hedge} \times B_i \right) - \sum_{ind} w_{ind} \times M_{ind} \times B_{ind} \right)^2 + A}$$

Where:

$$A = \sum_i 0.75 \times w_i^2 \times \left(M_i \times EAD_i^{total} - M_i^{hedge} \times B_i \right)^2$$

In Formula 1, w_i refers to the weight applicable to counterparty i assigned according to Table 2 below.[9] In Basel III, the BCBS assigned w_i based on the external rating of the counterparty. However, to comply with the Dodd-Frank requirement to remove references to ratings, the agencies propose to assign w_i based on the relevant PD of the counterparty, as assigned by the banking organization. W_{ind} in Formula 1 refers to the weight applicable to the CDS_{ind} based on the average weight under Table 2 of the underlying reference names that comprise the index.

Table 2 - Assignment of counterparty weight under the simple CVA

Internal PD (in percent)	**Weight W_{ind} (in percent)**
0.00-0.07	0.70
>0.07-0.15	0.80
>0.15-0.40	1.00
>0.4-2.00	2.00
>2.0 - 6.00	3.00
>6.0	10.00

EAD_i^{total} in Formula 1 refers to the sum of the EAD for all netting sets of OTC derivative contracts with counterparty i calculated using the current exposure methodology described in section 132(c) of the proposed rule as adjusted by Formula 2 or the IMM described in section 132(d) of the proposed rule. When the banking organization calculates EAD using the IMM, EAD_i^{total} equals $EAD_{unstressed}$

[9] These weights represent the assumed values of the product of a counterparties' current credit spread and the volatility of that credit spread.

Formula 2[10]

$$EAD \times \left(\frac{1 - exp^{-.05 \times M_i}}{.05 \times M_i} \right)$$

M_i in Formulas 1 and 2 refers to the EAD-weighted average of the effective maturity of each netting set with counterparty i (where each netting set's M cannot be smaller than one). M_i^{hedge} in Formula 1 refers to the notional weighted average maturity of the hedge instrument. M_{ind} in Formula 1 equals the maturity of the CDS_{ind} or the notional weighted average maturity of any CDS_{ind} purchased to hedge CVA risk of counterparty i.

B_i in Formula 1 refers to the sum of the notional amounts of any purchased single name CDS referencing counterparty *i* that is used to hedge CVA risk to counterparty *i* multiplied by $(1-\exp(-0.05 \times M_i^{hedge}))/(0.05 \times M_i^{hedge})$. B_{ind} in Formula 1 refers to the notional amount of one or more CDS_{ind} purchased as protection to hedge CVA risk for counterparty *i* multiplied by $(1-\exp(-0.05 \times M_{ind}))/(0.05 \times M_{ind})$. A banking organization would be allowed to treat the notional amount in the index attributable to that counterparty as a single name hedge of counterparty *i* ($B_{i,}$) when calculating K_{CVA} and subtract the notional amount of B_i from the notional amount of the CDS_{ind}. The banking organization would be required to then calculate its capital requirement for the remaining notional amount of the CDS_{ind} as a stand-alone position.

Advanced CVA Approach

Under the advanced CVA approach, a banking organization would use the VaR model it uses to calculate specific risk under section 205(b) of subpart F or another model that meets the quantitative requirements of sections 205(b) and 207(b) of subpart F to calculate its CVA capital requirement for a counterparty by modeling the impact of changes in the counterparty's credit spreads, together with any recognized CVA hedges on the CVA for the counterparty. A banking organization's total capital requirement for CVA equals the sum of the CVA capital requirements for each counterparty.

The agencies are proposing that the VaR model incorporate only changes in the counterparty's credit spreads, not changes in other risk factors. The banking organization would not be required to capture jump-to-default risk in its VaR model. A banking organization would be required to include any immaterial OTC derivative portfolios for which it uses the current exposure methodology by using the EAD calculated under the current exposure methodology as a constant EE in the formula for the calculation of CVA and setting the maturity equal to the greater of half of the longest maturity occurring in the netting set and the notional weighted average maturity of all transactions in the netting set.

In order for a banking organization to receive approval to use the advanced CVA approach, under the NPR, the banking organization would need to have the systems capability to

[10] The term "exp" is the exponential function.

calculate the CVA capital requirement on a daily basis, but would not be expected or required to calculate the CVA capital requirement on a daily basis.

The CVA capital requirement under the advanced CVA approach would be equal to the general market risk capital requirement of the CVA exposure using the ten-business-day time horizon of the revised market risk framework. The capital requirement would not include the incremental risk requirement of subpart F. The agencies propose to require a banking organization to use the Basel III formula for the advanced CVA approach to calculate K_{CVA} as follows:

Formula 3

$$K_{CVA} = 3 \times \left(CVA_{UnstressedVAR} + CVA_{StressedVAR} \right)$$

$$CVA_j = \left(LGD_{MKT} \right) \times \sum_{i=1}^{T} Max\left(0; \exp\left(-\frac{s_{i-1} \times t_{i-1}}{LGD_{MKT}} \right) - \exp\left(-\frac{s_i \times t_i}{LGD_{MKT}} \right) \right) \times \left(\frac{EE_{i-1} \times D_{i-1} + EE_i \times D_i}{2} \right)$$

In Formula 3:

(A) $CVA_j = CVA_{UnstressedVAR}$ and $CVA_{StressedVAR}$

(B) t_i = the time of the i-th revaluation time bucket starting from $t_0 = 0$.

(C) t_T = the longest contractual maturity across the OTC derivative contracts with the counterparty.

(D) s_i = the CDS spread for the counterparty at tenor t_i used to calculate the CVA for the counterparty. If a CDS spread is not available, the banking organization would use a proxy spread based on the credit quality, industry and region of the counterparty.

(E) LGD_{MKT} = the loss given default of the counterparty based on the spread of a publicly traded debt instrument of the counterparty, or, where a publicly traded debt instrument spread is not available, a proxy spread based on the credit quality, industry and region of the counterparty.

(F) EE_i = the sum of the expected exposures for all netting sets with the counterparty at revaluation time t_i calculated using the IMM.

(G) D_i = the risk-free discount factor at time t_i, where $D_0 = 1$.

(H) Exp is the exponential function.

Under the proposal, if a banking organization's VaR model is not based on full repricing, the banking organization would use either Formula 4 or Formula 5 to calculate credit spread sensitivities. If the VaR model is based on credit spread sensitivities for specific tenors, the banking organization would calculate each credit spread sensitivity according to Formula 4:

Formula 4

$$\text{Regulatory CS01}^{11} = 0.0001 \times t_i \times \exp\left(-\frac{s_i \times t_i}{LGD_{MKT}}\right) \times \left(\frac{EE_{i-1} \times D_{i-1} - EE_{i+1} \times D_{i+1}}{2}\right)$$

If the VaR model uses credit spread sensitivities to parallel shifts in credit spreads, the banking organization would calculate each credit spread sensitivity according to Formula 5:

Formula 5

$$\text{Regulatory CS01} = 0.0001 \times \sum_{i=1}^{T}\left(t_i \times \exp\left(-\frac{s_i \times t_i}{LGD_{MKT}}\right) - t_{i-1} \times \exp\left(-\frac{s_{i-1} \times t_{i-1}}{LGD_{MKT}}\right)\right) \times \left(\frac{EE_{i-1} \times D_{i-1} + EE_i \times D_i}{2}\right)$$

To calculate the $CVA_{UnstressedVAR}$ measure in Formula 3, a banking organization would use the EE for a counterparty calculated using current market data to compute current exposures and would estimate model parameters using the historical observation period required under section 205(b)(2) of subpart F. However, if a banking organization uses the shortcut method described in section 132(d)(5) of the proposed rule to capture the effect of a collateral agreement when estimating EAD using the IMM, the banking organization would calculate the EE for the counterparty using that method and keep that EE constant with the maturity equal to the maximum of half of the longest maturity occurring in the netting set, and the notional weighted average maturity of all transactions in the netting set.

To calculate the $CVA_{StressedVAR}$ measure in Formula 3, the banking organization would use the EE_i for a counterparty calculated using the stress calibration of the IMM. However, if a banking organization uses the shortcut method described in section 132(d)(5) of the proposed rule to capture the effect of a collateral agreement when estimating EAD using the IMM, the banking organization would calculate the EE_i for the counterparty using that method and keep that EE_i constant with the maturity equal to the greater of half of the longest maturity occurring in the netting set with the notional amount equal to the weighted average maturity of all transactions in the netting set. Consistent with Basel III, the agencies propose to require a banking organization to calibrate the VaR model inputs to historical data from the most severe twelve-month stress period contained within the three-year stress period used to calculate EE_i. However, the agencies propose to retain the flexibility to require a banking organization to use a different period of significant financial stress in the calculation of the $CVA_{StressedVAR}$ measure that would better reflect actual historic losses of the portfolio.

Under the NPR, a banking organization's VaR model would be required to capture the basis between the spreads of the index that is used as the hedging instrument and the hedged

[11] For the final time bucket i = T, the corresponding formula is Regulatory CS01 =

$$0.0001 \times t_i \times \exp\left(-\frac{s_i \times t_i}{LGD_{MKT}}\right) \times \left(\frac{EE_{i-1} \times D_{i-1} - EE_T \times D_T}{2}\right)$$

counterparty exposure over various time periods, including benign and stressed environments. If the VaR model does not capture that basis, the banking organization would be permitted to reflect only 50 percent of the notional amount of the CDS_{ind} hedge in the VaR model. The remaining 50 percent of the notional amount of the CDS_{ind} hedge wouldbe covered position under the market risk capital rule..

Question 4: The agencies solicit comments on the proposed CVA capital requirements, including the simple CVA approach and the advanced CVA approach.

5. Cleared Transactions (Central Counterparties)

CCPs help improve the safety and soundness of the derivatives and repo-style transaction markets through the multilateral netting of exposures, establishment and enforcement of collateral requirements, and market transparency. Under the current advanced approaches rule, exposures to qualifying central counterparties (QCCPs) received a zero percent risk weight. However, when developing Basel III, the BCBS recognized that as more derivatives and repo-style transactions move to CCPs, the potential for systemic risk increases. To address these concerns, the BCBS has sought comment on a specific capital requirement for such transactions with CCPs and a more risk-sensitive approach for determining a capital requirement for a banking organization's contributions to the default funds of these CCPs. The BCBS also has sought comment on a preferential capital treatment for exposures arising from derivative and repo-style transactions with, and related default fund contributions to, CCPs that meet the standards established by the Committee on Payment and Settlement Systems (CPSS) and International Organization of Securities Commissions (IOSCO).[12] The treatment for exposures that arise from the settlement of cash transactions (such as equities, fixed income, spot FX, and spot commodities) with a QCCP where there is no assumption of ongoing counterparty credit risk by the QCCP after settlement of the trade and associated default fund contributions remains unchanged.

A banking organization that is a clearing member, a term that is defined in the Basel III NPR as a member of, or direct participant in, a CCP that is entitled to enter into transactions with the CCP, or a clearing member client, proposed to be defined as a party to a cleared transaction associated with a CCP in which a clearing member acts either as a financial intermediary with respect to the party or guarantees the performance of the party to the CCP, would first calculate its trade exposure for a cleared transaction. The trade exposure amount for a cleared transaction would be determined as follows:

(1) For a cleared transaction that is a derivative contract or netting set of derivative contracts, the trade exposure amount equals:

(i) The exposure amount for the derivative contract or netting set of derivative contracts, calculated using the methodology used to calculate exposure amount for OTC derivative contracts under section 132(c) or 132(d) of this NPR, plus

[12] See CPSS, "Recommendations for Central Counterparties," (November 2004), available at http://www.bis.org/publ/cpss64.pdf?noframes=1.

(ii) The fair value of the collateral posted by the banking organization and held by the CCP or a clearing member in a manner that is not bankruptcy remote.

(2) For a cleared transaction that is a repo-style transaction, the trade exposure amount equals:

(i) The exposure amount for the repo-style transaction calculated using the methodologies under sections 132(b)(2), 132(b)(3) or 132(d) of this NPR, plus

(ii) The fair value of the collateral posted by the banking organization and held by the CCP or a clearing member in a manner that is not bankruptcy remote.

When the banking organization calculates EAD under the IMM, EAD would be calculated using the most recent three years of historical data, that is, $EAD_{unstressed}$. Trade exposure would not include any collateral held by a custodian in a manner that is bankruptcy remote from the CCP.

Under the proposal, a clearing member banking organization would apply a risk weight of 2 percent to its trade exposure amount with a QCCP. The proposed definition of QCCP is discussed in the Standardized Approach NPR preamble. A banking organization that is a clearing member client would apply a 2 percent risk weight to the trade exposure amount if:

(1) The collateral posted by the banking organization to the QCCP or clearing member is subject to an arrangement that prevents any losses to the clearing member due to the joint default or a concurrent insolvency, liquidation, or receivership proceeding of the clearing member and any other clearing member clients of the clearing member; and

(2) The clearing member client has conducted sufficient legal review to conclude with a well-founded basis (and maintains sufficient written documentation of that legal review) that in the event of a legal challenge (including one resulting from default or a receivership, insolvency, or liquidation proceeding) the relevant court and administrative authorities would find the arrangements to be legal, valid, binding, and enforceable under the law of the relevant jurisdiction, provided certain additional criteria are met.

The agencies believe that omnibus accounts (that is, accounts that are generally established by clearing entities for non-clearing members) in the United States would satisfy these requirements because of the protections afforded client accounts under certain regulations of the SEC and CFTC. [13] If the criteria above are not met, a banking organization that is clearing member client would apply a risk weight of 4 percent to the trade exposure amount.

For a cleared transaction with a CCP that is not a QCCP, a clearing member and a banking organization that is a clearing member client would risk weight the trade exposure according to the risk weight applicable to the CCP under the Standardized Approach NPR.

[13] See Securities Investor Protection Act of 1970, 15 U.S.C Section 78aaa – 78lll; 17 CFR part 300; 17 CFR part 190.

Collateral posted by a clearing member or clearing member client banking organization that is held in a manner that is bankruptcy remote from the CCP would not be subject to a capital requirement for counterparty credit risk. As with all posted collateral, the banking organization would continue to have a capital requirement for any collateral provided to a CCP or a custodian in connection with a cleared transaction.

Under the proposal, a cleared transaction would not include an exposure of a banking organization that is a clearing member to its clearing member client where the banking organization is either acting as a financial intermediary and enters into an offsetting transaction with a CCP or where the banking organization provides a guarantee to the CCP on the performance of the client. Such a transaction would be treated as an OTC derivative transaction. However, the agencies recognize that this treatment may create a disincentive for banking organizations to act as intermediaries and provide access to CCPs for clients. As a result, the agencies are considering approaches that could address this disincentive while at the same time appropriately reflect the risks of these transactions. For example, one approach would allow banking organizations that are clearing members to adjust the EAD calculated under section 132 downward by a certain percentage or, for banking organizations using the IMM, to adjust the margin period of risk. International discussions are ongoing on this issue, and the agencies would expect to revisit the treatment of these transactions in the event that the BCBS revises its treatment of these transactions.

Default Fund Contribution

The agencies are proposing that, under the advanced approaches rule, a banking organization that is a clearing member of a CCP calculate its capital requirement for its default fund contributions at least quarterly or more frequently upon material changes to the CCP. Banking organizations seeking more information on the proposed risk-based capital treatment of default fund contributions should refer to the preamble of the Standardized Approach NPR.

Question 5: The agencies request comment on the proposed treatment of cleared transactions. The agencies solicit comment on whether the proposal provides an appropriately risk sensitive treatment of a transaction between a banking organization that is clearing member and its client and a clearing member's guarantee of its client's transaction with a CCP by treating these exposures as OTC derivative contracts. The agencies also request comment on whether the adjustment of the exposure amount would address possible disincentives for banking organizations that are clearing members to facilitate the clearing of their clients' transactions. What other approaches should the agencies consider and why?

Question 6: The agencies are seeking comment on the proposed calculation of the risk-based capital for cleared transactions, including the proposed risk-based capital requirements for exposures to a QCCP. Are there specific types of exposures to certain QCCPs that would warrant an alternative risk-based capital approach? Please provide a detailed description of such transactions or exposures, the mechanics of the alternative risk-based approach, and the supporting rationale.

6. Stress period for own internal estimates

Under the collateral haircut approach in the advanced approaches rule, banking organizations that receive prior approval from their primary federal supervisory may calculate market price and foreign exchange volatility using own internal estimates. To receive approval to use such an approach, banking organizations are required to base own internal estimates on a historical observation period of at least one year, among other criteria. During the financial crisis, increased volatility in the value of collateral led to higher counterparty exposures than estimated by banking organizations. In response, the agencies are proposing in this NPR to modify the quantitative standards for approval by requiring banking organizations to base own internal estimates of haircuts on a historical observation period that reflects a continuous 12-month period of significant financial stress appropriate to the security or category of securities. As described in the Standardized Approach NPR preamble, a banking organization would also be required to have policies and procedures that describe how it determines the period of significant financial stress used to calculate the banking organization's own internal estimates, and to be able to provide empirical support for the period used. To ensure an appropriate level of conservativeness, in certain circumstances a primary federal supervisor may require a banking organization to use a different period of significant financial stress in the calculation of own internal estimates for haircuts.

B. Removal of Credit Ratings

Consistent with section 939A of the Dodd-Frank Act, the agencies are proposing a number of changes to the definitions in the advanced approaches rule that currently reference credit ratings.[14] These changes are similar to alternative standards proposed in the Standardized Approach NPR and alternative standards that already have been implemented in the agencies' market risk capital rule. In addition, the agencies are proposing necessary changes to the hierarchy for risk weighting securitization exposures necessitated by the removal of the ratings based approach, as described further below.

The agencies propose to use an "investment grade" standard that does not rely on credit ratings as an alternative standard in a number of requirements under the advanced approaches rule, as explained below. Under this NPR and the Standardized Approach NPR, investment grade would mean that the entity to which the banking organization is exposed through a loan or security, or the reference entity with respect to a credit derivative, has adequate capacity to meet financial commitments for the projected life of the asset or exposure. Such an entity or reference entity has adequate capacity to meet financial commitments if the risk of its default is low and the full and timely repayment of principal and interest is expected.

Eligible Guarantor

Under the current advanced approaches rule, guarantors are required to meet a number of criteria in order to be considered as eligible guarantors under the securitization framework. For example, the entity must have issued and outstanding an unsecured long-term debt security

[14] See 76 FR 79380 (Dec. 21, 2011).

without credit enhancement that has a long-term applicable external rating in one of the three highest investment-grade rating categories. The agencies are proposing to replace the term "eligible securitization guarantor" with the term "eligible guarantor," which includes certain entities that have issued and outstanding an unsecured debt security without credit enhancement that is investment grade. Other modifications to the definition of eligible guarantor are discussed in subpart C of this preamble.

Eligible Double Default Guarantor

Under this proposal, the term "eligible double default guarantor," with respect to a guarantee or credit derivative obtained by a banking organization, means:

(1) U.S.-based-entities. A depository institution, bank holding company, savings and loan holding company, or securities broker or dealer registered with the SEC under the Securities Exchange Act of 1934 (15 U.S.C. 78o et seq.), if at the time the guarantee is issued or anytime thereafter, has issued and outstanding an unsecured debt security without credit enhancement that is investment grade.

(2) Non-U.S.-based entities. A foreign bank, or a non-U.S.-based securities firm if the banking organization demonstrates that the guarantor is subject to consolidated supervision and regulation comparable to that imposed on U.S. depository institutions, or securities broker-dealers) if at the time the guarantee is issued or anytime thereafter, has issued and outstanding an unsecured debt security without credit enhancement that is investment grade. Under the proposal, insurance companies in the business of providing credit protection would no longer be eligible double default guarantors.

Conversion Factor Matrix for OTC Derivative Contracts

Under this proposal and Standardized Approach NPR, the agencies propose to retain the metrics used to calculate the potential future exposure (PFE) for derivative contracts (as set forth in Table 3 of the proposed rule), and apply the proposed definition of "investment grade."

Money Market Fund Approach

Previously, under the advanced approaches money market fund approach, banking organizations were permitted to assign a 7 percent risk weight to exposures to money market funds that were subject to SEC rule 2a-7 and that had an applicable external rating in the highest investment grade rating category. In this NPR, the agencies propose to eliminate the money market fund approach. The agencies believe it is appropriate to eliminate the preferential risk weight for money market fund investments due to the agencies' and banking organizations' experience with them during the recent financial crisis, in which they demonstrated, at times, elevated credit risk. As a result of the proposed changes, a banking organization would use one of the three alternative approaches under section 154 of this proposal to determine the risk weight for its exposures to a money market fund, subject to a 20 percent floor.

Modified Look-Through Approaches for Equity Exposures to Investment Funds

Under the proposal, risk weights for equity exposures under the simple modified look-through approach would be based on the highest risk weight assigned according to subpart D of

the Standardized Approach NPR based on the investment limits in the fund's prospectus, partnership agreement, or similar contract that defines the fund's permissible investments.

Qualifying Operational Risk Mitigants

Under section 161 of the proposal, a banking organization may adjust its estimate of operational risk exposure to reflect qualifying operational risk mitigants. Previously, for insurance to be considered as a qualifying operational risk mitigant, it was required to be provided by an unaffiliated company rated in the three highest rating categories by a NRSRO. Under the proposal, qualifying operational risk mitigants, among other criteria, would be required to be provided by an unaffiliated company that the banking organization deems to have strong capacity to meet its claims payment obligations and the obligor rating category to which the banking organization assigns the company is assigned a PD equal to or less than 10 basis points.

Question 7: The agencies request comment on the proposed use of alternative standards as they would relate to the definitions of investment grade, eligible guarantor, eligible double default guarantor under the advanced approaches rule, as well as the treatment of certain OTC derivative contracts, operational risk mitigants, money market mutual funds, and investment funds under the advanced approaches rule.

C. Proposed Revisions to the Treatment of Securitization Exposures

1. Definitions

Consistent with the 2009 Enhancements and as proposed in the Standardized Approach NPR, the agencies are proposing to introduce a new definition for resecuritization exposures and broaden the definition of securitization. In addition, the agencies are proposing to amend the existing definition of traditional securitization in order to exclude certain types of investment firms from treatment under the securitization framework.

The definition of a securitization exposure would be broadened to include an exposure that directly or indirectly references a securitization exposure. Specifically, a securitization exposure would be defined as an on-balance sheet or off-balance sheet credit exposure (including credit-enhancing representations and warranties) that arises from a traditional securitization or synthetic securitization exposure (including a resecuritization), or an exposure that directly or indirectly references a securitization exposure. The agencies are proposing to define a resecuritization exposure as (1) an on- or off-balance sheet exposure to a resecuritization; or (2) an exposure that directly or indirectly references a resecuritization exposure. An exposure to an asset-backed commercial paper program would not be a resecuritization exposure if either: the program-wide credit enhancement does not meet the definition of a resecuritization exposure; or the entity sponsoring the program fully supports the commercial paper through the provision of liquidity so that the commercial paper holders effectively are exposed to the default risk of the sponsor instead of the underlying exposures. Resecuritization would mean a securitization in which one or more of the underlying exposures is a securitization exposure.

The recent financial crisis demonstrated that resecuritization exposures, such as collateralized debt obligations (CDOs) comprised of asset-backed securities (ABS), generally

present greater levels of risk relative to other securitization exposures due to their increased complexity and lack of transparency and potential to concentrate systematic risk. Accordingly, the 2009 Enhancements amended the Basel II internal ratings-based approach in the securitization framework to require a banking organization to assign higher risk weights to resecuritization exposures than other, similarly-rated securitization exposures. In this proposal, the agencies are proposing to assign risk weights under the simplified supervisory formula approach (SSFA) in a manner that would result in higher risk weights for resecuritization exposures. In addition, the agencies are proposing to modify the definition of financial collateral such that resecuritizations would no longer qualify as eligible financial collateral under the advanced approaches rule.

Asset-backed Commercial Paper

The following is an example of how to evaluate whether a transaction involving a traditional multi-seller asset-backed commercial paper (ABCP) conduit would be considered a resecuritization exposure under the proposed rule. In this example, an ABCP conduit acquires securitization exposures where the underlying assets consist of wholesale loans and no securitization exposures. As is typically the case in multi-seller ABCP conduits, each seller provides first-loss protection by over-collateralizing the conduit to which it sells its loans. To ensure that the commercial paper issued by each conduit is highly-rated, a banking organization sponsor provides either a pool-specific liquidity facility or a program-wide credit enhancement such as a guarantee to cover a portion of the losses above the seller-provided protection.

The pool-specific liquidity facility generally would not be treated as a resecuritization exposure under this proposal because the pool-specific liquidity facility represents a tranche of a single asset pool (that is, the applicable pool of wholesale exposures), which contains no securitization exposures. However, a sponsor's program-wide credit enhancement that does not cover all losses above the seller-provided credit enhancement across the various pools generally would constitute tranching of risk of a pool of multiple assets containing at least one securitization exposure, and therefore would be treated as a resecuritization exposure.

In addition, if the conduit from the example funds itself entirely with a single class of commercial paper, then the commercial paper generally would not be considered a resecuritization exposure if either the program-wide credit enhancement did not meet the proposed definition of a resecuritization exposure, or the commercial paper was fully guaranteed by the sponsoring banking organization. When the sponsoring banking organization fully guarantees the commercial paper, the commercial paper holders effectively would be exposed to the default risk of the sponsor instead of the underlying exposures, thus ensuring that the commercial paper does not represent a tranched risk position.

Since issuing the advanced approaches rules in 2007, the agencies have received feedback from banking organizations that the existing definition of traditional securitization is inconsistent with their risk experience and market practice. The agencies have reviewed this definition in light of this feedback and agree with commenters that changes to it may be appropriate. The agencies are proposing to exclude from the definition of traditional securitization exposures to investment funds, collective investment funds, pension funds regulated under ERISA and their foreign equivalents, and transactions regulated under the

Investment Company Act of 1940 and their foreign equivalents, because these entities are generally prudentially regulated and subject to strict leverage requirements. Moreover, the agencies believe that the capital requirements for an extension of credit to, or an equity holding in these transactions would be more appropriately calculated under the rules for corporate and equity exposures, and that the securitization framework was not designed to apply to such transactions.

Accordingly, in this proposal, the agencies propose to amend the definition of a traditional securitization by excluding any fund that is (1) an investment fund, as defined under the rule, (2) a pension fund regulated under ERISA or a foreign equivalent, or (3) a company regulated under the Investment Company Act of 1940 or a foreign equivalent. Under the current rule, the definition of investment fund, which the agencies are not proposing to amend, means a company all or substantially all of the assets of which are financial assets; and that has no material liabilities.

Question 8: The agencies request comment on the proposed revisions to the definition of traditional securitization.

Under the current advanced approaches rule, the definition of eligible securitization guarantor includes, among other entities, any entity (other than a securitization SPE) that has issued and has outstanding an unsecured long-term debt security without credit enhancement that has a long-term applicable external rating in one of the three highest investment-grade rating categories, or has a PD assigned by the banking organization that is lower than or equal to the PD associated with a long-term external rating in the third highest investment grade category. The agencies are proposing to remove the existing references to ratings from the definition of an eligible guarantor (the proposed new term for an eligible securitization guarantor). As revised, the definition for an eligible guarantor would include:

(1) A sovereign, the Bank for International Settlements, the International Monetary Fund, the European Central Bank, the European Commission, a Federal Home Loan Bank, Federal Agricultural Mortgage Corporation (Farmer Mac), a multilateral development bank, a depository institution, a bank holding company, a savings and loan holding company (as defined in 12 U.S.C. 1467a), a credit union, or a foreign bank; or

(2) An entity (other than a special purpose entity):

(i) That at the time the guarantee is issued or anytime thereafter, has issued and outstanding an unsecured debt security without credit enhancement that is investment grade;

(ii) Whose creditworthiness is not positively correlated with the credit risk of the exposures for which it has provided guarantees; and

(iii) That is not an insurance company engaged predominately in the business of providing credit protection (such as a monoline bond insurer or re-insurer).

During the financial crisis, certain guarantors of securitization exposures had difficulty honoring those guarantees as the financial condition of the guarantors deteriorated at the same time as the guaranteed exposures experienced losses. Therefore, the agencies are proposing to

add the requirement related to the correlation between the guarantor's creditworthiness and the credit risk of the exposures it has guaranteed to address this concern.

Question 9: The agencies request comment on the proposed revisions to the definition of eligible securitization guarantor.

2. Operational Criteria for Recognizing Risk Transference in Traditional Securitizations

Section 41 of the current advanced approaches rule includes operational criteria for recognizing the transfer of risk. Under the criteria, a banking organization that transfers exposures that it has originated or purchased to a securitization SPE or other third party in connection with a traditional securitization may exclude the exposures from the calculation of risk-weighted assets only if certain conditions are met. Among the criteria listed is that the transfer is considered a sale under the Generally Accepted Accounting Principles (GAAP).

The purpose of the criterion that the transfer be considered a sale under GAAP was to ensure that the banking organization that transferred the exposures was not required under GAAP to consolidate the exposures on its balance sheet. Given changes in GAAP since the rule was published in 2007, the agencies propose to amend paragraph (a)(1) of section 41 of the advanced approaches rule to require that the transferred exposures are not reported on the banking organization's balance sheet under GAAP.[15]

Question 10: The agencies request comment on the proposed revisions to operational criteria under section 41 of the advanced approaches rule.

3. Proposed Revisions to the Hierarchy of Approaches

Consistent with section 939A of the Dodd-Frank Act, the agencies are proposing to remove the advanced approaches rule's ratings-based approach (RBA) and internal assessment approach (IAA) for securitization exposures. Under the proposal, the hierarchy for securitization exposures would be modified as follows:

(1) A banking organization would be required to deduct from common equity tier 1capital any after-tax gain-on-sale resulting from a securitization and apply a 1,250 percent risk weight to the portion of a credit-enhancing interest-only strip (CEIO) that does not constitute after-tax gain-on-sale.

(2) If a securitization exposure does not require deduction, a banking organization would be required to assign a risk weight to the securitization exposure using the supervisory formula approach (SFA). The agencies expect banking organizations to use the SFA rather than the SSFA in all instances where data to calculate the SFA is available.

(3) If the banking organization cannot apply the SFA because not all the relevant qualification criteria are met, it would be allowed to apply the simplified supervisory formula

[15] For more information on the changes in GAAP related to the transfer of exposures, see Financial Accounting Standards Board, Topics 810 and 860.

approach (SSFA). A banking organization should be able to explain and justify (e.g., based on data availability) to its primary federal regulator any instances in which the banking organization uses the SSFA rather than the SFA for its securitization exposures.

If the banking organization does not apply the SSFA to the exposure, the banking organization would be required to assign a 1,250 percent risk weight, unless the exposure qualifies for a treatment available to certain ABCP exposures under section 44 of Standardized Approach NPR.

The SSFA, described in detail in the Standardized Approach NPR, is similar in construct and function to the SFA. A banking organization would need several inputs to calculate the SSFA. The first input is the weighted-average capital requirement under the requirements described in Standardized Approach NPR that would be applied to the underlying exposures if they were held directly by the banking organization. The second and third inputs indicate the position's level of subordination and relative size within the securitization. The fourth input is the level of delinquencies experienced on the underlying exposures. A bank would apply the hierarchy of approaches in section 142 of this proposed rule to determine which approach it would apply to a securitization exposure.

Banking organizations using the advanced approaches rule should note that the Standardized Approach NPR would require the use of the SSFA for certain securitizations subject to the advanced approaches rule.

Question 11: The agencies request comment on the proposed revisions to the hierarchy for securitization exposures under the advanced approaches rule.

4. Guarantees and Credit Derivatives Referencing a Securitization Exposure

The advanced approaches rule includes methods for calculating risk-weighted assets for n^{th}-to-default credit derivatives, including first-to-default credit derivatives and second-or-subsequent-to-default credit derivatives.[16] The advanced approaches rule, however, does not specify how to treat guarantees or non-nth-to-default credit derivatives purchased or sold that reference a securitization exposure. Accordingly, the agencies are proposing clarifying revisions to the risk-based capital requirements for credit protection purchased or provided in the form of a guarantee or derivative other than n^{th}-to-default credit derivatives that reference a securitization exposure.

For a guarantee or credit derivative (other than an n^{th}-to-default credit derivative), the proposal would require a banking organization to determine the risk-based capital requirement for the guarantee or credit derivative as if it directly holds the portion of the reference exposure covered by the guarantee or credit derivative. The banking organization would calculate its risk-based capital requirement for the guarantee or credit derivative by applying either (1) the SFA as

[16] N^{th}-to-default credit derivative means a credit derivative that provides credit protection only for the n^{th}-defaulting reference exposure in a group of reference exposures. See 12 CFR part 3, appendix C, section 42(l) (OCC); 12 CFR part 208, appendix F, and 12 CFR part 225, appendix G (Board); 12 CFR part 325, appendix D, section 4(l), and 12 CFR part 390, subpart Z, appendix A, section 4(l) (FDIC).

provided in section 143 of the proposal to the reference exposure if the bank and the reference exposure qualify for the SFA; or (2) the SSFA as provided in section 144 of the proposal. If the guarantee or credit derivative and the reference securitization exposure would not qualify for the SFA, or the SSFA, the bank would be required to assign a 1,250 percent risk weight to the notional amount of protection provided under the guarantee or credit derivative.

The proposal also would modify the advanced approaches rule to clarify how a banking organization may recognize a guarantee or credit derivative (other than an n^{th}-to-default credit derivative) purchased as a credit risk mitigant for a securitization exposure held by the banking organization. In addition, the proposal adds a provision that would require a banking organization to use section 131 of the proposal instead of the approach required under the hierarchy of approaches in section 142 to calculate the risk-based capital requirements for a credit protection purchased by a banking organization in the form of a guarantee or credit derivative (other than an n^{th}-to-default credit derivative) that references a securitization exposure that a banking organization does not hold. Credit protection purchased that references a securitization exposure not held by a banking organization subjects the banking organization to counterparty credit risk with respect to the credit protection but not credit risk to the securitization exposure.

Question 12: The agencies request comment on the proposed revisions to the treatment of guarantees and credit derivatives that reference a securitization exposure.

5. Due Diligence Requirements for Securitization Exposures

As the recent financial crisis unfolded, weaknesses in exposures underlying securitizations became apparent and resulted in nationally recognized statistical ratings organizations (NRSROs) downgrading many securitization exposures held by banks. The agencies found that many banking organizations relied on NRSRO ratings as a proxy for the credit quality of securitization exposures they purchased and held without conducting their own sufficient independent credit analysis. As a result, some banking organizations did not have sufficient capital to absorb the losses attributable to these exposures. Accordingly, consistent with the 2009 Enhancements, the agencies are proposing to implement due diligence requirements that banking organizations would be required to use the SFA or SSFA to determine the risk-weighted asset amount for securitization exposures under the advanced approaches proposal. These disclosure requirements are consistent with those required in the standardized approach, as discussed in the Standardized Approach NPR.

Question 13: The agencies solicit comments on what, if any, are specific challenges that are involved with meeting the proposed due diligence requirements and for what types of securitization exposures? How might the agencies address these challenges while ensuring that a banking organization conducts an appropriate level of due diligence commensurate with the risks of its exposures?

6. Nth-to-Default Credit Derivatives

The agencies propose that a banking organization that provides credit protection through an nth-to-default derivative assign a risk weight to the derivative using the SFA or the SSFA. In

the case of credit protection sold, a banking organization would determine its exposure in the nth-to-default credit derivative as the largest notional dollar amount of all the underlying exposures.

When applying the SSFA to protection provided in the form of an nth-to-default credit derivative, the attachment point (parameter A) is the ratio of the sum of the notional amounts of all underlying exposures that are subordinated to the banking organization's exposure to the total notional amount of all underlying exposures. For purposes of applying the SFA, parameter A would be set equal to the credit enhancement level (L) used in the SFA formula. In the case of a first-to-default credit derivative, there are no underlying exposures that are subordinated to the banking organization's exposure. In the case of a second-or-subsequent-to default credit derivative, the smallest (n-1) underlying exposure(s) are subordinated to the banking organization's exposure.

Under the SSFA, the detachment point (parameter D) would be the sum of the attachment point and the ratio of the notional amount of the banking organization's exposure to the total notional amount of the underlying exposures. Under the SFA, Parameter D would be set to equal L plus the thickness of the tranche (T) under the SFA formula. A banking organization that does not use the SFA or SSFA to calculate a risk weight for an n^{th}-to-default credit derivative would assign a risk weight of 1,250 percent to the exposure.

For the treatment of protection purchased through an nth-to-default, a banking organization would determine its risk-based capital requirement for the underlying exposures as if the banking organization had synthetically securitized the underlying exposure with the lowest risk-based capital requirement and had obtained no credit risk mitigant on the underlying exposures. A banking organization would calculate a risk-based capital requirement for counterparty credit risk according to section 132 of the proposal for a first-to-default credit derivative that does not meet the rules of recognition for guarantees and credit derivatives under section 134(b).

A banking organization that obtains credit protection on a group of underlying exposures through a nth -to-default credit derivative that meets the rules of recognition of section 134(b) of the proposal (other than a first-to-default credit derivative) would be permitted to recognize the credit risk mitigation benefits of the derivative only if the banking organization also has obtained credit protection on the same underlying exposures in the form of first-through-(n-1)-to-default credit derivatives; or if n-1 of the underlying exposures have already defaulted. If a banking organization satisfies these requirements, the banking organization would determine its risk-based capital requirement for the underlying exposures as if the banking organization had only synthetically securitized the underlying exposure with the nth lowest risk-based capital requirement and had obtained no credit risk mitigant on the other underlying exposures. A banking organization that does not fulfill these requirements would calculate a risk-based capital requirement for counterparty credit risk according to section 132 of the proposal for a nth-to-default credit derivative that does not meet the rules of recognition of section 134(b) of the proposal.

For a guarantee or credit derivative (other than an nth-to-default credit derivative) provided by a banking organization that covers the full amount or a pro rata share of a

securitization exposure's principal and interest, the banking organization would risk weight the guarantee or credit derivative as if it holds the portion of the reference exposure covered by the guarantee or credit derivative.

As a protection purchaser, if a banking organization chooses (and is able) to recognize a guarantee or credit derivative (other than an nth-to-default credit derivative) that references a securitization exposure as a credit risk mitigant, where applicable, the banking organization must apply section 145 of the proposal for the recognition of credit risk mitigants. If a banking organization cannot, or chooses not to, recognize a credit derivative that references a securitization exposure as a credit risk mitigant under section 145, the banking organization would determine its capital requirement only for counterparty credit risk in accordance with section 131 of the proposal.

Question 14: The agencies request comment on the proposed treatment for nth-to-default credit derivatives.

D. Treatment of Exposures Subject to Deduction

Under the current advanced approaches rule, a banking organization must deduct certain exposures from total capital, including securitization exposures such as CEIOs, low-rated securitization exposures, and high-risk securitization exposures subject to the SFA; eligible credit reserves shortfall; and certain failed capital markets transactions.[17] Consistent with Basel III, the agencies are proposing that the exposures noted above that are currently deducted from total capital would instead be assigned a 1,250 percent risk weight, except as required under subpart B of the Standardized Approach NPR, and except for deductions from total capital of insurance underwriting subsidiaries of bank holding companies. The proposed change would reduce the differences in the measure of tier 1 capital for risk-based capital purposes under the advanced approaches rule as compared to the leverage capital requirements.

The agencies note that such treatment is not equivalent to a deduction from tier 1 capital, as the effect of a 1,250 percent risk weight would depend on an individual banking organization's current risk-based capital ratios. Specifically, when a risk-based capital ratio (either tier 1 or total risk-based capital) exceeds 8.0 percent, the effect on that risk-based capital ratio of assigning an exposure a 1,250 percent risk weight would be more conservative than a deduction from total capital. The more a risk-based capital ratio exceeds 8.0 percent, the harsher is the effect of a 1,250 percent risk weight on risk-based capital ratios. Conversely, the effect of a 1,250 percent risk weight would be less harsh than a deduction from total capital for any risk-based capital ratio that is below 8.0 percent. Unlike a deduction from total capital, however, a bank's leverage ratio would not be affected by assigning an exposure a 1,250 percent risk weight.

[17] Section 42(a)(1) of the advanced approaches rule states, in part, that a banking organization must deduct from total capital the portion of any CEIO that does not constitute gain-on-sale. The proposal would clarify that this provision relates to any CEIO that does not constitute after-tax gain-on-sale; see 12 CFR part 3, appendix C, section 11, and 12 CFR part 167, section 11 (OCC); 12 CFR part 208, appendix F, section 11, and 12 CFR part 225, appendix G, section 11 (Board); 12 CFR part 325, appendix D, section 11, and 12 CFR part 390, subpart Z, appendix A, section 11 (FDIC).

The agencies are not proposing to apply a 1,250 percent risk weight to those exposures currently deducted from tier 1 capital under the advanced approaches rule. For example, the agencies are proposing that gain-on-sale that is deducted from tier 1 under the advanced approaches rule be deducted from common equity tier 1 under the proposed rule. In this regard, the agencies also clarify that any asset deducted from common equity tier 1, tier 1, or tier 2 capital under the advanced approaches rule would not be included in the measure of risk-weighted assets under the advanced approaches rule.

Question 14: The agencies request comment on the proposed 1,250 risk weighting approach to CEIOs, low-rated securitization exposures, and high-risk securitization exposures subject to the SFA, any eligible credit reserves shortfall, and certain failed capital markets transactions.

E. Other Amendments to the Advanced approaches rules

The agencies are proposing other amendments to the advanced approaches rule that are designed to refine and clarify certain aspects of the rule's implementation. Each of these revisions is described below.

1. Eligible Guarantees and Contingent U.S. Government Guarantees

In order to be recognized as an eligible guarantee under the advanced approaches rule, the guarantee, among other criteria, must be unconditional. The agencies note that this definition would exclude certain guarantees provided by the U.S. Government or its agencies that would require some action on the part of the bank or some other third party. However, based on their risk perspective, the agencies believe that these guarantees should be recognized as eligible guarantees. Therefore, the agencies are proposing to amend the definition of eligible guarantee so that it explicitly includes a contingent obligation of the U.S. Government or an agency of the U.S. Government, the validity of which is dependent on some affirmative action on the part of the beneficiary or a third party (for example, servicing requirements) irrespective of whether such contingent obligation would otherwise be considered a conditional guarantee. A corresponding provision is included in section 36 of the Standardized Approach NPR.

2. Calculation of Foreign Exposures for Applicability of the Advanced Approaches - Insurance Underwriting Subsidiaries

A banking organization is subject to the advanced approaches rule if it has consolidated assets greater than or equal to $250 billion, or if it has total consolidated on-balance sheet foreign exposures of at least $10 billion.[18] For bank holding companies, in particular, the advanced approaches rule provides that the $250 billion threshold criterion excludes assets held by an insurance underwriting subsidiary. However, a similar provision does not exist for the $10 billion foreign-exposure threshold criteria. Therefore, for bank holding companies and savings and loan holding companies, the Board is proposing to exclude assets held by insurance

[18] See 12 CFR part 3, appendix C, and 12 CFR part 167, appendix C (OCC); 12 CFR part 208, appendix F, and 12 CFR part 225, appendix G (Board); 12 CFR part 325, appendix D, and 12 CFR part 390, subpart Z (FDIC).

underwriting subsidiaries from the $10 billion in total foreign exposures threshold. The Board believes such a parallel provision would result in a more appropriate scope of application for the advanced approaches rule.

3. Calculation of Foreign Exposures for Applicability of the Advanced Approaches – Changes to FFIEC 009

The agencies are proposing to revise the advanced approaches rule to comport with changes to the Federal Financial Institution Examination Council (FFIEC) Country Exposure Report (FFIEC 009) that occurred after the issuance of the advanced approaches rule in 2007. Specifically, the FFIEC 009 replaced the term "local country claims" with the term "foreign-office claims." Accordingly, the agencies have made a similar change under section 100, the section of the advanced approaches rule that makes the rules applicable to a banking organization that has consolidated total on-balance sheet foreign exposures equal to $10 billion or more. As a result, to determine total on-balance sheet foreign exposure, a bank would sum its adjusted cross-border claims, local country claims, and cross-border revaluation gains calculated in accordance with FFIEC 009. Adjusted cross-border claims would equal total cross-border claims less claims with the head office or guarantor located in another country, plus redistributed guaranteed amounts to the country of the head office or guarantor.

4. Applicability of the Rule

The agencies believe it would not be appropriate for banking organizations to move in and out of the scope of the advanced approaches rule based on fluctuating asset sizes. As a result, the agencies are proposing to amend the advanced to clarify that once a banking organization is subject to the advanced approaches rule, it would remain subject to the rule until its primary federal supervisor determines that application of the rule would not be appropriate in light of the banking organization's asset size, level of complexity, risk profile, or scope of operations. In connection with the consideration of a banking organization's level of complexity, risk profile, and scope of operations, the agencies also may consider a banking organization's interconnectedness and other relevant risk-related factors.

5. Change to the Definition of Probability of Default Related to Seasoning

The advanced approaches rule require an upward adjustment to estimated PD for segments of retail exposures for which seasoning effects are material. The rationale underlying this requirement was the seasoning pattern displayed by some types of retail exposures – that is, the exposures have very low default rates in their first year, rising default rates in the next few years, and declining default rates for the remainder of their terms. Because of the one-year internal ratings-based (IRB) default horizon, capital based on the very low PDs for newly originated, or "unseasoned," loans would be insufficient to cover the elevated risk in subsequent years. The upward seasoning adjustment to PD was designed to ensure that banking organizations would have sufficient capital when default rates for such segments rose predictably beginning in year two.

Since the issuance of the advanced approaches rule, the agencies have found the seasoning provision to be problematic. First, it is difficult to ensure consistency across

institutions, given that there is no guidance or criteria for determining when seasoning is "material" or what magnitude of upward adjustment to PD is "appropriate." Second, the advanced approaches rule lacks flexibility by requiring an upward PD adjustment whenever there is a significant relationship between a segment's default rate and its age (since origination). For example, the upward PD adjustment may be inappropriate in cases where (1) the outstanding balance of a segment is falling faster over time (due to defaults and prepayments) than the default rate is rising; (2) the age (since origination) distribution of a portfolio is stable over time; or (3) where the loans in a segment are intended, with a high degree of certainty, to be sold or securitized within a short time period.

Therefore, the agencies are proposing to delete the regulatory (Pillar I) seasoning provision and instead to treat seasoning under Pillar II. In addition to the difficulties in applying the advanced approaches rule's seasoning requirements discussed above, the agencies believe that the consideration of seasoning belongs more appropriately in Pillar II. First, seasoning involves the determination of minimum required capital for a period in excess of the 12-month time horizon of Pillar I. It thus falls more appropriately under longer-term capital planning and capital adequacy, which are major focal points of the internal capital adequacy assessment process component of Pillar II. Second, seasoning is a major issue only where a banking organization has a concentration of unseasoned loans. The capital treatment of loan concentrations of all kinds is omitted from Pillar I; however, it is dealt with explicitly in Pillar II.

6. Cash Items in Process of Collection

Previously under the advanced approaches rule issued in 2007, cash items in the process of collection were not assigned a risk-based capital treatment and, as a result, would have been subject to a 100 percent risk weight. Under the proposed rule, the agencies are revising the advanced approaches rule to risk weight cash items in the process of collection at 20 percent of the carrying value, as the agencies have concluded that this treatment would be more commensurate with the risk of these exposures. A corresponding provision is included in section 32 of the Standardized Approach NPR.

7. Change to the Definition of Qualified Revolving Exposure

The agencies are proposing to modify the definition of Qualified Revolving Exposure (QRE) such that certain unsecured and unconditionally cancellable exposures where a banking organization consistently imposes in practice an upper exposure limit of $100,000 and requires payment in full every cycle will now qualify as QRE. Under the current definition, only unsecured and unconditionally cancellable revolving exposures with a pre-established maximum exposure amount of $100,000 (such as credit cards) are classified as QRE. Unsecured, unconditionally cancellable exposures that requirement payment in full and have no communicated maximum exposure amount (often referred to as "charge cards") are instead classified as "other retail." For regulatory capital purposes, this classification is material and would generally result in substantially higher minimum required capital to the extent that the exposure's asset value correlation (AVC) will differ if classified as QRE (where it is assigned an AVC of 4 percent) or other retail (where AVC varies inversely with through-the-cycle PD estimated at the segment level and can go as high as almost 16 percent for very low PD segments).

The proposed definition would allow certain charge card products to qualify as QRE. Charge card exposures may be viewed as revolving in that there is an ability to borrow despite a requirement to pay in full. Where a banking organization consistently imposes in practice an upper exposure limit of $100,000 the agencies believe that charge cards are more closely aligned from a risk perspective with credit cards than with any type of "other retail" exposure and are therefore proposing to amend the definition of QRE in order to allow such products to qualify as QRE.

The agencies also have considered the appropriate treatment of hybrid cards. Hybrid cards have characteristics of both charge and credit cards. The agencies are uncertain whether it would be prudent to allow hybrid cards to qualify as QREs at this time. Hybrid cards are a relatively new product, and there is limited information available about them including data on their market and risk characteristics.

Question 15: Do hybrid cards exhibit similar risk characteristics to credit and charge cards and should the agencies allow them to qualify as QREs? Commenters are requested to provide a detailed explanation, as appropriate, as well as the relevant data and impact analysis to support their positions. Such information should include data on the number or dollar-amounts of cards issued to date, anticipated growth rate, and performance data including default and delinquency rates, credit score distribution of cardholders, volatilities, or asset-value correlations.

8. Trade-Related Letters of Credit

In 2011, the BCBS revised the Basel II advanced internal ratings-based approach to remove the one-year maturity floor for trade finance instruments. Consistent with this revision, this proposed rule would specify that an exposure's effective maturity must be no greater than five years and no less than one year, except that an exposure's effective maturity must be no less than one day if the exposure is a trade-related letter of credit, or if the exposure has an original maturity of less than one year and is not part of a banking organization's ongoing financing of the obligor.

A corresponding provision is included in section 33 of the Standardized Approach NPR.

Question 16: The agencies request comment on all the other proposed amendments to the advanced approaches rule described in section E (items1through 8), of this preamble.

F. Pillar 3 Disclosures

1. Frequency and Timeliness of Disclosures

Under the proposed rule, a banking organization is required to provide certain qualitative and quantitative disclosures on a quarterly, or in some cases, annual basis, and these disclosures must be "timely." In the preamble to the advanced approaches rule issued in 2007, the agencies indicated that quarterly disclosures would be timely if they were provided within 45 days after calendar quarter-end. The preamble did not specify expectations regarding annual disclosures. The agencies acknowledged that timing of disclosures required under the federal banking laws may not always coincide with the timing of disclosures under other federal laws, including federal securities laws and their implementing regulations by the SEC. The agencies also

indicated that a banking organization may use disclosures made pursuant to SEC, regulatory reporting, and other disclosure requirements to help meet its public disclosure requirements under the advanced approaches rule.

The agencies understand that the deadline for certain SEC financial reports is more than 45 calendar days after calendar quarter-end. Therefore, the agencies are proposing to clarify in this NPR that, where a banking organization's fiscal year-end coincides with the end of a calendar quarter, the requirement for timely disclosure would be no later than the applicable reporting deadlines for regulatory reports (for example, FR Y-9C) and financial reports (for example, SEC Forms 10-Q and 10-K). When these deadlines differ, banking organizations would adhere to the later deadline. In cases where a banking organization's fiscal year-end does not coincide with the end of a calendar quarter, the agencies would consider those disclosures that are made within 45 days as timely.

2. Enhanced Securitization Disclosure Requirements

In view of the significant contribution of securitization exposures to the financial crisis, the agencies believe that enhanced disclosure requirements are appropriate. Consistent with the disclosures introduced by the 2009 Enhancements, the agencies are proposing to amend the qualitative section for Table 11.8 disclosures (Securitization) to include the following:

- The nature of the risks inherent in a banking organization's securitized assets,
- A description of the policies that monitor changes in the credit and market risk of a banking organization's securitization exposures,
- A description of a banking organization's policy regarding the use of credit risk mitigation for securitization exposures,
- A list of the special purpose entities a banking organization uses to securitize exposures and the affiliated entities that a bank manages or advises and that invest in securitization exposures or the referenced SPEs, and
- A summary of the banking organization's accounting policies for securitization activities.

To the extent possible, the agencies are proposing the disclosure requirements included in the 2009 Enhancements. However, due to the prohibition on the use of credit ratings in the risk-based capital rules required by the Dodd-Frank Act, the proposed tables do not include those disclosure requirements related to the use of ratings.

3. Equity Holding That Are Not Covered Positions

Section 71 of the current advanced approaches rule requires banking organizations to include in their public disclosures a discussion of "important policies covering the valuation of and accounting for equity holdings in the banking book." Since "banking book" is not a defined term under the advanced approaches rule, the agencies propose to refer to such exposures as equity holdings that are not covered positions.

III. Market Risk Capital Rule

In today's Federal Register, the federal banking agencies are finalizing revisions to the agencies' market risk capital rule (the market risk capital rule), which generally requires national banks, state banks, and bank holding companies with significant exposure to market risk to implement systems and procedures necessary to manage and measure that risk and to hold a commensurate amount of capital. As noted in the introduction of this preamble, in this NPR, the agencies are proposing to expand the scope of the market risk capital rule to include savings associations and savings and loan holding companies and codify the market risk rule in a manner similar to the other regulatory capital rules in the three proposals. In the process of incorporating the market risk rule into the regulatory capital framework, the agencies note that there will be some overlap among certain defined terms. In any final rule, the agencies intend to merge definitions and make any appropriate technical changes.

As a general matter, a banking organization subject to the market risk capital rule will not include assets held for trading purposes when calculating its risk-weighted assets for the purpose of the other risk-based capital rules. Instead, the banking organization must determine an appropriate capital requirement for such assets using the methodologies set forth in the final market risk capital rule. The banking organization then must multiply its market risk capital requirement by 12.5 to determine a risk-weighted asset amount for its market risk exposures and then add that amount to its credit risk-weighted assets to arrive at its total risk-weighted asset amount.

As described in the preamble to the market risk capital rule, the agencies revised their respective market risk rules to better capture positions subject to market risk, reduce pro-cyclicality in market risk capital requirements, enhance the rule's sensitivity to risks that were not adequately captured under the prior regulatory measurement methodologies, and increase transparency through enhanced disclosures.

The market risk capital rules is designed to determine capital requirements for trading assets based on general and specific market risk associated with these assets. General market risk is the risk of loss in the market value of positions resulting from broad market movements, such as changes in the general level of interest rates, equity prices, foreign exchange rates, or commodity prices. Specific market risk is the risk of loss from changes in the market value of a position due to factors other than broad market movements, including event risk (changes in market price due to unexpected events specific to a particular obligor or position) and default risk.

The agencies' current market risk capital rules do not apply to savings associations or savings and loan holding companies. The Board has previously expressed its intention to assess the condition, performance, and activities of SLHCs on a consolidated risk-based basis in a manner that is consistent with the Board's established approach regarding bank holding company supervision while considering any unique characteristics of SLHCs and the requirements of the Home Owners Loan Act.[19] Therefore, as noted above, the agencies are proposing in this NPR to

[19] See 76 FR 22663 (April, 22, 2011).

expand the scope of the market risk rule to savings associations and savings and loan holding companies that meet the stated thresholds. As proposed, the market risk capital rule would apply to any savings association or savings and loan holding company whose trading activity (the gross sum of its trading assets and trading liabilities) is equal to 10 percent or more of its total assets or $1 billion or more. Under the proposed rule, each agency would retain the authority to apply its respective market risk rule to any entity under its jurisdiction, regardless of whether it meets the aforementioned thresholds, if the agency deems it necessary or appropriate for safe and sound banking practices.

As a general matter, savings associations and savings and loan holding companies do not engage in trading activity to a substantial degree. However, the agencies believe that any savings association or savings and loan holding company whose trading activity grows to the extent that it meets the thresholds should hold capital commensurate with the risk of the trading activity and should have in place the prudential risk management systems and processes required under the market risk capital rule. Therefore, the agencies believe it would be necessary and appropriate to expand the scope of the market risk rule to apply to savings associations and savings and loan holding companies.

Application of the market risk capital rule to all banking organizations with material exposure to market risk would be particularly important because of banking organizations' increased exposure to traded credit products, such as credit default swaps, asset-backed securities and other structured products, as well as other less liquid products. In fact, many of the revisions to the final market risk capital rule were made in response to concerns that arose during the financial crisis when certain trading assets suffered substantial losses, causing banking organizations holding those assets to suffer substantial losses. For example, in addition to a market risk capital requirement to account for general market risk, the revised rules apply more conservative standardized specific risk capital requirements to most securitization positions, implement an additional incremental risk capital requirement for a banking organization that models specific risk for one or more portfolios of debt or, if applicable, equity positions. Additionally, to address concerns about the appropriate treatment of traded positions that have limited price transparency, a banking organization subject to the market risk capital rule must have a well-defined valuation process for all covered positions.

Question 16: The agencies request comment on the application of the market risk rule to savings associations and savings and loan holding companies.

IV. List of Acronyms

ABCP Asset-Backed Commercial Paper

ABS Asset-Backed Security

AVC Asset Value Correlation

BCBS Basel Committee on Banking Supervision

CCP Central Counterparty

CDO Collateralized Debt Obligation

CDS Credit Default Swap

CDS_{ind} Index Credit Default Swap

CEIO Credit-Enhancing Interest-Only Strip

CPSS Committee on Payment and Settlement Systems

CVA Credit Valuation Adjustment

DFA Dodd-Frank Act

DvP Delivery-versus-Payment

E Measure of Effectiveness

EAD Exposure-at-Default

EE Expected Exposure

Expected Operational Loss (EOL)

EPE Expected Positive Exposure

FDIC Federal Deposit Insurance Corporation

FFIEC Federal Financial Institutions Examination Council

FR Federal Register

GAAP Generally Accepted Accounting Principles

HVCRE High-Volatility Commercial Real Estate

IAA Internal Assessment Approach

IMA Internal Models Approach

IMM Internal Models Methodology

I/O Interest-Only

IOSCO International Organization of Securities Commissions

IRB Internal Ratings-Based

Loss Given Default (LGD)

M Effective Maturity

NGR Net-to-Gross Ratio

NPR Notice of Proposed Rulemaking

NRSRO Nationally Recognized Statistical Rating Organization

OCC Office of the Comptroller of the Currency

OTC Over-the-Counter

PD Probability of Default

PFE Potential Future Exposure

PvP Payment-versus-Payment

QCCP Qualifying Central Counterparty

QRE Qualified Retail Exposure

RBA Ratings-Based Approach

RVC Ratio of Value Change

SFA Supervisory Formula Approach

SSFA Simplified Supervisory Formula Approach

U.S.C. United States Code

VaR Value-at-Risk

V. Regulatory Flexibility Act Analysis

The Regulatory Flexibility Act, 5 U.S.C. 601 et seq. (RFA) requires an agency to provide an initial regulatory flexibility analysis with a proposed rule or to certify that the rule will not have a significant economic impact on a substantial number of small entities (defined for purposes of the RFA to include banks with assets less than or equal to $175 million) and publish its certification and a short, explanatory statement in the Federal Register along with the proposed rule.

The Board is providing an initial regulatory flexibility analysis with respect to this NPR. The OCC and FDIC are certifying that the proposals in this NPR will not have a significant economic impact on a substantial number of small entities.

Board

Under regulations issued by the Small Business Administration,[20] a small entity includes a depository institution or bank holding company with total assets of $175 million or less (a small banking organization). As of March 31, 2012 there were 373 small state member banks. As of December 31, 2011, there were approximately 128 small savings and loan holding companies and 2,385 small bank holding companies.[21]

As discussed previously in the Supplementary Information, the Board is proposing to revise its capital requirements to promote safe and sound banking practices, implement Basel III, and other aspects of the Basel capital framework, and codify its capital requirements.

The proposals also satisfy certain requirements under the Dodd-Frank Act by imposing new or revised minimum capital requirements on certain depository institution holding companies.[22] Additionally, under section 38(c)(1) of the Federal Deposit Insurance Act, the agencies may prescribe capital standards for depository institutions that they regulate.[23] In addition, among other authorities, the Board may establish capital requirements for state member banks under the Federal Reserve Act,[24] for state member banks and bank holding companies under the International Lending Supervision Act and Bank Holding Company Act,[25] and for savings and loan holding companies under the Home Owners Loan Act.[26]

The proposed requirements in this NPR generally would not apply to small bank holding companies that are not engaged in significant nonbanking activities, do not conduct significant off-balance sheet activities, and do not have a material amount of debt or equity securities outstanding that are registered with the SEC. These small bank holding companies remain subject to the Board's Small Bank Holding Company Policy Statement (Policy Statement).[27]

The proposals in this NPR would generally not apply to other small banking organizations. Those small banking organizations that would be subject to the proposed modifications to the advanced approaches rules would only be subject to those requirements because they are a subsidiary of a large banking organization that meets the criteria for advanced approaches. The Board expects that all such entities would rely on the systems developed by

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[20] See 13 CFR 121.201.

[21] The December 31, 2011, data are the most recent available data on small savings and loan holding companies and small bank holding companies.

[22] See 12 U.S.C. 5371.

[23] See 12 U.S.C. 1831o(c)(1).

[24] See 12 CFR 208.43.

[25] See 12 U.S.C. 3907; 12 U.S.C. 1844.

[26] See 12 U.S.C. 1467a(g)(1).

[27] See 12 CFR part 225, appendix C; see also 12 U.S.C. § 5371(b)(5)(C). Section 171 of the Dodd-Frank provides an exemption from its requirements for bank holding companies subject to the Policy Statement (as in effect on May 19, 2010). Section 171 does not provide a similar exemption for small savings and loan holding companies and they are therefore subject to the proposed rules.

their parent banking organizations and would have no additional compliance costs. The Board also expects that the parent banking organization would remedy any capital shortfalls at such a subsidiary that would occur due to the proposals in this NPR.

The Board welcomes comment on all aspects of its analysis. A final regulatory flexibility analysis will be conducted after consideration of comments received during the public comment period.

OCC

Pursuant to section 605(b) of the Regulatory Flexibility Act, (RFA), the regulatory flexibility analysis otherwise required under section 604 of the RFA is not required if an agency certifies that the rule will not have a significant economic impact on a substantial number of small entities (defined for purposes of the RFA to include banks with assets less than or equal to $175 million) and publishes its certification and a short, explanatory statement in the Federal Register along with its rule.

As of March 31, 2012, there were approximately 599 small national banks and 284 small federally chartered savings associations. The proposed changes to OCC's minimum risk-based capital requirements included in this NPR would impact only those small national banks and federal savings associations that are subsidiaries of large internationally active banking organizations that use the advanced approaches risk-based capital rules, and those small federal savings associations that meet the threshold criteria for application of the market risk rule. Only six small institutions would be subject to the advanced approaches risk-based capital rules, and no small federal savings associations satisfy the threshold criteria for application of the market risk rule. Therefore, the OCC does not believe that the proposed rule will result in a significant economic impact on a substantial number of small entities.

FDIC

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VI. Paperwork Reduction Act

Paperwork Reduction Act

Request for Comment on Proposed Information Collection

In accordance with the requirements of the Paperwork Reduction Act (PRA) of 1995, the Agencies may not conduct or sponsor, and the respondent is not required to respond to, an information collection unless it displays a currently valid Office of Management and Budget (OMB) control number. The Agencies are requesting comment on a proposed information collection.

The information collection requirements contained Subpart E of this joint notice of proposed rulemaking (NPR) have been submitted by the OCC and FDIC to OMB for review under the PRA, under OMB Control Nos. 1557-0234 and 3064-0153. The information collection requirements contained in Subpart F of this NPR have been submitted by the OCC and FDIC to OMB for review under the PRA, under OMB Control Nos. 1557-0### and 3064-0###. In

accordance with the PRA (44 U.S.C. 3506; 5 CFR part 1320, Appendix A.1), the Board has reviewed the NPR under the authority delegated by OMB. The Board's OMB Control Number for the information collection requirements contained Subpart E of this NPR is 7100-0313 and for the information collection requirements contained Subpart F of this NPR is 7100-0314. The requirements in Subpart E are found in proposed sections ___.121, ___.122, ___.123, ___.124, ___.132, ___.141, ___.142, ___.152, ___.173. The requirements in Subpart F are found in proposed sections __.203, __.204, __.205, __.206, __.207, __.208, __.209, __.210, and __.212.

The Agencies have published two other NPRs in this issue of the Federal Register. Please see the NPRs entitled "Regulatory Capital Rules: Regulatory Capital, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions" and "Regulatory Capital Rules: Standardized Approach for Risk-Weighted Assets; Market Discipline and Disclosure Requirements." While the three NPRs together comprise an integrated capital framework, the PRA burden has been divided among the three NPRs and a PRA statement has been provided in each.

Comments are invited on:

(a) Whether the collection of information is necessary for the proper performance of the Agencies' functions, including whether the information has practical utility;

(b) The accuracy of the estimates of the burden of the information collection, including the validity of the methodology and assumptions used;

(c) Ways to enhance the quality, utility, and clarity of the information to be collected;

(d) Ways to minimize the burden of the information collection on respondents, including through the use of automated collection techniques or other forms of information technology; and

(e) Estimates of capital or start up costs and costs of operation, maintenance, and purchase of services to provide information.

All comments will become a matter of public record.
Comments should be addressed to:

OCC: Communications Division, Office of the Comptroller of the Currency, Public Information Room, Mail stop 1-5, Attention: 1557-NEW R-####, 250 E Street, SW., Washington, DC 20219. In addition, comments may be sent by fax to 202-874-4448, or by electronic mail to regs.comments@occ.treas.gov. You can inspect and photocopy the comments at the OCC's Public Information Room, 250 E Street, SW., Washington, DC 20219. You can make an appointment to inspect the comments by calling 202-874-5043.

Board: You may submit comments, identified by R-####, by any of the following methods:

• Agency Web Site: http://www.federalreserve.gov. Follow the instructions for submitting comments on the http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm.

• Federal eRulemaking Portal: http://www.regulations.gov. Follow the instructions for submitting comments.

• E-mail: regs.comments@federalreserve.gov. Include docket number in the subject line of the message.

• FAX: 202-452-3819 or 202-452-3102.

• Mail: Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, NW, Washington, DC 20551.

All public comments are available from the Board's Web site at http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm as submitted, unless modified for technical reasons. Accordingly, your comments will not be edited to remove any identifying or contact information. Public comments may also be viewed electronically or in paper in Room MP-500 of the Board's Martin Building (20th and C Streets, NW.) between 9 a.m. and 5 p.m. on weekdays.

FDIC: You may submit written comments, which should refer to 3064-____, R-#### by any of the following methods:

• Agency Web Site: http://www.fdic.gov/regulations/laws/federal/propose.html. Follow the instructions for submitting comments on the FDIC Web site.

• Federal eRulemaking Portal: http://www.regulations.gov. Follow the instructions for submitting comments.

• E-mail: Comments@FDIC.gov.

• Mail: Robert E. Feldman, Executive Secretary, Attention: Comments, FDIC, 550 17th Street, NW., Washington, DC 20429.

• Hand Delivery/Courier: Guard station at the rear of the 550 17th Street Building (located on F Street) on business days between 7 a.m. and 5 p.m.

Public Inspection: All comments received will be posted without change to http://www.fdic.gov/regulations/laws/federal/propose/html including any personal information provided. Comments may be inspected at the FDIC Public Information Center, Room 100, 801 17th Street, NW., Washington, DC, between 9 a.m. and 4:30 p.m. on business days.

Proposed Information Collection

Title of Information Collection: Regulatory Capital Rules (Part 3): Advanced Approaches Risk-based Capital Rules (Basel III, Part 3).

Frequency of Response: Quarterly and annually.

Affected Public:

OCC: National banks and federally chartered savings associations.

Board: State member banks (SMBs), bank holding companies (BHCs), and savings and loan holding companies (SLHCs).

FDIC: Insured state nonmember banks and certain subsidiaries of these entities.

Estimated Burden:

OCC

Number of Respondents: __.

Estimated Burden per Respondent: __ hours.

Total Estimated Annual Burden: __ hours.

Board

Estimated number of Respondents: SMBs, 4; BHCs, 20; SLHCs, 13.

Estimated Burden per Respondent: One-time recordkeeping, 460 hours; ongoing recordkeeping, 176 hours; one-time disclosures, 280 hours; ongoing disclosures, 140 hours.

Total Estimated Annual Burden: 39,072 hours.

FDIC

Number of Respondents: __.

Estimated Burden per Respondent: __ hours.

Total Estimated Annual Burden: __ hours.

Abstract:

The PRA burden associated with reporting, recordkeeping, and disclosure requirements of Subpart E that are found in proposed sections ___.121, ___.122, ___.123, ___.124, ___.132(b)(2)(iii), ___.132(b)(3), ___.132 (d)(1), ___.132(d)(1)(iii), ___.141(b)(3), ___.142(h)(2), ___.152(c)(2), ___.173 (tables: 11.1, 11.2, 11.3, 11.6, 11.7, 11.8, 11.10, and 11.11) are currently accounted for under the Agencies' existing information collections (ICs).[28]

The PRA burden associated with recordkeeping and disclosure requirements found in proposed sections _____.132(b)(2)(iii)(A), _____.132(d)(2)(iv), _____.132(d)(3)(vi), _____.132(d)(3)(viii), _____.132(d)(3)(ix), _____.132(d)(3)(x), _____.132(d)(3)(xi), _____.141(c)(2)(i), _____.141(c)(2)(ii), _____.173(tables: 11.4, 11.5, 11.9, and 11.12) would revised the Agencies' existing ICs and are described below.[29]

Section-by-Section Analysis

Recordkeeping Requirements

Under proposed section _____.132(b)(2)(iii)(A), counterparty credit risk of repo-style transactions, eligible margin loans, and OTC derivative contracts, Own internal estimates for haircuts. With the prior written approval of the [AGENCY], a [BANK] may calculate haircuts

[28] The current OMB inventory for these ICs are available at: http://www.reginfo.gov/public/do/PRAMain: OCC (OMB No. 1557-0234); Board (OMB No. 7100-0313); FDIC (OMB No. 3064-0153).

[29] The ICs in this NPR will be incorporated into each Agencies' existing ICs:
The burden estimates provided in this rule pertain only to the ICs associated with this NPR.

(H_s and H_{fx}) using its own internal estimates of the volatilities of market prices and foreign exchange rates. To receive [AGENCY] approval to use its own internal estimates, a [BANK] must satisfy the minimum quantitative standards outlined in this section. The agencies estimate that respondents would take on average 80 hours (two business weeks) to reprogram and update systems with the requirements outlined in this section. In addition, the agencies estimate that, on a continuing basis, respondents would take on average 16 hours annually to maintain their internal systems.

Under proposed section _____.132(d)(2)(iv), counterparty credit risk of repo-style transactions, eligible margin loans, and OTC derivative contracts, Risk-weighted assets using IMM - Under the IMM, a [BANK] uses an internal model to estimate the expected exposure (EE) for a netting set and then calculates EAD based on that EE. A [BANK] must calculate two EEs and two EADs (one stressed and one unstressed) for each netting as outlined in this section. The agencies estimate that respondents would take on average 80 hours (two business weeks) to update their current model with the requirements outlined in this section. In addition, the agencies estimate that, on a continuing basis, respondents would take on average 40 hours annually to maintain their internal model.

Under proposed section _____.132(d)(3)(vi), counterparty credit risk of repo-style transactions, eligible margin loans, and OTC derivative contracts. To obtain [AGENCY] approval to calculate the distributions of exposures upon which the EAD calculation is based, the [BANK] must demonstrate to the satisfaction of the [AGENCY] that it has been using for at least one year an internal model that broadly meets the minimum standards , with which the [BANK] must maintain compliance. The [BANK] must have procedures to identify, monitor, and control wrong-way risk throughout the life of an exposure. The procedures must include stress testing and scenario analysis. The agencies estimate that respondents would take on average 80 hours (two business weeks) to implement a model with the requirements outlined in this section.

Under proposed section _____.132(d)(3)(viii), counterparty credit risk of repo-style transactions, eligible margin loans, and OTC derivative contracts. When estimating model parameters based on a stress period, the [BANK] must use at least three years of historical data that include a period of stress to the credit default spreads of the [BANK]'s counterparties. The [BANK] must review the data set and update the data as necessary, particularly for any material changes in its counterparties. The [BANK] must demonstrate at least quarterly that the stress period coincides with increased CDS or other credit spreads of the [BANK]'s counterparties. The [BANK] must have procedures to evaluate the effectiveness of its stress calibration that include a process for using benchmark portfolios that are vulnerable to the same risk factors as the [BANK]'s portfolio. The [AGENCY] may require the [BANK] to modify its stress calibration to better reflect actual historic losses of the portfolio. The agencies estimate that respondents would take on average 80 hours (two business weeks) to implement procedures with the requirements outlined in this section.

Under proposed section _____.132(d)(3)(ix), counterparty credit risk of repo-style transactions, eligible margin loans, and OTC derivative contracts. A [BANK] must subject its internal model to an initial validation and annual model review process. The model review should consider whether the inputs and risk factors, as well as the model outputs, are appropriate. As part of the model review process, the [BANK] must have a backtesting program for its model

that includes a process by which unacceptable model performance will be determined and remedied. The agencies estimate that respondents would take on average 40 hours (one business week) to implement a model with the requirements outlined in this section. In addition, the agencies estimate that, on a continuing basis, respondents would take on average 40 hours annually to maintain their internal model.

Under proposed section _____.132(d)(3)(x), counterparty credit risk of repo-style transactions, eligible margin loans, and OTC derivative contracts. A [BANK] must have policies for the measurement, management and control of collateral and margin amounts. The agencies estimate that respondents would take on average 20 hours to implement policies with the requirements outlined in this section.

Under proposed section _____.132(d)(3)(xi), counterparty credit risk of repo-style transactions, eligible margin loans, and OTC derivative contracts. A [BANK] must have a comprehensive stress testing program that captures all credit exposures to counterparties, and incorporates stress testing of principal market risk factors and creditworthiness of counterparties. The agencies estimate that respondents would take on average 40 hours (one business week) to implement a program with the requirements outlined in this section. In addition, the agencies estimate that, on a continuing basis, respondents would take on average 40 hours annually to maintain their program.

Under proposed sections _____.141(c)(2)(i) and (ii), operational criteria for recognizing the transfer of risk. A [BANK] must demonstrate its comprehensive understanding of a securitization exposure under section 141(c)(1), for each securitization exposure by conducting an analysis of the risk characteristics of a securitization exposure prior to acquiring the exposure and document such analysis within three business days after acquiring the exposure. On an on-going basis (no less frequently than quarterly), evaluate, review, and update as appropriate the analysis required under this section for each securitization exposure. The agencies estimate that respondents would take on average 40 hours (one business week) to implement a program with the requirements outlined in this section. The agencies estimate that, on a continuing basis, respondents would take on average 10 hours quarterly to evaluate, review, and update the program requirements.

Disclosure Requirements

Under proposed section _____.173, disclosures by banks that are advanced approaches banks. A [BANK] that is an advanced approaches bank must make the disclosures described in Tables 11.1 through 11.12. The [BANK] must make these disclosures publicly available for each of the last three years (that is, twelve quarters) or such shorter period beginning on the effective date of this subpart E.

Under proposed table 11.4 – Capital Conservation and Countercyclical Buffers. The [BANK] must comply with the qualitative and quantitative public disclosures outlined in this table. The agencies estimate that respondents would take on average 80 hours (two business weeks) to comply with the disclosure requirements outlined in this table. The agencies estimate that, on a continuing basis, respondents would take on average 40 hours annually comply with the disclosure requirements outlined in this table.

Under proposed table 11.5 – Credit Risk: General Disclosures. The [BANK] must comply with the qualitative and quantitative public disclosures outlined in this table. The agencies estimate that respondents would take on average 80 hours (two business weeks) to comply with the disclosure requirements outlined in this table. The agencies estimate that, on a continuing basis, respondents would take on average 40 hours annually to comply with the disclosure requirements outlined in this table.

Under proposed table 11.9 – Securitization. The [BANK] must comply with the qualitative and quantitative public disclosures outlined in this table. The agencies estimate that respondents would take on average 60 hours to comply with the disclosure requirements outlined in this table. The agencies estimate that, on a continuing basis, respondents would take on average 30 hours annually comply with the disclosure requirements outlined in this table.

Under proposed Table 11.12 – Interest Rate Risk for Non-trading Activities. The [BANK] must comply with the qualitative and quantitative public disclosures outlined in this table. The agencies estimate that respondents would take on average 60 hours to comply with the disclosure requirements outlined in this table. The agencies estimate that, on a continuing basis, respondents would take on average 30 hours annually comply with the disclosure requirements outlined in this table.

Proposed Information Collection

Title of Information Collection: Regulatory Capital Rules (Part 3): Market Risk Capital Rule (Basel III, Part 3).

Frequency of Response: Quarterly and annually.

Affected Public:

OCC: National banks and federally chartered savings associations.

Board: Savings associations and saving and loan holding companies.

FDIC: Insured state nonmember banks and certain subsidiaries of these entities.

Estimated Burden:

OCC

Number of Respondents: __.

Estimated Burden per Respondent: 1,964 hours.

Total Estimated Annual Burden: __ hours.

Board

Estimated number of Respondents: 30.

Estimated Burden per Respondent: 2,204 hours.

Total Estimated Annual Burden: 66, 120 hours.

FDIC

Number of Respondents: __.

Estimated Burden per Respondent: 1,964 hours.

Total Estimated Annual Burden: __ hours.

Abstract:

The PRA burden associated with reporting, recordkeeping, and disclosure requirements of Subpart F that are found in proposed sections __.203, __.204, __.205, __.206, __.207, __.208, __.209, __.210, and __.212.[30] They would enhance risk sensitivity and introduce requirements for public disclosure of certain qualitative and quantitative information about a savings association's or a savings and loan holding company's market risk. The collection of information is necessary to ensure capital adequacy according to the level of market risk.

Section-by-Section Analysis

Section __.203 sets forth the requirements for applying the market risk framework. Section __.203(a)(1) requires clearly defined policies and procedures for determining which trading assets and trading liabilities are trading positions, which of its trading positions are correlation trading positions, and specifies what must be taken into account. Section __.203(a)(2) requires a clearly defined trading and hedging strategy for trading positions approved by senior management and specifies what each strategy must articulate. Section __.203(b)(1) requires clearly defined policies and procedures for actively managing all covered positions and specifies the minimum that they must require. Sections __.203(c)(4) through __.203(c)(10) require the annual review of internal models and include certain requirements that the models must meet. Section __.203(d)(4) requires an annual report to the board of directors on the effectiveness of controls supporting market risk measurement systems.

Section __.204(b) requires quarterly backtesting. Section __.205(a)(5) requires institutions to demonstrate to the agencies the appropriateness of proxies used to capture risks within value-at- risk models. Section __.205(c) requires institutions to retain value-at-risk and profit and loss information on sub-portfolios for two years. Section __.206(b)(3) requires policies and procedures for stressed value-at-risk models and prior approvals on determining periods of significant financial stress.

Section __.207(b)(1) specifies what internal models for specific risk must include and address. Section 208(a) requires prior written approval for incremental risk. Section __.209(a) requires prior approval for comprehensive risk models. Section __.209(c)(2) requires retaining and making available the results of supervisory stress testing on a quarterly basis. Section __.210(f) requires documentation quarterly for analysis of risk characteristics of each securitization position it holds. Section __.212 requires quarterly quantitative disclosures, annual qualitative disclosures, and a formal disclosure policy approved by the board of directors that addresses the bank's approach for determining the market risk disclosures it makes.

VII. Plain Language

Section 722 of the Gramm-Leach-Bliley Act requires the Federal banking agencies to use plain language in all proposed and final rules published after January 1, 2000. The agencies invited comment on whether the proposed rule was written plainly and clearly or whether there

[30] The burden estimates for the Subpart F requirements would be added to the burden estimates for the agencies' current Mark Risk information collections. The burden estimates provided in this NPR are only apply to this NPR and do not include the existing information collections.

were ways the agencies could make the rule easier to understand. The agencies received no comments on these matters and believe that the final rule is written plainly and clearly in conjunction with the agencies' risk-based capital rules.

VIII. OCC Unfunded Mandates Reform Act of 1995 Determination

Section 202 of the Unfunded Mandates Reform Act of 1995 (UMRA) (2 U.S.C. 1532 et seq.) requires that an agency prepare a written statement before promulgating a rule that includes a Federal mandate that may result in the expenditure by State, local, and Tribal governments, in the aggregate, or by the private sector of $100 million or more (adjusted annually for inflation) in any one year. If a written statement is required, the UMRA (2 U.S.C. 1535) also requires an agency to identify and consider a reasonable number of regulatory alternatives before promulgating a rule and from those alternatives, either select the least costly, most cost-effective or least burdensome alternative that achieves the objectives of the rule, or provide a statement with the rule explaining why such an option was not chosen.

This NPR would incorporate revisions to the Basel Committee's capital framework into the banking agencies' advanced approaches risk-based capital rules and remove references to credit ratings consistent with section 939A of the Dodd-Frank Act. This NPR would modify various elements of the advanced approached risk-based capital rules regarding the determination of risk-weighted assets. These changes would (1) modify treatment of counterparty credit risk, (2) remove references to credit ratings, (3) modify the treatment of securitization exposures, and (4) modify the treatment of exposures subject to deduction from capital. The NPR also would enhance disclosure requirements, especially with regard to securitizations, and would amend the advanced approaches so that capital requirements using the internal models methodology take into consideration stress in calibration data, stress testing, initial validation, collateral management, and annual model review. The NPR rule also would require national banks and federal savings associations subject to the advanced approaches risk-based capital rules to identify, monitor, and control wrong-way risk.

Finally, the NPR would expand the scope of the agencies' market risk capital rule to savings associations that meet certain thresholds.

To estimate the impact of this NPR on national banks and federal savings associations, the OCC estimated the amount of capital banks will need to raise to meet the new requirements relative to the amount of capital they currently hold, as well as the compliance costs associated with establishing the infrastructure to determine correct risk weights using the revised methods for calculating risk-weighted assets and the compliance costs associated with new disclosure requirements. The OCC has determined that its proposed rule will not result in expenditures by State, local, and Tribal governments, or by the private sector, of $100 million or more. Accordingly, the UMRA does not require that a written statement accompany this NPR.

Text of Common Rule

Part ___ CAPITAL ADEQUACY OF [BANK]s

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Subpart E – Risk Weighted Assets – Internal Ratings-Based and Advanced Measurement Approaches

§___.100 Purpose, Applicability, and Principle of Conservatism

(a) Purpose. This subpart E establishes:

(1) Minimum qualifying criteria for [BANK]s using [BANK]-specific internal risk measurement and management processes for calculating risk-based capital requirements; and

(2) Methodologies for such [BANK]s to calculate their total risk-weighted assets.

(b) Applicability. (1) This subpart applies to a [BANK] that:

(i) Has consolidated total assets, as reported on the most recent year-end [Regulatory Reports] equal to $250 billion or more;

(ii) Has consolidated total on-balance sheet foreign exposure at the most recent year-end equal to $10 billion or more (where total on-balance sheet foreign exposure equals total cross-border claims less claims with a head office or guarantor located in another country plus redistributed guaranteed amounts to the country of head office or guarantor plus local country claims on local residents plus revaluation gains on foreign exchange and derivative products, calculated in accordance with the Federal Financial Institutions Examination Council (FFIEC) 009 Country Exposure Report);

(iii) Is a subsidiary of a depository institution that uses the advanced approaches pursuant to subpart E of 12 CFR part 3 (OCC), 12 CFR part 217 (Board), or 12 CFR part 325 (FDIC) to calculate its total risk-weighted assets;

(iv) Is a subsidiary of a bank holding company or savings and loan holding company that uses the advanced approaches pursuant to 12 CFR part 217 to calculate its total risk-weighted assets; or

(v) Elects to use this subpart to calculate its total risk-weighted assets.

(2) A bank that is subject to this subpart shall remain subject to this subpart unless the [AGENCY] determines in writing that application of this subpart is not appropriate in light of the

[BANK]'s asset size, level of complexity, risk profile, or scope of operations. In making a determination under this paragraph, the [AGENCY] will apply notice and response procedures in the same manner and to the same extent as the notice and response procedures in 12 CFR 3.12 (OCC), 12 CFR 263.202 (Board), and 12 CFR 325.6(c) (FDIC).

(3) A market risk [BANK] must exclude from its calculation of risk-weighted assets under this subpart the risk-weighted asset amounts of all covered positions, as defined in subpart F (except foreign exchange positions that are not trading positions, over-the-counter derivative positions, cleared transactions, and unsettled transactions).

(c) Principle of Conservatism. Notwithstanding the requirements of this subpart, a [BANK] may choose not to apply a provision of this subpart to one or more exposures provided that:

(1) The [BANK] can demonstrate on an ongoing basis to the satisfaction of the [AGENCY] that not applying the provision would, in all circumstances, unambiguously generate a risk-based capital requirement for each such exposure greater than that which would otherwise be required under this subpart;

(2) The [BANK] appropriately manages the risk of each such exposure;

(3) The [BANK] notifies the [AGENCY] in writing prior to applying this principle to each such exposure; and

(4) The exposures to which the [BANK] applies this principle are not, in the aggregate, material to the [BANK].

§___.101 Definitions

(a) Terms set forth in §___.2 and used in this subpart have the definitions assigned thereto in §___.2.

(b) For the purposes of this subpart, the following terms are defined as follows:

Advanced internal ratings-based (IRB) systems means an advanced approaches [BANK]'s internal risk rating and segmentation system; risk parameter quantification system; data management and maintenance system; and control, oversight, and validation system for credit risk of wholesale and retail exposures.

Advanced systems means an advanced approaches [BANK]'s advanced IRB systems, operational risk management processes, operational risk data and assessment systems, operational risk quantification systems, and, to the extent used by the [BANK], the internal models methodology, advanced CVA approach, double default excessive correlation detection process, and internal models approach (IMA) for equity exposures.

Backtesting means the comparison of a [BANK]'s internal estimates with actual outcomes during a sample period not used in model development. In this context, backtesting is one form of out-of-sample testing.

Benchmarking means the comparison of a [BANK]'s internal estimates with relevant internal and external data or with estimates based on other estimation techniques.

Bond option contract means a bond option, bond future, or any other instrument linked to a bond that gives rise to similar counterparty credit risk.

Business environment and internal control factors means the indicators of a [BANK]'s operational risk profile that reflect a current and forward-looking assessment of the [BANK]'s underlying business risk factors and internal control environment.

Credit default swap (CDS) means a financial contract executed under standard industry documentation that allows one party (the protection purchaser) to transfer the credit risk of one or more exposures (reference exposure(s)) to another party (the protection provider) for a certain period of time.

Credit valuation adjustment (CVA) means the fair value adjustment to reflect counterparty credit risk in valuation of an OTC derivative contract.

Default – For the purposes of calculating capital requirements under this subpart:

(1) Retail. (i) A retail exposure of a [BANK] is in default if:

(A) The exposure is 180 days past due, in the case of a residential mortgage exposure or revolving exposure;

(B) The exposure is 120 days past due, in the case of retail exposures that are not residential mortgage exposures or revolving exposures; or

(C) The [BANK] has taken a full or partial charge-off, write-down of principal, or material negative fair value adjustment of principal on the exposure for credit-related reasons.

(ii) Notwithstanding paragraph (1)(i) of this definition, for a retail exposure held by a non-U.S. subsidiary of the [BANK] that is subject to an internal ratings-based approach to capital adequacy consistent with the Basel Committee on Banking Supervision's "International Convergence of Capital Measurement and Capital Standards: A Revised Framework" in a non-U.S. jurisdiction, the [BANK] may elect to use the definition of default that is used in that jurisdiction, provided that the [BANK] has obtained prior approval from the [AGENCY] to use the definition of default in that jurisdiction.

(iii) A retail exposure in default remains in default until the [BANK] has reasonable assurance of repayment and performance for all contractual principal and interest payments on the exposure.

(2) Wholesale. (i) A [BANK]'s wholesale obligor is in default if:

(A) The [BANK] determines that the obligor is unlikely to pay its credit obligations to the [BANK] in full, without recourse by the [BANK] to actions such as realizing collateral (if held); or

(B) The obligor is past due more than 90 days on any material credit obligation(s) to the [BANK].[31]

(ii) An obligor in default remains in default until the [BANK] has reasonable assurance of repayment and performance for all contractual principal and interest payments on all exposures of the [BANK] to the obligor (other than exposures that have been fully written-down or charged-off).

Dependence means a measure of the association among operational losses across and within units of measure.

Economic downturn conditions means, with respect to an exposure held by the [BANK], those conditions in which the aggregate default rates for that exposure's wholesale or retail exposure subcategory (or subdivision of such subcategory selected by the [BANK]) in the exposure's national jurisdiction (or subdivision of such jurisdiction selected by the [BANK]) are significantly higher than average.

Effective maturity (M) of a wholesale exposure means:

(1) For wholesale exposures other than repo-style transactions, eligible margin loans, and OTC derivative contracts described in paragraph (2) or (3) of this definition:

(i) The weighted-average remaining maturity (measured in years, whole or fractional) of the expected contractual cash flows from the exposure, using the undiscounted amounts of the cash flows as weights; or

(ii) The nominal remaining maturity (measured in years, whole or fractional) of the exposure.

(2) For repo-style transactions, eligible margin loans, and OTC derivative contracts subject to a qualifying master netting agreement for which the [BANK] does not apply the internal models approach in section 132(d), the weighted-average remaining maturity (measured in years, whole or fractional) of the individual transactions subject to the qualifying master netting agreement, with the weight of each individual transaction set equal to the notional amount of the transaction.

(3) For repo-style transactions, eligible margin loans, and OTC derivative contracts for which the [BANK] applies the internal models approach in §___.132(d), the value determined in §___.132(d)(5).

Effective notional amount means, for an eligible guarantee or eligible credit derivative, the lesser of the contractual notional amount of the credit risk mitigant and the EAD of the hedged exposure, multiplied by the percentage coverage of the credit risk mitigant.

[31] Overdrafts are past due once the obligor has breached an advised limit or been advised of a limit smaller than the current outstanding balance.

Eligible double default guarantor, with respect to a guarantee or credit derivative obtained by a [BANK], means:

(1) U.S.-based entities. A depository institution, a bank holding company, a savings and loan holding company, or a securities broker or dealer registered with the SEC under the Securities Exchange Act, if at the time the guarantee is issued or anytime thereafter, has issued and outstanding an unsecured debt security without credit enhancement that is investment grade.

(2) Non-U.S.-based entities. A foreign bank, or a non-U.S.-based securities firm if the [BANK] demonstrates that the guarantor is subject to consolidated supervision and regulation comparable to that imposed on U.S. depository institutions, or securities broker-dealers) if at the time the guarantee is issued or anytime thereafter, has issued and outstanding an unsecured debt security without credit enhancement that is investment grade.

Eligible operational risk offsets means amounts, not to exceed expected operational loss, that:

(1) Are generated by internal business practices to absorb highly predictable and reasonably stable operational losses, including reserves calculated consistent with GAAP; and

(2) Are available to cover expected operational losses with a high degree of certainty over a one-year horizon.

Eligible purchased wholesale exposure means a purchased wholesale exposure that:

(1) The [BANK] or securitization SPE purchased from an unaffiliated seller and did not directly or indirectly originate;

(2) Was generated on an arm's-length basis between the seller and the obligor (intercompany accounts receivable and receivables subject to contra-accounts between firms that buy and sell to each other do not satisfy this criterion);

(3) Provides the [BANK] or securitization SPE with a claim on all proceeds from the exposure or a pro rata interest in the proceeds from the exposure;

(4) Has an M of less than one year; and

(5) When consolidated by obligor, does not represent a concentrated exposure relative to the portfolio of purchased wholesale exposures.

Expected exposure (EE) means the expected value of the probability distribution of non-negative credit risk exposures to a counterparty at any specified future date before the maturity date of the longest term transaction in the netting set. Any negative market values in the probability distribution of market values to a counterparty at a specified future date are set to zero to convert the probability distribution of market values to the probability distribution of credit risk exposures.

Expected operational loss (EOL) means the expected value of the distribution of potential aggregate operational losses, as generated by the [BANK]'s operational risk quantification system using a one-year horizon.

Expected positive exposure (EPE) means the weighted average over time of expected (non-negative) exposures to a counterparty where the weights are the proportion of the time interval that an individual expected exposure represents. When calculating risk-based capital requirements, the average is taken over a one-year horizon.

Exposure at default (EAD) means:

(1) For the on-balance sheet component of a wholesale exposure or segment of retail exposures (other than an OTC derivative contract, a repo-style transaction or eligible margin loan for which the [BANK] determines EAD under §___.132, a cleared transaction, or default fund contribution), EAD means the [BANK]'s carrying value (including net accrued but unpaid interest and fees) for the exposure or segment less any allocated transfer risk reserve for the exposure or segment.

(2) For the off-balance sheet component of a wholesale exposure or segment of retail exposures (other than an OTC derivative contract, a repo-style transaction or eligible margin loan for which the [BANK] determines EAD under §___.132, cleared transaction, or default fund contribution) in the form of a loan commitment, line of credit, trade-related letter of credit, or transaction-related contingency, EAD means the [BANK]'s best estimate of net additions to the outstanding amount owed the [BANK], including estimated future additional draws of principal and accrued but unpaid interest and fees, that are likely to occur over a one-year horizon assuming the wholesale exposure or the retail exposures in the segment were to go into default. This estimate of net additions must reflect what would be expected during economic downturn conditions. For the purposes of this definition:

(i) Trade-related letters of credit are short-term, self-liquidating instruments that are used to finance the movement of goods and are collateralized by the underlying goods.

(ii) Transaction-related contingencies relate to a particular transaction and include, among other things, performance bonds and performance-based letters of credit.

(3) For the off-balance sheet component of a wholesale exposure or segment of retail exposures (other than an OTC derivative contract, a repo-style transaction, or eligible margin loan for which the [BANK] determines EAD under §___.132, cleared transaction, or default fund contribution) in the form of anything other than a loan commitment, line of credit, trade-related letter of credit, or transaction-related contingency, EAD means the notional amount of the exposure or segment.

(4) EAD for OTC derivative contracts is calculated as described in §___.132. A [BANK] also may determine EAD for repo-style transactions and eligible margin loans as described in §___.132.

Exposure category means any of the wholesale, retail, securitization, or equity exposure categories.

External operational loss event data means, with respect to a [BANK], gross operational loss amounts, dates, recoveries, and relevant causal information for operational loss events occurring at organizations other than the [BANK].

IMM exposure means a repo-style transaction, eligible margin loan, or OTC derivative for which a [BANK] calculates its EAD using the internal models methodology of §___.132(d).

Internal operational loss event data means, with respect to a [BANK], gross operational loss amounts, dates, recoveries, and relevant causal information for operational loss events occurring at the [BANK].

Loss given default (LGD) means:

(1) For a wholesale exposure, the greatest of:

(i) Zero;

(ii) The [BANK]'s empirically based best estimate of the long-run default-weighted average economic loss, per dollar of EAD, the [BANK] would expect to incur if the obligor (or a typical obligor in the loss severity grade assigned by the [BANK] to the exposure) were to default within a one-year horizon over a mix of economic conditions, including economic downturn conditions; or

(iii) The [BANK]'s empirically based best estimate of the economic loss, per dollar of EAD, the [BANK] would expect to incur if the obligor (or a typical obligor in the loss severity grade assigned by the [BANK] to the exposure) were to default within a one-year horizon during economic downturn conditions.

(2) For a segment of retail exposures, the greatest of:

(i) Zero;

(ii) The [BANK]'s empirically based best estimate of the long-run default-weighted average economic loss, per dollar of EAD, the [BANK] would expect to incur if the exposures in the segment were to default within a one-year horizon over a mix of economic conditions, including economic downturn conditions; or

(iii) The [BANK]'s empirically based best estimate of the economic loss, per dollar of EAD, the [BANK] would expect to incur if the exposures in the segment were to default within a one-year horizon during economic downturn conditions.

(3) The economic loss on an exposure in the event of default is all material credit-related losses on the exposure (including accrued but unpaid interest or fees, losses on the sale of collateral, direct workout costs, and an appropriate allocation of indirect workout costs). Where positive or negative cash flows on a wholesale exposure to a defaulted obligor or a defaulted retail exposure (including proceeds from the sale of collateral, workout costs, additional extensions of credit to facilitate repayment of the exposure, and draw-downs of unused credit

lines) occur after the date of default, the economic loss must reflect the net present value of cash flows as of the default date using a discount rate appropriate to the risk of the defaulted exposure.

Obligor means the legal entity or natural person contractually obligated on a wholesale exposure, except that a [BANK] may treat the following exposures as having separate obligors:

(1) Exposures to the same legal entity or natural person denominated in different currencies;

(2) (i) An income-producing real estate exposure for which all or substantially all of the repayment of the exposure is reliant on the cash flows of the real estate serving as collateral for the exposure; the [BANK], in economic substance, does not have recourse to the borrower beyond the real estate collateral; and no cross-default or cross-acceleration clauses are in place other than clauses obtained solely out of an abundance of caution; and

(ii) Other credit exposures to the same legal entity or natural person; and

(3) (i) A wholesale exposure authorized under section 364 of the U.S. Bankruptcy Code (11 U.S.C. 364) to a legal entity or natural person who is a debtor-in-possession for purposes of Chapter 11 of the Bankruptcy Code; and

(ii) Other credit exposures to the same legal entity or natural person.

Operational loss means a loss (excluding insurance or tax effects) resulting from an operational loss event. Operational loss includes all expenses associated with an operational loss event except for opportunity costs, forgone revenue, and costs related to risk management and control enhancements implemented to prevent future operational losses.

Operational loss event means an event that results in loss and is associated with any of the following seven operational loss event type categories:

(1) Internal fraud, which means the operational loss event type category that comprises operational losses resulting from an act involving at least one internal party of a type intended to defraud, misappropriate property, or circumvent regulations, the law, or company policy excluding diversity- and discrimination-type events.

(2) External fraud, which means the operational loss event type category that comprises operational losses resulting from an act by a third party of a type intended to defraud, misappropriate property, or circumvent the law. Retail credit card losses arising from non-contractual, third-party initiated fraud (for example, identity theft) are external fraud operational losses. All other third-party initiated credit losses are to be treated as credit risk losses.

(3) Employment practices and workplace safety, which means the operational loss event type category that comprises operational losses resulting from an act inconsistent with employment, health, or safety laws or agreements, payment of personal injury claims, or payment arising from diversity- and discrimination-type events.

(4) Clients, products, and business practices, which means the operational loss event type category that comprises operational losses resulting from the nature or design of a product or from an unintentional or negligent failure to meet a professional obligation to specific clients (including fiduciary and suitability requirements).

(5) Damage to physical assets, which means the operational loss event type category that comprises operational losses resulting from the loss of or damage to physical assets from natural disaster or other events.

(6) Business disruption and system failures, which means the operational loss event type category that comprises operational losses resulting from disruption of business or system failures.

(7) Execution, delivery, and process management, which means the operational loss event type category that comprises operational losses resulting from failed transaction processing or process management or losses arising from relations with trade counterparties and vendors.

Operational risk means the risk of loss resulting from inadequate or failed internal processes, people, and systems or from external events (including legal risk but excluding strategic and reputational risk).

Operational risk exposure means the 99.9^{th} percentile of the distribution of potential aggregate operational losses, as generated by the [BANK]'s operational risk quantification system over a one-year horizon (and not incorporating eligible operational risk offsets or qualifying operational risk mitigants).

Other retail exposure means an exposure (other than a securitization exposure, an equity exposure, a residential mortgage exposure, a pre-sold construction loan, a qualifying revolving exposure, or the residual value portion of a lease exposure) that is managed as part of a segment of exposures with homogeneous risk characteristics, not on an individual-exposure basis, and is either:

(1) An exposure to an individual for non-business purposes; or

(2) An exposure to an individual or company for business purposes if the [BANK]'s consolidated business credit exposure to the individual or company is $1 million or less.

Probability of default (PD) means:

(1) For a wholesale exposure to a non-defaulted obligor, the [BANK]'s empirically based best estimate of the long-run average one-year default rate for the rating grade assigned by the [BANK] to the obligor, capturing the average default experience for obligors in the rating grade over a mix of economic conditions (including economic downturn conditions) sufficient to provide a reasonable estimate of the average one-year default rate over the economic cycle for the rating grade.

(2) For a segment of non-defaulted retail exposures, the [BANK]'s empirically based best estimate of the long-run average one-year default rate for the exposures in the segment, capturing

the average default experience for exposures in the segment over a mix of economic conditions (including economic downturn conditions) sufficient to provide a reasonable estimate of the average one-year default rate over the economic cycle for the segment.

(3) For a wholesale exposure to a defaulted obligor or segment of defaulted retail exposures, 100 percent.

Qualifying cross-product master netting agreement means a qualifying master netting agreement that provides for termination and close-out netting across multiple types of financial transactions or qualifying master netting agreements in the event of a counterparty's default, provided that:

(1) The underlying financial transactions are OTC derivative contracts, eligible margin loans, or repo-style transactions; and

(2) The [BANK] obtains a written legal opinion verifying the validity and enforceability of the agreement under applicable law of the relevant jurisdictions if the counterparty fails to perform upon an event of default, including upon receivership, insolvency, liquidation, or similar proceeding.

Qualifying revolving exposure (QRE) means an exposure (other than a securitization exposure or equity exposure) to an individual that is managed as part of a segment of exposures with homogeneous risk characteristics, not on an individual-exposure basis, and:

(1) Is revolving (that is, the amount outstanding fluctuates, determined largely by the borrower's decision to borrow and repay, up to a pre-established maximum amount);

(2) Is unsecured and unconditionally cancelable by the [BANK] to the fullest extent permitted by Federal law; and

(3) Has a maximum contractual exposure amount (drawn plus undrawn) of up to $100,000, or the [BANK] consistently imposes in practice an upper limit of $100,000.

Retail exposure means a residential mortgage exposure, a qualifying revolving exposure, or an other retail exposure.

Retail exposure subcategory means the residential mortgage exposure, qualifying revolving exposure, or other retail exposure subcategory.

Risk parameter means a variable used in determining risk-based capital requirements for wholesale and retail exposures, specifically probability of default (PD), loss given default (LGD), exposure at default (EAD), or effective maturity (M).

Scenario analysis means a systematic process of obtaining expert opinions from business managers and risk management experts to derive reasoned assessments of the likelihood and loss impact of plausible high-severity operational losses. Scenario analysis may include the well-reasoned evaluation and use of external operational loss event data, adjusted as appropriate to ensure relevance to a [BANK]'s operational risk profile and control structure.

Total wholesale and retail risk-weighted assets means:

(1) The sum of:

(i) Risk-weighted assets for wholesale exposures that are not IMM exposures, cleared transactions, or default fund contributions to non-defaulted obligors and segments of non-defaulted retail exposures;

(ii) Risk-weighted assets for wholesale exposures to defaulted obligors and segments of defaulted retail exposures;

(iii) Risk-weighted assets for assets not defined by an exposure category;

(iv) Risk-weighted assets for non-material portfolios of exposures;

(v) Risk-weighted assets for IMM exposures (as determined in §___.132(d));

(vi) Risk-weighted assets for cleared transactions and risk-weighted assets for default fund contributions (as determined in §___.133); and

(vii) Risk-weighted assets for unsettled transactions (as determined in §___.136); minus

(2) Any amounts deducted from capital pursuant to §___.22.

Unexpected operational loss (UOL) means the difference between the [BANK]'s operational risk exposure and the [BANK]'s expected operational loss.

Unit of measure means the level (for example, organizational unit or operational loss event type) at which the [BANK]'s operational risk quantification system generates a separate distribution of potential operational losses.

Wholesale exposure means a credit exposure to a company, natural person, sovereign, or governmental entity (other than a securitization exposure, retail exposure, or equity exposure).

Wholesale exposure subcategory means the HVCRE or non-HVCRE wholesale exposure subcategory.

QUALIFICATION

§___.121 Qualification Process.

(a) Timing. (1) A [BANK] that is described in §§___.100(b)(1)(i) through (iv) must adopt a written implementation plan no later than six months after the date the [BANK] meets a criterion in that section. The implementation plan must incorporate an explicit start date no later than 36 months after the date the [BANK] meets at least one criterion under §§___.100(b)(1)(i) through (iv). The [AGENCY] may extend the start date.

(2) A [BANK] that elects to be subject to this appendix under §___.100(b)(1)(v) must adopt a written implementation plan.

(b) Implementation plan. (1) The [BANK]'s implementation plan must address in detail how the [BANK] complies, or plans to comply, with the qualification requirements in §___.122. The [BANK] also must maintain a comprehensive and sound planning and governance process to oversee the implementation efforts described in the plan. At a minimum, the plan must:

(i) Comprehensively address the qualification requirements in §___.122 for the [BANK] and each consolidated subsidiary (U.S. and foreign-based) of the [BANK] with respect to all portfolios and exposures of the [BANK] and each of its consolidated subsidiaries;

(ii) Justify and support any proposed temporary or permanent exclusion of business lines, portfolios, or exposures from the application of the advanced approaches in this subpart (which business lines, portfolios, and exposures must be, in the aggregate, immaterial to the [BANK]);

(iii) Include the [BANK]'s self-assessment of:

(A) The [BANK]'s current status in meeting the qualification requirements in §___.122; and

(B) The consistency of the [BANK]'s current practices with the [AGENCY]'s supervisory guidance on the qualification requirements;

(iv) Based on the [BANK]'s self-assessment, identify and describe the areas in which the [BANK] proposes to undertake additional work to comply with the qualification requirements in §___.122 or to improve the consistency of the [BANK]'s current practices with the [AGENCY]'s supervisory guidance on the qualification requirements (gap analysis);

(v) Describe what specific actions the [BANK] will take to address the areas identified in the gap analysis required by paragraph (b)(1)(iv) of this section;

(vi) Identify objective, measurable milestones, including delivery dates and a date when the [BANK]'s implementation of the methodologies described in this subpart will be fully operational;

(vii) Describe resources that have been budgeted and are available to implement the plan; and

(viii) Receive approval of the [BANK]'s board of directors.

(2) The [BANK] must submit the implementation plan, together with a copy of the minutes of the board of directors' approval, to the [AGENCY] at least 60 days before the [BANK] proposes to begin its parallel run, unless the [AGENCY] waives prior notice.

(c) Parallel run. Before determining its risk-weighted assets under this subpart and following adoption of the implementation plan, the [BANK] must conduct a satisfactory parallel run. A satisfactory parallel run is a period of no less than four consecutive calendar quarters during which the [BANK] complies with the qualification requirements in §___.122 to the satisfaction of the [AGENCY]. During the parallel run, the [BANK] must report to the [AGENCY] on a calendar quarterly basis its risk-based capital ratios determined in accordance with sections 10(b)(1)-(3) and sections 10(c)(1)-(3) of subpart B. During this period, the [BANK]'s minimum risk-based capital ratios are determined as set forth in subpart D.

(d) Approval to calculate risk-based capital requirements under this subpart. The [AGENCY] will notify the [BANK] of the date that the [BANK] must begin to use this subpart for purposes of §___.10 if the [AGENCY] determines that:

(1) The [BANK] fully complies with all the qualification requirements in section§___.122;

(2) The [BANK] has conducted a satisfactory parallel run under §___.121(c); and

(3) The [BANK] has an adequate process to ensure ongoing compliance with the qualification requirements in §___.122.

§___.122 Qualification Requirements.

(a) Process and systems requirements. (1) A [BANK] must have a rigorous process for assessing its overall capital adequacy in relation to its risk profile and a comprehensive strategy for maintaining an appropriate level of capital.

(2) The systems and processes used by a [BANK] for risk-based capital purposes under this subpart must be consistent with the [BANK]'s internal risk management processes and management information reporting systems.

(3) Each [BANK] must have an appropriate infrastructure with risk measurement and management processes that meet the qualification requirements of this section and are appropriate given the [BANK]'s size and level of complexity. Regardless of whether the systems and models that generate the risk parameters necessary for calculating a [BANK]'s risk-based capital requirements are located at any affiliate of the [BANK], the [BANK] itself must ensure that the risk parameters and reference data used to determine its risk-based capital requirements are representative of its own credit risk and operational risk exposures.

(b) Risk rating and segmentation systems for wholesale and retail exposures. (1) A [BANK] must have an internal risk rating and segmentation system that accurately and reliably differentiates among degrees of credit risk for the [BANK]'s wholesale and retail exposures.

(2) For wholesale exposures:

(i) A [BANK] must have an internal risk rating system that accurately and reliably assigns each obligor to a single rating grade (reflecting the obligor's likelihood of default). A [BANK] may elect, however, not to assign to a rating grade an obligor to whom the [BANK] extends credit based solely on the financial strength of a guarantor, provided that all of the [BANK]'s exposures to the obligor are fully covered by eligible guarantees, the [BANK] applies the PD substitution approach in §___.134(c)(1) to all exposures to that obligor, and the [BANK] immediately assigns the obligor to a rating grade if a guarantee can no longer be recognized under this subpart. The [BANK]'s wholesale obligor rating system must have at least seven discrete rating grades for non-defaulted obligors and at least one rating grade for defaulted obligors.

(ii) Unless the [BANK] has chosen to directly assign LGD estimates to each wholesale exposure, the [BANK] must have an internal risk rating system that accurately and reliably assigns each wholesale exposure to a loss severity rating grade (reflecting the [BANK]'s estimate of the LGD of the exposure). A [BANK] employing loss severity rating grades must have a sufficiently granular loss severity grading system to avoid grouping together exposures with widely ranging LGDs.

(3) For retail exposures, a [BANK] must have an internal system that groups retail exposures into the appropriate retail exposure subcategory, groups the retail exposures in each retail exposure subcategory into separate segments with homogeneous risk characteristics, and assigns accurate and reliable PD and LGD estimates for each segment on a consistent basis. The [BANK]'s system must identify and group in separate segments by subcategories exposures identified in sections 131(c)(2)(ii) and (iii).

(4) The [BANK]'s internal risk rating policy for wholesale exposures must describe the [BANK]'s rating philosophy (that is, must describe how wholesale obligor rating assignments are affected by the [BANK]'s choice of the range of economic, business, and industry conditions that are considered in the obligor rating process).

(5) The [BANK]'s internal risk rating system for wholesale exposures must provide for the review and update (as appropriate) of each obligor rating and (if applicable) each loss severity rating whenever the [BANK] receives new material information, but no less frequently than annually. The [BANK]'s retail exposure segmentation system must provide for the review and update (as appropriate) of assignments of retail exposures to segments whenever the [BANK] receives new material information, but generally no less frequently than quarterly.

(c) Quantification of risk parameters for wholesale and retail exposures. (1) The [BANK] must have a comprehensive risk parameter quantification process that produces accurate, timely, and reliable estimates of the risk parameters for the [BANK]'s wholesale and retail exposures.

(2) Data used to estimate the risk parameters must be relevant to the [BANK]'s actual wholesale and retail exposures, and of sufficient quality to support the determination of risk-based capital requirements for the exposures.

(3) The [BANK]'s risk parameter quantification process must produce appropriately conservative risk parameter estimates where the [BANK] has limited relevant data, and any adjustments that are part of the quantification process must not result in a pattern of bias toward lower risk parameter estimates.

(4) The [BANK]'s risk parameter estimation process should not rely on the possibility of U.S. government financial assistance, except for the financial assistance that the U.S. government has a legally binding commitment to provide.

(5) Where the [BANK]'s quantifications of LGD directly or indirectly incorporate estimates of the effectiveness of its credit risk management practices in reducing its exposure to troubled obligors prior to default, the [BANK] must support such estimates with empirical analysis showing that the estimates are consistent with its historical experience in dealing with such exposures during economic downturn conditions.

(6) PD estimates for wholesale obligors and retail segments must be based on at least five years of default data. LGD estimates for wholesale exposures must be based on at least seven years of loss severity data, and LGD estimates for retail segments must be based on at least five years of loss severity data. EAD estimates for wholesale exposures must be based on at least seven years of exposure amount data, and EAD estimates for retail segments must be based on at least five years of exposure amount data.

(7) Default, loss severity, and exposure amount data must include periods of economic downturn conditions, or the [BANK] must adjust its estimates of risk parameters to compensate for the lack of data from periods of economic downturn conditions.

(8) The [BANK]'s PD, LGD, and EAD estimates must be based on the definition of default in §___.101.

(9) The [BANK] must review and update (as appropriate) its risk parameters and its risk parameter quantification process at least annually.

(10) The [BANK] must, at least annually, conduct a comprehensive review and analysis of reference data to determine relevance of reference data to the [BANK]'s exposures, quality of reference data to support PD, LGD, and EAD estimates, and consistency of reference data to the definition of default in this §___.101.

(d) Counterparty credit risk model. A [BANK] must obtain the prior written approval of the [AGENCY] under §___.132 to use the internal models methodology for counterparty credit risk and the advanced CVA approach for the CVA capital requirement.

(e) Double default treatment. A [BANK] must obtain the prior written approval of the [AGENCY] under §___.135 to use the double default treatment.

(f) Equity exposures model. A [BANK] must obtain the prior written approval of the [AGENCY] under §___.153 to use the internal models approach for equity exposures.

(g) Operational risk. (1) Operational risk management processes. A [BANK] must:

(i) Have an operational risk management function that:

(A) Is independent of business line management; and

(B) Is responsible for designing, implementing, and overseeing the [BANK]'s operational risk data and assessment systems, operational risk quantification systems, and related processes;

(ii) Have and document a process (which must capture business environment and internal control factors affecting the [BANK]'s operational risk profile) to identify, measure, monitor, and control operational risk in [BANK] products, activities, processes, and systems; and

(iii) Report operational risk exposures, operational loss events, and other relevant operational risk information to business unit management, senior management, and the board of directors (or a designated committee of the board).

(2) Operational risk data and assessment systems. A [BANK] must have operational risk data and assessment systems that capture operational risks to which the [BANK] is exposed. The [BANK]'s operational risk data and assessment systems must:

(i) Be structured in a manner consistent with the [BANK]'s current business activities, risk profile, technological processes, and risk management processes; and

(ii) Include credible, transparent, systematic, and verifiable processes that incorporate the following elements on an ongoing basis:

(A) Internal operational loss event data. The [BANK] must have a systematic process for capturing and using internal operational loss event data in its operational risk data and assessment systems.

(1) The [BANK]'s operational risk data and assessment systems must include a historical observation period of at least five years for internal operational loss event data (or such shorter period approved by the [AGENCY] to address transitional situations, such as integrating a new business line).

(2) The [BANK] must be able to map its internal operational loss event data into the seven operational loss event type categories.

(3) The [BANK] may refrain from collecting internal operational loss event data for individual operational losses below established dollar threshold amounts if the [BANK] can demonstrate to the satisfaction of the [AGENCY] that the thresholds are reasonable, do not exclude important internal operational loss event data, and permit the [BANK] to capture substantially all the dollar value of the [BANK]'s operational losses.

(B) External operational loss event data. The [BANK] must have a systematic process for determining its methodologies for incorporating external operational loss event data into its operational risk data and assessment systems.

(C) Scenario analysis. The [BANK] must have a systematic process for determining its methodologies for incorporating scenario analysis into its operational risk data and assessment systems.

(D) Business environment and internal control factors. The [BANK] must incorporate business environment and internal control factors into its operational risk data and assessment systems. The [BANK] must also periodically compare the results of its prior business environment and internal control factor assessments against its actual operational losses incurred in the intervening period.

(3) Operational risk quantification systems. (i) The [BANK]'s operational risk quantification systems:

(A) Must generate estimates of the [BANK]'s operational risk exposure using its operational risk data and assessment systems;

(B) Must employ a unit of measure that is appropriate for the [BANK]'s range of business activities and the variety of operational loss events to which it is exposed, and that does not combine business activities or operational loss events with demonstrably different risk profiles within the same loss distribution;

(C) Must include a credible, transparent, systematic, and verifiable approach for weighting each of the four elements, described in paragraph (g)(2)(ii) of this section, that a [BANK] is required to incorporate into its operational risk data and assessment systems;

(D) May use internal estimates of dependence among operational losses across and within units of measure if the [BANK] can demonstrate to the satisfaction of the [AGENCY] that its process for estimating dependence is sound, robust to a variety of scenarios, and implemented with integrity, and allows for uncertainty surrounding the estimates. If the [BANK] has not made such a demonstration, it must sum operational risk exposure estimates across units of measure to calculate its total operational risk exposure; and

(E) Must be reviewed and updated (as appropriate) whenever the [BANK] becomes aware of information that may have a material effect on the [BANK]'s estimate of operational risk exposure, but the review and update must occur no less frequently than annually.

(ii) With the prior written approval of the [AGENCY], a [BANK] may generate an estimate of its operational risk exposure using an alternative approach to that specified in paragraph (g)(3)(i) of this section. A [BANK] proposing to use such an alternative operational risk quantification system must submit a proposal to the [AGENCY]. In determining whether to approve a [BANK]'s proposal to use an alternative operational risk quantification system, the [AGENCY] will consider the following principles:

(A) Use of the alternative operational risk quantification system will be allowed only on an exception basis, considering the size, complexity, and risk profile of the [BANK];

(B) The [BANK] must demonstrate that its estimate of its operational risk exposure generated under the alternative operational risk quantification system is appropriate and can be supported empirically; and

(C) A [BANK] must not use an allocation of operational risk capital requirements that includes entities other than depository institutions or the benefits of diversification across entities.

(h) Data management and maintenance. (1) A [BANK] must have data management and maintenance systems that adequately support all aspects of its advanced systems and the timely and accurate reporting of risk-based capital requirements.

(2) A [BANK] must retain data using an electronic format that allows timely retrieval of data for analysis, validation, reporting, and disclosure purposes.

(3) A [BANK] must retain sufficient data elements related to key risk drivers to permit adequate monitoring, validation, and refinement of its advanced systems.

(i) Control, oversight, and validation mechanisms. (1) The [BANK]'s senior management must ensure that all components of the [BANK]'s advanced systems function effectively and comply with the qualification requirements in this section.

(2) The [BANK]'s board of directors (or a designated committee of the board) must at least annually review the effectiveness of, and approve, the [BANK]'s advanced systems.

(3) A [BANK] must have an effective system of controls and oversight that:

(i) Ensures ongoing compliance with the qualification requirements in this section;

(ii) Maintains the integrity, reliability, and accuracy of the [BANK]'s advanced systems; and

(iii) Includes adequate governance and project management processes.

(4) The [BANK] must validate, on an ongoing basis, its advanced systems. The [BANK]'s validation process must be independent of the advanced systems' development, implementation, and operation, or the validation process must be subjected to an independent review of its adequacy and effectiveness. Validation must include:

(i) An evaluation of the conceptual soundness of (including developmental evidence supporting) the advanced systems;

(ii) An ongoing monitoring process that includes verification of processes and benchmarking; and

(iii) An outcomes analysis process that includes back-testing.

(5) The [BANK] must have an internal audit function independent of business-line management that at least annually assesses the effectiveness of the controls supporting the [BANK]'s advanced systems and reports its findings to the [BANK]'s board of directors (or a committee thereof).

(6) The [BANK] must periodically stress test its advanced systems. The stress testing must include a consideration of how economic cycles, especially downturns, affect risk-based capital requirements (including migration across rating grades and segments and the credit risk mitigation benefits of double default treatment).

(j) Documentation. The [BANK] must adequately document all material aspects of its advanced systems.

§___.123 Ongoing Qualification.

(a) Changes to advanced systems. A [BANK] must meet all the qualification requirements in §___.122 on an ongoing basis. A [BANK] must notify the [AGENCY] when the [BANK] makes any change to an advanced system that would result in a material change in the

[BANK]'s advanced approaches total risk-weighted asset amount for an exposure type or when the [BANK] makes any significant change to its modeling assumptions.

(b) Failure to comply with qualification requirements. (1) If the [AGENCY] determines that a [BANK] that uses this subpart and that has conducted a satisfactory parallel run fails to comply with the qualification requirements in §___.122, the [AGENCY] will notify the [BANK] in writing of the [BANK]'s failure to comply.

(2) The [BANK] must establish and submit a plan satisfactory to the [AGENCY] to return to compliance with the qualification requirements.

(3) In addition, if the [AGENCY] determines that the [BANK]'s advanced approaches total risk-weighted assets are not commensurate with the [BANK]'s credit, market, operational, or other risks, the [AGENCY] may require such a [BANK] to calculate its advanced approaches total risk-weighted assets with any modifications provided by the [AGENCY].

§___.124 Merger and Acquisition Transitional Arrangements.

(a) Mergers and acquisitions of companies without advanced systems. If a [BANK] merges with or acquires a company that does not calculate its risk-based capital requirements using advanced systems, the [BANK] may use subpart D to determine the risk-weighted asset amounts for the merged or acquired company's exposures for up to 24 months after the calendar quarter during which the merger or acquisition consummates. The [AGENCY] may extend this transition period for up to an additional 12 months. Within 90 days of consummating the merger or acquisition, the [BANK] must submit to the [AGENCY] an implementation plan for using its advanced systems for the acquired company. During the period when subpart D applies to the merged or acquired company, any ALLL, net of allocated transfer risk reserves established pursuant to 12 U.S.C. 3904, associated with the merged or acquired company's exposures may be included in the acquiring [BANK]'s tier 2 capital up to 1.25 percent of the acquired company's risk-weighted assets. All general allowances of the merged or acquired company must be excluded from the [BANK]'s eligible credit reserves. In addition, the risk-weighted assets of the merged or acquired company are not included in the [BANK]'s credit-risk-weighted assets but are included in total risk-weighted assets. If a [BANK] relies on this paragraph, the [BANK] must disclose publicly the amounts of risk-weighted assets and qualifying capital calculated under this subpart for the acquiring [BANK] and under subpart D for the acquired company.

(b) Mergers and acquisitions of companies with advanced systems. (1) If a [BANK] merges with or acquires a company that calculates its risk-based capital requirements using advanced systems, the [BANK] may use the acquired company's advanced systems to determine total risk-weighted assets for the merged or acquired company's exposures for up to 24 months after the calendar quarter during which the acquisition or merger consummates. The [AGENCY] may extend this transition period for up to an additional 12 months. Within 90 days of consummating the merger or acquisition, the [BANK] must submit to the [AGENCY] an implementation plan for using its advanced systems for the merged or acquired company.

(2) If the acquiring [BANK] is not subject to the advanced approaches in this subpart at the time of acquisition or merger, during the period when subpart D applies to the acquiring [BANK], the ALLL associated with the exposures of the merged or acquired company may not be directly included in tier 2 capital. Rather, any excess eligible credit reserves associated with the merged or acquired company's exposures may be included in the [BANK]'s tier 2 capital up to 0.6 percent of the credit-risk-weighted assets associated with those exposures.

RISK-WEIGHTED ASSETS FOR GENERAL CREDIT RISK

§___.131 Mechanics for Calculating Total Wholesale and Retail Risk-Weighted Assets

(a) Overview. A [BANK] must calculate its total wholesale and retail risk-weighted asset amount in four distinct phases:

(1) Phase 1 – categorization of exposures;

(2) Phase 2 – assignment of wholesale obligors and exposures to rating grades and segmentation of retail exposures;

(3) Phase 3 – assignment of risk parameters to wholesale exposures and segments of retail exposures; and

(4) Phase 4 – calculation of risk-weighted asset amounts.

(b) Phase 1 − Categorization. The [BANK] must determine which of its exposures are wholesale exposures, retail exposures, securitization exposures, or equity exposures. The [BANK] must categorize each retail exposure as a residential mortgage exposure, a QRE, or an other retail exposure. The [BANK] must identify which wholesale exposures are HVCRE exposures, sovereign exposures, OTC derivative contracts, repo-style transactions, eligible margin loans, eligible purchased wholesale exposures, cleared transactions, default fund contributions, unsettled transactions to which §___.136 applies, and eligible guarantees or eligible credit derivatives that are used as credit risk mitigants. The [BANK] must identify any on-balance sheet asset that does not meet the definition of a wholesale, retail, equity, or securitization exposure, as well as any non-material portfolio of exposures described in paragraph (e)(4) of this section.

(c) Phase 2 – Assignment of wholesale obligors and exposures to rating grades and retail exposures to segments. (1) Assignment of wholesale obligors and exposures to rating grades.

(i) The [BANK] must assign each obligor of a wholesale exposure to a single obligor rating grade and must assign each wholesale exposure to which it does not directly assign an LGD estimate to a loss severity rating grade.

(ii) The [BANK] must identify which of its wholesale obligors are in default.

(2) Segmentation of retail exposures. (i) The [BANK] must group the retail exposures in each retail subcategory into segments that have homogeneous risk characteristics.

(ii) The [BANK] must identify which of its retail exposures are in default. The [BANK] must segment defaulted retail exposures separately from non-defaulted retail exposures.

(iii) If the [BANK] determines the EAD for eligible margin loans using the approach in §___.132(b), the [BANK] must identify which of its retail exposures are eligible margin loans for which the [BANK] uses this EAD approach and must segment such eligible margin loans separately from other retail exposures.

(3) Eligible purchased wholesale exposures. A [BANK] may group its eligible purchased wholesale exposures into segments that have homogeneous risk characteristics. A [BANK] must use the wholesale exposure formula in Table 1 of this section to determine the risk-based capital requirement for each segment of eligible purchased wholesale exposures.

(d) Phase 3 − Assignment of risk parameters to wholesale exposures and segments of retail exposures. (1) Quantification process. Subject to the limitations in this paragraph (d), the [BANK] must:

(i) Associate a PD with each wholesale obligor rating grade;

(ii) Associate an LGD with each wholesale loss severity rating grade or assign an LGD to each wholesale exposure;

(iii) Assign an EAD and M to each wholesale exposure; and

(iv) Assign a PD, LGD, and EAD to each segment of retail exposures.

(2) Floor on PD assignment. The PD for each wholesale obligor or retail segment may not be less than 0.03 percent, except for exposures to or directly and unconditionally guaranteed by a sovereign entity, the Bank for International Settlements, the International Monetary Fund, the European Commission, the European Central Bank, or a multilateral development bank, to which the [BANK] assigns a rating grade associated with a PD of less than 0.03 percent.

(3) Floor on LGD estimation. The LGD for each segment of residential mortgage exposures (other than segments of residential mortgage exposures for which all or substantially all of the principal of each exposure is directly and unconditionally guaranteed by the full faith and credit of a sovereign entity) may not be less than 10 percent.

(4) Eligible purchased wholesale exposures. A [BANK] must assign a PD, LGD, EAD, and M to each segment of eligible purchased wholesale exposures. If the [BANK] can estimate ECL (but not PD or LGD) for a segment of eligible purchased wholesale exposures, the [BANK] must assume that the LGD of the segment equals 100 percent and that the PD of the segment equals ECL divided by EAD. The estimated ECL must be calculated for the exposures without regard to any assumption of recourse or guarantees from the seller or other parties.

(5) Credit risk mitigation: credit derivatives, guarantees, and collateral. (i) A [BANK] may take into account the risk reducing effects of eligible guarantees and eligible credit derivatives in support of a wholesale exposure by applying the PD substitution or LGD adjustment treatment to the exposure as provided in §___.134 or, if applicable, applying double

default treatment to the exposure as provided in §___.135. A [BANK] may decide separately for each wholesale exposure that qualifies for the double default treatment under §___.135 whether to apply the double default treatment or to use the PD substitution or LGD adjustment treatment without recognizing double default effects.

(ii) A [BANK] may take into account the risk reducing effects of guarantees and credit derivatives in support of retail exposures in a segment when quantifying the PD and LGD of the segment.

(iii) Except as provided in paragraph (d)(6) of this section, a [BANK] may take into account the risk reducing effects of collateral in support of a wholesale exposure when quantifying the LGD of the exposure, and may take into account the risk reducing effects of collateral in support of retail exposures when quantifying the PD and LGD of the segment.

(6) EAD for OTC derivative contracts, repo-style transactions, and eligible margin loans. (i) A [BANK] must calculate its EAD for an OTC derivative contract as provided in §§___.132 (c) and (d). A [BANK] may take into account the risk-reducing effects of financial collateral in support of a repo-style transaction or eligible margin loan and of any collateral in support of a repo-style transaction that is included in the [BANK]'s VaR-based measure under subpart F of this [PART] through an adjustment to EAD as provided in §§___.132(b) and (d). A [BANK] that takes collateral into account through such an adjustment to EAD under §___.132 may not reflect such collateral in LGD.

(7) Effective maturity. An exposure's M must be no greater than five years and no less than one year, except that an exposure's M must be no less than one day if the exposure is a trade related letter of credit, or if the exposure has an original maturity of less than one year and is not part of a [BANK]'s ongoing financing of the obligor. An exposure is not part of a [BANK]'s ongoing financing of the obligor if the [BANK]:

(i) Has a legal and practical ability not to renew or roll over the exposure in the event of credit deterioration of the obligor;

(ii) Makes an independent credit decision at the inception of the exposure and at every renewal or roll over; and

(iii) Has no substantial commercial incentive to continue its credit relationship with the obligor in the event of credit deterioration of the obligor.

(8) EAD for exposures to certain central counterparties. A [BANK] may attribute an EAD of zero to exposures that arise from the settlement of cash transactions (such as equities, fixed income, spot FX and spot commodities) with a central counterparty where there is no assumption of ongoing counterparty credit risk by the central counterparty after settlement of the trade and associated default fund contributions.

(e) Phase 4 − Calculation of risk-weighted assets. (1) Non-defaulted exposures.

(i) A [BANK] must calculate the dollar risk-based capital requirement for each of its wholesale exposures to a non-defaulted obligor (except for eligible guarantees and eligible credit

derivatives that hedge another wholesale exposure, IMM exposures, cleared transactions, default fund contributions, unsettled transactions, and exposures to which the [BANK] applies the double default treatment in §___.135) and segments of non-defaulted retail exposures by inserting the assigned risk parameters for the wholesale obligor and exposure or retail segment into the appropriate risk-based capital formula specified in Table 1 and multiplying the output of the formula (K) by the EAD of the exposure or segment. Alternatively, a [BANK] may apply a 300 percent risk weight to the EAD of an eligible margin loan if the [BANK] is not able to meet the agencies' requirements for estimation of PD and LGD for the margin loan.

TABLE 1 – IRB RISK-BASED CAPITAL FORMULAS FOR WHOLESALE EXPOSURES TO NON-DEFAULTED OBLIGORS AND SEGMENTS OF NON-DEFAULTED RETAIL EXPOSURES[2]

Retail	**Capital Requirement (K)**	$K = \left[LGD \times N\left(\frac{N^{-1}(PD) + \sqrt{R} \times N^{-1}(0.999)}{\sqrt{1-R}} \right) - (LGD \times PD) \right]$
	Non-Defaulted Exposures	
	Correlation Factor (R)	For residential mortgage exposures: $R = 0.15$ For qualifying revolving exposures: $R = 0.04$ For other retail exposures: $R = 0.03 + 0.13 \times e^{-35 \times PD}$
Wholesale	**Capital Requirement (K)**	$K = \left[LGD \times N\left(\frac{N^{-1}(PD) + \sqrt{R} \times N^{-1}(0.999)}{\sqrt{1-R}} \right) - (LGD \times PD) \right] \times \left(\frac{1 + (M - 2.5) \times b}{1 - 1.5 \times b} \right)$
	Non-Defaulted Exposures	
	Correlation Factor (R)	For HVCRE exposures: $R = 0.12 + 0.18 \times e^{-50 \times PD}$ For wholesale exposures to unregulated financial institutions: $R = 1.25 \times \left(0.12 + 0.18 \times e^{-50 \times PD}\right)$ For wholesale exposures to regulated financial institutions with total assets greater than or equal to $100 billion: $R = 1.25 \times \left(0.12 + 0.18 \times e^{-50 \times PD}\right)$ For wholesale exposures other than HVCRE exposures:

$$R = 0.12 + 0.12 \times e^{-50 \times PD}$$

Maturity $$b = \left(0.11852 - 0.05478 \times \ln(PD)\right)^2$$

Adjustment
(b)

[2]N(.) means the cumulative distribution function for a standard normal random variable. $N^{-1}(.)$ means the inverse cumulative distribution function for a standard normal random variable. The symbol e refers to the base of the natural logarithms, and the function ln(.) refers to the natural logarithm of the expression within parentheses. The formulas apply when PD is greater than zero. If PD equals zero, the capital requirement K is set equal to zero.

(ii) The sum of all the dollar risk-based capital requirements for each wholesale exposure to a non-defaulted obligor and segment of non-defaulted retail exposures calculated in paragraph (e)(1)(i) of this §___.and in §___.135(e) equals the total dollar risk-based capital requirement for those exposures and segments.

(iii) The aggregate risk-weighted asset amount for wholesale exposures to non-defaulted obligors and segments of non-defaulted retail exposures equals the total dollar risk-based capital requirement §___.131(e)(1)(ii) multiplied by 12.5.

(2) Wholesale exposures to defaulted obligors and segments of defaulted retail exposures.

(i) The dollar risk-based capital requirement for each wholesale exposure to a defaulted obligor equals 0.08 multiplied by the EAD of the exposure.

(ii) The dollar risk-based capital requirement for a segment of defaulted retail exposures equals 0.08 multiplied by the EAD of the segment.

(iii) The sum of all the dollar risk-based capital requirements for each wholesale exposure to a defaulted obligor calculated in §___.131 (e)(2)(i) plus the dollar risk-based capital requirements for each segment of defaulted retail exposures calculated in §___.131 (e)(2)(ii) equals the total dollar risk-based capital requirement for those exposures and segments.

(iv) The aggregate risk-weighted asset amount for wholesale exposures to defaulted obligors and segments of defaulted retail exposures equals the total dollar risk-based capital requirement calculated in §___.131 (e)(2)(iii) multiplied by 12.5.

(3) Assets not included in a defined exposure category. (i) A [BANK] may assign a risk-weighted asset amount of zero to cash owned and held in all offices of the [BANK] or in transit and for gold bullion held in the [BANK]'s own vaults, or held in another [BANK]'s vaults on an allocated basis, to the extent the gold bullion assets are offset by gold bullion liabilities.

(ii) A [BANK] must assign a risk weighted asset amount equal to 20 percent of the carrying value of cash items in the process of collection.

(iii) The risk-weighted asset amount for the residual value of a retail lease exposure equals such residual value.

(iv) The risk-weighted asset amount for DTAs arising from temporary differences that the [BANK] could realize through net operating loss carrybacks equals the carrying value, netted in accordance with §___.22.

(v) The risk-weighted asset amount for MSAs, DTAs arising from temporary timing differences that the [BANK] could not realize through net operating loss carrybacks, and significant investments in the capital of unconsolidated financial institutions in the form of common stock that are not deducted pursuant to 22(a)(7) of subpart B equals the amount not subject to deduction multiplied by 250 percent.

(vi) The risk-weighted asset amount for any other on-balance-sheet asset that does not meet the definition of a wholesale, retail, securitization, IMM, or equity exposure, cleared transaction, or default fund contribution equals the carrying value of the asset.

(4) Non-material portfolios of exposures. The risk-weighted asset amount of a portfolio of exposures for which the [BANK] has demonstrated to the [AGENCY]'s satisfaction that the portfolio (when combined with all other portfolios of exposures that the [BANK] seeks to treat under this paragraph) is not material to the [BANK] is the sum of the carrying values of on-balance sheet exposures plus the notional amounts of off-balance sheet exposures in the portfolio. For purposes of this paragraph (e)(4), the notional amount of an OTC derivative contract that is not a credit derivative is the EAD of the derivative as calculated in §___.132.

§___.132 Counterparty Credit Risk of Repo-Style Transactions, Eligible Margin Loans, and OTC Derivative Contracts

(a) Methodologies for collateral recognition. (1) Instead of an LGD estimation methodology, a [BANK] may use the following methodologies to recognize the benefits of financial collateral in mitigating the counterparty credit risk of repo-style transactions, eligible margin loans, collateralized OTC derivative contracts and single product netting sets of such transactions, and to recognize the benefits of any collateral in mitigating the counterparty credit risk of repo-style transactions that are included in a [BANK]'s VaR-based measure under subpart F:

(i) The collateral haircut approach set forth in §___.132(b)(2);

(ii) The internal models methodology set forth in §___.132(d); and

(iii) For single product netting sets of repo-style transactions and eligible margin loans, the simple VaR methodology set forth in §___.132(b)(3).

(2) A [BANK] may use any combination of the three methodologies for collateral recognition; however, it must use the same methodology for transactions in the same category.

(3) A [BANK] must use the methodology in §___.132(c), or with prior [AGENCY] approval, the internal model methodology in §___.132(d), to calculate EAD for an OTC derivative contract or a set of OTC derivative contracts subject to a qualifying master netting agreement. To estimate EAD for qualifying cross-product master netting agreements, a [BANK] may only use the internal models methodology in §___.132(d).

(4) A [BANK] must also use the methodology in §___.132(e) for calculating the risk-weighted asset amounts for CVA for OTC derivatives.

(b) EAD for eligible margin loans and repo-style transactions. (1) General. A [BANK] may recognize the credit risk mitigation benefits of financial collateral that secures an eligible margin loan, repo-style transaction, or single-product netting set of such transactions by factoring the collateral into its LGD estimates for the exposure. Alternatively, a [BANK] may estimate an unsecured LGD for the exposure, as well as for any repo-style transaction that is included in the [BANK]'s VaR-based measure under subpart F, and determine the EAD of the exposure using:

(i) The collateral haircut approach described in §___.132(b)(2);

(ii) For netting sets only, the simple VaR methodology described in §___.132 (b)(3); or

(iii) The internal models methodology described in §___.132(d).

(2) Collateral haircut approach. (i) EAD equation. A [BANK] may determine EAD for an eligible margin loan, repo-style transaction, or netting set by setting EAD equal to max $\{0, [(\sum E - \sum C) + \sum(E_s \times H_s) + \sum(E_{fx} \times H_{fx})]\}$, where:

(A) $\sum E$ equals the value of the exposure (the sum of the current market values of all instruments, gold, and cash the [BANK] has lent, sold subject to repurchase, or posted as collateral to the counterparty under the transaction (or netting set));

(B) $\sum C$ equals the value of the collateral (the sum of the current market values of all instruments, gold, and cash the [BANK] has borrowed, purchased subject to resale, or taken as collateral from the counterparty under the transaction (or netting set));

(C) E_s equals the absolute value of the net position in a given instrument or in gold (where the net position in a given instrument or in gold equals the sum of the current market values of the instrument or gold the [BANK] has lent, sold subject to repurchase, or posted as collateral to the counterparty minus the sum of the current market values of that same instrument or gold the [BANK] has borrowed, purchased subject to resale, or taken as collateral from the counterparty);

(D) H_s equals the market price volatility haircut appropriate to the instrument or gold referenced in Es;

(E) E_{fx} equals the absolute value of the net position of instruments and cash in a currency that is different from the settlement currency (where the net position in a given currency equals the sum of the current market values of any instruments or cash in the currency the [BANK] has lent, sold subject to repurchase, or posted as collateral to the counterparty minus the sum of the

current market values of any instruments or cash in the currency the [BANK] has borrowed, purchased subject to resale, or taken as collateral from the counterparty); and

(F) Hfx equals the haircut appropriate to the mismatch between the currency referenced in Efx and the settlement currency.

(ii) Standard supervisory haircuts. (A) Under the standard supervisory haircuts approach:

(1) A [BANK] must use the haircuts for market price volatility (H_s) in Table 2, as adjusted in certain circumstances as provided in §§___.132(b)(2)(ii)(A)(3) and (4);

TABLE 2 – STANDARD SUPERVISORY MARKET PRICE VOLATILITY HAIRCUTS[1]

Residual Maturity	Sovereign issuers that receive a zero percent risk weight under §___.32 (in percent)	Sovereign issuers[2] that receive a 20 percent or 50 percent risk weight under §___.32 (in percent)	Sovereign issuers that receive a 100 percent risk weight under §___.32 (in percent)	Non-sovereign issuers that receive a 20 percent risk weight under §___.32 (in percent)	Non-sovereign issuers that receive a 50 percent risk weight under §___.32 (in percent)	Non-sovereign issuers that receive a 100 percent risk weight under §___.32 (in percent)	Investment grade securitization exposures (in percent)
Less than 1 year	0.5	1.0	15.0	1.0	2.0	25.0	4.0
Greater than 1 year and less than 5 years	2.0	3.0	15.0	4.0	6.0	25.0	12.0
Greater than 5 years	4.0	6.0	15.0	8.0	12.0	25.0	24.0
Main index equities (including convertible bonds) and gold				15.0			
Other publicly-traded equities (including convertible bonds)				25.0			
Mutual funds				Highest haircut applicable to any security in which the fund can invest.			
Cash collateral held				0			

[1]The market price volatility haircuts in Table 2 are based on a ten-business-day holding period.

[2] Includes a foreign PSE that receives a 0 percent risk weight.

(2) For currency mismatches, a [BANK] must use a haircut for foreign exchange rate volatility (Hfx) of 8 percent, as adjusted in certain circumstances as provided in sections 132 (b)(2)(ii)(A)(3) and (4).

(3) For repo-style transactions, a [BANK] may multiply the supervisory haircuts provided in sections 132(b)(2)(ii)(A)(1) and (2) by the square root of ½ (which equals 0.707107).

(4) A [BANK] must adjust the supervisory haircuts upward on the basis of a holding period longer than ten business days (for eligible margin loans) or five business days (for repo-style transactions) where the following conditions apply. If the number of trades in a netting set exceeds 5,000 at any time during a quarter, a [BANK] must adjust the supervisory haircuts upward on the basis of a holding period of twenty business days for the following quarter (except when a [BANK] is calculating EAD for a cleared transaction under §___.133). If a netting set contains one or more trades involving illiquid collateral or an OTC derivative that cannot be easily replaced, a [BANK] must adjust the supervisory haircuts upward on the basis of a holding period of twenty business days. If over the two previous quarters more than two margin disputes on a netting set have occurred that lasted more than the holding period, then the [BANK] must adjust the supervisory haircuts upward for that netting set on the basis of a holding period that is at least two times the minimum holding period for that netting set. A [BANK] must adjust the standard supervisory haircuts upward using the following formula:

$$H_A = H_S \sqrt{\frac{T_M}{T_S}}$$, where,

(i) T_M equals a holding period of longer than 10 business days for eligible margin loans and derivative contracts or longer than 5 business days for repo-style transactions;

(ii) H_S equals the standard supervisory haircut; and

(iii) T_S equals 10 business days for eligible margin loans and derivative contracts or 5 business days for repo-style transactions.

(5) If the instrument a [BANK] has lent, sold subject to repurchase, or posted as collateral does not meet the definition of financial collateral, the [BANK] must use a 25.0 percent haircut for market price volatility (Hs).

(iii) Own internal estimates for haircuts. With the prior written approval of the [AGENCY], a [BANK] may calculate haircuts (H_s and H_{fx}) using its own internal estimates of the volatilities of market prices and foreign exchange rates.

(A) To receive [AGENCY] approval to use its own internal estimates, a [BANK] must satisfy the following minimum quantitative standards:

(1) A [BANK] must use a 99th percentile one-tailed confidence interval.

(2) The minimum holding period for a repo-style transaction is five business days and for an eligible margin loan is ten business days except for transactions or netting sets for which §___.132(b)(2)(iii)(A)(3) applies. When a [BANK] calculates an own-estimates haircut on a T_N-day holding period, which is different from the minimum holding period for the transaction type, the applicable haircut (H_M) is calculated using the following square root of time formula:

$$H_M = H_N \sqrt{\frac{T_M}{T_N}}, \text{ where}$$

(i) T_M equals 5 for repo-style transactions and 10 for eligible margin loans;

(ii) T_N equals the holding period used by the [BANK] to derive H_N; and

(iii) H_N equals the haircut based on the holding period T_N.

(3) If the number of trades in a netting set exceeds 5,000 at any time during a quarter, a [BANK] must calculate the haircut using a minimum holding period of twenty business days for the following quarter (except when a [BANK] is calculating EAD for a cleared transaction under §___.133). If a netting set contains one or more trades involving illiquid collateral or an OTC derivative that cannot be easily replaced, a [BANK] must calculate the haircut using a minimum holding period of twenty business days. If over the two previous quarters more than two margin disputes on a netting set have occurred that lasted more than the holding period, then the [BANK] must calculate the haircut for transactions in that netting set on the basis of a holding period that is at least two times the minimum holding period for that netting set.

(4) A [BANK] is required to calculate its own internal estimates with inputs calibrated to historical data from a continuous 12-month period that reflects a period of significant financial stress appropriate to the security or category of securities.

(5) A [BANK] must have policies and procedures that describe how it determines the period of significant financial stress used to calculate the [BANK]'s own internal estimates for haircuts under this section and must be able to provide empirical support for the period used. The [BANK] must obtain the prior approval of the [AGENCY] for, and notify the [AGENCY] if the [BANK] makes any material changes to, these policies and procedures.

(6) Nothing in this section prevents the [AGENCY] from requiring a [BANK] to use a different period of significant financial stress in the calculation of own internal estimates for haircuts.

(7) A [BANK] must update its data sets and calculate haircuts no less frequently than quarterly and must also reassess data sets and haircuts whenever market prices change materially.

(B) With respect to debt securities that are investment grade, a [BANK] may calculate haircuts for categories of securities. For a category of securities, the [BANK] must calculate the haircut on the basis of internal volatility estimates for securities in that category that are representative of the securities in that category that the [BANK] has lent, sold subject to

repurchase, posted as collateral, borrowed, purchased subject to resale, or taken as collateral. In determining relevant categories, the [BANK] must at a minimum take into account:

(1) The type of issuer of the security;

(2) The credit quality of the security;

(3) The maturity of the security; and

(4) The interest rate sensitivity of the security.

(C) With respect to debt securities that are not investment grade and equity securities, a [BANK] must calculate a separate haircut for each individual security.

(D) Where an exposure or collateral (whether in the form of cash or securities) is denominated in a currency that differs from the settlement currency, the [BANK] must calculate a separate currency mismatch haircut for its net position in each mismatched currency based on estimated volatilities of foreign exchange rates between the mismatched currency and the settlement currency.

(E) A [BANK]'s own estimates of market price and foreign exchange rate volatilities may not take into account the correlations among securities and foreign exchange rates on either the exposure or collateral side of a transaction (or netting set) or the correlations among securities and foreign exchange rates between the exposure and collateral sides of the transaction (or netting set).

(3) Simple VaR methodology. With the prior written approval of the [AGENCY], a [BANK] may estimate EAD for a netting set using a VaR model that meets the requirements in §___.132 (b)(3)(iii). In such event, the [BANK] must set EAD equal to max {0, [(∑E - ∑C) + PFE]}, where:

(i) ∑E equals the value of the exposure (the sum of the current market values of all instruments, gold, and cash the [BANK] has lent, sold subject to repurchase, or posted as collateral to the counterparty under the netting set);

(ii) ∑C equals the value of the collateral (the sum of the current market values of all instruments, gold, and cash the [BANK] has borrowed, purchased subject to resale, or taken as collateral from the counterparty under the netting set); and

(iii) PFE (potential future exposure) equals the [BANK]'s empirically based best estimate of the 99th percentile, one-tailed confidence interval for an increase in the value of (∑E - ∑C) over a five-business-day holding period for repo-style transactions, or over a ten-business-day holding period for eligible margin loans except for netting sets for which §___.132(b)(3)(iv) applies using a minimum one-year historical observation period of price data representing the instruments that the [BANK] has lent, sold subject to repurchase, posted as collateral, borrowed, purchased subject to resale, or taken as collateral. The [BANK] must validate its VaR model by establishing and maintaining a rigorous and regular back-testing regime.

(iv) If the number of trades in a netting set exceeds 5,000 at any time during a quarter, a [BANK] must use a twenty-business-day holding period for the following quarter (except when a [BANK] is calculating EAD for a cleared transaction under §___.133). If a netting set contains one or more trades involving illiquid collateral, a [BANK] must use a twenty-business-day holding period. If over the two previous quarters more than two margin disputes on a netting set have occurred that lasted more than the holding period, then the [BANK] must set its PFE for that netting set equal to an estimate over a holding period that is at least two times the minimum holding period for that netting set.

(c) EAD for OTC derivative contracts. (1) A [BANK] must determine the EAD for an OTC derivative contract that is not subject to a qualifying master netting agreement using the current exposure methodology in §___.132(c)(5) or using the internal models methodology described in §___.132(d).

(2) A [BANK] must determine the EAD for multiple OTC derivative contracts that are subject to a qualifying master netting agreement using the current exposure methodology in §___.132(c)(6) or using the internal models methodology described in §___.132(d).

(3) Counterparty credit risk for credit derivatives. Notwithstanding the above:

(i) A [BANK] that purchases a credit derivative that is recognized under sections 134 or 135 as a credit risk mitigant for an exposure that is not a covered position under subpart F is not required to calculate a separate counterparty credit risk capital requirement under this section so long as the [BANK] does so consistently for all such credit derivatives and either includes or excludes all such credit derivatives that are subject to a master netting agreement from any measure used to determine counterparty credit risk exposure to all relevant counterparties for risk-based capital purposes.

(ii) A [BANK] that is the protection provider in a credit derivative must treat the credit derivative as a wholesale exposure to the reference obligor and is not required to calculate a counterparty credit risk capital requirement for the credit derivative under this section, so long as it does so consistently for all such credit derivatives and either includes all or excludes all such credit derivatives that are subject to a master netting agreement from any measure used to determine counterparty credit risk exposure to all relevant counterparties for risk-based capital purposes (unless the [BANK] is treating the credit derivative as a covered position under subpart F, in which case the [BANK] must calculate a supplemental counterparty credit risk capital requirement under this section).

(4) Counterparty credit risk for equity derivatives. A [BANK] must treat an equity derivative contract as an equity exposure and compute a risk-weighted asset amount for the equity derivative contract under sections 151 – 155 (unless the [BANK] is treating the contract as a covered position under subpart F). In addition, if the [BANK] is treating the contract as a covered position under subpart F, and under certain other circumstances described in §___.155, the [BANK] must also calculate a risk-based capital requirement for the counterparty credit risk of an equity derivative contract under this section.

(5) Single OTC derivative contract. Except as modified by §___.132(c)(7), the EAD for a single OTC derivative contract that is not subject to a qualifying master netting agreement is equal to the sum of the [BANK]'s current credit exposure and potential future credit exposure (PFE) on the derivative contract.

(i) Current credit exposure. The current credit exposure for a single OTC derivative contract is the greater of the mark-to-market value of the derivative contract or zero.

(ii) PFE. The PFE for a single OTC derivative contract, including an OTC derivative contract with a negative mark-to-market value, is calculated by multiplying the notional principal amount of the derivative contract by the appropriate conversion factor in Table 3. For purposes of calculating either the PFE under §___.132(c)(5) or the gross PFE under §___.132(c)(6) for exchange rate contracts and other similar contracts in which the notional principal amount is equivalent to the cash flows, the notional principal amount is the net receipts to each party falling due on each value date in each currency. For any OTC derivative contract that does not fall within one of the specified categories in Table 3, the PFE must be calculated using the "other" conversion factors. A [BANK] must use an OTC derivative contract's effective notional principal amount (that is, its apparent or stated notional principal amount multiplied by any multiplier in the OTC derivative contract) rather than its apparent or stated notional principal amount in calculating PFE. PFE of the protection provider of a credit derivative is capped at the net present value of the amount of unpaid premiums.

TABLE 3 – CONVERSION FACTOR MATRIX FOR OTC DERIVATIVE CONTRACTS[1]

Remaining maturity[2]	Interest rate	Foreign exchange rate and gold	Credit (investment-grade reference asset)[3]	Credit (non-investment-grade reference asset)	Equity	Precious metals (except gold)	Other
One year or less	0.00	0.01	0.05	0.10	0.06	0.07	0.10
Over one to five years	0.005	0.05	0.05	0.10	0.08	0.07	0.12
Over five years	0.015	0.075	0.05	0.10	0.10	0.08	0.15

[1] For an OTC derivative contract with multiple exchanges of principal, the conversion factor is multiplied by the number of remaining payments in the derivative contract.

[2] For an OTC derivative contract that is structured such that on specified dates any outstanding exposure is settled and the terms are reset so that the market value of the contract is zero, the remaining maturity equals the time until the next reset date. For an interest rate derivative contract with a remaining maturity of greater than one year that meets these criteria, the minimum conversion factor is 0.005.

[3] A [BANK] must use the column labeled "Credit (investment-grade reference asset)" for a credit derivative whose reference asset is an outstanding unsecured long-term debt security without credit enhancement that is investment grade. A [BANK] must use the column labeled "Credit (non-investment-grade reference asset)" for all other credit derivatives.

(6) Multiple OTC derivative contracts subject to a qualifying master netting agreement. Except as modified by §___.132(c)(7), the EAD for multiple OTC derivative contracts subject to a qualifying master netting agreement is equal to the sum of the net current credit exposure and the adjusted sum of the PFE exposure for all OTC derivative contracts subject to the qualifying master netting agreement.

(i) Net current credit exposure. The net current credit exposure is the greater of:

(A) The net sum of all positive and negative mark-to-market values of the individual OTC derivative contracts subject to the qualifying master netting agreement; or

(B) Zero.

(ii) Adjusted sum of the PFE. The adjusted sum of the PFE, A_{net}, is calculated as $A_{net} = (0.4\times A_{gross}) + (0.6 \times NGR \times A_{gross})$, where:

(A) A_{gross} = the gross PFE (that is, the sum of the PFE amounts (as determined under paragraph (c)(5)(ii) of this section) for each individual derivative contract subject to the qualifying master netting agreement); and

(B) NGR = the net to gross ratio (that is, the ratio of the net current credit exposure to the gross current credit exposure). In calculating the NGR, the gross current credit exposure equals the sum of the positive current credit exposures (as determined under §___.132(c)(6)(i)) of all individual derivative contracts subject to the qualifying master netting agreement.

(7) Collateralized OTC derivative contracts. A [BANK] may recognize the credit risk mitigation benefits of financial collateral that secures an OTC derivative contract or single-product netting set of OTC derivatives by factoring the collateral into its LGD estimates for the contract or netting set. Alternatively, a [BANK] may recognize the credit risk mitigation benefits of financial collateral that secures such a contract or netting set that is marked-to-market on a daily basis and subject to a daily margin maintenance requirement by estimating an unsecured LGD for the contract or netting set and adjusting the EAD calculated under §___.132(c)(5) or §___.132(c)(6) using the collateral haircut approach in §___.132(b)(2). The [BANK] must substitute the EAD calculated under §___.132(c)(5) or §___.132(c)(6) for $\sum E$ in the equation in §___.132(b)(2)(i) and must use a ten-business day minimum holding period (T_M = 10) unless a longer holding period is required by §___.132(b)(2)(iii)(A)(3).

(d) Internal models methodology. (1) With prior written approval from the [AGENCY], a [BANK] may use the internal models methodology in this §___.132(d) to determine EAD for counterparty credit risk for derivative contracts (collateralized or uncollateralized) and single-product netting sets thereof, for eligible margin loans and single-product netting sets thereof, and for repo-style transactions and single-product netting sets thereof. A [BANK] that uses the internal models methodology for a particular transaction type (derivative contracts, eligible

margin loans, or repo-style transactions) must use the internal models methodology for all transactions of that transaction type. A [BANK] may choose to use the internal models methodology for one or two of these three types of exposures and not the other types. A [BANK] may also use the internal models methodology for derivative contracts, eligible margin loans, and repo-style transactions subject to a qualifying cross-product netting agreement if:

(i) The [BANK] effectively integrates the risk mitigating effects of cross-product netting into its risk management and other information technology systems; and

(ii) The [BANK] obtains the prior written approval of the [AGENCY].

A [BANK] that uses the internal models methodology for a transaction type must receive approval from the [AGENCY] to cease using the methodology for that transaction type or to make a material change to its internal model.

(2) Risk-weighted assets using IMM. Under the IMM, a [BANK] uses an internal model to estimate the expected exposure (EE) for a netting set and then calculates EAD based on that EE. A [BANK] must calculate two EEs and two EADs (one stressed and one unstressed) for each netting set as follows:

(i) $EAD_{unstressed}$ is calculated using an EE estimate based on the most recent data meeting the requirements of §___.132(d)(3)(vii).

(ii) $EAD_{stressed}$ is calculated using an EE estimate based on a historical period that includes a period of stress to the credit default spreads of the [BANK]'s counterparties according to §___.132(d)(3)(viii).

(iii) The [BANK] must use its internal model's probability distribution for changes in the market value of a netting set that are attributable to changes in market variables to determine EE.

(iv) Under the internal models methodology, EAD = Max (0, α x effective EPE - CVA), or, subject to [AGENCY] approval as provided in §___.132(d)(10), a more conservative measure of EAD.

(A) CVA equals the credit valuation adjustment that the [BANK] has recognized in its balance sheet valuation of any OTC derivative contracts in the netting set. For purposes of this paragraph, CVA does not include any adjustments to common equity tier 1 capital attributable to changes in the fair value of the [BANK]'s liabilities that are due to changes in its own credit risk since the inception of the transaction with the counterparty.

$$Effective\ EPE_{t_k} = \sum_{k=1}^{n} Effective\ EE_{t_k} x \Delta t_k$$

(B) (that is, effective EPE is the time-weighted average of effective EE where the weights are the proportion that an individual effective EE represents in a one-year time interval) where:

(1) $EffectiveE\ E_{t_k} = \max\left(EffectiveE\ E_{t_{k-1}}, EE_{t_k}\right)$ (that is, for a specific date t_k, effective EE is the greater of EE at that date or the effective EE at the previous date); and

(2) t_k represents the k^{th} future time period in the model and there are n time periods represented in the model over the first year, and

(C) $\alpha = 1.4$ except as provided in §___.132(d)(5), or when the [AGENCY] has determined that the [BANK] must set α higher based on the [BANK]'s specific characteristics of counterparty credit risk or model performance.

(v) A [BANK] may include financial collateral currently posted by the counterparty as collateral (but may not include other forms of collateral) when calculating EE.

(vi) If a [BANK] hedges some or all of the counterparty credit risk associated with a netting set using an eligible credit derivative, the [BANK] may take the reduction in exposure to the counterparty into account when estimating EE. If the [BANK] recognizes this reduction in exposure to the counterparty in its estimate of EE, it must also use its internal model to estimate a separate EAD for the [BANK]'s exposure to the protection provider of the credit derivative.

(3) To obtain [AGENCY] approval to calculate the distributions of exposures upon which the EAD calculation is based, the [BANK] must demonstrate to the satisfaction of the [AGENCY] that it has been using for at least one year an internal model that broadly meets the following minimum standards, with which the [BANK] must maintain compliance:

(i) The model must have the systems capability to estimate the expected exposure to the counterparty on a daily basis (but is not expected to estimate or report expected exposure on a daily basis).

(ii) The model must estimate expected exposure at enough future dates to reflect accurately all the future cash flows of contracts in the netting set.

(iii) The model must account for the possible non-normality of the exposure distribution, where appropriate.

(iv) The [BANK] must measure, monitor, and control current counterparty exposure and the exposure to the counterparty over the whole life of all contracts in the netting set.

(v) The [BANK] must be able to measure and manage current exposures gross and net of collateral held, where appropriate. The [BANK] must estimate expected exposures for OTC derivative contracts both with and without the effect of collateral agreements.

(vi) The [BANK] must have procedures to identify, monitor, and control wrong-way risk throughout the life of an exposure. The procedures must include stress testing and scenario analysis.

(vii) The model must use current market data to compute current exposures. The [BANK] must estimate model parameters using historical data from the most recent three-year period and update the data quarterly or more frequently if market conditions warrant. The [BANK] should consider using model parameters based on forward-looking measures, where appropriate.

(viii) When estimating model parameters based on a stress period, the [BANK] must use at least three years of historical data that include a period of stress to the credit default spreads of the [BANK]'s counterparties. The [BANK] must review the data set and update the data as necessary, particularly for any material changes in its counterparties. The [BANK] must demonstrate at least quarterly that the stress period coincides with increased CDS or other credit spreads of the [BANK]'s counterparties. The [BANK] must have procedures to evaluate the effectiveness of its stress calibration that include a process for using benchmark portfolios that are vulnerable to the same risk factors as the [BANK]'s portfolio. The [AGENCY] may require the [BANK] to modify its stress calibration to better reflect actual historic losses of the portfolio.

(ix) A [BANK] must subject its internal model to an initial validation and annual model review process. The model review should consider whether the inputs and risk factors, as well as the model outputs, are appropriate. As part of the model review process, the [BANK] must have a backtesting program for its model that includes a process by which unacceptable model performance will be determined and remedied.

(x) A [BANK] must have policies for the measurement, management and control of collateral and margin amounts.

(xi) A [BANK] must have a comprehensive stress testing program that captures all credit exposures to counterparties, and incorporates stress testing of principal market risk factors and creditworthiness of counterparties.

(4) Maturity. (i) If the remaining maturity of the exposure or the longest-dated contract in the netting set is greater than one year, the [BANK] must set M for the exposure or netting set equal to the lower of five years or M(EPE), where:

(A) $$M(EPE) = 1 + \frac{\sum_{t_k > 1\,year}^{maturity} EE_k \times \Delta t_k \times df_k}{\sum_{t_k \le 1\,year} effectiveE\,E_k \times \Delta t_k \times df_k}\ ;$$

(B) df_k is the risk-free discount factor for future time period t_k; and

(C) $\Delta t_k = t_k - t_{k-1}$.

(ii) If the remaining maturity of the exposure or the longest-dated contract in the netting set is one year or less, the [BANK] must set M for the exposure or netting set equal to one year, except as provided in section§___.131(d)(7).

(iii) Alternatively, a [BANK] that uses an internal model to calculate a one-sided credit valuation adjustment may use the effective credit duration estimated by the model as M(EPE) in place of the formula in §___.132(d)(4)(i).

(5) Collateral agreements. A [BANK] may capture the effect on EAD of a collateral agreement that requires receipt of collateral when exposure to the counterparty increases, but may not capture the effect on EAD of a collateral agreement that requires receipt of collateral

when counterparty credit quality deteriorates. Two methods are available to capture the effect of a collateral agreement:

(i) With prior written approval from the [AGENCY], a [BANK] may include the effect of a collateral agreement within its internal model used to calculate EAD. The [BANK] may set EAD equal to the expected exposure at the end of the margin period of risk. The margin period of risk means, with respect to a netting set subject to a collateral agreement, the time period from the most recent exchange of collateral with a counterparty until the next required exchange of collateral, plus the period of time required to sell and realize the proceeds of the least liquid collateral that can be delivered under the terms of the collateral agreement and, where applicable, the period of time required to re-hedge the resulting market risk upon the default of the counterparty. The minimum margin period of risk is set according to §___.132(d)(5)(iii).

(ii) A [BANK] that can model EPE without collateral agreements but cannot achieve the higher level of modeling sophistication to model EPE with collateral agreements can set effective EPE for a collateralized netting set equal to the lesser of:

(A) An add-on that reflects the potential increase in exposure of the netting set over the margin period of risk, plus the larger of:

(1) The current exposure of the netting set reflecting all collateral held or posted by the [BANK] excluding any collateral called or in dispute; or

(2) The largest net exposure including all collateral held or posted under the margin agreement that would not trigger a collateral call. For purposes of this section, the add-on is computed as the largest expected increase in the netting set's exposure over any margin period of risk in the next year (set in accordance with §___.132(d)(5)(iii)); or

(B) Effective EPE without a collateral agreement plus any collateral the [BANK] posts to the counterparty that exceeds the required margin amount.

(iii) The margin period of risk for a netting set subject to a collateral agreement is:

(A) Five business days for repo-style transactions subject to daily remargining and daily marking-to-market, and ten business days for other transactions when liquid financial collateral is posted under a daily margin maintenance requirement, or

(B) Twenty business days if the number of trades in a netting set exceeds 5,000 at any time during the previous quarter or contains one or more trades involving illiquid collateral or any derivative contract that cannot be easily replaced (except if the [BANK] is calculating EAD for a cleared transaction under §___.133). If over the two previous quarters more than two margin disputes on a netting set have occurred that lasted more than the margin period of risk, then the [BANK] must use a margin period of risk for that netting set that is at least two times the minimum margin period of risk for that netting set. If the periodicity of the receipt of collateral is N-days, the minimum margin period of risk is the minimum margin period of risk under this paragraph plus N minus 1. This period should be extended to cover any impediments to prompt re-hedging of any market risk.

(6) Own estimate of alpha. With prior written approval of the [AGENCY], a [BANK] may calculate alpha as the ratio of economic capital from a full simulation of counterparty exposure across counterparties that incorporates a joint simulation of market and credit risk factors (numerator) and economic capital based on EPE (denominator), subject to a floor of 1.2. For purposes of this calculation, economic capital is the unexpected losses for all counterparty credit risks measured at a 99.9 percent confidence level over a one-year horizon. To receive approval, the [BANK] must meet the following minimum standards to the satisfaction of the [AGENCY]:

(i) The [BANK]'s own estimate of alpha must capture in the numerator the effects of:

(A) The material sources of stochastic dependency of distributions of market values of transactions or portfolios of transactions across counterparties;

(B) Volatilities and correlations of market risk factors used in the joint simulation, which must be related to the credit risk factor used in the simulation to reflect potential increases in volatility or correlation in an economic downturn, where appropriate; and

(C) The granularity of exposures (that is, the effect of a concentration in the proportion of each counterparty's exposure that is driven by a particular risk factor).

(ii) The [BANK] must assess the potential model uncertainty in its estimates of alpha.

(iii) The [BANK] must calculate the numerator and denominator of alpha in a consistent fashion with respect to modeling methodology, parameter specifications, and portfolio composition.

(iv) The [BANK] must review and adjust as appropriate its estimates of the numerator and denominator of alpha on at least a quarterly basis and more frequently when the composition of the portfolio varies over time.

(7) Risk-based capital requirements for transactions with specific wrong-way risk. A [BANK] must determine if a repo-style transaction, eligible margin loan, bond option, or equity derivative contract or purchased credit derivative to which the [BANK} applies the internal models methodology has specific wrong-way risk. If a transaction has specific wrong-way risk, the [BANK] must exclude it from the model described in 132(d)(2) and instead calculate the risk-based capital requirement for the transaction as follows:

(i) For an equity derivative contract, by multiplying:

(A) K, calculated using the appropriate risk-based capital formula specified in Table 1 of §___.131 using the PD of the counterparty and LGD equal to 100 percent, by

(B) The maximum amount the [BANK] could lose on the equity derivative.

(ii) For a purchased credit derivative by multiplying:

(A) K, calculated using the appropriate risk-based capital formula specified in Table 1 of §___.131 using the PD of the counterparty and LGD equal to 100 percent, by

(B) The fair value of the reference asset of the credit derivative.

(iii) For a bond option, by multiplying:

(A) K, calculated using the appropriate risk-based capital formula specified in Table 1 of §___.131 using the PD of the counterparty and LGD equal to 100 percent, by

(B) The smaller of the notional amount of the underlying reference asset and the maximum potential loss under the bond option contract.

(iv) For a repo-style transaction or eligible margin loan by multiplying:

(A) K, calculated using the appropriate risk-based capital formula specified in Table 1 of §___.131 using the PD of the counterparty and LGD equal to 100 percent, by

(B) The EAD of the transaction determined according to the EAD equation in §___.131(b)(2), substituting the estimated value of the collateral assuming a default of the counterparty for the value of the collateral in $\sum C$ of the equation.

(8) Risk-weighted asset amount for IMM exposures with specific wrong-way risk. The aggregate risk-weighted asset amount for IMM exposures with specific wrong-way risk is the sum of a [BANK]'s risk-based capital requirement for purchased credit derivatives that are not bond options with specific wrong-way risk as calculated under §___.132(d)(7)(ii), a [BANK]'s risk-based capital requirement for equity derivatives with specific wrong-way risk as calculated under §___.132 (d)(7)(i), a [BANK]'s risk-based capital requirement for bond options with specific wrong-way risk as calculated under §___.132 (d)(7)(iii), and a [BANK]'s risk-based capital requirement for repo-style transactions and eligible margin loans with specific wrong-way risk as calculated under §___.132(d)(7)(iv), multiplied by 12.5.

(9) Risk-weighted assets for IMM exposures. (i) The [BANK] must insert the assigned risk parameters for each counterparty and netting set into the appropriate formula specified in Table 1 of §___.131 and multiply the output of the formula by the $EAD_{unstressed}$ of the netting set to obtain the unstressed capital requirement for each netting set. A [BANK] that uses an advanced CVA approach that captures migrations in credit spreads under §___.132(e)(3) must set the maturity adjustment (b) in the formula equal to zero. The sum of the unstressed capital requirement calculated for each netting set equals $K_{unstressed}$.

(ii) The [BANK] must insert the assigned risk parameters for each wholesale obligor and netting set into the appropriate formula specified in Table 1 of §___.131 and multiply the output of the formula by the $EAD_{stressed}$ of the netting set to obtain the stressed capital requirement for each netting set. A [BANK] that uses an advanced CVA approach that captures migrations in credit spreads under §___.132(e)(3) must set the maturity adjustment (b) in the formula equal to zero. The sum of the stressed capital requirement calculated for each netting set equals $K_{stressed}$.

(iii) The [BANK]'s dollar risk-based capital requirement under the internal models methodology equals the larger of $K_{unstressed}$ and $K_{stressed}$. A [BANK]'s risk-weighted assets amount for IMM exposures is equal to the capital requirement multiplied by 12.5, plus risk weighted assets for IMM exposures with specific wrong-way risk in §___.132(d)(8) and those in §___.132(d)(10).

(10) Other measures of counterparty exposure. (i) With prior written approval of the [AGENCY], a [BANK] may set EAD equal to a measure of counterparty credit risk exposure, such as peak EAD, that is more conservative than an alpha of 1.4 (or higher under the terms of §___.132(d)(7)(iv)(C)) times the larger of $EPE_{unstressed}$ and $EPE_{stressed}$ for every counterparty whose EAD will be measured under the alternative measure of counterparty exposure. The [BANK] must demonstrate the conservatism of the measure of counterparty credit risk exposure used for EAD.

(A) For material portfolios of new OTC derivative products, the [BANK] may assume that the current exposure methodology in §___.132(c)(5) and §___.132(c)(6) meets the conservatism requirement of this section for a period not to exceed 180 days.

(B) For immaterial portfolios of OTC derivative contracts, the [BANK] generally may assume that the current exposure methodology in §___.132(c)(5) and §___.132(c)(6) meets the conservatism requirement of this section.

(ii) To calculate risk-weighted assets under this approach, the [BANK] must insert the assigned risk parameters for each counterparty and netting set into the appropriate formula specified in Table 1 of §___.131, multiply the output of the formula by the EAD for the exposure as specified above, and multiply by 12.5.

(e) Credit Valuation Adjustment (CVA) Risk-Weighted Assets. (1) In general. With respect to its OTC derivative contracts, a [BANK] must calculate a CVA risk-weighted asset amount for each counterparty using the simple CVA approach described in §___.132 (e)(5) or, with prior written approval of the [AGENCY], the advanced CVA approach described in §___.132(e)(6). A [BANK] that receives prior [AGENCY] approval to calculate its CVA risk-weighted asset amounts for a class of counterparties using the advanced CVA approach must continue to use that approach for that class of counterparties until it notifies the [AGENCY] in writing that the [BANK] expects to begin calculating its CVA risk-weighted asset amount using the simple CVA approach. Such notice must include an explanation of the [BANK]'s rationale and the date upon which the [BANK] will begin to calculate its CVA risk-weighted asset amount using the simple CVA approach.

(2) Market risk [BANK]s. Notwithstanding the prior approval requirement in §___.132(e)(1), a market risk [BANK] may calculate its CVA risk-weighted asset amount for a counterparty using the advanced CVA approach if the [BANK] has [AGENCY] approval to:

(i) Determine EAD for OTC derivative contracts using the internal models methodology described in §___.132(d); and

(ii) Determine its specific risk add-on for debt positions issued by the counterparty using a specific risk model described in §___.207(b) of subpart F.

(3) Recognition of Hedges. (i) A [BANK] may recognize a single name CDS, single name contingent CDS, any other equivalent hedging instrument that references the counterparty directly, and index credit default swaps (CDS_{ind}) as a CVA hedge under §___.132(e)(5)(ii) or §___.132(e)(6), provided that the position is managed as a CVA hedge in accordance with the [BANK]'s hedging policies.

(ii) A [BANK] shall not recognize as a CVA hedge any tranched or nth-to-default credit derivative.

(4) Total CVA risk-weighted assets. Total CVA risk-weighted assets is the sum of the CVA capital requirement, $K_{CVA,}$ calculated for each of a [BANK]'s OTC derivative counterparties, multiplied by 12.5.

(5) Simple CVA approach. (i) Under the simple CVA approach, the CVA capital requirement, K_{CVA}, is calculated according to the following formula:

$$K_{CVA} = 2.33 \times \sqrt{\left(\sum_i 0.5 \times w_i \times \left(M_i \times EAD_i^{total} - M_i^{hedge} \times B_i \right) - \sum_{ind} w_{ind} \times M_{ind} \times B_{ind} \right)^2 + A}$$ Where:

$$A = \sum_i 0.75 \times w_i^2 \times \left(M_i \times EAD_i^{total} - M_i^{hedge} \times B_i \right)^2$$

(A) w_i = the weight applicable to counterparty i under Table 4;

(B) M_i = the EAD-weighted average of the effective maturity of each netting set with counterparty i (where each netting set's M can be no less than one year.)

1. (C) EAD_i^{total} = the sum of the EAD for all netting sets of OTC derivative contracts with counterparty i calculated using the current exposure methodology described in §___.132(c) or the internal models methodology described in §___.132(d). When the [BANK] calculates EAD under §___.132(c), such EAD may be adjusted for purposes of calculating EAD_i^{total} by multiplying EAD by (1-exp(-0.05 x M_i))/(0.05 x M_i).[32] When the [BANK] calculates EAD under §___.132(d), EAD_i^{total} equals $EAD_{unstressed}$.

(D) M_i^{hedge} = the notional weighted average maturity of the hedge instrument.

(E) B_i = the sum of the notional amounts of any purchased single name CDS referencing counterparty i that is used to hedge CVA risk to counterparty i multiplied by (1-exp(-0.05 x M_i^{hedge}))/(0.05 x M_i^{hedge}).

(F) M_{ind} = the maturity of the CDS_{ind} or the notional weighted average maturity of any CDS_{ind} purchased to hedge CVA risk of counterparty i.

[32] The term "exp" is the exponential function.

(G) B_{ind} = the notional amount of one or more CDS_{ind} purchased to hedge CVA risk for counterparty i multiplied by $(1-\exp(-0.05 \times M_{ind}))/(0.05 \times M_{ind})$

(H) w_{ind} = the weight applicable to the CDS_{ind} based on the average weight of the underlying reference names that comprise the index under Table 4.

(ii) The [BANK] may treat the notional amount of the index attributable to a counterparty as a single name hedge of counterparty i (B_i) when calculating K_{CVA}, and subtract the notional amount of B_i from the notional amount of the CDS_{ind}. The [BANK] must calculate its capital requirement for the remaining notional amount of the CDS_{ind} as a stand alone position.

Assignment of counterparty weight:

TABLE 4

Internal PD (in percent)	Weight Wi (in percent)
0.00-0.07	0.70
>0.070-0.15	0.80
>0.15-0.40	1.00
>0.40-2.00	2.00
>2.00 - 6.00	3.00
>6.00	10.00

(6) Advanced CVA Approach. (i) A [BANK] may use the VaR model it uses to determine specific risk under §___.207(b) or another VaR model that meets the quantitative requirements of §___.205(b) and §___.207(b)(1) to calculate its CVA capital requirement for a counterparty by modeling the impact of changes in the counterparty's credit spreads, together with any recognized CVA hedges, on the CVA for the counterparty.

(A) The VaR model must incorporate only changes in the counterparty's credit spreads, not changes in other risk factors. It is not required that the VaR model capture jump-to-default risk.

(B) A [BANK] that qualifies to use the advanced CVA approach must include in that approach any immaterial OTC derivative portfolios for which it uses the current exposure methodology in §___.132(c) according to §___.132(e)(6)(viii).

(C) A [BANK] must have the systems capability to calculate the CVA capital requirement for a counterparty on a daily basis (but is not required to calculate the CVA capital requirement on a daily basis).

(ii) Under the advanced CVA approach, the CVA capital requirement for a counterparty, $K_{CVA,}$ is calculated according to the following formulas:

$$K_{CVA} = 3 \times \left(CVA_{Unstressed\ VAR} + CVA_{StressedVA\ R}\right)$$

$$CVA_j = \left(LGD_{MKT}\right) \times \sum_{i=1}^{T} Max\left(0; \exp\left(-\frac{s_{i-1} \times t_{i-1}}{LGD_{MKT}}\right) - \exp\left(-\frac{s_i \times t_i}{LGD_{MKT}}\right)\right) \times \left(\frac{EE_{i-1} \times D_{i-1} + EE_i \times D_i}{2}\right)$$

Where

(A) $CVA_j = CVA_{UnstressedVaR}$ and $CVA_{StressedVaR}$

(B) t_i = the time of the i-th revaluation time bucket starting from $t_0 = 0$.

(C) t_T = the longest contractual maturity across the OTC derivative contracts with the counterparty.

(D) s_i = the CDS spread for the counterparty at tenor t_i used to calculate the CVA for the counterparty. If a CDS spread is not available, the [BANK] must use a proxy spread based on the credit quality, industry and region of the counterparty.

(E) LGD_{MKT} = the loss given default of the counterparty based on the spread of a publicly-traded debt instrument of the counterparty, or, where a publicly-traded debt instrument spread is not available, a proxy spread based on the credit quality, industry, and region of the counterparty.

(F) EE_i = the sum of the expected exposures for all netting sets with the counterparty at revaluation time t_i, calculated above.

(G) D_i = the risk-free discount factor at time $t_{i,}$ where $D_0 = 1$.

(H) Exp is the exponential function.

(iii) A [BANK] must use the formulas in §___.132(e)(6)(iii)(A) or §___.132(e)(6)(iii)(B) to calculate credit spread sensitivities if its VaR model is not based on full repricing.

(A) If the VaR model is based on credit spread sensitivities for specific tenors, the [BANK] must calculate each credit spread sensitivity according to the following formula:

Regulatory CS01[33] =

(B) If the VaR model uses credit spread sensitivities to parallel shifts in credit spreads, the [BANK] must calculate each credit spread sensitivity according to the following formula:

Regulatory CS01 =

$$0.0001 \times \sum_{i=1}^{T} \left(t_i \times \exp\left(-\frac{s_i \times t_i}{LGD_{MKT}} \right) - t_{i-1} \times \exp\left(-\frac{s_{i-1} \times t_{i-1}}{LGD_{MKT}} \right) \right) \times \left(\frac{EE_{i-1} \times D_{i-1} + EE_i \times D_i}{2} \right)$$

(iv) To calculate the $CVA_{UnstressedVaR}$ measure for purposes of §___.132(e)(6)(ii), the [BANK] must:

(A) Use the EE_i calculated using the calibration of §___.132(d)(3)(vii), except as provided in §___.132 (e)(6)(vi), and

(B) Use the historical observation period required under §___.205(b)(2) of subpart F.

(v) To calculate the $CVA_{StressedVaR}$ measure for purposes of §___.132(e)(6)(ii), the [BANK] must:

(A) Use the EE_i calculated using the stress calibration in §___.132(d)(3)(viii) except as provided in §___.132(e)(6)(vi).

(B) Calibrate VaR model inputs to historical data from the most severe twelve-month stress period contained within the three-year stress period used to calculate EE_i. The [AGENCY] may require a [BANK] to use a different period of significant financial stress in the calculation of the $CVA_{StressedVaR}$ measure.

(vi) If a [BANK] captures the effect of a collateral agreement on EAD using the method described in §___.132(d)(5)(ii), for purposes of §___.132(e)(6)(ii), the [BANK] must calculate EE_i using the method in §___.132(d)(5)(ii) and keep that EE constant with the maturity equal to the maximum of:

(A) Half of the longest maturity of a transaction in the netting set, and

(B) The notional weighted average maturity of all transactions in the netting set.

(vii) The [BANK]'s VaR model must capture the basis between the spreads of any CDS_{ind} that is used as the hedging instrument and the hedged counterparty exposure over various time periods, including benign and stressed environments. If the VaR model does not capture that basis, the [BANK] must reflect only 50 percent of the notional amount of the CDS_{ind} hedge

[33] For the final time bucket i = T, the corresponding formula is

Regulatory CS01 = $$0.0001 \times t_i \times \exp\left(-\frac{s_i \times t_i}{LGD_{MKT}} \right) \times \left(\frac{EE_{i-1} \times D_{i-1} - EE_T \times D_T}{2} \right)$$

in the VaR model. The remaining 50 percent of the notional amount of the CDS_{ind} hedge is a covered position under subpart F.

(viii) If a [BANK] uses the current exposure methodology described in §___.132(c)(5) and §___.132(c)(6)to calculate the EAD for any immaterial portfolios of OTC derivative contracts, the [BANK] must use that EAD as a constant EE in the formula for the calculation of CVA with the maturity equal to the maximum of:

(A) Half of the longest maturity of a transaction in the netting set, and
(B) The notional weighted average maturity of all transactions in the netting set.

§___.133 Cleared Transactions

(a) General requirements.

(1) A [BANK] that is a clearing member client must use the methodologies set forth in §___.133(b) to calculate risk-weighted assets for a cleared transaction.

(2) A [BANK] that is a clearing member must use the methodologies set forth in §___.133(c) to calculate its risk-weighted assets for cleared transactions and §___.133(d) to calculate its risk-weighted assets for its default fund contribution to a CCP.

(b) Clearing member client [BANK]s. (1) Risk-weighted assets for cleared transactions.

(i) To determine the risk-weighted asset amount for a cleared transaction, a clearing member client [BANK] must multiply the trade exposure amount for the cleared transaction, calculated in accordance with §___.133(b)(2), by the risk weight appropriate for the cleared transaction, determined in accordance with §___.133(b)(3) .

(ii) A clearing member client [BANK]'s total risk-weighted assets for cleared transactions is the sum of the risk-weighted asset amounts for all of its cleared transactions.

(2) Trade exposure amount. (i) For a cleared transaction that is a derivative contract or netting set of derivative contracts, trade exposure amount equals the EAD for the derivative contract or netting set calculated using the methodology used to calculate EAD for OTC derivative contracts set forth in §___.132(c) or §___.132(d), plus the fair value of the collateral posted by the clearing member client [BANK] and held by the CCP or a clearing member in a manner that is not bankruptcy remote. When the [BANK] calculates EAD for the cleared transaction using the methodology in §___.132(d), EAD equals $EAD_{unstressed.}$

(ii) For a cleared transaction that is a repo-style transaction, trade exposure amount equals the EAD for the repo-style transaction calculated using the methodology set forth in sections 132(b)(2), 132(b)(3), or 132(d), plus the fair value of the collateral posted by the clearing member client [BANK] and held by the CCP or a clearing member in a manner that is not bankruptcy remote. When the [BANK] calculates EAD for the cleared transaction under §___.132(d), EAD equals $EAD_{unstressed}$

(3) Cleared transaction risk weights. (i) For a cleared transaction with a QCCP, a clearing member client [BANK] must apply a risk weight of:

(A) Two percent if the collateral posted by the [BANK] to the QCCP or clearing member is subject to an arrangement that prevents any loss to the clearing member client [BANK] due to the joint default or a concurrent insolvency, liquidation, or receivership proceeding of the clearing member and any other clients of the clearing member; and the clearing member client [BANK] has conducted sufficient legal review to conclude with a well-founded basis (and maintains sufficient written documentation of that legal review) that in the event of a legal challenge (including one resulting from default or from liquidation, insolvency, receivership or similar proceeding) the relevant court and administrative authorities would find the arrangements to be legal, valid, binding and enforceable under the law of the relevant jurisdictions.

(B) Four percent, if the requirements of §___.132(b)(3)(i)(A) are not met.

(ii) For a cleared transaction with a CCP that is not a QCCP, a clearing member client [BANK] must apply the risk weight applicable to the CCP under §___.32.

(iii) Notwithstanding any other requirement of this section, collateral posted by a clearing member client [BANK] that is held by a custodian in a manner that is bankruptcy remote from the CCP, clearing member, and other clearing member clients of the clearing member, is not subject to a capital requirement under this section. A [BANK] must calculate a risk-weighted asset amount for any collateral provided to a CCP, clearing member or a custodian in connection with a cleared transaction according to §___.131.

(c) Clearing member banks. (1) Risk-weighted assets for cleared transactions. (i) To determine the risk-weighted asset amount for a cleared transaction, a clearing member [BANK] must multiply the trade exposure amount for the cleared transaction, calculated in accordance with §___.133(c)(2) by the risk weight appropriate for the cleared transaction, determined in accordance with §___.133(c)(3).

(ii) A clearing member [BANK]'s total risk-weighted assets for cleared transactions is the sum of the risk-weighted asset amounts for all of its cleared transactions.

(2) Trade exposure amount. A clearing member [BANK] must calculate its trade exposure amount for a cleared transaction as follows:

(i) For a cleared transaction that is a derivative contract, trade exposure amount equals the EAD calculated using the methodology used to calculate EAD for OTC derivative contracts set forth in §___.132(c) or §___.132(d), plus the fair value of the collateral posted by the [BANK] and held by the CCP in a manner that is not bankruptcy remote. When the [BANK] calculates EAD for the cleared transaction using the methodology in §___.132(d), EAD equals $EAD_{unstressed}$.

(ii) For a cleared transaction that is a repo-style transaction, trade exposure amount equals the EAD calculated under sections §___.132(b)(2), §___.132(b)(3), or §___.132(d), plus the fair value of the collateral posted by the clearing member [BANK] and held by the CCP in a manner that is not bankruptcy remote. When the [BANK] calculates EAD for the cleared transaction under §___.132(d), EAD equals $EAD_{unstressed}$.

(3) Cleared transaction risk weights. (i) For a cleared transaction with a QCCP, a clearing member [BANK] must apply a risk weight of 2 percent.

(ii) For a cleared transaction with a CCP that is not a QCCP, a clearing member [BANK] must apply the risk weight applicable to the CCP according to §___.32.

(iii) Notwithstanding any other requirement of this section, collateral posted by a clearing member [BANK] that is held by a custodian in a manner that is bankruptcy remote from the CCP is not subject to a capital requirement under this section. A [BANK] must calculate a risk-weighted asset amount for any collateral provided to a CCP or a custodian in connection with a cleared transaction according to §___.131.

(d) Default fund contributions. (1) General requirement. A clearing member [BANK] must determine the risk-weighted asset amount for a default fund contribution to a CCP at least quarterly, or more frequently if there is a material change in the financial condition of the CCP.

(2) Risk-weighted asset amount for default fund contributions to non-qualifying CCPs. A clearing member [BANK]'s risk-weighted asset amount for default fund contributions to CCPs that are not QCCPs equals the sum of such default fund contributions multiplied by 1,250 percent.

(3) Risk-weighted asset amount for default fund contributions to QCCPs. A clearing member [BANK]'s risk-weighted asset amount for default fund contributions to QCCPs equals the sum of its capital requirement, K_{CM} for each QCCP, as calculated under this §___.133(d)(3), multiplied by 1,250 percent.

(i) The hypothetical capital requirement of a QCCP (K_{CCP}) equals:

$$K_{CCP} = \sum_{clearing\,member\ i} \max\left(EBRM_i - VM_i - IM_i - DF_i; 0\right) \times RW \times 0.08$$

Where

(A) $EBRM_i$ = the EAD for each transaction cleared through the QCCP by clearing member i, calculated using the methodology used to calculate EAD for OTC derivative contracts set forth in §___.132(c)(5) and §___.132.(c)(6) or the methodology used to calculate EAD for repo-style transactions set forth in §___.132(b)(2) for repo-style transactions, provided that:

(1) For purposes of this section, when calculating the EAD, the [BANK] may replace the formula provided in §___.132 (c)(6)(ii) with the following formula:

Anet = (0.3 x A_{gross}) + (0.7 x NGR x A_{gross}); or

(2) If the [BANK] cannot calculate NGR, it may use a value of 0.30 until March 31, 2013; and

(3) For cleared transactions that are option derivative contracts, the PFE set forth in §___.132(c)(5) must be adjusted by multiplying the notional principal amount of the derivative contract by the appropriate conversion factor in Table 3 and the absolute value of the option's delta, that is, the ratio of the change in the value of the derivative contract to the corresponding change in the price of the underlying asset.

(B) VM_i = any collateral posted by clearing member i to the QCCP that it is entitled to receive from the QCCP but has not yet received, and any collateral that the QCCP is entitled to receive from clearing member i but has not yet received;

(C) IM_i = the collateral posted as initial margin by clearing member i to the QCCP;

(D) DF_i = the funded portion of clearing member i's default fund contribution that will be applied to reduce the QCCP's loss upon a default by clearing member i; and

(E) RW = 20 percent, except when the [AGENCY] has determined that a higher risk weight is more appropriate based on the specific characteristics of the QCCP and its clearing members.

(ii) For a [BANK] that is a clearing member of a QCCP with a default fund supported by funded commitments, K_{CM} equals:

$$K_{CM_i} = \left((1+\beta) \cdot \frac{N}{N-2} \right) \cdot \frac{DF_i}{DF_{CM}} \cdot K^*_{CM}$$

$$K^*_{CM} = \begin{cases} c_2 \cdot \mu \cdot (K_{CCP} - DF') + c_2 \cdot DF'_{CM} & if \quad DF' < K_{CCP} \quad (i) \\ c_2 \cdot (K_{CCP} - DF_{CCP}) + c_1 \cdot (DF' - K_{CCP}) & if \quad DF_{CCP} < K_{CCP} \le DF' \quad (ii) \\ c_1 \cdot DF'_{CM} & if \quad K_{CCP} \le DF_{CCP} \quad (iii) \end{cases}$$

Where

(A) $$\beta = \frac{A_{Net,1} + A_{Net,2}}{\sum_i A_{Net,i}}$$

Subscripts 1 and 2 denote the clearing members with the two largest A_{Net} values. For purposes of this section, for cleared transactions that are derivatives, A_{Net} is defined using the definition set forth in §___.132(c)(6)(ii) and for cleared transactions that are repo-style transactions, A_{Net} is the EAD equation max {0, [(∑E - ∑C) + ∑(E_s x H_s) + ∑(Efx]} from §___.132(b)(2(i));

(B) N = the number of clearing members in the QCCP;

(C) DF_{CCP} = the QCCP's own funds and other financial resources that would be used to cover its losses before clearing members' default fund contributions are used to cover losses;

(D) DF_{CM} = Funded default fund contributions from all clearing members and any other clearing member contributed financial resources that are available to absorb mutualized QCCP losses;

(E) DF = DF_{CCP} + DF_{CM} (that is, the total funded default fund contribution);

(F) $\overline{DF_i}$ = Average $\overline{DF_i}$ = the average funded default fund contribution from an individual clearing member;

(G) $DF_{CM}^{'} = DF_{CM} - 2 \cdot \overline{DF_i} = \sum_i DF_i - 2 \cdot \overline{DF_i}$ (that is, the funded default fund contribution from surviving clearing members assuming that two average clearing members have defaulted and their default fund contributions and initial margins have been used to absorb the resulting losses);

(H) $DF' = DF_{CCP} + DF_{CM}^{'} = DF - 2 \cdot \overline{DF_i}$ (that is, the total funded default fund contributions from the QCCP and the surviving clearing members that are available to mutualize losses, assuming that two average clearing members have defaulted);

(I) $; c_1 = Max\left\{ \frac{1.6\%}{\left(DF'/K_{CCP}\right)^{0.3}}; 0.16\% \right\}$ (that is, a decreasing capital factor, between .16 percent and 1.6 percent, applied to the excess funded default funds provided by clearing members);

(J) c_2 = 100 percent; and

(K) μ= 1.2;

(iii) For a [BANK] that is a clearing member of a QCCP with a default fund supported by unfunded commitments, K_{CM} equals:

$$K_{CM_i} = \frac{DF_i}{DF_{CM}} \cdot K_{CM}^{*}$$

Where

(A) DF_i = the [BANK]'s unfunded commitment to the default fund;

(B) DF_{CM} = the total of all clearing members' unfunded commitments to the default fund; and

(C) K_{CM}^{*} as defined in §___.133(d)(3)(ii) .

(D) For a [BANK] that is a clearing member of a QCCP with a default fund supported by unfunded commitments and that is unable to calculate K_{CM} using the methodology described above in this §___.133(d)(3)(iii), K_{CM} equals:

$$K_{CM_i} = \frac{IM_i}{IM_{CM}} \cdot K_{CM}^{*}$$

Where

(1) IM_i = the [BANK]'s initial margin posted to the QCCP;

(2) IM_{CM} = the total of initial margin posted to the QCCP; and

(3) K_{CM}^{*} as defined above in this §___.133(d)(3)(iii).

(iv) Total risk-weighted assets for default fund contributions. Total risk-weighted assets for default fund contributions is the sum of a clearing member [BANK]'s risk-weighted assets for all of its default fund contributions to all CCPs of which the [BANK] is a clearing member.

§___.134 Guarantees and Credit Derivatives: PD Substitution and LGD Adjustment Approaches.

(a) Scope. (1) This section applies to wholesale exposures for which:
(i) Credit risk is fully covered by an eligible guarantee or eligible credit derivative; or

(ii) Credit risk is covered on a pro rata basis (that is, on a basis in which the [BANK] and the protection provider share losses proportionately) by an eligible guarantee or eligible credit derivative.

(2) Wholesale exposures on which there is a tranching of credit risk (reflecting at least two different levels of seniority) are securitization exposures subject to sections 141 through 145.

(3) A [BANK] may elect to recognize the credit risk mitigation benefits of an eligible guarantee or eligible credit derivative covering an exposure described in §___.134(a)(1) by using the PD substitution approach or the LGD adjustment approach in §___.134 (c) or, if the transaction qualifies, using the double default treatment in §___.135. A [BANK]'s PD and LGD for the hedged exposure may not be lower than the PD and LGD floors described in sections 131(d)(2) and (d)(3).

(4) If multiple eligible guarantees or eligible credit derivatives cover a single exposure described in §___.134 (a)(1), a [BANK] may treat the hedged exposure as multiple separate exposures each covered by a single eligible guarantee or eligible credit derivative and may calculate a separate risk-based capital requirement for each separate exposure as described §___.134 (a)(3).

(5) If a single eligible guarantee or eligible credit derivative covers multiple hedged wholesale exposures described in §___.134(a)(1), a [BANK] must treat each hedged exposure as covered by a separate eligible guarantee or eligible credit derivative and must calculate a separate risk-based capital requirement for each exposure as described in §___.134(a)(3).

(6) A [BANK] must use the same risk parameters for calculating ECL as it uses for calculating the risk-based capital requirement for the exposure.

(b) Rules of recognition. (1) A [BANK] may only recognize the credit risk mitigation benefits of eligible guarantees and eligible credit derivatives.

(2) A [BANK] may only recognize the credit risk mitigation benefits of an eligible credit derivative to hedge an exposure that is different from the credit derivative's reference exposure used for determining the derivative's cash settlement value, deliverable obligation, or occurrence of a credit event if:

(i) The reference exposure ranks pari passu (that is, equally) with or is junior to the hedged exposure; and

(ii) The reference exposure and the hedged exposure are exposures to the same legal entity, and legally enforceable cross-default or cross-acceleration clauses are in place to assure payments under the credit derivative are triggered when the obligor fails to pay under the terms of the hedged exposure.

(c) Risk parameters for hedged exposures. (1) PD substitution approach.

(i) Full coverage. If an eligible guarantee or eligible credit derivative meets the conditions in sections 134(a) and (b) and the protection amount (P) of the guarantee or credit derivative is greater than or equal to the EAD of the hedged exposure, a [BANK] may recognize the guarantee or credit derivative in determining the [BANK]'s risk-based capital requirement for the hedged exposure by substituting the PD associated with the rating grade of the protection provider for the PD associated with the rating grade of the obligor in the risk-based capital formula applicable to the guarantee or credit derivative in Table 1 of §___.131 and using the appropriate LGD as described in §___.134(c)(1)(iii). If the [BANK] determines that full substitution of the protection provider's PD leads to an inappropriate degree of risk mitigation, the [BANK] may substitute a higher PD than that of the protection provider.

(ii) Partial coverage. If an eligible guarantee or eligible credit derivative meets the conditions in sections 134 (a) and (b) and P of the guarantee or credit derivative is less than the EAD of the hedged exposure, the [BANK] must treat the hedged exposure as two separate exposures (protected and unprotected) in order to recognize the credit risk mitigation benefit of the guarantee or credit derivative.

(A) The [BANK] must calculate its risk-based capital requirement for the protected exposure under §___.131, where PD is the protection provider's PD, LGD is determined under §___.134(c)(1)(iii), and EAD is P. If the [BANK] determines that full substitution leads to an inappropriate degree of risk mitigation, the [BANK] may use a higher PD than that of the protection provider.

(B) The [BANK] must calculate its risk-based capital requirement for the unprotected exposure under §___.131, where PD is the obligor's PD, LGD is the hedged exposure's LGD (not adjusted to reflect the guarantee or credit derivative), and EAD is the EAD of the original hedged exposure minus P.

(C) The treatment in this §___.134(c)(1)(ii) is applicable when the credit risk of a wholesale exposure is covered on a partial pro rata basis or when an adjustment is made to the effective notional amount of the guarantee or credit derivative under sections 134 (d), (e), or (f).

(iii) LGD of hedged exposures. The LGD of a hedged exposure under the PD substitution approach is equal to:

(A) The lower of the LGD of the hedged exposure (not adjusted to reflect the guarantee or credit derivative) and the LGD of the guarantee or credit derivative, if the guarantee or credit derivative provides the [BANK] with the option to receive immediate payout upon triggering the protection; or

(B) The LGD of the guarantee or credit derivative, if the guarantee or credit derivative does not provide the [BANK] with the option to receive immediate payout upon triggering the protection.

(2) LGD adjustment approach. (i) Full coverage. If an eligible guarantee or eligible credit derivative meets the conditions in sections 134 (a) and (b) and the protection amount (P) of the guarantee or credit derivative is greater than or equal to the EAD of the hedged exposure, the [BANK]'s risk-based capital requirement for the hedged exposure is the greater of:

(A) The risk-based capital requirement for the exposure as calculated under §___.131, with the LGD of the exposure adjusted to reflect the guarantee or credit derivative; or

(B) The risk-based capital requirement for a direct exposure to the protection provider as calculated under §___.131, using the PD for the protection provider, the LGD for the guarantee or credit derivative, and an EAD equal to the EAD of the hedged exposure.

(ii) Partial coverage. If an eligible guarantee or eligible credit derivative meets the conditions in sections 134 (a) and (b) and the protection amount (P) of the guarantee or credit derivative is less than the EAD of the hedged exposure, the [BANK] must treat the hedged exposure as two separate exposures (protected and unprotected) in order to recognize the credit risk mitigation benefit of the guarantee or credit derivative.

(A) The [BANK]'s risk-based capital requirement for the protected exposure would be the greater of:

(1) The risk-based capital requirement for the protected exposure as calculated under §___.131, with the LGD of the exposure adjusted to reflect the guarantee or credit derivative and EAD set equal to P; or

(2) The risk-based capital requirement for a direct exposure to the guarantor as calculated under §___.131, using the PD for the protection provider, the LGD for the guarantee or credit derivative, and an EAD set equal to P.

(B) The [BANK] must calculate its risk-based capital requirement for the unprotected exposure under §___.131, where PD is the obligor's PD, LGD is the hedged exposure's LGD (not adjusted to reflect the guarantee or credit derivative), and EAD is the EAD of the original hedged exposure minus P.

(3) M of hedged exposures. The M of the hedged exposure is the same as the M of the exposure if it were unhedged.

(d) Maturity mismatch. (1) A [BANK] that recognizes an eligible guarantee or eligible credit derivative in determining its risk-based capital requirement for a hedged exposure must adjust the effective notional amount of the credit risk mitigant to reflect any maturity mismatch between the hedged exposure and the credit risk mitigant.

(2) A maturity mismatch occurs when the residual maturity of a credit risk mitigant is less than that of the hedged exposure(s).

(3) The residual maturity of a hedged exposure is the longest possible remaining time before the obligor is scheduled to fulfil its obligation on the exposure. If a credit risk mitigant has embedded options that may reduce its term, the [BANK] (protection purchaser) must use the shortest possible residual maturity for the credit risk mitigant. If a call is at the discretion of the protection provider, the residual maturity of the credit risk mitigant is at the first call date. If the call is at the discretion of the [BANK] (protection purchaser), but the terms of the arrangement at origination of the credit risk mitigant contain a positive incentive for the [BANK] to call the transaction before contractual maturity, the remaining time to the first call date is the residual maturity of the credit risk mitigant.[34]

(4) A credit risk mitigant with a maturity mismatch may be recognized only if its original maturity is greater than or equal to one year and its residual maturity is greater than three months.

(5) When a maturity mismatch exists, the [BANK] must apply the following adjustment to the effective notional amount of the credit risk mitigant: $P_m = E \times (t-0.25)/(T-0.25)$, where:

(i) P_m = effective notional amount of the credit risk mitigant, adjusted for maturity mismatch;

(ii) E = effective notional amount of the credit risk mitigant;

[34] For example, where there is a step-up in cost in conjunction with a call feature or where the effective cost of protection increases over time even if credit quality remains the same or improves, the residual maturity of the credit risk mitigant will be the remaining time to the first call.

(iii) t = the lesser of T or the residual maturity of the credit risk mitigant, expressed in years; and

(iv) T = the lesser of five or the residual maturity of the hedged exposure, expressed in years.

(e) Credit derivatives without restructuring as a credit event. If a [BANK] recognizes an eligible credit derivative that does not include as a credit event a restructuring of the hedged exposure involving forgiveness or postponement of principal, interest, or fees that results in a credit loss event (that is, a charge-off, specific provision, or other similar debit to the profit and loss account), the [BANK] must apply the following adjustment to the effective notional amount of the credit derivative: $P_r = P_m \times 0.60$, where:

(1) P_r = effective notional amount of the credit risk mitigant, adjusted for lack of restructuring event (and maturity mismatch, if applicable); and

(2) P_m = effective notional amount of the credit risk mitigant adjusted for maturity mismatch (if applicable).

(f) Currency mismatch. (1) If a [BANK] recognizes an eligible guarantee or eligible credit derivative that is denominated in a currency different from that in which the hedged exposure is denominated, the [BANK] must apply the following formula to the effective notional amount of the guarantee or credit derivative: $P_c = P_r \times (1-H_{FX})$, where:

(i) P_c = effective notional amount of the credit risk mitigant, adjusted for currency mismatch (and maturity mismatch and lack of restructuring event, if applicable);

(ii) P_r = effective notional amount of the credit risk mitigant (adjusted for maturity mismatch and lack of restructuring event, if applicable); and

(iii) H_{FX} = haircut appropriate for the currency mismatch between the credit risk mitigant and the hedged exposure.

(2) A [BANK] must set H_{FX} equal to 8 percent unless it qualifies for the use of and uses its own internal estimates of foreign exchange volatility based on a ten-business-day holding period and daily marking-to-market and remargining. A [BANK] qualifies for the use of its own internal estimates of foreign exchange volatility if it qualifies for:

(i) The own-estimates haircuts in §___.132(b)(2)(iii);

(ii) The simple VaR methodology in §___.132(b)(3); or

(iii) The internal models methodology in §___.132(d).

(3) A [BANK] must adjust H_{FX} calculated in paragraph (f)(2) of this section upward if the [BANK] revalues the guarantee or credit derivative less frequently than once every ten business days using the square root of time formula provided in §___.132(b)(2)(iii)(A)(2).

§___.135 Guarantees and Credit Derivatives: Double Default Treatment.

(a) Eligibility and operational criteria for double default treatment. A [BANK] may recognize the credit risk mitigation benefits of a guarantee or credit derivative covering an exposure described in §___.134(a)(1) by applying the double default treatment in this section if all the following criteria are satisfied:

(1) The hedged exposure is fully covered or covered on a pro rata basis by:

(i) An eligible guarantee issued by an eligible double default guarantor; or

(ii) An eligible credit derivative that meets the requirements of §___.134(b)(2) and that is issued by an eligible double default guarantor.

(2) The guarantee or credit derivative is:

(i) An uncollateralized guarantee or uncollateralized credit derivative (for example, a credit default swap) that provides protection with respect to a single reference obligor; or

(ii) An n^{th}-to-default credit derivative (subject to the requirements of §___.142(m).

(3) The hedged exposure is a wholesale exposure (other than a sovereign exposure).

(4) The obligor of the hedged exposure is not:

(i) An eligible double default guarantor or an affiliate of an eligible double default guarantor; or

(ii) An affiliate of the guarantor.

(5) The [BANK] does not recognize any credit risk mitigation benefits of the guarantee or credit derivative for the hedged exposure other than through application of the double default treatment as provided in this section.

(6) The [BANK] has implemented a process (which has received the prior, written approval of the [AGENCY]) to detect excessive correlation between the creditworthiness of the obligor of the hedged exposure and the protection provider. If excessive correlation is present, the [BANK] may not use the double default treatment for the hedged exposure.

(b) Full coverage. If the transaction meets the criteria in paragraph (a) of this §___.and the protection amount (P) of the guarantee or credit derivative is at least equal to the EAD of the hedged exposure, the [BANK] may determine its risk-weighted asset amount for the hedged exposure under §___.135(e).

(c) Partial coverage. If the transaction meets the criteria in §___.135(a) and the protection amount (P) of the guarantee or credit derivative is less than the EAD of the hedged exposure, the [BANK] must treat the hedged exposure as two separate exposures (protected and

unprotected) in order to recognize double default treatment on the protected portion of the exposure.

(1) For the protected exposure, the [BANK] must set EAD equal to P and calculate its risk-weighted asset amount as provided in §___.135(e).

(2) For the unprotected exposure, the [BANK] must set EAD equal to the EAD of the original exposure minus P and then calculate its risk-weighted asset amount as provided in §___.131.

(d) Mismatches. For any hedged exposure to which a [BANK] applies double default treatment, the [BANK] must make applicable adjustments to the protection amount as required in sections 134(d), (e), and (f).

(e) The double default dollar risk-based capital requirement. The dollar risk-based capital requirement for a hedged exposure to which a [BANK] has applied double default treatment is K_{DD} multiplied by the EAD of the exposure. K_{DD} is calculated according to the following formula: $K_{DD} = K_o \times (0.15 + 160 \times PD_g)$,

where:

(1)

$$K_O = LGD_g \times \left[N\left(\frac{N^{-1}(PD_o) + N^{-1}(0.999)\sqrt{\rho_{os}}}{\sqrt{1-\rho_{os}}} \right) - PD_o \right] \times \left[\frac{1+(M-2.5)\times b}{1-1.5\times b} \right]$$

(2) PD_g = PD of the protection provider.

(3) PD_o = PD of the obligor of the hedged exposure.

(4) LGD_g = (i) The lower of the LGD of the hedged exposure (not adjusted to reflect the guarantee or credit derivative) and the LGD of the guarantee or credit derivative, if the guarantee or credit derivative provides the [BANK] with the option to receive immediate payout on triggering the protection; or

(ii) The LGD of the guarantee or credit derivative, if the guarantee or credit derivative does not provide the [BANK] with the option to receive immediate payout on triggering the protection.

(5) ρ_{os} (asset value correlation of the obligor) is calculated according to the appropriate formula for (R) provided in Table 1 in §___.131, with PD equal to PD_o.

(6) b (maturity adjustment coefficient) is calculated according to the formula for b provided in Table 1 in §___.131, with PD equal to the lesser of PD_o and PD_g.

(7) M (maturity) is the effective maturity of the guarantee or credit derivative, which may not be less than one year or greater than five years.

§___.136 Unsettled Transactions

(a) Definitions. For purposes of this section:

(1) Delivery-versus-payment (DvP) transaction means a securities or commodities transaction in which the buyer is obligated to make payment only if the seller has made delivery of the securities or commodities and the seller is obligated to deliver the securities or commodities only if the buyer has made payment.

(2) Payment-versus-payment (PvP) transaction means a foreign exchange transaction in which each counterparty is obligated to make a final transfer of one or more currencies only if the other counterparty has made a final transfer of one or more currencies.

(3) Normal settlement period. A transaction has a normal settlement period if the contractual settlement period for the transaction is equal to or less than the market standard for the instrument underlying the transaction and equal to or less than five business days.

(4) Positive current exposure. The positive current exposure of a [BANK] for a transaction is the difference between the transaction value at the agreed settlement price and the current market price of the transaction, if the difference results in a credit exposure of the [BANK] to the counterparty.

(b) Scope. This section applies to all transactions involving securities, foreign exchange instruments, and commodities that have a risk of delayed settlement or delivery. This section does not apply to:

(1) Cleared transactions that are subject to daily marking-to-market and daily receipt and payment of variation margin;

(2) Repo-style transactions, including unsettled repo-style transactions (which are addressed in sections 131 and 132);

(3) One-way cash payments on OTC derivative contracts (which are addressed in sections 131 and 132); or

(4) Transactions with a contractual settlement period that is longer than the normal settlement period (which are treated as OTC derivative contracts and addressed in sections 131 and 132).

(c) System-wide failures. In the case of a system-wide failure of a settlement or clearing system, or a central counterparty, the [AGENCY] may waive risk-based capital requirements for unsettled and failed transactions until the situation is rectified.

(d) Delivery-versus-payment (DvP) and payment-versus-payment (PvP) transactions. A [BANK] must hold risk-based capital against any DvP or PvP transaction with a normal settlement period if the [BANK]'s counterparty has not made delivery or payment within five business days after the settlement date. The [BANK] must determine its risk-weighted asset

amount for such a transaction by multiplying the positive current exposure of the transaction for the [BANK] by the appropriate risk weight in Table 5.

TABLE 5 – RISK WEIGHTS FOR UNSETTLED DVP AND PVP TRANSACTIONS

Number of business days after contractual settlement date	**Risk weight to be applied to positive current exposure (in percent)**
From 5 to 15	100
From 16 to 30	625
From 31 to 45	937.5
46 or more	1,250

(e) Non-DvP/non-PvP (non-delivery-versus-payment/non-payment-versus-payment) transactions. (1) A [BANK] must hold risk-based capital against any non-DvP/non-PvP transaction with a normal settlement period if the [BANK] has delivered cash, securities, commodities, or currencies to its counterparty but has not received its corresponding deliverables by the end of the same business day. The [BANK] must continue to hold risk-based capital against the transaction until the [BANK] has received its corresponding deliverables.

(2) From the business day after the [BANK] has made its delivery until five business days after the counterparty delivery is due, the [BANK] must calculate its risk-based capital requirement for the transaction by treating the current market value of the deliverables owed to the [BANK] as a wholesale exposure.

(i) A [BANK] may use a 45 percent LGD for the transaction rather than estimating LGD for the transaction provided the [BANK] uses the 45 percent LGD for all transactions described in sections 135 (e)(1) and (e)(2).

(ii) A [BANK] may use a 100 percent risk weight for the transaction provided the [BANK] uses this risk weight for all transactions described in sections 135 (e)(1) and (e)(2).

(3) If the [BANK] has not received its deliverables by the fifth business day after the counterparty delivery was due, the [BANK] must apply a 1,250 percent risk weight to the current market value of the deliverables owed to the [BANK].

(f) Total risk-weighted assets for unsettled transactions. Total risk-weighted assets for unsettled transactions is the sum of the risk-weighted asset amounts of all DvP, PvP, and non-DvP/non-PvP transactions.

RISK-WEIGHTED ASSETS FOR SECURITIZATION EXPOSURES

§___.141 Operational Criteria for Recognizing the Transfer of Risk.

(a) Operational criteria for traditional securitizations. A [BANK] that transfers exposures it has originated or purchased to a securitization SPE or other third party in connection with a traditional securitization may exclude the exposures from the calculation of its risk-weighted assets only if each of the conditions in this §___.141(a) is satisfied. A [BANK] that meets these conditions must hold risk-based capital against any securitization exposures it retains in connection with the securitization. A [BANK] that fails to meet these conditions must hold risk-based capital against the transferred exposures as if they had not been securitized and must deduct from common equity tier 1 capital any after-tax gain-on-sale resulting from the transaction. The conditions are:

(1) The exposures are not reported on the [BANK]'s balance sheet under GAAP;

(2) The [BANK] has transferred to third parties credit risk associated with the underlying exposures;

(3) Any clean-up calls relating to the securitization are eligible clean-up calls; and

(4) The securitization does not (i) include one or more underlying exposures in which the borrower is permitted to vary the drawn amount within an agreed limit under a line of credit; and (ii) contains an early amortization provision.

(b) Operational criteria for synthetic securitizations. For synthetic securitizations, a [BANK] may recognize for risk-based capital purposes the use of a credit risk mitigant to hedge underlying exposures only if each of the conditions in this §___.is satisfied. A [BANK] that meets these conditions must hold risk-based capital against any credit risk of the exposures it retains in connection with the synthetic securitization. A [BANK] that fails to meet these conditions must hold risk-based capital against the underlying exposures as if they had not been synthetically securitized. The conditions are:

(1) The credit risk mitigant is financial collateral, an eligible credit derivative from an eligible guarantor or an eligible guarantee from an eligible guarantor;

(2) The [BANK] transfers credit risk associated with the underlying exposures to third parties, and the terms and conditions in the credit risk mitigants employed do not include provisions that:

(i) Allow for the termination of the credit protection due to deterioration in the credit quality of the underlying exposures;

(ii) Require the [BANK] to alter or replace the underlying exposures to improve the credit quality of the pool of underlying exposures;

(iii) Increase the [BANK]'s cost of credit protection in response to deterioration in the credit quality of the underlying exposures;

(iv) Increase the yield payable to parties other than the [BANK] in response to a deterioration in the credit quality of the underlying exposures; or

(v) Provide for increases in a retained first loss position or credit enhancement provided by the [BANK] after the inception of the securitization;

(3) The [BANK] obtains a well-reasoned opinion from legal counsel that confirms the enforceability of the credit risk mitigant in all relevant jurisdictions; and

(4) Any clean-up calls relating to the securitization are eligible clean-up calls.

(c)Due diligence requirements for securitization exposures. (1) Except for exposures that are deducted from common equity tier 1 capital and exposures subject to §___.142(k), if a [BANK] is unable to demonstrate to the satisfaction of the [AGENCY] a comprehensive understanding of a feature of a securitization exposure that would materially affect the performance of the position, the [BANK] must assign a 1,250 percent risk weight to the securitization exposure. The [BANK]'s analysis must be commensurate with the complexity of the securitization exposure and the materiality of the position in relation to capital.

(2) A [BANK] must demonstrate its comprehensive understanding of a securitization exposure under §___.141(c)(1), for each securitization exposure by:

(i) Conduct an analysis of the risk characteristics of a securitization exposure prior to acquiring the exposure and document such analysis within three business days after acquiring the exposure, considering:

(A) Structural features of the securitization that would materially impact the performance of the exposure, for example, the contractual cash flow waterfall, waterfall-related triggers, credit enhancements, liquidity enhancements, market value triggers, the performance of organizations that service the position, and deal-specific definitions of default;

(B) Relevant information regarding the performance of the underlying credit exposure(s), for example, the percentage of loans 30, 60, and 90 days past due; default rates; prepayment rates; loans in foreclosure; property types; occupancy; average credit score or other measures of creditworthiness; average loan-to-value ratio; and industry and geographic diversification data on the underlying exposure(s);

(C) Relevant market data of the securitization, for example, bid-ask spreads, most recent sales price and historical price volatility, trading volume, implied market rating, and size, depth and concentration level of the market for the securitization; and

(D) For resecuritization exposures, (i) performance information on the underlying securitization exposures, for example, the issuer name and credit quality, and the characteristics and performance of the exposures underlying the securitization exposures; and

(ii) On an on-going basis (no less frequently than quarterly), evaluate, review, and update as appropriate the analysis required under this section for each securitization exposure.

§___.142 Risk-Weighted Assets for Securitization Exposures.

(a) Hierarchy of approaches. Except as provided elsewhere in this section and in §___.141:

(1) A [BANK] must deduct from common equity tier 1 capital any after-tax gain-on-sale resulting from a securitization and must apply a 1,250 percent risk weight to the portion of any CEIO that does not constitute after tax gain-on-sale.

(2) If a securitization exposure does not require deduction or a 1,250 percent risk weight under §___.142(a)(1), the [BANK] must apply the supervisory formula approach in §___.143 to the exposure if the [BANK] and the exposure qualify for the supervisory formula approach according to §___.143(e).

(3) If a securitization exposure does not require deduction or a 1,250 percent risk weight under §___.142(a)(1) and does not qualify for the supervisory formula approach, the [BANK] may apply the simplified supervisory formula approach under §___.144

(4) If a securitization exposure does not require deduction or a 1,250 percent risk weight under §___.142 (a)(1), does not qualify for the supervisory formula approach, and the [BANK] does not apply the simplified supervisory formula approach, the [BANK] must apply a 1,250 percent risk weight to the exposure.

(5) If a securitization exposure is a derivative contract (other than a credit derivative) that has a first priority claim on the cash flows from the underlying exposures (notwithstanding amounts due under interest rate or currency derivative contracts, fees due, or other similar payments), with approval of the [AGENCY], a [BANK] may choose to set the risk-weighted asset amount of the exposure equal to the amount of the exposure as determined in §___.142(e) rather than apply the hierarchy of approaches described in sections 142 (a)(1) through (4).

(b) Total risk-weighted assets for securitization exposures. A [BANK]'s total risk-weighted assets for securitization exposures is equal to the sum of its risk-weighted assets calculated using sections 142 through 146.

(c) Deductions. A [BANK] may calculate any deduction from common equity tier 1 capital for a securitization exposure net of any DTLs associated with the securitization exposure.

(d) Maximum risk-based capital requirement. Except as provided in §___.141(c), unless one or more underlying exposures does not meet the definition of a wholesale, retail, securitization, or equity exposure, the total risk-based capital requirement for all securitization exposures held by a single [BANK] associated with a single securitization (excluding any risk-based capital requirements that relate to the [BANK]'s gain-on-sale or CEIOs associated with the securitization) may not exceed the sum of:

(1) The [BANK]'s total risk-based capital requirement for the underlying exposures calculated under this subpart as if the [BANK] directly held the underlying exposures; and

(2) The total ECL of the underlying exposures calculated under this subpart.

(e) Amount of a securitization exposure. (1) The amount of an on-balance sheet securitization exposure that is not a repo-style transaction, eligible margin loan, or OTC derivative contract (other than a credit derivative) is the [BANK]'s carrying value.

(2) The amount of an off-balance sheet securitization exposure that is not an OTC derivative contract or cleared transaction (other than a credit derivative) is the notional amount of the exposure. For an off-balance-sheet securitization exposure to an ABCP program, such as an eligible ABCP liquidity facility, the notional amount may be reduced to the maximum potential amount that the [BANK] could be required to fund given the ABCP program's current underlying assets (calculated without regard to the current credit quality of those assets).

(3) The amount of a securitization exposure that is a repo-style transaction, eligible margin loan, or OTC derivative contract or cleared transaction (other than a credit derivative) is the EAD of the exposure as calculated in §___.132 or §___.133.

(f) Overlapping exposures. If a [BANK] has multiple securitization exposures that provide duplicative coverage of the underlying exposures of a securitization (such as when a [BANK] provides a program-wide credit enhancement and multiple pool-specific liquidity facilities to an ABCP program), the [BANK] is not required to hold duplicative risk-based capital against the overlapping position. Instead, the [BANK] may assign to the overlapping securitization exposure the applicable risk-based capital treatment that results in the highest risk-based capital requirement.

(g) Securitizations of non-IRB exposures. Except as provided in §___.141(c), if a [BANK] has a securitization exposure where any underlying exposure is not a wholesale exposure, retail exposure, securitization exposure, or equity exposure, the [BANK]:

(1) Must deduct from common equity tier 1 capital any after-tax gain-on-sale resulting from the securitization and apply a 1,250 percent risk weight to the portion of any CEIO that does not constitute gain-on-sale, if the [BANK] is an originating [BANK];

(2) May apply the simplified supervisory formula approach in §___.144 to the exposure, if the securitization exposure does not require deduction or a 1,250 percent risk weight under paragraph (g)(1);

(3) Must assign a 1,250 percent risk weight to the exposure if the securitization exposure does not require deduction or a 1,250 percent risk weight under §___.142 (g)(1), does not qualify for the supervisory formula approach, and the [BANK] does not apply the simplified supervisory formula approach to the exposure.

(h) Implicit support. If a [BANK] provides support to a securitization in excess of the [BANK]'s contractual obligation to provide credit support to the securitization (implicit support):

(1) The [BANK] must calculate a risk-weighted asset amount for underlying exposures associated with the securitization as if the exposures had not been securitized and must deduct from common equity tier 1 capital any after-tax gain-on-sale resulting from the securitization; and

(2) The [BANK] must disclose publicly:

(i) That it has provided implicit support to the securitization; and

(ii) The regulatory capital impact to the [BANK] of providing such implicit support.

(i) Eligible servicer cash advance facilities. Regardless of any other provisions of subpart E, a [BANK] is not required to hold risk-based capital against the undrawn portion of an eligible servicer cash advance facility.

(j) Interest-only mortgage-backed securities. Except as provided in §___.141(c), the risk weight for a non-credit-enhancing interest-only mortgage-backed security may not be less than 100 percent.

(k) Small-business loans and leases on personal property transferred with recourse.

(1) Notwithstanding any other provisions of this subpart E, a [BANK] that has transferred small-business loans and leases on personal property (small-business obligations) with recourse must include in risk-weighted assets only the contractual amount of retained recourse if all the following conditions are met:

(i) The transaction is a sale under GAAP.

(ii) The [BANK] establishes and maintains, pursuant to GAAP, a non-capital reserve sufficient to meet the [BANK]'s reasonably estimated liability under the recourse arrangement.

(iii) The loans and leases are to businesses that meet the criteria for a small-business concern established by the Small Business Administration under section 3(a) of the Small Business Act.

(iv) The [BANK] is well capitalized, as defined in[the [AGENCY]'s [prompt corrective action regulation] -- 12 CFR part 6 (for national banks), 12 CFR part 208, subpart D (for state member banks or bank holding companies), 12 CFR part 325, subpart B (for state nonmember banks), and 12 CFR part 165 (for savings associations)]. For purposes of determining whether a [BANK] is well capitalized for purposes of this paragraph, the [BANK]'s capital ratios must be calculated without regard to the capital treatment for transfers of small-business obligations with recourse specified in §___.142(k)(1).

(2) The total outstanding amount of recourse retained by a [BANK] on transfers of small-business obligations receiving the capital treatment specified in §___.142(k)(1) cannot exceed 15 percent of the [BANK]'s total capital.

(3) If a [BANK] ceases to be well capitalized or exceeds the 15 percent capital limitation, the preferential capital treatment specified in §___.142(k)(1) will continue to apply to any transfers of small-business obligations with recourse that occurred during the time that the [BANK] was well capitalized and did not exceed the capital limit.

(4) The risk-based capital ratios of the [BANK] must be calculated without regard to the capital treatment for transfers of small-business obligations with recourse specified in §___.142(k)(1) .

(l) N^{th}-to-default credit derivatives. (1) Protection provider. A [BANK] must determine a risk weight using the SFA or the SSFA for an nth-to-default credit derivative in accordance with this paragraph. In the case of credit protection sold, a [BANK] must determine its exposure in the nth-to-default credit derivative as the largest notional dollar amount of all the underlying exposures

(2) For purposes of determining the risk weight for an nth-to-default credit derivative using the SFA or the SSFA, the [BANK] must calculate the attachment point and detachment point of its exposure as follows:

(i) The attachment point (parameter A) is the ratio of the sum of the notional amounts of all underlying exposures that are subordinated to the [BANK]'s exposure to the total notional amount of all underlying exposures. For purposes of using the SFA to calculate the risk weight for its exposure in an nth-to-default credit derivative, parameter A must be set equal to the credit enhancement level (L) input to the SFA formula. In the case of a first-to-default credit derivative, there are no underlying exposures that are subordinated to the [BANK]'s exposure. In the case of a second-or-subsequent-to-default credit derivative, the smallest (n-1) risk-weighted asset amounts of the underlying exposure(s) are subordinated to the [BANK]'s exposure.

(ii) The detachment point (parameter D) equals the sum of parameter A plus the ratio of the notional amount of the [BANK]'s exposure in the nth-to-default credit derivative to the total notional amount of all underlying exposures. For purposes of using the SFA to calculate the risk weight for its exposure in an nth-to-default credit derivative, parameter D must be set to equal L plus the thickness of tranche T input to the SFA formula.

(3) A [BANK] that does not use the SFA or the SSFA to determine a risk weight for its exposure in an nth-to-default credit derivative must assign a risk weight of 1,250 percent to the exposure.

(4) Protection purchaser. (i) First-to-default credit derivatives. A [BANK] that obtains credit protection on a group of underlying exposures through a first-to-default credit derivative that meets the rules of recognition of §___.134(b) must determine its risk-based capital requirement for the underlying exposures as if the [BANK] synthetically securitized the underlying exposure with the lowest risk-based capital requirement and had obtained no credit risk mitigant on the other underlying exposures. A [BANK] must calculate a risk-based capital requirement for counterparty credit risk according to §___.132 for a first-to-default credit derivative that does not meet the rules of recognition of §___.134(b).

(ii) Second-or-subsequent-to-default credit derivatives. (A) A [BANK] that obtains credit protection on a group of underlying exposures through a nth -to-default credit derivative that meets the rules of recognition of §___.134(b) (other than a first-to-default credit derivative) may recognize the credit risk mitigation benefits of the derivative only if:

(1) The [BANK] also has obtained credit protection on the same underlying exposures in the form of first-through-(n-1)-to-default credit derivatives; or

(2) If n-1 of the underlying exposures have already defaulted.

(B) If a [BANK] satisfies the requirements of paragraph (l)(3)(ii)(A) of this section, the [BANK] must determine its risk-based capital requirement for the underlying exposures as if the bank had only synthetically securitized the underlying exposure with the nth lowest risk-based capital requirement and had obtained no credit risk mitigant on the other underlying exposures.

(C) A [BANK] must calculate a risk-based capital requirement for counterparty credit risk according to §___.132 for a nth-to-default credit derivative that does not meet the rules of recognition of §___.134(b).

(m) Guarantees and credit derivatives other than N-th to default credit derivatives. (1) Protection provider. For a guarantee or credit derivative (other than an n^{th}-to-default credit derivative) provided by a [BANK] that covers the full amount or a pro rata share of a securitization exposure's principal and interest, the [BANK] must risk weight the guarantee or credit derivative as if it holds the portion of the reference exposure covered by the guarantee or credit derivative.

(2) Protection purchaser. (i) If a [BANK] chooses (and is able) to recognize a guarantee or credit derivative (other than an n^{th}-to-default credit derivative) that references a securitization exposure as a credit risk mitigant, where applicable, the [BANK] must apply §___.145.

(ii) If a [BANK] cannot, or chooses not to, recognize a credit derivative that references a securitization exposure as a credit risk mitigant under §___.145 of this appendix, the [BANK] must determine its capital requirement only for counterparty credit risk in accordance with §___.131.

§___.143 Supervisory Formula Approach (SFA)

(a) Eligibility requirements. A [BANK] must use the SFA to determine its risk-weighted asset amount for a securitization exposure if the [BANK] can calculate on an ongoing basis each of the SFA parameters in §___.143(e).

(b) Mechanics. The risk-weighted asset amount for the securitization exposure equals the SFA risk-based capital requirement for the exposure multiplied by 12.5.

(c) The SFA risk-based capital requirement. (1) If K_{IRB} is greater than or equal to L+T, the capital requirement equals the exposure amount.

(2) If K_{IRB} is less than or equal to L, the exposure's SFA risk-based capital requirement is UE multiplied by TP multiplied by the greater of:

(i) F x T (where F is 0.016 for all securitization exposures); or

(ii) S[L + +T] – S[L].

(3) If K_{IRB} is greater than L and less than L +T, the [BANK] must apply a 1,250 percent risk weight to an amount equal to UE *TP *(K_{IRB} – L), and the exposure's SFA risk-based capital requirement is UE multiplied by TP multiplied by the greater of:

(i) F x (T – (K_{IRB} – L) (where F is 0.016for all other securitization exposures); or

(ii) S[L + +T] – S[K_{IRB}].

(d) The supervisory formula:

(1) $$S[Y] = \begin{cases} Y & when\ Y \le K_{IRB} \\ K_{IRB} + K[Y] - K[K_{IRB}] + \dfrac{d \cdot K_{IRB}}{20}\left(1 - e^{\frac{20 \cdot (K_{IRB} - Y)}{K_{IRB}}}\right) & when\ Y > K_{IRB} \end{cases}$$

(2) $$K[Y] = (1-h) \cdot \left[(1 - \beta[Y; a, b]) \cdot Y + \beta[Y; a+1, b] \cdot c\right]$$

(3) $$h = \left(1 - \frac{K_{IRB}}{EWALGD}\right)^N$$

(4) $$a = g \cdot c$$

(5) $$b = g \cdot (1 - c)$$

(6) $$c = \frac{K_{IRB}}{1 - h}$$

(7) $$g = \frac{(1 - c) \cdot c}{f} - 1$$

(8) $$f = \frac{v + K_{IRB}^{\ 2}}{1-h} - c^2 + \frac{(1 - K_{IRB}) \cdot K_{IRB} - v}{(1-h) \cdot 1000}$$

(9) $$v = K_{IRB} \cdot \frac{(EWALGD\ - K_{IRB}) + .25 \cdot (1 - EWALGD)}{N}$$

(10) $$d = 1 - (1-h) \cdot (1 - \beta[K_{IRB}; a, b])\ .$$

(11) In these expressions, β [Y; a, b] refers to the cumulative beta distribution with parameters a and b evaluated at Y. In the case where N = 1 and EWALGD = 100 percent, S[Y] in formula (1) must be calculated with K[Y] set equal to the product of K_{IRB} and Y, and d set equal to 1 - K_{IRB}.

(e) SFA parameters. (1) Amount of the underlying exposures (UE). UE is the EAD of any underlying exposures that are wholesale and retail exposures (including the amount of any funded spread accounts, cash collateral accounts, and other similar funded credit enhancements)

plus the amount of any underlying exposures that are securitization exposures (as defined in §___.142(e)) plus the adjusted carrying value of any underlying exposures that are equity exposures (as defined in §___.151(b)).

(2) Tranche percentage (TP). TP is the ratio of the amount of the [BANK]'s securitization exposure to the amount of the tranche that contains the securitization exposure.

(3) Capital requirement on underlying exposures (K_{IRB}).

(i) K_{IRB} is the ratio of:

(A) The sum of the risk-based capital requirements for the underlying exposures plus the expected credit losses of the underlying exposures (as determined under this subpart E as if the underlying exposures were directly held by the [BANK]); to

(B) UE.

(ii) The calculation of K_{IRB} must reflect the effects of any credit risk mitigant applied to the underlying exposures (either to an individual underlying exposure, to a group of underlying exposures, or to the entire pool of underlying exposures).

(iii) All assets related to the securitization are treated as underlying exposures, including assets in a reserve account (such as a cash collateral account).

(4) Credit enhancement level (L). (i) L is the ratio of:

(A) The amount of all securitization exposures subordinated to the tranche that contains the [BANK]'s securitization exposure; to

(B) UE.

(ii) A [BANK] must determine L before considering the effects of any tranche-specific credit enhancements.

(iii) Any gain-on-sale or CEIO associated with the securitization may not be included in L.

(iv) Any reserve account funded by accumulated cash flows from the underlying exposures that is subordinated to the tranche that contains the [BANK]'s securitization exposure may be included in the numerator and denominator of L to the extent cash has accumulated in the account. Unfunded reserve accounts (that is, reserve accounts that are to be funded from future cash flows from the underlying exposures) may not be included in the calculation of L.

(v) In some cases, the purchase price of receivables will reflect a discount that provides credit enhancement (for example, first loss protection) for all or certain tranches of the securitization. When this arises, L should be calculated inclusive of this discount if the discount provides credit enhancement for the securitization exposure.

(5) Thickness of tranche (T). T is the ratio of:

(i) The amount of the tranche that contains the [BANK]'s securitization exposure; to

(ii) UE.

(6) Effective number of exposures (N). (i) Unless the [BANK] elects to use the formula provided in §___.143(f),

$$N = \frac{(\sum_i EAD_i)^2}{\sum_i EAD_i^2}$$

where EAD_i represents the EAD associated with the i^{th} instrument in the pool of underlying exposures.

(ii) Multiple exposures to one obligor must be treated as a single underlying exposure.

(iii) In the case of a re-securitization, the [BANK] must treat each underlying exposure as a single underlying exposure and must not look through to the originally securitized underlying exposures.

(7) Exposure-weighted average loss given default (EWALGD). EWALGD is calculated as:

$$EWALGD = \frac{\sum_i LGD_i \cdot EAD_i}{\sum_i EAD_i}$$

where LGD_i represents the average LGD associated with all exposures to the i^{th} obligor. In the case of a re-securitization, an LGD of 100 percent must be assumed for the underlying exposures that are themselves securitization exposures.

(f) Simplified method for computing N and EWALGD. (1) If all underlying exposures of a securitization are retail exposures, a [BANK] may apply the SFA using the following simplifications:

(i) h = 0; and

(ii) v = 0.

(2) Under the conditions in sections 143(f)(3) and (f)(4), a [BANK] may employ a simplified method for calculating N and EWALGD.

(3) If C_1 is no more than 0.03, a [BANK] may set EWALGD = 0.50 if none of the underlying exposures is a securitization exposure, or may set EWALGD = 1 if one or more of the underlying exposures is a securitization exposure, and may set N equal to the following amount:

$$N = \frac{1}{C_1 C_m + \left(\frac{C_m - C_1}{m-1}\right)\max(1 - mC_1, 0)}$$

where:

(i) C_m is the ratio of the sum of the amounts of the 'm' largest underlying exposures to UE; and

(ii) The level of m is to be selected by the [BANK].

(4) Alternatively, if only C_1 is available and C_1 is no more than 0.03, the [BANK] may set EWALGD = 0.50 if none of the underlying exposures is a securitization exposure, or may set EWALGD = 1 if one or more of the underlying exposures is a securitization exposure and may set $N = 1/C_1$.

§___.144 Simplified Supervisory Formula Approach (SSFA)

(a) General requirements. To use the SSFA to determine the risk weight for a securitization exposure, a [BANK] must have data that enables it to assign accurately the parameters described in §___.144(b). Data used to assign the parameters described in §___.144(b) must be the most currently available data and no more than 91 calendar days old. A [BANK] that does not have the appropriate data to assign the parameters described in §___.144(b) must assign a risk weight of 1,250 percent to the exposure.

(b) SSFA parameters. To calculate the risk weight for a securitization exposure using the SSFA, a [BANK] must have accurate information on the five inputs to the SSFA calculation described and defined, for purposes of this section, in §§___.144(b)(1) through (b)(5):

(1) K_G is the weighted-average (with unpaid principal used as the weight for each exposure) total capital requirement of the underlying exposures calculated using this subpart. K_G is expressed as a decimal value between zero and 1 (that is, an average risk weight of 100 percent represents a value of K_G equal to .08).

(2) Parameter W is expressed as a decimal value between zero and one. Parameter W is the ratio of the sum of the dollar amounts of any underlying exposures within the securitized pool that meet any of the criteria as set forth in paragraphs (i) through (vi) of §___.144(b)(2) to the ending balance, measured in dollars, of underlying exposures.

(i) Ninety days or more past due;

(ii) Subject to a bankruptcy or insolvency proceeding;

(iii) In the process of foreclosure;

(iv) Held as real estate owned;

(v) Has contractually deferred interest payments for 90 days or more; or

(vi) Is in default.

(3) Parameter A is the attachment point for the exposure, which represents the threshold at which credit losses will first be allocated to the exposure. Parameter A equals the ratio of the current dollar amount of underlying exposures that are subordinated to the exposure of the [BANK] to the current dollar amount of underlying exposures. Any reserve account funded by the accumulated cash flows from the underlying exposures that is subordinated to the [BANK]'s securitization exposure may be included in the calculation of parameter A to the extent that cash is present in the account. Parameter A is expressed as a decimal value between zero and one.

(4) Parameter D is the detachment point for the exposure, which represents the threshold at which credit losses of principal allocated to the exposure would result in a total loss of principal. Parameter D equals parameter A plus the ratio of the current dollar amount of the securitization exposures that are pari passu with the exposure (that is, have equal seniority with respect to credit risk) to the current dollar amount of the underlying exposures. Parameter D is expressed as a decimal value between zero and one.

(5) A supervisory calibration parameter, p, is equal to 0.5 for securitization exposures that are not resecuritization exposures and equal to 1.5 for resecuritization exposures.

(c) Mechanics of the SSFA. K_G and W are used to calculate K_A, the augmented value of K_G, which reflects the observed credit quality of the underlying pool of exposures. K_A is defined in paragraph (d) of this section. The values of parameters A and D, relative to K_A determine the risk weight assigned to a securitization exposure as described in paragraph (d) of this section. The risk weight assigned to a securitization exposure, or portion of an exposure, as appropriate, is the larger of the risk weight determined in accordance with this paragraph and paragraph (d) of this section and a risk weight of 20 percent.

(1) When the detachment point, parameter D, for a securitization exposure is less than or equal to K_A, the exposure must be assigned a risk weight of 1,250 percent.

(2) When the attachment point, parameter A, for a securitization exposure is greater than or equal to K_A, the [BANK] must calculate the risk weight in accordance with paragraph (d) of this section.

(3) When A is less than K_A and D is greater than K_A, the risk weight is a weighted-average of 1,250 percent and 1,250 percent times K_{SSFA} calculated in accordance with paragraph (d) of this section, but with the parameter A revised to be set equal to K_A. For the purpose of this weighted-average calculation:

(i) The weight assigned to 1,250 percent equals $\frac{K_A - A}{D - A}$.

(ii) The weight assigned to 1,250 percent times K_{SSFA} equals $\frac{D - K_A}{D - A}$. The risk weight will be set equal to:

$$Risk\ Weight =$$

$$\left[\left(\frac{K_A - A}{D - A}\right) \times 1{,}250\ percent\right] + \left[\left(\frac{D - K_A}{D - A}\right) \times 1{,}250\ percent \times K_{SSFA}\right]$$

(d) SSFA equation. (1) The [BANK] must define the following parameters:

$$K_A = (1 - W) \cdot K_G + (.5 \cdot W)$$

$a = -\frac{1}{p \cdot K_A}$
$u = D - K_A$
$l = A - K_A$
$e = 2.71828$, the base of the natural logarithms.
(2) Then the [BANK] must calculate K_{SSFA} according to the following equation:
$K_{SSFA} = \frac{e^{a \cdot u} - e^{a \cdot l}}{a(u-l)}$

(3) The risk weight for the exposure (expressed as a percent) is equal to $K_{SSFA} \times 1{,}250$.

§___.145 Recognition of Credit Risk Mitigants for Securitization Exposures.

(a) General. An originating [BANK] that has obtained a credit risk mitigant to hedge its securitization exposure to a synthetic or traditional securitization that satisfies the operational criteria in §___.141 may recognize the credit risk mitigant, but only as provided in this section. An investing [BANK] that has obtained a credit risk mitigant to hedge a securitization exposure may recognize the credit risk mitigant, but only as provided in this section.

(b) Collateral. (1) Rules of recognition. A [BANK] may recognize financial collateral in determining the [BANK]'s risk-weighted asset amount for a securitization exposure (other than a repo-style transaction, an eligible margin loan, or an OTC derivative contract for which the [BANK] has reflected collateral in its determination of exposure amount under §___.132) as follows. The [BANK]'s risk-weighted asset amount for the collateralized securitization exposure is equal to the risk-weighted asset amount for the securitization exposure as calculated under the SSFA in §___.144 or under the SFA in §___.143 multiplied by the ratio of adjusted exposure amount (SE*) to original exposure amount (SE), where:

(i) SE* = max {0, [SE - C x (1 - Hs - Hfx)]};

(ii) SE = the amount of the securitization exposure calculated under §___.142(e);

(iii) C = the current market value of the collateral;

(iv) Hs = the haircut appropriate to the collateral type; and

(v) Hfx = the haircut appropriate for any currency mismatch between the collateral and the exposure.

(2) Mixed collateral. Where the collateral is a basket of different asset types or a basket of assets denominated in different currencies, the haircut on the basket will be $H = \sum_i a_i H_i$, where a_i is the current market value of the asset in the basket divided by the current market value of all assets in the basket and H_i is the haircut applicable to that asset.

(3) Standard supervisory haircuts. Unless a [BANK] qualifies for use of and uses own-estimates haircuts in §___.145(b)(4):

(i) A [BANK] must use the collateral type haircuts (Hs) in Table 2;

(ii) A [BANK] must use a currency mismatch haircut (Hfx) of 8 percent if the exposure and the collateral are denominated in different currencies;

(iii) A [BANK] must multiply the supervisory haircuts obtained in sections 145 (b)(3)(i) and (ii) by the square root of 6.5 (which equals 2.549510); and

(iv) A [BANK] must adjust the supervisory haircuts upward on the basis of a holding period longer than 65 business days where and as appropriate to take into account the illiquidity of the collateral.

(4) Own estimates for haircuts. With the prior written approval of the [AGENCY], a [BANK] may calculate haircuts using its own internal estimates of market price volatility and foreign exchange volatility, subject to §___.132(b)(2)(iii). The minimum holding period (T_M) for securitization exposures is 65 business days.

(c) Guarantees and credit derivatives. (1) Limitations on recognition. A [BANK] may only recognize an eligible guarantee or eligible credit derivative provided by an eligible guarantor in determining the [BANK]'s risk-weighted asset amount for a securitization exposure.

(2) ECL for securitization exposures. When a [BANK] recognizes an eligible guarantee or eligible credit derivative provided by an eligible guarantor in determining the [BANK]'s risk-weighted asset amount for a securitization exposure, the [BANK] must also:

(i) Calculate ECL for the protected portion of the exposure using the same risk parameters that it uses for calculating the risk-weighted asset amount of the exposure as described in §___.145(c)(3); and

(ii) Add the exposure's ECL to the [BANK]'s total ECL.

(3) Rules of recognition. A [BANK] may recognize an eligible guarantee or eligible credit derivative provided by an eligible guarantor in determining the [BANK]'s risk-weighted asset amount for the securitization exposure as follows:

(i) Full coverage. If the protection amount of the eligible guarantee or eligible credit derivative equals or exceeds the amount of the securitization exposure, the [BANK] may set the risk-weighted asset amount for the securitization exposure equal to the risk-weighted asset amount for a direct exposure to the eligible guarantor (as determined in the wholesale risk weight

function described in §___.131), using the [BANK]'s PD for the guarantor, the [BANK]'s LGD for the guarantee or credit derivative, and an EAD equal to the amount of the securitization exposure (as determined in §___.142(e)).

(ii) Partial coverage. If the protection amount of the eligible guarantee or eligible credit derivative is less than the amount of the securitization exposure, the [BANK] may set the risk-weighted asset amount for the securitization exposure equal to the sum of:

(A) Covered portion. The risk-weighted asset amount for a direct exposure to the eligible guarantor (as determined in the wholesale risk weight function described in §___.131 of this subpart), using the [BANK]'s PD for the guarantor, the [BANK]'s LGD for the guarantee or credit derivative, and an EAD equal to the protection amount of the credit risk mitigant; and

(B) Uncovered portion. (1) 1.0 minus the ratio of the protection amount of the eligible guarantee or eligible credit derivative to the amount of the securitization exposure); multiplied by

(2) The risk-weighted asset amount for the securitization exposure without the credit risk mitigant (as determined in sections 142 through 146 of this subpart).

(4) Mismatches. The [BANK] must make applicable adjustments to the protection amount as required in sections 134(d), (e), and (f) of this subpart for any hedged securitization exposure and any more senior securitization exposure that benefits from the hedge. In the context of a synthetic securitization, when an eligible guarantee or eligible credit derivative covers multiple hedged exposures that have different residual maturities, the [BANK] must use the longest residual maturity of any of the hedged exposures as the residual maturity of all the hedged exposures.

RISK-WEIGHTED ASSETS FOR EQUITY EXPOSURES

§___.151 Introduction and Exposure Measurement.

(a) General. To calculate its risk-weighted asset amounts for equity exposures that are not equity exposures to investment funds, a [BANK] may apply either the Simple Risk Weight Approach (SRWA) in §___.152 or, if it qualifies to do so, the Internal Models Approach (IMA) in §___.153. A [BANK] must use the look-through approaches in §___.154 to calculate its risk-weighted asset amounts for equity exposures to investment funds.

(b) Adjusted carrying value. For purposes of this [PART], the adjusted carrying value of an equity exposure is:

(1) For the on-balance sheet component of an equity exposure, the [BANK]'s carrying value of the exposure; and

(2) For the off-balance sheet component of an equity exposure, the effective notional principal amount of the exposure, the size of which is equivalent to a hypothetical on-balance sheet position in the underlying equity instrument that would evidence the same change in fair value (measured in dollars) for a given small change in the price of the underlying equity

instrument, minus the adjusted carrying value of the on-balance sheet component of the exposure as calculated in paragraph (b)(1) of this section. For unfunded equity commitments that are unconditional, the effective notional principal amount is the notional amount of the commitment. For unfunded equity commitments that are conditional, the effective notional principal amount is the [BANK]'s best estimate of the amount that would be funded under economic downturn conditions.

§___.152 Simple Risk Weight Approach (SRWA).

(a) General. Under the SRWA, a [BANK]'s aggregate risk-weighted asset amount for its equity exposures is equal to the sum of the risk-weighted asset amounts for each of the [BANK]'s individual equity exposures (other than equity exposures to an investment fund) as determined in this section and the risk-weighted asset amounts for each of the [BANK]'s individual equity exposures to an investment fund as determined in §___.154.

(b) SRWA computation for individual equity exposures. A [BANK] must determine the risk-weighted asset amount for an individual equity exposure (other than an equity exposure to an investment fund) by multiplying the adjusted carrying value of the equity exposure or the effective portion and ineffective portion of a hedge pair (as defined in §___.152(c)) by the lowest applicable risk weight in this section.

(1) Zero percent risk weight equity exposures. An equity exposure to an entity whose credit exposures are exempt from the 0.03 percent PD floor in §___.131(d)(2) is assigned a zero percent risk weight.

(2) 20 percent risk weight equity exposures. An equity exposure to a Federal Home Loan Bank or the Federal Agricultural Mortgage Corporation (Farmer Mac) is assigned a 20 percent risk weight.

(3) 100 percent risk weight equity exposures. The following equity exposures are assigned a 100 percent risk weight:

(i) Community development equity exposures. An equity exposure that qualifies as a community development investment under section 24 (Eleventh) of the National Bank Act, excluding equity exposures to an unconsolidated small business investment company and equity exposures held through a consolidated small business investment company described in section 302 of the Small Business Investment Act.

(ii) Effective portion of hedge pairs. The effective portion of a hedge pair.

(iii) Non-significant equity exposures. Equity exposures, excluding exposures to an investment firm that would meet the definition of a traditional securitization were it not for the [AGENCY]'s application of paragraph (8) of that definition and has greater than immaterial leverage, to the extent that the aggregate adjusted carrying value of the exposures does not exceed 10 percent of the [BANK]'s total capital.

(A) To compute the aggregate adjusted carrying value of a [BANK]'s equity exposures for purposes of this section, the [BANK] may exclude equity exposures described in sections

152(b)(1), (b)(2), (b)(3)(i), and (b)(3)(ii), the equity exposure in a hedge pair with the smaller adjusted carrying value, and a proportion of each equity exposure to an investment fund equal to the proportion of the assets of the investment fund that are not equity exposures or that meet the criterion of §___.152(b)(3)(i). If a [BANK] does not know the actual holdings of the investment fund, the [BANK] may calculate the proportion of the assets of the fund that are not equity exposures based on the terms of the prospectus, partnership agreement, or similar contract that defines the fund's permissible investments. If the sum of the investment limits for all exposure classes within the fund exceeds 100 percent, the [BANK] must assume for purposes of this section that the investment fund invests to the maximum extent possible in equity exposures.

(B) When determining which of a [BANK]'s equity exposures qualify for a 100 percent risk weight under this section, a [BANK] first must include equity exposures to unconsolidated small business investment companies or held through consolidated small business investment companies described in section 302 of the Small Business Investment Act, then must include publicly-traded equity exposures (including those held indirectly through investment funds), and then must include non-publicly-traded equity exposures (including those held indirectly through investment funds).

(4) 250 percent risk weight equity exposures. Significant investments in the capital of unconsolidated financial institutions that are not deducted from capital pursuant to §___.22(b)(4) are assigned a 250 percent risk weight.

(5) 300 percent risk weight equity exposures. A publicly-traded equity exposure (other than an equity exposure described in §___.152(b)(6) and including the ineffective portion of a hedge pair) is assigned a 300 percent risk weight.

(6) 400 percent risk weight equity exposures. An equity exposure (other than an equity exposure described in §___.152(b)(6)) that is not publicly-traded is assigned a 400 percent risk weight.

(7) 600 percent risk weight equity exposures. An equity exposure to an investment firm that:

(i) Would meet the definition of a traditional securitization were it not for the [AGENCY]'s application of paragraph (8) of that definition; and

(ii) Has greater than immaterial leverage is assigned a 600 percent risk weight.

(c) Hedge transactions. (1) Hedge pair. A hedge pair is two equity exposures that form an effective hedge so long as each equity exposure is publicly-traded or has a return that is primarily based on a publicly-traded equity exposure.

(2) Effective hedge. Two equity exposures form an effective hedge if the exposures either have the same remaining maturity or each has a remaining maturity of at least three months; the hedge relationship is formally documented in a prospective manner (that is, before the [BANK] acquires at least one of the equity exposures); the documentation specifies the measure of effectiveness (E) the [BANK] will use for the hedge relationship throughout the life

of the transaction; and the hedge relationship has an E greater than or equal to 0.8. A [BANK] must measure E at least quarterly and must use one of three alternative measures of E:

(i) Under the dollar-offset method of measuring effectiveness, the [BANK] must determine the ratio of value change (RVC). The RVC is the ratio of the cumulative sum of the periodic changes in value of one equity exposure to the cumulative sum of the periodic changes in the value of the other equity exposure. If RVC is positive, the hedge is not effective and E equals zero. If RVC is negative and greater than or equal to -1 (that is, between zero and -1), then E equals the absolute value of RVC. If RVC is negative and less than -1, then E equals 2 plus RVC.

(ii) Under the variability-reduction method of measuring effectiveness:

$$E = 1 - \frac{\sum_{t=1}^{T} \left(X_t - X_{t-1} \right)^2}{\sum_{t=1}^{T} \left(A_t - A_{t-1} \right)^2}, \text{ where}$$

(A) $X_t = A_t - B_t$;

(B) $A_t =$ the value at time t of one exposure in a hedge pair; and

(C) $B_t =$ the value at time t of the other exposure in a hedge pair.

(iii) Under the regression method of measuring effectiveness, E equals the coefficient of determination of a regression in which the change in value of one exposure in a hedge pair is the dependent variable and the change in value of the other exposure in a hedge pair is the independent variable. However, if the estimated regression coefficient is positive, then the value of E is zero.

(3) The effective portion of a hedge pair is E multiplied by the greater of the adjusted carrying values of the equity exposures forming a hedge pair.

(4) The ineffective portion of a hedge pair is (1-E) multiplied by the greater of the adjusted carrying values of the equity exposures forming a hedge pair.

§___.153 Internal Models Approach (IMA).

(a) General. A [BANK] may calculate its risk-weighted asset amount for equity exposures using the IMA by modeling publicly-traded and non-publicly-traded equity exposures (in accordance with §___.153(c)) or by modeling only publicly-traded equity exposures (in accordance with §___.153(c)(d)).

(b) Qualifying criteria. To qualify to use the IMA to calculate risk-weighted assets for equity exposures, a [BANK] must receive prior written approval from the [AGENCY]. To

receive such approval, the [BANK] must demonstrate to the [AGENCY]'s satisfaction that the [BANK] meets the following criteria:

(1) The [BANK] must have one or more models that:

(i) Assess the potential decline in value of its modeled equity exposures;

(ii) Are commensurate with the size, complexity, and composition of the [BANK]'s modeled equity exposures; and

(iii) Adequately capture both general market risk and idiosyncratic risk.

(2) The [BANK]'s model must produce an estimate of potential losses for its modeled equity exposures that is no less than the estimate of potential losses produced by a VaR methodology employing a 99.0 percent, one-tailed confidence interval of the distribution of quarterly returns for a benchmark portfolio of equity exposures comparable to the [BANK]'s modeled equity exposures using a long-term sample period.

(3) The number of risk factors and exposures in the sample and the data period used for quantification in the [BANK]'s model and benchmarking exercise must be sufficient to provide confidence in the accuracy and robustness of the [BANK]'s estimates.

(4) The [BANK]'s model and benchmarking process must incorporate data that are relevant in representing the risk profile of the [BANK]'s modeled equity exposures, and must include data from at least one equity market cycle containing adverse market movements relevant to the risk profile of the [BANK]'s modeled equity exposures. In addition, the [BANK]'s benchmarking exercise must be based on daily market prices for the benchmark portfolio. If the [BANK]'s model uses a scenario methodology, the [BANK] must demonstrate that the model produces a conservative estimate of potential losses on the [BANK]'s modeled equity exposures over a relevant long-term market cycle. If the [BANK] employs risk factor models, the [BANK] must demonstrate through empirical analysis the appropriateness of the risk factors used.

(5) The [BANK] must be able to demonstrate, using theoretical arguments and empirical evidence, that any proxies used in the modeling process are comparable to the [BANK]'s modeled equity exposures and that the [BANK] has made appropriate adjustments for differences. The [BANK] must derive any proxies for its modeled equity exposures and benchmark portfolio using historical market data that are relevant to the [BANK]'s modeled equity exposures and benchmark portfolio (or, where not, must use appropriately adjusted data), and such proxies must be robust estimates of the risk of the [BANK]'s modeled equity exposures.

(c) Risk-weighted assets calculation for a [BANK] modeling publicly-traded and non-publicly-traded equity exposures. If a [BANK] models publicly-traded and non-publicly-traded equity exposures, the [BANK]'s aggregate risk-weighted asset amount for its equity exposures is equal to the sum of:

(1) The risk-weighted asset amount of each equity exposure that qualifies for a 0 percent, 20 percent, or 100 percent risk weight under §§___.152(b)(1) through (b)(3)(i) (as determined under §___.152) and each equity exposure to an investment fund (as determined under §___.154); and

(2) The greater of:

(i) The estimate of potential losses on the [BANK]'s equity exposures (other than equity exposures referenced in §___.153(c)(1) of this section) generated by the [BANK]'s internal equity exposure model multiplied by 12.5; or

(ii) The sum of:

(A) 200 percent multiplied by the aggregate adjusted carrying value of the [BANK]'s publicly-traded equity exposures that do not belong to a hedge pair, do not qualify for a 0 percent, 20 percent, or 100 percent risk weight under §§___.152(b)(1) through (b)(3)(i), and are not equity exposures to an investment fund;

(B) 200 percent multiplied by the aggregate ineffective portion of all hedge pairs; and

(C) 300 percent multiplied by the aggregate adjusted carrying value of the [BANK]'s equity exposures that are not publicly-traded, do not qualify for a 0 percent, 20 percent, or 100 percent risk weight under §§___.152(b)(1) through (b)(3)(i), and are not equity exposures to an investment fund.

(d) Risk-weighted assets calculation for a [BANK] using the IMA only for publicly-traded equity exposures. If a [BANK] models only publicly-traded equity exposures, the [BANK]'s aggregate risk-weighted asset amount for its equity exposures is equal to the sum of:

(1) The risk-weighted asset amount of each equity exposure that qualifies for a 0 percent, 20 percent, or 100 percent risk weight under §§___.152(b)(1) through (b)(3)(i) (as determined under §___.152), each equity exposure that qualifies for a 400 percent risk weight under §___.152(b)(5) or a 600 percent risk weight under §___.152(b)(6) (as determined under §___.152), and each equity exposure to an investment fund (as determined under §___.154); and

(2) The greater of:

(i) The estimate of potential losses on the [BANK]'s equity exposures (other than equity exposures referenced in §___.153(d)(1)) generated by the [BANK]'s internal equity exposure model multiplied by 12.5; or

(ii) The sum of:

(A) 200 percent multiplied by the aggregate adjusted carrying value of the [BANK]'s publicly-traded equity exposures that do not belong to a hedge pair, do not qualify for a 0 percent, 20 percent, or 100 percent risk weight under §§___.152(b)(1) through (b)(3)(i), and are not equity exposures to an investment fund; and

(B) 200 percent multiplied by the aggregate ineffective portion of all hedge pairs.

§___.154 Equity Exposures to Investment Funds.

(a) Available approaches. (1) Unless the exposure meets the requirements for a community development equity exposure in §___.152(b)(3)(i), a [BANK] must determine the risk-weighted asset amount of an equity exposure to an investment fund under the Full Look-Through Approach in §___.154(b), the Simple Modified Look-Through Approach in §___.154(c), or the Alternative Modified Look-Through Approach in §___.154(d).

(2) The risk-weighted asset amount of an equity exposure to an investment fund that meets the requirements for a community development equity exposure in §___.152(b)(3)(i) is its adjusted carrying value.

(3) If an equity exposure to an investment fund is part of a hedge pair and the [BANK] does not use the Full Look-Through Approach, the [BANK] may use the ineffective portion of the hedge pair as determined under §___.152(c) as the adjusted carrying value for the equity exposure to the investment fund. The risk-weighted asset amount of the effective portion of the hedge pair is equal to its adjusted carrying value.

(b) Full Look-Through Approach. A [BANK] that is able to calculate a risk-weighted asset amount for its proportional ownership share of each exposure held by the investment fund (as calculated under this subpart E as if the proportional ownership share of each exposure were held directly by the [BANK]) may either:

(1) Set the risk-weighted asset amount of the [BANK]'s exposure to the fund equal to the product of:

(i) The aggregate risk-weighted asset amounts of the exposures held by the fund as if they were held directly by the [BANK]; and

(ii) The [BANK]'s proportional ownership share of the fund; or

(2) Include the [BANK]'s proportional ownership share of each exposure held by the fund in the [BANK]'s IMA.

(c) Simple Modified Look-Through Approach. Under this approach, the risk-weighted asset amount for a [BANK]'s equity exposure to an investment fund equals the adjusted carrying value of the equity exposure multiplied by the highest risk weight assigned according to subpart D that applies to any exposure the fund is permitted to hold under its prospectus, partnership agreement, or similar contract that defines the fund's permissible investments (excluding derivative contracts that are used for hedging rather than speculative purposes and that do not constitute a material portion of the fund's exposures).

(d) Alternative Modified Look-Through Approach. Under this approach, a [BANK] may assign the adjusted carrying value of an equity exposure to an investment fund on a pro rata basis to different risk weight categories assigned according to subpart D based on the investment limits in the fund's prospectus, partnership agreement, or similar contract that defines the fund's

permissible investments. The risk-weighted asset amount for the [BANK]'s equity exposure to the investment fund equals the sum of each portion of the adjusted carrying value assigned to an exposure class multiplied by the applicable risk weight. If the sum of the investment limits for all exposure types within the fund exceeds 100 percent, the [BANK] must assume that the fund invests to the maximum extent permitted under its investment limits in the exposure type with the highest risk weight under subpart D, and continues to make investments in order of the exposure type with the next highest risk weight under subpart D until the maximum total investment level is reached. If more than one exposure type applies to an exposure, the [BANK] must use the highest applicable risk weight. A [BANK] may exclude derivative contracts held by the fund that are used for hedging rather than for speculative purposes and do not constitute a material portion of the fund's exposures.

§___.155 Equity Derivative Contracts.

(a) Under the IMA, in addition to holding risk-based capital against an equity derivative contract under this [PART], a [BANK] must hold risk-based capital against the counterparty credit risk in the equity derivative contract by also treating the equity derivative contract as a wholesale exposure and computing a supplemental risk-weighted asset amount for the contract under §___.132.

(b) Under the SRWA, a [BANK] may choose not to hold risk-based capital against the counterparty credit risk of equity derivative contracts, as long as it does so for all such contracts. Where the equity derivative contracts are subject to a qualified master netting agreement, a [BANK] using the SRWA must either include all or exclude all of the contracts from any measure used to determine counterparty credit risk exposure.

RISK-WEIGHTED ASSETS FOR OPERATIONAL RISK

§___.161 Qualification Requirements for Incorporation of Operational Risk Mitigants

(a) Qualification to use operational risk mitigants. A [BANK] may adjust its estimate of operational risk exposure to reflect qualifying operational risk mitigants if:

(1) The [BANK]'s operational risk quantification system is able to generate an estimate of the [BANK]'s operational risk exposure (which does not incorporate qualifying operational risk mitigants) and an estimate of the [BANK]'s operational risk exposure adjusted to incorporate qualifying operational risk mitigants; and

(2) The [BANK]'s methodology for incorporating the effects of insurance, if the [BANK] uses insurance as an operational risk mitigant, captures through appropriate discounts to the amount of risk mitigation:

(i) The residual term of the policy, where less than one year;

(ii) The cancellation terms of the policy, where less than one year;

(iii) The policy's timeliness of payment;

(iv) The uncertainty of payment by the provider of the policy; and

(v) Mismatches in coverage between the policy and the hedged operational loss event.

(b) Qualifying operational risk mitigants. Qualifying operational risk mitigants are:

(1) Insurance that:

(i) Is provided by an unaffiliated company that the [BANK] deems to have strong capacity to meet its claims payment obligations and the obligor rating category to which the [BANK] assigns the company is assigned a PD equal to or less than 10 basis points;

(ii) Has an initial term of at least one year and a residual term of more than 90 days;

(iii) Has a minimum notice period for cancellation by the provider of 90 days;

(iv) Has no exclusions or limitations based upon regulatory action or for the receiver or liquidator of a failed depository institution; and

(v) Is explicitly mapped to a potential operational loss event;

(2) Operational risk mitigants other than insurance for which the [AGENCY] has given prior written approval. In evaluating an operational risk mitigant other than insurance, the [AGENCY] will consider whether the operational risk mitigant covers potential operational losses in a manner equivalent to holding total capital.

§___.162 Mechanics of Risk-Weighted Asset Calculation

(a) If a [BANK] does not qualify to use or does not have qualifying operational risk mitigants, the [BANK]'s dollar risk-based capital requirement for operational risk is its operational risk exposure minus eligible operational risk offsets (if any).

(b) If a [BANK] qualifies to use operational risk mitigants and has qualifying operational risk mitigants, the [BANK]'s dollar risk-based capital requirement for operational risk is the greater of:

(1) The [BANK]'s operational risk exposure adjusted for qualifying operational risk mitigants minus eligible operational risk offsets (if any); or

(2) 0.8 multiplied by the difference between:

(i) The [BANK]'s operational risk exposure; and

(ii) Eligible operational risk offsets (if any).

(c) The [BANK]'s risk-weighted asset amount for operational risk equals the [BANK]'s dollar risk-based capital requirement for operational risk determined under sections 162(a) or (b) multiplied by 12.5.

DISCLOSURES

§___.171 Purpose and Scope

Sections ___.171 ___.173 of this subpart establish public disclosure requirements related to the capital requirements of a [BANK] that is an advanced approaches bank.

§___.172 Disclosure Requirements

(a) A [BANK] that is an advanced approaches bank must publicly disclose each quarter its total and tier 1 risk-based capital ratios and their components as calculated under this subpart (that is, common equity tier 1 capital, additional tier 1 capital, tier 2 capital, total qualifying capital, and total risk-weighted assets).

(b) A [BANK] that is an advanced approaches bank must comply with §___.172(c) of this subpart unless it is a consolidated subsidiary of a bank holding company, savings and loan holding company, or depository institution that is subject to these disclosure requirements or a subsidiary of a non-U.S. banking organization that is subject to comparable public disclosure requirements in its home jurisdiction.

(c) (1) A [BANK] described in paragraph (b) of this section must provide timely public disclosures each calendar quarter of the information in the applicable tables in §___.173 of this subpart. If a significant change occurs, such that the most recent reported amounts are no longer reflective of the [BANK]'s capital adequacy and risk profile, then a brief discussion of this change and its likely impact must be disclosed as soon as practicable thereafter. Qualitative disclosures that typically do not change each quarter (for example, a general summary of the [BANK]'s risk management objectives and policies, reporting system, and definitions) may be disclosed annually, provided that any significant changes to these are disclosed in the interim. Management is encouraged to provide all of the disclosures required by this subpart in one place on the [BANK]'s public website.[35]

(2) A [BANK] described in §___.172(b) must have a formal disclosure policy approved by the board of directors that addresses its approach for determining the disclosures it makes. The policy must address the associated internal controls and disclosure controls and procedures. The board of directors and senior management are responsible for establishing and maintaining an effective internal control structure over financial reporting, including the disclosures required by this subpart, and must ensure that appropriate review of the disclosures takes place. One or more senior officers of the [BANK] must attest that the disclosures meet the requirements of this subpart.

(3) If a [BANK] described in §___.172(b) believes that disclosure of specific commercial or financial information would prejudice seriously its position by making public information that is either proprietary or confidential in nature, the [BANK] is not required to disclose those specific items, but must disclose more general information about the subject matter of the

[35] Alternatively, a [BANK] may provide the disclosures in more than one place, as some of them may be included in public financial reports (for example, in Management's Discussion and Analysis included in SEC filings) or other regulatory reports. The [BANK] must publicly provide a summary table that specifically indicates where all the disclosures may be found (for example, regulatory report schedules, page numbers in annual reports).

requirement, together with the fact that, and the reason why, the specific items of information have not been disclosed.

§___. 173 Disclosures by Certain Advanced Approaches [BANKS]

Except as provided in §___.172(b), a [BANK] that is an advanced approaches bank must make the disclosures described in Tables 11.1 through 11.12 below. The [BANK] must make these disclosures publicly available for each of the last three years (that is, twelve quarters) or such shorter period beginning on the effective date of this subpart E.

Table 11.1 – Scope of Application

Qualitative Disclosures	(a)	The name of the top corporate entity in the group to which subpart E of this [PART] applies.
	(b)	A brief description of the differences in the basis for consolidating entities[36] for accounting and regulatory purposes, with a description of those entities: (a) that are fully consolidated; (b) that are deconsolidated and deducted from total capital; (c) for which the total capital requirement is deducted; and (d) that are neither consolidated nor deducted (for example, where the investment in the entity is assigned a risk weight in accordance with this subpart).
	(c)	Any restrictions, or other major impediments, on transfer of funds or total capital within the group.
Quantitative Disclosures	(d)	The aggregate amount of surplus capital of insurance subsidiaries included in the total capital of the consolidated group.
	(e)	The aggregate amount by which actual total capital is less than the minimum total capital requirement in all subsidiaries, with total capital requirements and the name(s) of the subsidiaries with such deficiencies.

[36] Such entities include securities, insurance and other financial subsidiaries, commercial subsidiaries (where permitted), and significant minority equity investments in insurance, financial and commercial entities.

Table 11.2 – Capital Structure

Qualitative Disclosures	(a)	Summary information on the terms and conditions of the main features of all regulatory capital instruments.
Quantitative Disclosures	(b)	The amount of common equity tier 1 capital, with separate disclosure of: • Common stock and related surplus; • Retained earnings; • Common equity minority interest; • AOCI (net of tax) and other reserves; and • Regulatory deductions and adjustments made to common equity tier 1 capital.
	(c)	The amount of tier 1 capital, with separate disclosure of: • Additional tier 1 capital elements, including additional tier 1 capital instruments and tier 1 minority interest not included in common equity tier 1 capital; and • Regulatory deductions and adjustments made to tier 1 capital.
	(d)	The amount of total capital, with separate disclosure of: • Tier 2 capital elements, including tier 2 capital instruments and total capital minority interest not included in tier 1 capital; and • Regulatory deductions and adjustments made to total capital.

Table 11.3 – Capital Adequacy

Qualitative disclosures	(a)	A summary discussion of the [BANK]'s approach to assessing the adequacy of its capital to support current and future activities.

Quantitative disclosures	(b)	Risk-weighted assets for credit risk from:
		• Wholesale exposures;
		• Residential mortgage exposures;
		• Qualifying revolving exposures;
		• Other retail exposures;
		• Securitization exposures;
		• Equity exposures:
		  • Equity exposures subject to the simple risk weight approach; and
		  • Equity exposures subject to the internal models approach.

	(c)	Standardized market risk-weighted assets and advanced market risk-weighted assets as calculated under subpart F of this [PART]:[37] • Standardized approach for specific risk; and • Internal models approach for specific risk.
	(d)	Risk-weighted assets for operational risk.
	(e)	Common equity tier 1, tier 1 and total risk-based capital ratios: • For the top consolidated group; and • For each depository institution subsidiary.

[37] Standardized market risk-weighted assets and advanced market risk-weighted assets as calculated under this subpart are to be disclosed only with respect to an approach that is used by a [BANK].

	(f)	Total risk-weighted assets.

Table 11.4 – Capital Conservation and Countercyclical Buffers

Qualitative disclosures	(a)	The [BANK] must publicly disclose the geographic breakdown of its private sector credit exposures used in the calculation of the countercyclical capital buffer.
Quantitative disclosures	(b)	At least quarterly, the [BANK] must calculate and publicly disclose the capital conservation buffer and the countercyclical capital buffer as described under §___.11.
	(c)	At least quarterly, the [BANK] must calculate and publicly disclose the buffer retained income of the [BANK], as described under §___.11.
	(d)	At least quarterly, the [BANK] must calculate and publicly disclose any limitations it has on capital distributions and discretionary bonus payments resulting from the capital conservation buffer and the countercyclical buffer framework described under §___.11, including the maximum payout amount for the quarter.

General qualitative disclosure requirement

For each separate risk area described in Tables 11.5 through 11.12, the [BANK] must describe its risk management objectives and policies, including:

- Strategies and processes;
- The structure and organization of the relevant risk management function;
- The scope and nature of risk reporting and/or measurement systems; and
- Policies for hedging and/or mitigating risk and strategies and processes for monitoring the continuing effectiveness of hedges/mitigants.

Table 11.5[38]– Credit Risk: General Disclosures

Qualitative Disclosures	(a)	The general qualitative disclosure requirement with respect to credit risk (excluding counterparty credit risk disclosed in accordance with Table 11.7), including: • Policy for determining past due or delinquency status; • Policy for placing loans on nonaccrual; • Policy for returning loans to accrual status; • Definition of and policy for identifying impaired loans (for financial accounting purposes). • Description of the methodology that the entity uses to estimate its allowance for loan losses, including statistical methods used where applicable; • Policy for charging-off uncollectible amounts; and • Discussion of the [BANK]'s credit risk management policy
Quantitative Disclosures	(b)	Total credit risk exposures and average credit risk exposures, after accounting offsets in accordance with GAAP,[39] without taking into account the effects of credit risk mitigation techniques (for example, collateral and netting not permitted under GAAP), over the period categorized by major types of credit exposure. For example, [BANK]s could use categories similar to that used for financial statement purposes. Such categories might include, for instance (a) loans, off-balance sheet commitments, and other non-derivative off-balance sheet exposures, (b) debt securities, and (c) OTC derivatives.
	(c)	Geographic[40] distribution of exposures, categorized in significant areas by major types of credit exposure.

[38] Table 11.5 does not cover equity exposures.

[39] See, for example, ASC Topic 815-10 and 210-20 (formerly FASB Interpretation Numbers 37 and 41).

[40] Geographical areas may comprise individual countries, groups of countries, or regions within countries. A [BANK] might choose to define the geographical areas based on the way the company's portfolio is geographically managed. The criteria used to allocate the loans to geographical areas must be specified.

	(d)	Industry or counterparty type distribution of exposures, categorized by major types of credit exposure.
	(e)	By major industry or counterparty type: • Amount of impaired loans for which there was a related allowance under GAAP; • Amount of impaired loans for which there was no related allowance under GAAP; • Amount of loans past due 90 days and on nonaccrual; • Amount of loans past due 90 days and still accruing;[41] • The balance in the allowance for credit losses at the end of each period, disaggregated on the basis of the entity's impairment method. To disaggregate the information required on the basis of impairment methodology, an entity shall separately disclose the amounts based on the requirements in GAAP; and • Charge-offs during the period.
	(f)	Amount of impaired loans and, if available, the amount of past due loans categorized by significant geographic areas including, if practical, the amounts of allowances related to each geographical area[42], further categorized as required by GAAP.
	(g)	Reconciliation of changes in ALLL.[43]
	(h)	Remaining contractual maturity breakdown (for example, one year or less) of the whole portfolio, categorized by credit exposure.

[41] A [BANK] is encouraged also to provide an analysis of the aging of past-due loans.

[42] The portion of the general allowance that is not allocated to a geographical area should be disclosed separately.

[43] The reconciliation should include the following: a description of the allowance; the opening balance of the allowance; charge-offs taken against the allowance during the period; amounts provided (or reversed) for estimated probable loan losses during the period; any other adjustments (for example, exchange rate differences, business combinations, acquisitions and disposals of subsidiaries), including transfers between allowances; and the closing balance of the allowance. Charge-offs and recoveries that have been recorded directly to the income statement should be disclosed separately.

Table 11.6 – Credit Risk: Disclosures for Portfolios Subject to IRB Risk-Based Capital Formulas

Qualitative disclosures	(a)	Explanation and review of the: • Structure of internal rating systems and relation between internal and external ratings; • Use of risk parameter estimates other than for regulatory capital purposes; • Process for managing and recognizing credit risk mitigation (see Table 11.8); and • Control mechanisms for the rating system, including discussion of independence, accountability, and rating systems review.

	(b)	Description of the internal ratings process, provided separately for the following:
		• Wholesale category;
		• Retail subcategories;
		  • Residential mortgage exposures;
		  • Qualifying revolving exposures; and
		  • Other retail exposures.
		For each category and subcategory above the description should include:
		• The types of exposure included in the category/subcategories; and
		• The definitions, methods and data for estimation and validation of PD, LGD, and EAD, including assumptions employed in the derivation of these variables.[44]

[44] This disclosure item does not require a detailed description of the model in full – it should provide the reader with a broad overview of the model approach, describing definitions of the variables and methods for estimating and

Quantitative disclosures: risk assessment	(c)	For wholesale exposures, present the following information across a sufficient number of PD grades (including default) to allow for a meaningful differentiation of credit risk:[45] • Total EAD;[46] • Exposure-weighted average LGD (percentage); • Exposure-weighted average risk weight; and • Amount of undrawn commitments and exposure-weighted average EAD including average drawdowns prior to default for wholesale exposures. For each retail subcategory, present the disclosures outlined above across a sufficient number of segments to allow for a meaningful differentiation of credit risk.

validating those variables set out in the quantitative risk disclosures below. This should be done for each of the four category/subcategories. The [BANK] must disclose any significant differences in approach to estimating these variables within each category/subcategories.

[45] The PD, LGD and EAD disclosures in Table 11.6(c) should reflect the effects of collateral, qualifying master netting agreements, eligible guarantees and eligible credit derivatives as defined under this part. Disclosure of each PD grade should include the exposure-weighted average PD for each grade. Where a [BANK] aggregates PD grades for the purposes of disclosure, this should be a representative breakdown of the distribution of PD grades used for regulatory capital purposes.

[46] Outstanding loans and EAD on undrawn commitments can be presented on a combined basis for these disclosures.

Quantitative disclosures: historical results	(d)	Actual losses in the preceding period for each category and subcategory and how this differs from past experience. A discussion of the factors that impacted the loss experience in the preceding period – for example, has the [BANK] experienced higher than average default rates, loss rates or EADs.
	(e)	[BANK]'s estimates compared against actual outcomes over a longer period.[47] At a minimum, this should include information on estimates of losses against actual losses in the wholesale category and each retail subcategory over a period sufficient to allow for a meaningful assessment of the performance of the internal rating processes for each category/subcategory.[48] Where appropriate, the [BANK] should further decompose this to provide analysis of PD, LGD, and EAD outcomes against estimates provided in the quantitative risk assessment disclosures above.[49]

[47] These disclosures are a way of further informing the reader about the reliability of the information provided in the "quantitative disclosures: risk assessment" over the long run. The disclosures are requirements from year-end 2010; in the meantime, early adoption is encouraged. The phased implementation is to allow a [BANK] sufficient time to build up a longer run of data that will make these disclosures meaningful.

[48] This disclosure item is not intended to be prescriptive about the period used for this assessment. Upon implementation, it is expected that a [BANK] would provide these disclosures for as long a set of data as possible – for example, if a [BANK] has 10 years of data, it might choose to disclose the average default rates for each PD grade over that 10-year period. Annual amounts need not be disclosed.

[49] A [BANK] must provide this further decomposition where it will allow users greater insight into the reliability of the estimates provided in the "quantitative disclosures: risk assessment." In particular, it must provide this information where there are material differences between its estimates of PD, LGD or EAD compared to actual outcomes over the long run. The [BANK] must also provide explanations for such differences.

Table 11.7 – General Disclosure for Counterparty Credit Risk of OTC Derivative Contracts, Repo-Style Transactions, and Eligible Margin Loans

Qualitative Disclosures	(a)	The general qualitative disclosure requirement with respect to OTC derivatives, eligible margin loans, and repo-style transactions, including: • Discussion of methodology used to assign economic capital and credit limits for counterparty credit exposures; • Discussion of policies for securing collateral, valuing and managing collateral, and establishing credit reserves; • Discussion of the primary types of collateral taken; • Discussion of policies with respect to wrong-way risk exposures; and • Discussion of the impact of the amount of collateral the [BANK] would have to provide if the [BANK] were to receive a credit rating downgrade.
Quantitative Disclosures	(b)	Gross positive fair value of contracts, netting benefits, netted current credit exposure, collateral held (including type, for example, cash, government securities), and net unsecured credit exposure.[50] Also report measures for EAD used for regulatory capital for these transactions, the notional value of credit derivative hedges purchased for counterparty credit risk protection, and, for [BANK]s not using the internal models methodology in §___.132(d) , the distribution of current credit exposure by types of credit exposure.[51]
	(c)	Notional amount of purchased and sold credit derivatives, segregated between use for the [BANK]'s own credit portfolio and for its intermediation activities, including the distribution of the credit derivative products used, categorized further by protection bought and sold within each product group.
	(d)	The estimate of alpha if the [BANK] has received supervisory approval to estimate alpha.

[50] Net unsecured credit exposure is the credit exposure after considering the benefits from legally enforceable netting agreements and collateral arrangements, without taking into account haircuts for price volatility, liquidity, etc.

[51] This may include interest rate derivative contracts, foreign exchange derivative contracts, equity derivative contracts, credit derivatives, commodity or other derivative contracts, repo-style transactions, and eligible margin loans.

Table 11.8 – Credit Risk Mitigation [52,53]

Qualitative Disclosures	(a)	The general qualitative disclosure requirement with respect to credit risk mitigation, including: • Policies and processes for, and an indication of the extent to which the [BANK] uses, on- or off-balance sheet netting; • Policies and processes for collateral valuation and management; • a description of the main types of collateral taken by the [BANK]; • The main types of guarantors/credit derivative counterparties and their creditworthiness; and • Information about (market or credit) risk concentrations within the mitigation taken.
Quantitative Disclosures	(b)	For each separately disclosed portfolio, the total exposure (after, where applicable, on- or off-balance sheet netting) that is covered by guarantees/credit derivatives.

[52] At a minimum, a [BANK] must provide the disclosures in Table 11.8 in relation to credit risk mitigation that has been recognized for the purposes of reducing capital requirements under this subpart. Where relevant, [BANK]s are encouraged to give further information about mitigants that have not been recognized for that purpose.

[53] Credit derivatives and other credit mitigation that are treated for the purposes of this subpart as synthetic securitization exposures should be excluded from the credit risk mitigation disclosures (in Table 11.8) and included within those relating to securitization (in Table 11.9).

Table 11.9 – Securitization

Qualitative Disclosures	(a)	The general qualitative disclosure requirement with respect to securitization (including synthetic securitizations), including a discussion of: • The [BANK]'s objectives for securitizing assets, including the extent to which these activities transfer credit risk of the underlying exposures away from the [BANK] to other entities and including the type of risks assumed and retained with resecuritization activity;[54] • The nature of the risks (e.g. liquidity risk) inherent in the securitized assets; • The roles played by the [BANK] in the securitization process[55] and an indication of the extent of the [BANK]'s involvement in each of them; • The processes in place to monitor changes in the credit and market risk of securitization exposures including how those processes differ for resecuritization exposures; • The [BANK]'s policy for mitigating the credit risk retained through securitization and resecuritization exposures; and • The risk-based capital approaches that the [BANK] follows for its securitization exposures including the type of securitization exposure to which each approach applies.
	(b)	A list of: • The type of securitization SPEs that the [BANK], as sponsor, uses to securitize third-party exposures. The [BANK] must indicate whether it has exposure to these SPEs , either on- or off- balance sheet; and • Affiliated entities (i) that the [BANK] manages or advises and (ii) that invest either in the securitization exposures that the [BANK] has securitized or in securitization SPEs that the [BANK] sponsors.[56]

[54] The [BANK] must describe the structure of resecuritizations in which it participates; this description must be provided for the main categories of resecuritization products in which the [BANK] is active.

[55] For example, these roles would include originator, investor, servicer, provider of credit enhancement, sponsor, liquidity provider, or swap provider.

[56] For example, money market mutual funds should be listed individually, and personal and private trusts, should be noted collectively.

	(c)	Summary of the [BANK]'s accounting policies for securitization activities, including: • Whether the transactions are treated as sales or financings; • Recognition of gain-on-sale; • Methods and key assumptions and inputs applied in valuing retained or purchased interests; • Changes in methods and key assumptions and inputs from the previous period for valuing retained interests and impact of the changes; • Treatment of synthetic securitizations; • How exposures intended to be securitized are valued and whether they are recorded under subpart E; and • Policies for recognizing liabilities on the balance sheet for arrangements that could require the [BANK] to provide financial support for securitized assets.
	(d)	An explanation of significant changes to any of the quantitative information set forth below since the last reporting period.
Quantitative Disclosures	(e)	The total outstanding exposures securitized[57] by the [BANK] in securitizations that meet the operational criteria in §___.141 (categorized into traditional/synthetic), by underlying exposure type[58], separately for securitizations of third-party exposures for which the bank acts only as sponsor.
	(f)	For exposures securitized by the [BANK] in securitizations that meet the operational criteria in §___.141: • Amount of securitized assets that are impaired[59]/past due categorized by exposure type; and • Losses recognized by the [BANK] during the current period categorized by exposure type. [60]

[57] "Exposures securitized" include underlying exposures originated by the bank, whether generated by them or purchased, and recognized in the balance sheet, from third parties, and third-party exposures included in sponsored transactions. Securitization transactions (including underlying exposures originally on the bank's balance sheet and underlying exposures acquired by the bank from third-party entities) in which the originating bank does not retain any securitization exposure should be shown separately but need only be reported for the year of inception.

[58] A [BANK] is required to disclose exposures regardless of whether there is a capital charge under Pillar 1.

[59] A [BANK] must include credit-related other than temporary impairment (OTTI).

[60] For example, charge-offs/allowances (if the assets remain on the bank's balance sheet) or credit-related OTTI of I/O strips and other retained residual interests, as well as recognition of liabilities for probable future financial support required of the bank with respect to securitized assets.

	(g)	The total amount of outstanding exposures intended to be securitized categorized by exposure type.
	(h)	Aggregate amount of: • On-balance sheet securitization exposures retained or purchased categorized by exposure type; and • Off-balance sheet securitization exposures categorized by exposure type.
	(i)	• Aggregate amount of securitization exposures retained or purchased and the associated capital requirements for these exposures, categorized between securitization and resecuritization exposures, further categorized into a meaningful number of risk weight bands and by risk-based capital approach (e.g. SA, SFA, or SSFA). • Exposures that have been deducted entirely from tier 1 capital, credit enhancing I/Os deducted from total capital (as described in §___.42(a)(1), and other exposures deducted from total capital should be disclosed separately by exposure type.
	(j)	Summary of current year's securitization activity, including the amount of exposures securitized (by exposure type), and recognized gain or loss on sale by asset type.
	(k)	Aggregate amount of resecuritization exposures retained or purchased categorized according to: • Exposures to which credit risk mitigation is applied and those not applied; and • Exposures to guarantors categorized according to guarantor credit worthiness categories or guarantor name.

Table 11.10 – Operational Risk

Qualitative disclosures	(a)	The general qualitative disclosure requirement for operational risk.
	(b)	Description of the AMA, including a discussion of relevant internal and external factors considered in the [BANK]'s measurement approach.
	(c)	A description of the use of insurance for the purpose of mitigating operational risk.

Table 11.11 – Equities Not Subject to Subpart F of this Part

Qualitative Disclosures	(a)	The general qualitative disclosure requirement with respect to the equity risk of equity holdings not subject to subpart F of this part, including: • Differentiation between holdings on which capital gains are expected and those held for other objectives, including for relationship and strategic reasons; and • Discussion of important policies covering the valuation of and accounting for equity holdings not subject to subpart F of this [PART]. This includes the accounting methodology and valuation methodologies used, including key assumptions and practices affecting valuation as well as significant changes in these practices.
Quantitative Disclosures	(b)	Carrying value on the balance sheet of equity investments, as well as the fair value of those investments.

	(c)	The types and nature of investments, including the amount that is: • Publicly-traded; and • Non-publicly-traded.
	(d)	The cumulative realized gains (losses) arising from sales and liquidations in the reporting period.
	(e)	• Total unrealized gains (losses)[61] • Total latent revaluation gains (losses)[62] • Any amounts of the above included in tier 1 and/or tier 2 capital.
	(f)	Capital requirements categorized by appropriate equity groupings, consistent with the [BANK]'s methodology, as well as the aggregate amounts and the type of equity investments subject to any supervisory transition regarding total capital requirements.[63]

Table 11.12 – Interest Rate Risk for Non-trading Activities

Qualitative disclosures	(a)	The general qualitative disclosure requirement, including the nature of interest rate risk for non-trading activities and key assumptions, including assumptions regarding loan prepayments and behavior of non-maturity deposits, and frequency of measurement of interest rate risk for non-trading activities.
Quantitative disclosures	(b)	The increase (decline) in earnings or economic value (or relevant measure used by management) for upward and downward rate shocks according to management's method for measuring interest rate risk for non-trading activities, categorized by currency (as appropriate).

[61] Unrealized gains (losses) recognized in the balance sheet but not through earnings.

[62] Unrealized gains (losses) not recognized either in the balance sheet or through earnings.

[63] This disclosure must include a breakdown of equities that are subject to the 0 percent, 20 percent, 100 percent, 300 percent, 400 percent, and 600 percent risk weights, as applicable.

Subpart F – Risk-weighted Assets – Market Risk

§___.201 Purpose, Applicability, and Reservation of Authority

(a) Purpose. This subpart F establishes risk-based capital requirements for [BANK]s with significant exposure to market risk, provides methods for these [BANK]s to calculate their standardized measure for market risk and, if applicable, advanced measure for market risk, and establishes public disclosure requirements.

(b) Applicability. (1) This subpart applies to any [BANK] with aggregate trading assets and trading liabilities (as reported in the [BANK]'s most recent quarterly [regulatory report]), equal to:

(i) 10 percent or more of quarter-end total assets as reported on the most recent quarterly [Call Report or FR Y–9C]; or

(ii) $1 billion or more.

(2) The [AGENCY] may apply this subpart to any [BANK] if the [AGENCY] deems it necessary or appropriate because of the level of market risk of the [BANK] or to ensure safe and sound banking practices.

(3) The [AGENCY] may exclude a [BANK] that meets the criteria of paragraph (b)(1) of this section from application of this subpart if the [AGENCY] determines that the exclusion is appropriate based on the level of market risk of the [BANK] and is consistent with safe and sound banking practices.

(c) Reservation of authority (1) The [AGENCY] may require a [BANK] to hold an amount of capital greater than otherwise required under this subpart if the [AGENCY] determines that the [BANK]'s capital requirement for market risk as calculated under this subpart is not commensurate with the market risk of the [BANK]'s covered positions. In making determinations under paragraphs (c)(1) through (c)(3) of this section, the [AGENCY] will apply notice and response procedures generally in the same manner as the notice and response procedures set forth in [12 CFR 3.12, 12 CFR 263.202, 12 CFR 325.6(c), 12 CFR 567.3(d)].

(2) If the [AGENCY] determines that the risk-based capital requirement calculated under this subpart by the [BANK] for one or more covered positions or portfolios of covered positions is not commensurate with the risks associated with those positions or portfolios, the [AGENCY] may require the [BANK] to assign a different risk-based capital requirement to the positions or portfolios that more accurately reflects the risk of the positions or portfolios.

(3) The [AGENCY] may also require a [BANK] to calculate risk-based capital requirements for specific positions or portfolios under this subpart, or under subpart D or subpart E, as appropriate, to more accurately reflect the risks of the positions.

(4) Nothing in this subpart limits the authority of the [AGENCY] under any other provision of law or regulation to take supervisory or enforcement action, including action to address unsafe or unsound practices or conditions, deficient capital levels, or violations of law.

§___.202 Definitions

(a) Terms set forth in section 2 and used in this subpart have the definitions assigned thereto in section 2.

(b) For the purposes of this subpart, the following terms are defined as follows:

Backtesting means the comparison of a [BANK]'s internal estimates with actual outcomes during a sample period not used in model development. For purposes of this subpart, backtesting is one form of out-of-sample testing.

Commodity position means a position for which price risk arises from changes in the price of a commodity.

Corporate debt position means a debt position that is an exposure to a company that is not a sovereign entity, the Bank for International Settlements, the European Central Bank, the European Commission, the International Monetary Fund, a multilateral development bank, a depository institution, a foreign bank, a credit union, a public sector entity, a government-sponsored entity, or a securitization.

Correlation trading position means:

(1) A securitization position for which all or substantially all of the value of the underlying exposures is based on the credit quality of a single company for which a two-way market exists, or on commonly traded indices based on such exposures for which a two-way market exists on the indices; or

(2) A position that is not a securitization position and that hedges a position described in paragraph (1) of this definition; and

(3) A correlation trading position does not include:

(i) A resecuritization position;

(ii) A derivative of a securitization position that does not provide a pro rata share in the proceeds of a securitization tranche; or

(iii) A securitization position for which the underlying assets or reference exposures are retail exposures, residential mortgage exposures, or commercial mortgage exposures.

Covered position means the following positions:

(1) A trading asset or trading liability (whether on- or off-balance sheet),[1] as reported on Schedule RC-D of the Call Report or Schedule HC-D of the FR Y–9C, that meets the following conditions:

[1] Securities subject to repurchase and lending agreements are included as if they are still owned by the lender.

(i) The position is a trading position or hedges another covered position[2]; and

(ii) The position is free of any restrictive covenants on its tradability or the [BANK] is able to hedge the material risk elements of the position in a two-way market;

(2) A foreign exchange or commodity position, regardless of whether the position is a trading asset or trading liability (excluding any structural foreign currency positions that the [BANK] chooses to exclude with prior supervisory approval); and

(3) Notwithstanding paragraphs (1) and (2) of this definition, a covered position does not include:

(i) An intangible asset, including any servicing asset;

(ii) Any hedge of a trading position that the [AGENCY] determines to be outside the scope of the [BANK]'s hedging strategy required in paragraph (a)(2) of section 203 of this subpart;

(iii) Any position that, in form or substance, acts as a liquidity facility that provides support to asset-backed commercial paper;

(iv) A credit derivative the [BANK] recognizes as a guarantee for risk-weighted asset amount calculation purposes under subpart D or subpart E;

(v) Any position that is recognized as a credit valuation adjustment hedge under section 132(e)(5) or section 132(e)(6) of subpart E, except as provided in section 132(e)(6)(vii) of subpart E;

(vi) Any equity position that is not publicly traded, other than a derivative that references a publicly traded equity;

(vii) Any position a [BANK] holds with the intent to securitize; or

(viii) Any direct real estate holding.

Default by a sovereign entity has the same meaning as the term sovereign default under section 2 of this part.

Debt position means a covered position that is not a securitization position or a correlation trading position and that has a value that reacts primarily to changes in interest rates or credit spreads.

Equity position means a covered position that is not a securitization position or a correlation trading position and that has a value that reacts primarily to changes in equity prices.

[2] A position that hedges a trading position must be within the scope of the bank's hedging strategy as described in paragraph (a)(2) of section 203 of this subpart.

Event risk means the risk of loss on equity or hybrid equity positions as a result of a financial event, such as the announcement or occurrence of a company merger, acquisition, spin-off, or dissolution.

Foreign exchange position means a position for which price risk arises from changes in foreign exchange rates.

General market risk means the risk of loss that could result from broad market movements, such as changes in the general level of interest rates, credit spreads, equity prices, foreign exchange rates, or commodity prices.

Hedge means a position or positions that offset all, or substantially all, of one or more material risk factors of another position.

Idiosyncratic risk means the risk of loss in the value of a position that arises from changes in risk factors unique to that position.

Incremental risk means the default risk and credit migration risk of a position. Default risk means the risk of loss on a position that could result from the failure of an obligor to make timely payments of principal or interest on its debt obligation, and the risk of loss that could result from bankruptcy, insolvency, or similar proceeding. Credit migration risk means the price risk that arises from significant changes in the underlying credit quality of the position.

Market risk means the risk of loss on a position that could result from movements in market prices.

Resecuritization position means a covered position that is:

(1) An on- or off-balance sheet exposure to a resecuritization; or

(2) An exposure that directly or indirectly references a resecuritization exposure in paragraph (1) of this definition.

Securitization means a transaction in which:

(1) All or a portion of the credit risk of one or more underlying exposures is transferred to one or more third parties;

(2) The credit risk associated with the underlying exposures has been separated into at least two tranches that reflect different levels of seniority;

(3) Performance of the securitization exposures depends upon the performance of the underlying exposures;

(4) All or substantially all of the underlying exposures are financial exposures (such as loans, commitments, credit derivatives, guarantees, receivables, asset-backed securities, mortgage-backed securities, other debt securities, or equity securities);

(5) For non-synthetic securitizations, the underlying exposures are not owned by an operating company;

(6) The underlying exposures are not owned by a small business investment company described in section 302 of the Small Business Investment Act;

(7) The underlying exposures are not owned by a firm an investment in which qualifies as a community development investment under section 24 (Eleventh) of the National Bank Act;

(8) The [AGENCY] may determine that a transaction in which the underlying exposures are owned by an investment firm that exercises substantially unfettered control over the size and composition of its assets, liabilities, and off-balance sheet exposures is not a securitization based on the transaction's leverage, risk profile, or economic substance;

(9) The [AGENCY] may deem an exposure to a transaction that meets the definition of a securitization, notwithstanding paragraph (5), (6), or (7) of this definition, to be a securitization based on the transaction's leverage, risk profile, or economic substance; and

(10) The transaction is not: (i) an investment fund; (ii) a collective investment fund (as defined in 12 CFR 208.34 (Board), 12 CFR 9.18 (OCC), and 12 CFR 344.3 (FDIC); (iii) a pension fund regulated under the ERISA or a foreign equivalent thereof; or (iv) regulated under the Investment Company Act of 1940 (15 U.S.C. 80a-1) or a foreign equivalent thereof.

Securitization position means a covered position that is:

(1) An on-balance sheet or off-balance sheet credit exposure (including credit-enhancing representations and warranties) that arises from a securitization (including a resecuritization); or

(2) An exposure that directly or indirectly references a securitization exposure described in paragraph (1) of this definition.

Sovereign debt position means a direct exposure to a sovereign entity.

Specific risk means the risk of loss on a position that could result from factors other than broad market movements and includes event risk, default risk, and idiosyncratic risk.

Structural position in a foreign currency means a position that is not a trading position and that is:

(1) Subordinated debt, equity, or minority interest in a consolidated subsidiary that is denominated in a foreign currency;

(2) Capital assigned to foreign branches that is denominated in a foreign currency;

(3) A position related to an unconsolidated subsidiary or another item that is denominated in a foreign currency and that is deducted from the [BANK]'s tier 1 or tier 2 capital; or

(4) A position designed to hedge a [BANK]'s capital ratios or earnings against the effect on paragraphs (1), (2), or (3) of this definition of adverse exchange rate movements.

Term repo-style transaction means a repo-style transaction that has an original maturity in excess of one business day.

Trading position means a position that is held by the [BANK] for the purpose of short-term resale or with the intent of benefiting from actual or expected short-term price movements, or to lock in arbitrage profits.

Two-way market means a market where there are independent bona fide offers to buy and sell so that a price reasonably related to the last sales price or current bona fide competitive bid and offer quotations can be determined within one day and settled at that price within a relatively short time frame conforming to trade custom.

Value-at-Risk (VaR) means the estimate of the maximum amount that the value of one or more positions could decline due to market price or rate movements during a fixed holding period within a stated confidence interval.

§___.203 Requirements for Application of Subpart F

(a) Trading positions. (1) Identification of trading positions. A [BANK] must have clearly defined policies and procedures for determining which of its trading assets and trading liabilities are trading positions and which of its trading positions are correlation trading positions. These policies and procedures must take into account:

(i) The extent to which a position, or a hedge of its material risks, can be marked-to-market daily by reference to a two-way market; and

(ii) Possible impairments to the liquidity of a position or its hedge.

(2) Trading and hedging strategies. A [BANK] must have clearly defined trading and hedging strategies for its trading positions that are approved by senior management of the [BANK].

(i) The trading strategy must articulate the expected holding period of, and the market risk associated with, each portfolio of trading positions.

(ii) The hedging strategy must articulate for each portfolio of trading positions the level of market risk the [BANK] is willing to accept and must detail the instruments, techniques, and strategies the [BANK] will use to hedge the risk of the portfolio.

(b) Management of covered positions. (1) Active management. A [BANK] must have clearly defined policies and procedures for actively managing all covered positions. At a minimum, these policies and procedures must require:

(i) Marking positions to market or to model on a daily basis;

(ii) Daily assessment of the [BANK]'s ability to hedge position and portfolio risks, and of the extent of market liquidity;

(iii) Establishment and daily monitoring of limits on positions by a risk control unit independent of the trading business unit;

(iv) Daily monitoring by senior management of information described in paragraphs (b)(1)(i) through (b)(1)(iii) of this section;

(v) At least annual reassessment of established limits on positions by senior management; and

(vi) At least annual assessments by qualified personnel of the quality of market inputs to the valuation process, the soundness of key assumptions, the reliability of parameter estimation in pricing models, and the stability and accuracy of model calibration under alternative market scenarios.

(2) Valuation of covered positions. The [BANK] must have a process for prudent valuation of its covered positions that includes policies and procedures on the valuation of positions, marking positions to market or to model, independent price verification, and valuation adjustments or reserves. The valuation process must consider, as appropriate, unearned credit spreads, close-out costs, early termination costs, investing and funding costs, liquidity, and model risk.

(c) Requirements for internal models. (1) A [BANK] must obtain the prior written approval of the [AGENCY] before using any internal model to calculate its risk-based capital requirement under this subpart.

(2) A [BANK] must meet all of the requirements of this section on an ongoing basis. The [BANK] must promptly notify the [AGENCY] when:

(i) The [BANK] plans to extend the use of a model that the [AGENCY] has approved under this subpart to an additional business line or product type;

(ii) The [BANK] makes any change to an internal model approved by the [AGENCY] under this subpart that would result in a material change in the [BANK]'s risk-weighted asset amount for a portfolio of covered positions; or

(iii) The [BANK] makes any material change to its modeling assumptions.

(3) The [AGENCY] may rescind its approval of the use of any internal model (in whole or in part) or of the determination of the approach under section 209(a)(2)(ii) of this subpart for a [BANK]'s modeled correlation trading positions and determine an appropriate capital requirement for the covered positions to which the model would apply, if the [AGENCY] determines that the model no longer complies with this subpart or fails to reflect accurately the risks of the [BANK]'s covered positions.

(4) The [BANK] must periodically, but no less frequently than annually, review its internal models in light of developments in financial markets and modeling technologies, and enhance those models as appropriate to ensure that they continue to meet the [AGENCY]'s standards for model approval and employ risk measurement methodologies that are most appropriate for the [BANK]'s covered positions.

(5) The [BANK] must incorporate its internal models into its risk management process and integrate the internal models used for calculating its VaR-based measure into its daily risk management process.

(6) The level of sophistication of a [BANK]'s internal models must be commensurate with the complexity and amount of its covered positions. A [BANK]'s internal models may use any of the generally accepted approaches, including but not limited to variance-covariance models, historical simulations, or Monte Carlo simulations, to measure market risk.

(7) The [BANK]'s internal models must properly measure all the material risks in the covered positions to which they are applied.

(8) The [BANK]'s internal models must conservatively assess the risks arising from less liquid positions and positions with limited price transparency under realistic market scenarios.

(9) The [BANK] must have a rigorous and well-defined process for re-estimating, re-evaluating, and updating its internal models to ensure continued applicability and relevance.

(10) If a [BANK] uses internal models to measure specific risk, the internal models must also satisfy the requirements in paragraph (b)(1) of section 207 of this subpart.

(d) Control, oversight, and validation mechanisms. (1) The [BANK] must have a risk control unit that reports directly to senior management and is independent from the business trading units.

(2) The [BANK] must validate its internal models initially and on an ongoing basis. The [BANK]'s validation process must be independent of the internal models' development, implementation, and operation, or the validation process must be subjected to an independent review of its adequacy and effectiveness. Validation must include:

(i) An evaluation of the conceptual soundness of (including developmental evidence supporting) the internal models;

(ii) An ongoing monitoring process that includes verification of processes and the comparison of the [BANK]'s model outputs with relevant internal and external data sources or estimation techniques; and

(iii) An outcomes analysis process that includes backtesting. For internal models used to calculate the VaR-based measure, this process must include a comparison of the changes in the [BANK]'s portfolio value that would have occurred were end-of-day positions to remain unchanged (therefore, excluding fees, commissions, reserves, net interest income, and intraday trading) with VaR-based measures during a sample period not used in model development.

(3) The [BANK] must stress test the market risk of its covered positions at a frequency appropriate to each portfolio, and in no case less frequently than quarterly. The stress tests must take into account concentration risk (including but not limited to concentrations in single issuers, industries, sectors, or markets), illiquidity under stressed market conditions, and risks arising from the [BANK]'s trading activities that may not be adequately captured in its internal models.

(4) The [BANK] must have an internal audit function independent of business-line management that at least annually assesses the effectiveness of the controls supporting the [BANK]'s market risk measurement systems, including the activities of the business trading units and independent risk control unit, compliance with policies and procedures, and calculation of the [BANK]'s measures for market risk under this subpart. At least annually, the internal audit function must report its findings to the [BANK]'s board of directors (or a committee thereof).

(e) Internal assessment of capital adequacy. The [BANK] must have a rigorous process for assessing its overall capital adequacy in relation to its market risk. The assessment must take into account risks that may not be captured fully in the VaR-based measure, including concentration and liquidity risk under stressed market conditions.

(f) Documentation. The [BANK] must adequately document all material aspects of its internal models, management and valuation of covered positions, control, oversight, validation and review processes and results, and internal assessment of capital adequacy.

§___.204 Measure for Market Risk

(a) General requirement. (1) A [BANK] must calculate its standardized measure for market risk by following the steps described in paragraph (a)(2) of this section. An advanced approaches [BANK] also must calculate an advanced measure for market risk by following the steps in paragraph (a)(2) of this section.

(2) Measure for market risk. A [BANK] must calculate the standardized measure for market risk, which equals the sum of the VaR-based capital requirement, stressed VaR-based capital requirement, specific risk add-ons, incremental risk capital requirement, comprehensive risk capital requirement, and capital requirement for de minimis exposures all as defined under this paragraph (a)(2), (except, that the [BANK] may not use the SFA in section 210(b)(2)(vii)(B) of this subpart for purposes of this calculation). An advanced approaches [BANK] also must calculate the advanced measure for market risk, which equals the sum of the VaR-based capital requirement, stressed VaR-based capital requirement, specific risk add-ons, incremental risk capital requirement, comprehensive risk capital requirement, and capital requirement for de minimis exposures as defined under this paragraph (a)(2).

(i) VaR-based capital requirement. A [BANK]'s VaR-based capital requirement equals the greater of:

(A) The previous day's VaR-based measure as calculated under section 205; or

(B) The average of the daily VaR-based measures as calculated under section 205 for each of the preceding 60 business days multiplied by three, except as provided in paragraph (b) of this section.

(ii) Stressed VaR-based capital requirement. A [BANK]'s stressed VaR-based capital requirement equals the greater of:

(A) The most recent stressed VaR-based measure as calculated under section 206 of this subpart; or

(B) The average of the stressed VaR-based measures as calculated under section 206 of this subpart for each of the preceding 12 weeks multiplied by three, except as provided in paragraph (b) of this section.

(iii) Specific risk add-ons. A [BANK]'s specific risk add-ons equal any specific risk add-ons that are required under section 207 and are calculated in accordance with section 210 of this subpart.

(iv) Incremental risk capital requirement. A [BANK]'s incremental risk capital requirement equals any incremental risk capital requirement as calculated under section 208 of this subpart.

(v) Comprehensive risk capital requirement. A [BANK]'s comprehensive risk capital requirement equals any comprehensive risk capital requirement as calculated under section 209 of this subpart.

(vi) Capital requirement for de minimis exposures. A [BANK]'s capital requirement for de minimis exposures equals:

(A) The absolute value of the market value of those de minimis exposures that are not captured in the [BANK]'s VaR-based measure or under paragraph (a)(2)(vi)(B) of this section; and

(B) With the prior written approval of the [AGENCY], the capital requirement for any de minimis exposures using alternative techniques that appropriately measure the market risk associated with those exposures.

(b) Backtesting. A [BANK] must compare each of its most recent 250 business days' trading losses (excluding fees, commissions, reserves, net interest income, and intraday trading) with the corresponding daily VaR-based measures calibrated to a one-day holding period and at a one-tail, 99.0 percent confidence level. A [BANK] must begin backtesting as required by this paragraph no later than one year after the later of January 1, 2013 and the date on which the [BANK] becomes subject to this subpart. In the interim, consistent with safety and soundness principles, a [BANK] subject to this subpart as of its effective date should continue to follow backtesting procedures in accordance with the [AGENCY]'s supervisory expectations.

(1) Once each quarter, the [BANK] must identify the number of exceptions (that is, the number of business days for which the actual daily net trading loss, if any, exceeds the corresponding daily VaR-based measure) that have occurred over the preceding 250 business days.

(2) A [BANK] must use the multiplication factor in table 1 that corresponds to the number of exceptions identified in paragraph (b)(1) of this section to determine its VaR-based capital requirement for market risk under paragraph (a)(2)(i) of this section and to determine its stressed VaR-based capital requirement for market risk under paragraph (a)(2)(ii) of this section until it obtains the next quarter's backtesting results, unless the [AGENCY] notifies the [BANK] in writing that a different adjustment or other action is appropriate.

Table 1 – Multiplication Factors Based on Results of Backtesting

Number of Exceptions	Multiplication Factor
4 or fewer	3.00
5	3.40
6	3.50
7	3.65
8	3.75
9	3.85
10 or more	4.00

§___.205 VaR-based Measure

(a) General requirement. A [BANK] must use one or more internal models to calculate daily a VaR-based measure of the general market risk of all covered positions. The daily VaR-based measure also may reflect the [BANK]'s specific risk for one or more portfolios of debt and equity positions, if the internal models meet the requirements of paragraph (b)(1) of section 207 of this subpart. The daily VaR-based measure must also reflect the [BANK]'s specific risk for any portfolio of correlation trading positions that is modeled under section 209. A [BANK] may elect to include term repo-style transactions in its VaR-based measure, provided that the [BANK] includes all such term repo-style transactions consistently over time.

(1) The [BANK]'s internal models for calculating its VaR-based measure must use risk factors sufficient to measure the market risk inherent in all covered positions. The market risk categories must include, as appropriate, interest rate risk, credit spread risk, equity price risk, foreign exchange risk, and commodity price risk. For material positions in the major currencies and markets, modeling techniques must incorporate enough segments of the yield curve – in no case less than six – to capture differences in volatility and less than perfect correlation of rates along the yield curve.

(2) The VaR-based measure may incorporate empirical correlations within and across risk categories, provided the [BANK] validates and demonstrates the reasonableness of its process for measuring correlations. If the VaR-based measure does not incorporate empirical correlations across risk categories, the [BANK] must add the separate measures from its internal models used to calculate the VaR-based measure for the appropriate market risk categories (interest rate risk, credit spread risk, equity price risk, foreign exchange rate risk, and/or commodity price risk) to determine its aggregate VaR-based measure.

(3) The VaR-based measure must include the risks arising from the nonlinear price characteristics of options positions or positions with embedded optionality and the sensitivity of the market value of the positions to changes in the volatility of the underlying rates, prices, or other material risk factors. A [BANK] with a large or complex options portfolio must measure the volatility of options positions or positions with embedded optionality by different maturities and/or strike prices, where material.

(4) The [BANK] must be able to justify to the satisfaction of the [AGENCY] the omission of any risk factors from the calculation of its VaR-based measure that the [BANK] uses in its pricing models.

(5) The [BANK] must demonstrate to the satisfaction of the [AGENCY] the appropriateness of any proxies used to capture the risks of the [BANK]'s actual positions for which such proxies are used.

(b) Quantitative requirements for VaR-based measure. (1) The VaR-based measure must be calculated on a daily basis using a one-tail, 99.0 percent confidence level, and a holding period equivalent to a 10-business-day movement in underlying risk factors, such as rates, spreads, and prices. To calculate VaR-based measures using a 10-business-day holding period, the [BANK] may calculate 10-business-day measures directly or may convert VaR-based measures using holding periods other than 10 business days to the equivalent of a 10-business-day holding period. A [BANK] that converts its VaR-based measure in such a manner must be able to justify the reasonableness of its approach to the satisfaction of the [AGENCY].

(2) The VaR-based measure must be based on a historical observation period of at least one year. Data used to determine the VaR-based measure must be relevant to the [BANK]'s actual exposures and of sufficient quality to support the calculation of risk-based capital requirements. The [BANK] must update data sets at least monthly or more frequently as changes in market conditions or portfolio composition warrant. For a [BANK] that uses a weighting scheme or other method for the historical observation period, the [BANK] must either:

(i) Use an effective observation period of at least one year in which the average time lag of the observations is at least six months; or

(ii) Demonstrate to the [AGENCY] that its weighting scheme is more effective than a weighting scheme with an average time lag of at least six months representing the volatility of the [BANK]'s trading portfolio over a full business cycle. A [BANK] using this option must update its data more frequently than monthly and in a manner appropriate for the type of weighting scheme.

(c) A [BANK] must divide its portfolio into a number of significant subportfolios approved by the [AGENCY] for subportfolio backtesting purposes. These subportfolios must be sufficient to allow the [BANK] and the [AGENCY] to assess the adequacy of the VaR model at the risk factor level; the [AGENCY] will evaluate the appropriateness of these subportfolios relative to the value and composition of the [BANK]'s covered positions. The [BANK] must retain and make available to the [AGENCY] the following information for each subportfolio for each business day over the previous two years (500 business days), with no more than a 60-day lag:

(1) A daily VaR-based measure for the subportfolio calibrated to a one-tail, 99.0 percent confidence level;

(2) The daily profit or loss for the subportfolio (that is, the net change in price of the positions held in the portfolio at the end of the previous business day); and

(3) The p-value of the profit or loss on each day (that is, the probability of observing a profit that is less than, or a loss that is greater than, the amount reported for purposes of paragraph (c)(2) of this section based on the model used to calculate the VaR-based measure described in paragraph (c)(1) of this section).

§___.206 Stressed VaR-based Measure

(a) General requirement. At least weekly, a [BANK] must use the same internal model(s) used to calculate its VaR-based measure to calculate a stressed VaR-based measure.

(b) Quantitative requirements for stressed VaR-based measure. (1) A [BANK] must calculate a stressed VaR-based measure for its covered positions using the same model(s) used to calculate the VaR-based measure, subject to the same confidence level and holding period applicable to the VaR-based measure under section 205 of this subpart, but with model inputs calibrated to historical data from a continuous 12-month period that reflects a period of significant financial stress appropriate to the [BANK]'s current portfolio.

(2) The stressed VaR-based measure must be calculated at least weekly and be no less than the [BANK]'s VaR-based measure.

(3) A [BANK] must have policies and procedures that describe how it determines the period of significant financial stress used to calculate the [BANK]'s stressed VaR-based measure under this section and must be able to provide empirical support for the period used. The [BANK] must obtain the prior approval of the [AGENCY] for, and notify the [AGENCY] if the [BANK] makes any material changes to, these policies and procedures. The policies and procedures must address:

(i) How the [BANK] links the period of significant financial stress used to calculate the stressed VaR-based measure to the composition and directional bias of its current portfolio; and

(ii) The [BANK]'s process for selecting, reviewing, and updating the period of significant financial stress used to calculate the stressed VaR-based measure and for monitoring the appropriateness of the period to the [BANK]'s current portfolio.

(4) Nothing in this section prevents the [AGENCY] from requiring a [BANK] to use a different period of significant financial stress in the calculation of the stressed VaR-based measure.

§___.207 Specific Risk

(a) General requirement. A [BANK] must use one of the methods in this section to measure the specific risk for each of its debt, equity, and securitization positions with specific risk.

(b) Modeled specific risk. A [BANK] may use models to measure the specific risk of covered positions as provided in paragraph (a) of section 205 of this subpart (therefore, excluding securitization positions that are not modeled under section 209 of this subpart). A [BANK] must use models to measure the specific risk of correlation trading positions that are modeled under section 209 of this subpart.

(1) Requirements for specific risk modeling. (i) If a [BANK] uses internal models to measure the specific risk of a portfolio, the internal models must:

(A) Explain the historical price variation in the portfolio;

(B) Be responsive to changes in market conditions;

(C) Be robust to an adverse environment, including signaling rising risk in an adverse environment; and

(D) Capture all material components of specific risk for the debt and equity positions in the portfolio. Specifically, the internal models must:

(1) Capture event risk and idiosyncratic risk;

(2) Capture and demonstrate sensitivity to material differences between positions that are similar but not identical and to changes in portfolio composition and concentrations.

(ii) If a [BANK] calculates an incremental risk measure for a portfolio of debt or equity positions under section 208 of this subpart, the [BANK] is not required to capture default and credit migration risks in its internal models used to measure the specific risk of those portfolios.

(2) Specific risk fully modeled for one or more portfolios. If the [BANK]'s VaR-based measure captures all material aspects of specific risk for one or more of its portfolios of debt, equity, or correlation trading positions, the [BANK] has no specific risk add-on for those portfolios for purposes of paragraph (a)(2)(iii) of section 204 of this subpart.

(c) Specific risk not modeled.

(1) If the [BANK]'s VaR-based measure does not capture all material aspects of specific risk for a portfolio of debt, equity, or correlation trading positions, the [BANK] must calculate a

specific-risk add-on for the portfolio under the standardized measurement method as described in section 210 of this subpart.

(2) A [BANK] must calculate a specific risk add-on under the standardized measurement method as described in section 210 of this subpart for all of its securitization positions that are not modeled under section 209 of this subpart.

§___.208 Incremental Risk

(a) General requirement. A [BANK] that measures the specific risk of a portfolio of debt positions under section 207(b) of this subpart using internal models must calculate at least weekly an incremental risk measure for that portfolio according to the requirements in this section. The incremental risk measure is the [BANK]'s measure of potential losses due to incremental risk over a one-year time horizon at a one-tail, 99.9 percent confidence level, either under the assumption of a constant level of risk, or under the assumption of constant positions. With the prior approval of the [AGENCY], a [BANK] may choose to include portfolios of equity positions in its incremental risk model, provided that it consistently includes such equity positions in a manner that is consistent with how the [BANK] internally measures and manages the incremental risk of such positions at the portfolio level. If equity positions are included in the model, for modeling purposes default is considered to have occurred upon the default of any debt of the issuer of the equity position. A [BANK] may not include correlation trading positions or securitization positions in its incremental risk measure.

(b) Requirements for incremental risk modeling. For purposes of calculating the incremental risk measure, the incremental risk model must:

(1) Measure incremental risk over a one-year time horizon and at a one-tail, 99.9 percent confidence level, either under the assumption of a constant level of risk, or under the assumption of constant positions.

(i) A constant level of risk assumption means that the [BANK] rebalances, or rolls over, its trading positions at the beginning of each liquidity horizon over the one-year horizon in a manner that maintains the [BANK]'s initial risk level. The [BANK] must determine the frequency of rebalancing in a manner consistent with the liquidity horizons of the positions in the portfolio. The liquidity horizon of a position or set of positions is the time required for a [BANK] to reduce its exposure to, or hedge all of its material risks of, the position(s) in a stressed market. The liquidity horizon for a position or set of positions may not be less than the shorter of three months or the contractual maturity of the position.

(ii) A constant position assumption means that the [BANK] maintains the same set of positions throughout the one-year horizon. If a [BANK] uses this assumption, it must do so consistently across all portfolios.

(iii) A [BANK]'s selection of a constant position or a constant risk assumption must be consistent between the [BANK]'s incremental risk model and its comprehensive risk model described in section 209 of this subpart, if applicable.

(iv) A [BANK]'s treatment of liquidity horizons must be consistent between the [BANK]'s incremental risk model and its comprehensive risk model described in section 209, if applicable.

(2) Recognize the impact of correlations between default and migration events among obligors.

(3) Reflect the effect of issuer and market concentrations, as well as concentrations that can arise within and across product classes during stressed conditions.

(4) Reflect netting only of long and short positions that reference the same financial instrument.

(5) Reflect any material mismatch between a position and its hedge.

(6) Recognize the effect that liquidity horizons have on dynamic hedging strategies. In such cases, a [BANK] must:

(i) Choose to model the rebalancing of the hedge consistently over the relevant set of trading positions;

(ii) Demonstrate that the inclusion of rebalancing results in a more appropriate risk measurement;

(iii) Demonstrate that the market for the hedge is sufficiently liquid to permit rebalancing during periods of stress; and

(iv) Capture in the incremental risk model any residual risks arising from such hedging strategies.

(7) Reflect the nonlinear impact of options and other positions with material nonlinear behavior with respect to default and migration changes.

(8) Maintain consistency with the [BANK]'s internal risk management methodologies for identifying, measuring, and managing risk.

(c) Calculation of incremental risk capital requirement. The incremental risk capital requirement is the greater of:

(1) The average of the incremental risk measures over the previous 12 weeks; or

(2) The most recent incremental risk measure.

§___.209 Comprehensive Risk

(a) General requirement. (1) Subject to the prior approval of the [AGENCY], a [BANK] may use the method in this section to measure comprehensive risk, that is, all price risk, for one or more portfolios of correlation trading positions.

(2) A [BANK] that measures the price risk of a portfolio of correlation trading positions using internal models must calculate at least weekly a comprehensive risk measure that captures all price risk according to the requirements of this section. The comprehensive risk measure is either:

(i) The sum of:

(A) The [BANK]'s modeled measure of all price risk determined according to the requirements in paragraph (b) of this section; and

(B) A surcharge for the [BANK]'s modeled correlation trading positions equal to the total specific risk add-on for such positions as calculated under section 210 of this subpart multiplied by 8.0 percent; or

(ii) With approval of the [AGENCY] and provided the [BANK] has met the requirements of this section for a period of at least one year and can demonstrate the effectiveness of the model through the results of ongoing model validation efforts including robust benchmarking, the greater of:

(A) The [BANK]'s modeled measure of all price risk determined according to the requirements in paragraph (b) of this section; or

(B) The total specific risk add-on that would apply to the bank's modeled correlation trading positions as calculated under section 210 of this subpart multiplied by 8.0 percent.

(b) Requirements for modeling all price risk. If a [BANK] uses an internal model to measure the price risk of a portfolio of correlation trading positions:

(1) The internal model must measure comprehensive risk over a one-year time horizon at a one-tail, 99.9 percent confidence level, either under the assumption of a constant level of risk, or under the assumption of constant positions.

(2) The model must capture all material price risk, including but not limited to the following:

(i) The risks associated with the contractual structure of cash flows of the position, its issuer, and its underlying exposures;

(ii) Credit spread risk, including nonlinear price risks;

(iii) The volatility of implied correlations, including nonlinear price risks such as the cross-effect between spreads and correlations;

(iv) Basis risk;

(v) Recovery rate volatility as it relates to the propensity for recovery rates to affect tranche prices; and

(vi) To the extent the comprehensive risk measure incorporates the benefits of dynamic hedging, the static nature of the hedge over the liquidity horizon must be recognized. In such cases, a [BANK] must:

(A) Choose to model the rebalancing of the hedge consistently over the relevant set of trading positions;

(B) Demonstrate that the inclusion of rebalancing results in a more appropriate risk measurement;

(C) Demonstrate that the market for the hedge is sufficiently liquid to permit rebalancing during periods of stress; and

(D) Capture in the comprehensive risk model any residual risks arising from such hedging strategies;

(3) The [BANK] must use market data that are relevant in representing the risk profile of the [BANK]'s correlation trading positions in order to ensure that the [BANK] fully captures the material risks of the correlation trading positions in its comprehensive risk measure in accordance with this section; and

(4) The [BANK] must be able to demonstrate that its model is an appropriate representation of comprehensive risk in light of the historical price variation of its correlation trading positions.

(c) Requirements for stress testing.

(1) A [BANK] must at least weekly apply specific, supervisory stress scenarios to its portfolio of correlation trading positions that capture changes in:

(i) Default rates;

(ii) Recovery rates;

(iii) Credit spreads;

(iv) Correlations of underlying exposures; and

(v) Correlations of a correlation trading position and its hedge.

(2) Other requirements. (i) A [BANK] must retain and make available to the [AGENCY] the results of the supervisory stress testing, including comparisons with the capital requirements generated by the [BANK]'s comprehensive risk model.

(ii) A [BANK] must report to the [AGENCY] promptly any instances where the stress tests indicate any material deficiencies in the comprehensive risk model.

(d) Calculation of comprehensive risk capital requirement. The comprehensive risk capital requirement is the greater of:

(1) The average of the comprehensive risk measures over the previous 12 weeks; or

(2) The most recent comprehensive risk measure.

§___.210 Standardized Measurement Method for Specific Risk

(a) General requirement. A [BANK] must calculate a total specific risk add-on for each portfolio of debt and equity positions for which the [BANK]'s VaR-based measure does not capture all material aspects of specific risk and for all securitization positions that are not modeled under section 209 of this subpart. A [BANK] must calculate each specific risk add-on in accordance with the requirements of this section. Notwithstanding any other definition or requirement in this subpart F, a position that is a correlation trading position under paragraph (2) of that definition and that otherwise meets the definition of a debt position or an equity position shall be considered a debt position or an equity position, respectively, for purposes of this section 210 of this subpart.

(1) The specific risk add-on for an individual debt or securitization position that represents sold credit protection is capped at the notional amount of the credit derivative contract. The specific risk add-on for an individual debt or securitization position that represents purchased credit protection is capped at the current market value of the transaction plus the absolute value of the present value of all remaining payments to the protection seller under the transaction. This sum is equal to the value of the protection leg of the transaction.

(2) For debt, equity, or securitization positions that are derivatives with linear payoffs, a [BANK] must assign a specific risk-weighting factor to the market value of the effective notional amount of the underlying instrument or index portfolio, except for a securitization position for which the [BANK] directly calculates a specific risk add-on using the SFA in paragraph (b)(2)(vii)(B) of this section. A swap must be included as an effective notional position in the underlying instrument or portfolio, with the receiving side treated as a long position and the paying side treated as a short position. For debt, equity, or securitization positions that are derivatives with nonlinear payoffs, a [BANK] must risk weight the market value of the effective notional amount of the underlying instrument or portfolio multiplied by the derivative's delta.

(3) For debt, equity, or securitization positions, a [BANK] may net long and short positions (including derivatives) in identical issues or identical indices. A [BANK] may also net positions in depositary receipts against an opposite position in an identical equity in different markets, provided that the [BANK] includes the costs of conversion.

(4) A set of transactions consisting of either a debt position and its credit derivative hedge or a securitization position and its credit derivative hedge has a specific risk add-on of zero if:

(i) The debt or securitization position is fully hedged by a total return swap (or similar instrument where there is a matching of swap payments and changes in market value of the debt or securitization position);

(ii) There is an exact match between the reference obligation of the swap and the debt or securitization position;

(iii) There is an exact match between the currency of the swap and the debt or securitization position; and

(iv) There is either an exact match between the maturity date of the swap and the maturity date of the debt or securitization position; or, in cases where a total return swap references a portfolio of positions with different maturity dates, the total return swap maturity date must match the maturity date of the underlying asset in that portfolio that has the latest maturity date.

(5) The specific risk add-on for a set of transactions consisting of either a debt position and its credit derivative hedge or a securitization position and its credit derivative hedge that does not meet the criteria of paragraph (a)(4) of this section is equal to 20.0 percent of the capital requirement for the side of the transaction with the higher specific risk add-on when:

(i) The credit risk of the position is fully hedged by a credit default swap or similar instrument;

(ii) There is an exact match between the reference obligation of the credit derivative hedge and the debt or securitization position;

(iii) There is an exact match between the currency of the credit derivative hedge and the debt or securitization position; and

(iv) There is either an exact match between the maturity date of the credit derivative hedge and the maturity date of the debt or securitization position; or, in the case where the credit derivative hedge has a standard maturity date:

(A) The maturity date of the credit derivative hedge is within 30 business days of the maturity date of the debt or securitization position; or

(B) For purchased credit protection, the maturity date of the credit derivative hedge is later than the maturity date of the debt or securitization position, but is no later than the standard maturity date for that instrument that immediately follows the maturity date of the debt or securitization position. The maturity date of the credit derivative hedge may not exceed the maturity date of the debt or securitization position by more than 90 calendar days.

(6) The specific risk add-on for a set of transactions consisting of either a debt position and its credit derivative hedge or a securitization position and its credit derivative hedge that does not meet the criteria of either paragraph (a)(4) or (a)(5) of this section, but in which all or substantially all of the price risk has been hedged, is equal to the specific risk add-on for the side of the transaction with the higher specific risk add-on.

(b) Debt and securitization positions. (1) The total specific risk add-on for a portfolio of debt or securitization positions is the sum of the specific risk add-ons for individual debt or securitization positions, as computed under this section. To determine the specific risk add-on for individual debt or securitization positions, a [BANK] must multiply the absolute value of the current market value of each net long or net short debt or securitization position in the portfolio by the appropriate specific risk-weighting factor as set forth in paragraphs (b)(2)(i) through (b)(2)(vii) of this section.

(2) For the purpose of this section, the appropriate specific risk-weighting factors include:

(i) Sovereign debt positions. (A) In general. A [BANK] must assign a specific risk-weighting factor to a sovereign debt position based on the CRC applicable to the sovereign entity and, as applicable, the remaining contractual maturity of the position, in accordance with table 2 of this section. Sovereign debt positions that are backed by the full faith and credit of the United States are treated as having a CRC of 0.

TABLE 2 – SPECIFIC RISK-WEIGHTING FACTORS FOR SOVEREIGN DEBT POSITIONS

		Specific Risk-weighting Factor (in percent)	
Sovereign CRC	0-1	0.0	
	2-3	Remaining contractual maturity of 6 months or less	0.25
		Remaining contractual maturity of greater than 6 and up to and including 24 months	1.0
		Remaining contractual maturity exceeds 24 months	1.6
	4-6	8.0	
	7	12.0	
No CRC		8.0	
Default by the Sovereign Entity		12.0	

(B) Notwithstanding paragraph (b)(2)(i)(A) of this section, a [BANK] may assign to a sovereign debt position a specific risk-weighting factor that is lower than the applicable specific risk-weighting factor in table 2 if:

(1) The position is denominated in the sovereign entity's currency;

(2) The [BANK] has at least an equivalent amount of liabilities in that currency; and

(3) The sovereign entity allows banks under its jurisdiction to assign the lower specific risk-weighting factor to the same exposures to the sovereign entity.

(C) A [BANK] must assign a 12.0 percent specific risk-weighting factor to a sovereign debt position immediately upon determination a default has occurred; or if a default has occurred within the previous five years.

(D) A [BANK] must assign an 8.0 percent specific risk-weighting factor to a sovereign debt position if the sovereign entity does not have a CRC assigned to it, unless the sovereign debt position must be assigned a higher specific risk-weighting factor under paragraph (b)(2)(i)(C) of this section.

(ii) Certain supranational entity and multilateral development bank debt positions. A [BANK] may assign a 0.0 percent specific risk-weighting factor to a debt position that is an exposure to the Bank for International Settlements, the European Central Bank, the European Commission, the International Monetary Fund, or an MDB.

(iii) GSE debt positions. A [BANK] must assign a 1.6 percent specific risk-weighting factor to a debt position that is an exposure to a GSE. Notwithstanding the foregoing, a [BANK] must assign an 8.0 percent specific risk-weighting factor to preferred stock issued by a GSE.

(iv) Depository institution, foreign bank, and credit union debt positions. (A) Except as provided in paragraph (b)(2)(iv)(B) of this section, a [BANK] must assign a specific risk-weighting factor to a debt position that is an exposure to a depository institution, a foreign bank, or a credit union using the specific risk-weighting factor that corresponds to that entity's home country and, as applicable, the remaining contractual maturity of the position, in accordance with table 3 of this section.

TABLE 3 – SPECIFIC RISK-WEIGHTING FACTORS FOR DEPOSITORY INSTITUTION, FOREIGN BANK, AND CREDIT UNION DEBT POSITIONS

		Specific Risk-weighting Factor (in percent)	
Sovereign CRC	0-2	Remaining contractual maturity of 6 months or less	0.25
		Remaining contractual maturity of greater than 6 and up to and including 24 months	1.0
		Remaining contractual maturity exceeds 24 months	1.6
	3	8.0	
	4-7	12.0	
No CRC		8.0	
Default by the Sovereign Entity		12.0	

(B) A [BANK] must assign a specific risk-weighting factor of 8.0 percent to a debt position that is an exposure to a depository institution or a foreign bank that is includable in the depository institution's or foreign bank's regulatory capital and that is not subject to deduction as a reciprocal holding under section 22 of subpart C of this part.

(C) A [BANK] must assign a 12.0 percent specific risk-weighting factor to a debt position that is an exposure to a foreign bank immediately upon determination that a default by the foreign bank's home country has occurred or if a default by the foreign bank's home country has occurred within the previous five years.

(v) PSE debt positions. (A) Except as provided in paragraph (b)(2)(v)(B) of this section, a [BANK] must assign a specific risk-weighting factor to a debt position that is an exposure to a PSE based on the specific risk-weighting factor that corresponds to the PSE's home country and to the position's categorization as a general obligation or revenue obligation and, as applicable, the remaining contractual maturity of the position, as set forth in tables 4 and 5 of this section.

(B) A [BANK] may assign a lower specific risk-weighting factor than would otherwise apply under tables 4 and 5 of this section to a debt position that is an exposure to a foreign PSE if:

(1) The PSE's home country allows banks under its jurisdiction to assign a lower specific risk-weighting factor to such position; and

(2) The specific risk-weighting factor is not lower than the risk weight that corresponds to the PSE's home country in accordance with tables 4 and 5 of this section.

(C) A [BANK] must assign a 12.0 percent specific risk-weighting factor to a PSE debt position immediately upon determination that a default by the PSE's home country has occurred or if a default by the PSE's home country has occurred within the previous five years.

TABLE 4 – SPECIFIC RISK-WEIGHTING FACTORS FOR PSE GENERAL OBLIGATION DEBT POSITIONS

		General Obligation **Specific Risk-weighting Factor** **(in percent)**	
Sovereign CRC	0-2	Remaining contractual maturity of 6 months or less	0.25
		Remaining contractual maturity of greater than 6 and up to and including 24 months	1.0
		Remaining contractual maturity exceeds 24 months	1.6
	3	8.0	
	4-7	12.0	
No CRC		8.0	
Default by the Sovereign Entity		12.0	

TABLE 5 – SPECIFIC RISK-WEIGHTING FACTORS FOR PSE REVENUE OBLIGATION DEBT POSITIONS

		Revenue Obligation **Specific Risk-weighting Factor** **(in percent)**	
Sovereign CRC	0-1	Remaining contractual maturity of 6 months or less	0.25
		Remaining contractual maturity of greater than 6 and up to and including 24 months	1.0
		Remaining contractual maturity exceeds 24 months	1.6
	2-3	8.0	
	4-7	12.0	
No CRC		8.0	
Default by the Sovereign Entity		12.0	

(vi) Corporate debt positions. Except as otherwise provided in paragraph (b)(2)(vi)(B) of this section, a [BANK] must assign a specific risk-weighting factor to a corporate debt position in accordance with the investment grade methodology in paragraph (b)(2)(vi)(A) of this section.

(A) Investment grade methodology. (1) For corporate debt positions that are exposures to entities that have issued and outstanding publicly traded instruments, a [BANK] must assign a specific risk-weighting factor based on the category and remaining contractual maturity of the position, in accordance with table 6. For purposes of this paragraph (A)(1), the [BANK] must determine whether the position is in the investment grade or not investment grade category.

TABLE 6 – SPECIFIC RISK-WEIGHTING FACTORS FOR CORPORATE DEBT POSITIONS UNDER THE INVESTMENT GRADE METHODOLOGY

Category	Remaining Contractual Maturity	Specific Risk-weighting Factor (in percent)
Investment Grade	6 months or less	0.50
	Greater than 6 and up to and including 24 months	2.00
	Greater than 24 months	4.00
Non-investment Grade		12.00

(2) A [BANK] must assign an 8.0 percent specific risk-weighting factor for corporate debt positions that are exposures to entities that do not have publicly traded instruments outstanding.

(B) Limitations. (1) A [BANK] must assign a specific risk-weighting factor of at least 8.0 percent to an interest-only mortgage-backed security that is not a securitization position.

(2) A [BANK] shall not assign a corporate debt position a specific risk-weighting factor that is lower than the specific risk-weighting factor that corresponds to the CRC of the issuer's home country in table 2 of this section.

(vii) Securitization positions. (A) General requirements. (1) A [BANK] that is not an advanced approaches bank must assign a specific risk-weighting factor to a securitization position using either the simplified supervisory formula approach (SSFA) in paragraph (b)(2)(vii)(C) of this section (and section 211 of this subpart) or assign a specific risk-weighting factor of 100 percent to the position.

(2) A [BANK] that is an advanced approaches bank must calculate a specific risk add-on for a securitization position in accordance with paragraph (b)(2)(vii)(B) of this section if the [BANK] and the securitization position each qualifies to use the SFA in section 143 of subpart E. A [BANK] that is an advanced approaches bank with a securitization position that does not qualify for the SFA under paragraph (b)(2)(vii)(B) of this section may assign a specific risk-weighting factor to the securitization position using the SSFA in accordance with paragraph (b)(2)(vii)(C) of this section or assign a specific risk-weighting factor of 100 percent to the position.

(3) A [BANK] must treat a short securitization position as if it is a long securitization position solely for calculation purposes when using the SFA in paragraph (b)(2)(vii)(B) of this section or the SSFA in paragraph (b)(2)(vii)(C) of this section.

(B) SFA. To calculate the specific risk add-on for a securitization position using the SFA, a [BANK] that is an advanced approaches bank must set the specific risk add-on for the position equal to the risk-based capital requirement as calculated under section 143 of subpart E.

(C) SSFA. To use the SSFA to determine the specific risk-weighting factor for a securitization position, a [BANK] must calculate the specific risk-weighting factor in accordance with section 211 of this subpart.

(D) N^{th}-to-default credit derivatives. A [BANK] must determine a specific risk add-on using the SFA in paragraph (b)(2)(vii)(B) of this section, or assign a specific risk-weighting factor using the SSFA in paragraph (b)(2)(vii)(C) of this section to an n^{th}-to-default credit derivative in accordance with this paragraph D, regardless of whether the [BANK] is a net protection buyer or net protection seller. A [BANK] must determine its position in the n^{th}-to-default credit derivative as the largest notional dollar amount of all the underlying exposures.

(1) For purposes of determining the specific risk add-on using the SFA in paragraph (b)(2)(vii)(B) of this section or the specific risk-weighting factor for an n^{th}-to-default credit derivative using the SSFA in paragraph (b)(2)(vii)(C) of this section the [BANK] must calculate the attachment point and detachment point of its position as follows:

(i) The attachment point (parameter A) is the ratio of the sum of the notional amounts of all underlying exposures that are subordinated to the [BANK]'s position to the total notional amount of all underlying exposures. For purposes of using the SFA in paragraph (b)(2)(vii)(B) of this section to calculate the specific add-on for its position in an n^{th}-to-default credit derivative, parameter A must be set equal to *the credit enhancement level* (L) input to the SFA formula in section 143 of this subpart. In the case of a first-to-default credit derivative, there are no underlying exposures that are subordinated to the [BANK]'s position. In the case of a second-or-subsequent-to-default credit derivative, the smallest (n-1) notional amounts of the underlying exposure(s) are subordinated to the [BANK]'s position.

(ii) The detachment point (parameter D) equals the sum of parameter A plus the ratio of the notional amount of the [BANK]'s position in the n^{th}-to-default credit derivative to the total notional amount of all underlying exposures. For purposes of using the SFA in paragraph (b)(2)(vii)(B) of this section to calculate the specific risk add-on for its position in an n^{th}-to-default credit derivative, parameter D must be set to equal the L input plus the *thickness of tranche* T input to the SFA formula in section 143 of this subpart.

(2) A [BANK] that does not use the SFA in paragraph (b)(2)(vii)(B) of this section to determine a specific risk-add on, or the SSFA in paragraph (b)(2)(vii)(C) of this section to determine a specific risk-weighting factor for its position in an n^{th}-to-default credit derivative must assign a specific risk-weighting factor of 100 percent to the position.

(c) Modeled correlation trading positions. For purposes of calculating the comprehensive risk measure for modeled correlation trading positions under either paragraph (a)(2)(i) or (a)(2)(ii) of section 209 of this subpart, the total specific risk add-on is the greater of:

(1) The sum of the [BANK]'s specific risk add-ons for each net long correlation trading position calculated under this section; or

(2) The sum of the [BANK]'s specific risk add-ons for each net short correlation trading position calculated under this section.

(d) Non-modeled securitization positions. For securitization positions that are not correlation trading positions and for securitizations that are correlation trading positions not modeled under section 209 of this subpart, the total specific risk add-on is the greater of:

(1) The sum of the [BANK]'s specific risk add-ons for each net long securitization position calculated under this section; or

(2) The sum of the [BANK]'s specific risk add-ons for each net short securitization position calculated under this section.

(e) Equity positions. The total specific risk add-on for a portfolio of equity positions is the sum of the specific risk add-ons of the individual equity positions, as computed under this section. To determine the specific risk add-on of individual equity positions, a [BANK] must multiply the absolute value of the current market value of each net long or net short equity position by the appropriate specific risk-weighting factor as determined under this paragraph:

(1) The [BANK] must multiply the absolute value of the current market value of each net long or net short equity position by a specific risk-weighting factor of 8.0 percent. For equity positions that are index contracts comprising a well-diversified portfolio of equity instruments, the absolute value of the current market value of each net long or net short position is multiplied by a specific risk-weighting factor of 2.0 percent.[3]

(2) For equity positions arising from the following futures-related arbitrage strategies, a [BANK] may apply a 2.0 percent specific risk-weighting factor to one side (long or short) of each position with the opposite side exempt from an additional capital requirement:

(i) Long and short positions in exactly the same index at different dates or in different market centers; or

(ii) Long and short positions in index contracts at the same date in different, but similar indices.

(3) For futures contracts on main indices that are matched by offsetting positions in a basket of stocks comprising the index, a [BANK] may apply a 2.0 percent specific risk-weighting factor to the futures and stock basket positions (long and short), provided that such trades are deliberately entered into and separately controlled, and that the basket of stocks is comprised of stocks representing at least 90.0 percent of the capitalization of the index. A main index refers to the Standard & Poor's 500 Index, the FTSE All-World Index, and any other index for which the [BANK] can demonstrate to the satisfaction of the [AGENCY] that the equities represented in the index have liquidity, depth of market, and size of bid-ask spreads comparable to equities in the Standard & Poor's 500 Index and FTSE All-World Index.

[3] A portfolio is well-diversified if it contains a large number of individual equity positions, with no single position representing a substantial portion of the portfolio's total market value.

(f) Due diligence requirements. (1) A [BANK] must demonstrate to the satisfaction of the [AGENCY] a comprehensive understanding of the features of a securitization position that would materially affect the performance of the position by conducting and documenting the analysis set forth in paragraph (f)(2) of this section. The [BANK]'s analysis must be commensurate with the complexity of the securitization position and the materiality of the position in relation to capital.

(2) A [BANK] must demonstrate its comprehensive understanding for each securitization position by:

(i) Conduct an analysis of the risk characteristics of a securitization position prior to acquiring the position and document such analysis within three business days after acquiring position, considering:

(A) Structural features of the securitization that would materially impact the performance of the position, for example, the contractual cash flow waterfall, waterfall-related triggers, credit enhancements, liquidity enhancements, market value triggers, the performance of organizations that service the position, and deal-specific definitions of default;

(B) Relevant information regarding the performance of the underlying credit exposure(s), for example, the percentage of loans 30, 60, and 90 days past due; default rates; prepayment rates; loans in foreclosure; property types; occupancy; average credit score or other measures of creditworthiness; average loan-to-value ratio; and industry and geographic diversification data on the underlying exposure(s);

(C) Relevant market data of the securitization, for example, bid-ask spreads, most recent sales price and historical price volatility, trading volume, implied market rating, and size, depth and concentration level of the market for the securitization; and

(D) For resecuritization positions, performance information on the underlying securitization exposures, for example, the issuer name and credit quality, and the characteristics and performance of the exposures underlying the securitization exposures; and

(ii) On an on-going basis (no less frequently than quarterly), evaluating, reviewing, and updating as appropriate the analysis required under paragraph (f)(1) of this section for each securitization position.

§___.211 Simplified Supervisory Formula Approach (SSFA)

(a) General requirements. To use the SSFA to determine the specific risk-weighting factor for a securitization position, a [BANK] must have data that enables it to assign accurately the parameters described in paragraph (b) of this section. Data used to assign the parameters described in paragraph (b) of this section must be the most currently available data and no more than 91 calendar days old. A [BANK] that does not have the appropriate data to assign the parameters described in paragraph (b) of this section must assign a specific risk-weighting factor of 100 percent to the position.

(b) SSFA parameters. To calculate the specific risk-weighting factor for a securitization position using the SSFA, a [BANK] must have accurate information on the five inputs to the SSFA calculation described in paragraphs (b)(1) through (b)(5) of this section.

(1) K_G is the weighted-average (with unpaid principal used as the weight for each exposure) total capital requirement of the underlying exposures calculated using subpart D. K_G is expressed as a decimal value between zero and 1 (that is, an average risk weight of 100 percent represents a value of K_G equal to .08).

(2) Parameter W is expressed as a decimal value between zero and one. Parameter W is the ratio of the sum of the dollar amounts of any underlying exposures within the securitized pool that meet any of the criteria are set forth in paragraphs (i) through (vi) of this paragraph (b)(2) to the ending balance, measured in dollars, of underlying exposures:

(i) Ninety days or more past due;

(ii) Subject to a bankruptcy or insolvency proceeding;

(iii) In the process of foreclosure;

(iv) Held as real estate owned;

(v) Has contractually deferred interest payments for 90 days or more; or

(vi) Is in default.

(3) Parameter A is the attachment point for the position, which represents the threshold at which credit losses will first be allocated to the position. Parameter A equals the ratio of the current dollar amount of underlying exposures that are subordinated to the position of the [BANK] to the current dollar amount of underlying exposures. Any reserve account funded by the accumulated cash flows from the underlying exposures that is subordinated to the position that contains the [BANK]'s securitization exposure may be included in the calculation of parameter A to the extent that cash is present in the account. Parameter A is expressed as a decimal value between zero and one.

(4) Parameter D is the detachment point for the position, which represents the threshold at which credit losses of principal allocated to the position would result in a total loss of principal. Parameter D equals parameter A plus the ratio of the current dollar amount of the securitization positions that are pari passu with the position (that is, have equal seniority with respect to credit risk) to the current dollar amount of the underlying exposures. Parameter D is expressed as a decimal value between zero and one.

(5) A supervisory calibration parameter, p, is equal to 0.5 for securitization positions that are not resecuritization positions and equal to 1.5 for resecuritization positions.

(c) Mechanics of the SSFA. K_G and W are used to calculate K_A, the augmented value of K_G, which reflects the observed credit quality of the underlying pool of exposures. K_A is defined in paragraph (d) of this section. The values of parameters A and D, relative to K_A determine the

specific risk-weighting factor assigned to a position as described in this paragraph and paragraph (d) of this section. The specific risk-weighting factor assigned to a securitization position, or portion of a position, as appropriate, is the larger of the specific risk-weighting factor determined in accordance with this paragraph and paragraph (d) of this section and a specific risk-weighting factor of 1.6 percent.

(1) When the detachment point, parameter D, for a securitization position is less than or equal to K_A, the position must be assigned a specific risk-weighting factor of 100 percent.

(2) When the attachment point, parameter A, for a securitization position is greater than or equal to K_A, the [BANK] must calculate the specific risk-weighting factor in accordance with paragraph (d) of this section.

(3) When A is less than K_A and D is greater than K_A, the specific risk-weighting factor is a weighted-average of 1.00 and K_{SSFA} calculated under paragraphs (c)(3)(i) and (c)(3)(ii) of this section, but with the parameter A revised to be set equal to K_A. For the purpose of this calculation:

(i) The weight assigned to 1.00 equals $\frac{K_A - A}{D - A}$.

(ii) The weight assigned to K_{SSFA} equals $\frac{D - K_A}{D - A}$. The specific risk-weighting factor is equal to:

$$SRWF = 100 \times \left[\left(\frac{K_A - A}{D - A} \right) \times 1.00 \right] + \left[\left(\frac{D - K_A}{D - A} \right) \times K_{SSFA} \right]$$

(d) SSFA equation. (1) The [BANK] must define the following parameters:

$$K_A = (1 - W) \cdot K_G + (0.5 \cdot W)$$

$a = -\frac{1}{p \cdot K_A}$
$u = D - K_A$
$l = A - K_A$
$e = 2.71828$, the base of the natural logarithms.
(2) Then the [BANK] must calculate K_{SSFA} according to the following formula:
$K_{SSFA} = \frac{e^{a \cdot u} - e^{a \cdot l}}{a(u - l)}$

(3) The specific risk-weighting factor for the position (expressed as a percent) is equal to $K_{SSFA} \times 100$.

§___.212 Market Risk Disclosures

(a) Scope. A [BANK] must comply with this section unless it is a consolidated subsidiary of a bank holding company or a depository institution that is subject to these requirements or of a non-U.S. banking organization that is subject to comparable public disclosure requirements in its home jurisdiction. A [BANK] must make quantitative disclosures

publicly each calendar quarter. If a significant change occurs, such that the most recent reporting amounts are no longer reflective of the [BANK]'s capital adequacy and risk profile, then a brief discussion of this change and its likely impact must be provided as soon as practicable thereafter. Qualitative disclosures that typically do not change each quarter may be disclosed annually, provided any significant changes are disclosed in the interim. If a [BANK] believes that disclosure of specific commercial or financial information would prejudice seriously its position by making public certain information that is either proprietary or confidential in nature, the [BANK] is not required to disclose these specific items, but must disclose more general information about the subject matter of the requirement, together with the fact that, and the reason why, the specific items of information have not been disclosed.

(b) Disclosure policy. The [BANK] must have a formal disclosure policy approved by the board of directors that addresses the [BANK]'s approach for determining its market risk disclosures. The policy must address the associated internal controls and disclosure controls and procedures. The board of directors and senior management must ensure that appropriate verification of the disclosures takes place and that effective internal controls and disclosure controls and procedures are maintained. One or more senior officers of the [BANK] must attest that the disclosures meet the requirements of this subpart, and the board of directors and senior management are responsible for establishing and maintaining an effective internal control structure over financial reporting, including the disclosures required by this section.

(c) Quantitative disclosures. (1) For each material portfolio of covered positions, the [BANK] must disclose publicly the following information at least quarterly:

(i) The high, low, and mean VaR-based measures over the reporting period and the VaR-based measure at period-end;

(ii) The high, low, and mean stressed VaR-based measures over the reporting period and the stressed VaR-based measure at period-end;

(iii) The high, low, and mean incremental risk capital requirements over the reporting period and the incremental risk capital requirement at period-end;

(iv) The high, low, and mean comprehensive risk capital requirements over the reporting period and the comprehensive risk capital requirement at period-end, with the period-end requirement broken down into appropriate risk classifications (for example, default risk, migration risk, correlation risk);

(v) Separate measures for interest rate risk, credit spread risk, equity price risk, foreign exchange risk, and commodity price risk used to calculate the VaR-based measure; and

(vi) A comparison of VaR-based estimates with actual gains or losses experienced by the [BANK], with an analysis of important outliers.

(2) In addition, the [BANK] must disclose publicly the following information at least quarterly:

(i) The aggregate amount of on-balance sheet and off-balance sheet securitization positions by exposure type; and

(ii) The aggregate amount of correlation trading positions.

(d) Qualitative disclosures.

(1) For each material portfolio of covered positions, the [BANK] must disclose publicly the following information at least annually, or more frequently in the event of material changes for each portfolio:

(i) The composition of material portfolios of covered positions;

(ii) The [BANK]'s valuation policies, procedures, and methodologies for covered positions including, for securitization positions, the methods and key assumptions used for valuing such positions, any significant changes since the last reporting period, and the impact of such change;

(iii) The characteristics of the internal models used for purposes of this subpart. For the incremental risk capital requirement and the comprehensive risk capital requirement, this must include:

(A) The approach used by the [BANK] to determine liquidity horizons;

(B) The methodologies used to achieve a capital assessment that is consistent with the required soundness standard; and

(C) The specific approaches used in the validation of these models;

(iv) A description of the approaches used for validating and evaluating the accuracy of internal models and modeling processes for purposes of this subpart;

(v) For each market risk category (that is, interest rate risk, credit spread risk, equity price risk, foreign exchange risk, and commodity price risk), a description of the stress tests applied to the positions subject to the factor;

(vi) The results of the comparison of the [BANK]'s internal estimates for purposes of this subpart with actual outcomes during a sample period not used in model development;

(vii) The soundness standard on which the [BANK]'s internal capital adequacy assessment under this subpart is based, including a description of the methodologies used to achieve a capital adequacy assessment that is consistent with the soundness standard;

(2) A description of the [BANK]’s processes for monitoring changes in the credit and market risk of securitization positions, including how those processes differ for resecuritization positions; and

(3) A description of the [BANK]'s policy governing the use of credit risk mitigation to mitigate the risks of securitization and resecuritization positions.

End of Common Rule

List of Subjects

12 CFR Part 3

Administrative practices and procedure, Capital, National banks, Reporting and recordkeeping requirements, Risk.

12 CFR 217

Banks, banking, Federal Reserve System, Holding companies, Reporting and recordkeeping requirements, Securities.

12 CFR Part 325

Administrative practice and procedure, Banks, banking, Capital Adequacy, Reporting and recordkeeping requirements, Savings associations, State non-member banks.

Adoption of Proposed Common Rule

The adoption of the proposed common rules by the agencies, as modified by agency-specific text, is set forth below:

Department of the Treasury

Office of the Comptroller of the Currency

12 CFR CHAPTER I

Authority and Issuance

For the reasons set forth in the common preamble, the Office of the Comptroller of the Currency proposes to further amend part 3 of chapter I of title 12 of the Code of Federal Regulations is proposed to be amended elsewhere in this issue of the Federal Register under Docket ID OCC-2012-0008 and OCC-2012-0009, as follows:

PART 3 – MINIMUM CAPITAL RATIOS; ISSUANCE OF DIRECTIVES

1. The authority citation for part 3 continues to read as follows:

Authority: 12 U.S.C. 93a, 161, 1462, 1462a, 1463, 1464, 1818, 1828(n), 1828 note, 1831n note, 1835, 3907 and 3909, and 5412(b)(2)(B).

1. Part 3 is revised to read as set forth at the end of the common preamble
2. Subparts A-G of part 3 are amended as set forth below:

   i. Remove "[AGENCY]" and add "OCC" in its place, wherever it appears;

   ii. Remove "[BANK]" and add "national bank and Federal savings association" in its place, wherever it appears in the phrase "Each [BANK]" or "each [BANK]";
   iii. Remove "[BANK]" and add "national bank or Federal savings association" in its place, wherever it appears in the phrases "A [BANK]", "a [BANK]", "The [BANK]", or "the [BANK]";
   iv. Remove "[BANKS]" and add "national banks and Federal savings associations" in its place, wherever it appears;
   v. Remove "[PART]" and add "Part 3" in its place, wherever it appears;
   vi. Remove "[AGENCY]" and add "OCC" in its place, wherever it appears; and
   vii. Remove "[REGULATORY REPORT]" and add "Call Report" in its place, wherever it appears.

Subpart E– Risk-Weighted Assets – Internal Ratings-Based and Advanced Measurement Approaches

Subpart F– Risk-Weighted Assets – Market Risk

3. Subpart F to part 3 is further amended by:

a. Remove "[AGENCY]" and add "OCC" in its place wherever it appears.

b. Remove "[BANK]" and add "bank" in its place wherever it appears.

c. Remove "[REGULATORY REPORT]" wherever it appears and add in its place "Consolidated Reports of Condition and Income (Call Report), the first time it appears and "Call Report" every time thereafter;

Board of Governors of the Federal Reserve System

12 CFR CHAPTER II

Authority and Issuance

For the reasons set forth in the common preamble, part 217 of chapter II of title 12 of the Code of Federal Regulations are proposed to be amended as follows:

PART 217—CAPITAL ADEQUACY OF BANK HOLDING COMPANIES, SAVINGS AND LOAN HOLDING COMPANIES, AND STATE MEMBER BANKS

Subpart E– Risk-Weighted Assets – Internal Ratings-Based and Advanced Measurement Approaches

Subpart F– Risk-weighted Assets – Market Risk

1. The authority citation for part 217 shall read as follows:

Authority: 12 USC 248(a), 321–338a, 481-486, 1462a, 1467a, 1818, 1828, 1831n, 1831o, 1831p–l, 1831w, 1835, 1844(b), 3904, 3906-3909, 4808, 5365, 5371.

2. Part 217 is added as set forth at the end of the common preamble.

3. Part 217 is amended as set forth below:

a. Remove "[AGENCY]" and add "Board" in its place wherever it appears.

b. Remove "[BANK]" and add "Board-regulated institution" in its place wherever it appears.

c. Remove "[PART]" and add "part" in its place wherever it appears.

d. Remove "[REGULATORY REPORT]" wherever it appears and add in its place "Consolidated Reports of Condition and Income (Call Report), for a state member bank, or Consolidated Financial Statements for Bank Holding Companies (FR Y–9C), for a bank holding company or savings and loan holding company, as applicable" the first time it appears and "Call Report, for a state member bank or FR Y-9C, for a bank holding company or savings and loan holding company, as applicable" every time thereafter;

d. In § 217.100, revise paragraph (b) to read as follows:

§217.100 Purpose, Applicability, and Principle of Conservatism

* * * * *

(b) Applicability. (1) This subpart applies to:

(i) A top-tier bank holding company or savings and loan holding company domiciled in the United States that:

(A) Is not a consolidated subsidiary of another bank holding company or savings and loan holding company that uses 12 CFR part 217, subpart E, to calculate its risk-based capital requirements; and

(B) That:

(1) Has total consolidated assets (excluding assets held by an insurance underwriting subsidiary), as defined on schedule HC-K of the FR Y-9C, equal to $250 billion or more;

(2) Has consolidated total on-balance sheet foreign exposure at the most recent year-end equal to $10 billion (excluding exposures held by an insurance underwriting subsidiary). Total on-balance sheet foreign exposure equals total cross-border claims less claims with head office or guarantor located in another country plus redistributed guaranteed amounts to the country of head office or guarantor plus local country claims on local residents plus revaluation gains on foreign exchange and derivative products, calculated in accordance with the Federal Financial Institutions Examination Council (FFIEC) 009 Country Exposure Report); or

(3) Has a subsidiary depository institution that is required, or has elected, to use 12 CFR part 3, subpart E (OCC), 12 CFR part 217, subpart E (Board), or 12 CFR part 325, subpart E (FDIC) to calculate its risk-based capital requirements;

(ii) A state member bank that:

(A) Has total consolidated assets, as reported on the most recent year-end Consolidated Report of Condition and Income (Call Report), equal to $250 billion or more;

(B) Has consolidated total on-balance sheet foreign exposure at the most recent year-endequal to $10 billion or more (where total on-balance sheet foreign exposure equals total cross-border claims less claims with head office or guarantor located in another country plus redistributed guaranteed amounts to the country of head office or guarantor plus local country claims on local residents plus revaluation gains on foreign exchange and derivative products, calculated in accordance with the Federal Financial Institutions Examination Council (FFIEC) 009 Country Exposure Report);

(C) Is a subsidiary of a depository institution that uses 12 CFR part 3, subpart E (OCC), 12 CFR part 217, subpart E (Board), or 12 CFR part 325, subpart E (FDIC) to calculate its risk-based capital requirements; or

(D) Is a subsidiary of a bank holding company that uses 12 CFR part 217, subpart E, to calculate its risk-based capital requirements; and

(iii) Any Board-regulated institution that elects to use this subpart to calculate its risk-based capital requirements.

* * * * *

e. In § 217.121, revise paragraph (a) to read as follows:

* * * * *

§217.121 Qualification process

(a) Timing. (1) A Board-regulated institution that is described in section 217.100(b)(1)(i)-(ii) must adopt a written implementation plan no later than six months after the date the Board-regulated institution meets a criterion in that section. The implementation plan must incorporate an explicit start date no later than 36 months after the date the Board-regulated institution meets at least one criterion under section 217.100(b)(1)(i)-(ii). The Board may extend the start date.

(2) A Board-regulated institution that elects to be subject to this subpart under section 217.101(b)(iii) must adopt a written implementation plan.

* * * * *

f. In § 217.122(g), revise paragraph (g)(3)(ii) to read as follows:

(ii)(A) With the prior written approval of the Board, a state member bank may generate an estimate of its operational risk exposure using an alternative approach to that specified in paragraph (g)(3)(i) of this section. A state member bank proposing to use such an alternative operational risk quantification system must submit a proposal to the Board. In determining whether to approve a state member bank's proposal to use an alternative operational risk quantification system, the Board will consider the following principles:

(A) Use of the alternative operational risk quantification system will be allowed only on an exception basis, considering the size, complexity, and risk profile of the state member bank;

(B) The state member bank must demonstrate that its estimate of its operational risk exposure generated under the alternative operational risk quantification system is appropriate and can be supported empirically; and

(C) A state member bank must not use an allocation of operational risk capital requirements that includes entities other than depository institutions or the benefits of diversification across entities.

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g. In § 217.131, revise paragraph (b) and paragraph (e)(3)(i), and add a new paragraph (e)(5) to read as follows:

§ 217.131 Mechanics for Calculating Total Wholesale and Retail Risk-Weighted Assets.

* * * * *

(b) Phase 1 − Categorization. The Board-regulated institution must determine which of its exposures are wholesale exposures, retail exposures, securitization exposures, or equity exposures. The Board-regulated institution must categorize each retail exposure as a residential mortgage exposure, a QRE, or an other retail exposure. The Board-regulated institution must

identify which wholesale exposures are HVCRE exposures, sovereign exposures, OTC derivative contracts, repo-style transactions, eligible margin loans, eligible purchased wholesale exposures, cleared transactions, default fund contributions, and unsettled transactions to which § 217.136 applies, and eligible guarantees or eligible credit derivatives that are used as credit risk mitigants. The Board-regulated institution must identify any on-balance sheet asset that does not meet the definition of a wholesale, retail, equity, or securitization exposure, any non-material portfolio of exposures described in paragraph (e)(4) of this section, and for bank holding companies and savings and loan holding companies, any on-balance sheet asset that is held in a non-guaranteed separate account.

* * * * *

(e) * * *

(3) * * *

(i) A bank holding company or savings and loan holding company may assign a risk-weighted asset amount of zero to cash owned and held in all offices of subsidiary depository institutions or in transit; and for gold bullion held in a subsidiary depository institution's own vaults, or held in another depository institution's vaults on an allocated basis, to the extent the gold bullion assets are offset by gold bullion liabilities.

(ii) A state member bank may assign a risk–weighted asset amount to cash owned and held in all offices of the state member bank or in transit and for gold bullion held in the state member bank's own vaults, or held in another depository institution's vaults on an allocated basis, to the extent the gold bullion assets are offset by gold bullion liabilities.

* * * * *

(5) Assets held in non-guaranteed separate accounts. The risk-weighted asset amount for an on-balance sheet asset that is held in a non-guaranteed separate account is zero percent of the carrying value of the asset.

* * * * *

h. In § 217.142, revise paragraphs (k)(1)(iv) and (k)(4) to read as follows:

§ 217.142. Risk-Based Capital Requirement for Securitization Exposures.

* * * * *

(k)

(1) * * *

(iv)

(A) In the case of a state member bank, the bank is well capitalized, as defined in 12 CFR 208.43. For purposes of determining whether a state member bank is well capitalized for purposes of this paragraph, the state member bank's capital ratios must be calculated without regard to the capital treatment for transfers of small-business obligations with recourse specified in paragraph (k)(1) of this section.

(B) In the case of a bank holding company or savings and loan holding company, the bank holding company or savings and loan holding company is well capitalized, as defined in 12 CFR 225.2. For purposes of determining whether a bank holding company or savings and loan holding company is well capitalized for purposes of this paragraph, the bank holding company or savings and loan holding company's capital ratios must be calculated without regard to the capital treatment for transfers of small-business obligations with recourse specified in paragraph (k)(1) of this section.

* * * * *

i. In § 217.152, revise paragraph (b)(3)(i) to read as follows:

§ 217.152 Simple Risk Weight Approach (SRWA)

* * * * *

(b)

(3) * * *

(i) Community development equity exposures.

(A) For state member banks and bank holding companies, an equity exposure that qualifies as a community development investment under 12 U.S.C. 24 (Eleventh), excluding equity exposures to an unconsolidated small business investment company and equity exposures held through a consolidated small business investment company described in section 302 of the Small Business Investment Act of 1958 (15 U.S.C. 682).

(B) For savings and loan holding companies, an equity exposure that is designed primarily to promote community welfare, including the welfare of low- and moderate-income communities or families, such as by providing services or employment, and excluding equity exposures to an unconsolidated small business investment company and equity exposures held

through a small business investment company described in section 302 of the Small Business Investment Act of 1958 (15 U.S.C. 682).

* * * * *

j. In section 217.201, revise paragraph (b) to read as follows:

§271.201 Purpose, Applicability, and Reservation of Authority

(b) Applicability. (1) This subpart applies to any Board-regulated institution with aggregate trading assets and trading liabilities (as reported in the Board-regulated institution's most recent quarterly Call Report, for a state member bank, or FR Y-9C, for a bank holding company or savings and loan holding company[1], as applicable), equal to:

* * * * *

k. In section 217.202, revise paragraph (b) to read as follows:

Covered position means the following positions:

(1) A trading asset or trading liability (whether on- or off-balance sheet),[1] as reported on Schedule RC-D of the Call Report or Schedule HC-D of the FR Y–9C [2], that meets the following conditions:

* * * * *

§217.202 Definitions

Federal Deposit Insurance Corporation

12 CFR CHAPTER III

Authority and Issuance

For the reasons set forth in the common preamble, the Federal Deposit Insurance Corporation proposes to amend part 324 of chapter III of title 12 of the Code of Federal Regulations as follows:

PART 324 – CAPITAL ADEQUACY

[1] Savings and loan holding companies that do not file the FR Y-9C should follow the instructions to the FR Y-9C.

[1] Securities subject to repurchase and lending agreements are included as if they are still owned by the lender.

[2] Savings and loan holding companies that do not file the FR Y-9C should follow the instructions to the FR Y-9C.

1. Remove “[Authority citations to come]” and add in its place wherever it appears: “12 U.S.C. 1815(a), 1815(b), 1816, 1818(a), 1818(b), 1818(c), 1818(t), 1819(Tenth), 1828(c), 1828(d), 1828(i), 1828(n), 1828(o), 1831o, 1835, 3907, 3909, 4808; 5371; 5412; Pub. L. 102-233, 105 Stat. 1761, 1789, 1790 (12 U.S.C. 1831n note); Pub. L. 102-242, 105 Stat. 2236, 2355, as amended by Pub. L. 103-325, 108 Stat. 2160, 2233 (12 U.S.C. 1828 note); Pub. L. 102-242, 105 Stat. 2236, 2386, as amended by Pub. L. 102-550, 106 Stat. 3672, 4089 (12 U.S.C. 1828 note); Pub. L. 111-203, 124 Stat. 1376, 1887 (15 U.S.C. 78o-7 note).”;

2. Subparts E and F are added as set forth at the end of the common preamble.

3. Subparts E and F are amended as set forth below:

a. Remove “[AGENCY]” and add “FDIC” in its place, wherever it appears;

b. Remove “[Agency]” and add “FDIC” in its place, wherever it appears;

c. Remove “[Agency’s]” and add “FDIC’s” in its place, wherever it appears;

d. Remove “[12 CFR 3.12, 12 CFR 263.202, 12 CFR 325.6(c), 12 CFR 567.3(d)]” and add “12 CFR 325.6” in its place, wherever it appears;

e. Remove “[BANK]” and add “bank or state savings association” in its place, wherever it appears in the phrases “A [BANK]”, “a [BANK]”, “The [BANK]”, or “the [BANK]”;

f. Remove “[BANK]” and add “bank and state savings association” in its place, wherever it appears in the phrases “Each [BANK]” or “each [BANK]”;

g. Remove “[BANKS]” and add “banks and state savings associations” in its place, wherever its appears.

h. Remove “[PART]” and add “Part 324” in its place, wherever it appears;

i. Remove “[the general risk-based capital rules]” and add “Subpart D of this part” in its place, wherever it appears;

j. Remove “[REGULATORY REPORT]” and add “Consolidated Report of Condition and Income (Call Report)” in its place the first time it appears, and add “Call Report” in its place, wherever it appears every time thereafter;

k. Remove “[of 12 CFR part 3 (OCC), 12 CFR part 208 (Board), or 12 CFR part 325 (FDIC)]” and add “of 12 CFR part 324” in its place, wherever it appears;

l. Remove “[prompt corrective action regulation]” and add “Subpart H of this part” in its place, wherever it appears;

m. Remove “[under the advanced approach]” and add “under Subpart E of this part” in its place, wherever it appears;

n. Remove “[banking organization]” and add “bank and/or state savings associations, as

o. Remove “[banking organizations]” and add “banks and/or state savings associations, as appropriate” in its place, wherever it appears;

p. Remove “[the advanced capital adequacy framework]” and add “Subpart E of this part” in its place, wherever it appears;

q. Remove “[regulatory report]” and add “Consolidated Report of Condition and Income (Call Report)” in its place the first time it appears, and add “Call Report” in its place wherever, it appears every time thereafter; and

r. Remove “[Call Report or FR Y–9C]” and add “Call Report” in its place, wherever it appears.

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Appendix D to Part 325 – Capital Adequacy Guidelines for Banks: Internal-Ratings-Based and Advanced Measurement Approaches

4. Appendix D to part 325 is removed and reserved.