FEDERAL DEPOSIT INSURANCE CORPORATION

12 CFR Chapter III

RIN 3064-AD95

Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Capital Adequacy, Transition Provisions, Prompt Corrective Action, Standardized Approach for Risk-weighted Assets, Market Discipline and Disclosure Requirements, Advanced Approaches Risk-Based Capital Rule, and Market Risk Capital Rule

AGENCY: Federal Deposit Insurance Corporation.

ACTION: Interim final rule with request for comments.

SUMMARY:

The Federal Deposit Insurance Corporation (FDIC) is adopting an interim final rule that revises its risk-based and leverage capital requirements for FDIC-supervised institutions.[1] This interim final rule is substantially identical to a joint final rule issued by the Office of the Comptroller of the Currency (OCC) and the Board of Governors of the Federal Reserve System (Federal Reserve) (together, with the FDIC, the agencies). The interim final rule consolidates three separate notices of proposed rulemaking that the agencies jointly published in the Federal Register on August 30, 2012, with selected changes. The interim final rule implements a revised definition of regulatory capital, a new common equity tier 1 minimum capital requirement, a higher minimum tier 1 capital requirement, and, for FDIC-supervised institutions subject to the

[1] FDIC-supervised institutions include state nonmember banks and state savings associations. The term banking organizations includes 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 Federal Reserve'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, except certain savings and loan holding companies that are substantially engaged in insurance underwriting or commercial activities.

advanced approaches risk-based capital rules, a supplementary leverage ratio that incorporates a broader set of exposures in the denominator. The interim final rule incorporates these new requirements into the FDIC's prompt corrective action (PCA) framework. In addition, the interim final rule establishes limits on FDIC-supervised institutions' capital distributions and certain discretionary bonus payments if the FDIC-supervised institution 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. The interim final rule amends the methodologies for determining risk-weighted assets for all FDIC-supervised institutions. The interim final rule also adopts changes to the FDIC's regulatory capital requirements that meet the requirements of section 171 and section 939A of the Dodd-Frank Wall Street Reform and Consumer Protection Act.[2]

The interim final rule also codifies the FDIC's regulatory capital rules, which have previously resided in various appendices to their respective regulations, into a harmonized integrated regulatory framework. In addition, the FDIC is amending the market risk capital rule (market risk rule) to apply to state savings associations.

The FDIC is issuing these revisions to its capital regulations as an interim final rule. The FDIC invites comments on the interaction of this rule with other proposed leverage ratio requirements applicable to large, systemically important banking organizations. This interim final rule otherwise contains regulatory text that is identical to the common rule text adopted as a final rule by the Federal Reserve and the OCC. This interim final rule enables the FDIC to proceed on a unified, expedited basis with the other federal banking agencies pending consideration of other issues. Specifically, the FDIC intends to evaluate this interim final rule in

[2] Pub. L. 111–203, 124 Stat. 1376, 1435–38 (2010).

the context of the proposed well-capitalized and buffer levels of the supplementary leverage ratio applicable to large, systemically important banking organizations, as described in a separate Notice of Proposed Rulemaking (NPR), titled, Regulatory Capital Rules: Regulatory Capital, Enhanced Supplementary Leverage Ratio Standards for Certain Bank Holding Companies and the Insured Depository Institutions They Control.

The FDIC is seeking commenters' views on the interaction of this interim final rule with the proposed rule regarding the supplementary leverage ratio for large, systemically important banking organizations.

DATES: Effective date: January 1, 2014. Mandatory compliance date: January 1, 2014 for advanced approaches FDIC-supervised institutions; January 1, 2015 for all other FDIC-supervised institutions. Comments on the interim final rule must be received no later than [INSERT 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

ADDRESSES: You may submit comments, identified by RIN [3064-AD95], by any of the following methods:

- **Agency Website:** http://www.fdic.gov/regulations/laws/federal/propose.html. Follow instructions for submitting comments on the Agency website.
- **E-mail:** Comments@fdic.gov. Include the RIN 3064-AD95 on the subject line of the message.
- **Mail:** Robert E. Feldman, Executive Secretary, Attention: Comments, Federal Deposit Insurance Corporation, 550 17th Street, N.W., Washington, DC 20429.
- **Hand Delivery:** Comments may be hand delivered to 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.

Public Inspection: All comments received must include the agency name and RIN 3064-AD95 for this rulemaking. All comments received will be posted without change to http://www.fdic.gov/regulations/laws/federal/propose.html, including any personal information provided. Paper copies of public comments may be ordered from the FDIC Public Information Center, 3501 North Fairfax Drive, Room E-1002, Arlington, VA 22226 by telephone at (877) 275-3342 or (703) 562-2200.

FOR FURTHER INFORMATION CONTACT:

Bobby R. Bean, Associate Director, bbean@fdic.gov; Ryan Billingsley, Chief, Capital Policy Section, rbillingsley@fdic.gov; Karl Reitz, Chief, Capital Markets Strategies Section, kreitz@fdic.gov; David Riley, Senior Policy Analyst, dariley@fdic.gov; Benedetto Bosco, Capital Markets Policy Analyst, bbosco@fdic.gov, regulatorycapital@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; Ryan Clougherty, Senior Attorney, rclougherty@fdic.gov; or Rachel Jones, Attorney, racjones@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

On August 30, 2012, the agencies published in the Federal Register three joint notices of proposed rulemaking seeking public comment on revisions to their risk-based and leverage capital requirements and on methodologies for calculating risk-weighted assets under the standardized and advanced approaches (each, a proposal, and together, the NPRs, the proposed rules, or the proposals).[3] The proposed rules, in part, reflected 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), including subsequent changes to the BCBS's capital standards and recent BCBS consultative papers.[4] Basel III is intended to

[3] 77 FR 52792 (August 30, 2012); 77 FR 52888 (August 30, 2012); 77 FR 52978 (August 30, 2012).

[4] Basel III was published in December 2010 and revised in June 2011. The text is available at http://www.bis.org/publ/bcbs189.htm. The BCBS is a committee of banking supervisory authorities, which was established by the central bank governors of the G–10 countries in 1975. More information regarding the BCBS and its membership is available at

improve both the quality and quantity of banking organizations' capital, as well as to strengthen various aspects of the international capital standards for calculating regulatory capital. The proposed rules also reflect aspects of the Basel II Standardized Approach and other Basel Committee standards.

The proposals also included changes consistent with the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act);[5] would apply the risk-based and leverage capital rules to top-tier savings and loan holding companies (SLHCs) domiciled in the United States; and would apply the market risk capital rule (the market risk rule)[6] to Federal and state savings associations (as appropriate based on trading activity).

The NPR titled "Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Corrective Action"[7] (the Basel III NPR), provided for the implementation of the Basel III revisions to international capital standards related to minimum capital requirements, regulatory capital, and additional capital "buffer" standards to enhance the resilience of FDIC-supervised institutions to withstand periods of financial stress. The proposal included transition periods for many of the requirements, consistent with Basel III and the Dodd-Frank Act. The NPR titled "Regulatory Capital Rules: Standardized Approach for Risk-weighted Assets; Market Discipline and Disclosure Requirements"[8] (the Standardized Approach NPR), would revise the

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http://www.bis.org/bcbs/about.htm. Documents issued by the BCBS are available through the Bank for International Settlements web site at http:// www.bis.org.

[5] Pub. L. 111–203, 124 Stat. 1376, 1435–38 (2010).

[6] The FDIC's market risk rule is at 12 CFR part 325, appendix C.

[7] 77 FR 52792 (August 30, 2012).

[8] 77 FR 52888 (August 30, 2012).

methodologies for calculating risk-weighted assets in the agencies' general risk-based capital rules[9] (the general risk-based capital rules), incorporating aspects of the Basel II standardized approach,[10] and establish alternative standards of creditworthiness in place of credit ratings, consistent with section 939A of the Dodd-Frank Act.[11] The proposed minimum capital requirements in section 10(a) of the Basel III NPR, as determined using the standardized capital ratio calculations in section 10(b), would establish minimum capital requirements that would be the "generally applicable" capital requirements for purpose of section 171 of the Dodd-Frank Act.[12]

The NPR titled "Regulatory Capital Rules: Advanced Approaches Risk-Based Capital Rule; Market Risk Capital Rule"[13] (the Advanced Approaches NPR) included proposed changes to the agencies' current advanced approaches risk-based capital rules (the advanced approaches rule)[14] to incorporate applicable provisions of Basel III and the "Enhancements to the Basel II framework" (2009 Enhancements) published in July 2009[15] and subsequent consultative papers, to remove references to credit ratings, to apply the market risk rule to savings associations and

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[9] The FDIC's general risk-based capital rules is at 12 CFR part 325, appendix A, and 12 CFR part 390, subpart Z . The general risk-based capital rule is supplemented by the FDIC's market risk rule in 12 CFR part 325, appendix C.

[10] 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).

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

[12] See 77 FR 52856 (August 30, 2012).

[13] 77 FR 52978 (August 30, 2012).

[14] The FDIC's advanced approaches rules is at 12 CFR part 325, appendix D, and 12 CFR part 390, subpart Z, appendix A . The advanced approaches rule is supplemented by the market risk rule.

[15] See "Enhancements to the Basel II framework" (July 2009), available at http://www.bis.org/publ/bcbs157.htm.

SLHCs, and to apply the advanced approaches rule to SLHCs meeting the scope of application of those rules. Taken together, the three proposals also would have restructured the agencies' regulatory capital rules (the general risk-based capital rules, leverage rules,[16] market risk rule, and advanced approaches rule) into a harmonized, codified regulatory capital framework.

The FDIC is finalizing the Basel III NPR, Standardized Approach NPR, and Advanced Approaches NPR in this interim final rule, with certain changes to the proposals, as described further below. The OCC and Federal Reserve are jointly finalizing the Basel III NPR, Standardized Approach NPR, and Advanced Approaches NPR as a final rule, with identical changes to the proposals as the FDIC. This interim final rule applies to FDIC-supervised institutions.

Certain aspects of this interim final rule apply only to FDIC-supervised institutions subject to the advanced approaches rule (advanced approaches FDIC-supervised institutions) or to FDIC-supervised institutions with significant trading activities, as further described below.

Likewise, the enhanced disclosure requirements in the interim final rule apply only to FDIC-supervised institutions with $50 billion or more in total consolidated assets.

As under the proposal, the minimum capital requirements in section 10(a) of the interim final rule, as determined using the standardized capital ratio calculations in section 10(b), which apply to all FDIC-supervised institutions, establish the ''generally applicable'' capital requirements under section 171 of the Dodd-Frank Act.[17]

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[16] The FDIC's tier 1 leverage rules are at 12 CFR 325.3 (state nonmember banks) and 390.467 (state savings associations).

[17] See note 12, supra. Risk-weighted assets calculated under the market risk framework in subpart F of the interim final rule are included in calculations of risk-weighted assets both under the standardized approach and the advanced approaches.

Under the interim final rule, as under the proposal, in order to determine its minimum risk-based capital requirements, an advanced approaches FDIC-supervised institution that has completed the parallel run process and that has received notification from its primary Federal supervisor pursuant to section 121(d) of subpart E must determine its minimum risk-based capital requirements by calculating the three risk-based capital ratios using total risk-weighted assets under the standardized approach and, separately, total risk-weighted assets under the advanced approaches.[18] The lower ratio for each risk-based capital requirement is the ratio the FDIC-supervised institution must use to determine its compliance with the minimum capital requirement.[19] These enhanced prudential standards help ensure that advanced approaches FDIC-supervised institutions, which are among the largest and most complex FDIC-supervised institutions, have capital adequate to address their more complex operations and risks.

II. Summary of the Three Notices of Proposed Rulemaking

A. The Basel III Notice of Proposed Rulemaking

As discussed in the proposals, the recent financial crisis demonstrated that the amount of high-quality capital held by banking organizations was insufficient to absorb the losses generated over 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 characteristics of regulatory capital instruments, as well as inconsistencies in the definition of capital across jurisdictions, contributed to difficulties in evaluating a banking organization's capital strength. Accordingly, the BCBS assessed the

[18] An advanced approaches FDIC-supervised institution must also use its advanced-approaches-adjusted total to determine its total risk-based capital ratio.

[19] See section 10(c) of the interim final rule.

international capital framework and, in 2010, published Basel III, a comprehensive reform package designed to improve the quality and quantity of regulatory capital and build additional capacity into the banking system to absorb losses in times of market and economic stress. On August 30, 2012, the agencies published the NPRs in the Federal Register to revise regulatory capital requirements, as discussed above. As proposed, the Basel III NPR generally would have applied to all U.S. banking organizations.

Consistent with Basel III, the Basel III NPR would have required banking organizations to comply with the following minimum capital ratios: (i) a new requirement for a ratio of common equity tier 1 capital to risk-weighted assets (common equity tier 1 capital ratio) of 4.5 percent; (ii) a ratio of tier 1 capital to risk-weighted assets (tier 1 capital ratio) of 6 percent, increased from 4 percent; (iii) a ratio of total capital to risk-weighted assets (total capital ratio) of 8 percent; (iv) a ratio of tier 1 capital to average total consolidated assets (leverage ratio) of 4 percent; and (v) for advanced approaches banking organizations only, an additional requirement that the ratio of tier 1 capital to total leverage exposure (supplementary leverage ratio) be at least 3 percent.

The Basel III NPR also proposed implementation of a capital conservation buffer equal to 2.5 percent of risk-weighted assets above the minimum risk-based capital ratio requirements, which could be expanded by a countercyclical capital buffer for advanced approaches banking organizations under certain circumstances. If a banking organization failed to hold capital above the minimum capital ratios and proposed capital conservation buffer (as potentially expanded by the countercyclical capital buffer), it would be subject to certain restrictions on capital distributions and discretionary bonus payments. The proposed countercyclical capital buffer was designed to take into account the macro-financial environment in which large, internationally

active banking organizations function. The countercyclical capital buffer could be implemented if the agencies determined that credit growth in the economy became excessive. As proposed, the countercyclical capital buffer would initially be set at zero, and could expand to as much as 2.5 percent of risk-weighted assets.

The Basel III NPR proposed to apply a 4 percent minimum leverage ratio requirement to all banking organizations (computed using the new definition of capital), and to eliminate the exceptions for banking organizations with strong supervisory ratings or subject to the market risk rule. The Basel III NPR also proposed to require advanced approaches banking organizations to satisfy a minimum supplementary leverage ratio requirement of 3 percent, measured in a manner consistent with the international leverage ratio set forth in Basel III. Unlike the FDIC's current leverage ratio requirement, the proposed supplementary leverage ratio incorporates certain off-balance sheet exposures in the denominator.

To strengthen the quality of capital, the Basel III NPR proposed more conservative eligibility criteria for regulatory capital instruments. For example, the Basel III NPR proposed that trust preferred securities (TruPS) and cumulative perpetual preferred securities, which were tier-1-eligible instruments (subject to limits) at the BHC level, would no longer be includable in tier 1 capital under the proposal and would be gradually phased out from tier 1 capital. The proposal also eliminated the existing limitations on the amount of tier 2 capital that could be recognized in total capital, as well as the limitations on the amount of certain capital instruments (for example, term subordinated debt) that could be included in tier 2 capital.

In addition, the proposal would have required banking organizations to include in common equity tier 1 capital accumulated other comprehensive income (AOCI) (with the exception of gains and losses on cash-flow hedges related to items that are not fair-valued on the

balance sheet), and also would have established new limits on the amount of minority interest a banking organization could include in regulatory capital. The proposal also would have established more stringent requirements for several deductions from and adjustments to regulatory capital, including with respect to deferred tax assets (DTAs), investments in a banking organization's own capital instruments and the capital instruments of other financial institutions, and mortgage servicing assets (MSAs). The proposed revisions would have been incorporated into the regulatory capital ratios in the prompt corrective action (PCA) framework for depository institutions.

B. The Standardized Approach Notice of Proposed Rulemaking

The Standardized Approach NPR proposed changes to the agencies' general risk-based capital rules for determining risk-weighted assets (that is, the calculation of the denominator of a banking organization's risk-based capital ratios). The proposed changes were intended to revise and harmonize the agencies' rules for calculating risk-weighted assets, enhance risk sensitivity, and address weaknesses in the regulatory capital framework identified over recent years, including by strengthening the risk sensitivity of the regulatory capital treatment for, among other items, credit derivatives, central counterparties (CCPs), high-volatility commercial real estate, and collateral and guarantees.

In the Standardized Approach NPR, the agencies also proposed alternatives to credit ratings for calculating risk-weighted assets for certain assets, consistent with section 939A of the Dodd-Frank Act. These alternatives included methodologies for determining risk-weighted assets for exposures to sovereigns, foreign banks, and public sector entities, securitization exposures, and counterparty credit risk. The Standardized Approach NPR also proposed to include a framework for risk weighting residential mortgages based on underwriting and product

features, as well as loan-to-value (LTV) ratios, and disclosure requirements for top-tier banking organizations domiciled in the United States with $50 billion or more in total assets, including disclosures related to regulatory capital instruments.

C. The Advanced Approaches Notice of Proposed Rulemaking

The Advanced Approaches NPR proposed revisions to the advanced approaches rule to incorporate certain aspects of Basel III, the 2009 Enhancements, and subsequent consultative papers. The proposal also would have implemented relevant provisions of the Dodd-Frank Act, including section 939A (regarding the use of credit ratings in agency regulations),[20] and incorporated certain technical amendments to the existing requirements. In addition, the Advanced Approaches NPR proposed to codify the market risk rule in a manner similar to the codification of the other regulatory capital rules under the proposals.

Consistent with Basel III and the 2009 Enhancements, under the Advanced Approaches NPR, the agencies proposed further steps to strengthen capital requirements for internationally active banking organizations. This NPR would have required advanced approaches banking organizations to hold more appropriate levels of capital for counterparty credit risk, credit valuation adjustments (CVA), and wrong-way risk; would have strengthened the risk-based capital requirements for certain securitization exposures by requiring advanced approaches banking organizations to conduct more rigorous credit analysis of securitization exposures; and would have enhanced the disclosure requirements related to those exposures.

The agencies proposed to apply the market risk rule to SLHCs and to state and Federal savings associations.

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

III. Summary of General Comments on the Basel III Notice of Proposed Rulemaking and on the Standardized Approach Notice of Proposed Rulemaking; Overview of the Interim final rule

A. General Comments on the Basel III Notice of Proposed Rulemaking and on the Standardized Approach Notice of Proposed Rulemaking

Each agency received over 2,500 public comments on the proposals from banking organizations, trade associations, supervisory authorities, consumer advocacy groups, public officials (including members of the U.S. Congress), private individuals, and other interested parties. Overall, while most commenters supported more robust capital standards and the agencies' efforts to improve the resilience of the banking system, many commenters expressed concerns about the potential costs and burdens of various aspects of the proposals, particularly for smaller banking organizations. A substantial number of commenters also requested withdrawal of, or significant revisions to, the proposals. A few commenters argued that new capital rules were not necessary at this time. Some commenters requested that the agencies perform additional studies of the economic impact of part or all of the proposed rules. Many commenters asked for additional time to transition to the new requirements. A more detailed discussion of the comments provided on particular aspects of the proposals is provided in the remainder of this preamble.

1. Applicability and Scope

The agencies received a significant number of comments regarding the proposed scope and applicability of the Basel III NPR and the Standardized Approach NPR. The majority of comments submitted by or on behalf of community banking organizations requested an exemption from the proposals. These commenters suggested basing such an exemption on a banking organization's asset size – for example, total assets of less than $500 million, $1 billion, $10 billion, $15 billion, or $50 billion – or on its risk profile or business model. Under the latter

approach, the commenters suggested providing an exemption for banking organizations with balance sheets that rely less on leverage, short-term funding, or complex derivative transactions.

In support of an exemption from the proposed rule for community banking organizations, a number of commenters argued that the proposed revisions to the definition of capital would be overly conservative and would prohibit some of the instruments relied on by community banking organizations from satisfying regulatory capital requirements. Many of these commenters stated that, in general, community banking organizations have less access to the capital markets relative to larger banking organizations and could increase capital only by accumulating retained earnings. Owing to slow economic growth and relatively low earnings among community banking organizations, the commenters asserted that implementation of the proposal would be detrimental to their ability to serve local communities while providing reasonable returns to shareholders. Other commenters requested exemptions from particular sections of the proposed rules, such as maintaining capital against transactions with particular counterparties, or based on transaction types that they considered lower-risk, such as derivative transactions hedging interest rate risk.

The commenters also argued that application of the Basel III NPR and Standardized Approach NPR to community banking organizations would be unnecessary and inappropriate for the business model and risk profile of such organizations. These commenters asserted that Basel III was designed for large, internationally-active banking organizations in response to a financial crisis attributable primarily to those institutions. Accordingly, the commenters were of the view that community banking organizations require a different capital framework with less stringent capital requirements, or should be allowed to continue to use the general risk-based capital rules. In addition, many commenters, in particular minority depository institutions (MDIs), mutual

banking organizations, and community development financial institutions (CDFIs), expressed concern regarding their ability to raise capital to meet the increased minimum requirements in the current environment and upon implementation of the proposed definition of capital. One commenter asked for an exemption from all or part of the proposed rules for CDFIs, indicating that the proposal would significantly reduce the availability of capital for low- and moderate-income communities. Another commenter stated that the U.S. Congress has a policy of encouraging the creation of MDIs and expressed concern that the proposed rules contradicted this purpose.

In contrast, however, a few commenters supported the proposed application of the Basel III NPR to all banking organizations. For example, one commenter stated that increasing the quality and quantity of capital at all banking organizations would create a more resilient financial system and discourage inappropriate risk-taking by forcing banking organizations to put more of their own "skin in the game." This commenter also asserted that the proposed scope of the Basel III NPR would reduce the probability and impact of future financial crises and support the objectives of sustained growth and high employment. Another commenter favored application of the Basel III NPR to all banking organizations to ensure a level playing field among banking organizations within the same competitive market.

2. Aggregate Impact

A majority of the commenters expressed concern regarding the potential aggregate impact of the proposals, together with other provisions of the Dodd-Frank Act. Some of these commenters urged the agencies to withdraw the proposals and to conduct a quantitative impact study (QIS) to assess the potential aggregate impact of the proposals on banking organizations and the overall U.S. economy. Many commenters argued that the proposals would have

significant negative consequences for the financial services industry. According to the commenters, by requiring banking organizations to hold more capital and increase risk weighting on some of their assets, as well as to meet higher risk-based and leverage capital measures for certain PCA categories, the proposals would negatively affect the banking sector. Commenters cited, among other potential consequences of the proposals: restricted job growth; reduced lending or higher-cost lending, including to small businesses and low-income or minority communities; limited availability of certain types of financial products; reduced investor demand for banking organizations' equity; higher compliance costs; increased mergers and consolidation activity, specifically in rural markets, because banking organizations would need to spread compliance costs among a larger customer base; and diminished access to the capital markets resulting from reduced profit and from dividend restrictions associated with the capital buffers. The commenters also asserted that the recovery of the U.S. economy would be impaired by the proposals as a result of reduced lending by banking organizations that the commenters believed would be attributable to the higher costs of regulatory compliance. In particular, the commenters expressed concern that a contraction in small-business lending would adversely affect job growth and employment.

3. Competitive Concerns

Many commenters raised concerns that implementation of the proposals would create an unlevel playing field between banking organizations and other financial services providers. For example, a number of commenters expressed concern that credit unions would be able to gain market share from banking organizations by offering similar products at substantially lower costs because of differences in taxation combined with potential costs from the proposals. The commenters also argued that other financial service providers, such as foreign banks with

significant U.S. operations, members of the Federal Farm Credit System, and entities in the shadow banking industry, would not be subject to the proposed rule and, therefore, would have a competitive advantage over banking organizations. These commenters also asserted that the proposals could cause more consumers to choose lower-cost financial products from the unregulated, nonbank financial sector.

4. Costs

Commenters representing all types of banking organizations expressed concern that the complexity and implementation cost of the proposals would exceed their expected benefits. According to these commenters, implementation of the proposals would require software upgrades for new internal reporting systems, increased employee training, and the hiring of additional employees for compliance purposes. Some commenters urged the agencies to recognize that compliance costs have increased significantly over recent years due to other regulatory changes and to take these costs into consideration. As an alternative, some commenters encouraged the agencies to consider a simple increase in the minimum regulatory capital requirements, suggesting that such an approach would provide increased protection to the Deposit Insurance Fund and increase safety and soundness without adding complexity to the regulatory capital framework.

B. Comments on Particular Aspects of the Basel III Notice of Proposed Rulemaking and on the Standardized Approach Notice of Proposed Rulemaking

In addition to the general comments described above, the agencies received a significant number of comments on four particular elements of the proposals: the requirement to include most elements of AOCI in regulatory capital; the new framework for risk weighting residential

mortgages; and the requirement to phase out TruPS from tier 1 capital for all banking organizations.

1. Accumulated Other Comprehensive Income

AOCI generally includes accumulated unrealized gains and losses on certain assets and liabilities that have not been included in net income, yet are included in equity under U.S. generally accepted accounting principles (GAAP) (for example, unrealized gains and losses on securities designated as available-for-sale (AFS)). Under the agencies' general risk-based capital rules, most components of AOCI are not reflected in a banking organization's regulatory capital. In the proposed rule, consistent with Basel III, the agencies proposed to require banking organizations to include the majority of AOCI components in common equity tier 1 capital.

The agencies received a significant number of comments on the proposal to require banking organizations to recognize AOCI in common equity tier 1 capital. Generally, the commenters asserted that the proposal would introduce significant volatility in banking organizations' capital ratios due in large part to fluctuations in benchmark interest rates, and would result in many banking organizations moving AFS securities into a held-to-maturity (HTM) portfolio or holding additional regulatory capital solely to mitigate the volatility resulting from temporary unrealized gains and losses in the AFS securities portfolio. The commenters also asserted that the proposed rules would likely impair lending and negatively affect banking organizations' ability to manage liquidity and interest rate risk and to maintain compliance with legal lending limits. Commenters representing community banking organizations in particular asserted that they lack the sophistication of larger banking organizations to use certain risk-management techniques for hedging interest rate risk, such as the use of derivative instruments.

2. Residential Mortgages

The Standardized Approach NPR would have required banking organizations to place residential mortgage exposures into one of two categories to determine the applicable risk weight. Category 1 residential mortgage exposures were defined to include mortgage products with underwriting and product features that have demonstrated a lower risk of default, such as consideration and documentation of a borrower's ability to repay, and generally excluded mortgage products that included terms or other characteristics that the agencies have found to be indicative of higher credit risk, such as deferral of repayment of principal. Residential mortgage exposures with higher risk characteristics were defined as category 2 residential mortgage exposures. The agencies proposed to apply relatively lower risk weights to category 1 residential mortgage exposures, and higher risk weights to category 2 residential mortgage exposures. The proposal provided that the risk weight assigned to a residential mortgage exposure also depended on its LTV ratio.

The agencies received a significant number of comments objecting to the proposed treatment for one-to-four family residential mortgages and requesting retention of the mortgage treatment in the agencies' general risk-based capital rules. Commenters generally expressed concern that the proposed treatment would inhibit lending to creditworthy borrowers and could jeopardize the recovery of a still-fragile housing market. Commenters also criticized the distinction between category 1 and category 2 mortgages, asserting that the characteristics proposed for each category did not appropriately distinguish between lower- and higher-risk products and would adversely impact certain loan products that performed relatively well even during the recent crisis. Commenters also highlighted concerns regarding regulatory burden and the uncertainty of other regulatory initiatives involving residential mortgages. In particular, these commenters expressed considerable concern regarding the potential cumulative impact of

the proposed new mortgage requirements combined with the Dodd-Frank Act's requirements relating to the definitions of qualified mortgage and qualified residential mortgage[21] and asserted that when considered together with the proposed mortgage treatment, the combined effect could have an adverse impact on the mortgage industry.

3. Trust Preferred Securities for Smaller FDIC-Supervised Institutions

The proposed rules would have required all banking organizations to phase-out TruPS from tier 1 capital under either a 3- or 10-year transition period based on the organization's total consolidated assets. The proposal would have required banking organizations with more than $15 billion in total consolidated assets (as of December 31, 2009) to phase-out of tier 1 capital any non-qualifying capital instruments (such as TruPS and cumulative preferred shares) issued before May 19, 2010. The exclusion of non-qualifying capital instruments would have taken place incrementally over a three-year period beginning on January 1, 2013. Section 171 provides an exception that permits banking organizations with total consolidated assets of less than $15 billion as of December 31, 2009, and banking organizations that were mutual holding companies as of May 19, 2010 (2010 MHCs), to include in tier 1 capital all TruPS (and other instruments that could no longer be included in tier 1 capital pursuant to the requirements of section 171) that were issued prior to May 19, 2010.[22] However, consistent with Basel III and the general policy purpose of the proposed revisions to regulatory capital, the agencies proposed

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[21] See, e.g., the definition of "qualified mortgage" in section 1412 of the Dodd-Frank Act (15 U.S.C. 129C) and "qualified residential mortgage" in section 941(e)(4) of the Dodd-Frank Act (15 U.S.C. 78o-11(e)(4)).

[22] Specifically, section 171 provides that deductions of instruments "that would be required" under the section are not required for depository institution holding companies with total consolidated assets of less than $15 billion as of December 31, 2009 and 2010 MHCs. See 12 U.S.C. 5371(b)(4)(C).

to require banking organizations with total consolidated assets less than $15 billion as of December 31, 2009 and 2010 MHCs to phase out their non-qualifying capital instruments from regulatory capital over ten years.[23]

Many commenters representing community banking organizations criticized the proposal's phase-out schedule for TruPS and encouraged the agencies to grandfather TruPS in tier 1 capital to the extent permitted by section 171 of the Dodd-Frank Act. Commenters asserted that this was the intent of the U.S. Congress, including this provision in the statute. These commenters also asserted that this aspect of the proposal would unduly burden community banking organizations that have limited ability to raise capital, potentially impairing the lending capacity of these banking organizations.

C. Overview of the Interim final rule

The interim final rule will replace the FDIC's general risk-based capital rules, advanced approaches rule, market risk rule, and leverage rules in accordance with the transition provisions described below. After considering the comments received, the FDIC has made substantial modifications in the interim final rule to address specific concerns raised by commenters regarding the cost, complexity, and burden of the proposals.

During the recent financial crisis, lack of confidence in the banking sector increased banking organizations' cost of funding, impaired banking organizations' access to short-term funding, depressed values of banking organizations' equities, and required many banking

[23] See 12 U.S.C. 5371(b)(5)(A). While section 171 of the Dodd-Frank Act requires the agencies to establish minimum risk-based and leverage capital requirements subject to certain limitations, the agencies retain their general authority to establish capital requirements under other laws and regulations, including under the National Bank Act, 12 U.S.C. 1, et seq., Federal Reserve Act, Federal Deposit Insurance Act, Bank Holding Company Act, International Lending Supervision Act, 12 U.S.C. 3901, et seq., and Home Owners Loan Act, 12 U.S.C. 1461, et seq.

organizations to seek government assistance. Concerns about banking organizations arose not only because market participants expected steep losses on banking organizations' assets, but also because of substantial uncertainty surrounding estimated loss rates, and thus future earnings. Further, heightened systemic risks, falling asset values, and reduced credit availability had an adverse impact on business and consumer confidence, significantly affecting the overall economy. The interim final rule addresses these weaknesses by helping to ensure a banking and financial system that will be better able to absorb losses and continue to lend in future periods of economic stress. This important benefit in the form of a safer, more resilient, and more stable banking system is expected to substantially outweigh any short-term costs that might result from the interim final rule.

In this context, the FDIC is adopting most aspects of the proposals, including the minimum risk-based capital requirements, the capital conservation and countercyclical capital buffers, and many of the proposed risk weights. The FDIC has also decided to apply most aspects of the Basel III NPR and Standardized Approach NPR to all banking organizations, with some significant changes. Implementing the interim final rule in a consistent fashion across the banking system will improve the quality and increase the level of regulatory capital, leading to a more stable and resilient system for banking organizations of all sizes and risk profiles. The improved resilience will enhance their ability to continue functioning as financial intermediaries, including during periods of financial stress and reduce risk to the deposit insurance fund and to the financial system. The FDIC believes that, together, the revisions to the proposals meaningfully address the commenters' concerns regarding the potential implementation burden of the proposals.

The FDIC has considered the concerns raised by commenters and believe that it is important to take into account and address regulatory costs (and their potential effect on FDIC-supervised institutions' role as financial intermediaries in the economy) when the FDIC establishes or revises regulatory requirements. In developing regulatory capital requirements, these concerns are considered in the context of the FDIC's broad goals – to enhance the safety and soundness of FDIC-supervised institutions and promote financial stability through robust capital standards for the entire banking system.

The agencies participated in the development of a number of studies to assess the potential impact of the revised capital requirements, including participating in the BCBS's Macroeconomic Assessment Group as well as its QIS, the results of which were made publicly available by the BCBS upon their completion.[24] The BCBS analysis suggested that stronger capital requirements help reduce the likelihood of banking crises while yielding positive net economic benefits.[25] To evaluate the potential reduction in economic output resulting from the new framework, the analysis assumed that banking organizations replaced debt with higher-cost equity to the extent needed to comply with the new requirements, that there was no reduction in the cost of equity despite the reduction in the riskiness of banking organizations' funding mix, and that the increase in funding cost was entirely passed on to borrowers. Given these assumptions, the analysis concluded there would be a slight increase in the cost of borrowing and a slight decrease in the growth of gross domestic product. The analysis concluded that this cost

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[24] See "Assessing the macroeconomic impact of the transition to stronger capital and liquidity requirements" (MAG Analysis), Attachment E, also available at: http://www.bis.orpublIothp12.pdf. See also "Results of the comprehensive quantitative impact study," Attachment F, also available at: http://www.bis.org/publ/bcbs186.pdf.

[25] See "An assessment of the long-term economic impact of stronger capital and liquidity requirements," Executive Summary, pg. 1, Attachment G.

would be more than offset by the benefit to gross domestic product resulting from a reduced likelihood of prolonged economic downturns associated with a banking system whose lending capacity is highly vulnerable to economic shocks.

The agencies' analysis also indicates that the overwhelming majority of banking organizations already have sufficient capital to comply with the new capital rules. In particular, the agencies estimate that over 95 percent of all insured depository institutions would be in compliance with the minimums and buffers established under the interim final rule if it were fully effective immediately. The interim final rule will help to ensure that these FDIC-supervised institutions maintain their capacity to absorb losses in the future. Some FDIC-supervised institutions may need to take advantage of the transition period in the interim final rule to accumulate retained earnings, raise additional external regulatory capital, or both. As noted above, however, the overwhelming majority of banking organizations have sufficient capital to comply with the revised capital rules, and the FDIC believes that the resulting improvements to the stability and resilience of the banking system outweigh any costs associated with its implementation.

The interim final rule includes some significant revisions from the proposals in response to commenters' concerns, particularly with respect to the treatment of AOCI; residential mortgages; tier 1 non-qualifying capital instruments; and the implementation timeframes. The timeframes for compliance are described in the next section and more detailed discussions of modifications to the proposals are provided in the remainder of the preamble.

Consistent with the proposed rules, the interim final rule requires all FDIC-supervised institutions to recognize in regulatory capital all components of AOCI, excluding accumulated net 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. However, while the FDIC believes that the proposed AOCI treatment results in a regulatory capital measure that better reflects FDIC-supervised institutions' actual loss absorption capacity at a specific point in time, the FDIC recognizes that for many FDIC-supervised institutions, the volatility in regulatory capital that could result from the proposals could lead to significant difficulties in capital planning and asset-liability management. The FDIC also recognizes that the tools used by larger, more complex FDIC-supervised institutions for managing interest rate risk are not necessarily readily available for all FDIC-supervised institutions.

Accordingly, under the interim final rule, and as discussed in more detail in section V.B of this preamble, an FDIC-supervised institution that is not subject to the advanced approaches rule may make a one-time election not to include most elements of AOCI in regulatory capital under the interim final rule and instead effectively use the existing treatment under the general risk-based capital rules that excludes most AOCI elements from regulatory capital (AOCI opt-out election). Such an FDIC-supervised institution must make its AOCI opt-out election in its first Consolidated Reports of Condition and Income (Call Report) that is filed after the it becomes subject to the interim final rule. Consistent with regulatory capital calculations under the FDIC's general risk-based capital rules, an FDIC-supervised institution that makes an AOCI opt-out election under the interim final rule must adjust common equity tier 1 capital by: (1) subtracting any net unrealized gains and adding any net unrealized losses on AFS securities; (2) subtracting any unrealized loss on AFS preferred stock classified as an equity security under GAAP and equity exposures; (3) subtracting any accumulated net gain and adding any accumulated net loss on cash-flow hedges; (4) subtracting amounts recorded in AOCI attributed to defined benefit postretirement plans resulting from the initial and subsequent application of

the relevant GAAP standards that pertain to such plans (excluding, at the FDIC-supervised institution's option, the portion relating to pension assets deducted under section 22(a)(5) of the interim final rule); and (5) subtracting any net unrealized gains and adding any net unrealized losses on held-to-maturity securities that are included in AOCI. Consistent with the general risk-based capital rules, common equity tier 1 capital includes any net unrealized losses on AFS equity securities and any foreign currency translation adjustment. An FDIC-supervised institution that makes an AOCI opt-out election may incorporate up to 45 percent of any net unrealized gains on AFS preferred stock classified as an equity security under GAAP and equity exposures into its tier 2 capital.

An FDIC-supervised institution that does not make an AOCI opt-out election on the first Call Report filed after the FDIC-supervised institution becomes subject to the interim final rule will be required to recognize AOCI (excluding accumulated net 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) in regulatory capital as of the first quarter in which it calculates its regulatory capital requirements under the interim final rule and continuing thereafter.

The FDIC has decided not to adopt the proposed treatment of residential mortgages. The FDIC has considered the commenters' observations about the burden of calculating the risk weights for FDIC-supervised institutions' existing mortgage portfolios, and has taken into account the commenters' concerns that the proposal did not properly assess the use of different mortgage products across different types of markets in establishing the proposed risk weights. The FDIC is also particularly mindful of comments regarding the potential effect of the proposal and other mortgage-related rulemakings on credit availability. In light of these considerations, as

well as others raised by commenters, the FDIC has decided to retain in the interim final rule the current treatment for residential mortgage exposures under the general risk-based capital rules.

Consistent with the general risk-based capital rules, the interim final rule assigns a 50 or 100 percent risk weight to exposures secured by one-to-four family residential properties. Generally, residential mortgage exposures secured by a first lien on a one-to-four family residential property that are prudently underwritten and that are performing according to their original terms receive a 50 percent risk weight. All other one- to four-family residential mortgage loans, including exposures secured by a junior lien on residential property, are assigned a 100 percent risk weight. If an FDIC-supervised institution holds the first and junior lien(s) on a residential property and no other party holds an intervening lien, the FDIC-supervised institution must treat the combined exposure as a single loan secured by a first lien for purposes of assigning a risk weight.

The FDIC also considered comments on the proposal to require banking organizations with total consolidated assets less than $15 billion as of December 31, 2009 to phase out their non-qualifying tier 1 capital instruments from regulatory capital over ten years. Although the FDIC continues to believe that non-qualifying instruments do not absorb losses sufficiently to be included in tier 1 capital as a general matter, the FDIC is also sensitive to the difficulties community banking organizations often face when issuing new capital instruments and are aware of the importance their capacity to lend can play in local economies. Therefore, the interim final rule allows FDIC-supervised institutions to include in regulatory capital debt or equity instruments issued prior to September 12, 2010 that do not meet the criteria for additional tier 1 or tier 2 capital instruments in § 324.20 but that were included in tier 1 or tier 2 capital

respectively as of September 12, 2010 up to the percentage of the outstanding principal amount of such non-qualifying capital instruments outlined in Table 9 in § 324.300.

D. Timeframe for Implementation and Compliance

In order to give non-internationally active FDIC-supervised institutions more time to comply with the interim final rule and simplify their transition to the new regime, the interim final rule will require compliance from different types of organizations at different times. Generally, and as described in further detail below, FDIC-supervised institutions that are not subject to the advanced approaches rule must begin complying with the interim final rule on January 1, 2015, whereas advanced approaches FDIC-supervised institutions must begin complying with the interim final rule on January 1, 2014. The FDIC believes that advanced approaches FDIC-supervised institutions have the sophistication, infrastructure, and capital markets access to implement the interim final rule earlier than either FDIC-supervised institutions that do not meet the asset size or foreign exposure threshold for application of those rules.

A number of commenters requested that the agencies clarify the point at which a banking organization that meets the asset size or foreign exposure threshold for application of the advanced approaches rule becomes subject to subpart E of the proposed rule, and thus all of the provisions that apply to an advanced approaches banking organization. In particular, commenters requested that the agencies clarify whether subpart E of the proposed rule only applies to those banking organizations that have completed the parallel run process and that have received notification from their primary Federal supervisor pursuant to section 121(d) of subpart

E, or whether subpart E would apply to all banking organizations that meet the relevant thresholds without reference to completion of the parallel run process.

The interim final rule provides that an advanced approaches FDIC-supervised institution is one that meets the asset size or foreign exposure thresholds for or has opted to apply the advanced approaches rule, without reference to whether that FDIC-supervised institution has completed the parallel run process and has received notification from its primary Federal supervisor pursuant to section 121(d) of subpart E of the interim final rule. The FDIC has also clarified in the interim final rule when completion of the parallel run process and receipt of notification from the primary Federal supervisor pursuant to section 121(d) of subpart E is necessary for an advanced approaches FDIC-supervised institution to comply with a particular aspect of the rules. For example, only an advanced approaches FDIC-supervised institution that has completed parallel run and received notification from its primary Federal supervisor under Section 121(d) of subpart E must make the disclosures set forth under subpart E of the interim final rule. However, an advanced approaches FDIC-supervised institution must recognize most components of AOCI in common equity tier 1 capital and must meet the supplementary leverage ratio when applicable without reference to whether the FDIC-supervised institution has completed its parallel run process.

Beginning on January 1, 2015, FDIC-supervised institutions that are not subject to the advanced approaches rule become subject to the revised definitions of regulatory capital, the new minimum regulatory capital ratios, and the regulatory capital adjustments and deductions according to the transition provisions.[26] All FDIC-supervised institutions must begin calculating

[26] Prior to January 1, 2015, such FDIC-supervised institutions must continue to use the FDIC's general risk-based capital rules and tier 1 leverage rules.

standardized total risk-weighted assets in accordance with subpart D of the interim final rule, and if applicable, the revised market risk rule under subpart F, on January 1, 2015.[27]

Beginning on January 1, 2014, advanced approaches FDIC-supervised institutions must begin the transition period for the revised minimum regulatory capital ratios, definitions of regulatory capital, and regulatory capital adjustments and deductions established under the interim final rule. The revisions to the advanced approaches risk-weighted asset calculations will become effective on January 1, 2014.

From January 1, 2014 to December 31, 2014, an advanced approaches FDIC-supervised institution that is on parallel run must calculate risk-weighted assets using the general risk-based capital rules and substitute such risk-weighted assets for its standardized total risk-weighted assets for purposes of determining its risk-based capital ratios. An advanced approaches FDIC-supervised institution on parallel run must also calculate advanced approaches total risk-weighted assets using the advanced approaches rule in subpart E of the interim final rule for purposes of confidential reporting to its primary Federal supervisor on the Federal Financial Institutions Examination Council's (FFIEC) 101 report. An advanced approaches FDIC-supervised institution that has completed the parallel run process and that has received notification from its primary Federal supervisor pursuant to section 121(d) of subpart E will calculate its risk-weighted assets using the general risk-based capital rules and substitute such risk-weighted assets for its standardized total risk-weighted assets and also calculate advanced approaches total risk-weighted assets using the advanced approaches rule in subpart E of the interim final rule for purposes of determining its risk-based capital ratios from January 1, 2014 to

[27] The revised PCA thresholds, discussed further in section IV.E. of this preamble, become effective for all insured depository institutions on January 1, 2015.

December 31, 2014. Regardless of an advanced approaches FDIC-supervised institution's parallel run status, on January 1, 2015, the FDIC-supervised institution must begin to apply subpart D, and if applicable, subpart F, of the interim final rule to determine its standardized total risk-weighted assets.

The transition period for the capital conservation and countercyclical capital buffers for all FDIC-supervised institutions will begin on January 1, 2016.

An FDIC-supervised institution that is required to comply with the market risk rule must comply with the revised market risk rule (subpart F) as of the same date that it must comply with other aspects of the rule for determining its total risk-weighted assets.

Date	**FDIC-Supervised Institutions not Subject to the Advanced Approaches Rule***
January 1, 2015	Begin compliance with the revised minimum regulatory capital ratios and begin the transition period for the revised definitions of regulatory capital and the revised regulatory capital adjustments and deductions. Begin compliance with the standardized approach for determining risk-weighted assets.
January 1, 2016	Begin the transition period for the capital conservation and countercyclical capital buffers.

Date	**Advanced Approaches FDIC-supervised institutions***
January 1, 2014	Begin the transition period for the revised minimum regulatory capital ratios, definitions of regulatory capital, and regulatory capital adjustments and deductions. Begin compliance with the revised advanced approaches rule for determining risk-weighted assets.
January 1, 2015	Begin compliance with the standardized approach for determining risk-weighted assets.
January 1, 2016	Begin the transition period for the capital conservation and countercyclical capital buffers.

*If applicable, FDIC-supervised institutions must use the calculations in subpart F of the interim final rule (market risk) concurrently with the calculation of risk-weighted assets according either to subpart D (standardized approach) or subpart E (advanced approaches) of the interim final rule.

IV. 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 proposed rule would have required banking organizations to comply with the following minimum capital ratios: a common equity tier 1 capital to risk-weighted assets ratio of 4.5 percent; a tier 1 capital to risk-weighted assets ratio of 6 percent; a total capital to risk-weighted assets ratio of 8 percent; a leverage ratio of 4 percent; and for advanced approaches banking organizations only, a supplementary leverage ratio of 3 percent. The common equity tier 1 capital ratio is a new minimum requirement designed to ensure that banking organizations hold sufficient high-quality regulatory capital that is available to absorb losses on a going-concern basis. The proposed capital ratios would apply to a banking organization on a consolidated basis.

The agencies received a substantial number of comments on the proposed minimum risk-based capital requirements. Several commenters supported the proposal to increase the minimum tier 1 risk-based capital requirement. Other commenters commended the agencies for proposing to implement a minimum capital requirement that focuses primarily on common equity. These commenters argued that common equity is the strongest form of capital and that the proposed minimum common equity tier 1 capital ratio of 4.5 percent would promote the safety and soundness of the banking industry.

Other commenters provided general support for the proposed increases in minimum risk-based capital requirements, but expressed concern that the proposals could present unique challenges to mutual institutions because they can only raise common equity through retained earnings. A number of commenters asserted that the objectives of the proposal could be achieved through regulatory mechanisms other than the proposed risk-based capital

requirements, including enhanced safety and soundness examinations, more stringent underwriting standards, and alternative measures of capital.

Other commenters objected to the proposed increase in the minimum tier 1 capital ratio and the implementation of a common equity tier 1 capital ratio. One commenter indicated that increases in regulatory capital ratios would severely limit growth at many community banking organizations and could encourage consolidation through mergers and acquisitions. Other commenters stated that for banks under $750 million in total assets, increased compliance costs would not allow them to provide a reasonable return to shareholders, and thus would force them to consolidate. Several commenters urged the agencies to recognize community banking organizations' limited access to the capital markets and related difficulties raising capital to comply with the proposal.

One banking organization indicated that implementation of the common equity tier 1 capital ratio would significantly reduce its capacity to grow and recommended that the proposal recognize differences in the risk and complexity of banking organizations and provide favorable, less stringent requirements for smaller and non-complex institutions. Another commenter suggested that the proposed implementation of an additional risk-based capital ratio would confuse market observers and recommended that the agencies implement a regulatory capital framework that allows investors and the market to ascertain regulatory capital from measures of equity derived from a banking organization's balance sheet.

Other commenters expressed concern that the proposed common equity tier 1 capital ratio would disadvantage MDIs relative to other banking organizations. According to the commenters, in order to retain their minority- owned status, MDIs historically maintain a relatively high percentage of non-voting preferred stockholders that provide long-term, stable

sources of capital. Any public offering to increase common equity tier 1 capital levels would dilute the minority investors owning the common equity of the MDI and could potentially compromise the minority-owned status of such institutions. One commenter asserted that, for this reason, the implementation of the Basel III NPR would be contrary to the statutory mandate of section 308 of the Financial Institutions, Reform, Recovery and Enforcement Act (FIRREA).[28] Accordingly, the commenters encouraged the agencies to exempt MDIs from the proposed common equity tier 1 capital ratio requirement.

The FDIC believes that all FDIC-supervised institutions must have an adequate amount of loss-absorbing capital to continue to lend to their communities during times of economic stress, and therefore have decided to implement the regulatory capital requirements, including the minimum common equity tier 1 capital requirement, as proposed. For the reasons described in the NPR, including the experience during the crisis with lower quality capital instruments, the FDIC does not believe it is appropriate to maintain the general risk-based capital rules or to rely on the supervisory process or underwriting standards alone. Accordingly, the interim final rule maintains the minimum common equity tier 1 capital to total risk-weighted assets ratio of 4.5 percent. The FDIC has decided not to pursue the alternative regulatory mechanisms suggested by commenters, as such alternatives would be difficult to implement consistently across FDIC-supervised institutions and would not necessarily fulfill the objective of increasing the amount and quality of regulatory capital for all FDIC-supervised institutions.

In view of the concerns expressed by commenters with respect to MDIs, the FDIC evaluated the risk-based and leverage capital levels of MDIs to determine whether the interim final rule would disproportionately impact such institutions. This analysis found that of the 178

[28] 12 U.S.C. 1463 note.

MDIs in existence as of March 31, 2013, 12 currently are not well capitalized for PCA purposes, whereas (according to the FDIC's estimates) 14 would not be considered well capitalized for PCA purposes under the interim final rule if it were fully implemented without transition today. Accordingly, the FDIC does not believe that the interim final rule would disproportionately impact MDIs and are not adopting any exemptions or special provisions for these institutions. While the FDIC recognizes MDIs may face impediments in meeting the common equity tier 1 capital ratio, the FDIC believes that the improvements to the safety and soundness of these institutions through higher capital standards are warranted and consistent with their obligations under section 308 of FIRREA. As a prudential matter, the FDIC has a long-established regulatory policy that FDIC-supervised institutions 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 FDIC-supervised institution's activities and risk profile. Section IV.G of this preamble describes the requirement for overall capital adequacy of FDIC-supervised institutions and the supervisory assessment of capital adequacy.

Furthermore, consistent with the FDIC's authority under the general risk-based capital rules and the proposals, section 1(d) of the interim final rule includes a reservation of authority that allows FDIC to require the FDIC-supervised institution to hold a greater amount of regulatory capital than otherwise is required under the interim final rule, if the FDIC determines that the regulatory capital held by the FDIC-supervised institution is not commensurate with its credit, market, operational, or other risks. In exercising reservation of authority under the rule, the FDIC expects to consider the size, complexity, risk profile, and scope of operations of the

FDIC-supervised institution; and whether any public benefits would be outweighed by risk to an insured depository institution or to the financial system.

B. Leverage Ratio

The proposals would require a banking organization to satisfy a leverage ratio of 4 percent, calculated using the proposed definition of tier 1 capital and the banking organization's average total consolidated assets, minus amounts deducted from tier 1 capital. The agencies also proposed to eliminate the exception in the agencies' leverage rules that provides for a minimum leverage ratio of 3 percent for banking organizations with strong supervisory ratings.

The agencies received a number of comments on the proposed leverage ratio applicable to all banking organizations. Several of these commenters supported the proposed leverage ratio, stating that it serves as a simple regulatory standard that constrains the ability of a banking organization to leverage its equity capital base. Some of the commenters encouraged the agencies to consider an alternative leverage ratio measure of tangible common equity to tangible assets, which would exclude non-common stock elements from the numerator and intangible assets from the denominator of the ratio and thus, according to these commenters, provide a more reliable measure of a banking organization's viability in a crisis.

A number of commenters criticized the proposed removal of the 3 percent exception to the minimum leverage ratio requirement for certain banking organizations. One of these commenters argued that removal of this exception is unwarranted in view of the cumulative impact of the proposals and that raising the minimum leverage ratio requirement for the strongest banking organizations may lead to a deleveraging by the institutions most able to extend credit in a safe and sound manner. In addition, the commenters cautioned the agencies that a restrictive

leverage measure, together with more stringent risk-based capital requirements, could magnify the potential impact of an economic downturn.

Several commenters suggested modifications to the minimum leverage ratio requirement. One commenter suggested increasing the minimum leverage ratio requirement for all banking organizations to 6 percent, whereas another commenter recommended a leverage ratio requirement as high as 20 percent. Another commenter suggested a tiered approach, with minimum leverage ratio requirements of 6.25 percent and 8.5 percent for community banking organizations and large banking organizations, respectively. According to this commenter, such an approach could be based on the risk characteristics of a banking organization, including liquidity, asset quality, and local deposit levels, as well as its supervisory rating. Another commenter suggested a fluid leverage ratio requirement that would adjust based on certain macroeconomic variables. Under such an approach, the agencies could require banking organizations to meet a minimum leverage ratio of 10 percent under favorable economic conditions and a 6 percent leverage ratio during an economic contraction.

The FDIC continues to believe that a minimum leverage ratio requirement of 4 percent for all FDIC-supervised institutions is appropriate in light of its role as a complement to the risk-based capital ratios. The proposed leverage ratio is more conservative than the current leverage ratio because it incorporates a more stringent definition of tier 1 capital. In addition, the FDIC believes that it is appropriate for all FDIC-supervised institutions, regardless of their supervisory rating or trading activities, to meet the same minimum leverage ratio requirements. As a practical matter, the FDIC generally has found a leverage ratio of less than 4 percent to be inconsistent with a supervisory composite rating of “1.” Modifying the scope of the leverage ratio measure or implementing a fluid or tiered approach for the minimum leverage ratio

requirement would create additional operational complexity and variability in a minimum ratio requirement that is intended to place a constraint on the maximum degree to which an FDIC-supervised institution can leverage its equity base. Accordingly, the interim final rule retains the existing minimum leverage ratio requirement of 4 percent and removes the 3 percent leverage ratio exception as of January 1, 2014 for advanced approaches FDIC-supervised institutions and as of January 1, 2015 for all other FDIC-supervised institutions.

C. Supplementary Leverage Ratio for Advanced Approaches FDIC-Supervised Institutions

As part of Basel III, the BCBS introduced a minimum leverage ratio requirement of 3 percent (the Basel III leverage ratio) as a backstop measure to the risk-based capital requirements, designed to improve the resilience of the banking system worldwide by limiting the amount of leverage that a banking organization may incur. The Basel III leverage ratio is defined as the ratio of tier 1 capital to a combination of on- and off-balance sheet exposures.

As discussed in the Basel III NPR, the agencies proposed the supplementary leverage ratio only 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. Under the proposal, consistent with Basel III, advanced approaches banking organizations would be required to maintain a minimum supplementary leverage ratio of 3 percent of tier 1 capital to on- and off-balance sheet exposures (total leverage exposure).

The agencies received a number of comments on the proposed supplementary leverage ratio. Several commenters stated that the proposed supplementary leverage ratio is unnecessary in light of the minimum leverage ratio requirement applicable to all banking organizations. These commenters stated that the implementation of the supplementary leverage ratio requirement would create market confusion as to the inter-relationships among the ratios and as

to which ratio serves as the binding constraint for an individual banking organization. One commenter noted that an advanced approaches banking organization would be required to calculate eight distinct regulatory capital ratios (common equity tier 1, tier 1, and total capital to risk-weighted assets under the advanced approaches and the standardized approach, as well as two leverage ratios) and encouraged the agencies to streamline the application of regulatory capital ratios. In addition, commenters suggested that the agencies postpone the implementation of the supplementary leverage ratio until January 1, 2018, after the international supervisory monitoring process is complete, and to collect supplementary leverage ratio information on a confidential basis until then.

At least one commenter encouraged the agencies to consider extending the application of the proposed supplementary leverage ratio on a case-by-case basis to banking organizations with total assets of between $50 billion and $250 billion, stating that such institutions may have significant off-balance sheet exposures and engage in a substantial amount of repo-style transactions. Other commenters suggested increasing the proposed supplementary leverage ratio requirement to at least 8 percent for BHCs, under the Federal Reserve's authority in section 165 of the Dodd-Frank Act to implement enhanced capital requirements for systemically important financial institutions.[29]

With respect to specific aspects of the supplementary leverage ratio, some commenters criticized the methodology for the total leverage exposure. Specifically, one commenter expressed concern that using GAAP as the basis for determining a banking organization's total leverage exposure would exclude a wide range of off-balance sheet exposures, including derivatives and securities lending transactions, as well as permit extensive netting. To address

[29] See section 165 of the Dodd-Frank Act, 12 U.S.C. 5365.

these issues, the commenter suggested requiring advanced approaches banking organizations to determine their total leverage exposure using International Financial Reporting Standards (IFRS), asserting that it restricts netting and, relative to GAAP, requires the recognition of more off-balance sheet securities lending transactions.

Several commenters criticized the proposed incorporation of off-balance sheet exposures into the total leverage exposure. One commenter argued that including unfunded commitments in the total leverage exposure runs counter to the purpose of the supplementary leverage ratio as an on-balance sheet measure of capital that complements the risk-based capital ratios. This commenter was concerned that the proposed inclusion of unfunded commitments would result in a duplicative assessment against banking organizations when the forthcoming liquidity ratio requirements are implemented in the United States. The commenter noted that the proposed 100 percent credit conversion factor for all unfunded commitments is not appropriately calibrated to the vastly different types of commitments that exist across the industry. If the supplementary leverage ratio is retained in the interim final rule, the commenter requested that the agencies align the credit conversion factors for unfunded commitments under the supplementary leverage ratio and any forthcoming liquidity ratio requirements.

Another commenter encouraged the agencies to allow advanced approaches banking organizations to exclude from total leverage exposure the notional amount of any unconditionally cancellable commitment. According to this commenter, unconditionally cancellable commitments are not credit exposures because they can be extinguished at any time at the sole discretion of the issuing entity. Therefore, the commenter argued, the inclusion of these commitments could potentially distort a banking organization's measure of total leverage exposure.

A few commenters requested that the agencies exclude off-balance sheet trade finance instruments from the total leverage exposure, asserting that such instruments are based on underlying client transactions (for example, a shipment of goods) and are generally short-term. The commenters argued that trade finance instruments do not create excessive systemic leverage and that they are liquidated by fulfillment of the underlying transaction and payment at maturity. Another commenter requested that the agencies apply the same credit conversion factors to trade finance instruments as under the general risk-based capital rules – that is, 20 percent of the notional value for trade-related contingent items that arise from the movement of goods, and 50 percent of the notional value for transaction-related contingent items, including performance bonds, bid bonds, warranties, and performance standby letters of credit. According to this commenter, such an approach would appropriately consider the low-risk characteristics of these instruments and ensure price stability in trade finance.

Several commenters supported the proposed treatment for repo-style transactions (including repurchase agreements, securities lending and borrowing transactions, and reverse repos). These commenters stated that securities lending transactions are fully collateralized and marked to market daily and, therefore, the on-balance sheet amounts generated by these transactions appropriately capture the exposure for purposes of the supplementary leverage ratio. These commenters also supported the proposed treatment for indemnified securities lending transactions and encouraged the agencies to retain this treatment in the interim final rule. Other commenters stated that the proposed measurement of repo-style transactions is not sufficiently conservative and recommended that the agencies implement a methodology that includes in total leverage exposure the notional amounts of these transactions.

A few commenters raised concerns about the proposed methodology for determining the exposure amount of derivative contracts. Some commenters criticized the agencies for not allowing advanced approaches banking organizations to use the internal models methodology to calculate the exposure amount for derivative contracts. According to these commenters, the agencies should align the methods for calculating exposure for derivative contracts for purposes of the supplementary leverage ratio and the advanced approaches risk-based capital ratios to more appropriately reflect the risk-management activities of advanced approaches banking organizations and to measure these exposures consistently across the regulatory capital ratios. At least one commenter requested clarification of the proposed treatment of collateral received in connection with derivative contracts. This commenter also encouraged the agencies to permit recognition of eligible collateral for purposes of reducing total leverage exposure, consistent with proposed legislation in other BCBS member jurisdictions.

The introduction of an international leverage ratio requirement in the Basel III capital framework is an important development that would provide a consistent leverage ratio measure across internationally-active institutions. Furthermore, the supplementary leverage ratio is reflective of the on- and off-balance sheet activities of large, internationally active banking organizations. Accordingly, consistent with Basel III, the interim final rule implements for reporting purposes the proposed supplementary leverage ratio for advanced approaches FDIC-supervised institutions starting on January 1, 2015 and requires advanced approaches FDIC-supervised institutions to comply with the minimum supplementary leverage ratio requirement starting on January 1, 2018. Public reporting of the supplementary leverage ratio during the international supervisory monitoring period is consistent with the international implementation

timeline and enables transparency and comparability of reporting the leverage ratio requirement across jurisdictions.

The FDIC is not applying the supplementary leverage ratio requirement to FDIC-supervised institutions that are not subject to the advanced approaches rule in the interim final rule. Applying the supplementary leverage ratio routinely could create operational complexity for smaller FDIC-supervised institutions that are not internationally active, and that generally do not have off-balance sheet activities that are as extensive as FDIC-supervised institutions that are subject to the advanced approaches rule. The FDIC notes that the interim final rule imposes risk-based capital requirements on all repo-style transactions and otherwise imposes constraints on all FDIC-supervised institutions' off-balance sheet exposures.

With regard to the commenters' views to require the use of IFRS for purposes of the supplementary leverage ratio, the FDIC notes that the use of GAAP in the interim final rule as a starting point to measure exposure of certain derivatives and repo-style transactions, has the advantage of maintaining consistency between regulatory capital calculations and regulatory reporting, the latter of which must be consistent with GAAP or, if another accounting principle is used, no less stringent than GAAP.[30]

In response to the commenters' views regarding the scope of the total leverage exposure, the FDIC notes that the supplementary leverage ratio is intended to capture on- and off-balance sheet exposures of an FDIC-supervised institution. Commitments represent an agreement to extend credit and thus including commitments (both funded and unfunded) in the supplementary leverage ratio is consistent with its purpose to measure the on- and off-balance sheet leverage of an FDIC-supervised institution, as well as with safety and soundness principles. Accordingly,

[30] See 12 U.S.C. 1831n(a)(2).

the FDIC believes that total leverage exposure should include FDIC-supervised institutions' off-balance sheet exposures, including all loan commitments that are not unconditionally cancellable, financial standby letters of credit, performance standby letters of credit, and commercial and other similar letters of credit.

The proposal to include unconditionally cancellable commitments in the total leverage exposure recognizes that a banking organization may extend credit under the commitment before it is cancelled. If the banking organization exercises its option to cancel the commitment, its total leverage exposure amount with respect to the commitment will be limited to any extension of credit prior to cancellation. The proposal considered banking organizations' ability to cancel such commitments and, therefore, limited the amount of unconditionally cancellable commitments included in total leverage exposure to 10 percent of the notional amount of such commitments.

The FDIC notes that the credit conversion factors used in the supplementary leverage ratio and in any forthcoming liquidity ratio requirements have been developed to serve the purposes of the respective frameworks and may not be identical. Similarly, the commenters' proposed modifications to credit conversion factors for trade finance transactions would be inconsistent with the purpose of the supplementary leverage ratio – to capture all off-balance sheet exposures of banking organizations in a primarily non-risk-based manner.

For purposes of incorporating derivative contracts in the total leverage exposure, the proposal would require all advanced approaches banking organizations to use the same methodology to measure such exposures. The proposed approach provides a uniform measure of exposure for derivative contracts across banking organizations, without regard to their models. Accordingly, the FDIC does not believe an FDIC-supervised institution should be permitted to

use internal models to measure the exposure amount of derivative contracts for purposes of the supplementary leverage ratio.

With regard to commenters requesting a modification of the proposed treatment for repo-style transactions, the FDIC does not believe that the proposed modifications are warranted at this time because international discussions and quantitative analysis of the exposure measure for repo-style transactions are still ongoing.

The FDIC is continuing to work with the BCBS to assess the Basel III leverage ratio, including its calibration and design, as well as the impact of any differences in national accounting frameworks material to the denominator of the Basel III leverage ratio. The FDIC will consider any changes to the supplementary leverage ratio as the BCBS revises the Basel III leverage ratio.

Therefore, the FDIC has adopted the proposed supplementary leverage ratio in the interim final rule without modification. An advanced approaches FDIC-supervised institution must calculate the supplementary leverage ratio as the simple arithmetic mean of the ratio of the FDIC-supervised institution's tier 1 capital to total leverage exposure as of the last day of each month in the reporting quarter. The FDIC also notes that collateral may not be applied to reduce the potential future exposure (PFE) amount for derivative contracts.

Under the interim final rule, total leverage exposure equals the sum of the following:

(1) The balance sheet carrying value of all of the FDIC-supervised institution's on-balance sheet assets <u>less</u> amounts deducted from tier 1 capital under section 22(a), (c), and (d) of the interim final rule;

(2) The PFE amount for each derivative contract to which the FDIC-supervised institution is a counterparty (or each single-product netting set of such transactions) determined in accordance with section 34 of the interim final rule, but without regard to section 34(b);

(3) 10 percent of the notional amount of unconditionally cancellable commitments made by the FDIC-supervised institution; and

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

Advanced approaches FDIC-supervised institutions must maintain a minimum supplementary leverage ratio of 3 percent beginning on January 1, 2018, consistent with Basel III. However, as noted above, beginning on January 1, 2015, advanced approaches FDIC-supervised institutions must calculate and report their supplementary leverage ratio.

The FDIC is seeking commenters' views on the interaction of this interim final rule with the proposed rule regarding the supplementary leverage ratio for large, systemically important banking organizations.

D. Capital Conservation Buffer

During the recent financial crisis, some banking organizations continued to pay dividends and substantial discretionary bonuses even as their financial condition weakened. 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 enhance the resilience of the banking system, the proposed rule would have limited capital distributions and discretionary bonus payments for banking organizations that do not hold a specified amount of common equity

tier 1 capital in addition to the amount of regulatory capital necessary to meet the minimum risk-based capital requirements (capital conservation buffer), consistent with Basel III. In this way, the capital conservation buffer is intended to provide incentives for banking organizations to hold sufficient capital to reduce the risk that their capital levels would fall below their minimum requirements during a period of financial stress.

The proposed rules incorporated a capital conservation buffer composed of common equity tier 1 capital in addition to the minimum risk-based capital requirements. 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 limitations on capital distributions and discretionary bonus payments to executive officers, as defined in the proposal. The proposal provided that the maximum dollar amount that a banking organization could pay out in the form of capital distributions or discretionary bonus payments during the current calendar quarter (the maximum payout amount) would be equal to a maximum payout ratio, multiplied by the banking organization's eligible retained income, as discussed below. The proposal provided that a banking organization with a buffer of more than 2.5 percent of total risk-weighted assets (plus, for an advanced approaches banking organization, 100 percent of any applicable countercyclical capital buffer), would not be subject to a maximum payout amount. The proposal clarified that the agencies reserved the ability to restrict capital distributions under other authorities and that restrictions on capital distributions and discretionary bonus payments associated with the capital conservation buffer would not be part of the PCA framework. The calibration of the buffer is supported by an evaluation of the loss

experience of U.S. banking organizations as part of an analysis conducted by the BCBS, as well as by evaluation of historical levels of capital at U.S. banking organizations.[31]

The agencies received a significant number of comments on the proposed capital conservation buffer. In general, the commenters characterized the capital conservation buffer as overly conservative, and stated that the aggregate amount of capital that would be required for a banking organization to avoid restrictions on dividends and discretionary bonus payments under the proposed rule exceeded the amount required for a safe and prudent banking system. Commenters expressed concern that the capital conservation buffer could disrupt the priority of payments in a banking organization's capital structure, as any restrictions on dividends would apply to both common and preferred stock. Commenters also questioned the appropriateness of restricting a banking organization that fails to comply with the capital conservation buffer from paying dividends or bonus payments if it has established and maintained cash reserves to cover future uncertainty. One commenter supported the establishment of a formal mechanism for banking organizations to request agency approval to make capital distributions even if doing so would otherwise be restricted under the capital conservation buffer.

Other commenters recommended an exemption from the proposed capital conservation buffer for certain types of banking organizations, such as community banking organizations, banking organizations organized in mutual form, and rural BHCs that rely heavily on bank stock loans for growth and expansion purposes. Commenters also recommended a wide range of institutions that should be excluded from the buffer based on a potential size threshold, such as banking organizations with total consolidated assets of less than $250 billion. Commenters also

[31] "Calibrating regulatory capital requirements and buffers: a top-down approach." Basel Committee on Banking Supervision, October, 2010, available at www.bis.org.

recommended that S-corporations be exempt from the proposed capital conservation buffer because under the U.S. Internal Revenue Code, S-corporations are not subject to a corporate-level tax; instead, S-corporation shareholders must report income and pay income taxes based on their share of the corporation's profit or loss. An S-corporation generally declares a dividend to help shareholders pay their tax liabilities that arise from reporting their share of the corporation's profits. According to some commenters, the proposal disadvantaged S-corporations because shareholders of S-corporations would be liable for tax on the S-corporation's net income, and the S-corporation may be prohibited from making a dividend to these shareholders to fund the tax payment.

One commenter criticized the proposed composition of the capital conservation buffer (which must consist solely of common equity tier 1 capital) and encouraged the agencies to allow banking organizations to include noncumulative perpetual preferred stock and other tier 1 capital instruments. Several commenters questioned the empirical basis for a capital conservation buffer of 2.5 percent, and encouraged the agencies to provide a quantitative analysis for the proposal. One commenter suggested application of the capital conservation buffer only during economic downturn scenarios, consistent with the agencies' objective to restrict dividends and discretionary bonus payments during these periods. According to this commenter, a banking organization that fails to maintain a sufficient capital conservation buffer during periods of economic stress also could be required to submit a plan to increase its capital.

After considering these comments, the FDIC has decided to maintain common equity tier 1 capital as the basis of the capital conservation buffer and to apply the capital conservation buffer to all types of FDIC-supervised institutions at all times. Application of the buffer to all types of FDIC-supervised institutions and maintenance of a capital buffer during periods of

market and economic stability is appropriate to encourage sound capital management and help ensure that FDIC-supervised institutions will maintain adequate amounts of loss-absorbing capital going forward, strengthening the ability of the banking system to continue serving as a source of credit to the economy in times of stress. A buffer framework that restricts dividends and discretionary bonus payments only for certain types of FDIC-supervised institutions or only during an economic contraction would not achieve these objectives. Similarly, basing the capital conservation buffer on the most loss-absorbent form of capital is most consistent with the purpose of the capital conservation buffer as it helps to ensure that the buffer can be used effectively by FDIC-supervised institutions at a time when they are experiencing losses.

The FDIC recognizes that S-corporation FDIC-supervised institutions structure their tax payments differently from C corporations. However, the FDIC notes that this distinction results from S-corporations' pass-through taxation, in which profits are not subject to taxation at the corporate level, but rather at the shareholder level. The FDIC is charged with evaluating the capital levels and safety and soundness of the FDIC-supervised institution. At the point where a decrease in the organization's capital triggers dividend restrictions, the FDIC believes that capital should stay within the FDIC-supervised institution. S-corporation shareholders may receive a benefit from pass-through taxation, but with that benefit comes the risk that the corporation has no obligation to make dividend distributions to help shareholders pay their tax liabilities. Therefore, the interim final rule does not exempt S-corporations from the capital conservation buffer.

Accordingly, under the interim final rule an FDIC-supervised institution must maintain a capital conservation buffer of common equity tier 1 capital in an amount greater than 2.5 percent of total risk-weighted assets (plus, for an advanced approaches FDIC-supervised institution, 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.

The proposal defined eligible retained income 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 and associated tax effects not already reflected in net income. The agencies received a number of comments regarding the proposed definition of eligible retained income, which is used to calculate the maximum payout amount. Some commenters suggested that the agencies limit capital distributions based on retained earnings instead of eligible retained income, citing the Federal Reserve's Regulation H as an example of this regulatory practice.[32] Several commenters representing banking organizations organized as S-corporations recommended revisions to the definition of eligible retained income so that it would be net of pass-through tax distributions to shareholders that have made a pass-through election for tax purposes, allowing S-corporation shareholders to pay their tax liability notwithstanding any dividend restrictions resulting from failure to comply with the capital conservation buffer. Some commenters suggested that the definition of eligible retained income be adjusted for items such as goodwill impairment that are captured in the definition of "net income" for regulatory reporting purposes but which do not affect regulatory capital.

The interim final rule adopts the proposed definition of eligible retained income without change. The FDIC believes the commenters' suggested modifications to the definition of eligible retained income would add complexity to the interim final rule and in some cases may be counter-productive by weakening the incentives of the capital conservation buffer. The FDIC notes that the definition of eligible retained income appropriately accounts for impairment

[32] See 12 CFR part 208.

charges, which reduce eligible retained income but also reduces the balance sheet amount of goodwill that is deducted from regulatory capital. Further, the proposed definition of eligible retained income, which is based on net income as reported in the banking organization's quarterly regulatory reports, reflects a simple measure of a banking organization's recent performance upon which to base restrictions on capital distributions and discretionary payments to executive officers. For the same reasons as described above regarding the application of the capital conservation buffer to S-corporations generally, the FDIC has determined that the definition of eligible retained income should not be modified to address the tax-related concerns raised by commenters writing on behalf of S-corporations.

The proposed rule generally defined a capital distribution as a reduction of tier 1 or tier 2 capital through the repurchase or redemption of a capital instrument or by other means; a dividend declaration or payment on any tier 1 or tier 2 capital instrument if the banking organization has full discretion to permanently or temporarily suspend such payments without triggering an event of default; or any similar transaction that the primary Federal supervisor determines to be in substance a distribution of capital.

Commenters provided suggestions on the definition of "capital distribution." One commenter requested that a "capital distribution" be defined to exclude any repurchase or redemption to the extent the capital repurchased or redeemed was replaced in a contemporaneous transaction by the issuance of capital of an equal or higher quality tier. The commenter maintained that the proposal would unnecessarily penalize banking organizations that redeem capital but contemporaneously replace such capital with an equal or greater amount of capital of an equivalent or higher quality. In response to comments, and recognizing that redeeming capital instruments that are replaced with instruments of the same or similar quality does not

weaken a banking organization's overall capital position, the interim final rule provides that a redemption or repurchase of a capital instrument is not a distribution provided that the banking organization fully replaces that capital instrument by issuing another capital instrument of the same or better quality (that is, more subordinate) based on the interim final rule's eligibility criteria for capital instruments, and provided that such issuance is completed within the same calendar quarter the banking organization announces the repurchase or redemption. For purposes of this definition, a capital instrument is issued at the time that it is fully paid in. For purposes of the interim final rule, the FDIC changed the defined term from "capital distribution" to "distribution" to avoid confusion with the term "capital distribution" used in the Federal Reserve's capital plan rule.[33]

The proposed rule defined discretionary bonus payment as a payment made to an executive officer of a banking organization (as defined below) that meets the following conditions: the banking organization retains discretion as to the fact of the payment and as to the amount of the payment until the payment is awarded to the executive officer; the amount paid is determined by the banking organization without prior promise to, or agreement with, the executive officer; and the executive officer has no contractual right, express or implied, to the bonus payment.

The agencies received a number of comments on the proposed definition of discretionary bonus payments to executive officers. One commenter expressed concern that the proposed definition of discretionary bonus payment may not be effective unless the agencies provided clarification as to the type of payments covered, as well as the timing of such payments. This commenter asked whether the proposed rule would prohibit the establishment of a pre-funded

[33] See 12 CFR 225.8.

bonus pool with mandatory distributions and sought clarification as to whether non-cash compensation payments, such as stock options, would be considered a discretionary bonus payment.

The interim final rule's definition of discretionary bonus payment is unchanged from the proposal. The FDIC notes that if an FDIC-supervised institution prefunds a pool for bonuses payable under a contract, the bonus pool is not discretionary and, therefore, is not subject to the capital conservation buffer limitations. In addition, the definition of discretionary bonus payment does not include non-cash compensation payments that do not affect capital or earnings such as, in some cases, stock options.

Commenters representing community banking organizations maintained that the proposed restrictions on discretionary bonus payments would disproportionately impact such institutions' ability to attract and retain qualified employees. One commenter suggested revising the proposed rule so that a banking organization that fails to satisfy the capital conservation buffer would be restricted from making a discretionary bonus payment only to the extent it exceeds 15 percent of the employee's salary, asserting that this would prevent excessive bonus payments while allowing community banking organizations flexibility to compensate key employees. The interim final rule does not incorporate this suggestion. The FDIC notes that the potential limitations and restrictions under the capital conservation buffer framework do not automatically translate into a prohibition on discretionary bonus payments. Instead, the overall dollar amount of dividends and bonuses to executive officers is capped based on how close the banking organization's regulatory capital ratios are to its minimum capital ratios and on the earnings of the banking organization that are available for distribution. This approach provides appropriate incentives for capital conservation while preserving flexibility for institutions to

decide how to allocate income available for distribution between discretionary bonus payments and other distributions.

The proposal defined executive officer 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.[34]

Commenters generally supported a more restrictive definition of executive officer, arguing that the definition of executive officer should be no broader than the definition under the Federal Reserve's Regulation O,[35] which governs any extension of credit between a member bank and an executive officer, director, or principal shareholder. Some commenters, however, favored a more expansive definition of executive officer, with one commenter supporting the inclusion of directors of the banking organization or directors of any of the banking organization's affiliates, any other person in control of the banking organization or the banking organizations' affiliates, and any person in control of a major business line. In accordance with the FDIC's objective to include those individuals within an FDIC-supervised institution with the greatest responsibility for the organization's financial condition and risk exposure, the interim final rule maintains the definition of executive officer as proposed.

Under the proposal, advanced approaches banking organizations would have calculated their capital conservation buffer (and any applicable countercyclical capital buffer amount) using

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[34] See 76 FR 21170 (April 14, 2011) for a comparable definition of "executive officer."

[35] See 12 CFR part 215.

their advanced approaches total risk-weighted assets. Several commenters supported this aspect of the proposal, and one stated that the methodologies for calculating risk-weighted assets under the advanced approaches rule would more effectively capture the individual risk profiles of such banking organizations, asserting further that advanced approaches banking organizations would face a competitive disadvantage relative to foreign banking organizations if they were required to use standardized total risk-weighted assets to determine compliance with the capital conservation buffer. In contrast, another commenter suggested that advanced approaches banking organizations be allowed to use the advanced approaches methodologies as the basis for calculating the capital conservation buffer only when it would result in a more conservative outcome than under the standardized approach in order to maintain competitive equity domestically. Another commenter expressed concerns that the capital conservation buffer is based only on risk-weighted assets and recommended additional application of a capital conservation buffer to the leverage ratio to avoid regulatory arbitrage opportunities and to accomplish the agencies' stated objective of ensuring that banking organizations have sufficient capital to absorb losses.

The interim final rule requires that advanced approaches FDIC-supervised institutions that have completed the parallel run process and that have received notification from the FDIC supervisor pursuant to section 121(d) of subpart E use their risk-based capital ratios under section 10 of the interim final rule (that is, the lesser of the standardized and the advanced approaches ratios) as the basis for calculating their capital conservation buffer (and any applicable countercyclical capital buffer). The FDIC believes such an approach is appropriate because it is consistent with how advanced approaches FDIC-supervised institutions compute their minimum risk-based capital ratios.

Many commenters discussed the interplay between the proposed capital conservation buffer and the PCA framework. Some commenters encouraged the agencies to reset the buffer requirement to two percent of total risk-weighted assets in order to align it with the margin between the "adequately-capitalized" category and the "well-capitalized" category under the PCA framework. Similarly, some commenters characterized the proposal as confusing because a banking organization could be considered well capitalized for PCA purposes, but at the same time fail to maintain a sufficient capital conservation buffer and be subject to restrictions on capital distributions and discretionary bonus payments. These commenters encouraged the agencies to remove the capital conservation buffer for purposes of the interim final rule, and instead use their existing authority to impose restrictions on dividends and discretionary bonus payments on a case-by-case basis through formal enforcement actions. Several commenters stated that compliance with a capital conservation buffer that operates outside the traditional PCA framework adds complexity to the interim final rule, and suggested increasing minimum capital requirements if the agencies determine they are currently insufficient. Specifically, one commenter encouraged the agencies to increase the minimum total risk-based capital requirement to 10.5 percent and remove the capital conservation buffer from the rule.

The capital conservation buffer has been designed to give banking organizations the flexibility to use the buffer while still being well capitalized. Banking organizations that maintain their risk-based capital ratios at least 50 basis points above the well capitalized PCA levels will not be subject to any restrictions imposed by the capital conservation buffer, as applicable. As losses begin to accrue or a banking organization's risk-weighted assets begin to grow such that the capital ratios of a banking organization are below the capital conservation buffer but above the well capitalized thresholds, the incremental limitations on distributions are

unlikely to affect planned capital distributions or discretionary bonus payments but may provide a check on rapid expansion or other activities that would weaken the organization's capital position.

Under the interim final rule, the maximum payout ratio is the percentage of eligible retained income that an FDIC-supervised institution is allowed to pay out in the form of distributions and discretionary bonus payments, each as defined under the rule, during the current calendar quarter. The maximum payout ratio is determined by the FDIC-supervised institution's capital conservation buffer as calculated as of the last day of the previous calendar quarter.

An FDIC-supervised institution's capital conservation buffer is the lowest of the following ratios: (i) the FDIC-supervised institution's common equity tier 1 capital ratio minus its minimum common equity tier 1 capital ratio; (ii) the FDIC-supervised institution's tier 1 capital ratio minus its minimum tier 1 capital ratio; and (iii) the FDIC-supervised institution's total capital ratio minus its minimum total capital ratio. If the FDIC-supervised institution's common equity tier 1, tier 1 or total capital ratio is less than or equal to its minimum common equity tier 1, tier 1 or total capital ratio, respectively, the FDIC-supervised institution's capital conservation buffer is zero.

The mechanics of the capital conservation buffer under the interim final rule are unchanged from the proposal. An FDIC-supervised institution's maximum payout amount for the current calendar quarter is equal to the FDIC-supervised institution's eligible retained income, multiplied by the applicable maximum payout ratio, in accordance with Table 1. An FDIC-supervised institution with a capital conservation buffer that is greater than 2.5 percent (plus, for an advanced approaches FDIC-supervised institution, 100 percent of any applicable

countercyclical capital buffer) is not subject to a maximum payout amount as a result of the application of this provision. However, an FDIC-supervised institution may otherwise be subject to limitations on capital distributions as a result of supervisory actions or other laws or regulations.[36]

Table 1 illustrates the relationship between the capital conservation buffer and the maximum payout ratio. The maximum dollar amount that an FDIC-supervised institution is permitted to pay out in the form of distributions or discretionary bonus payments during the current calendar quarter is equal to the maximum payout ratio multiplied by the FDIC-supervised institution's eligible retained income. The calculation of the maximum payout amount is made as of the last day of the previous calendar quarter and any resulting restrictions apply during the current calendar quarter.

TABLE 1 — CAPITAL CONSERVATION BUFFER AND MAXIMUM PAYOUT RATIO[37]

Capital conservation buffer (as a percentage of standardized or advanced total risk-weighted assets, as applicable)	**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

[36] See, e.g., 1831o(d)(1), 12 CFR 303.241, and 12 CFR 324, Subpart H (state nonmember banks and state savings associations as of January 1, 2014 for advanced approaches banks and as of January 1, 2015 for all other organizations).

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

Table 1 illustrates that the capital conservation buffer requirements are divided into equal quartiles, each associated with increasingly stringent limitations on distributions and discretionary bonus payments to executive officers as the capital conservation buffer approaches zero. As described in the next section, each quartile expands proportionately for advanced approaches FDIC-supervised institutions when the countercyclical capital buffer amount is greater than zero. In a scenario where an FDIC-supervised institution'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 also would decline. An FDIC-supervised institution that becomes subject to a maximum payout ratio remains 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, an FDIC-supervised institution cannot make distributions or certain discretionary bonus payments during the current calendar quarter if the FDIC-supervised institution's eligible retained income is negative and its capital conservation buffer was less than 2.5 percent as of the end of the previous quarter.

Compliance with the capital conservation buffer is determined prior to any distribution or discretionary bonus payment. Therefore, an FDIC-supervised institution with a capital buffer of more than 2.5 percent is not subject to any restrictions on distributions or discretionary bonus payments even if such distribution or payment would result in a capital buffer of less than or equal to 2.5 percent in the current calendar quarter. However, to remain free of restrictions for purposes of any subsequent quarter, the FDIC-supervised institution must restore capital to

increase the buffer to more than 2.5 percent prior to any distribution or discretionary bonus payment in any subsequent quarter.

In the proposal, the agencies solicited comment on the impact, if any, of prohibiting a banking organization that is subject to a maximum payout ratio of zero percent from making a penny dividend to common stockholders. One commenter stated that such banking organizations should be permitted to pay a penny dividend on their common stock notwithstanding the limitations imposed by the capital conservation buffer. This commenter maintained that the inability to pay any dividend on common stock could make it more difficult to attract equity investors such as pension funds that often are required to invest only in institutions that pay a quarterly dividend. While the FDIC did not incorporate a blanket exemption for penny dividends on common stock, under the interim final rule, as under the proposal, it may permit an FDIC-supervised institution to make a distribution or discretionary bonus payment if it determines that such distribution or payment would not be contrary to the purpose of the capital conservation buffer or the safety and soundness of the organization. In making such determinations, the FDIC would consider the nature of and circumstances giving rise to the request.

E. Countercyclical Capital Buffer

The proposed rule introduced a countercyclical capital buffer applicable to advanced approaches banking organizations to augment the capital conservation buffer during periods of excessive credit growth. Under the proposed rule, the countercyclical capital buffer would have required advanced approaches banking organizations to hold additional common equity tier 1 capital during specific, agency-determined periods in order to avoid limitations on distributions and discretionary bonus payments. The agencies requested comment on the countercyclical

capital buffer and, specifically, on any factors that should be considered for purposes of determining whether to activate it. One commenter encouraged the agencies to consider readily available indicators of economic growth, employment levels, and financial sector profits. This commenter stated generally that the agencies should activate the countercyclical capital buffer during periods of general economic growth or high financial sector profits, instead of reserving it only for periods of "excessive credit growth."

Other commenters did not support using the countercyclical capital buffer as a macroeconomic tool. One commenter encouraged the agencies not to include the countercyclical capital buffer in the interim final rule and, instead, rely on the Federal Reserve's longstanding authority over monetary policy to mitigate excessive credit growth and potential asset bubbles. Another commenter questioned the buffer's effectiveness and encouraged the agencies to conduct a QIS prior to its implementation. One commenter recommended expanding the applicability of the proposed countercyclical capital buffer on a case-by-case basis to institutions with total consolidated assets between $50 and $250 billion. Another commenter, however, supported the application of the countercyclical capital buffer only to institutions with total consolidated assets above $250 billion.

The Dodd-Frank Act requires the agencies to consider the use of countercyclical aspects of capital regulation, and the countercyclical capital buffer is an explicitly countercyclical element of capital regulation.[38] The FDIC notes that implementation of the countercyclical capital buffer for advanced approaches FDIC-supervised institutions is an important part of the Basel III framework, which aims to enhance the resilience of the banking system and reduce

[38] Section 616(a), (b), and (c) of the Dodd-Frank Act, codified at 12 U.S.C. 1844(b), 1464a(g)(1), and 3907(a)(1).

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systemic vulnerabilities. The FDIC believes that the countercyclical capital buffer is most appropriately applied only to advanced approaches FDIC-supervised institutions because, generally, such organizations are more interconnected with other financial institutions. Therefore, the marginal benefits to financial stability from a countercyclical capital buffer function should be greater with respect to such institutions. Application of the countercyclical capital buffer only to advanced approaches FDIC-supervised institutions also reflects the fact that making cyclical adjustments to capital requirements may produce smaller financial stability benefits and potentially higher marginal costs for smaller FDIC-supervised institutions. The countercyclical capital buffer is designed to take into account the macro-financial environment in which FDIC-supervised institutions function and to protect the banking system from the systemic vulnerabilities that may build-up during periods of excessive credit growth, which may potentially unwind in a disorderly way, causing disruptions to financial institutions and ultimately economic activity.

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 act to absorb the above-normal losses that an FDIC-supervised institution likely would face. Consequently, even after these losses are realized, FDIC-supervised institutions would remain healthy and able to access funding, meet obligations, and continue to serve as credit intermediaries. Second, a countercyclical capital buffer also may 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, a countercyclical capital buffer may limit excessive credit.[39] Thus, the FDIC believes that the countercyclical capital buffer is an appropriate macroeconomic tool and is including it in the interim final rule. One commenter expressed concern that the proposed rule would not require the agencies to activate the countercyclical capital buffer pursuant to a joint, interagency determination. This commenter encouraged the agencies to adopt an interagency process for activating the buffer for purposes of the interim final rule. As discussed in the Basel III NPR, 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. The agencies solicited comment on the appropriateness of the proposed 12-month prior notification period for the countercyclical capital buffer amount. One commenter expressed concern regarding the potential for the agencies to activate the countercyclical capital buffer without providing banking organizations sufficient notice, and specifically requested the implementation of a prior notification requirement of not less than 12 months for purposes of the interim final rule.

In general, to provide banking organizations with sufficient time to adjust to any changes to the countercyclical capital buffer under the interim final rule, the agencies expect to announce an increase in the U.S. countercyclical capital buffer amount with an effective date at least 12 months after their announcement. However, if the agencies determine that a more immediate

[39] The operation of the countercyclical capital buffer is also consistent with sections 616(a), (b), and (c) of the Dodd-Frank Act, codified at 12 U.S.C. 1844(b), 1464a(g)(1), and 3907(a)(1).

implementation is necessary based on economic conditions, the agencies may require an earlier effective date. The agencies will follow the same procedures in adjusting the countercyclical capital buffer applicable for exposures located in foreign jurisdictions.

For purposes of the interim final rule, consistent with the proposal, a decrease in the countercyclical capital buffer amount will be effective on the day following announcement of the final determination or the earliest date permissible under applicable law or regulation, whichever is later. In addition, the countercyclical capital buffer amount will return to zero percent 12 months after its effective date, unless the agencies announce a decision to maintain the adjusted countercyclical capital buffer amount or adjust it again before the expiration of the 12-month period.

The countercyclical capital buffer augments the capital conservation buffer by up to 2.5 percent of an FDIC-supervised institution's total risk-weighted assets. Consistent with the proposal, the interim final rule requires an advanced approaches FDIC-supervised institution to determine its countercyclical capital buffer amount by calculating the weighted average of the countercyclical capital buffer amounts established for the national jurisdictions where the FDIC-supervised institution has private sector credit exposures. The contributing weight assigned to a jurisdiction's countercyclical capital buffer amount is calculated by dividing the total risk-weighted assets for the FDIC-supervised institution's private sector credit exposures located in the jurisdiction by the total risk-weighted assets for all of the FDIC-supervised institution's private sector credit exposures.

Under the proposed rule, private sector credit exposure was 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 entity, 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 Enterprise (GSE). While the proposed definition excluded covered positions with specific risk under the market risk rule, the agencies explicitly recognized that they should be included in the measure of risk-weighted assets for private-sector exposures and asked a question regarding how to incorporate these positions in the measure of risk-weighted assets, particularly for positions for which an FDIC-supervised institution uses models to measure specific risk. The agencies did not receive comments on this question.

The interim final rule includes covered positions under the market risk rule in the definition of private sector credit exposure. Thus, a private sector credit exposure is an exposure to a company or an individual, not including an exposure to a sovereign entity, the Bank for International Settlements, the European Central Bank, the European Commission, the International Monetary Fund, an MDB, a PSE, or a GSE. The interim final rule is also more specific than the proposal regarding how to calculate risk-weighted assets for private sector credit exposures, and harmonizes that calculation with the advanced approaches FDIC-supervised institution's determination of its capital conservation buffer generally. An advanced approaches FDIC-supervised institution is subject to the countercyclical capital buffer regardless of whether it has completed the parallel run process and received notification from the FDIC pursuant to section 121(d) of the rule. The methodology an advanced approaches FDIC-supervised institution must use for determining risk-weighted assets for private sector credit exposures must be the methodology that the FDIC-supervised institution uses to determine its risk-based capital ratios under section 10 of the interim final rule. Notwithstanding this provision, the risk-weighted asset amount for a private sector credit exposure that is a covered

position is its specific risk add-on, as determined under the market risk rule's standardized measurement method for specific risk, multiplied by 12.5. The FDIC chose this methodology because it allows the specific risk of a position to be allocated to the position's geographic location in a consistent manner across FDIC-supervised institutions.

Consistent with the proposal, under the interim final rule the geographic location of a private sector credit exposure (that is not a securitization exposure) is 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 a protection provider, the location of the non-securitization exposure is the location of the protection provider. The location of a securitization exposure is the location of the underlying exposures, determined by reference to the location of the borrowers on those exposures. If the underlying exposures are located in more than one national jurisdiction, the location of a securitization exposure is the national jurisdiction where the underlying exposures with the largest aggregate unpaid principal balance are located.

Table 2 illustrates how an advanced approaches FDIC-supervised institution calculates its weighted average countercyclical capital buffer amount. In the following example, the countercyclical capital buffer established in the various jurisdictions in which the FDIC-supervised institution has private sector credit exposures is reported in column A. Column B contains the FDIC-supervised institution's risk-weighted asset amounts for the private sector credit exposures in each jurisdiction. Column C shows the contributing weight for each countercyclical capital 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 FDIC-supervised institution's weighted average countercyclical capital buffer, which is 1.4 percent of risk-weighted assets.

TABLE 2—EXAMPLE OF WEIGHTED AVERAGE BUFFER CALCULATION FOR AN ADVANCED APPROACHES FDIC-SUPERVISED INSTITUTION

	(A) Countercyclical capital buffer amount set by national supervisor (percent)	(B) FDIC-supervised institution's risk-weighted assets 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

The countercyclical capital buffer expands an FDIC-supervised institution's capital conservation buffer range for purposes of determining the FDIC-supervised institution's maximum payout ratio. For instance, if an advanced approaches FDIC-supervised institution's countercyclical capital buffer amount is equal to zero percent of total risk-weighted assets, the FDIC-supervised institution must maintain a buffer of greater than 2.5 percent of total risk-weighted assets to avoid restrictions on its distributions and discretionary bonus payments. However, if its countercyclical capital buffer amount is equal to 2.5 percent of total risk-weighted assets, the FDIC-supervised institution must maintain a buffer of greater than 5 percent

of total risk-weighted assets to avoid restrictions on its distributions and discretionary bonus payments.

As another example, if the advanced approaches FDIC-supervised institution from the example in Table 2 above has a capital conservation buffer of 2.0 percent, and each of the jurisdictions in which it has private sector credit exposures sets its countercyclical capital buffer amount equal to zero, the FDIC-supervised institution would be subject to a maximum payout ratio of 60 percent. If, instead, each country sets its countercyclical capital buffer amount as shown in Table 2, resulting in a countercyclical capital buffer amount of 1.4 percent of total risk-weighted assets, the FDIC-supervised institution's capital conservation buffer ranges would be expanded as shown in Table 3 below. As a result, the FDIC-supervised institution would now be subject to a stricter 40 percent maximum payout ratio based on its capital conservation buffer of 2.0 percent.

TABLE 3— CAPITAL CONSERVATION BUFFER AND MAXIMUM PAYOUT RATIO[40]

Capital conservation buffer as expanded by the countercyclical capital buffer amount from Table 2	**Maximum payout ratio (as a percentage of eligible retained income)**
Greater than 3.9 percent (2.5 percent + 100 percent of the countercyclical capital buffer of 1.4)	No payout ratio limitation applies
Less than or equal to 3.9 percent, and greater than 2.925 percent (1.875 percent plus 75 percent of the countercyclical capital buffer of 1.4)	60 percent
Less than or equal to 2.925 percent, and greater than 1.95 percent (1.25 percent plus 50 percent of the countercyclical capital buffer of 1.4)	40 percent
Less than or equal to 1.95 percent, and greater than 0.975 percent (.625 percent plus 25	20 percent

[40] Calculations in this table are based on the assumption that the countercyclical capital buffer amount is 1.4 percent of risk-weighted assets, per the example in Table 2.

percent of the countercyclical capital buffer of 1.4)	
Less than or equal to 0.975 percent	0 percent

The countercyclical capital buffer amount under the interim final rule for U.S. credit exposures is initially set to zero, but it could increase if the agencies determine that there is excessive credit in the markets that could lead to subsequent wide-spread market failures. 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 system-wide credit risk.

F. Prompt Corrective Action Requirements

All insured depository institutions, regardless of total asset size or foreign exposure, currently are required to compute PCA capital levels using the agencies' general risk-based capital rules, as supplemented by the market risk rule. Section 38 of the Federal Deposit Insurance Act directs the federal banking agencies to resolve the problems of insured depository institutions at the least cost to the Deposit Insurance Fund.[41] To facilitate this purpose, the agencies have established five regulatory capital categories in the 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

[41] 12 U.S.C. 1831o.

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.[42] Insured depository institutions are expected to be closed within 90 days of becoming "critically undercapitalized," unless their primary Federal supervisor takes such other action as that primary Federal supervisor determines, with the concurrence of the FDIC, would better achieve the purpose of PCA.[43]

The proposal maintained the structure of the PCA framework while increasing some of the thresholds for the PCA capital categories and adding the proposed common equity tier 1 capital ratio. For example, under the proposed rule, the thresholds for adequately capitalized FDIC-supervised institutions would be equal to the minimum capital requirements. The risk-based capital ratios for well capitalized FDIC-supervised institutions under PCA would continue to be two percentage points higher than the ratios for adequately-capitalized FDIC-supervised institutions, and the leverage ratio for well capitalized FDIC-supervised institutions under PCA would be one percentage point higher than for adequately-capitalized FDIC-supervised institutions. Advanced approaches FDIC-supervised institutions that are insured depository institutions also would be required to satisfy a supplementary leverage ratio of 3 percent in order to be considered adequately capitalized. While the proposed PCA levels do not incorporate the capital conservation buffer, the PCA and capital conservation buffer frameworks would

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[42] 12 U.S.C. 1831o(e) – (i). See 12 CFR part 325, subpart B.

[43] 12 U.S.C. 1831o(g)(3).

complement each other to ensure that FDIC-supervised institutions hold an adequate amount of common equity tier 1 capital.

The agencies received a number of comments on the proposed PCA framework. Several commenters suggested modifications to the proposed PCA levels, particularly with respect to the leverage ratio. For example, a few commenters encouraged the agencies to increase the adequately-capitalized and well capitalized categories for the leverage ratio to six percent or more and eight percent or more, respectively. According to one commenter, such thresholds would more closely align with the actual leverage ratios of many state-charted depository institutions.

Another commenter expressed concern regarding the operational complexity of the proposed PCA framework in view of the addition of the common equity tier 1 capital ratio and the interaction of the PCA framework and the capital conservation buffer. For example, under the proposed rule a banking organization could be well capitalized for PCA purposes and, at the same time, be subject to restrictions on dividends and bonus payments. Other banking organizations expressed concern that the proposed PCA levels would adversely affect their ability to lend and generate income. This, according to a commenter, also would reduce net income and return-on-equity.

The FDIC believes the capital conservation buffer complements the PCA framework—the former works to keep FDIC-supervised institutions above the minimum capital ratios, whereas the latter imposes increasingly stringent consequences on depository institutions, particularly as they fall below the minimum capital ratios. Because the capital conservation buffer is designed to absorb losses in stressful periods, the FDIC believes it is appropriate for a

depository institution to be able to use some of its capital conservation buffer without being considered less than well capitalized for PCA purposes.

Consistent with the proposal, the interim final rule augments 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).[44] In addition, the interim final rule revises the three current risk-based capital measures for four of the five PCA categories to reflect the interim final rule's changes to the minimum risk-based capital ratios, as provided in revisions to the FDIC's PCA regulations. All FDIC-supervised institutions will remain subject to leverage measure thresholds using the current leverage ratio in the form of tier 1 capital to average total consolidated assets. In addition, the interim final rule amends the PCA leverage measure for advanced approaches depository institutions to include the supplementary leverage ratio that explicitly applies to the "adequately capitalized" and "undercapitalized" capital categories.

All insured depository institutions must comply with the revised PCA thresholds beginning on January 1, 2015. Consistent with transition provisions in the proposed rules, the supplementary leverage measure for advanced approaches FDIC-supervised institutions that are insured depository institutions becomes effective on January 1, 2018. Changes to the definitions of the individual capital components that are used to calculate the relevant capital measures under PCA are governed by the transition arrangements discussed in section VIII.3 below. Thus, the changes to these definitions, including any deductions from or adjustments to regulatory capital, automatically flow through to the definitions in the PCA framework.

Table 4 sets forth the risk-based capital and leverage ratio thresholds under the interim final rule for each of the PCA capital categories for all insured depository institutions. For each

[44] 12 U.S.C. 1831o(c)(1)(B)(i).

PCA category except critically undercapitalized, an insured depository institution must satisfy 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. In addition to the aforementioned requirements, advanced approaches FDIC-supervised institutions that are insured depository institutions are also subject to a supplementary leverage ratio.

TABLE 4 —PCA LEVELS FOR ALL INSURED DEPOSITORY INSTITUTIONS

PCA category	Total Risk-based Capital (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	”

*The supplementary leverage ratio as a PCA requirement applies only to advanced approaches FDIC-supervised institutions that are insured depository institutions. The supplementary leverage ratio also applies to advanced approaches bank holding companies, although not in the form of a PCA requirement.

To be well capitalized for purposes of the interim final rule, an insured depository institution must maintain a total risk-based capital ratio of 10 percent or more; a tier 1 capital ratio of 8 percent or more; a common equity tier 1 capital ratio of 6.5 percent or more; and a

leverage ratio of 5 percent or more. An adequately-capitalized depository institution must maintain a total risk-based capital ratio of 8 percent or more; a tier 1 capital ratio of 6 percent or more; a common equity tier 1 capital ratio of 4.5 percent or more; and a leverage ratio of 4 percent or more.

An insured depository institution is undercapitalized under the interim final rule if its total capital ratio is less than 8 percent, if its tier 1 capital ratio is less than 6 percent, its common equity tier 1 capital ratio is less than 4.5 percent, or its leverage ratio is less than 4 percent. If an institution's tier 1 capital ratio is less than 4 percent, or its common equity tier 1 capital ratio is less than 3 percent, it would be considered significantly undercapitalized. The other numerical capital ratio thresholds for being significantly undercapitalized remain unchanged from the current rules.[45]

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.[46] 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: (1) common stockholder's equity, (2)

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[45] 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 its primary Federal regulator 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. See 12 CFR 325.103(b)(1)(iv) (state nonmember banks) and 12 CFR 390.453(b)(1)(iv) (state savings associations). The interim final rule does not change this requirement.

[46] See 12 USC 1831o(c)(3)(A) and (B), which for purposes of the "critically undercapitalized" PCA category requires the ratio of tangible equity to total assets to be set at an amount "not less than 2 percent of total assets".

qualifying noncumulative perpetual preferred stock (including related surplus), and (3) minority interest in the equity accounts of consolidated subsidiaries; plus outstanding cumulative preferred perpetual stock; minus all intangible assets except mortgage servicing rights to the extent permitted 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.

Consistent with the proposal, the interim final rule revises the calculation of the capital measure 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 more appropriately aligns the calculation of tangible equity with the calculation of tier 1 capital generally for regulatory capital requirements. Assets included in an FDIC-supervised institution's equity under GAAP, such as DTAs, are included in tangible equity only to the extent that they are included in tier 1 capital. The FDIC believes this modification promotes consistency and provides for clearer boundaries across and between the various PCA categories.

G. 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 FDIC's general risk-based capital rules indicate that the capital requirements are minimum standards generally based on broad credit-risk considerations.[47] The risk-based capital ratios under these rules do not explicitly take account of

[47] See 12 CFR 325.3(a) (state nonmember banks) and 12 CFR 390.463 (state savings associations).

the quality of individual asset portfolios or the range of other types of risk to which FDIC-supervised institutions may be exposed, such as interest-rate, liquidity, market, or operational risks.[48]

An FDIC-supervised institution 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.[49] The nature of such capital adequacy assessments should be commensurate with FDIC-supervised institutions' size, complexity, and risk-profile. Consistent with longstanding practice, supervisory assessment of capital adequacy will take account of whether an FDIC-supervised institution plans appropriately to maintain an adequate level of capital given its activities and risk profile, as well as risks and other factors that can affect an FDIC-supervised institution's financial condition, including, for example, the level and severity of problem assets and its exposure to operational and interest rate risk, and significant asset concentrations. For this reason, a supervisory assessment of capital adequacy may differ significantly from conclusions that might be drawn solely from the level of an FDIC-supervised institution's regulatory capital ratios.

In light of these considerations, as a prudential matter, an FDIC-supervised institution 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 requirements. For example,

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[48] The risk-based capital ratios of an FDIC-supervised institution subject to the market risk rule do include capital requirements for the market risk of covered positions, and the risk-based capital ratios calculated using advanced approaches total risk-weighted assets for an advanced approaches FDIC-supervised institution that has completed the parallel run process and received notification from the FDIC pursuant to section 121(d) do include a capital requirement for operational risks.

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

FDIC-supervised institutions 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. FDIC-supervised institutions with high levels of risk are also expected to operate even further above minimum standards. In addition to evaluating the appropriateness of an FDIC-supervised institution's capital level given its overall risk profile, the supervisory assessment takes into account the quality and trends in an FDIC-supervised institution's capital composition, including the share of common and non-common-equity capital elements.

Some commenters stated that they manage their capital so that they operate with a buffer over the minimum and that examiners expect such a buffer. These commenters expressed concern that examiners will expect even higher capital levels, such as a buffer in addition to the new higher minimums and capital conservation buffer (and countercyclical capital buffer, if applicable). Consistent with the longstanding approach employed by the FDIC in its supervision of FDIC-supervised institutions, section 10(d) of the interim final rule maintains and reinforces supervisory expectations by requiring that an FDIC-supervised institution maintain capital commensurate with the level and nature of all risks to which it is exposed and that an FDIC-supervised institution 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 an FDIC-supervised institution's capital adequacy, including compliance with section 10(d), may include such factors as whether the FDIC-supervised institution is newly chartered, entering new activities, or introducing new products. The assessment also would consider whether an FDIC-supervised institution 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 an FDIC-supervised institution's holding company or other affiliates.

Supervisors also evaluate the comprehensiveness and effectiveness of an FDIC-supervised institution's capital planning in light of its activities and capital levels. An effective capital planning process involves an assessment of the risks to which an FDIC-supervised institution is exposed and its processes for managing and mitigating those risks, an evaluation of its capital adequacy relative to its risks, and consideration of the potential impact on its earnings and capital base from current and prospective economic conditions. While the elements of supervisory review of capital adequacy would be similar across FDIC-supervised institutions, evaluation of the level of sophistication of an individual FDIC-supervised institution's capital adequacy process would be commensurate with the FDIC-supervised institution's size, sophistication, and risk profile, similar to the current supervisory practice.

H. Tangible Capital Requirement for State Savings Associations

State savings associations currently are required to maintain tangible capital in an amount not less than 1.5 percent of total assets.[50] This statutory requirement is implemented under the FDIC's current capital rules applicable to state savings associations.[51] For purposes of the Basel

[50] Tangible capital is defined in section 5(t)(9)(B) of HOLA to mean "core capital minus any intangible assets (as intangible assets are defined by the OCC for national banks)." 12 USC 1464(t)(9)(B). Core capital means "core capital as defined by the OCC for national banks, less unidentifiable intangible assets", unless the OCC prescribes a more stringent definition. 12 USC 1464(t)(9)(A).

[51] 12 CFR 390.468.

III NPR, the FDIC also proposed to include a tangible capital requirement for state savings associations. The FDIC received no comments on this aspect of the proposal.

Concerning state savings associations, the FDIC does not believe that a unique regulatory definition of "tangible capital" is necessary for purposes of implementing HOLA. Accordingly, for purposes of the interim final rule, the FDIC also is defining "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. As discussed above, this definition is analogous to the definition of tangible capital adopted under the interim final rule for purposes of the PCA framework. The FDIC believes that this approach will reduce implementation burden associated with separate measures of tangible capital and is consistent with the purposes of HOLA and PCA.

The FDIC notes that for purposes of the interim final rule, the term "total adjusted assets" in the definition of "state savings associations tangible capital ratio" has been replaced with the term "total assets." As a result of this change, which should further reduce implementation burden, state savings associations will no longer calculate the tangible equity ratio using period-end total assets.

V. Definition of Capital

A. Capital Components and Eligibility Criteria for Regulatory Capital Instruments

1. Common Equity Tier 1 Capital

Under the proposed rule, common equity tier 1 capital was defined as the sum of a banking organization's outstanding common equity tier 1 capital instruments that satisfy the criteria set forth in section 20(b) of the proposal, related surplus (net of treasury stock), retained

earnings, AOCI, and common equity tier 1 minority interest subject to certain limitations, minus regulatory adjustments and deductions.

The proposed rule set forth a list of criteria that an instrument would be required to meet to be included in common equity tier 1 capital. The proposed criteria were 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. In the proposals, the agencies indicated that they believe most existing common stock instruments issued by U.S. banking organizations already would satisfy the proposed criteria.

The proposed criteria also applied to instruments issued by banking organizations such as mutual banking organizations where ownership of the organization is not freely transferable or evidenced by certificates of ownership or stock. For these entities, the proposal provided that instruments issued by such organizations would be considered common equity tier 1 capital if they are fully equivalent to common stock instruments in terms of their subordination and availability to absorb losses, and do not possess features that could cause the condition of the organization to weaken as a going concern during periods of market stress.

The agencies noted in the proposal that stockholders' voting rights generally are a valuable corporate governance tool that permits parties with an economic interest to participate in the decision-making process through votes on establishing corporate objectives and policy, and in electing the banking organization's board of directors. Therefore, the agencies believe 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. The proposal also provided that to the extent that a banking organization issues non-voting common stock or common stock with limited voting rights, the underlying

stock must be identical to those underlying the banking organization's voting common stock in all respects except for any limitations on voting rights.

To ensure that a banking organization's common equity tier 1 capital would be available to absorb losses as they occur, the proposed rule would have required common equity tier 1 capital instruments issued by a banking organization to 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 banking organization's primary Federal supervisor, 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.

The agencies requested comment on the proposed criteria for inclusion in common equity tier 1, and specifically on whether any of the criteria would be problematic, given the main characteristics of existing outstanding common stock instruments.

A substantial number of comments addressed the criteria for common equity tier 1 capital. Generally, commenters stated that the proposed criteria could prevent some instruments currently included in tier 1 capital from being included in the new common equity tier 1 capital measure. Commenters stated that this could create complicated and unnecessary burden for banking organizations that either would have to raise capital to meet the common equity tier 1 capital requirement or shrink their balance sheets by selling off or winding down assets and exposures. Many commenters stated that the burden of raising new capital would have the effect of reducing lending overall, and that it would be especially acute for smaller banking organizations that have limited access to capital markets.

Many commenters asked the agencies to clarify several aspects of the proposed criteria. For instance, a few commenters asked the agencies to clarify the proposed requirement that a common equity tier 1 capital instrument be redeemed only with prior approval by a banking organization's primary Federal supervisor. These commenters asked if this criterion would require a banking organization to note this restriction on the face of a regulatory capital instrument that it may be redeemed only with the prior approval of the banking organization's primary Federal supervisor.

The FDIC notes that the requirement that common equity tier 1 capital instruments be redeemed only with prior agency approval is consistent with the FDIC's rules and federal law,

which generally provide that an FDIC-supervised institution may not reduce its capital by redeeming capital instruments without receiving prior approval from the FDIC.[52] The interim final rule does not obligate the FDIC-supervised institution to include this restriction explicitly in the common equity tier 1 capital instrument's documentation. However, regardless of whether the instrument documentation states that its redemption is subject to FDIC approval, the FDIC-supervised institution must receive prior approval before redeeming such instruments. The FDIC believes that the approval requirement is appropriate as it provides for the monitoring of the strength of an FDIC-supervised institution's capital position, and therefore, have retained the proposed requirement in the interim final rule.

Several commenters also expressed concern about the proposed requirement that dividend payments and any other distributions on a common equity tier 1 capital 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. Commenters stated that, as proposed, this requirement could be construed to prevent a banking organization from paying a dividend on a common equity tier 1 capital instrument because of obligations that have not yet become due or because of immaterial delays in paying trade creditors[53] for obligations incurred in the ordinary course of business.

The FDIC notes that this criterion should not prevent an FDIC-supervised institution from paying a dividend on a common equity tier 1 capital instrument where it has incurred

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[52] See 12 CFR 303.241 (state nonmember banks) and 12 CFR 390.345 (state savings associations).

[53] Trade creditors, for this purpose, would include counterparties with whom the banking organization contracts to procure office space and/or supplies as well as basic services, such as building maintenance.

operational obligations in the normal course of business that are not yet due or that are subject to minor delays for reasons unrelated to the financial condition of the FDIC-supervised institution, such as delays related to contractual or other legal disputes.

A number of commenters also suggested that the proposed criteria providing that dividend payments may be paid only out of current and retained earnings potentially could conflict with state corporate law, including Delaware state law. According to these commenters, Delaware state law permits a corporation to make dividend payments out of its capital surplus account, even when the organization does not have current or retained earnings.

The FDIC observes that requiring that dividends be paid only out of net income and retained earnings is consistent with federal law and the existing regulations applicable to insured depository institutions. Under applicable statutes and regulations this aspect of the proposal did not include any substantive changes from the general risk-based capital rules.[54] With respect to FDIC-supervised institutions, prior supervisory approval is required to make a distribution that involves a reduction or retirement of capital stock. Under FDIC's general risk-based capital rules, a state nonmember bank is prohibited from paying a dividend that reduces the amount of its common or preferred capital stock (which includes any surplus), or retiring any part of its capital notes or debentures without prior approval from the FDIC.

Finally, several commenters expressed concerns about the potential impact of the proposed criteria on stock issued as part of certain employee stock ownership plans (ESOPs) (as defined under Employee Retirement Income Security Act of 1974[55] (ERISA) regulations at 29 CFR 2550.407d-6). Under the proposed rule, an instrument would not be included in common

[54] 12 U.S.C. 1828(i), 12 CFR 303.241 (state nonmember banks), and 12 CFR § 390.345 (state savings associations). .

[55] 29 U.S.C. 1002, et seq.

equity tier 1 capital if the banking organization creates an expectation that it will buy back, cancel, or redeem the instrument, or if the instrument includes any term or feature that might give rise to such an expectation. Additionally, the criteria would prevent a banking organization from including in common equity tier 1 capital any instrument that is subject to any type of arrangement that legally or economically enhances the seniority of the instrument. Commenters noted that under ERISA, stock that is not publicly traded and issued as part of an ESOP must include a "put option" that requires the company to repurchase the stock. By exercising the put option, an employee can redeem the stock instrument upon termination of employment. Commenters noted that this put option clearly creates an expectation that the instrument will be redeemed and arguably enhances the seniority of the instrument. Therefore, the commenters stated that the put option could prevent a privately-held banking organization from including earned ESOP shares in its common equity tier 1 capital.

The FDIC does not believe that an ERISA-mandated put option should prohibit ESOP shares from being included in common equity tier 1 capital. Therefore, under the interim final rule, shares issued under an ESOP by an FDIC-supervised institution that is not publicly-traded are exempt from the criteria that the shares can be redeemed only via discretionary repurchases and are not subject to any other arrangement that legally or economically enhances their seniority, and that the FDIC-supervised institution not create an expectation that the shares will be redeemed. In addition to the concerns described above, because stock held in an ESOP is awarded by a banking organization for the retirement benefit of its employees, some commenters expressed concern that such stock may not conform to the criterion prohibiting a banking organization from directly or indirectly funding a capital instrument. Because the FDIC believes that an FDIC-supervised institution should have the flexibility to provide an ESOP as a benefit

for its employees, the interim final rule provides that ESOP stock does not violate such criterion. Under the interim final rule, an FDIC-supervised institution's common stock held in trust for the benefit of employees as part of an ESOP in accordance with both ERISA and ERISA-related U.S. tax code requirements will qualify for inclusion as common equity tier 1 capital only to the extent that the instrument is includable as equity under GAAP and that it meets all other criteria of section 20(b)(1) of the interim final rule. Stock instruments held by an ESOP that are unawarded or unearned by employees or reported as "temporary equity" under GAAP (in the case of U.S. Securities and Exchange Commission (SEC) registrants), may not be counted as equity under GAAP and therefore may not be included in common equity tier 1 capital.

After reviewing the comments received, the FDIC has decided to finalize the proposed criteria for common equity tier 1 capital instruments, modified as discussed above. Although it is possible some currently outstanding common equity instruments may not meet the common equity tier 1 capital criteria, the FDIC believes that most common equity instruments that are currently eligible for inclusion in FDIC-supervised institutions' tier 1 capital meet the common equity tier 1 capital criteria, and have not received information that would support a different conclusion. The FDIC therefore believes that most FDIC-supervised institutions will not be required to reissue common equity instruments in order to comply with the final common equity tier 1 capital criteria. The final revised criteria for inclusion in common equity tier 1 capital are set forth in section 20(b)(1) of the interim final rule.

2. Additional Tier 1 Capital

Consistent with Basel III, the agencies proposed that additional tier 1 capital would equal the sum of: additional tier 1 capital instruments that satisfy the criteria set forth in section 20(c) of the proposal, related surplus, and any tier 1 minority interest that is not included in a banking

organization's common equity tier 1 capital (subject to the proposed limitations on minority interest), less applicable regulatory adjustments and deductions. The agencies proposed the following criteria for additional tier 1 capital instruments in section 20(c):

(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 its primary Federal supervisor 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 proposed rule (replacement can be concurrent with redemption of existing additional tier 1 capital instruments); or

(B) Demonstrate to the satisfaction of its primary Federal supervisor 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 banking organization's primary Federal supervisor.

(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.[56]

(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 were designed to ensure that additional tier 1 capital instruments would be available to absorb losses on a going-concern basis. TruPS 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, generally would not qualify for inclusion in additional tier 1 capital.[57] As explained in the proposal, the agencies believe that instruments

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

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

that allow for the accumulation of interest payable, like cumulative preferred securities, are not likely to absorb losses to the degree appropriate for inclusion in tier 1 capital. In addition, the exclusion of these instruments from the tier 1 capital of depository institution holding companies would be consistent with section 171 of the Dodd-Frank Act.

The agencies noted in the proposal that under Basel III, instruments classified as liabilities for accounting purposes could potentially be included in additional tier 1 capital. However, the agencies proposed that an instrument classified as a liability under GAAP could not qualify as additional tier 1 capital, reflecting the agencies' view that allowing only instruments classified as equity under GAAP in tier 1 capital helps strengthen the loss-absorption capabilities of additional tier 1 capital instruments, thereby increasing the quality of the capital base of U.S. banking organizations.

The agencies also proposed to allow banking organizations to include in additional tier 1 capital instruments that were: (1) issued under the Small Business Jobs Act of 2010[58] or, prior to October 4, 2010, under the Emergency Economic Stabilization Act of 2008,[59] and (2) included in tier 1 capital under the agencies' general risk-based capital rules. Under the proposal, these instruments would be included in tier 1 capital regardless of whether they satisfied the proposed qualifying criteria for common equity tier 1 or additional tier 1 capital. The agencies explained in the proposal that continuing to permit these instruments to be included in tier 1 capital is important to promote financial recovery and stability following the recent financial crisis.[60]

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[58] Pub. L. 111-240, 124 Stat. 2504 (2010).

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

[60] See, e.g., 73 FR 43982 (July 29, 2008); see also 76 FR 35959 (June 21, 2011).

A number of commenters addressed the proposed criteria for additional tier 1 capital. Consistent with comments on the criteria for common equity tier 1 capital, commenters generally argued that imposing new restrictions on qualifying regulatory capital instruments would be burdensome for many banking organizations that would be required to raise additional capital or to shrink their balance sheets to phase out existing regulatory capital instruments that no longer qualify as regulatory capital under the proposed rule.

With respect to the proposed criteria, commenters requested that the agencies make a number of changes and clarifications. Specifically, commenters asked the agencies to clarify the use of the term "secured" in criterion (3) above. In this context, a "secured" instrument is an instrument that is backed by collateral. In order to qualify as additional tier 1 capital, an instrument may not be collateralized, guaranteed by the issuing organization or an affiliate of the issuing organization, or subject to any other arrangement that legally or economically enhances the seniority of the instrument relative to more senior claims. Instruments backed by collateral, guarantees, or other arrangements that affect their seniority are less able to absorb losses than instruments without such enhancements. Therefore, instruments secured by collateral, guarantees, or other enhancements would not be included in additional tier 1 capital under the proposal. The FDIC has adopted this criterion as proposed.

Commenters also asked the agencies to clarify whether terms allowing a banking organization to convert a fixed-rate instrument to a floating rate in combination with a call option, without any increase in credit spread, would constitute an "incentive to redeem" under criterion (4). The FDIC does not consider the conversion from a fixed rate to a floating rate (or from a floating rate to a fixed rate) in combination with a call option without any increase in credit spread to constitute an "incentive to redeem" for purposes of this criterion. More

specifically, a call option combined with a change in reference rate where the credit spread over the second reference rate is equal to or less than the initial dividend rate less the swap rate (that is, the fixed rate paid to the call date to receive the second reference rate) would not be considered an incentive to redeem. For example, if the initial reference rate is 0.9 percent, the credit spread over the initial reference rate is 2 percent (that is, the initial dividend rate is 2.9 percent), and the swap rate to the call date is 1.2 percent, a credit spread over the second reference rate greater than 1.7 percent (2.9 percent minus 1.2 percent) would be considered an incentive to redeem. The FDIC believes that the clarification above should address the commenters' concerns, and the FDIC is retaining this criterion in the interim final rule as proposed.

Several commenters noted that the proposed requirement that a banking organization seek prior approval from its primary Federal supervisor before exercising a call option is redundant with the existing requirement that a banking organization seek prior approval before reducing regulatory capital by redeeming a capital instrument. The FDIC believes that the proposed requirement clarifies existing requirements and does not add any new substantive restrictions or burdens. Including this criterion also helps to ensure that the regulatory capital rules provide FDIC-supervised institutions a complete list of the requirements applicable to regulatory capital instruments in one location. Accordingly, the FDIC has retained this requirement in the interim final rule.

Banking industry commenters also asserted that some of the proposed criteria could have an adverse impact on ESOPs. Specifically, the commenters noted that the proposed requirement that instruments not be callable for at least five years after issuance could be problematic for compensation plans that enable a company to redeem shares after employment is terminated.

Commenters asked the agencies to exempt from this requirement stock issued as part of an ESOP. For the reasons stated above in the discussion of common equity tier 1 capital instruments, under the interim final rule, additional tier 1 instruments issued under an ESOP by an FDIC-supervised institution that is not publicly traded are exempt from the criterion that additional tier 1 instruments not be callable for at least five years after issuance. Moreover, similar to the discussion above regarding the criteria for common equity tier 1 capital, the FDIC believes that required compliance with ERISA and ERISA-related tax code requirements alone should not prevent an instrument from being included in regulatory capital. Therefore, the FDIC is including a provision in the interim final rule to clarify that the criterion prohibiting an FDIC-supervised institution from directly or indirectly funding a capital instrument, the criterion prohibiting a capital instrument from being covered by a guarantee of the FDIC-supervised institution or from being subject to an arrangement that enhances the seniority of the instrument, and the criterion pertaining to the creation of an expectation that the instrument will be redeemed, shall not prevent an instrument issued by a non-publicly traded FDIC-supervised institution as part of an ESOP from being included in additional tier 1 capital. In addition, capital instruments held by an ESOP trust that are unawarded or unearned by employees or reported as "temporary equity" under GAAP (in the case of U.S. SEC registrants) may not be counted as equity under GAAP and therefore may not be included in additional tier 1 capital.

Commenters also asked the agencies to add exceptions for early calls within five years of issuance in the case of an "investment company event" or a "rating agency event," in addition to the proposed exceptions for regulatory and tax events. After considering the comments on these issues, the FDIC has decided to revise the interim final rule to permit an FDIC-supervised institution to call an instrument prior to five years after issuance in the event that the issuing

entity is required to register as an investment company pursuant to the Investment Company Act of 1940.[61] The FDIC recognizes that the legal and regulatory burdens of becoming an investment company could make it uneconomic to leave some structured capital instruments outstanding, and thus would permit the FDIC-supervised institution to call such instruments early.

In order to ensure the loss-absorption capacity of additional tier 1 capital instruments, the FDIC has decided not to revise the rule to permit an FDIC-supervised institution to include in its additional tier 1 capital instruments issued on or after the effective date of the interim final rule that may be called prior to five years after issuance upon the occurrence of a rating agency event. However, understanding that many currently outstanding instruments have this feature, the FDIC has decided to revise the rule to allow an instrument that may be called prior to five years after its issuance upon the occurrence of a rating agency event to be included into additional tier 1 capital, provided that (i) the instrument was issued and included in an FDIC-supervised institution's tier 1 capital prior to the effective date of the rule, and (ii) that such instrument meets all other criteria for additional tier 1 capital instruments under the interim final rule.

In addition, a number of commenters reiterated the concern that restrictions on the payment of dividends from net income and current and retained earnings may conflict with state corporate laws that permit an organization to issue dividend payments from its capital surplus accounts. This criterion for additional tier 1 capital in the interim final rule reflects the identical final criterion for common equity tier 1 for the reasons discussed above with respect to common equity tier 1 capital.

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[61] 15 U.S.C. 80 a-1 et seq.

Commenters also noted that proposed criterion (10), which requires the paid-in amounts of tier 1 capital instruments to be classified as equity under GAAP before they may be included in regulatory capital, generally would prevent contingent capital instruments, which are classified as liabilities, from qualifying as additional tier 1 capital. These commenters asked the agencies to revise the rules to provide that contingent capital instruments will qualify as additional tier 1 capital, regardless of their treatment under GAAP. Another commenter noted the challenges for U.S. banking organizations in devising contingent capital instruments that would satisfy the proposed criteria, and noted that if U.S. banking organizations develop an acceptable instrument, the instrument likely would initially be classified as debt instead of equity for GAAP purposes. Thus, in order to accommodate this possibility, the commenter urged the agencies to revise the criterion to allow the agencies to permit such an instrument in additional tier 1 capital through interpretive guidance or specifically in the case of a particular instrument.

The FDIC continues to believe that restricting tier 1 capital instruments to those classified as equity under GAAP will help to ensure those instruments' capacity to absorb losses and further increase the quality of U.S. FDIC-supervised institutions' regulatory capital. The FDIC therefore has decided to retain this aspect of the proposal. To the extent that a contingent capital instrument is considered a liability under GAAP, an FDIC-supervised institution may not include the instrument in its tier 1 capital under the interim final rule. At such time as an instrument converts from debt to equity under GAAP, the instrument would then satisfy this criterion.

In the preamble to the proposed rule, the agencies included a discussion regarding whether criterion (7) should be revised to require banking organizations to reduce the dividend payment on tier 1 capital instruments to a penny when a banking organization reduces dividend payments on a common equity tier 1 capital instrument to a penny per share. Such a revision

would increase the capacity of additional tier 1 instruments to absorb losses as it would permit a banking organization to reduce its capital distributions on additional tier 1 instruments without eliminating entirely its common stock dividend. Commenters asserted that such a revision would be unnecessary and could affect the hierarchy of subordination in capital instruments. Commenters also claimed the revision could prove burdensome as it could substantially increase the cost of raising capital through additional tier 1 capital instruments. In light of these comments the FDIC has decided to not modify criterion (7) to accommodate the issuance of a penny dividend as discussed in the proposal.

Several commenters expressed concern that criterion (7) for additional tier 1 capital, could affect the tier 1 eligibility of existing noncumulative perpetual preferred stock. Specifically, the commenters were concerned that such a criterion would disallow contractual terms of an additional tier 1 capital instrument that restrict payment of dividends on another capital instrument that is pari passu in liquidation with the additional tier 1 capital instrument (commonly referred to as dividend stoppers). Consistent with Basel III, the FDIC agrees that restrictions related to capital distributions to holders of common stock instruments and holders of other capital instruments that are pari passu in liquidation with such additional tier 1 capital instruments are acceptable, and have amended this criterion accordingly for purposes of the interim final rule.

After considering the comments on the proposal, the FDIC has decided to finalize the criteria for additional tier 1 capital instruments with the modifications discussed above. The final revised criteria for additional tier 1 capital are set forth in section 20(c)(1) of the interim final rule. The FDIC expects that most outstanding noncumulative perpetual preferred stock that

qualifies as tier 1 capital under the FDIC's general risk-based capital rules, will qualify as additional tier 1 capital under the interim final rule.

3. Tier 2 Capital

Consistent with Basel III, under the proposed rule, tier 2 capital would equal the sum of: tier 2 capital instruments that satisfy the criteria set forth in section 20(d) of the proposal, related surplus, total capital minority interest not included in a banking organization's tier 1 capital (subject to certain limitations and requirements), and limited amounts of the allowance for loan and lease losses (ALLL) less any applicable regulatory adjustments and deductions. Consistent with the general risk-based capital rules, when calculating its total capital ratio using the standardized approach, a banking organization would be permitted to include in tier 2 capital the amount of ALLL that does not exceed 1.25 percent of its standardized total risk-weighted assets which would not include any amount of the ALLL. A banking organization subject to the market risk rule would exclude its standardized market risk-weighted assets from the calculation.[62] In contrast, when calculating its total capital ratio using the advanced approaches, a banking organization would be permitted to include in tier 2 capital the excess of its eligible credit reserves over its total expected credit loss, provided the amount does not exceed 0.6 percent of its credit risk-weighted assets.

Consistent with Basel III, the agencies proposed the following criteria for tier 2 capital instruments:

(1) The instrument is issued and paid-in.

[62] 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 its standardized total risk-weighted risk assets.

(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 its primary Federal supervisor to exercise a call option on the instrument.

(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 section 20 of the proposed rule;[63] or

(B) Demonstrate to the satisfaction of the banking organization's primary Federal supervisor 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.[64]

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

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

(10) Redemption of the instrument prior to maturity or repurchase requires the prior approval of the banking organization's primary Federal supervisor.

(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.

The agencies also proposed to eliminate the inclusion of a portion of certain unrealized gains on AFS equity securities in tier 2 capital given that unrealized gains and losses on AFS securities would flow through to common equity tier 1 capital under the proposed rules.

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 proposal eliminated the existing limitations on the amount of tier 2 capital that could be recognized in total capital, as well as the existing limitations on the amount of certain capital instruments (that is, term subordinated debt) that could be included in tier 2 capital.

Finally, the agencies proposed 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,[65] 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 met all of the proposed qualifying criteria.

Several commenters addressed the proposed eligibility criteria for tier 2 capital. A few banking industry commenters asked the agencies to clarify criterion (2) above to provide that

[65] Pub. L. 111-240, 124 Stat. 2504 (2010).

trade creditors are not among the class of senior creditors whose claims rank ahead of subordinated debt holders In response to these commenters, the FDIC notes that the general risk-based capital rules require subordinated debt to be subordinated to the claims of trade creditors to qualify as tier 2 capital, and the agencies did not intend to propose to change this required level of subordination for the purposes of the proposal. Therefore, the FDIC is clarifying that under the interim final rule, and consistent with the FDIC's general risk-based capital rules, subordinated debt instruments that qualify as tier 2 capital must be subordinated to the claims of depositors and general creditors, as well as to the claims of trade creditors in order to qualify as tier 2 capital.

In addition, one commenter noted that while many existing banking organizations' subordinated debt indentures contain subordination provisions, they may not explicitly include a subordination provision with respect to "general creditors" of the banking organization. Thus, they recommended that this aspect of the rules be modified to have only prospective application. The FDIC notes that if it is clear from an instrument's governing agreement, offering circular, or prospectus, that the instrument is subordinated to general creditors despite not specifically stating "general creditors," criterion (2) above is satisfied (that is, criterion (2) should not be read to mean that the phrase "general creditors" must appear in the instrument's governing agreement, offering circular, or prospectus, as the case may be).

One commenter also asked whether a debt instrument that automatically converts to an equity instrument within five years of issuance, and that satisfies all criteria for tier 2 instruments other than the five-year maturity requirement, would qualify as tier 2 capital. The FDIC notes that because such an instrument would automatically convert to a permanent form of regulatory

capital, the five-year maturity requirement would not apply and, thus, it would qualify as tier 2 capital. The FDIC has clarified the interim final rule in this respect.

Commenters also expressed concern about the impact of a number of the proposed criteria on outstanding TruPS. For example, commenters stated that a strict reading of criterion (3) above could exclude certain TruPS under which the banking organization guarantees that any payments made by the banking organization to the trust will be used by the trust to pay its obligations to security holders. However, the proposed rule would not have disqualified an instrument with this type of guarantee, which does not enhance or otherwise alter the subordination level of an instrument. Additionally, the commenters asked the agencies to allow in tier 2 capital instruments that provide for default and the acceleration of principal and interest if the issuer banking organization defers interest payments for five consecutive years. Commenters stated that these exceptions would be necessary to accommodate existing TruPS, which generally include such call, default and acceleration features.

Commenters also asked the agencies to clarify the use of the term “secured” in criterion (3). As discussed above with respect to the criteria for additional tier 1 capital, a “secured” instrument is an instrument where payments on the instrument are secured by collateral. Therefore, under criterion (3), a collateralized instrument will not qualify as tier 2 capital. Instruments secured by collateral are less able to absorb losses than instruments without such enhancement.

With respect to subordinated debt instruments included in tier 2 capital, a commenter recommended eliminating criterion (4)’s proposed five-year amortization requirement, arguing that that it was unnecessary given other capital planning requirements that banking organizations must satisfy. The FDIC declined to adopt the commenter’s recommendation, as it believes that

the proposed amortization schedule results in a more accurate reflection of the loss-absorbency of an FDIC-supervised institution's tier 2 capital. The FDIC notes that if an FDIC-supervised institution begins deferring interest payments on a TruPS instrument included in tier 2 capital, such an instrument will be treated as having a maturity of five years at that point and the FDIC-supervised institution must begin excluding the appropriate amount of the instrument from capital in accordance with section 20(d)(1)(iv) of the interim final rule.

Similar to the comments received on the criteria for additional tier 1 capital, commenters asked the agencies to add exceptions to the prohibition against call options that could be exercised within five years of the issuance of a capital instrument, specifically for an "investment company event" and a "rating agency event."

Although the FDIC declined to permit instruments that include acceleration provisions in tier 2 capital in the interim final rule, the FDIC believes that the inclusion in tier 2 capital of existing TruPS, which allow for acceleration after five years of interest deferral, does not raise safety and soundness concerns. Although the majority of existing TruPS would not technically comply with the interim final rule's tier 2 eligibility criteria, the FDIC acknowledges that the inclusion of existing TruPS in tier 2 capital (until they are redeemed or they mature) would benefit certain FDIC-supervised institutions until they are able to replace such instruments with new capital instruments that fully comply with the eligibility criteria of the interim final rule.

As with additional tier 1 capital instruments, the interim final rule permits an FDIC-supervised institution to call an instrument prior to five years after issuance in the event that the issuing entity is required to register with the SEC as an investment company pursuant to the Investment Company Act of 1940, for the reasons discussed above with respect to additional tier 1 capital. Also for the reasons discussed above with respect to additional tier 1 capital

instruments, the FDIC has decided not to permit an FDIC-supervised institution to include in its tier 2 capital an instrument issued on or after the effective date of the interim final rule that may be called prior to five years after its issuance upon the occurrence of a rating agency event. However, the FDIC has decided to allow such an instrument to be included in tier 2 capital, provided that the instrument was issued and included in an FDIC-supervised institution's tier 1 or tier 2 capital prior to the [effective date of the rule], and that such instrument meets all other criteria for tier 2 capital instruments under the interim final rule.

In addition, similar to the comment above with respect to the proposed criteria for additional tier 1 capital instruments, commenters noted that the proposed criterion that a banking organization seek prior approval from its primary Federal supervisor before exercising a call option is redundant with the requirement that a banking organization seek prior approval before reducing regulatory capital by redeeming a capital instrument. Again, the FDIC believes that this proposed requirement restates and clarifies existing requirements without adding any new substantive restrictions, and that it will help to ensure that the regulatory capital rules provide FDIC-supervised institutions with a complete list of the requirements applicable to their regulatory capital instruments. Therefore, the FDIC is retaining the requirement as proposed.

Under the proposal, an advanced approaches banking organization may include in tier 2 capital the excess of its eligible credit reserves over expected credit loss (ECL) to the extent that such amount does not exceed 0.6 percent of credit risk-weighted assets, rather than including the amount of ALLL described above. Commenters asked the agencies to clarify whether an advanced approaches banking organization that is in parallel run includes in tier 2 capital its ECL or ALLL (as described above). To clarify, for purposes of the interim final rule, an advanced approaches FDIC-supervised institution will always include in total capital its ALLL up to 1.25

percent of (non-market risk) risk-weighted assets when measuring its total capital relative to standardized risk-weighted assets. When measuring its total capital relative to its advanced approaches risk-weighted assets, as described in section 10(c)(3)(ii) of the interim final rule, an advanced approaches FDIC-supervised institution that has completed the parallel run process and that has received notification from the FDIC pursuant to section 121(d) of subpart E must adjust its total capital to reflect its excess eligible credit reserves rather than its ALLL.

Some commenters recommended that the agencies remove the limit on the amount of the ALLL includable in regulatory capital. Specifically, one commenter recommended allowing banking organizations to include ALLL in tier 1 capital equal to an amount of up to 1.25 percent of total risk-weighted assets, with the balance in tier 2 capital, so that the entire ALLL would be included in regulatory capital. Moreover, some commenters recommended including in tier 2 capital the entire amount of reserves held for residential mortgage loans sold with recourse, given that the proposal would require a 100 percent credit conversion factor for such loans. Consistent with the ALLL treatment under the general risk-based capital rules, for purposes of the interim final rule the FDIC has elected to permit only limited amounts of the ALLL in tier 2 capital given its limited purpose of absorbing incurred rather than unexpected losses. For similar reasons, the FDIC has further elected not to recognize in tier 2 capital reserves held for residential mortgage loans sold with recourse.

As described above, an FDIC-supervised institution that has made an AOCI opt-out election may incorporate up to 45 percent of any net unrealized gains on AFS preferred stock classified as an equity security under GAAP and equity exposures into its tier 2 capital.

After reviewing the comments received on this issue, the FDIC has determined to finalize the criteria for tier 2 capital instruments to include the aforementioned changes. The revised criteria for inclusion in tier 2 capital are set forth in section 20(d)(1) of the interim final rule.

4. Capital Instruments of Mutual FDIC-Supervised Institutions

Under the proposed rule, the qualifying criteria for common equity tier 1, additional tier 1, and tier 2 capital generally would apply to mutual banking organizations. Mutual banking organizations and industry groups representing mutual banking organizations encouraged the agencies to expand the qualifying criteria for additional tier 1 capital to recognize certain cumulative instruments. These commenters stressed that mutual banking organizations, which do not issue common stock, have fewer options for raising regulatory capital relative to other types of banking organizations.

The FDIC does not believe that cumulative instruments are able to absorb losses sufficiently reliably to be included in tier 1 capital. Therefore, after considering these comments, the FDIC has decided not to include in tier 1 capital under the interim final rule any cumulative instrument. This would include any previously-issued mutual capital instrument that was included in the tier 1 capital of mutual FDIC-supervised institutions under the general risk-based capital rules, but that does not meet the eligibility requirements for tier 1 capital under the interim final rule. These cumulative capital instruments will be subject to the transition provisions and phased out of the tier 1 capital of mutual FDIC-supervised institutions over time, as set forth in Table 9 of section 300 in the interim final rule. However, if a mutual FDIC-supervised institution develops a new capital instrument that meets the qualifying criteria for regulatory capital under the interim final rule, such an instrument may be included in regulatory capital with the prior approval of the FDIC under section 20(e) of the interim final rule.

The FDIC notes that the qualifying criteria for regulatory capital instruments under the interim final rule permit mutual FDIC-supervised institutions to include in regulatory capital many of their existing regulatory capital instruments (for example, non-withdrawable accounts, pledged deposits, or mutual capital certificates). The FDIC believes that the quality and quantity of regulatory capital currently maintained by most mutual FDIC-supervised institutions should be sufficient to satisfy the requirements of the interim final rule. For those organizations that do not currently hold enough capital to meet the revised minimum requirements, the transition arrangements are designed to ease the burden of increasing regulatory capital over time.

5. Grandfathering of Certain Capital Instruments

As described above, a substantial number of commenters objected to the proposed phase-out of non-qualifying capital instruments, including TruPS and cumulative perpetual preferred stock, from tier 1 capital. Community FDIC-supervised institutions in particular expressed concerns that the costs related to the replacement of such capital instruments, which they generally characterized as safe and loss-absorbent, would be excessive and unnecessary. Commenters noted that the proposal was more restrictive than section 171 of the Dodd-Frank Act, which requires the phase-out of non-qualifying capital instruments issued prior to May 19, 2010, only for depository institution holding companies with $15 billion or more in total consolidated assets as of December 31, 2009. Commenters argued that the agencies were exceeding Congressional intent by going beyond what was required under the Dodd-Frank Act Commenters requested that the agencies grandfather existing TruPS and cumulative perpetual preferred stock issued by depository institution holding companies with less than $15 billion and 2010 MHCs.

Although the FDIC continues to believe that TruPS are not sufficiently loss-absorbing to be includable in tier 1 capital as a general matter, the FDIC is also sensitive to the difficulties community banking organizations often face when issuing new capital instruments and are aware of the importance their capacity to lend plays in local economies. Therefore the FDIC has decided in the interim final rule to grandfather such non-qualifying capital instruments in tier 1 capital subject to a limit of 25 percent of tier 1 capital elements excluding any non-qualifying capital instruments and after all regulatory capital deductions and adjustments applied to tier 1 capital, which is substantially similar to the limit in the general risk-based capital rules. In addition, the FDIC acknowledges that the inclusion of existing TruPS in tier 2 capital would benefit certain FDIC-supervised institutions until they are able to replace such instruments with new capital instruments that fully comply with the eligibility criteria of the interim final rule.

6. Agency Approval of Capital Elements

The agencies noted in the proposal that they believe most existing regulatory capital instruments will continue to be includable in banking organizations' regulatory capital. However, over time, capital instruments that are equivalent in quality and capacity to absorb losses to existing instruments may be created to satisfy different market needs. Therefore, the agencies proposed to create a process to consider the eligibility of such instruments on a case-by-case basis. Under the proposed rule, a banking organization must request approval from its primary Federal supervisor before including 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 ability to absorb losses, to an element described in a

previous decision made publicly available by the banking organization's primary Federal supervisor.

In the preamble to the proposal, the agencies indicated that they intend to consult each other when determining whether a new element should be included in common equity tier 1, additional tier 1, or tier 2 capital, and indicated that once one 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, that agency would make its decision publicly available, including a brief description of the capital element and the rationale for the conclusion.

The FDIC continues to believe that it is appropriate to retain the flexibility necessary to consider new instruments on a case-by-case basis as they are developed over time to satisfy different market needs. The FDIC has decided to move its authority in section 20(e)(1) of the proposal to the its reservation of authority provision included in section 1(d)(2)(ii) of the interim final rule. Therefore, the FDIC is adopting this aspect of the interim final rule substantively as proposed to create a process to consider the eligibility of such instruments on a permanent or temporary basis, in accordance with the applicable requirements in subpart C of the interim final rule (section 20(e) of the interim final rule).

Section 20(e)(1) of the interim final rule provides that an FDIC-supervised institution must receive FDIC's prior approval to include a capital element in its common equity tier 1 capital, additional tier 1 capital, or tier 2 capital *unless* that element: (i) was included in the FDIC-supervised institution's tier 1 capital or tier 2 capital prior to May 19, 2010 in accordance with that supervisor'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 determined by that supervisor to be includable in regulatory capital pursuant to paragraph (e)(3) of section 20. In exercising this reservation of authority, the FDIC expects to consider the requirements for capital elements in the interim final rule; the size, complexity, risk profile, and scope of operations of the FDIC-supervised institution, and whether any public benefits would be outweighed by risk to an insured depository institution or to the financial system.

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

During the recent financial crisis, the United States and foreign governments lent to, and made capital investments in, 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 potential 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 (the 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 at which either: (1) the write-off or conversion of those instruments occurs; or (2) a 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 taxpayers 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]

U.S. law is consistent with the Basel non-viability standard. The resolution regime established in Title II, 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 a manner that minimizes systemic risk and moral hazard, so that (1) creditors and shareholders will bear the losses of the financial company; (2) management responsible for the condition of the financial company will not be retained; and (3) 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

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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] See 12 U.S.C. 5384.

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

capital instruments issued by a company would absorb losses in bankruptcy before instruments held by more senior unsecured creditors.

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 date on which such organizations would have been required to comply with any interim final rule would have been 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 a receivership, insolvency, liquidation, or similar proceeding. The FDIC is adopting this provision of the proposed rule without change.

8. Qualifying Capital Instruments Issued by Consolidated Subsidiaries of an FDIC-Supervised Institution

As highlighted during the recent financial crisis, capital issued by consolidated subsidiaries and not owned by the parent banking organization (minority interest) is available to absorb losses at the subsidiary level, but that capital does not always absorb losses at the consolidated level. Accordingly, and consistent with Basel III, the proposed rule revised limitations on the amount of minority interest that may be included in regulatory capital at the consolidated level to prevent highly capitalized subsidiaries from overstating the amount of capital available to absorb losses at the consolidated organization.

Under the proposal, minority interest would have been classified as a common equity tier 1, tier 1, or total capital minority interest depending on the terms of the underlying capital instrument and on the type of subsidiary issuing such instrument. Any instrument issued by a consolidated subsidiary to third parties would have been required to satisfy the qualifying criteria under the proposal to be included in the banking organization's common equity tier 1, additional

tier 1, or tier 2 capital, as appropriate. In addition, common equity tier 1 minority interest would have been limited to instruments issued by a depository institution or a foreign bank that is a consolidated subsidiary of a banking organization.

The proposed limits on the amount of minority interest that could have been included in the consolidated capital of a banking organization would have been based on the amount of capital held by the consolidated subsidiary, relative to the amount of capital the subsidiary would have had to hold to avoid any restrictions on capital distributions and discretionary bonus payments under the capital conservation buffer framework. For example, a subsidiary with a common equity tier 1 capital ratio of 8 percent that 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 would have been considered to have "surplus" common equity tier 1 capital and, at the consolidated level, the banking organization would not have been able to include the portion of such surplus common equity tier 1 capital that is attributable to third party investors.

In general, the amount of common equity tier 1 minority interest that could have been included in the common equity tier 1 capital of a banking organization under the proposal would have been equal to:

(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:

(1) the amount of common equity tier 1 capital the subsidiary must hold to avoid restrictions on capital distributions and discretionary bonus payments, or

(2) (a) the standardized total risk-weighted assets of the banking organization that relate to the subsidiary, *multiplied* by

(b) The common equity tier 1 capital ratio needed by the banking organization subsidiary to avoid restrictions on capital distributions and discretionary bonus payments.

If a subsidiary were not subject to the same minimum regulatory capital requirements or capital conservation buffer framework as the banking organization, the banking organization would have needed to assume, for the purposes of the calculation described above, that the subsidiary is in fact subject to the same minimum capital requirements and the same capital conservation buffer framework as the banking organization.

To determine the amount of tier 1 minority interest that could be included in the tier 1 capital of the banking organization and the total capital minority interest that could be included 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. The proposal set forth sample calculations. The amount of tier 1 minority interest that could have been included in the additional tier 1 capital of a banking organization under the proposal was equivalent to the banking organization's tier 1 minority interest, subject to the limitations outlined above, less any common equity tier 1 minority interest included in the banking organization's common equity tier 1 capital. Likewise, the amount of total capital minority interest that could have been included in the tier 2 capital of the banking organization was equivalent to its total capital minority interest, subject to the limitations outlined above, less any tier 1 minority interest that is included in the banking organization's tier 1 capital.

Under the proposal, 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 is eligible for inclusion in tier 1 capital under the general risk-based capital rules without limitation, generally would qualify for inclusion in common equity tier 1 and additional tier 1 capital, respectively, subject to the proposed limits. However, under the proposal, minority interest related to qualifying cumulative perpetual preferred stock directly issued by a consolidated U.S. depository institution or foreign bank subsidiary, which is eligible for limited inclusion in tier 1 capital under the general risk-based capital rules, generally would not have qualified for inclusion in additional tier 1 capital under the proposal.

A number of commenters addressed the proposed limits on the inclusion of minority interest in regulatory capital. Commenters generally asserted that the proposed methodology for calculating the amount of minority interest that could be included in regulatory capital was overly complex, overly conservative, and would reduce incentives for bank subsidiaries to issue capital to third-party investors. Several commenters suggested that the agencies should adopt a more straightforward and simple approach that would provide a single blanket limitation on the amount of minority interest includable in regulatory capital. For example, one commenter suggested allowing a banking organization to include minority interest equal to 18 percent of common equity tier 1 capital. Another commenter suggested that minority interest where shareholders have commitments to provide additional capital, as well as minority interest in joint ventures where there are guarantees or other credit enhancements, should not be subject to the proposed limitations.

Commenters also objected to any limitations on the amount of minority interest included in the regulatory capital of a parent banking organization attributable to instruments issued by a subsidiary when the subsidiary is a depository institution. These commenters stated that restricting such minority interest could create a disincentive for depository institutions to issue

capital instruments directly or to maintain capital at levels substantially above regulatory minimums. To address this concern, commenters asked the agencies to consider allowing a depository institution subsidiary to consider a portion of its capital above its minimum as not being part of its "surplus" capital for the purpose of calculating the minority interest limitation. Alternatively, some commenters suggested allowing depository institution subsidiaries to calculate surplus capital independently for each component of capital.

Several commenters also addressed the proposed minority interest limitation as it would apply to subordinated debt issued by a depository institution. Generally, these commenters stated that the proposed minority interest limitation either should not apply to such subordinated debt, or that the limitation should be more flexible to permit a greater amount to be included in the total capital of the consolidated organization.

Finally, some commenters pointed out that the application of the proposed calculation for the minority interest limitation was unclear in circumstances where a subsidiary depository institution does not have "surplus" capital. With respect to this comment, the FDIC has revised the proposed rule to specifically provide that the minority interest limitation will not apply in circumstances where a subsidiary's capital ratios are equal to or below the level of capital necessary to meet the minimum capital requirements plus the capital conservation buffer. That is, in the interim final rule the minority interest limitation would apply only where a subsidiary has "surplus" capital.

The FDIC continues to believe that the proposed limitations on minority interest are appropriate, including for capital instruments issued by depository institution subsidiaries, tier 2 capital instruments, and situations in which a depository institution holding company conducts the majority of its business through a single depository institution subsidiary. As noted above,

the FDIC's experience during the recent financial crisis showed that while minority interest generally is available to absorb losses at the subsidiary level, it may not always absorb losses at the consolidated level. Therefore, the FDIC continues to believe limitations on including minority interest will prevent highly-capitalized subsidiaries from overstating the amount of capital available to absorb losses at the consolidated organization. The increased safety and soundness benefits resulting from these limitations should outweigh any compliance burden issues related to the complexity of the calculations. Therefore, the FDIC is adopting the proposed treatment of minority interest without change, except for the clarification described above.

9. 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 included in the regulatory capital of the consolidated banking organization as minority interest under the general risk-based capital rules.

Under the general risk-based capital rules, preferred stock issued by a REIT subsidiary generally can be included in a banking organization's tier 1 capital as minority interest if the preferred stock meets the eligibility requirements for tier 1 capital.[70] The agencies interpreted this to require that the REIT-preferred stock 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

[70] 12 CFR part 325, subpart B.

REIT preferred stock into noncumulative perpetual preferred stock of the banking organization because the banking organization: (1) became undercapitalized under the PCA regulations;[71] (2) was placed into conservatorship or receivership; or (3) 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 have applied to capital instruments issued by consolidated REIT subsidiaries. Specifically, preferred stock issued by a REIT subsidiary that met the proposed definition of an operating entity (as defined below) would have qualified 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 stock met the criteria for additional tier 1 or tier 2 capital instruments outlined in section 20 of the proposed rules. Because a REIT must distribute 90 percent of its earnings to maintain its tax-advantaged status, a banking organization might be reluctant to cancel dividends on the REIT preferred stock. However, for a capital instrument to qualify as additional tier 1 capital the issuer must have the ability to cancel dividends. In cases where a REIT could maintain its tax status, for example, by declaring a consent dividend and it has the ability to do so, the agencies generally would consider REIT preferred stock to satisfy criterion (7) of the proposed eligibility criteria for additional tier 1 capital instruments.[73] The FDIC notes that the ability to declare a consent dividend need not be

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[71] 12 CFR part 325, subpart A (state nonmember banks), and 12 CFR part 390, subpart Y (state savings associations).

[72] 12 CFR part 325, subpart B (state nonmember banks) and 12 CFR 390, subpart Y (state savings associations).

[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.

included in the documentation of the REIT preferred instrument, but the FDIC-supervised institution must provide evidence to the relevant banking agency that it has such an ability. The FDIC does not expect preferred stock issued by a REIT that does not have the ability to declare a consent dividend or otherwise cancel cash dividends to qualify as tier 1 minority interest under the interim final rule; however, such an instrument could qualify as total capital minority interest if it meets all of the relevant tier 2 capital eligibility criteria under the interim final rule.

Commenters requested clarification on whether a REIT subsidiary would be considered an operating entity for the purpose of the interim final rule. For minority interest issued from a subsidiary to be included in regulatory capital, the subsidiary must be either an operating entity or an entity whose only asset is its investment in the capital of the parent banking organization and for which proceeds are immediately available without limitation to the banking organization. Since a REIT has assets that are not an investment in the capital of the parent banking organization, minority interest in a REIT subsidiary can be included in the regulatory capital of the consolidated parent banking organization only if the REIT is an operating entity. For purposes of the interim final rule, an operating entity is defined as a company established to conduct business with clients with the intention of earning a profit in its own right. However, certain REIT subsidiaries currently used by FDIC-supervised institutions to raise regulatory capital are not actively managed for the purpose of earning a profit in their own right, and therefore, will not qualify as operating entities for the purpose of the interim final rule. Minority interest investments in REIT subsidiaries that are actively managed for purposes of earning a profit in their own right will be eligible for inclusion in the regulatory capital of the FDIC-supervised institution subject to the limits described in section 21 of the interim final rule. To the extent that an FDIC-supervised institution is unsure whether minority interest investments in

a particular REIT subsidiary will be includable in the FDIC-supervised institution's regulatory capital, the organization should discuss the concern with its primary Federal supervisor prior to including any amount of the minority interest in its regulatory capital.

Several commenters objected to the application of the limitations on the inclusion of minority interest resulting from noncumulative perpetual preferred stock issued by REIT subsidiaries. Commenters noted that to be included in the regulatory capital of the consolidated parent banking organization under the general risk-based capital rules, REIT preferred stock must include an exchange feature that allows the REIT preferred stock to absorb losses at the parent banking organization through the exchange of REIT preferred instruments into noncumulative perpetual preferred stock of the parent banking organization. Because of this exchange feature, the commenters stated that REIT preferred instruments should be included in the tier 1 capital of the parent consolidated organization without limitation. Alternatively, some commenters suggested that the agencies should allow REIT preferred instruments to be included in the tier 2 capital of the consolidated parent organization without limitation. Commenters also noted that in light of the eventual phase-out of TruPS pursuant to the Dodd-Frank Act, REIT preferred stock would be the only tax-advantaged means for bank holding companies to raise tier 1 capital. According to these commenters, limiting this tax-advantaged option would increase the cost of doing business for many banking organizations.

After considering these comments, the FDIC has decided not to create specific exemptions to the limitations on the inclusion of minority interest with respect to REIT preferred instruments. As noted above, the FDIC believes that the inclusion of minority interest in 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 organization.

B. Regulatory Adjustments and Deductions

1. Regulatory Deductions from Common Equity Tier 1 Capital

Under the proposal, a banking organization must deduct from common equity tier 1 capital elements the items described in section 22 of the proposed rule. A banking organization would exclude the amount of these deductions from its total risk-weighted assets and leverage exposure. This section B discusses the deductions from regulatory capital elements as revised for purposes of the interim final rule.

a. Goodwill and Other Intangibles (other than Mortgage Servicing Assets)

U.S. federal banking statutes generally prohibit the inclusion of goodwill (as it is an "unidentified intangible asset") in the regulatory capital of insured depository institutions.[74] Accordingly, goodwill and other intangible assets have long been either fully or partially excluded from regulatory capital in the United States 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.[75] Under the proposed rule, a banking organization was required to deduct from common equity tier 1capital elements goodwill and other intangible assets other than MSAs[76] net of associated deferred tax liabilities (DTLs). For purposes of this deduction, goodwill would have included any goodwill embedded in the valuation of significant

[74] 12 U.S.C. 1828(n).

[75] 54 FR 11500, 11509 (March 21, 1989).

[76] Examples of other intangible assets include purchased credit card relationships (PCCRs) and non-mortgage servicing assets.

investments in the capital of an unconsolidated financial institution in the form of common stock. This deduction of embedded goodwill would have applied to investments accounted for under the equity method.[77] Consistent with Basel III, these items would have been deducted from common equity tier 1 capital elements. MSAs would have been subject to a different treatment under Basel III and the proposal, as explained below in this section.

One commenter sought clarification regarding the amount of goodwill that must be deducted from common equity tier 1 capital elements when a banking organization has an investment in the capital of an unconsolidated financial institution that is accounted for under the equity method of accounting under GAAP. The FDIC has revised section 22(a)(1) in the interim final rule to clarify that it is the amount of goodwill that is embedded in the valuation of a significant investment in the capital of an unconsolidated financial institution in the form of common stock that is accounted for under the equity method, and reflected in the consolidated financial statements of the FDIC-supervised institution that an FDIC-supervised institution must deduct from common equity tier 1 capital elements.

Another commenter requested clarification regarding the amount of embedded goodwill that a banking organization would be required to deduct where there are impairments to the embedded goodwill subsequent to the initial investment. The FDIC notes that, for purposes of the interim final rule, an FDIC-supervised institution must deduct from common equity tier 1 capital elements any embedded goodwill in the valuation of significant investments in the capital of an unconsolidated financial institution in the form of common stock net of any related

[77] 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).

impairments (subsequent to the initial investment) as determined under GAAP, not the goodwill reported on the balance sheet of the unconsolidated financial institution.

The proposal did not include a transition period for the implementation of the requirement to deduct goodwill from common equity tier 1 capital. A number of commenters expressed concern that this could disadvantage U.S. banking organizations relative to those in jurisdictions that permit such a transition period. The FDIC notes that section 221 of FIRREA (12 U.S.C. 1828(n)) requires all unidentifiable intangible assets (goodwill) acquired after April 12, 1989, to be deducted from an FDIC-supervised institution's capital elements. The only exception to this requirement, permitted under 12 U.S.C. 1464(t) (applicable to Federal savings association), has expired. Therefore, consistent with the requirements of section 221 of FIRREA and the general risk-based capital rules, the FDIC believes that it is not appropriate to permit any goodwill to be included in an FDIC-supervised institution's capital. The interim final rule does not include a transition period for the deduction of goodwill.

b. Gain-on-sale Associated with a Securitization Exposure

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

A number of commenters requested clarification that the proposed deduction for gain-on-sale would not require a double deduction for MSAs. According to the commenters, a sale of loans to a securitization structure that creates a gain may include an MSA that also meets the proposed definition of "gain-on-sale." The FDIC agrees that a double deduction for MSAs is not

required, and the interim final rule clarifies in the definition of "gain-on-sale" that a gain-on-sale excludes any portion of the gain that was reported by the FDIC-supervised institution as an MSA. The FDIC also notes that the definition of gain-on-sale was intended to relate only to gains associated with the sale of loans for the purpose of traditional securitization. Thus, the definition of gain-on-sale has been revised in the interim final rule to mean an increase in common equity tier 1 capital of the FDIC-supervised institution resulting from a traditional securitization except where such an increase results from the FDIC-supervised institution's receipt of cash in connection with the securitization or initial recognition of an MSA.

c. Defined Benefit Pension Fund Net Assets

For banking organizations other than insured depository institutions, the proposal required the deduction of a net pension fund asset in calculating common equity tier 1 capital. A banking organization was permitted to make such deduction net of any associated DTLs. This deduction would be required where a defined benefit pension fund is over-funded due to the high level of uncertainty regarding the ability of the banking organization to realize value from such assets.

The proposal provided that, with supervisory approval, a banking organization would not have been required to deduct defined benefit pension fund assets to which the banking organization had unrestricted and unfettered access.[78] In this case, the proposal established that the banking organization would have assigned to such assets the risk weight they would receive if the assets underlying the plan were directly owned and included on the balance sheet of the

[78] The FDIC has unfettered access to the pension fund assets of an insured depository institution's pension plan in the event of receivership; therefore, the FDIC determined that an insured depository institution would not be required to deduct a net pension fund asset.

banking organization. The proposal set forth that unrestricted and unfettered access would mean that a banking organization would not have been required to request and receive specific approval from pension beneficiaries each time it accessed excess funds in the plan.

One commenter asked whether shares of a banking organization that are owned by the banking organization's pension fund are subject to deduction. The FDIC notes that the interim final rule does not require deduction of banking organization shares owned by the pension fund. Another commenter asked for clarification regarding the treatment of an overfunded pension asset at an insured depository institution if the pension plan sponsor is the parent BHC. The FDIC clarifies that the requirement to deduct a defined benefit pension plan net asset is not dependent upon the sponsor of the plan; rather it is dependent upon whether the net pension fund asset is an asset of an insured depository institution. The agencies also received questions regarding the appropriate risk-weight treatment for a pension fund asset. As discussed above, with the prior agency approval, a banking organization that is not an insured depository institution may elect to not deduct any defined benefit pension fund net asset to the extent such banking organization has unrestricted and unfettered access to the assets in that defined benefit pension fund. Any portion of the defined benefit pension fund net asset that is not deducted by the banking organization must be risk-weighted as if the banking organization directly holds a proportional ownership share of each exposure in the defined benefit pension fund. For example, if the banking organization has a defined benefit pension fund net asset of $10 and it has unfettered and unrestricted access to the assets of defined benefit pension fund, and assuming 20 percent of the defined benefit pension fund is composed of assets that are risk-weighted at 100 percent and 80 percent is composed of assets that are risk-weighted at 300 percent, the banking organization would risk weight $2 at 100 percent and $8 at 300 percent. This treatment is

consistent with the full look-through approach described in section 53(b) of the interim final rule. If the defined benefit pension fund invests in the capital of a financial institution, including an investment in the banking organization's own capital instruments, the banking organization would risk weight the proportional share of such exposure in accordance with the treatment under subparts D or E, as appropriate.

The FDIC is adopting as final this section of the proposal with the changes described above.

d. Expected Credit Loss that Exceeds Eligible Credit Reserves

The proposal required an advanced approaches banking organization to deduct from common equity tier 1 capital elements the amount of expected credit loss that exceeds the banking organization's eligible credit reserves.

Commenters sought clarification that the proposed deduction would not apply for advanced approaches banking organizations that have not received the approval of their primary Federal supervisor to exit parallel run. The FDIC agrees that the deduction would not apply to FDIC-supervised institutions that have not received approval from their primary Federal supervisor to exit parallel run. In response, the FDIC has revised this provision of the interim final rule to apply to an FDIC-supervised institution subject to subpart E of the interim final rule that has completed the parallel run process and that has received notification from the FDIC under section 121(d) of the advanced approaches rule.

e. Equity Investments in Financial Subsidiaries

Section 121 of the Gramm-Leach-Bliley Act allows national banks and insured state banks to establish entities known as financial subsidiaries.[79] 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 depository institution's assets and tangible equity.[80] The FDIC implemented this statutory requirement through regulation at 12 CFR 362.18.

Under section 22(a)(7) of the proposal, investments by an insured state bank in financial subsidiaries would be deducted entirely from the bank's common equity tier 1 capital.[81] Because common equity tier 1 capital is a component of tangible equity, the proposed deduction from common equity tier 1 would have automatically resulted in a deduction from tangible equity. The FDIC believes that the more conservative treatment is appropriate for financial subsidiaries given the risks associated with nonbanking activities, and are finalizing this treatment as proposed. Therefore, under the interim final rule, an FDIC-supervised institution must deduct the aggregate amount of its outstanding equity investment in a financial subsidiary, including the retained earnings of a subsidiary from common equity tier 1 capital elements, and the assets and liabilities of the subsidiary may not be consolidated with those of the parent bank.

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

[80] 12 U.S.C. 24a(c); 12 U.S.C. 1831w(a)(2).

[81] The deduction provided for in the FDIC's existing regulations would be removed and would exist solely in the interim final rule.

f. Deduction for Subsidiaries of Savings Associations that Engage in Activities that are not Permissible for National Banks

Section 5(t)(5)[82] of HOLA requires a separate capital calculation for state savings associations for "investments in and extensions of credit to any subsidiary engaged in activities not permissible for a national bank." This statutory provision was implemented in the state savings associations' capital rules through a deduction from the core (tier 1) capital of the state savings association for those subsidiaries that are not "includable subsidiaries." The FDIC proposed to continue the general risk-based capital treatment of includable subsidiaries, with some technical modifications. Aside from those technical modifications, the proposal would have transferred, without substantive change, the current general regulatory treatment of deducting subsidiary investments where a subsidiary is engaged in activities not permissible for a national bank. Such treatment is consistent with how a national bank deducts its equity investments in financial subsidiaries. The FDIC proposed an identical treatment for state savings associations.[83]

The FDIC received no comments on this proposed deduction. The interim final rule adopts the proposal with one change and other minor technical edits, consistent with 12 U.S.C. 1464(t)(5), to clarify that the required deduction for a state savings association's investment in a subsidiary that is engaged in activities not permissible for a national bank includes extensions of credit to such a subsidiary.

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[82] 12 U.S.C. 1464(t)(5).

[83] 12 CFR 324.22.

g. Identified Losses for State Nonmember Banks

Under its existing capital rules, the FDIC requires state nonmember banks to deduct from tier 1 capital elements identified losses to the extent that tier 1 capital would have been reduced if the appropriate accounting entries had been recorded on the insured depository institution's books. Generally, for purposes of these rules, identified losses are those items that an examiner from the federal or state supervisor for that institution determines to be chargeable against income, capital, or general valuation allowances. For example, identified losses may include, among other items, assets classified loss, off-balance sheet items classified loss, any expenses that are necessary for the institution to record in order to replenish its general valuation allowances to an adequate level, and estimated losses on contingent liabilities.

The FDIC is revising the interim final rule to clarify that state nonmember banks and state savings associations remain subject to its long-standing supervisory procedures regarding the deduction of identified losses. Therefore, for purposes of the interim final rule, such institutions must deduct identified losses from common equity tier 1 capital elements.

2. Regulatory Adjustments to Common Equity Tier 1 Capital

a. Accumulated Net Gains and Losses on Certain Cash-flow Hedges

Consistent with Basel III, under the proposal, a banking organization would have been required to exclude from regulatory capital any accumulated net gains and losses on cash-flow hedges relating to items that are not recognized at fair value on the balance sheet.

This proposed regulatory adjustment was intended to reduce the artificial volatility that can arise in a situation in which the accumulated net 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. The agencies received a number of comments on this proposed regulatory capital adjustment. In

general, the commenters noted that while the intent of the adjustment is to remove an element that gives rise to artificial volatility in common equity, the proposed adjustment may actually increase volatility in the measure of common equity tier 1 capital. These commenters indicated that the proposed adjustment, together with the proposed treatment of net unrealized gains and losses on AFS debt securities, would create incentives for banking organizations to avoid hedges that reduce interest rate risk; shorten maturity of their investments in AFS securities; or move their investment securities portfolio from AFS to HTM. To address these concerns, commenters suggested several alternatives, such as including all accumulated net gains or losses on cash-flow hedges in common equity tier 1 capital to match the proposal to include in common equity tier 1 capital net unrealized gains and losses on AFS debt securities; retaining the provisions in the agencies' general risk-based capital rules that exclude most elements of AOCI from regulatory capital; or using a principles-based approach to accommodate variations in the interest rate management techniques employed by each banking organization.

Under the interim final rule, the FDIC has retained the requirement that all FDIC-supervised institutions subject to the advanced approaches rule, and those FDIC-supervised institutions that elect to include AOCI in common equity tier 1 capital, must subtract from common equity tier 1 capital elements any accumulated net gain and must add any accumulated net loss 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. The FDIC believes that this adjustment removes an element that gives rise to artificial volatility in common equity tier 1 capital as it would avoid a situation in which the changes in the fair value of the cash-flow hedge are reflected in capital but the changes in the fair value of the hedged item are not.

b. Changes in an FDIC-supervised institution's Own Credit Risk

The proposal provided that a banking organization would not be permitted to include in regulatory capital any change in the fair value of a liability attributable to changes in the banking organization's own credit risk. In addition, the proposal would have required advanced approaches banking organizations to deduct the credit spread premium over the risk-free rate for derivatives that are liabilities. Consistent with Basel III, these provisions were intended to prevent a banking organization from recognizing increases in regulatory capital resulting from any change in the fair value of a liability attributable to changes in the banking organization's own creditworthiness. Under the interim final rule, all FDIC-supervised institutions not subject to the advanced approaches rule must deduct any cumulative gain from and add back to common equity tier 1 capital elements any cumulative loss attributed to changes in the value of a liability measured at fair value arising from changes in the FDIC-supervised institution's own credit risk. This requirement would apply to all liabilities that an FDIC-supervised institution must measure at fair value under GAAP, such as derivative liabilities, or for which the FDIC-supervised institution elects to measure at fair value under the fair value option.[84]

Similarly, advanced approaches FDIC-supervised institutions must deduct any cumulative gain from and add back any cumulative loss to common equity tier 1 capital elements attributable to changes in the value of a liability that the FDIC-supervised institution elects to measure at fair value under GAAP. For derivative liabilities, advanced approaches FDIC-supervised institutions must implement this requirement by deducting the credit spread premium over the risk-free rate.

[84] 825-10-25 (former Financial Accounting Standards Board Statement No.159).

c. Accumulated Other Comprehensive Income

Under the agencies' general risk-based capital rules, most of the components of AOCI included in a company's GAAP equity are not included in an FDIC-supervised institution's regulatory capital. Under GAAP, AOCI includes unrealized gains and losses on certain assets and liabilities that are not included in net income. Among other items, AOCI includes unrealized gains and losses on AFS securities; other than temporary impairment on securities reported as HTM that are not credit-related; cumulative gains and losses on cash-flow hedges; foreign currency translation adjustments; and amounts attributed to defined benefit post-retirement plans resulting from the initial and subsequent application of the relevant GAAP standards that pertain to such plans

Under the agencies' general risk-based capital rules, FDIC-supervised institutions do not include most amounts reported in AOCI in their regulatory capital calculations. Instead, they exclude these amounts by subtracting unrealized or accumulated net gains from, and adding back unrealized or accumulated net losses to, equity capital. The only amounts of AOCI included in regulatory capital are unrealized losses on AFS equity securities and foreign currency translation adjustments, which are included in tier 1 capital. Additionally, FDIC-supervised institutions may include up to 45 percent of unrealized gains on AFS equity securities in their tier 2 capital.

In contrast, consistent with Basel III, the proposed rule required banking organizations to include all AOCI components in common equity tier 1 capital elements, except gains and losses on cash-flow hedges where the hedged item is not recognized on a banking organization's balance sheet at fair value. Unrealized gains and losses on all AFS securities would flow through to common equity tier 1 capital elements, including unrealized gains and losses on debt securities due to changes in valuations that result primarily from fluctuations in benchmark

interest rates (for example, U.S. Treasuries and U.S. government agency debt obligations), as opposed to changes in credit risk.

In the Basel III NPR, the agencies indicated that the proposed regulatory capital treatment of AOCI would better reflect an institution's actual risk. In particular, the agencies stated that while unrealized gains and losses on AFS debt securities might be temporary in nature and reverse over a longer time horizon (especially when those gains and losses are primarily attributable to changes in benchmark interest rates), unrealized losses could materially affect a banking organization's capital position at a particular point in time and associated risks should therefore be reflected in its capital ratios. In addition, the agencies observed that the proposed treatment would be consistent with the common market practice of evaluating a firm's capital strength by measuring its tangible common equity, which generally includes AOCI.

However, the agencies also acknowledged that including unrealized gains and losses related to debt securities (especially those 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. Specifically, the agencies observed that for some banking organizations, including unrealized losses on AFS debt securities in their regulatory capital calculations could mean that fluctuations in a benchmark interest rate could lead to changes in their PCA categories from quarter to quarter. Recognizing the potential impact of such fluctuations on regulatory capital management for some institutions, the agencies described possible alternatives to the proposed treatment of unrealized gains and losses on AFS debt securities, including an approach that would exclude from regulatory capital calculations those unrealized gains and losses that are related to AFS debt securities whose valuations primarily change as a result of fluctuations in benchmark interest rates, including U.S. government and

agency debt obligations, GSE debt obligations, and other sovereign debt obligations that would qualify for a zero percent risk weight under the standardized approach.

A large proportion of commenters addressed the proposed treatment of AOCI in regulatory capital. Banking organizations of all sizes, banking and other industry groups, public officials (including members of the U.S. Congress), and other individuals strongly opposed the proposal to include most AOCI components in common equity tier 1 capital.

Specifically, commenters asserted that the agencies should not implement the proposal and should instead continue to apply the existing treatment for AOCI that excludes most AOCI amounts from regulatory capital. Several commenters stated that the accounting standards that require banking organizations to take a charge against earnings (and thus reduce capital levels) to reflect credit-related losses as part of other-than-temporary impairments already achieve the agencies' goal to create regulatory capital ratios that provide an accurate picture of a banking organization's capital position, without also including AOCI in regulatory capital. For unrealized gains and losses on AFS debt securities that typically result from changes in benchmark interest rates rather than changes in credit risk, most commenters expressed concerns that the value of such securities on any particular day might not be a good indicator of the value of those securities for a banking organization, given that the banking organization could hold them until they mature and realize the amount due in full. Most commenters argued that the inclusion of unrealized gains and losses on AFS debt securities in regulatory capital could result in volatile capital levels and adversely affect other measures tied to regulatory capital, such as legal lending limits, especially if and when interest rates rise from their current historically-low levels.

Accordingly, several commenters requested that the agencies permit banking organizations to remove from regulatory capital calculations unrealized gains and losses on AFS debt securities that have low credit risk but experience price movements based primarily on fluctuations in benchmark interest rates. According to commenters, these debt securities would include securities issued by the United States and other stable sovereign entities, U.S. agencies and GSEs, as well as some municipal entities. One commenter expressed concern that the proposed treatment of AOCI would lead banking organizations to invest excessively in securities with low volatility. Some commenters also suggested that unrealized gains and losses on high-quality asset-backed securities and high-quality corporate securities should be excluded from regulatory capital calculations. The commenters argued that these adjustments to the proposal would allow regulatory capital to reflect unrealized gains or losses related to the credit quality of a banking organization's AFS debt securities.

Additionally, commenters noted that, under the proposal, offsetting changes in the value of other items on a banking organization's balance sheet would not be recognized for regulatory capital purposes when interest rates change. For example, the commenters observed that banking organizations often hold AFS debt securities to hedge interest rate risk associated with deposit liabilities, which are not marked to fair value on the balance sheet. Therefore, requiring banking organizations to include AOCI in regulatory capital would mean that interest rate fluctuations would be reflected in regulatory capital only for one aspect of this hedging strategy, with the result that the proposed treatment could greatly overstate the economic impact that interest rate changes have on the safety and soundness of the banking organization.

Several commenters used sample AFS securities portfolio data to illustrate how an upward shift in interest rates could have a substantial impact on a banking organization's capital

levels (depending on the composition of its AFS portfolio and its defined benefit postretirement obligations). According to these commenters, the potential negative impact on capital levels that could follow a substantial increase in interest rates would place significant strains on banking organizations.

To address the potential impact of incorporating the volatility associated with AOCI into regulatory capital, banking organizations also noted that they could increase their overall capital levels to create a buffer above regulatory minimums, hedge or reduce the maturities of their AFS debt securities, or shift more debt securities into their HTM portfolio. However, commenters asserted that these strategies would be complicated and costly, especially for smaller banking organizations, and could lead to a significant decrease in lending activity. Many community banking organization commenters observed that hedging or raising additional capital may be especially difficult for banking organizations with limited access to capital markets, while shifting more debt securities into the HTM portfolio would impair active management of interest rate risk positions and negatively impact a banking organization's liquidity position. These commenters also expressed concern that this could be especially problematic given the increased attention to liquidity by banking regulators and industry analysts.

A number of commenters indicated that in light of the potential impact of the proposed treatment of AOCI on a banking organization's liquidity position, the agencies should, at the very least, postpone implementing this aspect of the proposal until after implementation of the BCBS's revised liquidity standards. Commenters suggested that postponing the implementation of the AOCI treatment would help to ensure that the final capital rules do not create disincentives for a banking organization to increase its holdings of high-quality liquid assets. In addition, several commenters suggested that the agencies not require banking organizations to include in

regulatory capital unrealized gains and losses on assets that would qualify as "high quality liquid assets" under the BCBS's "liquidity coverage ratio" under the Basel III liquidity framework.

Finally, several commenters addressed the inclusion in AOCI of actuarial gains and losses on defined benefit pension fund obligations. Commenters stated that many banking organizations, particularly mutual banking organizations, offer defined benefit pension plans to attract employees because they are unable to offer stock options to employees. These commenters noted that actuarial gains and losses on defined benefit obligations represent the difference between benefit assumptions and, among other things, actual investment experiences during a given year, which is influenced predominantly by the discount rate assumptions used to determine the value of the plan obligation. The discount rate is tied to prevailing long-term interest rates at a point in time each year, and while market returns on the underlying assets of the plan and the discount rates may fluctuate year to year, the underlying liabilities typically are longer term – in some cases 15 to 20 years. Therefore, changing interest rate environments could lead to material fluctuations in the value of a banking organization's defined benefit post-retirement fund assets and liabilities, which in turn could create material swings in a banking organization's regulatory capital that would not be tied to changes in the credit quality of the underlying assets. Commenters stated that the added volatility in regulatory capital could lead some banking organizations to reconsider offering defined benefit pension plans.

The FDIC has considered the comments on the proposal to incorporate most elements of AOCI in regulatory capital, and has taken into account the potential effects that the proposed AOCI treatment could have on FDIC-supervised institutions and their function in the economy. As discussed in the proposal, the FDIC believes that the proposed AOCI treatment results in a regulatory capital measure that better reflects FDIC-supervised institutions' actual risk at a

specific point in time. The FDIC also believes that AOCI is an important indicator that market observers use to evaluate the capital strength of an FDIC-supervised institution.

However, the FDIC recognizes that for many FDIC-supervised institutions, the volatility in regulatory capital that could result from the proposal could lead to significant difficulties in capital planning and asset-liability management. The FDIC also recognizes that the tools used by advanced approaches FDIC-supervised institutions and other larger, more complex FDIC-supervised institutions for managing interest rate risk are not necessarily readily available to all FDIC-supervised institutions.

Therefore, in the interim final rule, the FDIC has decided to permit those FDIC-supervised institutions that are not subject to the advanced approaches risk-based capital rules to elect to calculate regulatory capital by using the treatment for AOCI in the FDIC's general risk-based capital rules, which excludes most AOCI amounts. Such FDIC-supervised institutions, may make a one-time, permanent election[85] to effectively continue using the AOCI treatment under the general risk-based capital rules for their regulatory calculations ("AOCI opt-out election") when filing the first Call Report or FR Y-9 series report after the date upon which they become subject to the interim final rule.

Pursuant to a separate notice under the Paperwork Reduction Act, the agencies intend to propose revisions to the Call Report to implement changes in reporting items that would correspond to the interim final rule. These revisions will include a line item for FDIC-supervised institutions to indicate their AOCI opt-out election in their first regulatory report filed after the

[85] This one-time, opt-out selection does not cover a merger, acquisition or purchase transaction involving all or substantially all of the assets or voting stock between two banking organizations of which only one made an AOCI opt-out election. The resulting organization may make an AOCI election with prior agency approval.

date the FDIC-supervised institution becomes subject to the interim final rule. Information regarding the AOCI opt-out election will be made available to the public and will be reflected on an ongoing basis in publically available regulatory reports. An FDIC-supervised institution that does not make an AOCI opt-out election on the first Call Report (after the effective date of the interim final rule) must include all AOCI components, except accumulated net gains and losses on cash-flow hedges related to items that are not recognized at fair value on the balance sheet, in regulatory capital elements starting the first quarter in which the FDIC-supervised institution calculates its regulatory capital requirements under the interim final rule.

Consistent with regulatory capital calculations under the FDIC's general risk-based capital rules, an FDIC-supervised institution that makes an AOCI opt-out election under the interim final rule must adjust common equity tier 1 capital elements by: (1) subtracting any net unrealized gains and adding any net unrealized losses on AFS securities; (2) subtracting any net unrealized losses on AFS preferred stock classified as an equity security under GAAP and equity exposures; (3) subtracting any accumulated net gain and adding back any accumulated net loss on cash-flow hedges included in AOCI; (4) subtracting amounts attributed to defined benefit postretirement plans resulting from the initial and subsequent application of the relevant GAAP standards that pertain to such plans (excluding, at the FDIC-supervised institution's option, the portion relating to pension assets deducted under section 22(a)(5)); and (5) subtracting any net unrealized gains and adding any net unrealized losses on held-to-maturity securities that are included in AOCI. In addition, consistent with the general risk-based capital rules, the FDIC-supervised institution must incorporate into common equity tier 1 capital any foreign currency translation adjustment. An FDIC-supervised institution may also incorporate up to 45 percent of any net unrealized gains on AFS preferred stock classified as an equity security under GAAP and

equity exposures into its tier 2 capital elements. However, the FDIC may exclude all or a portion of these unrealized gains from an FDIC-supervised institution's tier 2 capital under the reservation of authority provision of the interim final rule if the FDIC determines that such preferred stock or equity exposures are not prudently valued.

The FDIC believes that FDIC-supervised institutions that apply the advanced approaches rule or that have opted to use the advanced approaches rule should already have the systems in place necessary to manage the added volatility resulting from the new AOCI treatment. Likewise, pursuant to the Dodd-Frank Act, these large, complex FDIC-supervised institutions are subject to enhanced prudential standards, including stress-testing requirements, and therefore should be prepared to manage their capital levels through the types of stressed economic environments, including environments with shifting interest rates, that could lead to substantial changes in amounts reported in AOCI. Accordingly, under the interim final rule, advanced approaches FDIC-supervised institutions will be required to incorporate all AOCI components, except accumulated net gains and losses on cash-flow hedges that relate to items that are not measured at fair value on the balance sheet, into their common equity tier 1 capital elements according to the transition provisions set forth in the interim final rule.

The interim final rule additionally provides that in a merger, acquisition, or purchase transaction between two FDIC-supervised institutions that have each made an AOCI opt-out election, the surviving entity will be required to continue with the AOCI opt-out election, unless the surviving entity is an advanced approaches FDIC-supervised institution. Similarly, in a merger, acquisition, or purchase transaction between two FDIC-supervised institutions that have each not made an AOCI opt-out election, the surviving entity must continue implementing such treatment going forward. If an entity surviving a merger, acquisition, or purchase transaction

becomes subject to the advanced approaches rule, it is no longer permitted to make an AOCI opt-out election and, therefore, must include most elements of AOCI in regulatory capital in accordance with the interim final rule.

However, following a merger, acquisition or purchase transaction involving all or substantially all of the assets or voting stock between two banking organizations of which only one made an AOCI opt-out election (and the surviving entity is not subject to the advanced approaches rule), the surviving entity must decide whether to make an AOCI opt-out election by its first regulatory reporting date following the consummation of the transaction.[86] For example, if all of the equity of a banking organization that has made an AOCI opt-out election is acquired by a banking organization that has not made such an election, the surviving entity may make a new AOCI opt-out election in the first Call Report or FR Y-9 series report that it files after the effective date of the merger. The interim final rule also provides the FDIC with discretion to allow a new AOCI opt-out election where a merger, acquisition or purchase transaction between two banking organizations that have made different AOCI opt-out elections does not involve all or substantially all of the assets or voting stock of the purchased or acquired banking organization. In making such a determination, the FDIC may consider the terms of the merger, acquisition, or purchase transaction, as well as the extent of any changes to the risk profile, complexity, and scope of operations of the banking organization resulting from the merger,

[86] A merger would involve "all or substantially all" of the assets or voting stock where, for example: (1) a banking organization buys all of the voting stock of a target banking organization, except for the stock of a dissenting, non-controlling minority shareholder; or (2) the banking organization buys all of the assets and major business lines of a target banking organization, but does not purchase a minor business line of the target. Circumstances in which the "all or substantially all" standard likely would not be met would be, for example: (1) a banking organization buys less than 80 percent of another banking organization; or (3) a banking organization buys only three out of four of another banking organization's major business lines.

acquisition, or purchase transaction. The FDIC may also look to the Bank Merger Act[87] for guidance on the types of transactions that would allow the surviving entity to make a new AOCI opt-out election. Finally, a de novo FDIC-supervised institution formed after the effective date of the interim final rule is required to make a decision to opt out in the first Call Report or FR Y-9 series report it is required to file.

The interim final rule also provides that if a top-tier depository institution holding company makes an AOCI opt-out election, any subsidiary insured depository institution that is consolidated by the depository institution holding company also must make an AOCI opt-out election. The FDIC is concerned that if some FDIC-supervised institutions subject to regulatory capital rules under a common parent holding company make an AOCI opt-out election and others do not, there is a potential for these organizations to engage in capital arbitrage by choosing to book exposures or activities in the legal entity for which the relevant components of AOCI are treated most favorably.

Notwithstanding the availability of the AOCI opt-out election under the interim final rule, the FDIC has reserved the authority to require an FDIC-supervised institution to recognize all or some components of AOCI in regulatory capital if an agency determines it would be appropriate given an FDIC-supervised institution's risks under the FDIC's general reservation of authority under the interim final rule. The FDIC will continue to expect each FDIC-supervised institution to maintain capital appropriate for its actual risk profile, regardless of whether it has made an AOCI opt-out election. Therefore, the FDIC may determine that an FDIC-supervised institution with a large portfolio of AFS debt securities, or that is otherwise engaged in activities that expose it to high levels of interest-rate or other risks, should raise its common equity tier 1

[87] 12 U.S.C. § 1828(c).

capital level substantially above the regulatory minimums, regardless of whether that FDIC-supervised institution has made an AOCI opt-out election.

d. Investments in Own Regulatory Capital Instruments

To avoid the double-counting of regulatory capital, the proposal would have required a banking organization to deduct the amount of its investments in its own capital instruments, including direct and indirect exposures, to the extent such instruments are not already excluded from regulatory capital. Specifically, the proposal would require a banking organization to deduct its investment in its own common equity tier 1, additional tier 1, and tier 2 capital instruments from the sum of its common equity tier 1, additional tier 1, and tier 2 capital, respectively. In addition, under the proposal any common equity tier 1, additional tier 1, or tier 2 capital instrument issued by a banking organization that the banking organization could be contractually obligated to purchase also would have been deducted from common equity tier 1, additional tier 1, or tier 2 capital elements, respectively. The proposal noted that if a banking organization had already deducted its investment in its own capital instruments (for example, treasury stock) from its common equity tier 1 capital, it would not need to make such deductions twice.

The proposed rule would have required a banking organization to look through its holdings of an index 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 would have been netted against short positions in the same underlying index. Short positions in indexes to hedge long cash or synthetic positions could have been decomposed to recognize the hedge. More specifically, the portion of the index composed of the same underlying exposure that is being hedged could have been used to offset the long position only if

both the exposure being hedged and the short position in the index were covered positions under the market risk rule and the hedge was deemed effective by the banking organization's internal control processes which would have been assessed by the primary Federal supervisor of the banking organization. If the banking organization found it operationally burdensome to estimate the investment amount of an index holding, the proposal permitted the institution to use a conservative estimate with prior approval from its primary Federal supervisor. In all other cases, gross long positions would have been allowed to be deducted net of short positions in the same underlying instrument only if the short positions involved no counterparty risk (for example, the position was fully collateralized or the counterparty is a qualifying central counterparty (QCCP)).

As discussed above, under the proposal, a banking organization would be required to look through its holdings of an index security to deduct investments in its own capital instruments. Some commenters asserted that the burden of the proposed look-through approach outweighs its benefits because it is not likely a banking organization would re-purchase its own stock through such indirect means. These commenters suggested that the agencies should not require a look-through test for index securities on the grounds that they are not "covert buybacks," but rather are incidental positions held within a banking organization's trading book, often entered into on behalf of clients, customers or counterparties, and are economically hedged. However, the FDIC believes that it is important to avoid the double-counting of regulatory capital, whether held directly or indirectly. Therefore, the interim final rule implements the look-through requirements of the proposal without change. In addition, consistent with the treatment for indirect investments in an FDIC-supervised institution's own capital instruments,

the FDIC has clarified in the interim final rule that FDIC-supervised institutions must deduct synthetic exposures related to investments in own capital instruments.

e. Definition of Financial Institution

Under the proposed rule, a banking organization would have been required to deduct an investment in the capital of an unconsolidated financial institution exceeding certain thresholds, as described below. The proposed definition of financial institution was designed to include entities whose activities and primary business are financial in nature and therefore could contribute to interconnectedness in the financial system. The proposed definition covered entities whose primary business is banking, insurance, investing, and trading, or a combination thereof, and included BHCs, SLHCs, nonbank financial institutions supervised by the Federal Reserve under Title I of the Dodd-Frank Act, depository institutions, foreign banks, credit unions, insurance companies, securities firms, commodity pools, covered funds for purposes of section 13 of the Bank Holding Company Act and regulations issued thereunder, companies "predominantly engaged" in financial activities, non-U.S.-domiciled entities that would otherwise have been covered by the definition if they were U.S.-domiciled, and any other company that the agencies determined was a financial institution based on the nature and scope of its activities. The definition excluded GSEs and firms that were "predominantly engaged" in activities that are financial in nature but focus on community development, public welfare projects, and similar objectives. Under the proposed definition, a company would have been "predominantly engaged" in financial activities if (1) 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 (2) 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.

The proposed definition of "financial institution" was also relevant for purposes of the Advanced Approaches NPR. Specifically, the proposed rule would have required banking organizations to 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. The proposed rule also would have required advanced approaches banking organizations to apply a multiplier of 1.25 to wholesale exposures to regulated financial institutions with consolidated assets greater than or equal to $100 billion.[88]

The agencies received a number of comments on the proposed definition of "financial institution." Commenters expressed concern that the definition of a financial institution was overly broad and stated that it should not include investments in funds, commodity pools, or ERISA plans. Other commenters stated that the "predominantly engaged" test would impose significant operational burdens on banking organizations in determining what companies would be included in the proposed definition of "financial institution." Commenters suggested that the agencies should risk weight such exposures, rather than subjecting them to a deduction from capital based on the definition of financial institution.

[88] The definitions of regulated financial institutions and unregulated financial institutions are discussed in further detail in in section XII.A of this preamble. Under the proposal, a "regulated financial institution" would include a financial institution subject to consolidated supervision and regulation comparable to that imposed on U.S. companies that are depository institutions, depository institution holding companies, nonbank financial companies supervised by the Board, broker dealers, credit unions, insurance companies, and designated financial market utilities.

Some of the commenters noted that many of the exposures captured by the financial institution definition may be risk-weighted under certain circumstances, and expressed concerns that overlapping regulation would result in confusion. For similar reasons, commenters recommended that the agencies limit the definition of financial institution to specific enumerated entities, such as regulated financial institutions, including insured depository institutions and holding companies, nonbank financial companies designated by the Financial Stability Oversight Council, insurance companies, securities holding companies, foreign banks, securities firms, futures commission merchants, swap dealers, and security based swap dealers. Other commenters stated that the definition should cover only those entities subject to consolidated regulatory capital requirements. Commenters also encouraged the agencies to adopt alternatives to the "predominantly engaged" test for identifying a financial institution, such as the use of standard industrial classification codes or legal entity identifiers. Other commenters suggested that the agencies should limit the application of the "predominantly engaged" test in the definition of "financial institution" to companies above a specified size threshold. Similarly, others requested that the agencies exclude any company with total assets of less than $50 billion. Many commenters indicated that the broad definition proposed by the agencies was not required by Basel III and was unnecessary to promote systemic stability and avoid interconnectivity. Some commenters stated that funds covered by Section 13 of the Bank Holding Company Act also should be excluded. Other commenters suggested that the agencies should exclude investment funds registered with the SEC under the Investment Company Act of 1940 and their foreign equivalents, while some commenters suggested methods of narrowing the definition to cover only leveraged funds. Commenters also requested that the agencies clarify that investment or financial advisory activities include providing both discretionary and non-discretionary

investment or financial advice to customers, and that the definition would not capture either registered investment companies or investment advisers to registered funds.

After considering the comments, the FDIC has modified the definition of "financial institution" to provide more clarity around the scope of the definition as well as reduce operational burden. Separate definitions are adopted under the advanced approaches provisions of the interim final rule for "regulated financial institution" and "unregulated financial institution" for purposes of calculating the correlation factor for wholesale exposures, as discussed in section XII.A of this preamble.

Under the interim final rule, the first paragraph of the definition of a financial institution includes an enumerated list of regulated institutions similar to the list that appeared in the first paragraph of the proposed definition: a BHC; SLHC; nonbank financial institution supervised by the Federal Reserve under Title I of the Dodd-Frank Act; depository institution; foreign bank; credit union; industrial loan company, industrial bank, or other similar institution described in section 2 of the Bank Holding Company Act; national association, state member bank, or state nonmember bank that is not a depository institution; insurance company; securities holding company as defined in section 618 of the Dodd-Frank Act; broker or dealer registered with the SEC; futures commission merchant and swap dealer, each as defined in the Commodity Exchange Act; or security-based swap dealer; or any designated financial market utility (FMU). The definition also includes foreign companies that would be covered by the definition if they are supervised and regulated in a manner similar to the institutions described above that are included in the first paragraph of the definition of "financial institution." The FDIC also has retained in the final definition of "financial institution" a modified version of the proposed "predominantly engaged" test to capture additional entities that perform certain financial

activities that the FDIC believes appropriately addresses those relationships among financial institutions that give rise to concerns about interconnectedness, while reducing operational burden. Consistent with the proposal, a company is "predominantly engaged" in financial activities for the purposes of the definition if it meets the test to the extent the following activities make up more than 85 percent of the company's total assets or gross revenues:

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

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

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

(4) Asset management activities (not including investment or financial advisory activities).

In response to comments expressing concerns regarding operational burden and potential lack of access to necessary information in applying the proposed "predominantly engaged" test, the FDIC has revised that portion of the definition. Now, the FDIC-supervised institution would only apply the test if it has an investment in the GAAP equity instruments of the company with an adjusted carrying value or exposure amount equal to or greater than $10 million, or if it owns more than 10 percent of the company's issued and outstanding common shares (or similar equity interest). The FDIC believes that this modification would reduce burden on FDIC-supervised

institutions with small exposures, while those with larger exposures should have sufficient information as a shareholder to conduct the predominantly engaged analysis.[89]

In cases when an FDIC-supervised institution's investment in the FDIC-supervised institution exceeds one of the thresholds described above, the FDIC-supervised institution must determine whether the company is predominantly engaged in financial activities, in accordance with the interim final rule. The FDIC believes that this modification will substantially reduce operational burden for FDIC-supervised institutions with investments in multiple institutions. The FDIC also believes that an investment of $10 million in or a holding of 10 percent of the outstanding common shares (or equivalent ownership interest) of an entity has the potential to create a risk of interconnectedness, and also makes it reasonable for the FDIC-supervised institution to gain information necessary to understand the operations and activities of the company in which it has invested and to apply the proposed "predominantly engaged" test under the definition. The FDIC is clarifying that, consistent with the proposal, investment or financial advisers (whether they provide discretionary or non-discretionary advisory services) are not covered under the definition of financial institution. The revised definition also specifically excludes employee benefit plans. The FDIC believes, upon review of the comments, that employee benefit plans are heavily regulated under ERISA and do not present the same kind of risk of systemic interconnectedness that the enumerated financial institutions present. The revised definition also explicitly excludes investment funds registered with the SEC under the Investment Company Act of 1940, as the FDIC believes that such funds create risks of systemic interconnectedness largely through their investments in the capital of financial institutions.

[89] For advanced approaches FDIC-supervised institutions, for purposes of section 131 of the interim final rule, the definition of "unregulated financial institution" does not include the ownership limitation in applying the "predominantly engaged" standard.

These investments are addressed directly by the interim final rule's treatment of indirect investments in financial institutions. Although the revised definition does not specifically include commodities pools, under some circumstances an FDIC-supervised institution's investment in a commodities pool might meet the requirements of the modified "predominantly engaged" test.

Some commenters also requested that the agencies establish an asset threshold below which an entity would not be included in the definition of "financial institution." The FDIC has not included such a threshold because they are concerned that it could create an incentive for multiple investments and aggregated exposures in smaller financial institutions, thereby undermining the rationale underlying the treatment of investments in the capital of unconsolidated financial institutions. The FDIC believes that the definition of financial institution appropriately captures both large and small entities engaged in the core financial activities that the FDIC believes should be addressed by the definition and associated deductions from capital. The FDIC believes, however, that the modification to the "predominantly engaged" test, should serve to alleviate some of the burdens with which the commenters who made this point were concerned.

Consistent with the proposal, investments in the capital of unconsolidated financial institutions that are held indirectly (indirect exposures) are subject to deduction. Under the proposal, a banking organization's entire investment in, for example, a registered investment company would have been subject to deduction from capital. Although those entities are excluded from the definition of financial institution in the interim final rule unless the ownership threshold is met, any holdings in the capital instruments of financial institutions held indirectly through investment funds are subject to deduction from capital. More generally, and as

described later in this section of the preamble, the interim final rule provides an explicit mechanism for calculating the amount of an indirect investment subject to deduction.

f. The Corresponding Deduction Approach

The proposals incorporated the Basel III corresponding deduction approach for the deductions from regulatory capital related to reciprocal crossholdings, 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 proposal, a banking organization would have been 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 did not have a sufficient amount of a specific regulatory capital component against which to effect the deduction, the shortfall would have been deducted from the next higher (that is, more subordinated) regulatory capital component. For example, if a banking organization did not have enough additional tier 1 capital to satisfy the required deduction, the shortfall would be deducted from common equity tier 1 capital elements.

Under the proposal, if the banking organization invested in an instrument issued by an financial institution that is not a regulated financial institution, the banking organization would have treated 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 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: (1) 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; (2) 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 (3) tier 2 capital if the instrument is not GAAP equity but it is considered regulatory capital by the primary supervisor of the financial institution.

Some commenters sought clarification on whether, under the corresponding deduction approach, TruPS would be deducted from tier 1 or tier 2 capital. In response to these comments the FDIC has revised the interim final rule to clarify the deduction treatment for investments of non-qualifying capital instruments, including TruPS, under the corresponding deduction approach. The interim final rule includes a new paragraph section 22(c)(2)(iii) to provide that if an investment is in the form of a non-qualifying capital instrument described in section 300(d) of the interim final rule, the FDIC-supervised institution must treat the instrument as a: (1) tier 1 capital instrument if it was included in the FDIC-supervised institution's tier 1 capital prior to May 19, 2010; or (2) tier 2 capital instrument if it was included in the FDIC-supervised institution's tier 2 capital (but not eligible for inclusion in the FDIC-supervised institution's tier 1 capital) prior to May 19, 2010.

In addition, to avoid a potential circularity issue (related to the combined impact of the treatment of ALLL and the risk-weight treatment for threshold items that are not deducted from common equity tier 1 capital) in the calculation of common equity tier 1 capital, the interim final rule clarifies that FDIC-supervised institutions must apply any deductions under the corresponding deduction approach resulting from insufficient amounts of a specific regulatory capital component after applying any deductions from the items subject to the 10 and 15 percent

common equity tier 1 capital deduction thresholds discussed further below. This was accomplished by removing proposed paragraph 22(c)(2)(i) from the corresponding deduction approach section and inserting paragraph 22(f). Under section 22(f) of the interim final rule, and as noted above, if an FDIC-supervised institution does not have a sufficient amount of a specific component of capital to effect the required deduction under the corresponding deduction approach, the shortfall must be deducted from the next higher (that is, more subordinated) component of regulatory capital.

g. Reciprocal Crossholdings in the Capital Instruments of Financial Institutions

A reciprocal crossholding 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 crossholdings of capital instruments to artificially inflate the capital positions of each of the financial institutions involved would undermine the purpose of regulatory capital, potentially affecting the stability of such financial institutions as well as the financial system.

Under the agencies' general risk-based capital rules, reciprocal crossholdings of capital instruments of FDIC-supervised institutions are deducted from regulatory capital. Consistent with Basel III, the proposal would have required a banking organization to deduct reciprocal crossholdings of capital instruments of other financial institutions using the corresponding deduction approach. The interim final rule maintains this treatment.

h. Investments in the FDIC-supervised institution's Own Capital Instruments or in the Capital of Unconsolidated Financial Institutions

In the interim final rule, the FDIC made several non-substantive changes to the wording in the proposal to clarify that the amount of an investment in the FDIC-supervised institution's own capital instruments or in the capital of unconsolidated financial institutions is the net long position (as calculated under section 22(h) of the interim final rule) of such investments. The interim final rule also clarifies how to calculate the net long position of these investments, especially for the case of indirect exposures. It is the net long position that is subject to deduction. In addition, the interim final rule generally harmonizes the recognition of hedging for own capital instruments and for investments in the capital of unconsolidated financial institutions. Under the interim final rule, an investment in an FDIC-supervised institution's own capital instrument is deducted from regulatory capital and an investment in the capital of an unconsolidated financial institution is subject to deduction from regulatory capital if such investment exceeds certain thresholds.

An investment in the capital of an unconsolidated financial institution refers to the net long position (calculated in accordance with section 22(h) of the interim final rule) 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 GAAP equity of an unconsolidated unregulated financial institution. It includes direct, indirect, and synthetic exposures to capital instruments, and excludes underwriting positions held by an FDIC-supervised institution for fewer than five business days.

An investment in the FDIC-supervised institution's own capital instrument means a net long position calculated in accordance with section 22(h) of the interim final rule in the FDIC-supervised institution's own common stock instrument, own additional tier 1 capital instrument

or own tier 2 capital instrument, including direct, indirect or synthetic exposures to such capital instruments. An investment in the FDIC-supervised institution's own capital instrument includes any contractual obligation to purchase such capital instrument.

The interim final rule also clarifies that the gross long position for an investment in the FDIC-supervised institution's own capital instrument or the capital of an unconsolidated financial institution that is an equity exposure refers to the adjusted carrying value (determined in accordance with section 51(b) of the interim final rule). For the case of an investment in the FDIC-supervised institution's own capital instrument or the capital of an unconsolidated financial institution that is not an equity exposure, the gross long position is defined as the exposure amount (determined in accordance with section 2 of the interim final rule).

Under the proposal, the agencies included the methodology for the recognition of hedging and for the calculation of the net long position regarding investments in the banking organization's own capital instruments and in investments in the capital of unconsolidated financial institutions in the definitions section. However, such methodology appears in section 22 of the interim final rule as the FDIC believes it is more appropriate to include it in the adjustments and deductions to regulatory capital section.

The interim final rule provides that the net long position is the gross long position in the underlying instrument (including covered positions under the market risk rule) net of short positions in the same instrument 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. An FDIC-supervised institution may only net a short position against a long position in the FDIC-supervised institution's own capital instrument if the short position involves no counterparty credit risk. The long and short positions in the same index without a maturity date are considered to have

matching maturities. If both the long position and the short position do not have contractual maturity dates, then the positions are considered maturity-matched. For positions that are reported on an FDIC-supervised institution's regulatory report as trading assets or trading liabilities, if the FDIC-supervised institution has a contractual right or obligation to sell a long position at a specific point in time, and the counterparty to the contract has an obligation to purchase the long position if the FDIC-supervised institution 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 own capital instruments or in the capital instruments of unconsolidated financial institutions resulting from positions in an index 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, provided both the exposure being hedged and the short position in the index are trading assets or trading liabilities, and the hedge is deemed effective by the FDIC-supervised institution's internal control processes, which the FDIC has found not to be inadequate.

An indirect exposure results from an FDIC-supervised institution's investment in an investment fund that has an investment in the FDIC-supervised institution's own capital instrument or the capital of an unconsolidated financial institution. A synthetic exposure results from an FDIC-supervised institution's investment in an instrument where the value of such instrument is linked to the value of the FDIC-supervised institution's own capital instrument or a

capital instrument of a financial institution. Examples of indirect and synthetic exposures include: (1) an investment in the capital of an investment fund that has an investment in the capital of an unconsolidated financial institution; (2) a total return swap on a capital instrument of the FDIC-supervised institution or another financial institution; (3) a guarantee or credit protection, provided to a third party, related to the third party's investment in the capital of another financial institution; (4) a purchased call option or a written put option on the capital instrument of another financial institution; (5) a forward purchase agreement on the capital of another financial institution; and (6) a trust preferred security collateralized debt obligation (TruPS CDO).

Investments, including indirect and synthetic exposures, in the capital of unconsolidated financial institutions are subject to the corresponding deduction approach if they surpass certain thresholds described below. With the prior written approval of the FDIC, for the period of time stipulated by the supervisor, an FDIC-supervised institution is not required to deduct investments in the capital of unconsolidated financial institutions described in this section if the investment is made in connection with the FDIC-supervised institution providing financial support to a financial institution in distress, as determined by the supervisor. Likewise, an FDIC-supervised institution that is an underwriter of a failed underwriting can request approval from the FDIC to exclude underwriting positions related to such failed underwriting held for longer than five days.

Some commenters requested clarification that a long position and short hedging position are considered "maturity matched" if (1) the maturity period of the short position extends beyond the maturity period of the long position or (2) both long and short positions mature or terminate within the same calendar quarter. The FDIC notes that they concur with these commenters' interpretation of the maturity matching of long and short hedging positions.

For purposes of calculating the net long position in the capital of an unconsolidated financial institution, several commenters expressed concern that allowing banking organizations to net gross long positions with short positions only where the maturity of the short position either matches the maturity of the long position or has a maturity of at least one year is not practical, as some exposures, such as cash equities, have no maturity. These commenters expressed concern that such a maturity requirement could result in banking organizations deducting equities held as hedges for equity swap transactions with a client, making the latter transactions uneconomical and resulting in disruptions to market activity. Similarly, these commenters argued that providing customer accommodation equity swaps could become burdensome as a strict reading of the proposal could affect the ability of banking organizations to offset the equity swap with the long equity position because the maturity of the equity swap is typically less than one year. The FDIC has considered the comments and have decided to retain the maturity requirement as proposed. The FDIC believes that the proposed maturity requirements will reduce the possibility of "cliff effects" resulting from the deduction of open equity positions when an FDIC-supervised institution is unable to replace the hedge or sell the long equity position.

i. Indirect Exposure Calculations

The proposal provided that an indirect exposure would result from a banking organization's investment in an unconsolidated entity that has an exposure to a capital instrument of a financial institution, while a synthetic exposure would result 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. With the exception of index securities, the proposal did not, however, provide a mechanism for calculating the amount of the indirect exposure that is subject

to deduction. The interim final rule clarifies the methodologies for calculating the net long position related to an indirect exposure (which is subject to deduction under the interim final rule) by providing a methodology for calculating the gross long position of such indirect exposure. The FDIC believes that the options provided in the interim final rule will provide FDIC-supervised institutions with increased clarity regarding the treatment of indirect exposures, as well as increased risk-sensitivity to the FDIC-supervised institution's actual potential exposure.

In order to limit the potential difficulties in determining whether an unconsolidated entity in fact holds the FDIC-supervised institution's own capital or the capital of unconsolidated financial institutions, the interim final rule also provides that the indirect exposure requirements only apply when the FDIC-supervised institution holds an investment in an investment fund, as defined in the rule. Accordingly, an FDIC-supervised institution invested in, for example, a commercial company is not required to determine whether the commercial company has any holdings of the FDIC-supervised institution's own capital or the capital instruments of financial institutions.

The interim final rule provides that an FDIC-supervised institution may determine that its gross long position is equivalent to its carrying value of its investment in an investment fund that holds the FDIC-supervised institution's own capital or that holds an investment in the capital of an unconsolidated financial institution, which would be subject to deduction according to section 22(c). Recognizing, however, that the FDIC-supervised institution's exposure to those capital instruments may be less than its carrying value of its investment in the investment fund, the interim final rule provides two alternatives for calculating the gross long position of an indirect exposure. For an indirect exposure resulting from a position in an index, an FDIC-supervised

institution may, with the prior approval of the FDIC, use a conservative estimate of the amount of its investment in its own capital instruments or the capital instruments of other financial institutions. If the investment is held through an investment fund, an FDIC-supervised institution may use a look-through approach similar to the approach used for risk weighting equity exposures to investment funds. Under this approach, an FDIC-supervised institution may multiply the carrying value of its investment in an investment fund by either the exact percentage of the FDIC-supervised institution's own capital instrument or capital instruments of unconsolidated financial institutions held by the investment fund or by the highest stated prospectus limit for such investments held by the investment fund. Accordingly, if an FDIC-supervised institution with a carrying value of $10,000 for its investment in an investment fund knows that the investment fund has invested 30 percent of its assets in the capital of financial institutions, then the FDIC-supervised institution could subject $3,000 (the carrying value times the percentage invested in the capital of financial institutions) to deduction from regulatory capital. The FDIC believes that the approach is flexible and benefits an FDIC-supervised institution that obtains and maintains information about its investments through investment funds. It also provides a simpler calculation method for an FDIC-supervised institution that either does not have information about the holdings of the investment fund or chooses not to do the more complex calculation.

j. Non-significant Investments in the Capital of Unconsolidated Financial Institutions

The proposal provided that non-significant investments in the capital of unconsolidated financial institutions would be the net long position in investments where a banking organization owns 10 percent or less of the issued and outstanding common stock 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 own common equity tier 1 capital, 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 been required 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.[90]

Under the proposal, 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: (1) the amount of non-significant investments in the capital of unconsolidated financial institutions in the form of such capital component to (2) 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

[90] 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 (when the banking organization has elected to net DTLs in accordance with section 22(e)), DTAs that arise from net operating loss and tax credit carryforwards net of related valuation allowances and DTLs (in accordance with section 22(e)), cash-flow hedges associated with items that are not recognized at fair value on the balance sheet, 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 financial liabilities measured at fair value, defined benefit pension fund net assets for banking organizations that are not insured by the FDIC (net of associated DTLs in accordance with section 22(e)), investments in own regulatory capital instruments (not deducted as treasury stock), and reciprocal crossholdings.

percent threshold for non-significant investments would generally be assigned the applicable risk weight under section 32 or section 131, as applicable (in the case of non-common stock instruments), section 52 or section 152, as applicable (in the case of common stock instruments), or section 53 or section 154, as applicable (in the case of indirect investments via an investment fund) under the proposal.

One commenter requested clarification that a banking organization would not have to take a "double deduction" for an investment made in unconsolidated financial institutions held through another unconsolidated financial institution in which the banking organization has invested. The FDIC notes that, under the interim final rule, where an FDIC-supervised institution has an investment in an unconsolidated financial institution (Institution A) and Institution A has an investment in another unconsolidated financial institution (Institution B), the FDIC-supervised institution would not be deemed to have an indirect investment in Institution B for purposes of the interim final rule's capital thresholds and deductions because the FDIC-supervised institution's investment in Institution A is already subject to capital thresholds and deductions. However, if an FDIC-supervised institution has an investment in an investment fund that does not meet the definition of a financial institution, it must consider the assets of the investment fund to be indirect holdings.

Some commenters requested clarification that the deductions for non-significant investments in the capital of unconsolidated financial institutions may be net of associated DTLs. The FDIC has clarified in the interim final rule that an FDIC-supervised institution must deduct the net long position in non-significant investments in the capital of unconsolidated financial institutions, net of associated DTLs in accordance with section 22(e) of the interim final rule, that exceeds the 10 percent threshold for non-significant investments. Under section 22(e) of the

interim final rule, the netting of DTLs against assets that are subject to deduction or fully deducted under section 22 of the interim final rule is permitted but not required.

Other commenters asked the agencies to confirm that the proposal would not require that investments in TruPS CDOs be treated as investments in the capital of unconsolidated financial institutions, but rather treat the investments as securitization exposures. The FDIC believes that investments in TruPS CDOs are synthetic exposures to the capital of unconsolidated financial institutions and are thus subject to deduction. Under the interim final rule, any amounts of TruPS CDOs that are not deducted are subject to the securitization treatment.

k. Significant Investments in the Capital of Unconsolidated Financial Institutions that are not in the Form of Common Stock

Under the proposal, a significant investment in the capital of an unconsolidated financial institution would be the net long position in an investment where a banking organization owns more than 10 percent of the issued and outstanding common stock of the unconsolidated financial institution. Significant investments in the capital of unconsolidated financial institutions that are not in the form of common stock are investments where the banking organization owns capital of an unconsolidated financial institution that is not in the form of common stock in addition to 10 percent of the issued and outstanding common stock of that financial institution. Such a non-common stock investment would be deducted by applying the corresponding deduction approach. Significant investments in the capital of unconsolidated financial institutions that are in the form of common stock would be subject to 10 and 15 percent common equity tier 1 capital threshold deductions described below in this section.

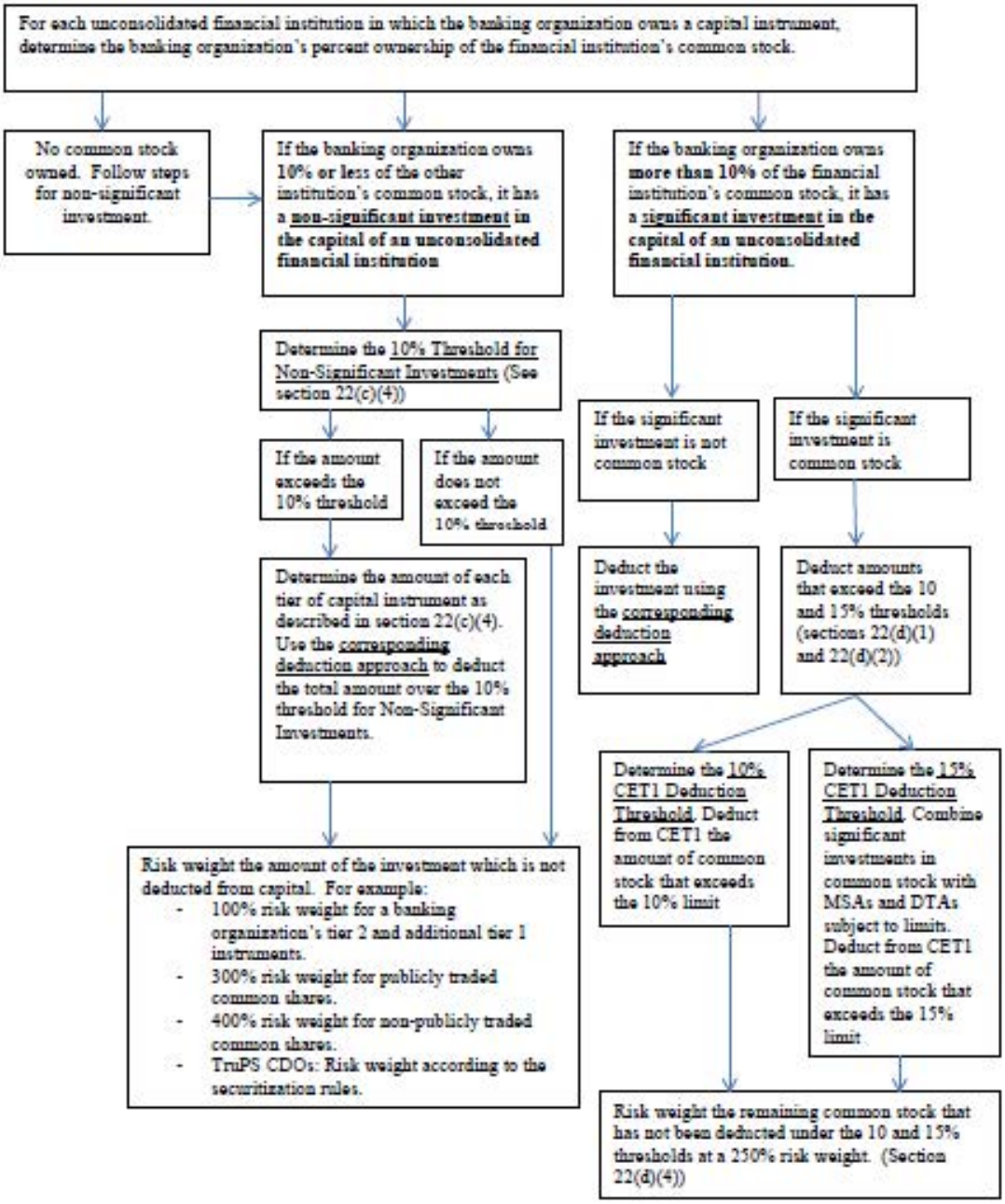
A number of commenters sought clarification as to whether under section 22(c) of the proposal, a banking organization may deduct any significant investments in the capital of

unconsolidated financial institutions that are not in the form of common stock net of associated DTLs. The interim final rule clarifies that such deductions may be net of associated DTLs in accordance with paragraph 22(e) of the interim final rule. Other than this revision, the interim final rule adopts the proposed rule.

More generally, commenters also sought clarification on the treatment of investments in the capital of unconsolidated financial institutions (for example, the distinction between significant and non-significant investments). Thus, the chart below summarizes the treatment of investments in the capital of unconsolidated financial institutions.

Treatment of Investments in the Capital of Unconsolidated Financial Institutions

Perform the following steps to determine the capital treatment of capital instruments in unconsolidated financial institutions:



l. Items Subject to the 10 and 15 percent Common Equity Tier 1 Capital Threshold Deductions

Under the proposal, a banking organization would have deducted 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: (1) DTAs arising from temporary differences that could not be realized through net operating loss carrybacks (net of any related valuation allowances and net of DTLs, as described in section 22(e) of the proposal); (2) MSAs, net of associated DTLs in accordance with section 22(e) of the proposal; and (3) significant investments in the capital of unconsolidated financial institutions in the form of common stock (referred to herein as items subject to the threshold deductions).

Under the proposal, a banking organization would have calculated 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.

As mentioned above in section V.B, under the proposal banking organizations would have been required to deduct from common equity tier 1 capital any goodwill embedded in the valuation of significant investments in the capital of unconsolidated financial institutions in the form of common stock. A banking organization would have been allowed to reduce the investment amount of such significant investment by the goodwill embedded in such 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 reduce the investment amount of such significant investment by the amount of embedded goodwill (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, under the proposal 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 must not 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 have been required to deduct in full the amounts of the items subject to the threshold deductions on a combined basis 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 deduction thresholds. As described below, the proposal required a banking organization 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.

Some commenters asserted that subjecting DTAs resulting from net unrealized losses in an investment portfolio to the proposed 10 percent common equity tier 1 capital deduction threshold under section 22(d) of the proposal would result in a "double deduction" in that the net unrealized losses would have already been included in common equity tier 1 through the AOCI treatment. Under GAAP, net unrealized losses recognized in AOCI are reported net of tax effects (that is, taxes that give rise to DTAs). The tax effects related to net unrealized losses would reduce the amount of net unrealized losses reflected in common equity tier 1 capital.

Given that the tax effects reduce the losses that would otherwise accrue to common equity tier 1 capital, the FDIC is of the view that subjecting these DTAs to the 10 percent limitation would not result in a "double deduction."

More generally, several commenters noted that the proposed 10 and 15 percent common equity tier 1 capital deduction thresholds and the proposed 250 percent risk-weight are unduly punitive. Commenters recommended several alternatives including, for example, that the agencies should only retain the 10 percent limit on each threshold item but eliminate the 15 percent aggregate limit. The FDIC believes that the proposed thresholds are appropriate as they increase the quality and loss-absorbency of regulatory capital, and are therefore adopting the proposed deduction thresholds as final. The FDIC realizes that these stricter limits on threshold items may require FDIC-supervised institutions to make appropriate changes in their capital structure or business model, and thus have provided a lengthy transition period to allow FDIC-supervised institutions to adequately plan for the new limits.

Under section 475 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) (12 U.S.C. 1828 note), the amount of readily marketable purchased mortgage servicing rights (PMSRs) that a banking organization may include in regulatory capital cannot be more than 90 percent of their fair value. In addition to this statutory requirement, the general risk-based capital rules require the same treatment for all MSAs, including PMSRs. Under the proposed rule, if the amount of MSAs a banking organization deducts after applying the 10 percent and 15 percent common equity tier 1 deduction threshold is less than 10 percent of the fair value of its MSAs, then the banking organization would have deducted 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.

Some commenters requested removal of the 90 percent MSA fair value limitation, including for PMSRs under FDICIA. These commenters note that section 475(b) of FDICIA provides the agencies with authority to remove the 90 percent limitation on PMSRs, subject to a joint determination by the agencies that its removal would not have an adverse effect on the deposit insurance fund or the safety and soundness of insured depository institutions. The commenters asserted that removal of the 90 percent limitation would be appropriate because other provisions of the proposal pertaining to MSAs (including PMSRs) would require more capital to be retained even if the fair value limitation were removed.

The FDIC agrees with these commenters and, pursuant to section 475(b) of FDICIA, have determined that PMSRs may be valued at not more than 100 percent of their fair value, because the capital treatment of PMSRs in the interim final rule (specifically, the deduction approach for MSAs (including PMSRs) exceeding the 10 and 15 common equity deduction thresholds and the 250 percent risk weight applied to all MSAs not subject to deduction) is more conservative than the FDICIA fair value limitation and the 100 percent risk weight applied to MSAs under existing rules and such approach will not have an adverse effect on the deposit insurance fund or safety and soundness of insured depository institutions. For the same reasons, the FDIC is also removing the 90 percent fair value limitation for all other MSAs.

Commenters also provided a variety of recommendations related to the proposed limitations on the inclusion of MSAs in regulatory capital. For instance, some commenters advocated removing the proposed deduction provision for hedged and commercial and multifamily-related MSAs, as well as requested an exemption from the proposed deduction requirement for community banking organizations with less than $10 billion.

Other commenters recommended increasing the amount of MSAs includable in regulatory capital. For example, one commenter recommended that MSAs should be limited to 100 percent of tier l capital if the underlying loans are prudently underwritten. Another commenter requested that the interim final rule permit thrifts and commercial banking organizations to include in regulatory capital MSAs equivalent to 50 and 25 percent of tier 1 capital, respectively.

Several commenters also objected to the proposed risk weights for MSAs, asserting that a 250 percent risk weight for an asset that is marked-to-fair value quarterly is unreasonably punitive and that a 100 percent risk weight should apply; that MSAs allowable in capital should be increased, at a minimum, to 30 percent of tier 1 capital, with a risk weight of no greater than 50 percent for existing MSAs; that commercial MSAs should continue to be subject to the risk weighting and deduction methodology under the general risk-based capital rules; and that originated MSAs should retain the same risk weight treatment under the general risk-based capital rules given that the ability to originate new servicing to replace servicing lost to prepayment in a falling-rate environment provides for a substantial hedge. Another commenter recommended that the agencies grandfather all existing MSAs that are being fair valued on banking organizations' balance sheets and exclude MSAs from the proposed 15 percent deduction threshold.

After considering these comments, the FDIC is adopting the proposed limitation on MSAs includable in common equity tier 1 capital without change in the interim final rule. MSAs, like other intangible assets, have long been either fully or partially excluded from regulatory capital in the United States because of the high level of uncertainty regarding the

ability of FDIC-supervised institutions to realize value from these assets, especially under adverse financial conditions.

m. Netting of Deferred Tax Liabilities against Deferred Tax Assets and Other Deductible Assets

Under the proposal, banking organizations would have been permitted to net DTLs against assets (other than DTAs) subject to deduction under section 22 of the proposal, 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 more than once for netting purposes. 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, under the proposal the amount of DTAs that arise from net 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, could be netted against DTLs if certain conditions are met.

The agencies received numerous comments recommending changes to and seeking clarification on various aspects of the proposed treatment of deferred taxes. Certain commenters asked whether deductions of significant and non-significant investments in the capital of unconsolidated financial institutions under section 22(c)(4) and 22(c)(5) of the proposed rule may be net of associated DTLs. A commenter also recommended that a banking organization be permitted to net a DTA against a fair value measurement or similar adjustment to an asset (for example, in the case of a certain cash-flow hedges) or a liability (for example, in the case of changes in the fair value of a banking organization's liabilities attributed to changes in the

banking organization's own credit risk) that is associated with the adjusted value of the asset or liability that itself is subject to a capital adjustment or deduction under the Basel III NPR. These DTAs would be derecognized under GAAP if the adjustment were reversed. Accordingly, one commenter recommended that proposed text in section 22(e) be revised to apply to netting of DTAs as well as DTLs.

The FDIC agrees that for regulatory capital purposes, an FDIC-supervised institution may exclude from the deduction thresholds DTAs and DTLs associated with fair value measurement or similar adjustments to an asset or liability that are excluded from common equity tier 1 capital under the interim final rule. The FDIC notes that GAAP requires net unrealized gains and losses[91] recognized in AOCI to be recorded net of deferred tax effects. Moreover, under the FDIC's general risk-based capital rules and associated regulatory reporting instructions, FDIC-supervised institutions must deduct certain net unrealized gains, net of applicable taxes, and add back certain net unrealized losses, again, net of applicable taxes. Permitting FDIC-supervised institutions to exclude net unrealized gains and losses included in AOCI without netting of deferred tax effects would cause an FDIC-supervised institution to overstate the amount of net unrealized gains and losses excluded from regulatory capital and potentially overstate or understate deferred taxes included in regulatory capital.

Accordingly, under the interim final rule, FDIC-supervised institutions must make all adjustments to common equity tier 1 capital under section 22(b) of the interim final rule net of any associated deferred tax effects. In addition, FDIC-supervised institutions may make all

[91] The word "net" in the term "net unrealized gains and losses" refers to the netting of gains and losses before tax.

deductions from common equity tier 1 capital elements under section 22(c) and (d) of the interim final rule net of associated DTLs, in accordance with section 22(e) of the interim final rule.

Commenters also sought clarification as to whether banking organizations may change from reporting period to reporting period their decision to net DTLs against DTAs as opposed to netting DTLs against other assets subject to deduction. Consistent with the FDIC's general risk-based capital rules, the interim final rule permits, but does not require, an FDIC-supervised institution to net DTLs associated with items subject to regulatory deductions from common equity tier 1 capital under section 22(a). The FDIC's general risk-based capital rules do not explicitly address whether or how often an FDIC-supervised institution may change its DTL netting approach for items subject to deduction, such as goodwill and other intangible assets.

If an FDIC-supervised institution elects to either net DTLs against DTAs or to net DTLs against other assets subject to deduction, the interim final rule requires that it must do so consistently. For example, an FDIC-supervised institution that elects to deduct goodwill net of associated DTLs will be required to continue that practice for all future reporting periods. Under the interim final rule, an FDIC-supervised institution must obtain approval from the FDIC before changing its approach for netting DTLs against DTAs or assets subject to deduction under section 22(a), which would be permitted, for example, in situations where an FDIC-supervised institution merges with or acquires another FDIC-supervised institution, or upon a substantial change in an FDIC-supervised institution's business model.

Commenters also asked whether banking organizations would be permitted or required to exclude (from the amount of DTAs subject to the threshold deductions under section 22(d) of the proposal) deferred tax assets and liabilities relating to net unrealized gains and losses reported in AOCI that are subject to: (1) regulatory adjustments to common equity tier 1 capital (section

22(b) of the proposal), (2) deductions from regulatory capital related to investments in capital instruments (section 22(c) of the proposal), and (3) items subject to the 10 and 15 percent common equity tier 1 capital deduction thresholds (section 22(d) of the proposal).

Under the FDIC's general risk-based capital rules, before calculating the amount of DTAs subject to the DTA limitations for inclusion in tier 1 capital, an FDIC-supervised institution may eliminate the deferred tax effects of any net unrealized gains and losses on AFS debt securities. An FDIC-supervised institution that adopts a policy to eliminate such deferred tax effects must apply that approach consistently in all future calculations of the amount of disallowed DTAs.

For purposes of the interim final rule, the FDIC has decided to permit FDIC-supervised institutions to eliminate from the calculation of DTAs subject to threshold deductions under section 22(d) of the interim final rule the deferred tax effects associated with any items that are subject to regulatory adjustment to common equity tier 1 capital under section 22(b). An FDIC-supervised institution that elects to eliminate such deferred tax effects must continue that practice consistently from period to period. An FDIC-supervised institution must obtain approval from the FDIC before changing its election to exclude or not exclude these amounts from the calculation of DTAs. Additionally, the FDIC has decided to require DTAs associated with any net unrealized losses or differences between the tax basis and the accounting basis of an asset pertaining to items (other than those items subject to adjustment under section 22(b)) that are: (1) subject to deduction from common equity tier 1 capital under section 22(c) or (2) subject to the threshold deductions under section 22(d) to be subject to the threshold deductions under section 22(d) of the interim final rule.

Commenters also sought clarification as to whether banking organizations would be required to compute DTAs and DTLs quarterly for regulatory capital purposes. In this regard, commenters stated that GAAP requires annual computation of DTAs and DTLs, and that more frequent computation requirements for regulatory capital purposes would be burdensome.

Some DTA and DTL items must be adjusted at least quarterly, such as DTAs and DTLs associated with certain gains and losses included in AOCI. Therefore, the FDIC expects FDIC-supervised institutions to use the DTA and DTL amounts reported in the regulatory reports for balance sheet purposes to be used for regulatory capital calculations. The interim final rule does not require FDIC-supervised institutions to perform these calculations more often than would otherwise be required in order to meet quarterly regulatory reporting requirements.

A few commenters also asked whether the agencies would continue to allow banking organizations to use DTLs embedded in the carrying value of a leveraged lease to reduce the amount of DTAs subject to the 10 percent and 15 percent common equity tier 1 capital deduction thresholds contained in section 22(d) of the proposal. The valuation of a leveraged lease acquired in a business combination gives recognition to the estimated future tax effect of the remaining cash-flows of the lease. Therefore, any future tax liabilities related to an acquired leveraged lease are included in the valuation of the leveraged lease, and are not separately reported under GAAP as DTLs. This can artificially increase the amount of net DTAs reported by banking organizations that acquire a leveraged lease portfolio under purchase accounting. Accordingly, the agencies' currently allow banking organizations to treat future taxes payable included in the valuation of a leveraged lease portfolio as a reversing taxable temporary

difference available to support the recognition of DTAs.[92] The interim final rule amends the proposal by explicitly permitting an FDIC-supervised institution to use the DTLs embedded in the carrying value of a leveraged lease to reduce the amount of DTAs consistent with section 22(e).

In addition, commenters asked the agencies to clarify whether a banking organization is required to deduct from the sum of its common equity tier 1 capital elements net DTAs arising from timing differences that the banking organization could realize through net operating loss carrybacks. The FDIC confirms that under the interim final rule, DTAs that arise from temporary differences that the FDIC-supervised institution may realize through net operating loss carrybacks are not subject to the 10 percent and 15 percent common equity tier 1 capital deduction thresholds (deduction thresholds). This is consistent with the FDIC's general risk-based capital rules, which do not limit DTAs that can potentially be realized from taxes paid in prior carryback years. However, consistent with the proposal, the interim final rule requires that FDIC-supervised institutions deduct from common equity tier 1 capital elements the amount of DTAs arising from temporary differences that the FDIC-supervised institution could not realize through net operating loss carrybacks that exceed the deduction thresholds under section 22(d) of the interim final rule.

Some commenters recommended that the agencies retain the provision in the agencies' general risk-based capital rules that permits a banking organization to measure the amount of DTAs subject to inclusion in tier 1 capital by the amount of DTAs that the banking organization

[92] Temporary differences arise when financial events or transactions are recognized in one period for financial reporting purposes and in another period, or periods, for tax purposes. A reversing taxable temporary difference is a temporary difference that produces additional taxable income future periods.

could reasonably be expected to realize within one year, based on its estimate of future taxable income.[93] In addition, commenters argued that the full deduction of net operating loss and tax credit carryforwards from common equity tier 1 capital is an inappropriate reaction to concerns about DTAs as an element of capital, and that there are appropriate circumstances where an institution should be allowed to include the value of its DTAs related to net operating loss carryforwards in regulatory capital.

The deduction thresholds for DTAs in the interim final rule are intended to address the concern that GAAP standards for DTAs could allow FDIC-supervised institutions to include in regulatory capital excessive amounts of DTAs that are dependent upon future taxable income. The concern is particularly acute when FDIC-supervised institutions begin to experience financial difficulty. In this regard, the FDIC observed that as the recent financial crisis began, many FDIC-supervised institutions that had included DTAs in regulatory capital based on future taxable income were no longer able to do so because they projected more than one year of losses for tax purposes.

The FDIC notes that under the proposal and interim final rule, DTAs that arise from temporary differences that the FDIC-supervised institution may realize through net operating loss carrybacks are not subject to the deduction thresholds and will be subject to a risk weight of 100 percent. Further, FDIC-supervised institutions will continue to be permitted to include

[93] Under the FDIC's general risk-based capital rules, a banking organization generally must deduct from tier 1 capital DTAs that are dependent upon future taxable income, which exceed the lesser of either: (1) the amount of DTAs that the bank could reasonably expect to realize within one year of the quarter-end regulatory report, based on its estimate of future taxable income for that year, or (2) 10 percent of tier 1 capital, net of goodwill and all intangible assets other than purchased credit card relationships, and servicing assets. See 12 CFR 325, appendix A section I.A.1.iii(a) (state nonmember banks), and 12 CFR 390.465(a)(2)(vii) (state savings associations).

some or all of their DTAs that are associated with timing differences that are not realizable through net operating loss carrybacks in regulatory capital. In this regard, the interim final rule strikes an appropriate balance between prudential concerns and practical considerations about the ability of FDIC-supervised institutions to realize DTAs.

The proposal stated: "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 (emphasis added)."[94] Commenters requested that the agencies clarify that the word "net" in this sentence was intended to refer to DTAs "net of valuation allowances." The FDIC has amended section 22(e) of the interim final rule text to clarify that the word "net" in this instance was intended to refer to DTAs "net of any related valuation allowances and net of DTLs."

In addition, a commenter requested that the agencies remove the condition in section 22(e) of the interim final rule providing that only DTAs and DTLs that relate to taxes levied by the same taxing authority may be offset for purposes of the deduction of DTAs. This commenter notes that under a GAAP, a company generally calculates its DTAs and DTLs relating to state income tax in the aggregate by applying a blended state rate. Thus, FDIC-supervised institutions do not typically track DTAs and DTLs on a state-by-state basis for financial reporting purposes.

The FDIC recognizes that under GAAP, if the tax laws of the relevant state and local jurisdictions do not differ significantly from federal income tax laws, then the calculation of deferred tax expense can be made in the aggregate considering the combination of federal, state, and local income tax *rates*. The rate used should consider whether amounts paid in one

[94] See footnote 14, 77 FR 52863 (August 30, 2012).

jurisdiction are deductible in another jurisdiction. For example, since state and local taxes are deductible for federal purposes, the aggregate combined rate would generally be (1) the federal tax rate plus (2) the state and local tax rates, minus (3) the federal tax effect of the deductibility of the state and local taxes at the federal tax rate. Also, for financial reporting purposes, consistent with GAAP, the FDIC allows FDIC-supervised institutions to offset DTAs (net of valuation allowance) and DTLs related to a particular tax jurisdiction. Moreover, for regulatory reporting purposes, consistent with GAAP, the FDIC requires separate calculations of income taxes, both current and deferred amounts, for each tax jurisdiction. Accordingly, FDIC-supervised institutions must calculate DTAs and DTLs on a state-by-state basis for financial reporting purposes under GAAP and for regulatory reporting purposes.

3. Investments in Hedge Funds and Private Equity Funds Pursuant to Section 13 of the Bank Holding Company Act

Section 13 of the Bank Holding Company Act, which was added by section 619 of the Dodd-Frank Act, contains a number of restrictions and other prudential requirements applicable to any "banking entity"[95] that engages in proprietary trading or has certain interests in, or relationships with, a hedge fund or a private equity fund.[96]

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[95] See 12 U.S.C. 1851. The term "banking entity" is defined in section 13(h)(1) of the Bank Holding Company 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.

[96] Section 13 of the Bank Holding Company 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, but for section 3(c)(1) or 3(c)(7) of that Act, or such similar funds as the [relevant agencies] may, by rule . . . determine." See 12 U.S.C. 1851(h)(2).

Section 13(d)(3) of the Bank Holding Company Act provides that the relevant agencies "shall . . . adopt rules imposing additional capital requirements and quantitative limitations, including diversification requirements, regarding activities permitted under [Section 13] if the appropriate Federal banking agencies, the SEC, and the Commodity Futures Trading Commission (CFTC) determine that additional capital and quantitative limitations are appropriate to protect the safety and soundness of banking entities engaged in such activities." The Dodd-Frank Act also added section 13(d)(4)(B)(iii) to the Bank Holding Company Act, which pertains to investments in a hedge fund or private equity fund organized and offered by a banking entity and provides for deductions from the assets and tangible equity of the banking entity for these investments in hedge funds or private equity funds.

On November 7, 2011, the agencies and the SEC issued a proposal to implement Section 13 of the Bank Holding Company Act.[97] The proposal 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.[98] The FDIC intends to address this capital requirement, as it applies to FDIC-supervised institutions, within the context of the its entire regulatory capital framework, so that its potential interaction with all other regulatory capital requirements can be fully assessed.

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[97] See 76 FR 68846 (November 7, 2011). On February 14, 2012, the CFTC published a substantively similar proposed rule implementing section 13 of the Bank Holding Company Act. See 77 FR 8332 (February 14, 2012).

[98] See Id., § 324.12(d).

VI. Denominator Changes Related to the Regulatory Capital Changes

Consistent with Basel III, the proposal provided a 250 percent risk weight for the portion of the following items that are not otherwise subject to deduction: (1) MSAs, (2) 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 rule), and (3) significant investments in the capital of unconsolidated financial institutions in the form of common stock that are not deducted from tier 1 capital.

Several commenters objected to the proposed 250 percent risk weight and stated that the agencies instead should apply a 100 percent risk weight to the amount of these assets below the deduction thresholds. Commenters stated that the relatively high risk weight would drive business, particularly mortgage servicing, out of the banking sector and into unregulated shadow banking entities.

After considering the comments, the FDIC continues to believe that the 250 percent risk weight is appropriate in light of the relatively greater risks inherent in these assets, as described above. These risks are sufficiently significant that concentrations in these assets warrant deductions from capital, and any exposure to these assets merits a higher-than 100 percent risk weight. Therefore, the interim final rule adopts the proposed treatment without change.

The interim final rule, consistent with the proposal, requires FDIC-supervised institutions to apply a 1,250 percent risk weight to certain exposures that were subject to deduction under the general risk-based capital rules. Therefore, for purposes of calculating total risk-weighted assets, the interim final rule requires an FDIC-supervised institution to apply a 1,250 percent risk weight to the portion of a credit-enhancing interest-only strip that does not constitute an after-tax-gain-on-sale.

VII. Transition Provisions

The proposal established transition provisions for: (i) minimum regulatory capital ratios; (ii) capital conservation and countercyclical capital buffers; (iii) regulatory capital adjustments and deductions; (iv) non-qualifying capital instruments; and (v) the supplementary leverage ratio. Most of the transition periods in the proposal began on January 1, 2013, and would have provided banking organizations between three and six years to comply with the requirements in the proposed rule. Among other provisions, the proposal would have provided a transition period for the phase-out of non-qualifying capital instruments from regulatory capital under either a three- or ten-year transition period based on the organization's consolidated total assets. The proposed transition provisions were designed to give banking organizations sufficient time to adjust to the revised capital framework while minimizing the potential impact that implementation could have on their ability to lend. The transition provisions also were designed to ensure compliance with the Dodd-Frank Act. As a result, they would have been, in certain circumstances, more stringent than the transition arrangements set forth in Basel III.

The agencies received multiple comments on the proposed transition framework. Most of the commenters characterized the proposed transition schedule for the minimum capital ratios as overly aggressive and expressed concern that banking organizations would not be able to meet the increased capital requirements (in accordance with the transition schedule) in the current economic environment. Commenters representing community banking organizations argued that such organizations generally have less access to the capital markets relative to larger banking organizations and, therefore, usually increase capital primarily by accumulating retained earnings. Accordingly, these commenters requested additional time to satisfy the minimum capital requirements under the proposed rule, and specifically asked the agencies to provide

banking organizations until January 1, 2019 to comply with the proposed minimum capital requirements. Other commenters commenting on behalf of community banking organizations, however, considered the transition period reasonable. One commenter requested a shorter implementation timeframe for the largest banking organizations, asserting that these organizations already comply with the proposed standards. Another commenter suggested removing the transition period and delaying the effective date until the industry more fully recovers from the recent crisis. According to this commenter, the effective date should be delayed to ensure that implementation of the rule would not result in a contraction in aggregate U.S. lending capacity.

A number of commenters suggested an effective date based on the publication date of the interim final rule in the Federal Register. According to the commenters, such an approach would provide banking organizations with certainty regarding the effective date of the interim final rule that would allow them to plan for and implement any required system and process changes. One commenter requested simultaneous implementation of all three proposals because some elements of the Standardized Approach NPR affect the implementation of the Basel III NPR. A number of commenters also requested additional time to comply with the proposed capital conservation buffer. According to these commenters, implementation of the capital conservation buffer would make the equity instruments of banking organizations less attractive to potential investors and could even encourage divestment among existing shareholders. Therefore, the commenters maintained, the proposed rule would require banking organizations to raise capital by accumulating retained earnings, and doing so could take considerable time in the current economic climate. For these reasons, the commenters asked the agencies to delay implementation of the capital conservation buffer for an additional five years to provide banking

organizations sufficient time to increase retained earnings without curtailing lending activity. Other commenters requested that the agencies fully exempt banks with total consolidated assets of $50 billion or less from the capital conservation buffer, further recommending that if the agencies declined to make this accommodation then the phase-in period for the capital conservation buffer should be extended by at least three years to January 1, 2022, to provide community banking organizations with enough time to meet the new regulatory minimums.

A number of commenters noted that Basel III phases in the deduction of goodwill from 2014 to 2018, and requested that the agencies adopt this transition for goodwill in the United States to prevent U.S. institutions from being disadvantaged relative to their global competitors.

Many commenters objected to the proposed schedule for the phase out of TruPS from tier 1 capital, particularly for banking organizations with less than $15 billion in total consolidated assets. As discussed in more detail in section V.A., the commenters requested that the agencies grandfather existing TruPS issued by depository institution holding companies with less than $15 billion and 2010 MHCs, as permitted by section 171 of the Dodd-Frank Act. In general, these commenters characterized TruPS as a relatively safe, low-cost form of capital issued in full compliance with regulatory requirements that would be difficult for smaller institutions to replace in the current economic environment. Some commenters requested that community banking organizations be exempt from the phase-out of TruPS and from the phase-out of cumulative preferred stock for these reasons. Another commenter requested that the agencies propose that institutions with under $5 billion in total consolidated assets be allowed to continue to include TruPS in regulatory capital at full value until the call or maturity of the TruPS instrument.

Some commenters encouraged the agencies to adopt the ten-year transition schedule under Basel III for TruPS of banking organizations with total consolidated assets of more than $15 billion. These commenters asserted that the proposed transition framework for TruPS would disadvantage U.S. banking organizations relative to foreign competitors. One commenter expressed concern that the transition framework under the proposed rule also would disrupt payment schedules for TruPS CDOs.

Commenters proposed several additional alternative transition frameworks for TruPS. For example, one commenter recommended a 10 percent annual reduction in the amount of TruPS banking organizations with $15 billion or more of total consolidated assets may recognize in tier 1 capital beginning in 2013, followed by a phase-out of the remaining amount in 2015. According to the commenter, such a framework would comply with the Dodd-Frank Act and allow banking organizations more time to replace TruPS. Another commenter suggested that the interim final rule allow banking organizations to progressively reduce the amount of TruPS eligible for inclusion in tier 1 capital by 1.25 to 2.5 percent per year. One commenter encouraged the agencies to avoid penalizing banking organizations that elect to redeem TruPS during the transition period. Specifically, the commenter asked the agencies to revise the proposed transition framework so that any TruPS redeemed during the transition period would not reduce the total amount of TruPS eligible for inclusion in tier 1 capital. Under such an approach, the amount of TruPS eligible for inclusion in tier 1 capital during the transition period would equal the lesser of: (a) the remaining outstanding balance or (b) the percentage decline factor times the balance outstanding at the time the interim final rule is published in the Federal Register.

One commenter encouraged the agencies to allow a banking organization that grows to more than $15 billion in total assets as a result of merger and acquisition activity to remain subject to the proposed transition framework for non-qualifying capital instruments issued by organizations with less than $15 billion in total assets. According to the commenter, such an approach should apply to either the buyer or seller in the transaction. Other commenters asked the agencies to allow banking organizations whose total consolidated assets grew to over $15 billion just prior to May 19, 2010, and whose asset base subsequently declined below that amount to include all TruPS in their tier 1 capital during 2013 and 2014 on the same basis as institutions with less than $15 billion in total consolidated assets and, thereafter, be subject to the deductions required by section 171 of the Dodd-Frank Act.

Commenters representing advanced approaches banking organizations generally objected to the proposed transition framework for the supplementary leverage ratio, and requested a delay in its implementation. For example, one commenter recommended the agencies defer implementation of the supplementary leverage ratio until the agencies have had an opportunity to consider whether it is likely to result in regulatory arbitrage and international competitive inequality as a result of differences in national accounting frameworks and standards. Another commenter asked the agencies to delay implementation of the supplementary leverage ratio until no earlier than January 1, 2018, as provided in Basel III, or until the BCBS completes its assessment and reaches international agreement on any further adjustments. A few commenters, however, supported the proposed transition framework for the supplementary leverage ratio because it could be used as an important regulatory tool to ensure there is sufficient capital in the financial system.

After considering the comments and the potential challenges some banking organizations may face in complying with the interim final rule, the FDIC has agreed to delay the compliance date for FDIC-supervised institutions that are not advanced approaches FDIC-supervised institutions until January 1, 2015. Therefore, such entities are not required to calculate their regulatory capital requirements under the interim final rule until January 1, 2015. Thereafter, these FDIC-supervised institutions must calculate their regulatory capital requirements in accordance with the interim final rule, subject to the transition provisions set forth in subpart G of the interim final rule.

The interim final rule also establishes the effective date of the interim final rule for advanced approaches FDIC-supervised institutions as January 1, 2014. In accordance with Tables 5 – 17 below, the transition provisions for the regulatory capital adjustments and deductions in the interim final rule commence either one or two years later than in the proposal, depending on whether the FDIC-supervised institution is or is not an advanced approaches FDIC-supervised institution. The December 31, 2018, end-date for the transition period for regulatory capital adjustments and deductions is the same under the interim final rule as under the proposal.

A. Transitions Provisions for Minimum Regulatory Capital Ratios

In response to the commenters' concerns, the interim final rule modifies the proposed transition provisions for the minimum capital requirements. FDIC-supervised institutions that are not advanced approaches FDIC-supervised institutions are not required to comply with the minimum capital requirements until January 1, 2015. This is a delay of two years from the beginning of the proposed transition period. Because the FDIC is not requiring compliance with the interim final rule until January 1, 2015 for these entities, there is no additional transition

period for the minimum regulatory capital ratios. This approach should give FDIC-supervised institutions sufficient time to raise or accumulate any additional capital needed to satisfy the new minimum requirements and upgrade internal systems without adversely affecting their lending capacity.

Under the interim final rule, an advanced approaches FDIC-supervised institution must comply with minimum common equity tier 1, tier 1, and total capital ratio requirements of 4.0 percent, 5.5 percent, and 8.0 percent during calendar year 2014, and 4.5 percent, 6.0 percent, 8.0 percent, respectively, beginning January 1, 2015. These transition provisions are consistent with those under Basel III for internationally-active FDIC-supervised institutions. During calendar year 2014, advanced approaches FDIC-supervised institutions must calculate their minimum common equity tier 1, tier 1, and total capital ratios using the definitions for the respective capital components in section 20 of the interim final rule (adjusted in accordance with the transition provisions for regulatory adjustments and deductions and for the non-qualifying capital instruments for advanced approaches FDIC-supervised institutions described in this section).

B. Transition Provisions for Capital Conservation and Countercyclical Capital Buffers

The FDIC has finalized transitions for the capital conservation and countercyclical capital buffers as proposed. The capital conservation buffer transition period begins in 2016, a full year after FDIC-supervised institutions that are not advanced approaches FDIC-supervised institutions are required to comply with the interim final rule, and two years after advanced approaches FDIC-supervised institutions are required to comply with the interim final rule. The FDIC believes that this is an adequate time frame to meet the buffer level necessary to avoid restrictions on capital distributions. Table 5 shows the regulatory capital levels advanced

approaches FDIC-supervised institutions generally must satisfy to avoid limitations on capital distributions and discretionary bonus payments during the applicable transition period, from January 1, 2016 until January 1, 2019.

TABLE 5 – REGULATORY CAPITAL LEVELS FOR ADVANCED APPROACHES FDIC-SUPERVISED INSTITUTIONS

	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	4.0%	4.5%	5.125%	5.75%	6.375%	7.0%
Minimum tier 1 capital ratio + capital conservation buffer	5.5%	6.0%	6.625%	7.25%	7.875%	8.5%
Minimum total capital ratio + capital conservation buffer	8.0%	8.0%	8.625%	9.25%	9.875%	10.5%
Maximum potential countercyclical capital buffer			0.625%	1.25%	1.875%	2.5%

Table 6 shows the regulatory capital levels FDIC-supervised institutions that are not advanced approaches FDIC-supervised institutions generally must satisfy to avoid limitations on capital distributions and discretionary bonus payments during the applicable transition period, from January 1, 2016 until January 1, 2019.

TABLE 6 – REGULATORY CAPITAL LEVELS FOR NON-ADVANCED APPROACHES FDIC-SUPERVISED INSTITUTIONS

	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	4.5%	5.125%	5.75%	6.375%	7.0%

Minimum tier 1 capital ratio + capital conservation buffer	6.0%	6.625%	7.25%	7.875%	8.5%
Minimum total capital ratio + capital conservation buffer	8.0%	8.625%	9.25%	9.875%	10.5%

As provided in Table 5 and Table 6, the transition period for the capital conservation and countercyclical capital buffers does not begin until January 1, 2016. During this transition period, from January 1, 2016 through December 31, 2018, all FDIC-supervised institutions are subject to transition arrangements with respect to the capital conservation buffer as outlined in more detail in Table 7. For advanced approaches FDIC-supervised institutions, the countercyclical capital buffer will be phased in according to the transition schedule set forth in Table 7 by proportionately expanding each of the quartiles of the capital conservation buffer.

TABLE 7 — TRANSITION PROVISION FOR THE CAPITAL CONSERVATION AND COUNTERCYCLICAL CAPITAL BUFFER

Transition Period	Capital conservation buffer	Maximum payout ratio (as a percentage of eligible retained income)
Calendar year 2016	Greater than 0.625 percent (plus 25 percent of any applicable countercyclical capital buffer amount)	No payout ratio limitation applies
	Less than or equal to 0.625 percent (plus 25 percent of any applicable countercyclical capital buffer amount), and greater than 0.469 percent (plus 18.75 percent of any applicable countercyclical capital buffer amount)	60 percent
	Less than or equal to 0.469 percent (plus 18.75 percent of any applicable countercyclical capital buffer amount), and greater than 0.313 percent (plus 12.5 percent of any applicable countercyclical capital buffer amount)	40 percent

	Less than or equal to 0.313 percent (plus 12.5 percent of any applicable countercyclical capital buffer amount), and greater than 0.156 percent (plus 6.25 percent of any applicable countercyclical capital buffer amount)	20 percent
	Less than or equal to 0.156 percent (plus 6.25 percent of any applicable countercyclical capital buffer amount)	0 percent
Calendar year 2017	Greater than 1.25 percent (plus 50 percent of any applicable countercyclical capital buffer amount)	No payout ratio limitation applies
	Less than or equal to 1.25 percent (plus 50 percent of any applicable countercyclical capital buffer amount), and greater than 0.938 percent (plus 37.5 percent of any applicable countercyclical capital buffer amount)	60 percent
	Less than or equal to 0.938 percent (plus 37.5 percent of any applicable countercyclical capital buffer amount), and greater than 0.625 percent (plus 25 percent of any applicable countercyclical capital buffer amount)	40 percent
	Less than or equal to 0.625 percent (plus 25 percent of any applicable countercyclical capital buffer amount), and greater than 0.313 percent (plus 12.5 percent of any applicable countercyclical capital buffer amount)	20 percent
	Less than or equal to 0.313 percent (plus 12.5 percent of any applicable countercyclical capital buffer amount)	0 percent
Calendar year 2018	Greater than 1.875 percent (plus 75 percent of any applicable countercyclical capital buffer amount)	No payout ratio limitation applies
	Less than or equal to 1.875 percent (plus 75 percent of any applicable countercyclical capital buffer amount), and greater than 1.406 percent (plus 56.25 percent of any applicable countercyclical capital buffer amount)	60 percent
	Less than or equal to 1.406 percent (plus 56.25 percent of any applicable countercyclical capital buffer amount), and greater than 0.938 percent (plus 37.5 percent of any applicable countercyclical capital buffer amount)	40 percent

	Less than or equal to 0.938 percent (plus 37.5 percent of any applicable countercyclical capital buffer amount), and greater than 0.469 percent (plus 18.75 percent of any applicable countercyclical capital buffer amount)	20 percent
	Less than or equal to 0.469 percent (plus 18.75 percent of any applicable countercyclical capital buffer amount)	0 percent

C. Transition Provisions for Regulatory Capital Adjustments and Deductions

To give sufficient time to FDIC-supervised institutions to adapt to the new regulatory capital adjustments and deductions, the interim final rule incorporates transition provisions for such adjustments and deductions that commence at the time at which the FDIC-supervised institution becomes subject to the interim final rule. As explained above, the interim final rule maintains the proposed transition periods, except for non-qualifying capital instruments as described below.

FDIC-supervised institutions that are not advanced approaches FDIC-supervised institutions will begin the transitions for regulatory capital adjustments and deductions on January 1, 2015. From January 1, 2015, through December 31, 2017, these FDIC-supervised institutions will be required to make the regulatory capital adjustments to and deductions from regulatory capital in section 22 of the interim final rule in accordance with the proposed transition provisions for such adjustments and deductions outlined below. Starting on January 1, 2018, these FDIC-supervised institutions will apply all regulatory capital adjustments and deductions as set forth in section 22 of the interim final rule.

For an advanced approaches FDIC-supervised institution, the first year of transition for adjustments and deductions begins on January 1, 2014. From January 1, 2014, through December 31, 2017, such FDIC-supervised institutions will be required to make the regulatory

capital adjustments to and deductions from regulatory capital in section 22 of the interim final rule in accordance with the proposed transition provisions for such adjustments and deductions outlined below. Starting on January 1, 2018, advanced approaches FDIC-supervised institutions will be subject to all regulatory capital adjustments and deductions as described in section 22 of the interim final rule.

1. Deductions for Certain Items under Section 22(a) of the Interim final rule

The interim final rule provides that FDIC-supervised institutions will deduct from common equity tier 1 capital or tier 1 capital in accordance with Table 8 below: (1) goodwill (section 22(a)(1)); (2) DTAs that arise from operating loss and tax credit carryforwards (section 22(a)(3)), (3) gain-on-sale associated with a securitization exposure (section 22(a)(4)), (4) defined benefit pension fund assets (section 22(a)(5)), (5) for an advanced approaches FDIC-supervised institution that has completed the parallel run process and that has received notification from the FDIC pursuant to section 121(d) of subpart E of the interim final rule, expected credit loss that exceeds eligible credit reserves (section 22(a)(6)), and (6) financial subsidiaries (section 22(a)(7)). During the transition period, the percentage of these items that is not deducted from common equity tier 1 capital must be deducted from tier 1 capital.

TABLE 8 – TRANSITION DEDUCTIONS UNDER SECTION 22(a)(1) AND SECTIONS 22(a)(3)-(a)(7) OF THE INTERIM FINAL RULE

Transition Period	Transition deductions under section 22(a)(1) and (7)	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
January 1, 2014 to December 31, 2014	100	20	80

(advanced approaches FDIC-supervised institutions only)			
January 1, 2015 to December 31, 2015	100	40	60
January 1, 2016 to December 31, 2016	100	60	40
January 1, 2017 to December 31, 2017	100	80	20
January 1, 2018 and thereafter	100	100	0

Beginning on January 1, 2014, advanced approaches FDIC-supervised institutions will be required to deduct the full amount of goodwill (which may be 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. All other FDIC-supervised institutions will begin deducting goodwill (which may be 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, on January 1, 2015. This approach is stricter than the Basel III approach, which transitions the goodwill deduction from common equity tier 1 capital through 2017. However, as discussed in section V.B of this preamble, under U.S. law, goodwill cannot be included in an FDIC-supervised institution's regulatory capital and has not been included in FDIC-supervised institutions'

regulatory capital under the general risk-based capital rules.[99] Additionally, the FDIC believes that fully deducting goodwill from common equity tier 1 capital from the date an FDIC-supervised institution must comply with the interim final rule will result in a more appropriate measure of common equity tier 1 capital.

Beginning on January 1, 2014, a national bank or insured state bank subject to the advanced approaches rule will be required to deduct 100 percent of the aggregate amount of its outstanding equity investment, including the retained earnings, in any financial subsidiary from common equity tier 1 capital. All other national and insured state banks will begin deducting 100 percent of the aggregate amount of their outstanding equity investment, including the retained earnings, in a financial subsidiary from common equity tier 1 capital on January 1, 2015. The deduction from common equity tier 1 capital represents a change from the general risk-based capital rules, which require the deduction to be made from total capital. As explained in section V.B of this preamble, similar to goodwill, this deduction is required by statute and is consistent with the general risk-based capital rules. Accordingly, the deduction is not subject to a transition period.

The interim final rule also retains the existing deduction for state savings associations' investments in, and extensions of credit to, non-includable subsidiaries at 12 CFR 324.22(a)(8).[100] This deduction is required by statute[101] and is consistent with the general risk-based capital rules. Accordingly, the deduction is not subject to a transition period and must be

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[99] See 12 U.S.C. 1464(t)(9)(A) and 12 U.S.C. 1828(n).

[100] For additional information on this deduction, see section V.B "Activities by savings association subsidiaries that are impermissible for national banks" of this preamble

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

fully deducted in the first year that the state savings association becomes subject to the interim final rule.

2. Deductions for Intangibles Other than Goodwill and Mortgage Servicing Assets

For deductions of intangibles other than goodwill and MSAs, including purchased credit-card relationships (PCCRs) (see section 22(a)(2) of the interim final rule), the applicable transition period in the interim final rule is set forth in Table 9. During the transition period, any of these items that are not deducted will be subject to a risk weight of 100 percent. Advanced approaches FDIC-supervised institutions will begin the transition on January 1, 2014, and other FDIC-supervised institutions will begin the transition on January 1, 2015.

TABLE 9—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
January 1, 2014 to December 31, 2014 (advanced approaches FDIC-supervised institutions only)	20
January 1, 2015 to December 31, 2015	40
January 1, 2016 to December 31, 2016	60
January 1, 2017 to December 31, 2017	80
January 1, 2018 and thereafter	100

3. Regulatory Adjustments under Section 22(b)(1) of the Interim final rule

During the transition period, any of the adjustments required under section 22(b)(1) that are not applied to common equity tier 1 capital must be applied to tier 1 capital instead, in accordance with Table 10. Advanced approaches FDIC-supervised institutions will begin the transition on January 1, 2014, and other FDIC-supervised institutions will begin the transition on January 1, 2015.

TABLE 10 - TRANSITION ADJUSTMENTS UNDER SECTION 22(b)(1)

Transition Period	Transition adjustments under section 22(b)(1)	
	Percentage of the adjustment applied to common equity tier 1 capital	Percentage of the adjustment applied to tier 1 capital
January 1, 2014, to December 31, 2014 (advanced approaches FDIC-supervised institutions only)	20	80
January 1, 2015, to December 31, 2015	40	60
January 1, 2016, to December 31, 2016	60	40
January 1, 2017, to December 31, 2017	80	20
January 1, 2018 and thereafter	100	0

4. Phase-out of Current Accumulated Other Comprehensive Income Regulatory Capital Adjustments

Under the interim final rule, the transition period for the inclusion of the aggregate amount of: (1) unrealized gains on available-for-sale equity securities; (2) net unrealized gains or losses on available-for-sale debt securities; (3) any amounts recorded in AOCI attributed to defined benefit postretirement plans resulting from the initial and subsequent application of the relevant GAAP standards that pertain to such plans (excluding, at the FDIC-supervised institution's option, the portion relating to pension assets deducted under section 22(a)(5)); (4) accumulated net gains or losses on cash-flow hedges related to items that are reported on the

balance sheet at fair value included in AOCI; and (5) net unrealized gains or losses on held-to-maturity securities that are included in AOCI (transition AOCI adjustment amount) only applies to advanced approaches FDIC-supervised institutions and other FDIC-supervised institutions that have not made an AOCI opt-out election under section 22(b)(2) of the rule and described in section V.B of this preamble. Advanced approaches FDIC-supervised institutions will begin the phase out of the current AOCI regulatory capital adjustments on January 1, 2014; other FDIC-supervised institutions that have not made the AOCI opt-out election will begin making these adjustments on January 1, 2015. Specifically, if an FDIC-supervised institution's transition AOCI adjustment amount is positive, it will adjust its common equity tier 1 capital by deducting the appropriate percentage of such aggregate amount in accordance with Table 11 below. If such amount is negative, it will adjust its common equity tier 1 capital by adding back the appropriate percentage of such aggregate amount in accordance with Table 11 below. The agencies did not include net unrealized gains or losses on held-to-maturity securities that are not included in AOCI as part of the transition AOCI adjustment amount in the proposal. However, the FDIC has decided to add such an adjustment as it reflects the FDIC's approach towards AOCI adjustments in the general risk-based capital rules.

TABLE 11 – 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
January 1, 2014, to December 31, 2014 (advanced approaches FDIC-supervised institutions only)	80
January 1, 2015, to December 31, 2015 (advanced approaches	60

FDIC-supervised institutions and FDIC-supervised institutions that have not made an opt-out election)	
January 1, 2016, to December 31, 2016 (advanced approaches FDIC-supervised institutions and FDIC-supervised institutions that have not made an opt-out election)	40
January 1, 2017, to December 31, 2017 (advanced approaches FDIC-supervised institutions and FDIC-supervised institutions that have not made an opt-out election)	20
January 1, 2018 and thereafter (advanced approaches FDIC-supervised institutions and FDIC-supervised institutions that have not made an opt-out election)	0

Beginning on January 1, 2018, advanced approaches FDIC-supervised institutions and other FDIC-supervised institutions that have not made an AOCI opt-out election must include AOCI in common equity tier 1 capital, with the exception of accumulated net gains and losses on cash-flow hedges related to items that are not measured at fair value on the balance sheet, which must be excluded from common equity tier 1 capital.

5. *Phase-out of Unrealized Gains on Available for Sale Equity Securities in Tier 2 Capital*

Advanced approaches FDIC-supervised institutions and FDIC-supervised institutions not subject to the advanced approaches rule that have not made an AOCI opt-out election will decrease the amount of unrealized gains on AFS preferred stock classified as an equity security under GAAP and equity exposures currently held in tier 2 capital during the transition period in accordance with Table 12. An advanced approaches FDIC-supervised institution will begin the adjustments on January 1, 2014; all other FDIC-supervised institutions that have not made an AOCI opt-out election will begin the adjustments on January 1, 2015.

TABLE 12 – PERCENTAGE OF UNREALIZED GAINS ON AFS PREFERRED STOCK CLASSIFIED AS AN EQUITY SECURITY UNDER GAAP AND EQUITY EXPOSURES THAT MAY BE INCLUDED IN TIER 2 CAPITAL

Transition Period	Percentage of unrealized gains on AFS preferred stock classified as an equity security under GAAP and equity exposures that may be included in tier 2 capital
January 1, 2014, to December 31, 2014 (advanced approaches FDIC-supervised institutions only)	36
January 1, 2015, to December 31, 2015 (advanced approaches FDIC-supervised institutions and FDIC-supervised institutions that have not made an opt-out election)	27
January 1, 2016, to December 31, 2016 (advanced approaches FDIC-supervised institutions and FDIC-supervised institutions	18

that have not made an opt-out election)	
January 1, 2017, to December 31, 2017 (advanced approaches FDIC-supervised institutions and FDIC-supervised institutions that have not made an opt-out election)	9
January 1, 2018 and thereafter (advanced approaches FDIC-supervised institutions and FDIC-supervised institutions that have not made an opt-out election)	0

6. Phase-in of Deductions Related to Investments in Capital Instruments and to the Items Subject to the 10 and 15 Percent Common Equity Tier 1 Capital Deduction Thresholds (Sections 22(c) and 22(d)) of the Interim final rule

Under the interim final rule, an FDIC-supervised institution must calculate the appropriate deductions under sections 22(c) and 22(d) of the rule related to investments in the capital of unconsolidated financial institutions 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 FDIC-supervised institution 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 13. Advanced approaches FDIC-supervised institutions will apply the transition framework beginning January 1, 2014. All other FDIC-supervised institutions will begin applying the transition framework on January 1, 2015. During the transition period, an FDIC-supervised institution will make the aggregate common equity tier

1 capital deductions related to these items in accordance with the percentages outlined in Table 13 and must apply a 100 percent risk-weight to the aggregate amount of such items that is not deducted. On January 1, 2018, and thereafter, each FDIC-supervised institution will 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 13 - 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
January 1, 2014, to December 31, 2014 (advanced approaches FDIC-supervised institutions only)	20
January 1, 2015, to December 31, 2015	40
January 1, 2016, to December 31, 2016	60
January 1, 2017, to December 31, 2017	80
January 1, 2018 and thereafter	100

During the transition period, FDIC-supervised institutions will phase in the deduction requirement for the amounts of DTAs arising from temporary differences that could not be realized through net operating loss carryback, MSAs, and significant investments in the capital of unconsolidated financial institutions in the form of common stock that exceed the 10 percent threshold in section 22(d) according to Table 13.

During the transition period, FDIC-supervised institutions will not be subject to the methodology to calculate the 15 percent common equity deduction threshold for 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 described in section 22(d) of the interim final rule. During the transition period, an FDIC-supervised institution will be required to deduct from its common equity tier 1 capital the percentage as set forth in Table 13 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 FDIC-supervised institution's common equity tier 1 capital after making the deductions and adjustments required under sections 22(a) through (c).

D. Transition Provisions for Non-qualifying Capital Instruments

Under the interim final rule, beginning on January 1, 2014, an advanced approaches depository institution and beginning on January 1, 2015, a depository institution that is not a depository institution subject to the advanced approaches rule may include in regulatory capital debt or equity instruments issued prior to September 12, 2010 that do not meet the criteria for additional tier 1 or tier 2 capital instruments in section 20 of the interim final rule, but that were included in tier 1 or tier 2 capital, respectively, as of September 12, 2010 (non-qualifying capital instruments issued prior to September 12, 2010). These instruments may be included up to the percentage of the outstanding principal amount of such non-qualifying capital instruments as of the effective date of the interim final rule in accordance with the phase-out schedule in Table 14.

As of January 1, 2014 for advanced approaches FDIC-supervised institutions, and January 1, 2015 for all other FDIC-supervised institutions, debt or equity instruments issued after

September 12, 2010, that do not meet the criteria for additional tier 1 or tier 2 capital instruments in section 20 of the interim final rule may not be included in additional tier 1 or tier 2 capital.

TABLE 14 -- PERCENTAGE OF NON-QUALIFYING CAPITAL INSTRUMENTS ISSUED PRIOR TO SEPTEMBER 12, 2010 INCLUDABLE IN ADDITIONAL TIER 1 OR TIER 2 CAPITAL

Transition Period (Calendar year)	Percentage of non-qualifying capital instruments issued prior to September 2010 includable in additional tier 1 or tier 2 capital for FDIC-supervised institutions
Calendar year 2014 (advanced approaches FDIC-supervised institutions only)	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

Under the transition provisions in the interim final rule, an FDIC-supervised institution is allowed to include in regulatory capital a portion of the common equity tier 1, tier 1, or total capital minority interest that is disqualified from regulatory capital as a result of the requirements and limitations outlined in section 21 (surplus minority interest). If an FDIC-supervised institution has surplus minority interest outstanding when the interim final rule becomes effective, that surplus minority interest will be subject to the phase-out schedule outlined in Table 16. Advanced approaches FDIC-supervised institutions must begin to phase out surplus minority interest in accordance with Table 16 beginning on January 1, 2014. All other FDIC-supervised institutions will begin the phase out for surplus minority interest on January 1, 2015.

During the transition period, an FDIC-supervised institution will also be able to include in tier 1 or total capital a portion of the instruments issued by a consolidated subsidiary that qualified as tier 1 or total capital of the FDIC-supervised institution on the date the rule becomes effective, but that do not qualify as tier 1 or total capital under section 20 of the interim final rule (non-qualifying minority interest) in accordance with Table 16.

TABLE 16 —PERCENTAGE OF THE AMOUNT OF SURPLUS OR NON-QUALIFYING MINORITY INTEREST INCLUDABLE IN REGULATORY CAPITAL DURING TRANSITION PERIOD

Transition Period	Percentage of the amount of surplus or non-qualifying minority interest that can be included in regulatory capital during the transition period
January 1, 2014, to December 31, 2014 (advanced approaches FDIC-supervised institutions only)	80
January 1, 2015, to December 31, 2015	60
January 1, 2016, to December 31, 2016	40

January 1, 2017, to December 31, 2017	20
January 1, 2018 and thereafter	0

VIII. Standardized Approach for Risk-weighted Assets

In the Standardized Approach NPR, the agencies proposed to revise methodologies for calculating risk-weighted assets. As discussed above and in the proposal, these revisions were intended to harmonize the agencies' rules for calculating risk-weighted assets and to enhance risk sensitivity and remediate weaknesses identified over recent years.[102] The proposed revisions incorporated elements of the Basel II standardized approach[103] as modified by the 2009 Enhancements, certain aspects of Basel III, and other proposals in recent consultative papers published by the BCBS.[104] Consistent with section 939A of the Dodd-Frank Act, the agencies also proposed alternatives to credit ratings for calculating risk weights for certain assets.

The proposal also included potential revisions for the recognition of credit risk mitigation that would allow for greater recognition of financial collateral and a wider range of eligible guarantors. In addition, the proposal set forth more risk-sensitive treatments for residential mortgages, equity exposures and past due loans, derivatives and repo-style transactions cleared through CCPs, and certain commercial real estate exposures that typically have higher credit

[102] 77 FR 52888 (August 30, 2012).

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

[104] 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; ''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.

risk, as well as operational requirements for securitization exposures. The agencies also proposed to apply disclosure requirements to banking organizations with $50 billion or more in total assets that are not subject to the advanced approaches rule.

The agencies received a significant number of comments regarding the proposed standardized approach for risk-weighted assets. Although a few commenters observed that the proposals would provide a sound framework for determining risk-weighted assets for all banking organizations that would generally benefit U.S. banking organizations, a significant number of other commenters asserted that the proposals were too complex and burdensome, especially for smaller banking organizations, and some argued that it was inappropriate to apply the proposed requirements to such banking organizations because such institutions did not cause the recent financial crisis. Other commenters expressed concern that the new calculation for risk-weighted assets would adversely affect banking organizations' regulatory capital ratios and that smaller banking organizations would have difficulties obtaining the data and performing the calculations required by the proposals. A number of commenters also expressed concern about the burden of the proposals in the context of multiple new regulations, including new standards for mortgages and increased regulatory capital requirements generally. One commenter urged the agencies to maintain key aspects of the proposed risk-weighted asset treatment for community banking organizations, but generally requested that the agencies reduce the perceived complexity. The FDIC has considered these comments and, where applicable, have focused on simplicity, comparability, and broad applicability of methodologies for U.S. banking organizations under the standardized approach.

Some commenters asked that the proposed requirements be optional for community banking organizations until the effects of the proposals have been studied, or that the proposed

standardized approach be withdrawn entirely. A number of the commenters requested specific modifications to the proposals. For example, some requested an exemption for community banking organizations from the proposed due diligence requirements for securitization exposures. Other commenters requested that the agencies grandfather the risk weighting of existing loans, arguing that doing so would lessen the proposed rule's implementation burden.

To address commenters' concerns about the standardized approach's burden and the accessibility of credit, the FDIC has revised elements of the proposed rule, as described in further detail below. In particular, the FDIC has modified the proposed approach to risk weighting residential mortgage loans to reflect the approach in the FDIC's general risk-based capital rules. The FDIC believes the standardized approach more accurately captures the risk of banking organizations' assets and, therefore, is applying this aspect of the interim final rule to all banking organizations subject to the rule.

This section of the preamble describes in detail the specific proposals for the standardized treatment of risk-weighted assets, comments received on those proposals, and the provisions of the interim final rule in subpart D as adopted by the FDIC. These sections of the preamble discuss how subpart D of the interim final rule differs from the general risk-based capital rules, and provides examples for how an FDIC-supervised institution must calculate risk-weighted asset amounts under the interim final rule.

Beginning on January 1, 2015, all FDIC-supervised institutions will be required to calculate risk-weighted assets under subpart D of the interim final rule. Until then, FDIC-supervised institutions must calculate risk-weighted assets using the methodologies set forth in the general risk-based capital rules. Advanced approaches FDIC-supervised institutions are

subject to additional requirements, as described in section III. D of this preamble, regarding the timeframe for implementation.

A. Calculation of Standardized Total Risk-weighted Assets

Consistent with the Standardized Approach NPR, the interim final rule requires an FDIC-supervised institution to calculate its risk-weighted asset amounts for its on- and off-balance sheet exposures and, for market risk banks only, standardized market risk-weighted assets as determined under subpart F. [105] Risk-weighted asset amounts generally are 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 are 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.

An FDIC-supervised institution must 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 (2) market risk-weighted assets, if applicable, minus (3) the amount of the FDIC-supervised institution's ALLL that is not included in tier 2 capital, and any amounts of allocated transfer risk reserves.

B. Risk-weighted Assets for General Credit Risk

Consistent with the proposal, under the interim final rule total risk-weighted assets for general credit risk equals the sum of the risk-weighted asset amounts as calculated under section

[105] This interim final rule incorporates the market risk rule into the integrated regulatory framework as subpart F of part 324.

31(a) of the interim final rule. General credit risk exposures include an FDIC-supervised institution's on-balance sheet exposures (other than cleared transactions, default fund contributions to CCPs, securitization exposures, and equity exposures, each as defined in section 2 of the interim final rule), exposures to 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.

Under the interim final rule, the exposure amount for the on-balance sheet component of an exposure is generally the FDIC-supervised institution's carrying value for the exposure as determined under GAAP. The FDIC believes that using GAAP to determine the amount and nature of an exposure provides a consistent framework that can be easily applied across all FDIC-supervised institutions. Generally, FDIC-supervised institutions already use GAAP to prepare their financial statements and regulatory reports, and this treatment reduces potential burden that could otherwise result from requiring FDIC-supervised institutions to comply with a separate set of accounting and measurement standards for risk-based capital calculation purposes under non-GAAP standards, such as regulatory accounting practices or legal classification standards.

For purposes of the definition of exposure amount for AFS or held-to-maturity debt securities and AFS preferred stock not classified as equity under GAAP that are held by an FDIC-supervised institution that has made an AOCI opt-out election, the exposure amount is the FDIC-supervised institution's carrying value (including net accrued but unpaid interest and fees) for the exposure, less any net unrealized gains, and plus any net unrealized losses. For purposes of the definition of exposure amount for AFS preferred stock classified as an equity security under GAAP that is held by a banking organization that has made an AOCI opt-out election, the

exposure amount is the banking organization's carrying value (including net accrued but unpaid interest and fees) for the exposure, less any net unrealized gains that are reflected in such carrying value but excluded from the banking organization's regulatory capital.

In most cases, the exposure amount for an off-balance sheet component of an exposure is determined by multiplying the notional amount of the off-balance sheet component by the appropriate CCF as determined under section 33 of the interim final rule. The exposure amount for an OTC derivative contract or cleared transaction that is a derivative is determined under section 34 of the interim final rule, whereas exposure amounts for collateralized OTC derivative contracts, collateralized cleared transactions that are derivatives, repo-style transactions, and eligible margin loans are determined under section 37 of the interim final rule.

1. Exposures to Sovereigns

Consistent with the proposal, the interim final rule defines a sovereign as a central government (including the U.S. government) or an agency, department, ministry, or central bank of a central government. In the Standardized Approach NPR, the agencies proposed to retain the general risk-based capital rules' risk weights for exposures to and claims directly and unconditionally guaranteed by the U.S. government or its agencies. The interim final rule adopts the proposed treatment and provides that 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 receive a zero percent risk weight.[106] Consistent with the general risk-based capital rules, the portion of

[106] Similar to the 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, for example, asset servicing

a deposit or other exposure insured or otherwise unconditionally guaranteed by the FDIC or the National Credit Union Administration also is assigned a zero percent risk weight. An exposure conditionally guaranteed by the U.S. government, its central bank, or a U.S. government agency receives a 20 percent risk weight.[107] This includes an exposure that is conditionally guaranteed by the FDIC or the National Credit Union Administration.

The agencies proposed in the Standardized Approach NPR to revise the risk weights for exposures to foreign sovereigns. 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 (OECD) and, as applicable, whether the exposure is unconditionally or conditionally guaranteed by the sovereign.[108]

Under the proposed rule, the risk weight for a foreign sovereign exposure would have been determined using OECD Country Risk Classifications (CRCs) (the CRC methodology).[109] The CRCs reflect an assessment of country risk, used to set interest rate charges for transactions

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requirements. See 12 CFR part 325, appendix A, section II.C. (footnote 35) (state nonmember banks) and 12 CFR 390.466 (state savings associations).

[107] 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, FDIC-supervised institutions should consult with the FDIC to determine the appropriate risk-based capital treatment for specific loss-sharing agreements.

[108] 12 CFR part 325, appendix A, section II.C (state nonmember banks) and 12 CFR 390.466(state savings associations).

[109] 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.

covered by the OECD arrangement on export credits. The CRC methodology classifies countries 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. Using CRCs to risk weight sovereign exposures is an option that is included in the Basel II standardized framework. The agencies proposed to map risk weights ranging from 0 percent to 150 percent 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 agencies also proposed to assign a 150 percent risk weight to foreign 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. The proposal defined sovereign default as 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 or interest fully and on a timely basis, arrearages, or restructuring. Restructuring 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 received several comments on the proposed risk weights for foreign sovereign exposures. Some commenters criticized the proposal, arguing that CRCs are not sufficiently risk sensitive and basing risk weights on CRCs unduly benefits certain jurisdictions with unstable fiscal positions. A few commenters asserted that the increased burden associated with tracking CRCs to determine risk weights outweighs any increased risk sensitivity gained by using CRCs relative to the general risk-based capital rules. Some commenters also requested

that the CRC methodology be disclosed so that banking organizations could perform their own due diligence. One commenter also indicated that community banking organizations should be permitted to maintain the treatment under the general risk-based capital rules.

Following the publication of the proposed rule, the OECD determined that certain high-income countries that received a CRC of 0 in 2012 will no longer receive any CRC.[110]

Despite the limitations associated with risk weighting foreign sovereign exposures using CRCs, the FDIC has decided to retain this methodology, modified as described below to take into account that some countries will no longer receive a CRC. Although the FDIC recognizes that the risk sensitivity provided by the CRCs is limited, it considers CRCs to be a reasonable alternative to credit ratings for sovereign exposures and the CRC methodology to be more granular and risk sensitive than the current risk-weighting methodology based solely on OECD membership. Furthermore, the OECD regularly updates CRCs and makes the assessments publicly available on its website.[111] Accordingly, the FDIC believes that risk weighting foreign sovereign exposures with reference to CRCs (as applicable) should not unduly burden FDIC-supervised institutions. Additionally, the 150 percent risk weight assigned to defaulted sovereign exposures should mitigate the concerns raised by some commenters that the use of CRCs assigns inappropriate risk weights to exposures to countries experiencing fiscal stress.

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[110] See http://www.oecd.or/tad/xcred/cat0.htm; Participants to the Arrangement on Officially Supported Export Credits agreed that the automatic classification of High Income OECD and High Income Euro Area countries in Country Risk Category Zero should be terminated. In the future, these countries will no longer be classified but will remain subject to the same market credit risk pricing disciplines that are applied to all Category Zero countries. This means that the change will have no practical impact on the rules that apply to the provision of official export credits.

[111] 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.

The interim final rule assigns risk weights to foreign sovereign exposures as set forth in Table 17 below. The FDIC modified the interim final rule to reflect a change in OECD practice for assigning CRCs for certain member countries so that those member countries that no longer receive a CRC are assigned a zero percent risk weight. Applying a zero percent risk weight to exposures to these countries is appropriate because they will remain subject to the same market credit risk pricing formulas of the OECD's rating methodologies that are applied to all OECD countries with a CRC of 0. In other words, OECD member countries that are no longer assigned a CRC exhibit a similar degree of country risk as that of a jurisdiction with a CRC of zero. The interim final rule, therefore, provides a zero percent risk weight in these cases. Additionally, a zero percent risk weight for these countries is generally consistent with the risk weight they would receive under the FDIC's general risk-based capital rules.

TABLE 17– RISK WEIGHTS FOR SOVEREIGN EXPOSURES

		Risk Weight (in percent)
CRC	0-1	0
	2	20
	3	50
	4-6	100
	7	150
OECD Member with No CRC		0
Non-OECD Member with No CRC		100
Sovereign Default		150

Consistent with the proposal, the interim final rule provides that if a banking supervisor in a sovereign jurisdiction allows banking organizations in that jurisdiction to apply a lower risk weight to an exposure to the sovereign than Table 17 provides, a U.S. FDIC-supervised institution may assign the lower risk weight to an exposure to the sovereign, provided the exposure is denominated in the sovereign's currency and the U.S. FDIC-supervised institution has at least an equivalent amount of liabilities in that foreign currency.

2. Exposures to Certain Supranational Entities and Multilateral Development Banks

Under the general risk-based capital rules, exposures to certain supranational entities and MDBs receive a 20 percent risk weight. Consistent with the Basel II standardized framework, the agencies proposed 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. The agencies also proposed to apply a zero percent risk weight to exposures to an MDB in accordance with the Basel framework. The proposal defined 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.

As explained in the proposal, 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. The FDIC has adopted this aspect of the proposal without change. Exposures to regional development banks and multilateral lending institutions that are not covered under the definition of MDB generally are treated as corporate exposures assigned to the 100 percent risk weight category.

3. Exposures to Government-sponsored Entities

The general risk-based capital rules assign a 20 percent risk weight to exposures to GSEs that are not equity exposures and a 100 percent risk weight to GSE preferred stock in the case of the Federal Reserve and the FDIC (the OCC has assigned a 20 percent risk weight to GSE preferred stock).

The agencies proposed to continue to assign a 20 percent risk weight to exposures to GSEs that are not equity exposures and to also assign a 100 percent risk weight to preferred stock issued by a GSE. As explained in the proposal, the agencies believe these risk weights remain appropriate for the GSEs under their current circumstances, including those in the conservatorship of the Federal Housing Finance Agency and receiving capital support from the U.S. Treasury. The FDIC maintains that the obligations of the GSEs, as private corporations whose obligations are not explicitly guaranteed by the full faith and credit of the United States, should not receive the same treatment as obligations that have such an explicit guarantee.

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 received a 100 percent risk weight.

The proposed rule would assign a 20 percent risk weight to exposures to U.S. depository institutions and credit unions.[112] Consistent with the Basel II standardized framework, under the proposed rule, 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 foreign bank's home country, based on the assignment of risk weights by CRC, as discussed above.[113] 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 foreign 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.

A few commenters asserted that the proposed 20 percent risk weight for exposures to U.S. banking organizations – when compared to corporate exposures that are assigned a 100 percent risk weight – would continue to encourage banking organizations to become overly concentrated in the financial sector. The FDIC has concluded that the proposed 20 percent risk weight is an appropriate reflection of risk for this exposure type when taking into consideration the extensive regulatory and supervisory frameworks under which these institutions operate. In addition, the FDIC notes that exposures to the capital of other financial institutions, including depository institutions and credit unions, are subject to deduction from capital if they exceed

[112] A depository institution is defined in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813(c)(1)). Under this interim final rule, a credit union refers to an insured credit union as defined under the Federal Credit Union Act (12 U.S.C. 1752(7)).

[113] 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 the proposal, home country meant the country where an entity is incorporated, chartered, or similarly established.

certain limits as set forth in section 22 of the interim final rule (discussed above in section V.B of this preamble). Therefore, the interim final rule retains, as proposed, the 20 percent risk weight for exposures to U.S. FDIC-supervised institutions.

The FDIC has adopted the proposal with modifications to take into account the OECD's decision to withdraw CRCs for certain OECD member countries. Accordingly, exposures to a foreign bank in a country that does not have a CRC, but that is a member of the OECD, are assigned a 20 percent risk weight and exposures to a foreign bank in a non-OECD member country that does not have a CRC continue to receive a 100 percent risk weight.

Additionally, the FDIC has adopted the proposed requirement that exposures to a financial institution that are included in the regulatory capital of such financial institution receive a risk weight of 100 percent, unless the exposure is (1) an equity exposure, (2) a significant investment in the capital of an unconsolidated financial institution in the form of common stock under section 22 of the interim final rule, (3) an exposure that is deducted from regulatory capital under section 22 of the interim final rule, or (4) an exposure that is subject to the 150 percent risk weight under Table 2 of section 32 of the interim final rule.

As described in the Standardized Approach NPR, 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.[114] In particular, the framework was revised to remove the sovereign floor for trade finance-related claims on banking organizations under the Basel II

[114] 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).

standardized approach.[115] The proposal incorporated this revision and would have permitted 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.[116] Consistent with the proposal, the interim final rule permits an FDIC-supervised institution 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.

As discussed in the proposal, although the Basel capital framework permits exposures to securities firms that meet certain requirements to be assigned the same risk weight as exposures to depository institutions, the agencies do not believe that the risk profile of securities firms is sufficiently similar to depository institutions to justify assigning the same risk weight to both exposure types. Therefore, the agencies proposed that banking organizations assign a 100 percent risk weight to exposures to securities firms, which is the same risk weight applied to BHCs, SLHCs, and other financial institutions that are not insured depository institutions or credit unions, as described in section VIII.B of this preamble.

Several commenters asserted that the interim final rule should be consistent with the Basel framework and permit lower risk weights for exposures to securities firms, particularly for securities firms in a sovereign jurisdiction with a CRC of 0 or 1. The FDIC considered these comments and has concluded that that exposures to securities firms exhibit a similar degree of

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[115] 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.

[116] One commenter requested that the agencies confirm whether short-term self-liquidating trade finance instruments are considered exempt from the one-year maturity floor in the advances approaches rule. Section 131(d)(7) of the interim final rule provides that a trade-related letter of credit is exempt from the one-year maturity floor.

risk as exposures to other financial institutions that are assigned a 100 percent risk weight, because of the nature and risk profile of their activities, which are more expansive and exhibit more varied risk profiles than the activities permissible for depository institutions and credit unions. Accordingly, the FDIC has adopted the 100 percent risk weight for securities firms without change.

5. Exposures to Public-sector Entities

The proposal defined a PSE as a state, local authority, or other governmental subdivision below the level of a sovereign, which includes U.S. states and municipalities. The proposed definition did 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. The agencies proposed to define a general obligation as a bond or similar obligation that is backed by the full faith and credit of a PSE, whereas a revenue obligation would be defined as a bond or similar obligation that is an obligation of a PSE, but which the PSE has committed to repay with revenues from a specific project rather than general tax funds. In the interim final rule, the FDIC is adopting these definitions as proposed.

The agencies proposed to 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. These are the risk weights assigned to U.S. states and municipalities under the general risk-based capital rules.

Some commenters asserted that available default data does not support a differentiated treatment between revenue obligations and general obligations. In addition, some commenters contended that higher risk weights for revenue obligation bonds would needlessly and adversely

affect state and local agencies' ability to meet the needs of underprivileged constituents. One commenter specifically recommended assigning a 20 percent risk weight to investment-grade revenue obligations. Another commenter recommended that exposures to U.S. PSEs should receive the same treatment as exposures to the U.S. government.

The FDIC considered these comments, including with respect to burden on state and local programs, but concluded that the higher regulatory capital requirement for revenue obligations is appropriate because those obligations are dependent on revenue from specific projects and generally a PSE is not legally obligated to repay these obligations from other revenue sources. Although some evidence may suggest that there are not substantial differences in credit quality between general and revenue obligation exposures, the FDIC believes that such dependence on project revenue presents more credit risk relative to a general repayment obligation of a state or political subdivision of a sovereign. Therefore, the proposed differentiation of risk weights between general obligation and revenue exposures is retained in the interim final rule. The FDIC also continues to believe that PSEs collectively pose a greater credit risk than U.S. sovereign debt and, therefore, are appropriately assigned a higher risk weight under the interim final rule.

Consistent with the Basel II standardized framework, the agencies proposed to require banking organizations to risk weight exposures to a non-U.S. PSE based on (1) the CRC assigned to the PSE's home country and (2) whether the exposure is a general obligation or a revenue obligation. The risk weights assigned to revenue obligations were proposed to be higher than the risk weights assigned to a general obligation issued by the same PSE.

For purposes of the interim final rule, the FDIC has adopted the proposed risk weights for non-U.S. PSEs with modifications to take into account the OECD's decision to withdraw CRCs for certain OECD member countries (discussed above), as set forth in Table 18 below. Under

the interim final rule, exposures to a non-U.S. PSE in a country that does not have a CRC and is not an OECD member 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 receive a 150 percent risk weight.

TABLE 18 – 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
CRC	0-1	20	50
	2	50	100
	3	100	100
	4-7	150	150
OECD Member with No CRC		20	50
Non-OECD member with No CRC		100	100
Sovereign Default		150	150

Consistent with the general risk-based capital rules as well as the proposed rule, an FDIC-supervised institution may apply a different risk weight to an exposure to a non-U.S. PSE if the banking organization supervisor in that PSE's home country allows supervised institutions to assign the alternative risk weight to exposures to that PSE. 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 the sovereign of that PSE's home country.

6. Corporate Exposures

Generally consistent with the general risk-based capital rules, the agencies proposed to require banking organizations to assign a 100 percent risk weight to all corporate exposures, including bonds and loans. The proposal defined 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, a credit union, a PSE, a GSE, a residential mortgage exposure, a pre-sold construction loan, a statutory multifamily mortgage, a high-volatility commercial real estate (HVCRE) exposure, a cleared transaction, a default fund contribution, a securitization exposure, an equity exposure, or an unsettled transaction. The definition also captured all exposures that are not otherwise included in another specific exposure category.

Several commenters recommended differentiating the proposed risk weights for corporate bonds based on a bond's credit quality. Other commenters requested the agencies align the interim final rule with the Basel international standard that aligns risk weights with credit ratings. Another commenter contended that corporate bonds should receive a 50 percent risk weight, arguing that other exposures included in the corporate exposure category (such as commercial and industrial bank loans) are empirically of greater risk than corporate bonds.

One commenter requested that the standardized approach provide a distinct capital treatment of a 75 percent risk weight for retail exposures, consistent with the international standard under Basel II. The FDIC has concluded that the proposed 100 percent risk weight assigned to retail exposures is appropriate given their risk profile in the United States and has retained the proposed treatment in the interim final rule. Consistent with the proposal, the interim final rule neither defines nor provides a separate treatment for retail exposures in the standardized approach.

As described in the proposal, the agencies removed the use of ratings from the regulatory capital framework, consistent with section 939A of the Dodd-Frank Act. The agencies therefore evaluated a number of alternatives to credit ratings to provide a more granular risk weight

treatment for corporate exposures.[117] For example, the agencies considered market-based alternatives, such as the use of credit default and bond spreads, and use of particular indicators or parameters to differentiate between relative levels of credit risk. However, the agencies viewed each of the possible alternatives as having significant drawbacks, including their operational complexity, or insufficient development. For instance, the agencies were concerned that bond markets may sometimes misprice risk and bond spreads may reflect factors other than credit risk. The agencies also were concerned that such approaches could introduce undue volatility into the risk-based capital requirements.

The FDIC considered suggestions offered by commenters and understands that a 100 percent risk weight may overstate the credit risk associated with some high-quality bonds. However, the FDIC believes that a single risk weight of less than 100 percent would understate the risk of many corporate exposures and, as explained, has not yet identified an alternative methodology to credit ratings that would provide a sufficiently rigorous basis for differentiating the risk of various corporate exposures. In addition, the FDIC believes that, on balance, a 100 percent risk weight is generally representative of a well-diversified corporate exposure portfolio. The interim final rule retains without change the 100 percent risk weight for all corporate exposures as well as the proposed definition of corporate exposure.

A few commenters requested clarification on the treatment for general-account insurance products. Under the final rule, consistent with the proposal, if a general-account exposure is to an organization that is not a banking organization, such as an insurance company, the exposure must receive a risk weight of 100 percent. Exposures to securities firms are subject to the corporate exposure treatment under the final rule, as described in section VIII.B of this preamble.

[117] See, for example, 76 FR 73526 (Nov. 29, 2011) and 76 FR 73777 (Nov. 29, 2011).

7. Residential Mortgage Exposures

Under the general risk-based capital requirements, first-lien residential mortgages made in accordance with prudent underwriting standards on properties that are owner-occupied or rented typically are assigned to the 50 percent risk-weight category. Otherwise, residential mortgage exposures are assigned to the 100 percent risk weight category.

The proposal would have substantially modified the risk-weight framework applicable to residential mortgage exposures and differed materially from both the general risk-based capital rules and the Basel capital framework. The agencies proposed to divide residential mortgage exposures into two categories. The proposal applied relatively low risk weights to residential mortgage exposures that did not have product features associated with higher credit risk, or "category 1" residential mortgages as defined in the proposal. The proposal defined all other residential mortgage exposures as "category 2" mortgages, which would receive relatively high risk weights. For both category 1 and category 2 mortgages, the proposed risk weight assigned also would have depended on the mortgage exposure's LTV ratio. Under the proposal, a banking organization would not be able to recognize private mortgage insurance (PMI) when calculating the LTV ratio of a residential mortgage exposure. Due to the varying degree of financial strength of mortgage insurance providers, the agencies stated that they did not believe that it would be prudent to consider PMI in the determination of LTV ratios under the proposal.

The agencies received a significant number of comments in opposition to the proposed risk weights for residential mortgages and in favor of retaining the risk-weight framework for residential mortgages in the general risk-based capital rules. Many commenters asserted that the increased risk weights for certain mortgages would inhibit lending to creditworthy borrowers,

particularly when combined with the other proposed statutory and regulatory requirements being implemented under the authority of the Dodd-Frank Act, and could ultimately jeopardize the recovery of a still-fragile residential real estate market. Various commenters asserted that the agencies did not provide sufficient empirical support for the proposal and stated the proposal was overly complex and would not contribute meaningfully to the risk sensitivity of the regulatory capital requirements. They also asserted that the proposal would require some banking organizations to raise revenue through other, more risky activities to compensate for the potential increased costs.

Commenters also indicated that the distinction between category 1 and category 2 residential mortgages would adversely impact certain loan products that performed relatively well even during the recent crisis, such as balloon loans originated by community banking organizations. Other commenters criticized the proposed increased capital requirements for various loan products, including balloon and interest-only mortgages. Community banking organization commenters in particular asserted that such mortgage products are offered to hedge interest-rate risk and are frequently the only option for a significant segment of potential borrowers in their regions.

A number of commenters argued that the proposal would place U.S. banking organizations at a competitive disadvantage relative to foreign banking organizations subject to the Basel II standardized framework, which generally assigns a 35 percent risk weight to residential mortgage exposures. Several commenters indicated that the proposed treatment would potentially undermine government programs encouraging residential mortgage lending to lower-income individuals and underserved regions. Commenters also asserted that PMI should receive explicit recognition in the interim final rule through a reduction in risk weights, given the

potential negative impact on mortgage availability (particularly to first-time borrowers) of the proposed risk weights.

In addition to comments on the specific elements of the proposal, a significant number of commenters alleged that the agencies did not sufficiently consider the potential impact of other regulatory actions on the mortgage industry. For instance, commenters expressed considerable concern regarding the new requirements associated with the Dodd-Frank Act's qualified mortgage definition under the Truth in Lending Act.[118] Many of these commenters asserted that when combined with this proposal, the cumulative effect of the new regulatory requirements could adversely impact the residential mortgage industry.

The agencies also received specific comments concerning potential logistical difficulties they would face implementing the proposal. Many commenters argued that tracking loans by LTV and category would be administratively burdensome, requiring the development or purchase of new systems. These commenters requested that, at a minimum, existing mortgages continue to be assigned the risk weights they would receive under the general risk-based capital rules and exempted from the proposed rules. Many commenters also requested clarification regarding the method for calculating the LTV for first and subordinate liens, as well as how and whether a loan could be reclassified between the two residential mortgage categories. For instance, commenters raised various technical questions on how to calculate the LTV of a restructured mortgage and under what conditions a restructured loan could qualify as a category 1 residential mortgage exposure.

[118] The proposal was issued prior to publication of the Consumer Financial Protection Bureau's final rule regarding qualified mortgage standards. See 78 FR 6407 (January 30, 2013).

The FDIC considered the comments pertaining to the residential mortgage proposal, particularly comments regarding the issuance of new regulations designed to improve the quality of mortgage underwriting and to generally reduce the associated credit risk, including the final definition of "qualified mortgage" as implemented by the Consumer Financial Protection Bureau (CFPB) pursuant to the Dodd-Frank Act.[119] Additionally, the FDIC is mindful of the uncertain implications that the proposal, along with other mortgage-related rulemakings, could have had on the residential mortgage market, particularly regarding underwriting and credit availability. The FDIC also considered the commenters' observations about the burden of calculating the risk weights for FDIC-supervised institutions' existing mortgage portfolios, and have taken into account the commenters' concerns about the availability of different mortgage products across different types of markets.

In light of these considerations, the FDIC has decided to retain in the interim final rule the treatment for residential mortgage exposures that is currently set forth in its general risk-based capital rules. The FDIC may develop and propose changes in the treatment of residential mortgage exposures in the future, and in that process, it intends to take into consideration structural and product market developments, other relevant regulations, and potential issues with implementation across various product types.

Accordingly, as under the general risk-based capital rules, the interim final rule assigns 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 an owner-occupied or rented one-to-four family residential property that meet prudential underwriting standards, including standards relating to the loan amount as a percentage of the appraised value of the property, are

[119] See id.

not 90 days or more past due or carried on non-accrual status, and that are not restructured or modified receive a 50 percent risk weight. If an FDIC-supervised institution holds the first and junior lien(s) on a residential property and no other party holds an intervening lien, the FDIC-supervised institution must treat the combined exposure as a single loan secured by a first lien for purposes of determining the loan-to-value ratio and assigning a risk weight. An FDIC-supervised institution must assign a 100 percent risk weight to all other residential mortgage exposures. Under the interim final rule, a residential mortgage guaranteed by the federal government through the Federal Housing Administration (FHA) or the Department of Veterans Affairs (VA) generally will be risk-weighted at 20 percent.

Consistent with the general risk-based capital rules, under the interim final rule, a residential mortgage exposure may be assigned to the 50 percent risk-weight category only if it is not restructured or modified. Under the interim final rule, consistent with the proposal, 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) is not considered to be restructured or modified. Several commenters from community banking organizations encouraged the agencies to broaden this exemption and not penalize banking organizations for participating in other successful loan modification programs. As described in greater detail in the proposal, the FDIC believes 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.

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 provisions of the Resolution Trust Corporation Refinancing, Restructuring, and Improvement Act of 1991 (RTCRRI Act).[120] The proposal maintained the same general treatment as the general risk-based capital rules and clarified and updated the manner in which the general risk-based capital rules define these exposures. Under the proposal, a pre-sold construction loan would be subject to a 50 percent risk weight unless the purchase contract is cancelled.

The FDIC is adopting this aspect of the proposal without change. The interim final rule defines a pre-sold construction loan, in part, 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 also harmonizes the FDIC's prior regulations. Under the interim final rule, a multifamily mortgage that does not meet the definition of a statutory multifamily mortgage is treated as a corporate exposure.

9. High-volatility Commercial Real Estate

Supervisory experience has demonstrated that certain acquisition, development, and constructions (ADC) loans (which are a subset of commercial real estate exposures) present particular risks for which the FDIC believes FDIC-supervised institutions should hold additional

[120] 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.

capital. Accordingly, the agencies proposed to require banking organizations to assign a 150 percent risk weight to any HVCRE exposure, which is higher than the 100 percent risk weight applied to such loans under the general risk-based capital rules. The proposal defined an HVCRE exposure to include any credit facility that finances or has financed the acquisition, development, or construction of real property, unless the facility finances one- to four-family residential mortgage property, or commercial real estate projects that meet certain prudential criteria, including with respect to the LTV ratio and capital contributions or expense contributions of the borrower.

Commenters criticized the proposed HVCRE definition as overly broad and suggested an exclusion for certain ADC loans, including: (1) ADC loans that are less than a specific dollar amount or have a debt service coverage ratio of 100 percent (rather than 80 percent, under the agencies' lending standards); (2) community development projects or projects financed by low-income housing tax credits; and (3) certain loans secured by agricultural property for the sole purpose of acquiring land. Several commenters asserted that the proposed 150 percent risk weight was too high for secured loans and would hamper local commercial development. Another commenter recommended the agencies increase the number of HVCRE risk-weight categories to reflect LTV ratios.

The FDIC has considered the comments and has decided to retain the 150 percent risk weight for HVCRE exposures (modified as described below), given the increased risk of these activities when compared to other commercial real estate loans. [121] The FDIC believes that segmenting HVCRE by LTV ratio would introduce undue complexity without providing a

[121] See the definition of "high-volatility commercial real estate exposure" in section 2 of the interim final rule.

sufficient improvement in risk sensitivity. The FDIC has also determined not to exclude from the HVCRE definition ADC loans that are characterized by a specified dollar amount or loans with a debt service coverage ratio greater than 80 percent because an arbitrary threshold would likely not capture certain ADC loans with elevated risks. Consistent with the proposal, a commercial real estate loan that is not an HVCRE exposure is treated as a corporate exposure.

Many commenters requested clarification as to whether all commercial real estate or ADC loans are considered HVCRE exposures. Consistent with the proposal, the interim final rule's HVCRE definition only applies to a specific subset of ADC loans and is, therefore, not applicable to all commercial real estate loans. Specifically, some commenters sought clarification on whether a facility would remain an HVCRE exposure for the life of the loan and whether owner-occupied commercial real estate loans are included in the HVCRE definition. The FDIC notes that when the life of the ADC project concludes and the credit facility is converted to permanent financing in accordance with the FDIC-supervised institution's normal lending terms, the permanent financing is not an HVCRE exposure. Thus, a loan permanently financing owner-occupied commercial real estate is not an HVCRE exposure. Given these clarifications, the FDIC believes that many concerns regarding the potential adverse impact on commercial development were, in part, driven by a lack of clarity regarding the definition of the HVCRE, and believes that the treatment of HVCRE exposures in the interim final rule appropriately reflects their risk relative to other commercial real estate exposures.

Commenters also sought clarification as to whether cash or securities used to purchase land counts as borrower-contributed capital. In addition, a few commenters requested further clarification on what constitutes contributed capital for purposes of the interim final rule.

Consistent with existing guidance, cash used to purchase land is a form of borrower contributed capital under the HVCRE definition.

In response to the comments, the interim final rule amends the proposed HVCRE definition to exclude loans that finance the acquisition, development, or construction of real property that would qualify as community development investments. The interim final rule does not require an FDIC-supervised institution to have an investment in the real property for it to qualify for the exemption: rather, if the real property is such that an investment in that property would qualify as a community development investment, then a facility financing acquisition, development, or construction of that property would meet the terms of the exemption. The FDIC has, however, determined not to give an automatic exemption from the HVCRE definition to all ADC loans to businesses or farms that have gross annual revenues of $1 million or less, although they could qualify for another exemption from the definition. For example, an ADC loan to a small business with annual revenues of under $1 million that meets the LTV ratio and contribution requirements set forth in paragraph (3) of the definition would qualify for that exemption from the definition as would a loan that finances real property that: provides affordable housing (including multi-family rental housing) for low to moderate income individuals; is used in the provision of community services for low to moderate income individuals; or revitalizes or stabilizes low to moderate income geographies, designated disaster areas, or underserved areas specifically determined by the federal banking agencies based on the needs of low- and moderate-income individuals in those areas. The final definition also exempts ADC loans for the purchase or development of agricultural land, which is defined as all land known to be used or usable for agricultural purposes (such as crop and livestock production), provided that the valuation of the agricultural land is based on its value for agricultural purposes

and the valuation does not consider any potential use of the land for non-agricultural commercial development or residential development.

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 exposures, except sovereign exposures and residential mortgage exposures, that are more than 90 days past due to reflect the increased risk of loss. Accordingly, to reflect the impaired credit quality of such exposures, the agencies proposed to require a banking organization to assign a 150 percent risk weight 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 number of commenters maintained that the proposed 150 percent risk weight is too high for various reasons. Specifically, several commenters asserted that ALLL is already reflected in the risk-based capital numerator, and therefore an increased risk weight double-counts the risk of a past-due exposure. Other commenters characterized the increased risk weight as procyclical and burdensome (particularly for community banking organizations), and maintained that it would unnecessarily discourage lending and loan modifications or workouts.

The FDIC has considered the comments and have decided to retain the proposed 150 percent risk weight for past-due exposures in the interim final rule. The FDIC notes that the ALLL is intended to cover estimated, incurred losses as of the balance sheet date, rather than unexpected losses. The higher risk weight on past due exposures ensures sufficient regulatory capital for the increased probability of unexpected losses on these exposures. The FDIC believes that any increased capital burden, potential rise in procyclicality, or impact on lending associated

with the 150 percent risk weight is justified given the overall objective of better capturing the risk associated with the impaired credit quality of these exposures.

One commenter requested clarification as to whether a banking organization could reduce the risk weight for past-due exposures from 150 percent when the carrying value is charged down to the amount expected to be recovered. For the purposes of the interim final rule, an FDIC-supervised institution must apply a 150 percent risk weight to all past-due exposures, including any amount remaining on the balance sheet following a charge-off, to reflect the increased uncertainty as to the recovery of the remaining carrying value.

11. Other Assets

Generally consistent with the general risk-based capital rules, the FDIC has decided to adopt, as proposed, the risk weights described below for exposures not otherwise assigned to a specific risk weight category. Specifically, an FDIC-supervised institution must assign:

(1) A zero percent risk weight to cash owned and held in all of an FDIC-supervised institution's offices or in transit; gold bullion held in the FDIC-supervised institution'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 CCP where there is no assumption of ongoing counterparty credit risk by the CCP 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 the interim final rule (other than exposures that would be deducted from tier 1 or tier 2 capital), including deferred acquisition costs (DAC) and value of business acquired (VOBA).

In addition, subject to the proposed transition arrangements under section 300 of the interim final rule, an FDIC-supervised institution must assign:

(1) A 100 percent risk weight to DTAs arising from temporary differences that the FDIC-supervised institution could realize through net operating loss carrybacks; and

(2) A 250 percent risk weight to the portion of MSAs and DTAs arising from temporary differences that the FDIC-supervised institution could not realize through net operating loss carrybacks that are not deducted from common equity tier 1 capital pursuant to section 22(d).

The agencies received a few comments on the treatment of DAC and VOBA. DAC represents certain costs incurred in the acquisition of a new contract or renewal insurance contract that are capitalized pursuant to GAAP. VOBA refers to assets that reflect revenue streams from insurance policies purchased by an insurance company. One commenter asked for clarification on risk weights for other types of exposures that are not assigned a specific risk weight under the proposal. Consistent with the proposal, under the interim final rule these assets receive a 100 percent risk weight, together with other assets not specifically assigned a different risk weight under the NPR.

Consistent with the general risk-based capital rules, the interim final rule retains the limited flexibility to address situations where exposures of an FDIC-supervised institution that are not exposures typically held by depository institutions do not fit wholly within the terms of another risk-weight category. Under the interim final rule, an FDIC-supervised institution may assign such exposures to the risk-weight category applicable under the capital rules for BHCs or covered SLHCs, provided that (1) the FDIC-supervised institution 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 interim final rule.

C. Off-balance Sheet Items

1. Credit Conversion Factors

Under the proposed rule, 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 contractual amount, by the applicable CCF. This treatment would apply to all off-balance sheet items, such as commitments, contingent items, guarantees, certain repo-style transactions, financial standby letters of credit, and forward agreements. The proposed rule, however, introduced new CCFs applicable to certain exposures, such as a higher CCF for commitments with an original maturity of one year or less that are not unconditionally cancelable.

Commenters offered a number of suggestions for revising the proposed CCFs that would be applied to off-balance sheet exposures. Commenters generally asked for lower CCFs that, according to the commenters, are more directly aligned with a particular off-balance sheet exposure's loss history. In addition, some commenters asked the agencies to conduct a calibration study to show that the proposed CCFs were appropriate.

The FDIC has decided to retain the proposed CCFs for off-balance sheet exposures without change for purposes of the interim final rule. The FDIC believes that the proposed CCFs meet its goals of improving risk sensitivity and implementing higher capital requirements for certain exposures through a simple methodology. Furthermore, alternatives proposed by commenters, such as exposure measures tied directly to a particular exposure's loss history, would create significant operational burdens for many small- and mid-sized banking

organizations, by requiring them to keep accurate historical records of losses and continuously adjust their capital requirements for certain exposures to account for new loss data. Such a system would be difficult for the FDIC to monitor, as the FDIC would need to verify the accuracy of historical loss data and ensure that capital requirements are properly applied across institutions. Incorporation of additional factors, such as loss history or increasing the number of CCF categories, would detract from the FDIC's stated goal of simplicity in its capital treatment of off-balance sheet exposures. Additionally, the FDIC believes that the CCFs, as proposed, were properly calibrated to reflect the risk profiles of the exposures to which they are applied and do not believe a calibration study is required.

Accordingly, under the interim final rule, as proposed, an FDIC-supervised institution may apply a zero percent CCF to the unused portion of commitments that are unconditionally cancelable by the FDIC-supervised institution. For purposes of the interim final rule, a commitment means any legally binding arrangement that obligates an FDIC-supervised institution to extend credit or to purchase assets. Unconditionally cancelable means a commitment for which an FDIC-supervised institution may, at any time, with or without cause, refuse to extend credit (to the extent permitted under applicable law). In the case of a residential mortgage exposure that is a line of credit, an FDIC-supervised institution can unconditionally cancel the commitment if it, at its option, may prohibit additional extensions of credit, reduce the credit line, and terminate the commitment to the full extent permitted by applicable law. If an FDIC-supervised institution provides a commitment that is structured as a syndication, the FDIC-supervised institution is only required to calculate the exposure amount for its pro rata share of the commitment.

The proposed rule provided a 20 percent CCF for commitments with an original maturity of one year or less that are not unconditionally cancelable by a banking organization, and for self-liquidating, trade-related contingent items that arise from the movement of goods with an original maturity of one year or less.

Some commenters argued that the proposed designation of a 20 percent CCF for certain exposures was too high. For example, they requested that the interim final rule continue the current practice of applying a zero percent CCF to all unfunded lines of credit with less than one year maturity, regardless of the lender's ability to unconditionally cancel the line of credit. They also requested a CCF lower than 20 percent for the unused portions of letters of credit extended to a small, mid-market, or trade finance company with durations of less than one year or less. These commenters asserted that current market practice for these lines have covenants based on financial ratios, and any increase in riskiness that violates the contractual minimum ratios would prevent the borrower from drawing down the unused portion.

For purposes of the interim final rule, the FDIC is retaining the 20 percent CCF, as it accounts for the elevated level of risk FDIC-supervised institutions face when extending short-term commitments that are not unconditionally cancelable. Although the FDIC understands certain contractual provisions are common in the market, these practices are not static, and it is more appropriate from a regulatory standpoint to base a CCF on whether a commitment is unconditionally cancellable. An FDIC-supervised institution must apply a 20 percent CCF to a commitment with an original maturity of one year or less that is not unconditionally cancellable by the FDIC-supervised institution. The interim final rule also maintains 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. The interim final rule also requires an FDIC-supervised

institution to apply a 50 percent CCF to commitments with an original maturity of more than one year that are not unconditionally cancelable by the FDIC-supervised institution, and to transaction-related contingent items, including performance bonds, bid bonds, warranties, and performance standby letters of credit.

Some commenters requested clarification regarding the treatment of commitments to extend letters of credit. They argued that these commitments are no more risky than commitments to extend loans and should receive similar treatment (20 percent or 50 percent CCF). For purposes of the interim final rule, the FDIC notes that section 33(a)(2) allows FDIC-supervised institutions to apply the lower of the two applicable CCFs to the exposures related to commitments to extend letters of credit. FDIC-supervised institutions will need to make this determination based upon the individual characteristics of each letter of credit.

Under the interim final rule, an FDIC-supervised institution must apply a 100 percent CCF to off-balance sheet guarantees, repurchase agreements, credit-enhancing representations and warranties that are not securitization exposures, securities lending or borrowing transactions, financial standby letters of credit, and forward agreements, and other similar exposures. The off-balance sheet component of a repurchase agreement equals the sum of the current fair values of all positions the FDIC-supervised institution has sold subject to repurchase. The off-balance sheet component of a securities lending transaction is the sum of the current fair values of all positions the FDIC-supervised institution has lent under the transaction. For securities borrowing transactions, the off-balance sheet component is the sum of the current fair values of all non-cash positions the FDIC-supervised institution has posted as collateral under the transaction. In certain circumstances, an FDIC-supervised institution may instead determine the exposure amount of the transaction as described in section 37 of the interim final rule.

In contrast to the general risk-based capital rules, which require capital for securities lending and borrowing transactions and repurchase agreements that generate an on-balance sheet exposure, the interim final rule requires an FDIC-supervised institution to hold risk-based capital against all repo-style transactions, regardless of whether they generate on-balance sheet exposures, as described in section 37 of the interim final rule. One commenter disagreed with this treatment and requested an exemption from the capital treatment for off-balance sheet repo-style exposures. However, the FDIC adopted this approach because banking organizations face counterparty credit risk when engaging in repo-style transactions, even if those transactions do not generate on-balance sheet exposures, and thus should not be exempt from risk-based capital requirements.

2. Credit-Enhancing Representations and Warranties

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.[122] 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 (1) contain early default clauses or similar warranties that permit the return of, or premium refund clauses covering, one-to-four family first-lien residential mortgage loans for a period not to exceed 120 days from the date of transfer; and (2) contain 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, provided the premium refund clauses are for a period not to exceed 120 days; or

[122] 12 CFR part 325, appendix A, section II.B.5(a) (state nonmember banks) and 12 CFR 390.466(b) (state savings associations).

(3) permit the return of assets in instances of fraud, misrepresentation, or incomplete documentation.[123]

In contrast, under the proposal, if a banking organization provides a credit-enhancing representation or warranty on assets it sold or otherwise transferred to third parties, including early default clauses that permit the return of, or premium refund clauses covering, one-to-four family residential first mortgage loans, the banking organization would treat such an arrangement as an off-balance sheet guarantee and apply a 100 percent CCF to determine the exposure amount, provided the exposure does not meet the definition of a securitization exposure. The agencies proposed a different treatment than the one under the general risk-based capital rules because of the risk to which banking organizations are exposed while credit-enhancing representations and warranties are in effect. Some commenters asked for clarification on what qualifies as a credit-enhancing representation and warranty, and commenters made numerous suggestions for revising the proposed definition. In particular, they disagreed with the agencies' proposal to remove the exemptions related to early default clauses and premium refund clauses since these representations and warranties generally are considered to be low risk exposures and banking organizations are not currently required to hold capital against these representations and warranties.

Some commenters encouraged the agencies to retain the 120-day safe harbor from the general risk-based capital rules, which would not require holding capital against assets sold with certain early default clauses of 120 days or less. These commenters argued that the proposal to remove the 120-day safe harbor would impede the ability of banking organizations to make loans

[123] 12 CFR part 325, appendix A, section II.B.5(a) (state nonmember banks) and 12 CFR part 390.466(b) (state savings associations).

and would increase the cost of credit to borrowers. Furthermore, certain commenters asserted that removal of the 120-day safe harbor was not necessary for loan portfolios that are well underwritten, those for which put-backs are rare, and where the banking organization maintains robust buyback reserves.

After reviewing the comments, the FDIC decided to retain in the interim final rule the 120-day safe harbor in the definition of credit-enhancing representations and warranties for early default and premium refund clauses on one-to-four family residential mortgages that qualify for the 50 percent risk weight as well as for 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. The FDIC determined that retaining the safe harbor would help to address commenters' confusion about what qualifies as a credit-enhancing representation and warranty. Therefore, consistent with the general risk-based capital rules, under the interim final rule, credit-enhancing representations and warranties will not include (1) early default clauses and similar warranties that permit the return of, or premium refund clauses covering, one-to-four family first-lien residential mortgage loans that qualify for a 50 percent risk weight for a period not to exceed 120 days from the date of transfer;[124] (2) premium refund clauses that cover assets guaranteed by the U.S. government, a U.S. Government agency, or a GSE, provided the premium refund clauses are for a period not to exceed 120 days from the date of transfer; or (3) warranties that permit the return of underlying exposures in instances of misrepresentation, fraud, or incomplete documentation.

Some commenters requested clarification from the agencies regarding representations made about the value of the underlying collateral of a sold loan. For example, many purchasers

[124] These warranties may cover only those loans that were originated within 1 year of the date of transfer.

of mortgage loans originated by banking organizations require that the banking organization repurchase the loan if the value of the collateral is other than as stated in the documentation provided to the purchaser or if there were any material misrepresentations in the appraisal process. The FDIC confirms that such representations meets the "misrepresentation, fraud, or incomplete documentation" exclusion in the definition of credit-enhancing representations and warranties and is not subject to capital treatment.

A few commenters also requested clarification regarding how the definition of credit-enhancing representations and warranties in the proposal interacts with Federal Home Loan Mortgage Corporation (FHLMC), Federal National Mortgage Association (FNMA), and Government National Mortgage Association (GNMA) sales conventions. These same commenters also requested verification in the interim final rule that mortgages sold with representations and warranties would all receive a 100 percent risk weight, regardless of the characteristics of the mortgage exposure. First, the definition of credit-enhancing representations and warranties described in this interim final rule is separate from the sales conventions required by FLHMA, FNMA, and GNMA. Those entities will continue to set their own requirements for secondary sales, including representation and warranty requirements. Second, the risk weights applied to mortgage exposures themselves are not affected by the inclusion of representations and warranties. Mortgage exposures will continue to receive either a 50 or 100 percent risk weight, as outlined in section 32(g) of this interim final rule, regardless of the inclusion of representations and warranties when they are sold in the secondary market. If such representations and warranties meet the rule's definition of credit-enhancing representations and warranties, then the institution must maintain regulatory capital against the associated credit risk.

Some commenters disagreed with the proposed methodology for determining the capital requirement for representations and warranties, and offered alternatives that they argued would conform to existing market practices and better incentivize high-quality underwriting. Some commenters indicated that many originators already hold robust buyback reserves and argued that the agencies should require originators to hold adequate liquidity in their buyback reserves, instead of requiring a duplicative capital requirement. Other commenters asked that any capital requirement be directly aligned to that originator's history of honoring representation and warranty claims. These commenters stated that originators who underwrite high-quality loans should not be required to hold as much capital against their representations and warranties as originators who exhibit what the commenters referred to as "poor underwriting standards." Finally, a few commenters requested that the agencies completely remove, or significantly reduce, capital requirements for representations and warranties. They argue that the market is able to regulate itself, as a banking organization will not be able to sell its loans in the secondary market if they are frequently put back by the buyers.

The FDIC considered these alternatives and has decided to finalize the proposed methodology for determining the capital requirement applied to representations and warranties without change. The FDIC is concerned that buyback reserves could be inadequate, especially if the housing market enters another prolonged downturn. Robust and clear capital requirements, in addition to separate buyback reserves held by originators, better ensure that representation and warranty claims will be fulfilled in times of stress. Furthermore, capital requirements based upon originators' historical representation and warranty claims are not only operationally difficult to implement and monitor, but they can also be misleading. Underwriting standards at firms are not static and can change over time. The FDIC believes that capital requirements based

on past performance of a particular underwriter do not always adequately capture the current risks faced by that firm. The FDIC believes that the incorporation of the 120-day safe harbor in the interim final rule as discussed above addresses many of the commenters' concerns.

Some commenters requested clarification on the duration of the capital treatment for credit-enhancing representations and warranties. For instance, some commenters questioned whether capital is required for credit-enhancing representations and warranties after the contractual life of the representations and warranties has expired or whether capital has to be held for the life of the asset. Banking organizations are not required to hold capital for any credit-enhancing representation and warranty after the expiration of the representation or warranty, regardless of the maturity of the underlying loan.

Additionally, commenters indicated that market practice for some representations and warranties for sold mortgages stipulates that originators only need to refund the buyer any servicing premiums and other earned fees in cases of early default, rather than requiring putback of the underlying loan to the seller. These commenters sought clarification as to whether the proposal would have required them to hold capital against the value of the underlying loan or only for the premium or fees that could be subject to a refund, as agreed upon in their contract with the buyer. For purposes of the interim final rule, an FDIC-supervised institution must hold capital only for the maximum contractual amount of the FDIC-supervised institution's exposure under the representations and warranties. In the case described by the commenters, the FDIC-supervised institution would hold capital against the value of the servicing premium and other earned fees, rather than the value of the underlying loan, for the duration specified in the representations and warranties agreement.

Some commenters also requested exemptions from the proposed treatment of representations and warranties for particular originators, types of transactions, or asset categories. In particular, many commenters asked for an exemption for community banking organizations, claiming that the proposed treatment would lessen credit availability and increase the costs of lending. One commenter argued that bona fide mortgage sale agreements should be exempt from capital requirements. Other commenters requested an exemption for the portion of any off-balance sheet asset that is subject to a risk retention requirement under section 941 of the Dodd-Frank Act and any regulations promulgated thereunder.[125] Some commenters also requested that the agencies delay action on the proposal until the risk retention rule is finalized. Other commenters also requested exemptions for qualified mortgages (QM) and "prime" mortgage loans.

The FDIC has decided not to adopt any of the specific exemptions suggested by the commenters. Although community banking organizations are critical to ensure the flow of credit to small businesses and individual borrowers, providing them with an exemption from the proposed treatment of credit-enhancing representations and warranties would be inconsistent with safety and soundness because the risks from these exposures to community banking organizations are no different than those to other banking organizations. The FDIC also has not provided exemptions in this rulemaking to portions of off-balance sheet assets subject to risk retention, QM, and "prime loans." The relevant agencies have not yet adopted a final rule implementing the risk retention provisions of section 941 of the Dodd-Frank Act, and the FDIC, therefore, does not believe it is appropriate to provide an exemption relating to risk retention in

[125] See 15 U.S.C. 78o-11, et seq.

this interim final rule. In addition, while the QM rulemaking is now final,[126] the FDIC believes it is appropriate to first evaluate how the QM designation affects the mortgage market before requiring less capital to be held against off-balance sheet assets that cover these loans. As noted above, the incorporation in the interim final rule of the 120-day safe harbor addresses many of the concerns about burden.

The risk-based capital treatment for off-balance sheet items in this interim final rule is consistent with section 165(k) of the Dodd-Frank Act which provides that, in the case of a BHC 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.[127] The interim final rule complies with the requirements of section 165(k) of the Dodd-Frank Act by requiring a BHC to hold risk-based capital for its off-balance sheet exposures, as described in sections 31, 33, 34 and 35 of the interim final rule.

D. Over-the-Counter Derivative Contracts

In the Standardized Approach NPR, the agencies proposed generally to retain the treatment of OTC derivatives provided under the general risk-based capital rules, which is similar to the current exposure method (CEM) for determining the exposure amount for OTC

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[126] See 12 CFR Part 1026.

[127] 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.

derivative contracts contained in the Basel II standardized framework.[128] Proposed revisions to the treatment of the OTC derivative contracts included an updated definition of an OTC derivative contract, a revised conversion factor matrix for calculating the PFE, a revision of the criteria for recognizing the netting benefits of qualifying master netting agreements and of financial collateral, and the removal of the 50 percent risk weight cap for OTC derivative contracts.

The agencies received a number of comments on the proposed CEM relating to OTC derivatives. These comments generally focused on the revised conversion factor matrix, the proposed removal of the 50 percent cap on risk weights for OTC derivative transactions in the general risk-based capital rules, and commenters' view that there is a lack of risk sensitivity in the calculation of the exposure amount of OTC derivatives and netting benefits. A specific discussion of the comments on particular aspects of the proposal follows.

One commenter asserted that the proposed conversion factors for common interest rate and foreign exchange contracts, and risk participation agreements (a simplified form of credit default swaps) (set forth in Table 19 below), combined with the removal of the 50 percent risk weight cap, would drive up banking organizations' capital requirements associated with these routine transactions and result in much higher transaction costs for small businesses. Another commenter asserted that the zero percent conversion factor assigned to interest rate derivatives

[128] The general risk-based capital rules for state savings associations regarding the calculation of credit equivalent amounts for derivative contracts differ from the rules for other banking organizations. (See 12 CFR 390.466(a)(2)). The state 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 banks.

with a remaining maturity of one year or less is not appropriate as the PFE incorrectly assumes all interest rate derivatives always can be covered by taking a position in a liquid market.

The FDIC acknowledges that the standardized matrix of conversion factors may be too simplified for some FDIC-supervised institutions. The FDIC believes, however, that the matrix approach appropriately balances the policy goals of simplicity and risk-sensitivity, and that the conversion factors themselves have been appropriately calibrated for the products to which they relate.

Some commenters supported retention of the 50 percent risk weight cap for derivative exposures under the general risk-based capital rules. Specifically, one commenter argued that the methodology for calculating the exposure amount without the 50 percent risk weight cap would result in inappropriately high capital charge unless the methodology were amended to recognize the use of netting and collateral. Accordingly, the commenter encouraged the agencies to retain the 50 percent risk weight cap until the BCBS enhances the CEM to improve risk-sensitivity.

The FDIC believes 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. In addition, the FDIC is aware of the ongoing work of the BCBS to improve the current exposure method and expect to consider any necessary changes to update the exposure amount calculation when the BCBS work is completed.

Some commenters suggested that the agencies allow the use of internal models approved by the primary Federal supervisor as an alternative to the proposal, consistent with Basel III. The FDIC chose not to incorporate all of the methodologies included in the Basel II standardized framework in the interim final rule. The FDIC believes that, given the range of FDIC-supervised

institutions that are subject to the interim final rule in the United States, it is more appropriate to permit only the proposed non-models based methodology for calculating OTC derivatives exposure amounts under the standardized approach. For larger and more complex FDIC-supervised institutions, the use of the internal model methodology and other models-based methodologies is permitted under the advanced approaches rule. One commenter asked the agencies to provide a definition for "netting," as the meaning of this term differs widely under various master netting agreements used in industry practice. Another commenter asserted that net exposures are likely to understate actual exposures and the risk of early close-out posed to banking organizations facing financial difficulties, that the conversion factors for PFE are inappropriate, and that a better measure of risk tied to gross exposure is needed. With respect to the definition of netting, the FDIC notes that the definition of "qualifying master netting agreement" provides a functional definition of netting. With respect to the use of net exposure for purposes of determining PFE, the FDIC believes that, in light of the existing international framework to enforce netting arrangements together with the conditions for recognizing netting that are included in this interim final rule, the use of net exposure is appropriate in the context of a risk-based counterparty credit risk charge that is specifically intended to address default risk. The interim final rule also continues to limit full recognition of netting for purposes of calculating PFE for counterparty credit risk under the standardized approach.[129]

Other commenters suggested adopting broader recognition of netting under the PFE calculation for netting sets, using a factor of 85 percent rather than 60 percent in the formula for recognizing netting effects to be consistent with the BCBS CCP interim framework (which is defined and discussed in section VIII.E of this preamble, below). Another commenter suggested

[129] See section 34(a)(2) of the interim final rule.

implementing a 15 percent haircut on the calculated exposure amount for failure to recognize risk mitigants and portfolio diversification. With respect to the commenters' request for greater recognition of netting in the calculation of PFE, the FDIC notes that the BCBS CCP interim framework's use of 85 percent recognition of netting was limited to the calculation of the hypothetical capital requirement of the QCCP for purposes of determining a clearing member banking organization's risk-weighted asset amount for its default fund contribution. As such, the interim final rule retains the proposed formula for recognizing netting effects for OTC derivative contracts that was set out in the proposal. The FDIC expects to consider whether it would be necessary to propose any changes to the CEM once BCBS discussions on this topic are complete.

The proposed rule placed a cap on the PFE of sold credit protection, equal to the net present value of the amount of unpaid premiums. One commenter questioned the appropriateness of the proposed cap, and suggested that a seller's exposure be measured as the gross exposure amount of the credit protection provided on the name referenced in the credit derivative contract. The FDIC believes that the proposed approach is appropriate for measuring counterparty credit risk because it reflects the amount an FDIC-supervised institution may lose on its exposure to the counterparty that purchased protection. The exposure amount on a sold credit derivative would be calculated separately under section 34(a).

Another commenter asserted that current credit exposure (netted and unnetted) understates or ignores the risk that the mark is inaccurate. Generally, the FDIC expects an FDIC-supervised institution to have in place policies and procedures regarding the valuation of positions, and that those processes would be reviewed in connection with routine and periodic supervisory examinations of an FDIC-supervised institution.

The interim final rule generally adopts the proposed treatment for OTC derivatives without change. Under the interim final rule, as under the general risk-based capital rules, an FDIC-supervised institution is required to hold risk-based capital for counterparty credit risk for an OTC derivative contract. As defined in the rule, 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 includes an interest rate, exchange rate, equity, or a commodity derivative contract, a credit derivative, 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. This applies, for example, to mortgage-backed securities (MBS) transactions that the GSEs conduct in the To-Be-Announced market.

Under the interim final rule, an OTC derivative contract does not include a derivative contract that is a cleared transaction, which is subject to a specific treatment as described in section VIII.E of this preamble. However, an OTC derivative contract includes an exposure of a banking organization that is a clearing member banking organization to its clearing member client where the clearing member banking organization is either acting as a financial intermediary and enters into an offsetting transaction with a CCP or where the clearing member banking organization provides a guarantee to the CCP on the performance of the client. The rationale for this treatment is the banking organization's continued exposure directly to the risk of the clearing member client. In recognition of the shorter close-out period for these transactions, however, the interim final rule permits an FDIC-supervised institution to apply a

scaling factor to recognize the shorter holding period as discussed in section VIII.E of this preamble.

To determine the risk-weighted asset amount for an OTC derivative contract under the interim final rule, an FDIC-supervised institution must 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 rule requires the exposure amount to be the sum of (1) the FDIC-supervised institution's current credit exposure, which is the greater of the fair value or zero, and (2) PFE, which is calculated by multiplying the notional principal amount of the OTC derivative contract by the appropriate conversion factor, in accordance with Table 19 below.

Under the interim final rule, the conversion factor matrix includes the additional categories of OTC derivative contracts as illustrated in Table 19. For an OTC derivative contract that does not fall within one of the specified categories in Table 19, the interim final rule requires PFE to be calculated using the "other" conversion factor.

TABLE 19 – CONVERSION FACTOR MATRIX FOR OTC DERIVATIVE CONTRACTS[130]

Remaining maturity[131]	Interest rate	Foreign exchange rate and gold	Credit (investment-grade reference asset)[132]	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, an FDIC-supervised institution must calculate the exposure amount 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. Under the interim final rule, the net current credit exposure is the greater of zero and the net sum of all positive and negative fair values of the individual OTC derivative contracts subject to the qualifying master netting agreement. The

[130] For a derivative contract with multiple exchanges of principal, the conversion factor is multiplied by the number of remaining payments in the derivative contract.

[131] 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.

[132] A FDIC-supervised institution 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 FDIC-supervised institution must use the column labeled "Credit (non-investment-grade reference asset)" for all other credit derivatives.

adjusted sum of the PFE amounts must be calculated as described in section 34(a)(2)(ii) of the interim final rule.

Under the interim final rule, to recognize the netting benefit of multiple OTC derivative contracts, the contracts must be subject to a qualifying master netting agreement; however, unlike under the general risk-based capital rules, under the interim final rule for most transactions, an FDIC-supervised institution may rely on sufficient legal review instead of an opinion on the enforceability of the netting agreement as described below.[133] The interim final rule defines a qualifying master netting agreement as any written, legally enforceable netting agreement that 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) provided that certain conditions set forth in section 3 of the interim final rule are met.[134] These conditions include requirements with respect to the FDIC-supervised institution's right to terminate the contract and liquidate collateral and meeting certain standards with respect to legal review of the agreement to ensure its meets the criteria in the definition.

The legal review must be sufficient so that the FDIC-supervised institution may conclude with a well-founded basis that, among other things, the contract would be found legal, binding, and enforceable under the law of the relevant jurisdiction and that the contract meets the other

[133] Under the general risk-based capital rules, to recognize netting benefits an FDIC-supervised institution 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.

[134] The interim final rule adds a new section 3: Operational requirements for counterparty credit risk. This section organizes substantive requirements related to cleared transactions, eligible margin loans, qualifying cross-product master netting agreements, qualifying master netting agreements, and repo-style transactions in a central place to assist FDIC-supervised institutions in determining their legal responsibilities. These substantive requirements are consistent with those included in the proposal.

requirements of the definition. 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 an FDIC-supervised institution has little experience, the FDIC-supervised institution would be expected to obtain an explicit, written legal opinion from external or internal legal counsel addressing the particular situation.

Under the interim final rule, if an OTC derivative contract is collateralized by financial collateral, an FDIC-supervised institution must first determine the exposure amount of the OTC derivative contract as described in this section of the preamble. Next, to recognize the credit risk mitigation benefits of the financial collateral, an FDIC-supervised institution could use the simple approach for collateralized transactions as described in section 37(b) of the interim final rule. Alternatively, if the financial collateral is marked-to-market on a daily basis and subject to a daily margin maintenance requirement, an FDIC-supervised institution could adjust the exposure amount of the contract using the collateral haircut approach described in section 37(c) of the interim final rule.

Similarly, if an FDIC-supervised institution purchases a credit derivative that is recognized under section 36 of the interim final rule as a credit risk mitigant for an exposure that is not a covered position under subpart F, it is not 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 FDIC-supervised institution must 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.

Under the interim final rule, an FDIC-supervised institution must treat an equity derivative contract as an equity exposure and compute its risk-weighted asset amount according to the simple risk-weight approach (SRWA) described in section 52 (unless the contract is a covered position under the market risk rule). If the FDIC-supervised institution risk weights a contract under the SRWA 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, an FDIC-supervised institution either includes or excludes all of the contracts from any measure used to determine counterparty credit risk exposures. If the FDIC-supervised institution is treating an OTC equity derivative contract as a covered position under subpart F, it also must calculate a risk-based capital requirement for counterparty credit risk of the contract under this section.

In addition, if an FDIC-supervised institution provides protection through a credit derivative that is not a covered position under subpart F of the interim final rule, it must 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 interim final rule. The FDIC-supervised institution is not required to compute a counterparty credit risk capital requirement for the credit derivative, as long as it does so consistently for all such OTC credit derivative contracts. Further, where these credit derivative contracts are subject to a qualifying master netting agreement, the FDIC-supervised institution must either include all or exclude all such credit derivatives from any measure used to determine counterparty credit risk exposure to all relevant counterparties for risk-based capital purposes.

Where the FDIC-supervised institution provides protection through a credit derivative treated as a covered position under subpart F, it must compute a supplemental counterparty credit

risk capital requirement using an amount determined under section 34 for OTC credit derivative contracts 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 interim final rule, the risk weight for OTC derivative transactions is not subject to any specific ceiling, consistent with the Basel capital framework.

Although the FDIC generally adopted the proposal without change, the interim final rule has been revised to add a provision regarding the treatment of a clearing member FDIC-supervised institution's exposure to a clearing member client (as described below under "Cleared Transactions," a transaction between a clearing member FDIC-supervised institution and a client is treated as an OTC derivative exposure). However, the interim final rule recognizes the shorter close-out period for cleared transactions that are derivative contracts, such that a clearing member FDIC-supervised institution can reduce its exposure amount to its client by multiplying the exposure amount by a scaling factor of no less than 0.71. See section VIII.E of this preamble, below, for additional discussion.

E. Cleared Transactions

The BCBS and the FDIC support incentives designed to encourage clearing of derivative and repo-style transactions[135] through a CCP wherever possible in order to promote transparency, multilateral netting, and robust risk-management practices.

Although there are some risks associated with CCPs, as discussed below, the FDIC believes that CCPs generally help improve the safety and soundness of the derivatives and repo-

[135] See section 2 of the interim final rule for the definition of a repo-style transaction.

style transactions markets through the multilateral netting of exposures, establishment and enforcement of collateral requirements, and the promotion of market transparency.

As discussed in the proposal, 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, in the period preceding the proposal, the BCBS sought comment on a more risk-sensitive approach for determining capital requirements for banking organizations' exposures to CCPs.[136] In addition, to encourage CCPs to maintain strong risk-management procedures, the BCBS sought comment on a proposal 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).[137] Exposures to such entities, termed QCCPs in the interim final rule, would be subject to lower risk weights than exposures to CCPs that did not meet those criteria.

Consistent with the BCBS proposals and the CPSS-IOSCO standards, the agencies sought comment on specific risk-based capital requirements for cleared derivative and repo-style transactions that are 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 proposal would have required a banking organization to hold risk-based capital

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[136] See "Capitalisation of Banking Organization Exposures to Central Counterparties" (November 2011) (CCP consultative release), available at http://www.bis.org/publ/bcbs206.pdf.

[137] See CPSS-IOSCO, "Recommendations for Central Counterparties" (November 2004), available at http://www.bis.org/publ/cpss64.pdf?noframes=1.

for an outstanding derivative contract or a repo-style transaction that has been cleared through a CCP, including an exchange.

The proposal also included a capital requirement for default fund contributions to CCPs. In the case of non-qualifying CCPs (that is, CCPs that do not meet the risk-management, supervision, and other standards for QCCPs outlined in the proposal), the risk-weighted asset amount for default fund contributions to such CCPs would be equal to the sum of the banking organization's default fund contributions to the CCPs multiplied by 1,250 percent. In the case of QCCPs, the risk-weighted asset amount would be calculated according to a formula based on the hypothetical capital requirement for a QCCP, consistent with the Basel capital framework. The proposal included a formula with inputs including the exposure amount of transactions cleared through the QCCP, collateral amounts, the number of members of the QCCP, and default fund contributions.

Following issuance of the proposal, the BCBS issued an interim framework for the capital treatment of bank exposures to CCPs (BCBS CCP interim framework).[138] The BCBS CCP interim framework reflects several key changes from the CCP consultative release, including: (1) a provision to allow a clearing member banking organization to apply a scalar when using the CEM (as described below) in the calculation of its exposure amount to a client (or use a reduced margin period of risk when using the internal models methodology (IMM) to calculate exposure at default (EAD) under the advanced approaches rule); (2) revisions to the risk weights applicable to a clearing member banking organization's exposures when such clearing member banking organization guarantees QCCP performance; (3) a provision to permit

[138] See "Capital requirements for bank exposures to central counterparties" (July 2012), available at http://www.bis.org/publ/bcbs227.pdf.

clearing member banking organizations to choose from one of two formulaic methodologies for determining the capital requirement for default fund contributions; and (4) revisions to the CEM formula to recognize netting to a greater extent for purposes of calculating the capital requirement for default fund contributions.

The agencies received a number of comments on the proposal relating to cleared transactions. Commenters also encouraged the agencies to revise certain aspects of the proposal in a manner consistent with the BCBS CCP interim framework.

Some commenters asserted that the definition of QCCP should be revised, specifically by including a definitive list of QCCPs rather than requiring each banking organization to demonstrate that a CCP meets certain qualifying criteria. The FDIC believes that a static list of QCCPs would not reflect the potentially dynamic nature of a CCP, and that FDIC-supervised institutions are situated to make this determination on an ongoing basis.

Some commenters recommended explicitly including derivatives clearing organizations (DCOs) and securities-based swap clearing agencies in the definition of a QCCP. Commenters also suggested including in the definition of QCCP any CCP that the CFTC or SEC exempts from registration because it is deemed by the CFTC or SEC to be subject to "comparable, comprehensive supervision" by another regulator. The FDIC notes that such registration (or exemption from registration based on being subject to "comparable, comprehensive supervision") does not necessarily mean that the CCP is subject to, or in compliance with, the standards established by the CPSS and IOSCO. In contrast, a designated FMU, which is included in the definition of QCCP, is subject to regulation that corresponds to such standards.

Another commenter asserted that, consistent with the BCBS CCP interim framework, the interim final rule should provide for the designation of a QCCP by the agencies in the absence of

a national regime for authorization and licensing of CCPs. The interim final rule has not been amended to include this aspect of the BCBS CCP interim framework because the FDIC believes a national regime for authorizing and licensing CCPs is a critical mechanism to ensure the compliance and ongoing monitoring of a CCP's adherence to internationally recognized risk-management standards. Another commenter requested that a three-month grace period apply for CCPs that cease to be QCCPs. The FDIC notes that such a grace period was included in the proposed rule, and the interim final rule retains the proposed definition without substantive change.[139]

With respect to the proposed definition of cleared transaction, some commenters asserted that the definition should recognize omnibus accounts because their collateral is bankruptcy-remote. The FDIC agrees with these commenters and has revised the operational requirements for cleared transactions to include an explicit reference to such accounts.

The BCBS CCP interim framework requires trade portability to be "highly likely," as a condition of whether a trade satisfies the definition of cleared transaction. One commenter who encouraged the agencies to adopt the standards set forth in the BCBS CCP interim framework sought clarification of the meaning of "highly likely" in this context. The FDIC clarifies that, consistent with the BCBS CCP interim framework, if there is clear precedent for transactions to be transferred to a non-defaulting clearing member upon the default of another clearing member (commonly referred to as "portability") and there are no indications that such practice will not continue, then these factors should be considered, when assessing whether client positions are portable. The definition of "cleared transaction" in the interim final rule is discussed in further detail below.

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[139] This provision is located in sections 35 and 133 of the interim final rule.

Another commenter sought clarification on whether reasonable reliance on a commissioned legal opinion for foreign financial jurisdictions could satisfy the "sufficient legal review" requirement for bankruptcy remoteness of client positions. The FDIC believes that reasonable reliance on a commissioned legal opinion could satisfy this requirement. Another commenter expressed concern that the proposed framework for cleared transactions would capture securities clearinghouses, and encouraged the agencies to clarify their intent with respect to such entities for purposes of the interim final rule. The FDIC notes that the definition of "cleared transaction" refers only to OTC derivatives and repo-style transactions. As a result, securities clearinghouses are not within the scope of the cleared transactions framework.

One commenter asserted that the agencies should recognize varying close-out period conventions for specific cleared products, specifically exchange-traded derivatives. This commenter also asserted that the agencies should adjust the holding period assumptions or allow CCPs to use alternative methods to compute the appropriate haircut for cleared transactions. For purposes of this interim final rule, the FDIC retained a standard close-out period in the interest of avoiding unnecessary complexity, and note that cleared transactions with QCCPs attract extremely low risk weights (generally, 2 or 4 percent), which, in part, is in recognition of the shorter close-out period involved in cleared transactions.

Another commenter requested confirmation that the risk weight applicable to the trade exposure amount for a cleared credit default swap (CDS) could be substituted for the risk weight assigned to an exposure that was hedged by the cleared CDS, that is, the substitution treatment described in sections 36 and 134 would apply. The FDIC confirms that under the interim final rule, an FDIC-supervised institution may apply the substitution treatment of sections 36 or 134 to recognize the credit risk mitigation benefits of a cleared CDS as long as the CDS is an eligible

credit derivative and meets the other criteria for recognition. Thus, if an FDIC-supervised institution purchases an eligible credit derivative as a hedge of an exposure and the eligible credit derivative qualifies as a cleared transaction, the FDIC-supervised institution may substitute the risk weight applicable to the cleared transaction under sections 35 or 133 of the interim final rule (instead of using the risk weight associated with the protection provider).[140] Furthermore, the FDIC has modified the definition of eligible guarantor to include a QCCP.

Another commenter asserted that the interim final rule should decouple the risk weights applied to collateral exposure and those assigned to other components of trade exposure to recognize the separate components of risk. The FDIC notes that, if collateral is bankruptcy remote, then it would not be included in the trade exposure amount calculation (see sections 35(b)(2) and 133(b)(2) of the interim final rule). The FDIC also notes that such collateral must be risk weighted in accordance with other sections of the interim final rule as appropriate, to the extent that the posted collateral remains an asset on an FDIC-supervised institution's balance sheet.

A number of commenters addressed the use of the CEM for purposes of calculating a capital requirement for a default fund contribution to a CCP (K_{ccp}).[141] Some commenters asserted that the CEM is not appropriate for determining the hypothetical capital requirement for a QCCP (K_{ccp}) under the proposed formula because it lacks risk sensitivity and sophistication, and was not developed for centrally-cleared transactions. Another commenter asserted that the use of CEM should be clarified in the clearing context, specifically, whether the modified CEM

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[140] See "Basel III counterparty credit risk and exposures to central counterparties – Frequently asked questions" (December 2012 (update of FAQs published in November 2012)), available at http://www.bis.org/publ/bcbs237.pdf.

[141] See section VIII.D of this preamble for a description of the CEM.

approach would permit the netting of offsetting positions booked under different "desk IDs" or "hub accounts" for a given clearing member banking organization. Another commenter encouraged the agencies to allow banking organizations to use the IMM to calculate K_{ccp}. Another commenter encouraged the agencies to continue to work with the BCBS to harmonize international and domestic capital rules for cleared transactions.

Although the FDIC recognizes that the CEM has certain limitations, it considers the CEM, as modified for cleared transactions, to be a reasonable approach that would produce consistent results across banking organizations. Regarding the commenter's request for clarification of netting positions across "desk IDs" or "hub accounts," the CEM would recognize netting across such transactions if such netting is legally enforceable upon a CCP's default. Moreover, the FDIC believes that the use of models either by the CCP, whose model would not be subject to review and approval by the FDIC, or by the banking organizations, whose models may vary significantly, likely would produce inconsistent results that would not serve as a basis for comparison across banking organizations. The FDIC recognizes that additional work is being performed by the BCBS to revise the CCP capital framework and the CEM. The FDIC expects to modify the interim final rule to incorporate the BCBS improvements to the CCP capital framework and CEM through the normal rulemaking process.

Other commenters suggested that the agencies not allow preferential treatment for clearinghouses, which they asserted are systemically critical institutions. In addition, some of these commenters argued that the agency clearing model should receive a more favorable capital requirement because the agency relationship facilitates protection and portability of client positions in the event of a clearing member default, compared to the back-to-back principal model. As noted above, the FDIC acknowledges that as more transactions move to central

clearing, the potential for risk concentration and systemic risk increases. As noted in the proposal, the risk weights applicable to cleared transactions with QCCPs (generally 2 or 4 percent) represent an increase for many cleared transactions as compared to the general risk-based capital rules (which exclude from the risk-based ratio calculations exchange rate contracts with an original maturity of fourteen or fewer calendar days and derivative contracts traded on exchanges that require daily receipt and payment of cash variation margin),[142] in part to reflect the increased concentration and systemic risk inherent in such transactions. In regards to the agency clearing model, the FDIC notes that a clearing member banking organization that acts as an agent for a client and that guarantees the client's performance to the QCCP would have no exposure to the QCCP to risk weight. The exposure arising from the guarantee would be treated as an OTC derivative with a reduced holding period, as discussed below.

Another commenter suggested that the interim final rule address the treatment of unfunded default fund contribution amounts and potential future contributions to QCCPs, noting that the treatment of these potential exposures is not addressed in the BCBS CCP interim framework. The FDIC has clarified in the interim final rule that if an FDIC-supervised institution's unfunded default fund contribution to a CCP is unlimited, the FDIC will determine the risk-weighted asset amount for such default fund contribution based on factors such as the size, structure, and membership of the CCP and the riskiness of its transactions. The interim final rule does not contemplate unlimited default fund contributions to QCCPs because defined default fund contribution amounts are a prerequisite to being a QCCP.

[142] See 12 CFR part 325, appendix A, § II.E.2.

Another commenter asserted that it is unworkable to require securities lending transactions to be conducted through a CCP, and that it would be easier and more sensible to make the appropriate adjustments in the interim final rule to ensure a capital treatment for securities lending transactions that is proportional to their actual risks. The FDIC notes that the proposed rule would not have required securities lending transactions to be cleared. The FDIC also acknowledges that clearing may not be widely available for securities lending transactions, and believes that the collateral haircut approach (sections 37(c) and 132(b) of the interim final rule) and for advanced approaches FDIC-supervised institutions, the simple value-at-risk (VaR) and internal models methodologies (sections 132(b)(3) and (d) of the interim final rule) are an appropriately risk-sensitive exposure measure for non-cleared securities lending exposures.

One commenter asserted that end users and client-cleared trades would be disadvantaged by the proposal. Although there may be increased transaction costs associated with the introduction of the CCP framework, the FDIC believes that the overall risk mitigation that should result from the capital requirements generated by the framework will help promote financial stability, and that the measures the FDIC has taken in the interim final rule to incentivize client clearing are aimed at addressing the commenters' concerns. Several commenters suggested that the proposed rule created a disincentive for client clearing because of the clearing member banking organization's exposure to the client. The FDIC agrees with the need to mitigate disincentives for client clearing in the methodology, and has amended the interim final rule to reflect a lower margin period of risk, or holding period, as applicable, as discussed further below.

Commenters suggested delaying implementation of a cleared transactions framework in the interim final rule until the BCBS CCP interim framework is finalized, implementing the

BCBS CCP interim framework in the interim final rule pending finalization of the BCBS interim framework, or providing a transition period for banking organizations to be able to comply with some of the requirements. A number of commenters urged the agencies to incorporate all substantive changes of the BCBS CCP interim framework, ranging from minor adjustments to more material modifications.

After considering the comments and reviewing the standards in the BCBS CCP interim framework, the FDIC believes that the modifications to capital standards for cleared transactions in the BCBS CCP interim framework are appropriate and believes that they would result in modifications that address many commenters' concerns. Furthermore, the FDIC believes that it is prudent to implement the BCBS CCP interim framework, rather than wait for the final framework, because the changes in the BCBS CCP interim framework represent a sound approach to mitigating the risks associated with cleared transactions. Accordingly, the FDIC has incorporated the material elements of the BCBS CCP interim framework into the interim final rule. In addition, given the delayed effective date of the interim final rule, the FDIC believes that an additional transition period, as suggested by some commenters, is not necessary.

The material changes to the proposed rule to incorporate the CCP interim rule are described below. Other than these changes, the interim final rule retains the capital requirements for cleared transaction exposures generally as proposed by the agencies. As noted in the proposal, the international discussions are ongoing on these issues, and the FDIC will revisit this issue once the Basel capital framework is revised.

1. Definition of Cleared Transaction

The interim final rule defines a cleared transaction as an exposure associated with an outstanding derivative contract or repo-style transaction that an FDIC-supervised institution or

clearing member has entered into with a CCP (that is, a transaction that a CCP has accepted).[143] Cleared transactions include the following: (1) a transaction between a CCP and a clearing member FDIC-supervised institution for the FDIC-supervised institution's own account; (2) a transaction between a CCP and a clearing member FDIC-supervised institution acting as a financial intermediary on behalf of its clearing member client; (3) a transaction between a client FDIC-supervised institution and a clearing member where the clearing member acts on behalf of the client FDIC-supervised institution and enters into an offsetting transaction with a CCP; and (4) a transaction between a clearing member client and a CCP where a clearing member FDIC-supervised institution guarantees the performance of the clearing member client to the CCP. Such transactions must also satisfy additional criteria provided in section 3 of the interim final rule, including bankruptcy remoteness of collateral, transferability criteria, and portability of the clearing member client's position. As explained above, the FDIC has modified the definition in the interim final rule to specify that regulated omnibus accounts meet the requirement for bankruptcy remoteness.

An FDIC-supervised institution is required to calculate risk-weighted assets for all of its cleared transactions, whether the FDIC-supervised institution 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

[143] For example, the FDIC expects that a transaction with a derivatives clearing organization (DCO) would meet the 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.

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 because they do not meet all the criteria are OTC derivative transactions. For example, if a transaction submitted to the CCP is not accepted by the CCP because the terms of the transaction submitted by the clearing members do not match or because other operational issues are identified by the CCP, the transaction does not meet the definition of a cleared transaction and is an OTC derivative transaction. If the counterparties to the transaction resolve the issues and resubmit the transaction and it is accepted, the transaction would then be a cleared transaction. A cleared transaction does not include an exposure of an FDIC-supervised institution that is a clearing member to its clearing member client where the FDIC-supervised institution is either acting as a financial intermediary and enters into an offsetting transaction with a CCP or where the FDIC-supervised institution provides a guarantee to the CCP on the performance of the client. Under the standardized approach, as discussed below, such a transaction is an OTC derivative transaction with the exposure amount calculated according to section 34(e) of the interim final rule or a repo-style transaction with the exposure amount calculated according to section 37(c) of the interim final rule. Under the advanced approaches rule, such a transaction is treated as either an OTC derivative transaction with the exposure amount calculated according to sections 132(c)(8) or (d)(5)(iii)(C) of the interim final rule or a repo-style transaction with the exposure amount calculated according to sections 132(b) or (d) of the interim final rule.

2. Exposure Amount Scalar for Calculating for Client Exposures

Under the proposal, a transaction between a clearing member FDIC-supervised institution and a client was treated as an OTC derivative exposure, with the exposure amount calculated

according to sections 34 or 132 of the proposal. The agencies acknowledged in the proposal that this treatment could have created disincentives for banking organizations to facilitate client clearing. Commenters' feedback and the BCBS CCP interim framework's treatment on this subject provided alternatives to address the incentive concern.

Consistent with comments and the BCBS CCP interim framework, under the interim final rule, a clearing member FDIC-supervised institution must treat its counterparty credit risk exposure to clients as an OTC derivative contract, irrespective of whether the clearing member FDIC-supervised institution guarantees the transaction or acts as an intermediary between the client and the QCCP. Consistent with the BCBS CCP interim framework, to recognize the shorter close-out period for cleared transactions, under the standardized approach a clearing member FDIC-supervised institution may calculate its exposure amount to a client by multiplying the exposure amount, calculated using the CEM, by a scaling factor of no less than 0.71, which represents a five-day holding period. A clearing member FDIC-supervised institution must use a longer holding period and apply a larger scaling factor to its exposure amount in accordance with Table 20 if it determines that a holding period longer than five days is appropriate. The FDIC may require a clearing member FDIC-supervised institution to set a longer holding period if it determines that a longer period is commensurate with the risks associated with the transaction. The FDIC believes that the recognition of a shorter close-out period appropriately captures the risk associated with such transactions while furthering the policy goal of promoting central clearing.

TABLE 20 – HOLDING PERIODS AND SCALING FACTORS

Holding Period (days)	Scaling Factor
5	0.71

6	0.77
7	0.84
8	0.89
9	0.95
10	1.00

3. Risk Weighting for Cleared Transactions

Under the interim final rule, to determine the risk-weighted asset amount for a cleared transaction, a clearing member client FDIC-supervised institution or a clearing member FDIC-supervised institution must multiply the trade exposure amount for the cleared transaction by the appropriate risk weight, determined as described below. The trade exposure amount is calculated as follows:

(1) For a cleared transaction that is a derivative contract or a netting set of derivatives contracts, the trade exposure amount is equal to the exposure amount for the derivative contract or netting set of derivative contracts, calculated using the CEM for OTC derivative contracts (described in sections 34 or 132(c) of the interim final rule) or for advanced approaches FDIC-supervised institutions that use the IMM, under section 132(d) of the interim final rule), plus the fair value of the collateral posted by the clearing member client FDIC-supervised institution and held by the CCP or clearing member in a manner that is not bankruptcy remote; and

(2) For a cleared transaction that is a repo-style transaction or a netting set of repo-style transactions, the trade exposure amount is equal to the exposure amount calculated under the collateral haircut approach used for financial collateral (described in section 37(c) and 132(b) of the interim final rule) (or for advanced approaches FDIC-supervised institutions the IMM under

section 132(d) of the interim final rule) plus the fair value of the collateral posted by the clearing member client FDIC-supervised institution that is held by the CCP or clearing member in a manner that is not bankruptcy remote.

The trade exposure amount does not include any collateral posted by a clearing member client FDIC-supervised institution or clearing member FDIC-supervised institution that is held by a custodian in a manner that is bankruptcy remote[144] from the CCP, clearing member, other counterparties of the clearing member, and the custodian itself. In addition to the capital requirement for the cleared transaction, the FDIC-supervised institution remains 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 or 131 of the interim final rule. Consistent with the BCBS CCP interim framework, the risk weight for a cleared transaction depends on whether the CCP is a QCCP. Central counterparties that are designated FMUs and foreign entities regulated and supervised in a manner equivalent to designated FMUs are QCCPs. In addition, a CCP could be a QCCP under the interim final rule if it is in sound financial condition and meets certain standards that are consistent with BCBS expectations for QCCPs, as set forth in the QCCP definition.

A clearing member FDIC-supervised institution must apply a 2 percent risk weight to its trade exposure amount to a QCCP. An FDIC-supervised institution that is a clearing member client may apply a 2 percent risk weight to the trade exposure amount only if:

(1) The collateral posted by the clearing member client FDIC-supervised institution to the QCCP or clearing member is subject to an arrangement that prevents any losses to the clearing

[144] Under the interim final rule, bankruptcy remote, with respect to an entity or asset, means that the entity or asset would be excluded from an insolvent entity's estate in a receivership, insolvency or similar proceeding.

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

(2) The clearing member client FDIC-supervised institution 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.

If the criteria above are not met, a clearing member client FDIC-supervised institution must apply a risk weight of 4 percent to the trade exposure amount.

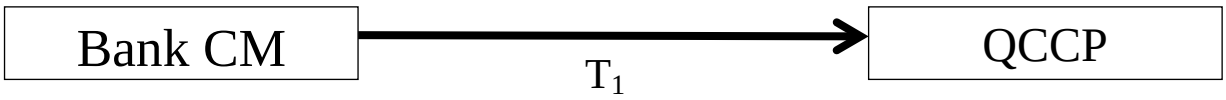
Under the interim final rule, as under the proposal, for a cleared transaction with a CCP that is not a QCCP, a clearing member FDIC-supervised institution and a clearing member client FDIC-supervised institution must risk weight the trade exposure amount to the CCP according to the risk weight applicable to the CCP under section 32 of the interim final rule (generally, 100 percent). Collateral posted by a clearing member FDIC-supervised institution that is held by a custodian in a manner that is bankruptcy remote from the CCP is not subject to a capital requirement for counterparty credit risk. Similarly, 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 is not be subject to a capital requirement for counterparty credit risk.

The proposed rule was silent on the risk weight that would apply where a clearing member banking organization acts for its own account or guarantees a QCCP's performance to a

client. Consistent with the BCBS CCP interim framework, the interim final rule provides additional specificity regarding the risk-weighting methodologies for certain exposures of clearing member banking organizations. The interim final rule provides that a clearing member FDIC-supervised institution that (i) acts for its own account, (ii) is acting as a financial intermediary (with an offsetting transaction or a guarantee of the client's performance to a QCCP), or (iii) guarantees a QCCP's performance to a client would apply a two percent risk weight to the FDIC-supervised institution's exposure to the QCCP. The diagrams below demonstrate the various potential transactions and exposure treatment in the interim final rule. Table 21 sets out how the transactions illustrated in the diagrams below are risk-weighted under the interim final rule.

In the diagram, "T" refers to a transaction, and the arrow indicates the direction of the exposure. The diagram describes the appropriate risk weight treatment for exposures from the perspective of a clearing member FDIC-supervised institution entering into cleared transactions for its own account (T_1), a clearing member FDIC-supervised institution entering into cleared transactions on behalf of a client (T_2 through T_7), and an FDIC-supervised institution entering into cleared transactions as a client of a clearing member (T_8 and T_9). Table 21 shows for each trade whom the exposure is to, a description of the type of trade, and the risk weight that would apply based on the risk of the counterparty.

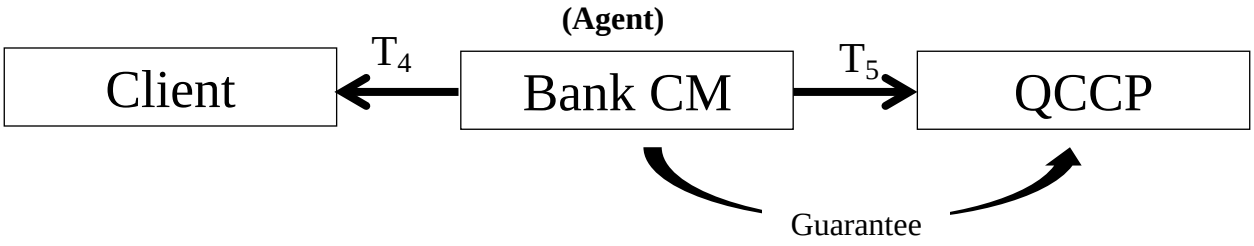
<u>FDIC-Supervised Institution Clearing Member (Bank CM) – Own Account</u>



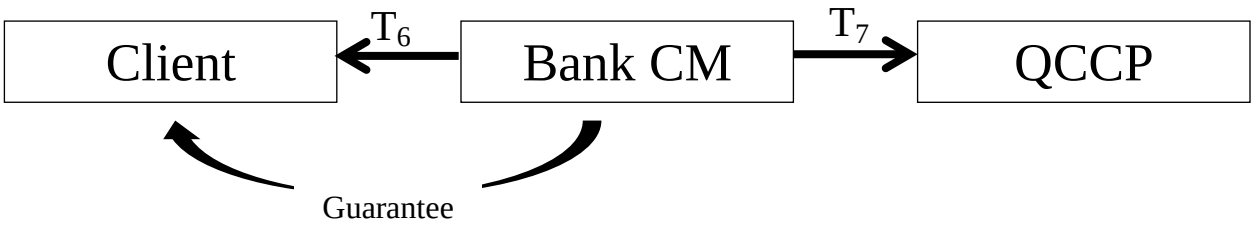
<u>Bank CM – Client Trade</u>

- Financial intermediary with offsetting transaction to QCCP

- Agency with guarantee of client performance



- Guarantee of QCCP performance



Bank Client – CM Trade

- Financial Intermediary with offsetting transaction to QCCP

- Agency with guarantee of client performance

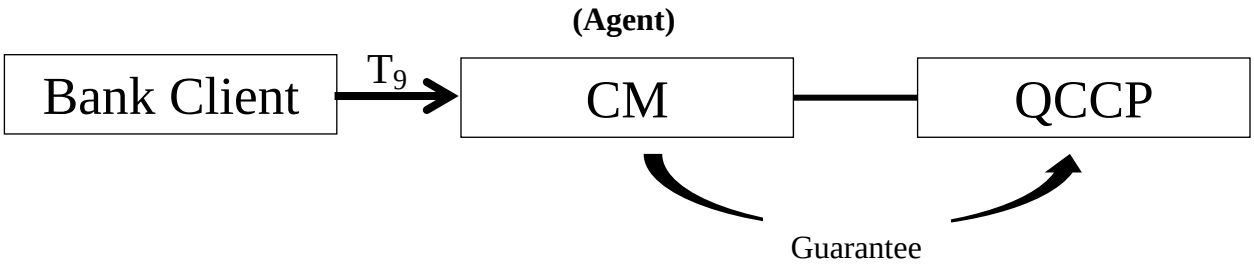


TABLE 21– RISK WEIGHTS FOR VARIOUS CLEARED TRANSACTIONS

	Exposure to	Description	Risk-weighting treatment under the interim final rule
T_1	QCCP	Own account	2% risk weight on trade exposure amount
T_2	Client	Financial intermediary with offsetting trade to QCCP	OTC derivative with CEM scalar**
T_3	QCCP	Financial intermediary with offsetting trade to QCCP	2% risk weight on trade exposure amount
T_4	Client	Agent with guarantee of client performance	OTC derivative with CEM scalar**
T_5	QCCP	Agent with guarantee of client performance	No exposure
T_6	Client	Guarantee of QCCP performance	OTC derivative with CEM scalar**
T_7	QCCP	Guarantee of QCCP performance	2% risk weight on trade exposure amount
T_8	CM	CM financial intermediary with offsetting trade to QCCP	2% or 4%* risk weight on trade exposure amount
T_9	QCCP	CM agent with guarantee of client performance	2% or 4%* risk weight on trade exposure amount

*Risk weight varies depending on compliance with bankruptcy remoteness of collateral and portability of client positions.
**Advanced approaches FDIC-supervised institution using the IMM may reduce the margin period of risk.

4. Default Fund Contribution Exposures

There are several risk mitigants available when a party clears a transaction through a CCP rather than on a bilateral basis: the protection provided to the CCP clearing members by the

margin requirements imposed by the CCP; the CCP members' default fund contributions; and the CCP's own capital and contribution to the default fund, which are an important source of collateral in case of counterparty default.[145] CCPs independently determine default fund contributions that are required from members. The BCBS therefore established, and the interim final rule adopts, a risk-sensitive approach for risk weighting an FDIC-supervised institution's exposure to a default fund.

Under the proposed rule, there was only one method that a clearing member banking organization could use to calculate its risk-weighted asset amount for default fund contributions. The BCBS CCP interim framework added a second method to better reflect the lower risks associated with exposures to those clearinghouses that have relatively large default funds with a significant amount unfunded. Commenters requested that the interim final rule adopt both methods contained in the BCBS CCP interim framework.

Accordingly, under the interim final rule, an FDIC-supervised institution that is a clearing member of a CCP must 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 FDIC-supervised institution or FDIC, in the financial condition of the CCP. A default fund contribution means the funds contributed or commitments made by a clearing member to a CCP's mutualized loss-sharing arrangement. If the CCP is not a QCCP, the FDIC-supervised institution's risk-weighted asset amount for its default fund contribution is either the sum of the default fund contributions multiplied by 1,250 percent, or in cases where the default fund contributions may be unlimited, an amount as determined by the FDIC based on factors described above.

[145] Default funds are also known as clearing deposits or guaranty funds.

Consistent with the BCBS CCP interim framework, the interim final rule requires an FDIC-supervised institution to calculate a risk-weighted asset amount for its default fund contribution using one of two methods. Method one requires a clearing member FDIC-supervised institution to use a three-step process. The first step is for the clearing member FDIC-supervised institution to calculate the QCCP's hypothetical capital requirement (K_{CCP}), unless the QCCP has already disclosed it, in which case the FDIC-supervised institution must rely on that disclosed figure, unless the FDIC-supervised institution determines that a higher figure is appropriate based on the nature, structure, or characteristics of the QCCP. K_{CCP} is defined as the capital that a QCCP is required to hold if it were an FDIC-supervised institution, and is calculated using the CEM for OTC derivatives or the collateral haircut approach for repo-style transactions, recognizing the risk-mitigating effects of collateral posted by and default fund contributions received from the QCCP clearing members.

The interim final rule provides several modifications to the calculation of K_{CCP} to adjust for certain features that are unique to QCCPs. Namely, the modifications permit: (1) a clearing member to offset its exposure to a QCCP with actual default fund contributions, and (2) greater recognition of netting when using the CEM to calculate K_{CCP} described below. Additionally, the risk weight of all clearing members is set at 20 percent, except when the FDIC 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 is 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 of method one, the interim final rule requires an FDIC-supervised institution to compare K_{CCP} to the funded portion of the default fund of a QCCP, and to calculate the total of all the clearing members' capital requirements (K^*_{cm}). If the total funded default fund of a QCCP is less than K_{CCP}, the interim final rule requires additional capital to 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} are risk-weighted at 100 percent and a decreasing capital factor, between 1.6 percent and 0.16 percent, is 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 is applied to the clearing members' default fund contributions.

In the third step of method one, the interim final rule requires (K^*_{cm}) to be 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 exposures among clearing members. A clearing member FDIC-supervised institution multiplies its allocated capital requirement by 12.5 to determine its risk-weighted asset amount for its default fund contribution to the QCCP.

As the alternative, an FDIC-supervised institution is permitted to use method two, which is a simplified method under which the risk-weighted asset amount for its default fund contribution to a QCCP equals 1,250 percent multiplied by the default fund contribution, subject

to an overall cap. The cap is based on an FDIC-supervised institution's trade exposure amount for all of its transactions with a QCCP. An FDIC-supervised institution's risk-weighted asset amount for its default fund contribution to a QCCP is either a 1,250 percent risk weight applied to its default fund contribution to that QCCP or 18 percent of its trade exposure amount to that QCCP. Method two subjects an FDIC-supervised institution to an overall cap on the risk-weighted assets from all its exposures to the CCP equal to 20 percent times the trade exposures to the CCP. This 20 percent cap is arrived at as the sum of the 2 percent capital requirement for trade exposure plus 18 percent for the default fund portion of an FDIC-supervised institution's exposure to a QCCP.

To address commenter concerns that the CEM underestimates the multilateral netting benefits arising from a QCCP, the interim final rule recognizes the larger diversification benefits inherent in a multilateral netting arrangement for purposes of measuring the QCCP's potential future exposure associated with derivative contracts. Consistent with the BCBS CCP interim framework, and as mentioned above, the interim final rule replaces the proposed factors (0.3 and 0.7) in the formula to calculate Anet with 0.15 and 0.85, in sections 35(d)(3)(i)(A)(1) and 133(d)(i)(A)(1) of the interim final rule, respectively .

F. Credit Risk Mitigation

Banking organizations use a number of techniques to mitigate credit risks. For example, a banking organization may collateralize exposures with cash or securities; a third party may guarantee an exposure; a banking organization may buy a credit derivative to 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 of the preamble describes how the interim final rule allows FDIC-

supervised institutions to recognize the risk-mitigation effects of guarantees, credit derivatives, and collateral for risk-based capital purposes. In general, the interim final rule provides for a greater variety of credit risk mitigation techniques than the general risk-based capital rules.

Similar to the general risk-based capital rules, under the interim final rule an FDIC-supervised institution generally may 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 FDIC-supervised institutions must 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. An FDIC-supervised institution 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, an FDIC-supervised institution should employ robust procedures and processes to control risks, including roll-off and concentration risks, and monitor and manage the implications of using credit risk mitigants for the FDIC-supervised institution's overall credit risk profile.

1. Guarantees and Credit Derivatives

a. Eligibility Requirements

Consistent with the Basel capital framework, the agencies proposed to recognize a wider range of eligible guarantors than permitted under the general risk-based capital rules, including sovereigns, the Bank for International Settlements, the International Monetary Fund, the

European Central Bank, the European Commission, Federal Home Loan Banks (FHLB), Federal Agricultural Mortgage Corporation (Farmer Mac), MDBs, depository institutions, BHCs, SLHCs, credit unions, and foreign banks. Eligible guarantors would also include entities that are not special purpose entities that have issued and outstanding unsecured debt securities without credit enhancement that are investment grade and that meet certain other requirements.[146]

Some commenters suggested modifying the proposed definition of eligible guarantor to remove the investment-grade requirement. Commenters also suggested that the agencies potentially include as eligible guarantors other entities, such as financial guaranty and private mortgage insurers. The FDIC believes that guarantees issued by these types of entities can exhibit significant wrong-way risk and modifying the definition of eligible guarantor to accommodate these entities or entities that are not investment grade would be contrary to one of the key objectives of the capital framework, which is to mitigate interconnectedness and systemic vulnerabilities within the financial system. Therefore, the FDIC has not included the recommended entities in the interim final rule's definition of "eligible guarantor." The FDIC has, however, amended the definition of eligible guarantor in the interim final rule to include QCCPs to accommodate use of the substitution approach for credit derivatives that are cleared transactions. The FDIC believes that QCCPs, as supervised entities subject to specific risk-management standards, are appropriately included as eligible guarantors under the interim final

[146] Under the proposed and interim final rule, an exposure is "investment grade" if the entity to which the FDIC-supervised institution 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.

rule.[147] In addition, the FDIC clarifies one commenter's concern and confirms that re-insurers that are engaged predominantly in the business of providing credit protection do not qualify as an eligible guarantor under the interim final rule.

Under the interim final rule, guarantees and credit derivatives are required to meet specific eligibility requirements to be recognized for credit risk mitigation purposes. Consistent with the proposal, under the interim final rule, an eligible guarantee is defined as a guarantee from an eligible guarantor that is written and meets certain standards and conditions, including with respect to its enforceability. An eligible credit derivative is defined as a credit derivative in the form of a CDS, n^{th}-to-default swap, total return swap, or any other form of credit derivative approved by the FDIC, provided that the instrument meets the standards and conditions set forth in the definition. See the definitions of "eligible guarantee" and "eligible credit derivative" in section 2 of the interim final rule.

Under the proposal, a banking organization would have been 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; (2) the reference exposure and the hedged exposure are to the same legal entity; and (3) 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.

In addition to these two exceptions, one commenter encouraged the agencies to revise the interim final rule to recognize a proxy hedge as an eligible credit derivative even though such a

[147] See the definition of "eligible guarantor" in section 2 of the interim final rule.

transaction hedges an exposure that differs from the credit derivative's reference exposure. A proxy hedge was characterized by the commenter as a hedge of an exposure supported by a sovereign using a credit derivative on that sovereign. The FDIC does not believe there is sufficient justification to include proxy hedges in the definition of eligible credit derivative because it has concerns regarding the ability of the hedge to sufficiently mitigate the risk of the underlying exposure. The FDIC has, therefore, adopted the definition of eligible credit derivative as proposed.

In addition, under the interim final rule, consistent with the proposal, when an FDIC-supervised institution has a group of hedged exposures with different residual maturities that are covered by a single eligible guarantee or eligible credit derivative, it must treat each hedged exposure as if it were fully covered by a separate eligible guarantee or eligible credit derivative.

b. Substitution Approach

The FDIC is adopting the substitution approach for eligible guarantees and eligible credit derivatives in the interim final rule without change. Under the 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, an FDIC-supervised institution substitutes the risk weight applicable to the guarantor or credit derivative protection provider for the risk weight applicable 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, an FDIC-supervised institution must 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, an FDIC-supervised institution calculates the risk-weighted asset amount for the protected exposure under section 36

of the interim final rule (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 FDIC-supervised institution calculates its risk-weighted asset amount for the unprotected exposure under section 32 of the interim final rule (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).

Under the interim final rule, the protection amount of an eligible guarantee or eligible credit derivative means the effective notional amount of the guarantee or credit derivative reduced to reflect any, maturity mismatch, lack of restructuring coverage, or currency mismatch as described below. The effective notional amount for an eligible guarantee or eligible credit derivative is 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 is $40.

c. Maturity Mismatch Haircut

The FDIC is adopting the proposed haircut for maturity mismatch in the interim final rule without change. Under the interim final rule, the FDIC has adopted the requirement that an FDIC-supervised institution that recognizes an eligible guarantee or eligible credit derivative 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. A maturity mismatch

occurs when the residual maturity of a credit risk mitigant is less than that of the hedged exposure(s).[148]

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. An FDIC-supervised institution is 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 is 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 is at the first call date. If the call is at the discretion of the FDIC-supervised institution purchasing the protection, but the terms of the arrangement at origination of the credit risk mitigant contain a positive incentive for the FDIC-supervised institution to call the transaction before contractual maturity, the remaining time to the first call date is the residual maturity of the credit risk mitigant. An FDIC-supervised institution is permitted, under the interim final rule, 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, an FDIC-supervised institution is required to apply the following adjustment to reduce the effective notional amount of the credit risk mitigant to recognize the maturity mismatch: $Pm = E \times [(t-0.25)/(T-0.25)]$, where:

[148] As noted above, when an FDIC-supervised institution has a group of hedged exposures with different residual maturities that are covered by a single eligible guarantee or eligible credit derivative, an FDIC-supervised institution treats 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 FDIC-supervised institution assesses whether the residual maturity of the eligible guarantee or eligible credit derivative is less than that of the hedged exposure.

(1) Pm equals effective notional amount of the credit risk mitigant, adjusted for maturity mismatch;

(2) E equals effective notional amount of the credit risk mitigant;

(3) t equals the lesser of T or residual maturity of the credit risk mitigant, expressed in years; and

(4) T equals 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

The FDIC is adopting in the interim final rule the proposed adjustment for credit derivatives without restructuring as a credit event. Consistent with the proposal, under the interim final rule, an FDIC-supervised institution that seeks to recognize an eligible credit derivative that does not include a restructuring of the hedged exposure as a credit event under the derivative must reduce the effective notional amount of the credit derivative recognized for credit risk mitigation purposes by 40 percent. For purposes of the credit risk mitigation framework, a restructuring may 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 FDIC-supervised institution is required to apply the following adjustment to reduce the effective notional amount of the credit derivative: Pr equals Pm x 0.60, where:

(1) Pr equals effective notional amount of the credit risk mitigant, adjusted for lack of a restructuring event (and maturity mismatch, if applicable); and

(2) Pm equals effective notional amount of the credit risk mitigant (adjusted for maturity mismatch, if applicable).

e. Currency Mismatch Adjustment

Consistent with the proposal, under the interim final rule, if an FDIC-supervised institution 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 FDIC-supervised institution must apply the following formula to the effective notional amount of the guarantee or credit derivative: P_C equals Pr x (1-H_{FX}), where:

(1) Pc equals effective notional amount of the credit risk mitigant, adjusted for currency mismatch (and maturity mismatch and lack of restructuring event, if applicable);

(2) Pr equals effective notional amount of the credit risk mitigant (adjusted for maturity mismatch and lack of restructuring event, if applicable); and

(3) H_{FX} equals haircut appropriate for the currency mismatch between the credit risk mitigant and the hedged exposure.

An FDIC-supervised institution is 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, an FDIC-supervised institution has the option to use internally estimated haircuts of H_{FX} based on a ten-business-day holding period and daily marking-to-market if the FDIC-supervised institution qualifies to use the own-estimates of haircuts in section 37(c)(4) of the interim final rule. In either case, the FDIC-supervised institution is required to scale the haircuts up using the square root of time formula if the FDIC-supervised institution 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

Consistent with the proposal, under the interim final rule, if multiple credit risk mitigants cover a single exposure, an FDIC-supervised institution may 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 a single credit risk mitigant covers multiple exposures, an FDIC-supervised institution must treat each hedged exposure as covered by a single credit risk mitigant and must calculate separate risk-weighted asset amounts for each exposure using the substitution approach described in section 36(c) of the interim final rule.

2. Collateralized Transactions

a. Eligible Collateral

Under the proposal, the agencies would recognize an expanded range of financial collateral as credit risk mitigants that may reduce the risk-based capital requirements associated with a collateralized transaction, consistent with the Basel capital framework. The agencies proposed that a banking organization could recognize the risk-mitigating effects of financial collateral using the "simple approach" for any exposure provided that the collateral meets certain requirements. 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. The proposal required a banking organization to use the same approach for similar exposures or transactions.

The commenters generally agreed with this aspect of the proposal; however, a few commenters encouraged the agencies to expand the definition of financial collateral to include precious metals and certain residential mortgages that collateralize warehouse lines of credit.

Several commenters asserted that the interim final rule should recognize as financial collateral conforming residential mortgages (or at least those collateralizing warehouse lines of credit) and/or those insured by the FHA or VA. They noted that by not including conforming residential mortgages in the definition of financial collateral, the proposed rule would require banking organizations providing warehouse lines to treat warehouse facilities as commercial loan exposures, thus preventing such entities from looking through to the underlying collateral in calculating the appropriate risk weighting. Others argued that a "look through" approach for a repo-style structure to the financial collateral held therein should be allowed. Another commenter argued that the interim final rule should allow recognition of intangible assets as financial collateral because they have real value. The FDIC believes that the collateral types suggested by the commenters are not appropriate forms of financial collateral because they exhibit increased variation and credit risk, and are relatively more speculative than the recognized forms of financial collateral under the proposal. For example, residential mortgages can be highly idiosyncratic in regards to payment features, interest rate provisions, lien seniority, and maturities. The FDIC believes that the proposed definition of financial collateral, which is broader than the collateral recognized under the general risk-based capital rules, included those collateral types of sufficient liquidity and asset quality to recognize as credit risk mitigants for risk-based capital purposes. As a result, the FDIC has retained the definition of financial collateral as proposed. Therefore, consistent with the proposal, the interim final rule defines financial collateral as collateral in the form of: (1) cash on deposit with the FDIC-supervised institution (including cash held for the FDIC-supervised institution 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 FDIC-supervised institution is also 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. Even if an FDIC-supervised institution has the legal right, it still must ensure it monitors or has a freeze on the account to prevent a customer from withdrawing cash on deposit prior to defaulting. An FDIC-supervised institution is permitted to recognize partial collateralization of an exposure.

Under the interim final rule, the FDIC requires that an FDIC-supervised institution to recognize the risk-mitigating effects of financial collateral using the simple approach described below, where: the collateral is subject to a collateral agreement for at least the life of the exposure; the collateral is revalued at least every six months; and the collateral (other than gold) and the exposure is denominated in the same currency. For repo-style transactions, eligible margin loans, collateralized derivative contracts, and single-product netting sets of such transactions, an FDIC-supervised institution could alternatively use the collateral haircut approach described below. The interim final rule, like the proposal, requires an FDIC-supervised institution to use the same approach for similar exposures or transactions.

b. Risk-management Guidance for Recognizing Collateral

Before an FDIC-supervised institution 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 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.

An FDIC-supervised institution also should ensure that the legal mechanism under which the collateral is pledged or transferred ensures that the FDIC-supervised institution 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, an FDIC-supervised institution 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 satisfaction 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

The FDIC is adopting the simple approach without change for purposes of the interim final rule. Under the interim final rule, the collateralized portion of the exposure receives the risk weight applicable to the collateral. The collateral is required to meet the definition of financial collateral. For repurchase agreements, reverse repurchase agreements, and securities lending and borrowing transactions, the collateral would be the instruments, gold, and cash that

an FDIC-supervised institution has borrowed, purchased subject to resale, or taken as collateral from the counterparty under the transaction. As noted above, in all cases, (1) the collateral must be subject to a collateral agreement for at least the life of the exposure; (2) the FDIC-supervised institution must revalue the collateral at least every six months; and (3) the collateral (other than gold) and the exposure must be denominated in the same currency.

Generally, the risk weight assigned to the collateralized portion of the exposure must be no less than 20 percent. However, the collateralized portion of an exposure may be assigned a risk weight of less than 20 percent for the following exposures. OTC derivative contracts that are marked to fair value on a daily basis and subject to a daily margin maintenance agreement, may receive (1) a zero percent risk weight to the extent that contracts 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 that qualifies for a zero percent risk weight under section 32 of the interim final rule. In addition, an FDIC-supervised institution 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 interim final rule, and the FDIC-supervised institution has discounted the fair value of the collateral by 20 percent.

d. Collateral Haircut Approach

Consistent with the proposal, in the interim final rule, an FDIC-supervised institution may use the collateral haircut approach to 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. In addition, the FDIC-supervised institution may use the collateral haircut approach with respect to any collateral that

secures a repo-style transaction that is included in the FDIC-supervised institution's VaR-based measure under subpart F of the interim final rule, even if the collateral does not meet the definition of financial collateral.

To apply the collateral haircut approach, an FDIC-supervised institution must determine the exposure amount and the relevant risk weight for the counterparty or guarantor.

The exposure amount for an eligible margin loan, repo-style transaction, collateralized derivative contract, or a netting set of such transactions is equal to the greater of zero and the sum of the following three quantities:

(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 FDIC-supervised institution 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 interim final rule. The value of the collateral equals the sum of the current market values of all instruments, gold and cash the FDIC-supervised institution 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 FDIC-supervised institution 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 FDIC-supervised institution 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 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 FDIC-supervised institution 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 FDIC-supervised institution 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 includes, 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

When determining the exposure amount, the FDIC-supervised institution must apply a haircut for price market volatility and foreign exchange rates, determined either using standard supervisory market price volatility haircuts and a standard haircut for exchange rates or, with prior approval of the agency, an FDIC-supervised institution's own estimates of volatilities of market prices and foreign exchange rates.

The standard supervisory market price volatility haircuts set a specified market price volatility haircut for various categories of financial collateral. These standard haircuts are based on the ten-business-day holding period for eligible margin loans and derivative contracts. For repo-style transactions, an FDIC-supervised institution may multiply the standard supervisory

haircuts by the square root of ½ to scale them for a holding period of five business days. Several commenters argued that the proposed haircuts were too conservative and insufficiently risk-sensitive, and that FDIC-supervised institutions should be allowed to compute their own haircuts. Some commenters proposed limiting the maximum haircut for non-sovereign issuers that receive a 100 percent risk weight to 12 percent and, more specifically, assigning a lower haircut than 25 percent for financial collateral in the form of an investment-grade corporate debt security that has a shorter residual maturity. The commenters asserted that these haircuts conservatively correspond to the existing rating categories and result in greater alignment with the Basel framework.

In the interim final rule, the FDIC has revised from 25.0 percent the standard supervisory market price volatility haircuts for financial collateral issued by non-sovereign issuers with a risk weight of 100 percent to 4.0 percent for maturities of less than one year, 8.0 percent for maturities greater than one year but less than or equal to five years, and 16.0 percent for maturities greater than five years, consistent with Table 22 below. The FDIC believes that the revised haircuts better reflect the collateral's credit quality and an appropriate differentiation based on the collateral's residual maturity.

An FDIC-supervised institution using the standard currency mismatch haircut is required to use an 8 percent haircut for each currency mismatch for transactions subject to a 10 day holding period, as adjusted for different required holding periods. One commenter asserted that the proposed adjustment for currency mismatch was unwarranted because in securities lending transactions, the parties typically require a higher collateral margin than in transactions where there is no mismatch. In the alternative, the commenter argued that the agencies should align the currency mismatch haircut more closely with a given currency combination and suggested those

currencies of countries with a more favorable CRC from the OECD should receive a smaller haircut. The FDIC has decided to adopt this aspect of the proposal without change in the interim final rule. The FDIC believes that the own internal estimates for haircuts methodology described below allows FDIC-supervised institutions appropriate flexibility to more granularly reflect individual currency combinations, provided they meet certain criteria.

TABLE 22 – STANDARD SUPERVISORY MARKET PRICE VOLATILITY HAIRCUTS[1]

Residual maturity	Haircut (in percent) assigned based on:						Investment-grade securitization exposures (in percent)
	Sovereign issuers risk weight under § 32[2]			Non-sovereign issuers risk weight under § 32			
	Zero	20 or 50	100	20	50	100	
Less than or equal to 1 year	0.5	1.0	15.0	1.0	2.0	4.0	4.0
Greater than 1 year and less than or equal to 5 years	2.0	3.0	15.0	4.0	6.0	8.0	12.0
Greater than 5 years	4.0	6.0	15.0	8.0	12.0	16.0	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				Zero			
Other exposure types				25.0			

[1] The market price volatility haircuts in Table 22 are based on a 10 business-day holding period.
[2] Includes a foreign PSE that receives a zero percent risk weight.

The interim final rule requires that an FDIC-supervised institution increase the standard supervisory haircut for transactions involving large netting sets. As noted in the proposed rule, during the recent 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.

Thus, consistent with the proposed rule, 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, the interim final rule requires an FDIC-supervised institution to assume a holding period of 20 business days for the collateral under the collateral haircut approach. The formula and methodology for increasing the haircut to reflect the longer holding period is described in section 37(c) of the interim final rule. Consistent with the Basel capital framework, an FDIC-supervised institution is not required to adjust the holding period upward for cleared transactions. When determining whether collateral is illiquid or whether an OTC derivative cannot be easily replaced for these purposes, an FDIC-supervised institution 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).

One commenter requested the agencies clarify whether the 5,000-trade threshold applies on a counterparty-by-counterparty (rather than aggregate) basis, and only will be triggered in the event there are 5,000 open trades with a single counterparty within a single netting set in a given quarter. Commenters also asked whether the threshold would be calculated on an average basis

or whether a de minimis number of breaches could be permitted without triggering the increased holding period or margin period of risk. One commenter suggested eliminating the threshold because it is ineffective as a measure of risk, and combined with other features of the proposals (for example, collateral haircuts, margin disputes), could create a disincentive for FDIC-supervised institutions to apply sound practices such as risk diversification.

The FDIC notes that the 5,000-trade threshold applies to a netting set, which by definition means a group of transactions with a single counterparty that are subject to a qualifying master netting agreement. The 5,000 trade calculation threshold was proposed as an indicator that a set of transactions may be more complex, or require a lengthy period, to close out in the event of a default of a counterparty. The FDIC continues to believe that the threshold of 5,000 is a reasonable indicator of the complexity of a close-out. Therefore, the interim final rule retains the 5,000 trade threshold as proposed, without any de minimis exception.

One commenter asked the agencies to clarify how trades would be counted in the context of an indemnified agency securities lending relationship. In such transactions, an agent banking organization acts as an intermediary for, potentially, multiple borrowers and lenders. The banking organization is acting as an agent with no exposure to either the securities lenders or borrowers except for an indemnification to the securities lenders in the event of a borrower default. The indemnification creates an exposure to the securities borrower, as the agent banking organization could suffer a loss upon the default of a borrower. In these cases, each transaction between the agent and a borrower would count as a trade. The FDIC notes that a trade in this

instance consists of an order by the borrower, and not the number of securities lenders providing shares to fulfil the order or the number of shares underlying such order.[149]

The commenters also addressed the longer holding period for trades involving illiquid collateral posted by the counterparty. Some commenters asserted that one illiquid exposure or one illiquid piece of collateral should not taint the entire netting set. Other commenters recommended applying a materiality threshold (for example, 1 percent) below which one or more illiquid exposures would not trigger the longer holding period, or allowing banking organizations to define "materiality" based on experience.

Regarding the potential for an illiquid exposure to "taint" an entire netting set, the interim final rule does not require an FDIC-supervised institution to recognize any piece of collateral as a risk mitigant. Accordingly, if an FDIC-supervised institution elects to exclude the illiquid collateral from the netting set for purposes of calculating risk-weighted assets, then such illiquid collateral does not result in an increased holding period for the netting set. With respect to a derivative that may not be easily replaced, an FDIC-supervised institution could create a separate netting set that would preserve the holding period for the original netting set of easily replaced transactions. Accordingly, the interim final rule adopts this aspect of the proposal without change.

One commenter asserted that the interim final rule should not require a banking organization to determine whether an instrument is liquid on a daily basis, but rather should base the timing of such determination by product category and on long-term liquidity data. According

[149] In the event that the agent FDIC-supervised institution reinvests the cash collateral proceeds on behalf of the lender and provides an explicit or implicit guarantee of the value of the collateral in such pool, the FDIC-supervised institution should hold capital, as appropriate, against the risk of loss of value of the collateral pool.

to the commenter, such an approach would avoid potential confusion, volatility and destabilization of the funding markets. For purposes of determining whether collateral is illiquid or an OTC derivative contract is easily replaceable under the interim final rule, an FDIC-supervised institution may 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). An FDIC-supervised institution is not required to make a daily determination of liquidity under the interim final rule; rather, FDIC-supervised institutions should have policies and procedures in place to evaluate the liquidity of their collateral as frequently as warranted.

Under the proposed rule, a banking organization would increase the holding period for a netting set if over the two previous quarters more than two margin disputes on a netting set have occurred that lasted longer than the holding period. However, consistent with the Basel capital framework, a banking organization would not be required to adjust the holding period upward for cleared transactions. Several commenters requested further clarification on the meaning of "margin disputes." Some of these commenters suggested restricting "margin disputes" to formal legal action. Commenters also suggested restricting "margin disputes" to disputes resulting in the creation of an exposure that exceeded any available overcollateralization, or establishing a materiality threshold. One commenter suggested that margin disputes were not an indicator of an increased risk and, therefore, should not trigger a longer holding period.

The FDIC continues to believe that an increased holding period is appropriate regardless of whether the dispute exceeds applicable collateral requirements and regardless of whether the disputes exceed a materiality threshold. The FDIC expects that the determination as to whether a

dispute constitutes a margin dispute for purposes of the interim final rule will depend solely on the timing of the resolution. That is to say, if collateral is not delivered within the time period required under an agreement, and such failure to deliver is not resolved in a timely manner, then such failure would count toward the two-margin-dispute limit. For the purpose of the interim final rule, where a dispute is subject to a recognized industry dispute resolution protocol, the FDIC expects to consider the dispute period to begin after a third-party dispute resolution mechanism has failed.

For comments and concerns that are specific to the parallel provisions in the advanced approaches rule, reference section XII.A of this preamble.

f. Own Estimates of Haircuts

Under the interim final rule, consistent with the proposal, FDIC-supervised institutions may calculate market price volatility and foreign exchange volatility using own internal estimates with prior written approval of the FDIC. To receive approval to calculate haircuts using its own internal estimates, an FDIC-supervised institution must meet certain minimum qualitative and quantitative standards set forth in the interim final rule, including the requirements that an FDIC-supervised institution: (1) uses a 99th 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) adjusts holding periods upward where and as appropriate to take into account the illiquidity of an instrument; (3) selects a historical observation period that reflects a continuous 12-month period of significant financial stress appropriate to the FDIC-supervised institution's current portfolio; and (4) updates its data sets and compute haircuts no less frequently than quarterly, as well as any time market prices change materially. An FDIC-supervised institution estimates the volatilities of exposures, the

collateral, and foreign exchange rates and should not take into account the correlations between them.

The interim final rule provides a formula for converting own-estimates of haircuts based on a holding period different from the minimum holding period under the rule to haircuts consistent with the rule's minimum holding periods. The minimum holding periods for netting sets with more than 5,000 trades, netting sets involving illiquid collateral or an OTC derivative that cannot easily be replaced, and netting sets involving more than two margin disputes over the previous two quarters described above also apply for own-estimates of haircuts.

Under the interim final rule, an FDIC-supervised institution is required to have policies and procedures that describe how it determines the period of significant financial stress used to calculate the FDIC-supervised institution's own internal estimates, and to be able to provide empirical support for the period used. These policies and procedures must address (1) how the FDIC-supervised institution links the period of significant financial stress used to calculate the own internal estimates to the composition and directional bias of the FDIC-supervised institution's current portfolio; and (2) the FDIC-supervised institution'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 FDIC-supervised institution's current portfolio. The FDIC-supervised institution is required to obtain the prior approval of the FDIC for these policies and procedures and notify the FDIC if it makes any material changes to them. The FDIC may require it to use a different period of significant financial stress in the calculation of its own internal estimates.

Under the interim final rule, an FDIC-supervised institution is allowed to calculate internally estimated haircuts for categories of debt securities that are investment-grade

exposures. The haircut for a category of securities must be representative of the internal volatility estimates for securities in that category that the FDIC-supervised institution has lent, sold subject to repurchase, posted as collateral, borrowed, purchased subject to resale, or taken as collateral. In determining relevant categories, the FDIC-supervised institution 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.

An FDIC-supervised institution must calculate a separate internally estimated haircut for each individual non-investment-grade debt security and for each individual equity security. In addition, an FDIC-supervised institution must 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 and Internal Models Methodology

In the NPR, the agencies did not propose a simple VaR approach to calculate exposure amounts for eligible margin loans and repo-style transactions or IMM to calculate the exposure amount for the counterparty credit exposure for OTC derivatives, eligible margin loans, and repo-style transactions. These methodologies are included in the advanced approaches rule. The agencies sought comment on whether to implement the simple VaR approach and IMM in the standardized approach. Several commenters asserted that the IMM and simple VaR approach should be implemented in the interim final rule to better capture the risk of counterparty credit exposures. The FDIC has considered these comments and has concluded that the increased complexity and limited applicability of these models-based approaches is inconsistent with the

FDIC's overall focus in the standardized approach on simplicity, comparability, and broad applicability of methodologies for U.S. FDIC-supervised institutions. Therefore, consistent with the proposal, the interim final rule does not include the simple VaR approach or the IMM in the standardized approach.

G. Unsettled Transactions

Under the proposed rule, a banking organization would be required to hold capital against the risk of certain unsettled transactions. One commenter expressed opposition to assigning a risk weight to unsettled transactions where previously none existed, because it would require a significant and burdensome tracking process without commensurate benefit. The FDIC believes that it is important for an FDIC-supervised institution to have procedures to identify and track a delayed or unsettled transaction of the types specified in the rule. Such procedures capture the resulting risks associated with such delay. As a result, the FDIC is adopting the risk-weighting requirements as proposed.

Consistent with the proposal, the interim final rule 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. Under the interim final rule, the capital requirement does 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 defined as the lesser

of the market standard for the particular instrument or five business days).[150] In the case of a system-wide failure of a settlement, clearing system, or central counterparty, the FDIC may waive risk-based capital requirements for unsettled and failed transactions until the situation is rectified.

The interim final rule provides 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 refers 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 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. A transaction is 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.

Consistent with the proposal, under the interim final rule, an FDIC-supervised institution is required to hold risk-based capital against a DvP or PvP transaction with a normal settlement period if the FDIC-supervised institution's counterparty has not made delivery or payment within five business days after the settlement date. The FDIC-supervised institution determines its risk-weighted asset amount for such a transaction by multiplying the positive current exposure of the transaction for the FDIC-supervised institution by the appropriate risk weight in Table 23. The

[150] Such transactions are treated as derivative contracts as provided in section 34 or section 35 of the interim final rule.

positive current exposure from an unsettled transaction of an FDIC-supervised institution 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 FDIC-supervised institution to the counterparty.

TABLE 23 – 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

An FDIC-supervised institution must hold risk-based capital against any non-DvP/non-PvP transaction with a normal settlement period if the FDIC-supervised institution 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 FDIC-supervised institution must continue to hold risk-based capital against the transaction until it has received the corresponding deliverables. From the business day after the FDIC-supervised institution has made its delivery until five business days after the counterparty delivery is due, the FDIC-supervised institution must calculate the risk-weighted asset amount for the transaction by risk weighting the current fair value of the deliverables owed to the FDIC-supervised institution, using the risk weight appropriate for an exposure to the counterparty in accordance with section 32. If an FDIC-supervised institution has not received its deliverables by the fifth business day

after the counterparty delivery due date, the FDIC-supervised institution must assign a 1,250 percent risk weight to the current market value of the deliverables owed.

H. Risk-weighted Assets for Securitization Exposures

In the proposal, the agencies proposed to significantly revise the risk-based capital framework for securitization exposures. These proposed revisions included removing references to and reliance on credit ratings to determine risk weights for these exposures and using alternative standards of creditworthiness, as required by section 939A of the Dodd-Frank Act. These alternative standards were designed to produce capital requirements that generally would be consistent with those under the BCBS securitization framework and were consistent with those incorporated into the agencies' market risk rule.[151] They would have replaced both the ratings-based approach and an approach that permits banking organizations to use supervisor-approved internal systems to replicate external ratings processes for certain unrated exposures in the general risk-based capital rules.

In addition, the agencies proposed to update the terminology for the securitization framework, include a definition of securitization exposure that encompasses a wider range of exposures with similar risk characteristics, and implement new due diligence requirements for securitization exposures.

1. Overview of the Securitization Framework and Definitions

The proposed securitization framework was designed to address the credit risk of exposures that involve the tranching of credit risk of one or more underlying financial exposures. Consistent with the proposal, the interim final rule defines a securitization exposure as an on- or

[151] 77 FR 53060 (August 30, 2012).

off-balance sheet credit exposure (including credit-enhancing representations and warranties) that arises from a traditional or synthetic securitization (including a resecuritization), or an exposure that directly or indirectly references a securitization exposure. Commenters expressed concerns that the proposed scope of the securitization framework was overly broad and requested that the definition of securitizations be narrowed to exposures that tranche the credit risk associated with a pool of assets. However, the FDIC believes that limiting the securitization framework to exposures backed by a pool of assets would exclude tranched credit risk exposures that are appropriately captured under the securitization framework, such as certain first loss or other tranched guarantees provided to a single underlying exposure.

In the proposal a traditional securitization was defined, in part, as a transaction in which credit risk of one or more underlying exposures has been transferred to one or more third parties (other than through the use of credit derivatives or guarantees), where the credit risk associated with the underlying exposures has been separated into at least two tranches reflecting different levels of seniority. The definition included certain other conditions, such as requiring all or substantially all of the underlying exposures to be financial exposures. The FDIC has decided to finalize the definition of traditional securitization largely as proposed, with some revisions (as discussed below), that reflect certain comments regarding exclusions under the framework and other modifications to the interim final rule.

Both the designation of exposures as securitization exposures (or resecuritization exposures, as described below) and the calculation of risk-based capital requirements for securitization exposures under the interim final rule are guided by the economic substance of a transaction rather than its legal form. Provided there is tranching of credit risk, securitization exposures could include, among other things, ABS and MBS, 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 credit-enhancing interest-only strips (CEIOs). Securitization exposures also include assets sold with retained tranches.

The FDIC believes that requiring all or substantially all of the underlying exposures of a securitization to 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, the FDIC also considers asset classes such as lease residuals and entertainment royalties to be financial assets. The securitization framework is not designed, however, to apply to tranched credit exposures to commercial or industrial companies or nonfinancial assets or to amounts deducted from capital under section 22 of the interim final rule. Accordingly, 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).

Consistent with the proposal, under the interim final rule, an operating company does not fall under the definition of a traditional securitization (even if substantially all of its assets are financial exposures). Operating companies generally refer to companies that are established to conduct business with clients with the intention of earning a profit in their own right and generally produce goods or provide services beyond the business of investing, reinvesting,

holding, or trading in financial assets. Accordingly, an equity investment in an operating company generally would be an equity exposure. Under the interim final rule, FDIC-supervised institutions are operating companies and do not fall under the definition of a traditional securitization. However, 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 under the interim final rule and would not qualify for this general exclusion from the definition of traditional securitization.

Under the proposed rule, paragraph (10) of the definition of traditional securitization specifically excluded exposures to investment funds (as defined in the proposal) and collective investment and pension funds (as defined in relevant regulations and set forth in the proposed definition of "traditional securitization"). These specific exemptions served 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 registered with the SEC under the Investment Company Act of 1940 and their foreign equivalents would be exempted from the definition because these entities and transactions are regulated and subject to strict leverage requirements. The proposal defined an investment fund as 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 explained in the proposal 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.

Commenters generally agreed with the proposed exemptions from the definition of traditional securitization and requested that the agencies provide exemptions for exposures to a

broader set of investment firms, such as pension funds operated by state and local governments. In view of the comments regarding pension funds, the interim final rule provides an additional exclusion from the definition of traditional securitization for a "governmental plan" (as defined in 29 U.S.C. 1002(32)) that complies with the tax deferral qualification requirements provided in the Internal Revenue Code. The FDIC believes that an exemption for such government plans is appropriate because they are subject to substantial regulation. Commenters also requested that the agencies provide exclusions for certain products provided to investment firms, such as extensions of short-term credit that support day-to-day investment-related activities. The FDIC believes that exposures that meet the definition of traditional securitization, regardless of product type or maturity, would fall under the securitization framework. Accordingly, the FDIC has not provided for any such exemptions under the interim final rule.[152]

To address the treatment of investment firms that are not specifically excluded from the securitization framework, the proposed rule provided discretion to the primary Federal supervisor of a banking organization to exclude from the definition of a traditional securitization those transactions 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. While the commenters supported the agencies' recognition that certain investment firms may warrant an exemption from the securitization framework, some expressed concern that the process for making such a determination may present significant implementation burden.

[152] The interim final rule also clarifies that the portion of a synthetic exposure to the capital of a financial institution that is deducted from capital is not a traditional securitization.

To maintain sufficient flexibility to provide an exclusion for certain investment firms from the securitization framework, the FDIC has retained this discretionary provision in the interim final rule without change. In determining whether to exclude an investment firm from the securitization framework, the FDIC will consider a number of factors, including the assessment of the transaction's leverage, risk profile, and economic substance. This supervisory exclusion gives the FDIC discretion to distinguish structured finance transactions, to which the securitization framework is 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, are eligible for the exclusion from the definition of traditional securitization under this provision. The FDIC does 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 meet the definition of traditional securitization under the interim final rule.

The line between securitization exposures and non-securitization exposures may be difficult to identify in some circumstances. In addition to the supervisory exclusion from the definition of traditional securitization described above, FDIC may expand the scope of the securitization framework to include other transactions if doing so is justified by the economics of the transaction. Similar to the analysis for excluding an investment firm from treatment as a traditional securitization, the FDIC will consider the economic substance, leverage, and risk profile of a transaction to ensure that an appropriate risk-based capital treatment is applied. The FDIC will 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.

Under the proposal, a synthetic securitization was defined as 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). The FDIC has decided to finalize the definition of synthetic securitization largely as proposed, but has also clarified in the interim final rule that transactions in which a portion of credit risk has been retained, not just transferred, through the use of credit derivatives is subject to the securitization framework.

In response to the proposal, commenters requested that the agencies provide an exemption for guarantees that tranche credit risk under certain mortgage partnership finance programs, such as certain programs provided by the FHLBs, whereby participating member banking organizations provide credit enhancement to a pool of residential mortgage loans that have been delivered to the FHLB. The FDIC believes that these exposures that tranche credit risk meet the definition of a synthetic securitization and that the risk of such exposures would be

appropriately captured under the securitization framework. In contrast, mortgage-backed pass-through securities (for example, those guaranteed by FHLMC or FNMA) that feature various maturities but do not involve tranching of credit risk do not meet the definition of a securitization exposure. Only those MBS that involve tranching of credit risk are considered to be securitization exposures.

Consistent with the 2009 Enhancements, the proposed rule defined 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. A resecuritization would have meant a securitization in which one or more of the underlying exposures is a securitization exposure. An exposure to an asset-backed commercial paper (ABCP) program would not have been 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.

Commenters asked the agencies to narrow the definition of resecuritization by exempting resecuritizations in which a minimal amount of underlying assets are securitization exposures. According to commenters, the proposed definition would have a detrimental effect on certain collateralized loan obligation exposures, which typically include a small amount of securitization exposures as part of the underlying pool of assets in a securitization. Specifically, the commenters requested that resecuritizations be defined as a securitization in which five percent or more of the underlying exposures are securitizations. Commenters also asked the agencies to consider employing a pro rata treatment by only applying a higher capital surcharge to the

portion of a securitization exposure that is backed by underlying securitization exposures. The FDIC believes that the introduction of securitization exposures into a pool of securitized exposures significantly increases the complexity and correlation risk of the exposures backing the securities issued in the transaction, and that the resecuritization framework is appropriate for applying risk-based capital requirements to exposures to pools that contain securitization exposures.

Commenters sought clarification as to whether the proposed definition of resecuritization would include a single exposure that has been retranched, such as a resecuritization of a real estate mortgage investment conduit (Re-REMIC). The FDIC believes that the increased capital surcharge, or p factor, for resecuritizations was meant to address the increased correlation risk and complexity resulting from retranching of multiple underlying exposures and was not intended to apply to the retranching of a single underlying exposure. As a result, the definition of resecuritization in the interim final rule has been refined to clarify that resecuritizations do not include exposures comprised of a single asset that has ben retranched. The FDIC notes that for purposes of the interim final rule, a resecuritization does not include pass-through securities that have been pooled together and effectively re-issued as tranched securities. This is because the pass-through securities do not tranche credit protection and, as a result, are not considered securitization exposures under the interim final rule.

Under the interim final rule, if a transaction involves a traditional multi-seller ABCP conduit, an FDIC-supervised institution must 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 loans. To ensure that the commercial paper issued by each conduit is highly-rated, an FDIC-supervised institution 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 is not a resecuritization exposure under the interim final rule 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 constitutes tranching of risk of a pool of multiple assets containing at least one securitization exposure, and, therefore, is 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 is not a resecuritization exposure if, as noted above, either (1) the program-wide credit enhancement does not meet the definition of a resecuritization exposure or (2) the commercial paper is fully supported by the sponsoring FDIC-supervised institution. When the sponsoring FDIC-supervised institution fully supports the commercial paper, the commercial paper holders effectively are exposed to default risk of the sponsor instead of the underlying exposures, and the external rating of the commercial paper is expected to be based primarily on the credit quality of the FDIC-supervised institution 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 ratings issued by Nationally Recognized Statistical Rating Organizations (NRSROs) and did not perform internal credit analysis of their securitization exposures. Consistent with the Basel capital framework and the agencies' general expectations for investment analysis, the proposal required banking organizations to satisfy specific due diligence requirements for securitization exposures. Specifically, under the proposal 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 its performance. The banking organization's analysis would have to be commensurate with the complexity of the exposure and the materiality of the exposure in relation to capital of the banking organization. On an ongoing basis (no less frequently than quarterly), the banking organization must evaluate, review, and update as appropriate the analysis required under section 41(c)(1) of the proposed rule for each securitization exposure. The analysis of the risk characteristics of the exposure prior to acquisition, and periodically thereafter, would have to consider:

(1) Structural features of the securitization that 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.

Commenters expressed concern that many banking organizations would be unable to perform the due diligence necessary to meet the requirements and, as a result, would no longer purchase privately-issued securitization exposures and would increase their holdings of GSE-guaranteed securities, thereby increasing the size of the GSEs. Commenters also expressed concerns regarding banking organizations' ability to obtain relevant market data for certain exposures, such as foreign exposures and exposures that are traded in markets that are typically illiquid, as well as their ability to obtain market data during periods of general market illiquidity. Commenters also stated concerns that uneven application of the requirements by supervisors may result in disparate treatment for the same exposure held at different banking organizations due to perceived management deficiencies. For these reasons, many commenters requested that the agencies consider removing the market data requirement from the due diligence requirements. In addition, some commenters suggested that the due diligence requirements be waived provided that all of the underlying loans meet certain underwriting standards.

The FDIC notes that the proposed due diligence requirements are generally consistent with the goal of the its investment permissibility requirements, which provide that FDIC-

supervised institutions must be able to determine the risk of loss is low, even under adverse economic conditions. The FDIC acknowledges potential restrictions on data availability and believes that the standards provide sufficient flexibility so that the due diligence requirements, such as relevant market data requirements, would be implemented as applicable. In addition, the FDIC notes that, where appropriate, pool-level data could be used to meet certain of the due diligence requirements. As a result, the FDIC is finalizing the due diligence requirements as proposed.

Under the proposal, if a banking organization is not able to meet these due diligence requirements and 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. Commenters requested that the agencies adopt a more flexible approach to due diligence requirements rather than requiring a banking organization to assign a risk weight of 1,250 percent for violation of those requirements. For example, some commenters recommended that the agencies assign progressively increasing risk weights based on the severity and duration of infringements of due diligence requirements, to allow the agencies to differentiate between minor gaps in due diligence requirements and more serious violations.

The FDIC believes that the requirement to assign a 1,250 percent risk weight, rather than applying a lower risk weight, to exposures for violation of these requirements is appropriate given that such information is required to monitor appropriately the risk of the underlying assets. The FDIC recognizes the importance of consistent and uniform application of the standards across FDIC-supervised institutions and will endeavor to ensure that the FDIC consistently reviews FDIC-supervised institutions' due diligence on securitization exposures. The FDIC

believes that these efforts will mitigate concerns that the 1,250 percent risk weight will be applied inappropriately to FDIC-supervised institutions' failure to meet the due diligence requirements. At the same time, the FDIC believes that the requirement that an FDIC-supervised institution's analysis be commensurate with the complexity and materiality of the securitization exposure provides the FDIC-supervised institution with sufficient flexibility to mitigate the potential for undue burden. As a result, the FDIC is finalizing the risk weight requirements related to due diligence requirements as proposed.

b. Operational Requirements for Traditional Securitizations

The proposal outlined certain operational requirements for traditional securitizations that had to be met in order to apply the securitization framework. The FDIC is finalizing these operational requirements as proposed.

In a traditional securitization, an originating FDIC-supervised institution typically transfers a portion of the credit risk of exposures to third parties by selling them to a securitization special purpose entity (SPE).[153] Consistent with the proposal, the interim final rule defines an FDIC-supervised institution to be an originating FDIC-supervised institution with respect to a securitization 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.

[153] The interim final rule defines 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.

Under the interim final rule, consistent with the proposal, an FDIC-supervised institution that transfers exposures it has originated or purchased to a securitization SPE or other third party in connection with a traditional securitization can 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 FDIC-supervised institution's consolidated balance sheet under GAAP; (2) the FDIC-supervised institution 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).[154]

An originating FDIC-supervised institution that meets these conditions must hold risk-based capital against any credit risk it retains or acquires in connection with the securitization. An originating FDIC-supervised institution that fails to meet these conditions is required to 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.

In addition, if a securitization (1) includes 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 (2) contains an early amortization provision, the originating FDIC-supervised institution is 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

[154] Commenters asked the agencies to consider the interaction between the proposed non-consolidation condition and the agencies' proposed rules implementing section 941 of the Dodd-Frank Act regarding risk retention, given concerns that satisfaction of certain of the proposed risk retention requirements would affect the accounting treatment for certain transactions. The FDIC acknowledges these concerns and will take into consideration any effects on the securitization framework as they continue to develop the risk retention rules.

from the transaction.[155] The FDIC believes that this treatment is appropriate given the lack of risk transference in securitizations of revolving underlying exposures with early amortization provisions.

c. Operational Requirements for Synthetic Securitizations

In general, the proposed operational requirements for synthetic securitizations were similar to those proposed for traditional securitizations. The operational requirements for synthetic securitizations, however, were more detailed to ensure that the originating banking organization has truly transferred credit risk of the underlying exposures to one or more third parties. Under the proposal, an originating banking organization would have been able to recognize for risk-based capital purposes the use of a credit risk mitigant to hedge underlying exposures only if each of the conditions in the proposed definition of "synthetic securitization" was satisfied. The FDIC is finalizing the operational requirements largely as proposed. However, to ensure that synthetic securitizations created through tranched guarantees and credit derivatives are properly included in the framework, in the interim final rule the FDIC has

[155] 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 an FDIC-supervised institution capital needs if new draws on the revolving credit facilities need to be financed by the FDIC-supervised institution 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 the FDIC-supervised institution to a greater risk of loss than in other securitization transactions. The interim final rule defines an early amortization provision 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 (1) is solely triggered by events not related to the performance of the underlying exposures or the originating FDIC-supervised institution (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.

amended the operational requirements to recognize guarantees that meet all of the criteria set forth in the definition of eligible guarantee except the criterion under paragraph (3) of the definition. Additionally, the operational criteria recognize a credit derivative provided that the credit derivative meets all of the criteria set forth in the definition of eligible credit derivative except for paragraph 3 of the definition of eligible guarantee. As a result, a guarantee or credit derivative that provides a tranched guarantee would not be excluded by the operational requirements for synthetic securitizations.

Failure to meet these operational requirements for a synthetic securitization prevents an FDIC-supervised institution that has purchased tranched credit protection referencing one or more of its exposures from using the securitization framework with respect to the reference exposures and requires the FDIC-supervised institution to hold risk-based capital against the underlying exposures as if they had not been synthetically securitized. An FDIC-supervised institution that holds a synthetic securitization as a result of purchasing credit protection may use the securitization framework to determine the risk-based capital requirement for its exposure. Alternatively, it may instead choose to disregard the credit protection and use the general credit risk framework. An FDIC-supervised institution that provides tranched credit protection in the form of a synthetic securitization or credit protection to a synthetic securitization must use the securitization framework to compute risk-based capital requirements for its exposures to the synthetic securitization even if the originating FDIC-supervised institution fails to meet one or more of the operational requirements for a synthetic securitization.

d. Clean-up Calls

Under the proposal, 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 proposed rule defined 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.

The interim final rule retains the proposed treatment for clean-up calls, and defines an eligible clean-up call as a clean-up call that (1) is exercisable solely at the discretion of the originating FDIC-supervised institution 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 meets criteria (3) of the definition of "eligible clean-up call" as long as the outstanding principal amount in that series or tranche was 10 percent or less of its original amount at the inception of the series.

3. Risk-weighted Asset Amounts for Securitization Exposures

The proposed framework for assigning risk-based capital requirements to securitization exposures required banking organizations generally to calculate a risk-weighted asset amount for a securitization exposure by applying either (i) the simplified supervisory formula approach (SSFA), described in section VIII.H of the preamble, or (ii) if the banking organization is 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 SSFA or the gross-up approach consistently across all of its securitization exposures. However, a banking organization could choose to assign a 1,250 percent risk weight to any securitization exposure.

Commenters expressed concerns regarding the potential differences in risk weights for similar exposures when using the gross-up approach compared to the SSFA, and the potential for capital arbitrage depending on the outcome of capital treatment under the framework. The FDIC acknowledges these concerns and, to reduce arbitrage opportunities, has required that a banking organization apply either the gross-up approach or the SSFA consistently across all of its securitization exposures. Commenters also asked the agencies to clarify how often and under what circumstances a banking organization is allowed to switch between the SSFA and the gross-up approach. While the FDIC is not placing restrictions on the ability of FDIC-supervised institutions to switch from the SSFA to the gross-up approach, the FDIC does not anticipate there should be a need for frequent changes in methodology by an FDIC-supervised institution absent significant change in the nature of the FDIC-supervised institution's securitization activities, and expect FDIC-supervised institutions to be able to provide a rationale for changing methodologies to the FDIC if requested.

Citing potential disadvantages of the proposed securitization framework as compared to standards to be applied to international competitors that rely on the use of credit ratings, some commenters requested that banking organizations be able to continue to implement a ratings-based approach to allow the agencies more time to calibrate the SSFA in accordance with international standards that rely on ratings. The FDIC again observes that the use of ratings in FDIC regulations is inconsistent with section 939A of the Dodd-Frank Act. Accordingly, the interim final rule does not include any references to, or reliance on, credit ratings. The FDIC has determined that the SSFA is an appropriate substitute standard to credit ratings that can be used to measure risk-based capital requirements and may be implemented uniformly across institutions.

Under the proposed securitization framework, banking organizations would have been required or could choose to assign a risk weight of 1,250 percent to certain securitization exposures. Commenters stated that the 1,250 percent risk weight required under certain circumstances in the securitization framework would penalize banking organizations that hold capital above the total risk-based capital minimum and could require a banking organization to hold more capital against the exposure than the actual exposure amount at risk. As a result, commenters requested that the amount of risk-based capital required to be held against a banking organization's exposure be capped at the exposure amount. The FDIC has decided to retain the proposed 1,250 percent risk weight in the interim final rule, consistent with their overall goals of simplicity and comparability, to provide for comparability in risk-weighted asset amounts for the same exposure across institutions.

Consistent with the proposal, the interim final rule provides for alternative treatment of securitization exposures to ABCP programs and certain gains-on-sale and CEIO exposures.

Specifically, similar to the general risk-based capital rules, the interim final rule includes a minimum 100 percent risk weight for interest-only mortgage-backed securities and exceptions to the securitization framework for certain small-business loans and certain derivatives as described below. An FDIC-supervised institution may use the securitization credit risk mitigation rules to adjust the capital requirement under the securitization framework for an exposure to reflect certain collateral, credit derivatives, and guarantees, as described in more detail below.

a. Exposure Amount of a Securitization Exposure

Under the interim final rule, 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 is generally the FDIC-supervised institution's carrying value of the exposure. The interim final rule modifies the proposed treatment for determining exposure amounts under the securitization framework to reflect the ability of an FDIC-supervised institution not subject to the advanced approaches rule to opt-out of the inclusion of AOCI in regulatory capital. As a result, the exposure amount of an on-balance sheet securitization exposure that is an available-for-sale debt security or an available-for-sale debt security transferred to held-to-maturity held by an FDIC-supervised institution that has made an AOCI opt-out election is the FDIC-supervised institution's carrying value (including net accrued but unpaid interest and fees), less any net unrealized gains on the exposure and plus any net unrealized losses on 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 (other than a credit derivative), or a derivative that is a cleared transaction (other than a

credit derivative) is the notional amount of the exposure. The treatment for OTC credit derivatives is described in more detail below.

For purposes of calculating the exposure amount of an off-balance sheet exposure to an ABCP securitization exposure, such as a liquidity facility, consistent with the proposed rule, the notional amount may be reduced to the maximum potential amount that the FDIC-supervised institution 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 improve, then the exposure amount is $200. An ABCP program is defined 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 is defined as a liquidity facility supporting ABCP, in form or in substance, which 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 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.

Commenters, citing accounting changes that require certain ABCP securitization exposures to be consolidated on banking organizations balance sheets, asked the agencies to consider capping the amount of an off-balance sheet securitization exposure to the maximum potential amount that the banking organization could be required to fund given the securitization

SPE's current underlying assets. These commenters stated that the downward adjustment of the notional amount of a banking organization's off-balance sheet securitization exposure to the amount of the available asset pool generally should be permitted regardless of whether the exposure to a customer SPE is made directly through a credit commitment by the banking organization to the SPE or indirectly through a funding commitment that the banking organization makes to an ABCP conduit. The FDIC believes that the requirement to hold risk-based capital against the full amount that may be drawn more accurately reflects the risks of potential draws under these exposures and have decided not to provide a separate provision for off-balance sheet exposures to customer-sponsored SPEs that are not ABCP conduits.

Under the interim final rule, consistent with the proposal, the exposure amount of an eligible ABCP liquidity facility that is subject to the SSFA equals the notional amount of the exposure multiplied by a 100 percent CCF. The exposure amount of an eligible ABCP liquidity facility that is not subject to the SSFA is the notional amount of the exposure multiplied by a 50 percent CCF. The exposure amount of a securitization exposure that is a repo-style transaction, eligible margin loan, an OTC derivative contract (other than a purchased credit derivative), or derivative that is a cleared transaction (other than a purchased credit derivative) is the exposure amount of the transaction as calculated under section 34 or section 37 of the interim final rule, as applicable.

b. Gains-on-sale and Credit-enhancing Interest-only Strips

Consistent with the proposal, under the interim final rule an FDIC-supervised institution 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 a CEIO that does not constitute an after-tax gain-on-sale. The FDIC believes 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 FDIC-supervised institution's risk-based capital requirement following a securitization, the FDIC believes that such anomalies are rare where a securitization transfers significant credit risk from the originating FDIC-supervised institution to third parties.

c. Exceptions under the Securitization Framework

Commenters stated concerns that the proposal would inhibit demand for private label securitization by making it more difficult for banking organizations, especially community banking organizations, to purchase private label mortgage-backed securities. Instead of implementing the SSFA and the gross-up approach, commenters suggested allowing banking organizations to assign a 20 percent risk weight to securitization exposures that are backed by mortgage exposures that would be "qualified mortgages" under the Truth in Lending Act and implementing regulations issued by the CFPB.[156] The FDIC believes that the proposed securitization approaches would be more appropriate in capturing the risks provided by structured transactions, including those backed by QM. The interim final rule does not provide an exclusion for such exposures.

Under the interim final rule, consistent with the proposal, there are several exceptions to the general provisions in the securitization framework that parallel the general risk-based capital rules. First, an FDIC-supervised institution is required to assign a risk weight of at least 100 percent to an interest-only MBS. The FDIC believes that a minimum risk weight of 100 percent is prudent in light of the uncertainty implied by the substantial price volatility of these securities.

[156] 78 FR 6408 (Jan. 30, 2013).

Second, as required by federal statute, a special set of rules continues to apply to securitizations of small-business loans and leases on personal property transferred with retained contractual exposure by well-capitalized depository institutions.[157] Finally, 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 (notwithstanding amounts due under interest rate or currency derivative contracts, fees due, or other similar payments), an FDIC-supervised institution may choose to set the risk-weighted asset amount of the exposure equal to the amount of the exposure.

d. Overlapping Exposures

Consistent with the proposal, the interim final rule includes provisions to limit the double counting of risks in situations involving overlapping securitization exposures. If an FDIC-supervised institution has multiple securitization exposures that provide duplicative coverage to the underlying exposures of a securitization (such as when an FDIC-supervised institution provides a program-wide credit enhancement and multiple pool-specific liquidity facilities to an ABCP program), the FDIC-supervised institution is not required to hold duplicative risk-based capital against the overlapping position. Instead, the FDIC-supervised institution must apply to the overlapping position the applicable risk-based capital treatment under the securitization framework that results in the highest risk-based capital requirement.

[157] 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. The interim final rule does not expressly provide that the FDIC may permit adequately-capitalized FDIC-supervised institutions to use the small business recourse rule on a case-by-case basis because the FDIC may make such a determination under the general reservation of authority in section 1 of the interim final rule.

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.

Consistent with the proposal, under the interim final rule an FDIC-supervised institution must apply the SSFA or the gross-up approach, as described below, or a 1,250 percent risk weight to a servicer cash advance facility. The treatment of the undrawn portion of the facility depends on whether the facility is an eligible servicer cash advance facility. An eligible servicer cash advance facility is 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.

Under the proposal, a banking organization that is a servicer under an eligible servicer cash advance facility is not required to hold risk-based capital against potential future cash advanced payments that it may be required to provide under the contract governing the 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 other off-balance sheet securitization exposures. The FDIC is clarifying the terminology in the interim final rule to specify that an FDIC-supervised institution that is a servicer under a non-eligible servicer cash advance facility must hold risk-based capital against the amount of all potential future cash advance payments that it may be contractually required to provide during the subsequent 12-month period under the contract governing the facility.

f. Implicit Support

Consistent with the proposed rule, the interim final rule requires an FDIC-supervised institution that provides support to a securitization in excess of its predetermined contractual obligation (implicit support) to 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.[158] In addition, the FDIC-supervised institution must disclose publicly (i) that it has provided implicit support to the securitization, and (ii) the risk-based capital impact to the FDIC-supervised institution of providing such implicit support. The FDIC notes that under the reservations of authority set forth in the interim final rule, the FDIC also could require the FDIC-supervised institution to hold risk-based capital against all the underlying exposures associated with some or all the FDIC-supervised institution's other securitizations as if the underlying exposures had not

[158] The interim final rule is consistent with longstanding guidance on the treatment of implicit support, entitled, "Interagency Guidance on Implicit Recourse in Asset Securitizations," (May 23, 2002). See FIL-52-2002.

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

The proposed rule incorporated the SSFA, a simplified version of the supervisory formula approach (SFA) in the advanced approaches rule, to assign risk weights to securitization exposures. Many of the commenters focused on the burden of implementing the SSFA given the complexity of the approach in relation to the proposed treatment of mortgages exposures. Commenters also stated concerns that implementation of the SSFA would generally restrict credit growth and create competitive equity concerns with other jurisdictions implementing ratings-based approaches. The FDIC acknowledges that there may be differences in capital requirements under the SSFA and the ratings-based approach in the Basel capital framework. As explained previously, the use of alternative standards of creditworthiness in FDIC regulations is consistent with section 939A of the Dodd-Frank Act. Any alternative standard developed by the FDIC may not generate the same result as a ratings-based capital framework under every circumstance. However, the FDIC, together with the other agencies, has designed the SSFA to result in generally comparable capital requirements to those that would be required under the Basel ratings-based approach without undue complexity. The FDIC will monitor implementation of the SSFA and, based on supervisory experience, consider what modifications, if any, may be necessary to improve the SSFA in the future.

The FDIC has adopted the proposed SSFA largely as proposed, with a revision to the delinquency parameter (parameter W) that will increase the risk sensitivity of the approach and clarify the operation of the formula when the contractual terms of the exposures underlying a securitization permit borrowers to defer payments of principal and interest, as described below.

To limit potential burden of implementing the SSFA, FDIC-supervised institutions that are not subject to the market risk rule may also choose to use as an alternative the gross-up approach described in section VIII.H.5 below, provided that they apply the gross-up approach to all of their securitization exposures.

Similar to the SFA under the advanced approaches rule, the SSFA is a formula that starts with a baseline derived from the capital requirements that apply to all exposures underlying the securitization and then assigns risk weights based on the subordination level of an exposure. The FDIC designed the SSFA 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 applies a 1,250 percent risk weight to securitization exposures that absorb losses up to the amount of capital that is required for the underlying exposures under subpart D of the interim final rule had those exposures been held directly by an FDIC-supervised institution. In addition, the FDIC is implementing a supervisory risk-weight floor or minimum risk weight for a given securitization of 20 percent. While some commenters requested that the floor be lowered for certain low-risk securitization exposures, the FDIC believes that a 20 percent floor is prudent given the performance of many securitization exposures during the recent crisis.

At the inception of a securitization, the SSFA requires more capital on a transaction-wide basis than would be required if the underlying assets had not been securitized. That is, if the FDIC-supervised institution held every tranche of a securitization, its overall capital requirement would be greater than if the FDIC-supervised institution held the underlying assets in portfolio.

The FDIC believes this overall outcome is important in reducing the likelihood of regulatory capital arbitrage through securitizations.

The proposed rule required banking organizations to use data to assign the SSFA parameters that are not more than 91 days old. Commenters requested that the data requirement be amended to account for securitizations of underlying assets with longer payment periods, such as transactions featuring annual or biannual payments. In response, the FDIC amended this requirement in the interim final rule so that data used to determine SSFA parameters must be the most currently available data. However, for exposures that feature payments on a monthly or quarterly basis, the interim final rule requires the data to be no more than 91 calendar days old.

Under the interim final rule, to use the SSFA, an FDIC-supervised institution must obtain or determine the weighted-average risk weight of the underlying exposures (K_G), as well as the attachment and detachment points for the FDIC-supervised institution's position within the securitization structure. "K_G," is calculated using the risk-weighted asset amounts in the standardized approach and 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 FDIC-supervised institution may recognize the relative seniority of the exposure, as well as all cash funded enhancements, in determining attachment and detachment points. In addition, an FDIC-supervised institution must be able to determine the credit performance of the underlying exposures.

The commenters expressed concerns that certain types of data that would be required to calculate K_G may not be readily available, particularly data necessary to calculate the weighted-average capital requirement of residential mortgages according to the proposed rule's standardized approach for residential mortgages. Some commenters therefore asked to be able to

use the risk weights under the general risk-based capital rules for residential mortgages in the calculation of K_G. Commenters also requested the use of alternative estimates or conservative proxy data to implement the SSFA when a parameter is not readily available, especially for securitizations of mortgage exposures. As previously discussed, the FDIC is retaining in the interim final rule the existing mortgage treatment under the general risk-based capital rules. Accordingly, the FDIC believes that FDIC-supervised institutions should generally have access to the data necessary to calculate the SSFA parameters for mortgage exposures.

Commenters characterized the K_G parameter as not sufficiently risk sensitive and asked the agencies to provide more recognition under the SSFA with respect to the credit quality of the underlying assets. Some commenters observed that the SSFA did not take into account sequential pay structures. As a result, some commenters requested that banking organizations be allowed to implement cash-flow models to increase risk sensitivity, especially given that the SSFA does not recognize the various types of cash-flow waterfalls for different transactions.

In developing the interim final rule, the FDIC considered the trade-offs between added risk sensitivity, increased complexity that would result from reliance on cash-flow models, and consistency with standardized approach risk weights. The FDIC believes it is important to calibrate capital requirements under the securitization framework in a manner that is consistent with the calibration used for the underlying assets of the securitization to reduce complexity and best align capital requirements under the securitization framework with requirements for credit exposures under the standardized approach. As a result, the FDIC has decided to finalize the K_G parameter as proposed.

To make the SSFA more risk-sensitive and forward-looking, the parameter K_G is modified based on delinquencies among the underlying assets of the securitization. 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.

$$K_A = (1 - W) \cdot K_G + (0.5 \cdot W)$$

Under the proposal, the W parameter equaled the ratio of the sum of the dollar amounts of any underlying exposures of the securitization 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, in default, or have contractually deferred interest for 90 days or more divided by the ending balance, measured in dollars, of the underlying exposures. Commenters expressed concern that the proposal would require additional capital for payment deferrals that are unrelated to the creditworthiness of the borrower, and encouraged the agencies to amend the proposal so that the numerator of the W parameter would not include deferrals of interest that are unrelated to the performance of the loan or the borrower, as is the case for certain federally-guaranteed student loans or certain consumer credit facilities that allow the borrower to defer principal and interest payments for the first 12 months following the purchase of a product or service. Some commenters also asserted that the proposed SSFA would not accurately calibrate capital requirements for those student loans with a partial government guarantee. Another commenter also asked for clarification on which exposures are in the securitized pool.

In response to these concerns, the FDIC has decided to explicitly exclude from the numerator of parameter W loans with deferral of principal or interest for (1) federally-guaranteed student loans, in accordance with the terms of those programs, or (2) for consumer loans, including non-federally-guaranteed student loans, provided that such payments are deferred

pursuant to provisions included in the contract at the time funds are disbursed that provide for period(s) of deferral that are not initiated based on changes in the creditworthiness of the borrower. The FDIC believes that the SSFA appropriately reflects partial government guarantees because such guarantees are reflected in K_G in the same manner that they are reflected in capital requirements for loans held on balance sheet. For clarity, the FDIC has eliminated the term "securitized pool" from the interim final rule. The calculation of parameter W includes all underlying exposures of a securitization transaction.

The FDIC believes that, with the parameter W calibration set equal to 0.5, the overall capital requirement produced by the SSFA is sufficiently responsive and prudent to ensure sufficient capital for pools that demonstrate credit weakness. The entire specification of the SSFA in the interim 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:

$$a = -\frac{1}{p \cdot K_A}$$

$$u = D - K_A$$

$$l = \max(A - K_A, 0)$$

$e = 2.71828$, the base of the natural logarithms.

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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 held by the FDIC-supervised institution to the current dollar amount of all underlying exposures.

Commenters requested that the agencies recognize unfunded forms of credit support, such as excess spread, in the calculation of A. Commenters also stated that where the carrying value of an exposure is less than its par value, the discount to par for a particular exposure should be recognized as additional credit protection. However, the FDIC believes it is prudent to recognize only funded credit enhancements, such as overcollateralization or reserve accounts funded by accumulated cash flows, in the calculation of parameter A. Discounts and write-downs can be related to credit risk or due to other factors such as interest rate movements or liquidity. As a result, the FDIC does not believe that discounts or write-downs should be factored into the SSFA as credit enhancement.

Parameter D is the detachment point for the tranche that contains the securitization exposure and represents the threshold at which credit losses 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 parameter A plus the ratio of the current dollar amount of the securitization exposures that are pari passu with the FDIC-supervised institution's securitization exposure (that is, have equal seniority with respect to credit risk) to the current 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_4, which is described above.

When 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. 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}. As suggested by commenters, in order to make the description of the SSFA formula clearer, the term "l" has been redefined to be the maximum of 0 and A-K_A, instead of the proposed A-K_A. The risk weight would be determined according to the following formula:

$$RW = \left[\left(\frac{K_A - A}{D - A}\right) \times 1{,}250 \text{ percent}\right] + \left[\left(\frac{D - K_A}{D - A}\right) \times 1{,}250 \text{ percent} \times K_{SSFA}\right]$$

For resecuritizations, FDIC-supervised institutions must use the SSFA to measure the underlying securitization exposure'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 were mortgage loans that qualified for a 50 percent risk weight and that the remaining 10 percent of the pool was a tranche of a separate securitization (where the underlying exposures consisted of mortgages that also qualified for a 50 percent weight). An exposure to this hypothetical tranche would meet the definition of a resecuritization exposure. Next, assume that the attachment point A of the underlying securitization that is the 10 percent share of the pool is 0.06 and the detachment point D is 0.08. Finally, assume that none of the underlying mortgage exposures of either the hypothetical tranche or the underlying securitization exposure meet the interim final rule definition of "delinquent."

The value of K_G for the resecuritization exposure equals 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 resecuritization, K_G equals 0.04 (that is, 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 $K_{G,securitization}$ an FDIC-supervised institution 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 resecuritization (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.

To apply the securitization framework to a single tranched exposure that has been re-tranched, such as some Re-REMICs, an FDIC-supervised institution must apply the SSFA or gross-up approach to the retranched exposure as if it were still part of the structure of the original securitization transaction. Therefore, an FDIC-supervised institution implementing the SSFA or the gross-up approach would calculate parameters for those approaches that would treat the retranched exposure as if it were still embedded in the original structure of the transaction while

still recognizing any added credit enhancement provided by retranching. For example, under the SSFA an FDIC-supervised institution would calculate the approach using hypothetical attachment and detachment points that reflect the seniority of the retranched exposure within the original deal structure, as well as any additional credit enhancement provided by retranching of the exposure. Parameters that depend on pool-level characteristics, such as the W parameter under the SSFA, would be calculated based on the characteristics of the total underlying exposures of the initial securitization transaction, not just the retranched exposure.

5. Gross-up Approach

Under the interim final rule, consistent with the proposal, FDIC-supervised institutions that are not subject to the market risk rule may assign risk-weighted asset amounts to securitization exposures by implementing the gross-up approach described in section 43 of the interim final rule, which is similar to an existing approach provided under the general risk-based capital rules. If the FDIC-supervised institution chooses to apply the gross-up approach, it is 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 interim final rule.

The gross-up approach assigns risk-weighted asset amounts based on the full amount of the credit-enhanced assets for which the FDIC-supervised institution directly or indirectly assumes credit risk. To calculate risk-weighted assets under the gross-up approach, an FDIC-supervised institution determines 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 FDIC-supervised institution's exposure as a percentage of the par value of the tranche in which the securitization exposure resides. The enhanced amount is the par 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 as calculated under the standardized approach.

Under the gross-up approach, an FDIC-supervised institution is required to calculate the credit equivalent amount, which equals the sum of (1) the exposure of the FDIC-supervised institution's securitization exposure and (2) the pro rata share multiplied by the enhanced amount. To calculate risk-weighted assets for a securitization exposure under the gross-up approach, an FDIC-supervised institution is 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 is 20 percent.

As discussed above, the FDIC recognizes that different capital requirements are likely to result from the application of the gross-up approach as compared to the SSFA. However, the FDIC believes allowing smaller, less complex FDIC-supervised institutions not subject to the market risk rule to use the gross up approach (consistent with past practice under the existing general risk-based capital rules) is appropriate and should reduce operational burden for many FDIC-supervised institutions.

6. Alternative Treatments for Certain Types of Securitization Exposures

Under the proposal, a banking organization generally would assign a 1,250 percent risk weight to any securitization exposure to which the banking organization does not apply the SSFA or the gross-up approach. However, the proposal provided 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 Asset-backed Commercial Paper Liquidity Facilities

Under the interim final rule, consistent with the proposal and the Basel capital framework, an FDIC-supervised institution is permitted to 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.

b. A Securitization Exposure in a Second-loss Position or Better to an Asset-backed Commercial Paper Program

Under the interim final rule and consistent with the proposal, an FDIC-supervised institution 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, provided the exposure meets the following criteria:

(1) The exposure is not 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 FDIC-supervised institution holding the exposure does not retain or provide protection for the first-loss position.

The FDIC believes 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. The FDIC is adopting this aspect of the proposal, without change, for purposes of the interim final rule.

7. Credit risk Mitigation for Securitization Exposures

Under the interim final rule, and consistent with the proposal, the treatment of credit risk mitigation for securitization exposures would differ slightly from the treatment for other exposures. To recognize the risk mitigating effects of financial collateral or an eligible guarantee or an eligible credit derivative from an eligible guarantor, an FDIC-supervised institution that purchases credit protection uses the approaches for collateralized transactions under section 37 of the interim final rule or the substitution treatment for guarantees and credit derivatives described in section 36 of the interim final rule. In cases of maturity or currency mismatches, or, if applicable, lack of a restructuring event trigger, the FDIC-supervised institution must make any applicable adjustments to the protection amount of an eligible guarantee or credit derivative as required by section 36 for any hedged securitization exposure. In addition, for synthetic securitizations, when an eligible guarantee or eligible credit derivative covers multiple hedged exposures that have different residual maturities, the FDIC-supervised institution is required to use the longest residual maturity of any of the hedged exposures as the residual maturity of all the hedged exposures. In the interim final rule, the FDIC is clarifying that an FDIC-supervised institution is not required to compute a counterparty credit risk capital requirement for the credit derivative provided that this treatment is applied consistently for all of its OTC credit derivatives. However, an FDIC-supervised institution must calculate counterparty credit risk if the OTC credit derivative is a covered position under the market risk rule.

Consistent with the proposal, an FDIC-supervised institution that purchases an OTC credit derivative (other than an nth-to-default credit derivative) that is recognized as a credit risk mitigant for a securitization exposure that is not a covered position under the market risk rule is not required to compute a separate counterparty credit risk capital requirement provided that the FDIC-supervised institution does so consistently for all such credit derivatives. The FDIC-

supervised institution 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. If an FDIC-supervised institution cannot, or chooses not to, recognize a credit derivative that is a securitization exposure as a credit risk mitigant, the FDIC-supervised institution must determine the exposure amount of the credit derivative under the treatment for OTC derivatives in section 34. In the interim final rule, the FDIC is clarifying that if the FDIC-supervised institution purchases the credit protection from a counterparty that is a securitization, the FDIC-supervised institution must determine the risk weight for counterparty credit risk according to the securitization framework. If the FDIC-supervised institution purchases credit protection from a counterparty that is not a securitization, the FDIC-supervised institution must determine the risk weight for counterparty credit risk according to general risk weights under section 32. An FDIC-supervised institution that provides protection in the form of a guarantee or credit derivative (other than an nth-to-default credit derivative) that covers the full amount or a pro rata share of a securitization exposure's principal and interest 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.

8. N^{th}-to-default Credit Derivatives

Under the interim final rule and consistent with the proposal, the capital requirement for credit protection provided through an nth-to-default credit derivative is determined either by using the SSFA, or applying a 1,250 percent risk weight.

An FDIC-supervised institution providing credit protection must determine its exposure to an nth-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 FDIC-supervised institution'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 FDIC-supervised institution'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 FDIC-supervised institution'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 FDIC-supervised institution's exposure to the total notional amount of the underlying exposures. An FDIC-supervised institution that does not use the SSFA to calculate a risk weight for an nth-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, an FDIC-supervised institution 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) of the interim final rule must determine its risk-based capital requirement for the underlying exposures as if the FDIC-supervised institution synthetically securitized the underlying exposure with the smallest risk-weighted asset amount and had obtained no credit risk mitigant on the other underlying exposures. An FDIC-supervised institution must calculate a risk-based capital requirement for counterparty credit risk according to section 34 of the interim final rule 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, an FDIC-supervised institution 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) of the interim final rule (other than a first-to-default credit derivative) may recognize the credit risk mitigation benefits of the derivative only if the FDIC-supervised institution 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 an FDIC-supervised institution satisfies these requirements, the FDIC-supervised institution determines its risk-based capital requirement for the underlying exposures as if the FDIC-supervised institution had only synthetically securitized the underlying exposure with the nth smallest risk-weighted asset amount and had obtained no credit risk mitigant on the other underlying exposures. For a nth-to-default credit derivative that does not meet the rules of recognition of section 36(b), an FDIC-supervised institution must calculate a risk-based capital requirement for counterparty credit risk according to the treatment of OTC derivatives under section 34 of the interim final rule. The FDIC is adopting this aspect of the proposal without change for purposes of the interim final rule.

IX. Equity Exposures

The proposal significantly revised the general risk-based capital rules' treatment for equity exposures. To improve risk sensitivity, the interim final rule generally follows the same approach to equity exposures as the proposal, while providing clarification on investments in a separate account as detailed below. In particular, the interim final rule requires an FDIC-supervised institution to apply the 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. These approaches are discussed in greater detail below.

A. Definition of Equity Exposure and Exposure Measurement

The FDIC is adopting the proposed definition of equity exposures, without change, for purposes of the interim final rule.[159] Under the interim final rule, an FDIC-supervised institution is 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, other than an equity exposure that is classified as AFS where the FDIC-supervised institution has made an AOCI opt-out election under section 22(b)(2) of the interim final rule, the adjusted carrying value is an FDIC-supervised institution's carrying value of the exposure. For the on-balance sheet component of an equity exposure that is classified as AFS where the FDIC-supervised institution has made an AOCI opt-out election under section 22(b)(2) of the interim final rule, the adjusted carrying value of the exposure is the FDIC-supervised institution's carrying value of the exposure less any net gains on the exposure that are reflected in the carrying value but excluded from the FDIC-supervised institution's regulatory capital components. For a commitment to acquire an equity exposure that is unconditional, the adjusted carrying value is 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 is 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

[159] See the definition of "equity exposure" in section 2 of the interim final rule. However, as described above in section VIII.A of this preamble, the FDIC has adjusted the definition of "exposure amount" in line with certain requirements necessary for FDIC-supervised institutions that make an AOCI opt-out election.

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 is 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.

The FDIC included the concept of the effective notional principal amount of the off-balance sheet portion of an equity exposure to provide a uniform method for FDIC-supervised institutions 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.

B. Equity Exposure Risk Weights

The proposal set forth a SRWA for equity exposures, which the FDIC has adopted without change in the interim final rule. Therefore, under the interim final rule, an FDIC-supervised institution determines 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 section 52 of the interim final rule. An FDIC-supervised institution determines the risk-weighted asset amount for an equity exposure to an investment fund under section 53 of the interim final rule. An FDIC-supervised institution sums risk-weighted asset amounts for all of its equity exposures to calculate its aggregate risk-weighted asset amount for its equity exposures.

Some commenters asserted that mutual banking organizations, which are more highly exposed to equity exposures than traditional depository institutions, should be permitted to assign a 100 percent risk weight to their equity exposures rather than the proposed 300 percent risk weight for publicly-traded equity exposures or 400 percent risk weight for non-publicly traded equity exposures. Some commenters also argued that a banking organization's equity investment in a banker's bank should get special treatment, for instance, exemption from the 400 percent risk weight or deduction as an investment in the capital of an unconsolidated financial institution.

The FDIC has decided to retain the proposed risk weights in the interim final rule because it does not believe there is sufficient justification for a lower risk weight solely based on the nature of the institution (for example, mutual banking organization) holding the exposure. In addition, the FDIC believes that a 100 percent risk weight does not reflect the inherent risk for equity exposures that fall under the proposed 300 percent and 400 percent risk-weight categories or that are subject to deduction as investments in unconsolidated financial institutions. The FDIC has agreed to finalize the SRWA risk weights as proposed, which are summarized below in Table 24.

TABLE 24 – SIMPLE RISK-WEIGHT APPROACH

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 interim final rule.
20	An equity exposure to a PSE, Federal Home Loan Bank or Farmer Mac.
100	• Community development equity exposures[160] • 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 in the form of common stock that is not deducted under section 22 of the interim final rule.
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).

[160] The interim final rule generally defines these exposures as exposures that 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). Under the proposal, a savings association's community development equity exposure investments was defined to mean an equity exposure 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). The FDIC has determined that a separate definition for a savings association's community development equity exposure is not necessary and, therefore, the interim final rule applies one definition of community development equity exposure to all types of covered FDIC-supervised institutions.

600	An equity exposure to an investment firm that (i) would meet the definition of a traditional securitization were it not for the FDIC's application of paragraph (8) of that definition and (ii) has greater than immaterial leverage.

Consistent with the proposal, the interim final rule 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 refers 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.

C. Non-significant Equity Exposures

Under the interim final rule, and as proposed, an FDIC-supervised institution may apply a 100 percent risk weight to certain equity exposures deemed non-significant. Non-significant equity exposures means an equity exposure to the extent that the aggregate adjusted carrying value of the exposures does not exceed 10 percent of the FDIC-supervised institution's total capital.[161] To compute the aggregate adjusted carrying value of an FDIC-supervised institution's equity exposures for determining their non-significance, the FDIC-supervised institution may exclude (1) equity exposures that receive less than a 300 percent risk weight under the SRWA

[161] The definition excludes exposures to an investment firm that (1) meet the definition of traditional securitization were it not for the primary Federal regulator's application of paragraph (8) of the definition of a traditional securitization and (2) has greater than immaterial leverage.

(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. If an FDIC-supervised institution does not know the actual holdings of the investment fund, the FDIC-supervised institution 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 FDIC-supervised institution must assume that the investment fund invests to the maximum extent possible in equity exposures.

To determine which of an FDIC-supervised institution's equity exposures qualify for a 100 percent risk weight based on non-significance, the FDIC-supervised institution first must 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 must include publicly-traded equity exposures (including those held indirectly through investment funds), and then it must include non-publicly-traded equity exposures (including those held indirectly through investment funds).[162]

One commenter proposed that certain exposures, including those to small-business investment companies, should not be subject to the 10 percent capital limitation for non-significant equity exposures and should receive a 100 percent risk weight, consistent with the treatment of community development investments. The FDIC reflected upon this comment and determined to retain the proposed 10 percent limit on an FDIC-supervised institution's total

[162] See 15 U.S.C. 682.

capital in the interim final rule given the inherent credit and concentration risks associated with these exposures.

D. Hedged Transactions

Under the proposal, to determine risk-weighted assets under the SRWA, a banking organization could identify hedge pairs, which 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. A banking organization would 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. A few commenters requested that non-publicly traded equities be recognized in a hedged transaction under the rule. Equities that are not publicly traded are subject to considerable valuation uncertainty due to a lack of transparency and are generally far less liquid than publicly traded equities. The FDIC has therefore determined that given the potential increased risk associated with equities that are not publicly traded, recognition of these instruments as hedges under the rule is not appropriate. One commenter indicated that the test of hedge effectiveness used in the calculation of publicly traded equities should be more risk sensitive in evaluating all components of the transaction to better determine the appropriate risk weight. The examples the commenter highlighted indicated dissatisfaction with the assignment of a 100 percent risk weight to the effective portion of all hedge pairs. As described further below, the proposed rule contained three methodologies for identifying the measure of effectiveness of an equity hedge relationship, methodologies which recognize less-than-perfect hedges. The proposal assigns a 100 percent risk weight to the effective portion of a hedge pair because some hedge pairs involve residual risks. In developing the standardized approach the agencies sought to balance complexity and risk sensitivity, which

limits the degree of granularity in hedge recognition. On balance, the FDIC believes that it is more reflective of an FDIC-supervised institutions risk profile to recognize a broader range of hedge pairs and assign all hedge pairs a 100 percent risk weight than to recognize only perfect hedges and assign a lower risk weight. Accordingly, the FDIC is finalizing the proposed treatment without change.

Under the interim final rule, 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 FDIC-supervised institution acquires at least one of the equity exposures); the documentation specifies the measure of effectiveness (E) the FDIC-supervised institution uses for the hedge relationship throughout the life of the transaction; and the hedge relationship has an E greater than or equal to 0.8. An FDIC-supervised institution measures E at least quarterly and uses 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 an FDIC-supervised institution's exposure to a particular equity instrument is part of a hedge pair. For example, assume an FDIC-supervised institution 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 FDIC-supervised institution treats $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 is 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 is 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 is 0.8 x $100 = $80, and the ineffective portion of the hedge pair is (1 – 0.8) x $100 = $20.

E. Measures of Hedge Effectiveness

As stated above, an FDIC-supervised institution 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, an FDIC-supervised institution determines 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 is -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 equals the absolute value of RVC. If RVC is negative and less than -1, then E equals 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 is 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 ranges 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 equals 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. Accordingly, E is higher when the relationship between the values of the two exposures is closer.

F. 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 proposal included an additional option, referred to in the NPR as the full look-through approach. The agencies proposed this separate treatment for equity exposures to an investment fund to ensure that the regulatory capital treatment for these exposures is commensurate with the risk. Thus, the risk-based capital requirement for equity exposures to investment funds that hold only low-risk

assets would be relatively low, whereas high-risk exposures held through investment funds would be subject to a higher capital requirement. The interim final rule implements these three approaches as proposed and clarifies that the risk-weight for any equity exposure to an investment fund must be no less than 20 percent.

In addition, the interim final rule clarifies, generally consistent with prior agency guidance, that an FDIC-supervised institution must treat an investment in a separate account, such as bank-owned life insurance, as if it were an equity exposure to an investment fund.[163] An FDIC-supervised institution must use one of the look-through approaches provided in section 53 and, if applicable, section 154 of the interim final rule to determine the risk-weighted asset amount for such investments. An FDIC-supervised institution that purchases stable value protection on its investment in a separate account must treat the portion of the carrying value of its investment in the separate account attributable to the stable value protection as an exposure to the provider of the protection and the remaining portion as an equity exposure to an investment fund. Stable value protection means a contract where the provider of the contract pays to the policy owner of the separate account an amount equal to the shortfall between the fair value and cost basis of the separate account when the policy owner of the separate account surrenders the policy. It also includes a contract where the provider of the contract pays to the beneficiary an amount equal to the shortfall between the fair value and book value of a specified portfolio of assets.

An FDIC-supervised institution that provides stable value protection, such as through a stable value wrap that has provisions and conditions that minimize the wrap's exposure to credit

[163] Interagency Statement on the Purchase and Risk Management of Life Insurance, pp. 19-20, http://www.federalreserve.gov/boarddocs/srletters/2004/SR0419a1.pdf.

risk of the underlying assets in the fund, must treat the exposure as if it were an equity derivative on an investment fund and determine the adjusted carrying value of the exposure according to section 51(b), and, if applicable, section 151(b) of the interim final rule. The adjusted carrying value is 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 under the same paragraph. Risk-weighted assets for such an exposure is determined by applying one of the three look-through approaches as provided in section 53 and, if applicable, section 154 of the interim final rule.

As discussed further below, under the interim final rule, an FDIC-supervised institution determines 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. The risk-weighted asset amount for such community development equity exposures is the exposure's adjusted carrying value. If an FDIC-supervised institution does not use the full look-through approach, and an equity exposure to an investment fund is part of a hedge pair, an FDIC-supervised institution must 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 is equal to its adjusted carrying value. An FDIC-supervised institution could choose which approach to apply for each equity exposure to an investment fund.

1. Full Look-through Approach

An FDIC-supervised institution may use the full look-through approach only if the FDIC-supervised institution is able to calculate a risk-weighted asset amount for each of the exposures held by the investment fund. Under the interim final rule, an FDIC-supervised institution using the full look-through approach is required to calculate the risk-weighted asset amount for its proportionate ownership share of each of the exposures held by the investment fund (as calculated under subpart D of the interim final rule) as if the proportionate ownership share of the adjusted carrying value of each exposures were held directly by the FDIC-supervised institution. The FDIC-supervised institution's risk-weighted asset amount for the exposure to the fund is equal to (1) the aggregate risk-weighted asset amount of the exposures held by the fund as if they were held directly by the FDIC-supervised institution multiplied by (2) the FDIC-supervised institution's proportional ownership share of the fund.

2. Simple Modified Look-through Approach

Under the simple modified look-through approach, an FDIC-supervised institution sets 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 applicable risk weight under subpart D of the interim final rule 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 FDIC-supervised institution 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.

3. Alternative Modified Look-through Approach

Under the alternative modified look-through approach, an FDIC-supervised institution 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 interim final rule 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 FDIC-supervised institution's equity exposure to the investment fund is 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 permissible investments within the fund exceeds 100 percent, the FDIC-supervised institution 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 subpart D 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 FDIC-supervised institution must use the highest applicable risk weight. An FDIC-supervised institution 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.

Commenters expressed concerns regarding the application of the look-through approaches where an investment fund holds securitization exposures. Specifically, the commenters indicated a banking organization would be forced to apply a 1,250 percent risk weight to investment funds that hold securitization exposures if the banking organization does not have the information required to use one of the two applicable methods under subpart D to calculate the risk weight applicable to a securitization exposure: gross-up treatment or the SSFA.

According to the commenters, such an outcome would be overly punitive and inconsistent with the generally diversified composition of investment funds. The FDIC acknowledges that an FDIC-supervised institution may have some difficulty obtaining all the information needed to use the gross-up treatment or SSFA, but believes that the proposed approach provides strong incentives for FDIC-supervised institutions to obtain such information. As a result, the FDIC is finalizing the treatment as proposed.

X. Market Discipline and Disclosure Requirements

A. Proposed Disclosure Requirements

The FDIC has long supported meaningful public disclosure by FDIC-supervised institutions with the objective of improving market discipline and encouraging sound risk-management practices. 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.[164] The BCBS introduced additional disclosure requirements in Basel III, which, under the interim final rule, apply to banking organizations as discussed herein.[165]

The agencies received a limited number of comments on the proposed disclosure requirements. The commenters expressed some concern that the proposed requirements would be extended to apply to smaller banking organizations. As discussed further below, the agencies proposed the disclosure requirements for banking organizations with $50 billion or more in

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[164] The agencies incorporated the BCBS disclosure requirements into the advanced approaches rule in 2007. See 72 FR 69288, 69432 (December 7, 2007).

[165] In June 2012, the BCBS adopted Pillar 3 disclosure requirements in a paper titled "Composition of Capital Disclosure Requirements," available at http://www.bis.org/publ/bcbs221.pdf. The FDIC anticipates incorporating these disclosure requirements through a separate notice and comment period.

assets and believe they are most appropriate for these companies. The FDIC believes that the proposed disclosure requirements strike the appropriate balance between the market benefits of disclosure and the additional burden to an FDIC-supervised institution that provides the disclosures, and therefore has adopted the requirements as proposed, with minor clarification with regard to timing of disclosures as discussed further below.

The public disclosure requirements under section 62 of the interim final rule apply only to FDIC-supervised institutions with total consolidated assets of $50 billion or more that are not a consolidated subsidiary of a BHC, covered SLHC, or depository institution that is subject to these disclosure requirements or a subsidiary of a non-U.S. FDIC-supervised institution that is subject to comparable public disclosure requirements in its home jurisdiction or an advanced approaches FDIC-supervised institution making public disclosures pursuant to section 172 of the interim final rule. An advanced approaches FDIC-supervised institution that meets the $50 billion asset threshold, but that has not received approval from the FDIC to exit parallel run, must make the disclosures described in sections 62 and 63 of the interim final rule. The FDIC notes 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 FDIC-supervised institutions.[166] An FDIC-supervised institution may be able to fulfill some of the disclosure requirements by relying on similar disclosures made in accordance with federal securities law requirements. In addition, an FDIC-supervised institution may use information provided in regulatory reports to fulfill certain disclosure requirements. In these situations, an

[166] 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).

FDIC-supervised institution is required to explain any material differences between the accounting or other disclosures and the disclosures required under the interim final rule.

An FDIC-supervised institution'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 FDIC-supervised institution. Accordingly, an FDIC-supervised institution must have a formal disclosure policy approved by its board of directors that addresses the FDIC-supervised institution'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 should 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 FDIC-supervised institution must attest that the disclosures meet the requirements of this interim final rule.

An FDIC-supervised institution must decide the relevant disclosures based on a materiality concept. Information is regarded as material for purposes of the disclosure requirements in the interim final rule if the information's 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 FDIC's longstanding requirements for robust quarterly disclosures in regulatory reports, and considering the potential for rapid changes in risk profiles, the interim final rule requires that an FDIC-supervised institution provide timely public disclosures after each calendar quarter. However, qualitative disclosures that provide a general summary of an FDIC-supervised institution's risk-management objectives and policies, reporting system, and

definitions may be disclosed annually after the end of the fourth calendar quarter, provided any significant changes are disclosed in the interim. The FDIC acknowledges 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 FDIC considers those disclosures that are made within 45 days of the end of the calendar quarter (or within 60 days for the limited purpose of the FDIC-supervised institution's first reporting period in which it is subject to the rule's disclosure requirements) as timely. In general, where an FDIC-supervised institution's fiscal year-end coincides with the end of a calendar quarter, the FDIC considers qualitative and quantitative 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 FDIC 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 FDIC-supervised institution's capital adequacy and risk profile. In those cases, an FDIC-supervised institution needs to disclose the general nature of these changes and briefly describe how they are likely to affect public disclosures going forward. An FDIC-supervised institution should 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 under the interim final rule must 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 FDIC-supervised institution became subject to the disclosure requirements. For example, an FDIC-supervised institution that begins to make public disclosures in the first quarter of 2015 must make all of its required disclosures publicly available until the first quarter of 2018, after which it must make its required disclosures for the previous three years publicly available. Except as discussed below, management has some discretion to determine the appropriate medium and location of the disclosure. Furthermore, an FDIC-supervised institution has flexibility in formatting its public disclosures.

The FDIC encourages management to provide all of the required disclosures in one place on the entity's public website and the FDIC anticipates that the public website address would be reported in an FDIC-supervised institution's regulatory report. However, an FDIC-supervised institution may provide the disclosures in more than one public financial report or other regulatory reports (for example, in Management's Discussion and Analysis included in SEC filings), provided that the FDIC-supervised institution publicly provides a summary table specifically indicating the location(s) of all such disclosures (for example, regulatory report schedules, page numbers in annual reports). The FDIC expects that 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.

D. Proprietary and Confidential Information

The FDIC believes that the disclosure requirements strike an appropriate balance between the need for meaningful disclosure and the protection of proprietary and confidential information.[167] Accordingly, the FDIC believes that FDIC-supervised institutions would be able

[167] Proprietary information encompasses information that, if shared with competitors, would render an FDIC-supervised institution's investment in these products/systems less valuable, and,

to 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 interim final rule compel an FDIC-supervised institution to reveal confidential and proprietary information. In these unusual situations, if an FDIC-supervised institution 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 FDIC-supervised institution will not be required to disclose those specific items under the rule's periodic disclosure requirement. Instead, the FDIC-supervised institution 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 applies only to those disclosures included in this interim final rule and does not apply to disclosure requirements imposed by accounting standards, other regulatory agencies, or under other requirements of the FDIC.

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 FDIC notes that the substantive content of the tables is the focus of the disclosure requirements, not the tables themselves. The

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hence, could undermine its competitive position. Information about customers is often confidential, in that it is provided under the terms of a legal agreement or counterparty relationship.

table numbers below refer to the table numbers in section 63 of the interim final rule. An FDIC-supervised institution must make the disclosures described in Tables 1 through 10. [168]

Table 1 disclosures, "Scope of Application," name the top corporate entity in the group to which subpart D of the interim final rule applies and 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 2 disclosures, "Capital Structure," provide summary information on the terms and conditions of the main features of regulatory capital instruments, which allow for an evaluation of the quality of the capital available to absorb losses within an FDIC-supervised institution. An FDIC-supervised institution also must disclose the total amount of common equity tier 1, tier 1 and total capital, with separate disclosures for deductions and adjustments to capital. The FDIC expects that many of these disclosure requirements would be captured in revised regulatory reports.

Table 3 disclosures, "Capital Adequacy," provide information on an FDIC-supervised institution's approach for categorizing and risk weighting its exposures, as well as the amount of total risk-weighted assets. The Table also includes common equity tier 1, and tier 1 and total risk-based capital ratios for the top consolidated group, and for each depository institution subsidiary.

[168] Other public disclosure requirements would continue to apply, such as federal securities law, and regulatory reporting requirements for FDIC-supervised institution s.

Table 4 disclosures, “Capital Conservation Buffer,” require an FDIC-supervised institution to disclose the capital conservation buffer, the eligible retained income and any limitations on capital distributions and certain discretionary bonus payments, as applicable.

Disclosures in Tables 5, “Credit Risk: General Disclosures,” 6, “General Disclosure for Counterparty Credit Risk-Related Exposures,” and 7, “Credit Risk Mitigation,” relate to credit risk, counterparty credit risk and credit risk mitigation, respectively, and provide market participants with insight into different types and concentrations of credit risk to which an FDIC-supervised institution 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 FDIC-supervised institution without revealing proprietary information.

Table 8 disclosures, “Securitization,” provide information to market participants on the amount of credit risk transferred and retained by an FDIC-supervised institution 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 provide a better understanding of how securitization transactions impact the credit risk of an FDIC-supervised institution. For purposes of these disclosures, “exposures securitized” include underlying exposures transferred into a securitization by an FDIC-supervised institution, whether originated by the FDIC-supervised institution or purchased from third parties, and third-party exposures included in sponsored programs. Securitization transactions in which the originating FDIC-supervised institution does not retain any securitization exposure are shown separately and are only reported for the year of inception of the transaction.

Table 9 disclosures, "Equities Not Subject to Subpart F of this Part," provide market participants with an understanding of the types of equity securities held by the FDIC-supervised institution and how they are valued. These disclosures also provide information on the capital allocated to different equity products and the amount of unrealized gains and losses.

Table 10 disclosures, "Interest Rate Risk for Non-trading Activities," require an FDIC-supervised institution to provide certain quantitative and qualitative disclosures regarding the FDIC-supervised institution's management of interest rate risks.

XI. Risk-weighted Assets – Modifications to the Advanced Approaches

In the Advanced Approaches NPR, the agencies proposed revisions to the advanced approaches rule to incorporate certain aspects of Basel III, as well as the requirements introduced by the BCBS in the 2009 Enhancements[169] and subsequent consultative papers. In accordance with Basel III, the proposal sought to require advanced approaches banking organizations to hold more appropriate levels of capital for counterparty credit risk, CVA, and wrong-way risk. Consistent with the 2009 Enhancements, the agencies proposed to strengthen the risk-based capital requirements for certain securitization exposures by requiring banking organizations that are subject to the advanced approaches rule to conduct more rigorous credit analysis of securitization exposures and to enhance the disclosure requirements related to those exposures.

The agencies also proposed revisions to the advanced approaches rule that are consistent with the requirements of section 939A of the Dodd-Frank Act.[170] The agencies proposed to remove references to ratings from certain defined terms under the advanced approaches rule, as

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[169] See "Enhancements to the Basel II framework" (July 2009), available at http://www.bis.org/publ/bcbs157.htm.

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

well as the ratings-based approach for securitization exposures, and replace these provisions with alternative standards of creditworthiness. The proposed rule also contained a number of proposed technical amendments to clarify or adjust existing requirements under the advanced approaches rule. .

This section of the preamble describes the proposals in the Advanced Approaches NPR, comments received on those proposals, and the revisions to the advanced approaches rule reflected in the interim final rule.

In many cases, the comments received on the Standardized Approach NPR were also relevant to the proposed changes to the advanced approaches framework. The FDIC generally took a consistent approach towards addressing the comments with respect to the standardized approach and the advanced approaches rule. Banking organizations that are or would be subject to the advanced approaches rule should refer to the relevant sections of the discussion of the standardized approach for further discussion of these comments.

One commenter raised concerns about the use of models in determining regulatory capital requirements and encouraged the agencies to conduct periodic validation of banking organizations' models for capital adequacy and require modification if necessary. Consistent with the current advanced approaches rule, the interim final rule requires an FDIC-supervised institution to validate its models used to determine regulatory capital requirements on an ongoing basis. This validation must include an evaluation of conceptual soundness; an ongoing monitoring process that includes verification of processes and benchmarking; and an outcomes analysis process that includes backtesting. Under section 123 of the interim final rule, the FDIC may require the FDIC-supervised institution to calculate its advanced approaches risk-weighted

assets according to modifications provided by the FDIC if the FDIC determines that the FDIC-supervised institution's advanced approaches total risk-weighted assets are not commensurate with its credit, market, operational or other risks.

Other commenters suggested that the agencies interpret section 171 of the Dodd-Frank Act narrowly with regard to the advanced approaches framework. The FDIC has adopted the approach taken in the proposed rule because it believes that the approach provides clear, consistent minimum requirements across institutions that comply with the requirements of section 171.

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 were intended to 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 proposed rule included counterparty credit risk revisions in a manner generally consistent with the Basel III revisions to international standards, modified to incorporate alternative standards to the use of credit ratings. The discussion below highlights the proposed revisions, industry comments, and outcome of the interim final rule.

1. Recognition of Financial Collateral

a. Financial Collateral

The EAD adjustment approach under section 132 of the proposed rules permitted a banking organization to recognize the credit risk mitigation benefits of financial collateral by adjusting the EAD rather than the loss given default (LGD) of the exposure for repo-style transactions, eligible margin loans and OTC derivative contracts. The permitted methodologies for recognizing such benefits included the collateral haircut approach, simple VaR approach and the IMM.

Consistent with Basel III, the Advanced Approaches NPR proposed certain modifications to the definition of financial collateral. For example, the definition of financial collateral was modified so that resecuritizations would no longer qualify as financial collateral.[171] Thus, resecuritization collateral could not be used to adjust the EAD of an exposure. The FDIC believes that this treatment is appropriate because resecuritizations have been shown to have more market value volatility than other types of financial collateral.

The proposed rule also removed conforming residential mortgages from the definition of financial collateral. As a result, a banking organization would no longer be able to recognize the credit risk mitigation benefit of such instruments through an adjustment to EAD. Consistent with the Basel III framework, the agencies proposed to exclude all debt securities that are not investment grade from the definition of financial collateral. As discussed in section VII.F of this

[171] Under the proposed rule, a securitization in which one or more of the underlying exposures is a securitization position would be a resecuritization. A resecuritization position under the proposal meant an on- or off-balance sheet exposure to a resecuritization, or an exposure that directly or indirectly references a securitization exposure.

preamble, the proposed rule revised the definition of "investment grade" for the advanced approaches rule and proposed conforming changes to the market risk rule.

As discussed in section VIII.F of the preamble, the FDIC believes that the additional collateral types suggested by commenters are not appropriate forms of financial collateral because they exhibit increased variation and credit risk, and are relatively more speculative than the recognized forms of financial collateral under the proposal. In some cases, the assets suggested by commenters for eligibility as financial collateral were precisely the types of assets that became illiquid during the recent financial crisis. As a result, the FDIC has retained the definition of financial collateral as proposed.

b. Revised Supervisory Haircuts

Securitization exposures have increased levels of volatility relative to other types of financial collateral. To address this issue, consistent with Basel III, the proposal incorporated new standardized supervisory haircuts for securitization exposures in the EAD adjustment approach based on the credit quality of the exposure. Consistent with section 939A of the Dodd-Frank Act, the proposed rule set out an alternative approach to assigning standard supervisory haircuts for securitization exposures, and amended the standard supervisory haircuts for other types of financial collateral to remove the references to credit ratings.

Some commenters proposed limiting the maximum haircut for non-sovereign issuers that receive a 100 percent risk weight to 12 percent, and more specifically assigning a lower haircut than 25 percent for financial collateral in the form of an investment-grade corporate debt security that has a shorter residual maturity. The commenters asserted that these haircuts conservatively correspond to the existing rating categories and result in greater alignment with the Basel framework. As discussed in section VIII.F of the preamble, in the interim final rule, the FDIC

has revised the standard supervisory market price volatility haircuts for financial collateral issued by non-sovereign issuers with a risk weight of 100 percent from 25.0 percent to 4.0 percent for maturities of less than one year, 8.0 percent for maturities greater than one year but less than or equal to five years, and 16.0 percent for maturities greater than five years, consistent with Table 25 below. The FDIC believes that the revised haircuts better reflect the collateral's credit quality and an appropriate differentiation based on the collateral's residual maturity.

Consistent with the proposal, under the interim final rule, supervisory haircuts for exposures to sovereigns, government-sponsored entities, public sector entities, depository institutions, foreign banks, credit unions, and corporate issuers are calculated based upon the risk weights for such exposures described under section 32 of the interim final rule. The interim final rule also clarifies that if an FDIC-supervised institution lends instruments that do not meet the definition of financial collateral, such as non-investment-grade corporate debt securities or resecuritization exposures, the haircut applied to the exposure must be 25 percent.

TABLE 25 – STANDARD SUPERVISORY MARKET PRICE VOLATILITY HAIRCUTS[1]

Residual maturity	Haircut (in percent) assigned based on:						Investment-grade securitization exposures (in percent)
	Sovereign issuers risk weight under section 32[2] (in percent)			Non-sovereign issuers risk weight under section 32 (in percent)			
	Zero	20 or 50	100	20	50	100	
Less than or equal to 1 year	0.5	1.0	15.0	1.0	2.0	4.0	4.0
Greater than 1 year and less than or equal to 5 years	2.0	3.0	15.0	4.0	6.0	8.0	12.0
Greater than 5 years	4.0	6.0	15.0	8.0	12.0	16.0	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	Zero						
Other exposure types	25.0						

[1] The market price volatility haircuts in Table 25 are based on a 10 business-day holding period.
[2] Includes a foreign PSE that receives a zero percent risk weight.

2. Holding Periods and the Margin Period of Risk

As noted in the proposal, during the recent financial crisis, many financial institutions experienced significant delays in settling or closing out collateralized transactions, such as repo-style transactions and collateralized OTC derivative contracts. The assumed holding period for collateral in the collateral haircut and simple VaR approaches and the margin period of risk in the IMM proved to be inadequate for certain transactions and netting sets. [172] It also did not reflect the difficulties and delays experienced by institutions when settling or liquidating collateral during a period of financial stress.

Consistent with Basel III, the proposed rule would have amended the advanced approaches rule to incorporate 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, and eligible margin loans, with respect to large netting sets, netting sets involving illiquid collateral or including OTC derivatives that could not easily be replaced, or two margin disputes within a netting set over the previous two quarters that last for a certain length of time. For cleared transactions, which are discussed below, the agencies proposed not to require a banking organization to adjust the holding period or margin period of risk upward when determining the capital requirement for its counterparty credit risk exposures to the CCP, which is also consistent with Basel III.

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[172] 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.

One commenter asserted that the proposed triggers for the increased margin period of risk were not in the spirit of the advanced approaches rule, which is intended to be more risk sensitive than the general risk-based capital rules. Another commenter asserted that banking organizations should be permitted to increase the holding period or margin period of risk by one or more business days, but not be required to increase it to the full period required under the proposal (20 business days or at least double the margin period of risk).

The FDIC believes the triggers set forth in the proposed rule, as well as the increased holding period or margin period of risk are empirical indicators of increased risk of delay or failure of close-out on the default of a counterparty. The goal of risk sensitivity would suggest that modifying these indicators is not warranted and could lead to increased risks to the banking system. Accordingly, the interim final rule adopts these features as proposed.

3. Internal Models Methodology

Consistent with Basel III, the proposed rule would have amended the advanced approaches rule so that the capital requirement for IMM exposures is 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. The proposed rule defined an IMM exposure as a repo-style transaction, eligible margin loan, or OTC derivative contract for which a banking organization calculates EAD using the IMM.

The proposed rule would have required a banking organization to demonstrate to the satisfaction of the banking organization's primary Federal supervisor at least quarterly that the stress period it uses for the IMM coincides with increased CDS or other credit spreads of its counterparties and to have procedures in place to evaluate the effectiveness of its stress

calibration. These procedures would have been 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, under the proposal, the primary Federal supervisor could require a banking organization to modify its stress calibration if the primary Federal supervisor believes that another calibration better reflects the actual historic losses of the portfolio.

Consistent with Basel III and the current advanced approaches rule, the proposed rule would have required a banking organization to establish a process for initial validation and annual review of its internal models. As part of the process, the proposed rule would have required a banking organization to have a backtesting program for its model that includes a process by which unacceptable model performance is identified and remedied. In addition, a banking organization would have been required to multiply the expected positive exposure (EPE) of a netting set by the default scaling factor alpha (set equal to 1.4) in calculating EAD. The primary Federal supervisor could require the banking organization to set a higher default scaling factor based on the past performance of the banking organization's internal model.

The proposed rule would have required 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 have been required to have a comprehensive stress testing program for the IMM that captures all credit exposures to counterparties and incorporates stress testing of principal market risk factors and the creditworthiness of its counterparties.

Basel III provided that a banking organization could 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 the "shortcut" method for capturing the effects of collateral agreements 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 proposed rule included the Basel III modification of the "shortcut" method.

The interim final rule adopts all the proposed requirements discussed above with two modifications. With respect to the proposed requirement that an FDIC-supervised institution must demonstrate on a quarterly basis to the FDIC the appropriateness of its stress period, under the interim final rule, the FDIC-supervised institution must instead demonstrate at least quarterly that the stress period coincides with increased CDS or other credit spreads of the FDIC-supervised institution's counterparties, and must maintain documentation of such demonstration. In addition, the formula for the "shortcut" method has been modified to clarify that the add-on is computed as the expected increase in the netting set's exposure over the margin period of risk.

a. Recognition of Wrong-way Risk

The recent financial crisis highlighted the interconnectedness of large financial institutions through an array of complex transactions. In recognition of 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 defined wrong-way risk as the risk that arises when an exposure to a particular counterparty is positively correlated with the probability of default of that counterparty.

The proposed rule provided enhancements to the advanced approaches rule that require banking organizations' risk-management procedures to identify, monitor, and control wrong-way risk throughout the life of an exposure. The proposed rule required these risk-management procedures to 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. The proposed rule defined specific wrong-way risk as 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, under the proposal, 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 otherwise applies the IMM, the banking organization would set the probability of default (PD) of the counterparty and a LGD equal to 100 percent. The banking organization would then enter these parameters into the appropriate risk-based capital formula specified in Table 1 of section 131 of the proposed rule, and 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,[173] 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 of the interim final rule and with the estimated value of the collateral substituted for the parameter C in the equation.

The interim final rule adopts the proposed requirements regarding wrong-way risk discussed above.

b. Increased Asset Value Correlation Factor

To recognize the correlation of financial institutions' creditworthiness attributable to similar sensitivities to common risk factors, the agencies proposed to incorporate the Basel III increase in the correlation factor used in the formulas provided in Table 1 of section 131 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

[173] Under the interim final rule, equity derivatives that are call options are not subject to a counterparty credit risk capital requirement for specific wrong-way risk.

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. The proposal also included a definition of "regulated financial institution," meaning a financial institution subject to consolidated supervision and regulation comparable to that imposed on certain U.S. financial institutions, namely depository institutions, depository institution holding companies, nonbank financial companies supervised by the Federal Reserve, designated FMUs, securities broker-dealers, credit unions, or insurance companies. 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.

Several commenters pointed out that in the proposed formulas for wholesale exposures to unregulated and regulated financial institutions, the 0.18 multiplier should be revised to 0.12 in order to be consistent with Basel III. The FDIC has corrected this aspect of both formulas in the interim final rule.

Another comment asserted that the 1.25 multiplier for the correlation factor for wholesale exposures to unregulated financial institutions or regulated financial institutions with more than $100 billion in assets is an overly blunt tool and is not necessary as single counterparty credit limits already address interconnectivity risk. Consistent with the concerns about systemic risk and interconnectedness surrounding these classes of institutions, the FDIC continues to believe that the 1.25 multiplier appropriately reflects the associated additional risk. Therefore, the interim final rule retains the 1.25 multiplier. In addition, the interim final rule also adopts the definition of "regulated financial institution" without change from the proposal. As discussed in section V.B, above, the FDIC received significant comment on the definition of "financial

institution" in the context of deductions of investments in the capital of unconsolidated financial institutions. That definition also, under the proposal, defined the universe of "unregulated" financial institutions as companies meeting the definition of "financial institution" that were not regulated financial institutions. For the reasons discussed in section V.B of the preamble, the FDIC has modified the definition of "financial institution," including by introducing an ownership interest threshold to the "predominantly engaged" test to determine if an FDIC-supervised institution must subject a particular unconsolidated investment in a company that may be a financial institution to the relevant deduction thresholds under subpart C of the interim final rule. While commenters stated that it would be burdensome to determine whether an entity falls within the definition of financial institution using the predominantly engaged test, the FDIC believes that advanced approaches FDIC-supervised institutions should have the systems and resources to identify the activities of their wholesale counterparties. Accordingly, under the interim final rule, the FDIC has adopted a definition of "unregulated financial institution" that does not include the ownership interest threshold test but otherwise incorporates revisions to the definition of "financial institution." Under the interim final rule, an "unregulated financial institution" is a financial institution that is not a regulated financial institution and that meets the definition of "financial institution" under the interim final rule without regard to the ownership interest thresholds set forth in paragraph (4)(i) of that definition. The FDIC believes the "unregulated financial institution" definition is necessary to maintain an appropriate scope for the 1.25 multiplier consistent with the proposal and Basel III.

4. Credit Valuation Adjustments

After the recent financial crisis, 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 fair value losses from CVA (that is, the fair value adjustment to reflect counterparty credit risk in the valuation of an OTC derivative contract), whereas one-third of counterparty credit risk losses resulted from actual defaults. The internal ratings-based approach in Basel II addressed counterparty credit risk as a combination of default risk and credit migration risk. Credit migration risk accounts for fair 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. Basel III therefore includes an explicit capital requirement for CVA risk. Accordingly, consistent with Basel III and the proposal, the interim final rule requires FDIC-supervised institutions to calculate risk-weighted assets for CVA risk.

Consistent with the Basel III CVA capital requirement and the proposal, the interim final rule reflects in risk-weighted assets a potential increase of the firm-wide CVA due to changes in counterparties' credit spreads, assuming fixed expected exposure (EE) profiles. The proposed and interim final rules provide two approaches for calculating the CVA capital requirement: the simple approach and the advanced CVA approach. However, unlike Basel III, they do not include references to credit ratings.

Consistent with the proposal and Basel III, the simple CVA approach in the interim final rule permits calculation of the CVA capital requirement (K_{CVA}) based on a formula described in more detail below, with a modification consistent with section 939A of the Dodd-Frank Act. Under the advanced CVA approach in the interim final rule, consistent with the proposal, an FDIC-supervised institution would use the VaR model that it uses to calculate specific risk under section 207(b) of subpart F or another model that meets the quantitative requirements of sections 205(b) and 207(b)(1) of subpart F to calculate its CVA capital requirement for its entire

portfolio of OTC derivatives that are subject to the CVA capital requirement[174] by modeling the impact of changes in the counterparties' credit spreads, together with any recognized CVA hedges on the CVA for the counterparties. To convert the CVA capital requirement to a risk-weighted asset amount, an FDIC-supervised institution must multiply its CVA capital requirement by 12.5. The CVA risk-weighted asset amount is not a component of credit risk-weighted assets and therefore is not subject to the 1.06 multiplier for credit risk-weighted assets under the interim final rule. Consistent with the proposal, the interim final rule provides that only an FDIC-supervised institution that is subject to the market risk rule and had obtained prior approval from the FDIC to calculate (1) the EAD for OTC derivative contracts using the IMM described in section 132, and (2) the specific risk add-on for debt positions using a specific risk model described in section 207(b) of subpart F is eligible to use the advanced CVA approach. An FDIC-supervised institution that receives such approval would be able to continue to use the advanced CVA approach until it notifies the FDIC in writing that it expects to begin calculating its CVA capital requirement using the simple CVA approach. Such notice must include an explanation from the FDIC-supervised institution as to why it is choosing to use the simple CVA approach and the date when the FDIC-supervised institution would begin to calculate its CVA capital requirement using the simple CVA approach.

Consistent with the proposal, under the interim final rule, when calculating a CVA capital requirement, an FDIC-supervised institution may recognize the hedging benefits of single name CDS, single name contingent CDS, any other equivalent hedging instrument that references the

[174] Certain CDS may be exempt from inclusion in the portfolio of OTC derivatives that are subject to the CVA capital requirement. For example, a CDS on a loan that is recognized as a credit risk mitigant and receives substitution treatment under section 134 would not be included in the portfolio of OTC derivatives that are subject to the CVA capital requirement.

counterparty directly, and index CDS (CDS_{ind}), provided that the equivalent hedging instrument is managed as a CVA hedge in accordance with the FDIC-supervised institution's hedging policies. A tranched or n^{th}-to-default CDS would not qualify as a CVA hedge. In addition, any position that is recognized as a CVA hedge would not be a covered position under the market risk rule, except in the case where the FDIC-supervised institution 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. The agencies received several comments on the proposed CVA capital requirement. One commenter asserted that there was ambiguity in the "total CVA risk-weighted assets" definition which could be read as indicating that K_{CVA} is calculated for each counterparty and then summed. The FDIC agrees that K_{CVA} relates to an FDIC-supervised institution's entire portfolio of OTC derivatives contracts, and the interim final rule reflects this clarification.

A commenter asserted that the proposed CVA treatment should not apply to central banks, MDBs and other similar counterparties that have very low credit risk, such as the Bank for International Settlements and the European Central Bank, as well as U.S. PSEs. Another commenter pointed out that the proposal in the European Union to implement Basel III excludes sovereign, pension fund, and corporate counterparties from the proposed CVA treatment. Another commenter argued that the proposed CVA treatment should not apply to transactions executed with end-users when hedging business risk because the resulting increase in pricing will disproportionately impact small- and medium-sized businesses.

The interim final rule does not exempt the entities suggested by commenters. However, the FDIC anticipates that a counterparty that is exempt from the 0.03 percent PD floor under §

324.131(d)(2) and receives a zero percent risk weight under § 324.32 (that is, central banks, MDBs, the Bank for International Settlements and European Central Bank) likely would attract a minimal CVA requirement because the credit spreads associated with these counterparties have very little variability. Regarding the other entities mentioned by commenters (U.S. public sector entities, pension funds and corporate end-users), the FDIC believes it is appropriate for CVA to apply as these counterparty types exhibit varying degrees of credit risk.

Some commenters asked that the agencies clarify that interest rate hedges of CVA are not covered positions as defined in subpart F and, therefore, not subject to a market risk capital requirement. In addition, some commenters asserted that the overall capital requirements for CVA are more appropriately addressed as a trading book issue in the context of the BCBS Fundamental Review of the Trading Book.[175] Another commenter asserted that CVA rates hedges (to the extent they might be covered positions) should be excluded from the market-risk rule capital requirements until supervisors are ready to approve allowing CVA rates sensitivities to be incorporated into a banking organization's general market risk VaR.

The FDIC recognizes that CVA is not a covered position under the market risk rule. Hence, as elaborated in the market risk rule, hedges of non-covered positions that are not themselves trading positions also are not eligible to be a covered position under the market risk rule. Therefore, the FDIC clarifies that non-credit risk hedges (market risk hedges or exposure hedges) of CVA generally are not covered positions under the market risk rule, but rather are assigned risk-weighted asset amounts under subparts D and E of the interim final rule.[176] Once

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[175] See "Fundamental review of the trading book" (May 2012) available at http://www.bis.org/publ/bcbs219.pdf.

[176] The FDIC believes that an FDIC-supervised institution needs to demonstrate rigorous risk management and the efficacy of its CVA hedges and should follow the risk management

the BCBS Fundamental Review of the Trading Book is complete, the agencies will review the BCBS findings and consider whether they are appropriate for U.S. banking organizations.

One commenter asserted that observable LGDs for credit derivatives do not represent the best estimation of LGD for calculating CVA under the advanced CVA approach, and that a final rule should instead consider a number of parameters, including market observable recovery rates on unsecured bonds and structural components of the derivative. Another commenter argued that banking organizations should be permitted greater flexibility in determining market-implied loss given default (LGD_{MKT}) and credit spread factors for VaR.

Consistent with the BCBS's frequently asked question (BCBS FAQ) on this topic,[177] the FDIC recognizes that while there is often limited market information of LGD_{MKT} (or equivalently the market implied recovery rate), the FDIC considers the use of LGD_{MKT} to be the most appropriate approach to quantify CVA. It is also the market convention to use a fixed recovery rate for CDS pricing purposes; FDIC-supervised institutions may use that information for purposes of the CVA capital requirement in the absence of other information. In cases where a netting set of OTC derivative contracts has a different seniority than those derivative contracts that trade in the market from which LGD_{MKT} is inferred, an FDIC-supervised institution may adjust LGD_{MKT} to reflect this difference in seniority. Where no market information is available to determine LGD_{MKT}, an FDIC-supervised institution may propose a method for determining

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principles of the Interagency Supervisory Guidance on Counterparty Credit Risk Management (2011) and identification of covered positions as in the FDIC's market risk rule, see 77 FR 53060 (August 30, 2012).

[177] See "Basel III counterparty credit risk and exposures to central counterparties – Frequently asked questions (December 2012 (update of FAQs published November 2012)) at http://www.bis.org/publ/bcbs237.pdf.

LGD_{MKT} based upon data collected by the FDIC-supervised institution that would be subject to approval by the FDIC. The interim final rule has been amended to include this alternative.

Regarding the proposed CVA EAD calculation assumptions in the advanced CVA approach, one commenter asserted that EE constant treatment is inappropriate, and that it is more appropriate to use the weighted average maturity of the portfolio rather than the netting set. Another commenter asserted that maturity should equal the weighted average maturity of all transactions in the netting set, rather than the greater of the notional weighted average maturity and the maximum of half of the longest maturity occurring in the netting set. The FDIC notes that this issue is relevant only where an FDIC-supervised institution utilized the current exposure method or the "shortcut" method, rather than IMM, for any immaterial portfolios of OTC derivatives contracts. As a result, the interim final rule retains the requirement to use the greater of the notional weighted average maturity (WAM) and the maximum of half of the longest maturity in the netting set when calculating EE constant treatment in the advanced CVA approach.

One commenter asked the agencies to clarify that section 132(c)(3) would exempt the purchased CDS from the proposed CVA capital requirements in section 132(e) of a final rule. Consistent with the BCBS FAQ on this topic, the FDIC agrees that purchased credit derivative protection against a wholesale exposure that is subject to the double default framework or the PD substitution approach and where the wholesale exposure itself is not subject to the CVA capital requirement, will not be subject to the CVA capital requirement in the interim final rule. Also consistent with the BCBS FAQ, the purchased credit derivative protection may not be recognized as a hedge for any other exposure under the interim final rule.

Another commenter asserted that single-name proxy CDS trades should be allowed as hedges in the advanced CVA approach CVA VaR calculation. Under the interim final rule, an FDIC-supervised institution is permitted to recognize the hedging benefits of single name CDS, single name contingent CDS, any other equivalent hedging instrument that references the counterparty directly, and CDS_{ind}, provided that the hedging instrument is managed as a CVA hedge in accordance with the FDIC-supervised institution's hedging policies. The interim final rule does not permit the use of single-name proxy CDS. The FDIC believes this is an important limitation because of the significant basis risk that could arise from the use of a single-name proxy.

Additionally, the interim final rule reflects several clarifying amendments to the proposed rule. First, the interim final rule divides the Advanced CVA formulas in the proposed rule into two parts: Formula 3 and Formula 3a. The FDIC believes that this clarification is important to reflect the different purposes of the two formulas: the first formula (Formula 3) is for the CVA VaR calculation, whereas the second formula (Formula 3a) is for calculating CVA for each credit spread simulation scenario. The interim final rule includes a description that clarifies each formula's purpose. In addition, the notations in proposed Formula 3 have been changed from $CVA_{stressedVaR}$ and $CVA_{unstressedVaR}$ to $VaR^{CVA}{}_{stressed}$ and $VaR^{CVA}{}_{unstressed}$. The definitions of these terms have not changed in the interim final rule. Finally, the subscript "$_j$" in Formula 3a has been defined as referring either to stressed or unstressed calibrations. These formulas are discussed in the interim final rule description below.

a. Simple Credit Valuation Adjustment approach

Under the interim final rule, an FDIC-supervised institution without approval to use the advanced CVA approach must use formula 1 to calculate its CVA capital requirement for its

entire portfolio of OTC derivative contracts. The simple CVA approach is based on an analytical approximation derived from a general CVA VaR formulation under a set of simplifying assumptions:

(1) All credit spreads have a flat term structure;

(2) All credit spreads at the time horizon have a lognormal distribution;

(3) Each single name credit spread is driven by the combination of a single systematic factor and an idiosyncratic factor;

(4) The correlation between any single name credit spread and the systematic factor is equal to 0.5;

(5) All credit indices are driven by the single systematic factor; and

(6) The time horizon is short (the square root of time scaling to 1 year is applied). The approximation is based on the linearization of the dependence of both CVA and CDS hedges on credit spreads. Given the assumptions listed above, a measure of CVA VaR has a closed-form analytical solution. The formula of the simple CVA approach is obtained by applying certain standardizations, conservative adjustments, and scaling to the analytical CVA VaR result.

An FDIC-supervised institution calculates 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 26 below.[178] In Basel III, the BCBS assigned w_i based on the external rating of the counterparty. However, consistent with the proposal and section 939A of the Dodd-Frank Act, the interim final rule assigns w_i based on the relevant PD of the counterparty, as assigned by the FDIC-supervised institution. Quantity w_{ind} in Formula 1 refers to the weight applicable to the CDS_{ind} based on the average weight under Table 26 of the underlying reference names that comprise the index.

TABLE 26 – ASSIGNMENT OF COUNTERPARTY WEIGHT UNDER THE SIMPLE CVA

Internal PD (in percent)	Weight w_i (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 interim final rule, as adjusted by Formula 2 or the IMM described in section 132(d) of the interim final rule. When the FDIC-supervised institution calculates EAD using the IMM, EAD_i^{total} equals $EAD_{unstressed}$.

[178] These weights represent the assumed values of the product of a counterparties' current credit spread and the volatility of that credit spread.

Formula 2

$$EAD \times \left(\frac{1 - exp^{-.05 \times M_i}}{.05 \times M_i} \right)$$

.

The term "exp" is the exponential function. Quantity 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). Quantity M_i^{hedge} in Formula 1 refers to the notional weighted average maturity of the hedge instrument. Quantity 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.

Quantity 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 x M_i^{hedge}))/(0.05 x M_i^{hedge}). Quantity 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 x M_{ind}))/(0.05 x M_{ind}). If counterparty *i* is part of an index used for hedging, an FDIC-supervised institution is allowed to treat the notional amount in an 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 CDS_{ind} hedge with the notional amount reduced by B_i can still be treated as a CVA index hedge.

b. Advanced Credit Valuation Adjustment approach

The interim final rule requires that the VaR model incorporate only changes in the counterparties' credit spreads, not changes in other risk factors; it does not require an FDIC-supervised institution to capture jump-to-default risk in its VaR model.

In order for an FDIC-supervised institution to receive approval to use the advanced CVA approach under the interim final rule, the FDIC-supervised institution needs to have the systems capability to calculate the CVA capital requirement on a daily basis but is not expected or required to calculate the CVA capital requirement on a daily basis.

The CVA capital requirement under the advanced CVA approach is equal to the general market risk capital requirement of the CVA exposure using the ten-business-day time horizon of the market risk rule. The capital requirement does not include the incremental risk requirement of subpart F. If an FDIC-supervised institution uses the current exposure methodology to calculate the EAD of any immaterial OTC derivative portfolio, under the interim final rule the FDIC-supervised institution must use this EAD as a constant EE in the formula for the calculation of CVA. Also, the FDIC-supervised institution must set 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.

The interim final rule requires an FDIC-supervised institution to use the formula for the advanced CVA approach to calculate K_{CVA} as follows:

Formula 3

$$K_{CVA} = 3 \times \left(VaR_{Unstressed} + VaR_{Stressed} \right)$$

VaR_j is the 99 percent VaR reflecting changes of CVA_j and fair value of eligible hedges (aggregated across all counterparties and eligible hedges) resulting from simulated changes of credit spreads over a ten-day time horizon.[179] CVA_j for a given counterparty must be calculated according to

[179] For purposes of this formula, the subscript "$_j$" refers either to a stressed or unstressed calibration as described in section 133(e)(6)(iv) and (v) of the interim final rule.

Formula 3a

$$CVA_j = \left(LGD_{MKT}\right) \times \sum_{i=1}^{T} Max\left(0; \exp\left(-\frac{s_{i-1} \times t_{i-1}}{LGD_{MKT}}\right) - \exp\left(-\frac{s_i \times t_i}{LGD_{MKT}}\right)\right) \times \left(\frac{EE_{i-1} \times D_{i-1} + EE_i \times D_i}{2}\right)$$

In Formula 3a:

(A) t_i equals the time of the i-th revaluation time bucket starting from $t_0 = 0$.

(B) t_T equals the longest contractual maturity across the OTC derivative contracts with the counterparty.

(C) s_i equals 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 FDIC-supervised institution must use a proxy spread based on the credit quality, industry and region of the counterparty.

(D) LGD_{MKT} equals 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.

(E) EE_i equals the sum of the expected exposures for all netting sets with the counterparty at revaluation time t_i calculated using the IMM.

(F) D_i equals the risk-free discount factor at time t_i, where $D_0 = 1$.

(G) The function exp is the exponential function.

(H) The subscript j refers either to a stressed or an unstressed calibration as described in section 132(e)(6)(iv) and (v) of the interim final rule.

Under the interim final rule, if an FDIC-supervised institution's VaR model is not based on full repricing, the FDIC-supervised institution must 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 FDIC-supervised institution must calculate each credit spread sensitivity according to Formula 4:

Formula 4

$$\text{Regulatory CS01}^{180} = 0.0001 \times t_i \times \exp\left(-\frac{s_i \times t_i}{LGD_{MKT}}\right) \times \left(\frac{EE_{i-1} \times D_{i-1} - EE_{i+1} \times D_{i+1}}{2}\right)$$

If the VaR model uses credit spread sensitivities to parallel shifts in credit spreads, the FDIC-supervised institution must calculate each credit spread sensitivity according to Formula 5:

Formula 5

Regulatory CS01 =

$$0.0001 \times \sum_{i=1}^{T}\left(t_i \times \exp\left(-\frac{s_i \times t_i}{LGD_{MKT}}\right) - t_{i-1} \times \exp\left(-\frac{s_{i-1} \times t_{i-1}}{LGD_{MKT}}\right)\right) \times \left(\frac{EE_{i-1} \times D_{i-1} + EE_i \times D_i}{2}\right)$$

Under the interim final rule, an FDIC-supervised institution must calculate $\text{VaR}^{\text{CVA}}_{\text{unstressed}}$ using $\text{CVA}_{Unstressed}$ and $\text{VaR}^{\text{CVA}}_{\text{stressed}}$ using $\text{CVA}_{Stressed}$. To calculate the $CVA_{Unstressed}$ measure in Formula 3a, an FDIC-supervised institution must use the EE for a counterparty calculated using current market data to compute current exposures and estimate model parameters using the historical observation period required under section 205(b)(2) of subpart F. However, if an FDIC-supervised institution uses the "shortcut" method described in section 132(d)(5) of the interim final rule to capture the effect of a collateral agreement when estimating EAD using the IMM, the FDIC-supervised institution must calculate the EE for the counterparty using that method and keep that EE constant with the maturity equal to the

[180] For the final time bucket $i = T$, the corresponding formula is Regulatory CS01 = $0.0001 \times t_i \times \exp\left(-\frac{s_i \times t_i}{LGD_{MKT}}\right) \times \left(\frac{EE_{i-1} \times D_{i-1} + EE_T \times D_T}{2}\right)$

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 $CVA_{Stressed}$ measure in Formula 3a, the interim final rule requires an FDIC-supervised institution to use the EE for a counterparty calculated using the stress calibration of the IMM. However, if an FDIC-supervised institution uses the "shortcut" method described in section 132(d)(5) of the interim final rule to capture the effect of a collateral agreement when estimating EAD using the IMM, the FDIC-supervised institution must calculate the EE for the counterparty using that method and keep that EE 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 interim final rule requires an FDIC-supervised institution 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. However, the FDIC retains the flexibility to require an FDIC-supervised institution to use a different period of significant financial stress in the calculation of the $CVA_{Stressed}$ measure that better reflects actual historic losses of the portfolio.

Under the interim final rule, an FDIC-supervised institution's VaR model is required to 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, including benign and stressed environments. If the VaR model does not capture that basis, the FDIC-supervised institution is permitted to reflect only 50 percent of the notional amount of the CDS_{ind} hedge in the VaR model.

5. Cleared Transactions (Central Counterparties)

As discussed more fully in section VIII.E. of this preamble on cleared transactions under the standardized approach, 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. Similar to the changes to the cleared transaction treatment in the subpart D of the interim final rule, the requirements regarding the cleared transaction framework in the subpart E has been revised to reflect the material changes from the BCBS CCP interim framework. Key changes from the CCP interim framework, include: (1) allowing a clearing member FDIC-supervised institution to use a reduced margin period of risk when using the IMM or a scaling factor of no less than .71[181] when using the CEM in the calculation of its EAD for client-facing derivative trades; (2) updating the risk weights applicable to a clearing member FDIC-supervised institution's exposures when the clearing member FDIC-supervised institution guarantees QCCP performance; (3) permitting clearing member FDIC-supervised institutions to choose from one of two approaches for determining the capital requirement for exposures to default fund contributions; and (4) updating the CEM formula to recognize netting to a greater extent for purposes of calculating its risk-weighted asset amount for default fund contributions.

Additionally, changes in response to comments received on the proposal, as discussed in detail in section VIII.E of this preamble with respect to cleared transactions in the standardized approach, are also reflected in the interim final rule for advanced approaches. FDIC-supervised institutions seeking more information on the changes relating to the material elements of the

[181] See Table 20 in section VIII.E of this preamble. Consistent with the scaling factor for the CEM in Table 20, an advanced approaches FDIC-supervised institution may reduce the margin period of risk when using the IMM to no shorter than 5 days.

BCBS CCP interim framework and the comments received should refer to section VIII.E of this preamble.

6. Stress Period for Own Estimates

During the recent financial crisis, increased volatility in the value of collateral led to higher counterparty exposures than estimated by banking organizations. Under the collateral haircut approach in the advanced approaches interim final rule, consistent with the proposal, an FDIC-supervised institution that receives prior approval from the FDIC may calculate market price and foreign exchange volatility using own internal estimates. In response to the increased volatility experienced during the crisis, however, the interim final rule modifies the quantitative standards for approval by requiring FDIC-supervised institutions 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 section VIII.F of this preamble with respect to the standardized approach, an FDIC-supervised institution is also required to have policies and procedures that describe how it determines the period of significant financial stress used to calculate the FDIC-supervised institution's own internal estimates, and must be able to provide empirical support for the period used. To ensure an appropriate level of conservativeness, in certain circumstances the FDIC may require an FDIC-supervised institution to use a different period of significant financial stress in the calculation of own internal estimates for haircuts. The FDIC is adopting this aspect of the proposal without change.

B. Removal of Credit Ratings

Consistent with the proposed rule and section 939A of the Dodd-Frank Act, the interim final rule includes a number of changes to definitions in the advanced approaches rule that

currently reference credit ratings.[182] These changes are consistent with the alternative standards included in the Standardized Approach and alternative standards that already have been implemented in the FDIC's market risk rule. In addition, the interim final rule includes necessary changes to the hierarchy for risk weighting securitization exposures necessitated by the removal of the ratings-based approach, as described further below.

In certain instances, the interim final rule uses an "investment grade" standard that does not rely on credit ratings. Under the interim final rule and consistent with the market risk rule, investment grade means that the entity to which the FDIC-supervised institution 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.

The FDIC is largely finalizing the proposed alternatives to ratings as proposed. Consistent with the proposal, the FDIC is retaining the standards used to calculate the PFE for derivative contracts (as set forth in Table 2 of the interim final rule), which are based in part on whether the counterparty satisfies the definition of investment grade under the interim final rule. The FDIC is also finalizing as proposed the term "eligible double default guarantor," which is used for purposes of determining whether an FDIC-supervised institution may recognize a guarantee or credit derivative under the credit risk mitigation framework. In addition, the FDIC is finalizing the proposed requirements for qualifying operational risk mitigants, which among other criteria, must be provided by an unaffiliated company that the FDIC-supervised institution deems to have strong capacity to meet its claims payment obligations and the obligor rating

[182] See 76 FR 79380 (Dec. 21, 2011).

category to which the FDIC-supervised institution assigns the company is assigned a PD equal to or less than 10 basis points.

1. Eligible Guarantor

Previously, to be an eligible securitization guarantor under the advanced approaches rule, a guarantor was required to meet a number of criteria. For example, the guarantor must have issued and 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. The interim final rule replaces the term "eligible securitization guarantor" with the term "eligible guarantor," which includes certain entities that have issued and outstanding unsecured debt securities without credit enhancement that are investment grade. Comments and modifications to the definition of eligible guarantor are discussed below and in section VIII.F of this preamble.

2. Money Market Fund Approach

Previously, under the money market fund approach in the advanced approaches rule, 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. The proposed rule eliminated the money market fund approach. Commenters stated that the elimination of the existing 7 percent risk weight for equity exposures to money market funds would result in an overly stringent treatment for those exposures under the remaining look-through approaches. However, during the recent financial crisis, several money market funds demonstrated elevated credit risk that is not consistent with a low 7 percent risk weight. Accordingly, the FDIC believes it is appropriate to eliminate the preferential risk weight for money market fund investments. As a result of the changes, an

FDIC-supervised institution must use one of the three alternative approaches under section 154 of the interim final rule to determine the risk weight for its exposures to a money market fund.

3. 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 have been based on the highest risk weight assigned to the exposure under the standardized approach (subpart D) based on the investment limits in the fund's prospectus, partnership agreement, or similar contract that defines the fund's permissible investments. As discussed in the preamble regarding the standardized approach, commenters expressed concerns regarding their ability to implement the look-through approaches for investment funds that hold securitization exposures. However, the FDIC believes that FDIC-supervised institutions should be aware of the nature of the investments in a fund in which the organization invests. To the extent that information is not available, the treatment in the interim final rule will create incentives for FDIC-supervised institutions to obtain the information necessary to compute risk-based capital requirements under the approach. These incentives are consistent with the FDIC's supervisory aim that FDIC-supervised institutions have sufficient understanding of the characteristics and risks of their investments.

C. Revisions to the Treatment of Securitization Exposures

1. Definitions

As discussed in section VIII.H of this preamble with respect to the standardized approach, the proposal introduced a new definition for resecuritization exposures consistent with the 2009 Enhancements and broadened the definition of a securitization exposure. In addition, the agencies proposed to amend the existing definition of traditional securitization in order to exclude certain types of investment firms from treatment under the securitization framework.

Consistent with the approach taken with respect to the standardized approach, the proposed definitions under the securitization framework in the advanced approach are largely included in the interim final rule as proposed, except for changes described below. Banking organizations should refer to part VIII.H of this preamble for further discussion of these comments.

In response to the proposed definition of traditional securitization, commenters generally agreed with the proposed exemptions from the definition and requested that the agencies provide exemptions for exposures to a broader set of investment firms, such as pension funds operated by state and local governments. In view of the comments regarding pension funds, the interim final rule, as described in part VIII.H of this preamble, excludes from the definition of traditional securitization a "governmental plan" (as defined in 29 U.S.C. 1002(32)) that complies with the tax deferral qualification requirements provided in the Internal Revenue Code. In response to the proposed definition of resecuritization, commenters requested clarification regarding its potential scope of application to exposures that they believed should not be considered resecuritizations. In response, the FDIC has amended the definition of resecuritization by excluding securitizations that feature re-tranching of a single exposure. In addition, the FDIC notes that for purposes of the interim final rule, a resecuritization does not include pass-through securities that have been pooled together and effectively re-issued as tranched securities. This is because the pass-through securities do not tranche credit protection and, as a result, are not considered securitization exposures under the interim final rule.

Previously, under the advanced approaches rule issued in 2007, the definition of eligible securitization guarantor included, 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 interim final rule removes the existing references to ratings from the definition of an eligible guarantor (the new term for an eligible securitization guarantor) and finalizes the requirements as proposed, as described in section VIII.F of this preamble.

During the recent 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. Consistent with the proposal, a guarantor is not an eligible guarantor under the interim final rule if the guarantor's creditworthiness is positively correlated with the credit risk of the exposures for which it has provided guarantees. In addition, insurance companies engaged predominately in the business of providing credit protection are not eligible guarantors. Further discussion can be found in section VIII.F of this preamble.

2. Operational Criteria for Recognizing Risk Transference in Traditional Securitizations

The proposal outlined certain operational requirements for traditional securitizations that had to be met in order to apply the securitization framework. Consistent with the standardized approach as discussed in section VIII.H of this preamble, the interim final rule includes the operational criteria for recognizing risk transference in traditional securitizations largely as proposed.

3. The Hierarchy of Approaches

Consistent with section 939A of the Dodd-Frank Act, the proposed rule removed the ratings-based approach (RBA) and internal assessment approach for securitization exposures.

The interim final rule includes the hierarchy largely as proposed. Under the interim final rule, the hierarchy for securitization exposures is as follows:

(1) An FDIC-supervised institution is required to deduct from common equity tier 1 capital 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, an FDIC-supervised institution is required to assign a risk weight to the securitization exposure using the SFA. The FDIC expects FDIC-supervised institutions to use the SFA rather than the SSFA in all instances where data to calculate the SFA is available.

(3) If the FDIC-supervised institution cannot apply the SFA because not all the relevant qualification criteria are met, it is allowed to apply the SSFA. An FDIC-supervised institution should be able to explain and justify (for example, based on data availability) to the FDIC any instances in which the FDIC-supervised institution uses the SSFA rather than the SFA for its securitization exposures.

The SSFA, described in detail in part VIII.H of this preamble, is similar in construct and function to the SFA. An FDIC-supervised institution needs several inputs to calculate the SSFA. The first input is the weighted-average capital requirement calculated under the standardized approach that applies to the underlying exposures as if they are held directly by the FDIC-supervised institution. 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. An FDIC-supervised institution must apply the hierarchy of approaches in section 142 of this interim final rule to determine which approach it applies to a securitization exposure. The SSFA is included in this interim final rule as proposed,

with the exception of some modifications to the delinquency parameter, as discussed in part VIII.H of this preamble.

4. Guarantees and Credit Derivatives Referencing a Securitization Exposure

The current 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.[183] The current advanced approaches rule, however, does not specify how to treat guarantees or credit derivatives (other than n^{th}-to-default credit derivatives) purchased or sold that reference a securitization exposure. Accordingly, the proposal included specific treatment for credit protection purchased or provided in the form of a guarantee or credit derivative (other than an nth-to-default credit derivative) that references a securitization exposure.

For a guarantee or credit derivative (other than an nth-to-default credit derivative) where the FDIC-supervised institution has provided protection, the interim final rule requires an FDIC-supervised institution providing credit protection 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 FDIC-supervised institution calculates its risk-based capital requirement for the guarantee or credit derivative by applying either (1) the SFA as provided in section 143 of the interim final rule to the reference exposure if the FDIC-supervised institution and the reference exposure qualify for the SFA; or (2) the SSFA as provided in section 144 of the interim final rule. If the guarantee or credit derivative and the

[183] N^{th}-to-default credit derivative means a credit derivative that provides credit protection only for the nth-defaulting reference exposure in a group of reference exposures. See 12 CFR part 325, appendix D, section 42(l) (state nonmember banks), and 12 CFR part 390, subpart Z, appendix A, section 42(l) (state savings associations).

reference securitization exposure do not qualify for the SFA, or the SSFA, the FDIC-supervised institution is required to assign a 1,250 percent risk weight to the notional amount of protection provided under the guarantee or credit derivative.

The interim final rule also clarifies how an FDIC-supervised institution may recognize a guarantee or credit derivative (other than an nth-to-default credit derivative) purchased as a credit risk mitigant for a securitization exposure held by the FDIC-supervised institution. An FDIC-supervised institution that purchases an OTC credit derivative (other than an nth-to-default credit derivative) that is recognized as a credit risk mitigant for a securitization exposure that is not a covered position under the market risk rule is not required to compute a separate counterparty credit risk capital requirement provided that the FDIC-supervised institution does so consistently for all such credit derivatives. The FDIC-supervised institution 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. If an FDIC-supervised institution cannot, or chooses not to, recognize a credit derivative that is a securitization exposure as a credit risk mitigant, the FDIC-supervised institution must determine the exposure amount of the credit derivative under the treatment for OTC derivatives in section 132. If the FDIC-supervised institution purchases the credit protection from a counterparty that is a securitization, the FDIC-supervised institution must determine the risk weight for counterparty credit risk according to the securitization framework. If the FDIC-supervised institution purchases credit protection from a counterparty that is not a securitization, the FDIC-supervised institution must determine the risk weight for counterparty credit risk according to general risk weights under section 131.

5. Due Diligence Requirements for Securitization Exposures

As the recent financial crisis unfolded, weaknesses in exposures underlying securitizations became apparent and resulted in NRSROs downgrading many securitization exposures held by banking organizations. 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 proposed rule introduced due diligence requirements that banking organizations would be required to undertake to use the SFA or SSFA. Comments received regarding the proposed due diligence requirements and the rationale for adopting the proposed treatment in the interim final rule are discussed in part VIII of the preamble.

6. N^{th}-to-Default Credit Derivatives

Consistent with the proposal, the interim final rule provides that an FDIC-supervised institution that provides credit protection through an nth-to-default derivative must assign a risk weight to the derivative using the SFA or the SSFA. In the case of credit protection sold, an FDIC-supervised institution must 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 FDIC-supervised institution's exposure to the total notional amount of all underlying exposures. For purposes of applying the SFA, parameter A is 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 FDIC-supervised institution'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 FDIC-supervised institution'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 FDIC-supervised institution's exposure to the total notional amount of the underlying exposures. Under the SFA, Parameter D is set to equal L plus the thickness of the tranche (T) under the SFA formula. An FDIC-supervised institution that does not use the SFA or SSFA to calculate a risk weight for an nth-to-default credit derivative must assign a risk weight of 1,250 percent to the exposure.

For the treatment of protection purchased through a first-to-default credit derivative, an FDIC-supervised institution must determine its risk-based capital requirement for the underlying exposures as if the FDIC-supervised institution had synthetically securitized the underlying exposure with the lowest risk-based capital requirement and had obtained no credit risk mitigant on the other underlying exposures. An FDIC-supervised institution must calculate a risk-based capital requirement for counterparty credit risk according to section 132 of the interim final rule for a first-to-default credit derivative that does not meet the rules of recognition for guarantees and credit derivatives under section 134(b).

For second-or-subsequent-to default credit derivatives, an FDIC-supervised institution 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 interim final rule (other than a first-to-default credit derivative) is permitted to recognize the credit risk mitigation benefits of the derivative only if the FDIC-supervised institution 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 an FDIC-supervised institution satisfies these requirements, the FDIC-supervised institution determines its risk-based capital requirement for the underlying exposures as if the FDIC-supervised institution had only synthetically securitized the underlying exposure with the nth smallest risk-based capital requirement and had obtained no credit risk mitigant on the other underlying exposures. An FDIC-supervised institution that does not fulfill these requirements must calculate a risk-based capital requirement for counterparty credit risk according to section 132 of the interim final rule for a nth-to-default credit derivative that does not meet the rules of recognition of section 134(b) of the interim final rule.

D. Treatment of Exposures Subject to Deduction

Under the current advanced approaches rule, an FDIC-supervised institution is required to 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. Consistent with Basel III, the proposed rule required a banking organization to assign a 1,250 percent risk weight to many exposures that previously were deducted from capital.

In the proposal, the agencies noted that such treatment would not be 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. Commenters acknowledged these points and asked the agencies to replace the 1,250 percent risk weight with the maximum risk weight that would correspond with deduction. Commenters also stated that the agencies should consider the effect of the 1,250 percent risk weight given that the Basel III proposals, over time, would require banking organizations to maintain a total risk-based capital ratio of at least 10.5 percent to meet the minimum required capital ratio plus the capital conservation buffer.

The FDIC is finalizing the requirements as proposed, in order to provide for comparability in risk-weighted asset measurements across institutions. The FDIC did not propose 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 proposed that an after-tax 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 clarified 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. The interim final rule includes these requirements as proposed.

E. Technical Amendments to the Advanced Approaches Rule

In the proposed rule, the agencies introduced a number of amendments to the advanced approaches rule that were designed to refine and clarify certain aspects of the rule's implementation. The interim final rule includes each of these technical amendments as proposed. Additionally, in the interim final rule, the FDIC is amending the treatment of defaulted exposures that are covered by government guarantees. 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 FDIC notes 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 FDIC-supervised institution or some other third party. However, based on their risk characteristics, the FDIC believes that these guarantees should be recognized as eligible guarantees. Therefore, the FDIC is amending 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 is otherwise considered a conditional guarantee.

Related to the change to the eligible guarantee definition, the FDIC has amended the provision in the advanced approaches rule pertaining to the 10 percent floor on the LGD for residential mortgage exposures. Currently, the rule provides that 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. The provision would therefore require a 10 percent LGD floor on segments of residential mortgage exposures for which all or substantially of the principal are conditionally guaranteed by the U.S. government. The interim final rule allows an exception from the 10 percent floor in such cases.

2. Calculation of Foreign Exposures for Applicability of the Advanced Approaches – Changes to Federal Financial Institutions Economic Council 009

The FDIC is revising the advanced approaches rule to comport with changes to the FFIEC's 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 FDIC has made a similar change under section 100, the section of the interim final rule that makes the rules applicable to an FDIC-supervised institution 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, an FDIC-supervised institution sums its adjusted cross-border claims, local country claims, and cross-border revaluation gains calculated in accordance with FFIEC 009. Adjusted cross-border claims 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.

3. Applicability of the Interim final rule

The FDIC believes that once an FDIC-supervised institution reaches the asset size or level of foreign activity that causes it to become subject to the advanced approaches that it should remain subject to the advanced approaches rule even if it subsequently drops below the asset or foreign exposure threshold. The FDIC believes that it is appropriate for it to evaluate whether an FDIC-supervised institution's business or risk exposure has changed after dropping below the thresholds in a manner that it would no longer be appropriate for the FDIC-supervised institution to be subject to the advanced approaches. As a result, consistent with the proposal, the interim final rule clarifies that once an FDIC-supervised institution is subject to the advanced approaches rule under subpart E, it remains subject to subpart E until the FDIC determines that

application of the rule would not be appropriate in light of the FDIC-supervised institution's asset size, level of complexity, risk profile, or scope of operations. In connection with the consideration of an FDIC-supervised institution's level of complexity, risk profile, and scope of operations, the FDIC also may consider an FDIC-supervised institution's interconnectedness and other relevant risk-related factors.

4. Change to the Definition of Probability of Default Related to Seasoning

The advanced approaches rule requires 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 FDIC has 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, consistent with the proposal, the FDIC is deleting the regulatory seasoning provision and will instead consider seasoning when evaluating an FDIC-supervised institution's assessment of its capital adequacy from a supervisory perspective. In addition to the difficulties in applying the advanced approaches rule's seasoning requirements discussed above, the FDIC believes that seasoning is more appropriately considered from a supervisory perspective. First, seasoning involves the determination of minimum required capital for a period in excess of the 12-month time horizon implicit in the advanced approaches risk-based capital ratio calculations. 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. Second, seasoning is a major issue only where an FDIC-supervised institution has a concentration of unseasoned loans. The risk-based capital ratios do not take concentrations of any kind into account; however, they are an explicit factor in the internal capital adequacy assessment process.

5. Cash Items in Process of Collection

Under the current advanced approaches rule, cash items in the process of collection are not assigned a risk-based capital treatment and, as a result, are subject to a 100 percent risk weight. Under the interim final rule, consistent with the proposal, the FDIC is revising the advanced approaches rule to risk weight cash items in the process of collection at 20 percent of the carrying value, as the FDIC believes that this treatment is more commensurate with the risk of these exposures. A corresponding provision is included in section 32 of the interim final rule.

6. Change to the Definition of Qualifying Revolving Exposure

The agencies proposed modifying the definition of qualifying 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 would qualify as QRE. Under the previous definition in the advanced approaches rule, only unsecured and unconditionally cancellable revolving exposures with a pre-established maximum exposure amount of $100,000 or less (such as credit cards) were classified as QRE. Unsecured, unconditionally cancellable exposures that require payment in full and have no communicated maximum exposure amount (often referred to as "charge cards") were instead classified as "other retail." For risk-based capital purposes, this classification was material and generally results in substantially higher minimum required capital to the extent that the exposure's asset value correlation (AVC) would 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).

Under the proposed definition, certain charge card products would 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. Commenters agreed that charge cards should be included as QRE because, compared to credit cards, they generally exhibit lower loss rates and loss volatility. Where an FDIC-supervised institution consistently imposes in practice an upper exposure limit of $100,000 the FDIC believes that charge cards are more closely aligned from a risk perspective with credit cards than with any type of "other retail" exposure and is therefore amending the definition of QRE in order to more appropriately capture such products under the definition of QRE. With respect to a product with a balance that the borrower is required to pay

in full every month, the exposure would qualify as QRE under the interim final rule as long as its balance does not in practice exceed $100,000. If the balance of an exposure were to exceed that amount, it would represent evidence that such a limit is not maintained in practice for the segment of exposures in which that exposure is placed for risk parameter estimation purposes. As a result, that segment of exposures would not qualify as QRE over the next 24 month period. In addition, the FDIC believes that the definition of QRE should be sufficiently flexible to encompass products with new features that were not envisioned at the time of finalizing the advanced approaches rule, provided, however, that the FDIC-supervised institution can demonstrate to the satisfaction of the FDIC that the performance and risk characteristics (in particular the volatility of loss rates over time) of the new product are consistent with the definition and requirements of QRE portfolios.

7. 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, the proposed rule specified 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. Commenters requested clarification on whether short-term self-liquidating trade finance instruments would be considered exempt from the one-year maturity floor, as they do not constitute an ongoing financing of the obligor. In addition, commenters stated that applying the proposed framework for AVCs to trade-related letters of credit would result in banking organizations maintaining overly conservative capital requirements in relation to the risk of trade

finance exposures, which could reduce the availability of trade finance and increase the cost of providing trade finance for businesses globally. As a result, commenters requested that trade finance exposures be assigned a separate AVC that would better reflect the product's low default rates and low correlation.

The FDIC believes that, in light of the removal of the one-year maturity floor, the proposed requirements for trade-related letters of credit are appropriate without a separate AVC. The interim final rule includes the treatment of trade-related letters of credit as proposed. Under the interim final rule, trade finance exposures that meet the stated requirements above may be assigned a maturity lower than one year. Section 32 of the interim final rule includes a provision that similarly recognizes the low default rates of these exposures.

8. Defaulted Exposures that are Guaranteed by the U.S. Government

Under the current advanced approaches rule, a banking organization is required to apply an 8.0 percent capital requirement to the EAD for each wholesale exposure to a defaulted obligor and for each segment of defaulted retail exposures. The advanced approaches rule does not recognize yet-to-be paid protection in the form of guarantees or insurance on defaulted exposures. For example, under certain programs, a U.S. government agency that provides a guarantee or insurance is not required to pay on claims on exposures to defaulted obligors or segments of defaulted retail exposures until the collateral is sold. The time period from default to sale of collateral can be significant and the exposure amount covered by such U.S. sovereign guarantees or insurance can be substantial.

In order to make the treatment for exposures to defaulted obligors and segments of defaulted retail exposures more risk sensitive, the FDIC has decided to amend the advanced approaches rule by assigning a 1.6 percent capital requirement to the portion of the EAD for each

wholesale exposure to a defaulted obligor and each segment of defaulted retail exposures that is covered by an eligible guarantee from the U.S. government. The portion of the exposure amount for each wholesale exposure to a defaulted obligor and each segment of defaulted retail exposures not covered by an eligible guarantee from the U.S. government continues to be assigned an 8.0 percent capital requirement.

9. Stable Value Wraps

The FDIC is clarifying that an FDIC-supervised institution that provides stable value protection, such as through a stable value wrap that has provisions and conditions that minimize the wrap's exposure to credit risk of the underlying assets in the fund, must treat the exposure as if it were an equity derivative on an investment fund and determine the adjusted carrying value of the exposure according to section 151(b) of the interim final rule. The adjusted carrying value is 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 under the same paragraph. Risk-weighted assets for such an exposure is determined by applying one of the three look-through approaches as provided in section 154 of the interim final rule.

10. Treatment of Pre-sold Construction Loans and Multi-family Residential Loans

The interim final rule assigns either a 50 percent or a 100 percent risk weight to certain one-to-four family residential pre-sold construction loans under the advanced approaches rule,

consistent with provisions of the RTCRRI Act.[184] This treatment is consistent with the treatment under the general risk-based capital rules and under the standardized approach.

F. Pillar 3 Disclosures

1. Frequency and Timeliness of Disclosures

For purposes of the interim final rule, an FDIC-supervised institution is required to provide certain qualitative and quantitative public disclosures on a quarterly, or in some cases, annual basis, and these disclosures must be "timely." Qualitative disclosures that provide a general summary of an FDIC-supervised institution's risk-management objectives and policies, reporting system, and definitions may be disclosed annually after the end of the fourth calendar quarter, provided any significant changes are disclosed in the interim. In the preamble to the advanced approaches rule, the FDIC 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 FDIC acknowledges 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 FDIC also indicated that an FDIC-supervised institution 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. For calendar quarters that do not correspond to fiscal year end, the FDIC considers those disclosures that are made within 45 days of the end of the calendar quarter (or within 60 days for the limited purpose of the FDIC-supervised institution's first

[184] See 12 U.S.C. 1831n, note.

reporting period in which it is subject to the public disclosure requirements) as timely. In general, where an FDIC-supervised institution's fiscal year-end coincides with the end of a calendar quarter, the FDIC considers qualitative and quantitative 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 FDIC 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 FDIC-supervised institution's capital adequacy and risk profile. In those cases, an FDIC-supervised institution needs to disclose the general nature of these changes and briefly describe how they are likely to affect public disclosures going forward. An FDIC-supervised institution should make these interim disclosures as soon as practicable after the determination that a significant change has occurred.

2. Enhanced Securitization Disclosure Requirements

In view of the significant market uncertainty during the recent financial crisis caused by the lack of disclosures regarding banking organizations' securitization-related exposures, the FDIC believes that enhanced disclosure requirements are appropriate. Consistent with the disclosures introduced by the 2009 Enhancements, the proposal amended the qualitative section for Table 9 disclosures (Securitization) under section 173 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 FDIC is implementing the disclosure requirements included in the 2009 Enhancements in the interim final rule. However, consistent with section 939A of the Dodd-Frank Act, the tables do not include those disclosure requirements that are tied to the use of ratings.

3. Equity Holdings That Are Not Covered Positions

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 interim final rule, the FDIC refers to such exposures as equity holdings that are not covered positions in the interim final rule.

XII. Market Risk Rule

On August 30, 2012, 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.[185]

[185] See 77 FR 53060 (August 30, 2012).

As noted in the introduction of this preamble, the agencies proposed to expand the scope of the market risk rule to include state savings associations, and to codify the market risk rule in a manner similar to the other regulatory capital rules in the three proposals. In the interim final rule, consistent with the proposal, the FDIC has also merged definitions and made appropriate technical changes.

As a general matter, an FDIC-supervised institution that is subject to the market risk rule will continue to exclude covered positions (other than certain foreign exchange and commodities positions) when calculating its risk-weighted assets under the other risk-based capital rules. Instead, the FDIC-supervised institution must determine an appropriate capital requirement for such positions using the methodologies set forth in the final market risk 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 include that amount in its standardized approach risk-weighted assets and for an advanced approaches banking organization's advanced approaches risk-weighted assets.

The market risk rule 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 fair 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 proposed to apply the market risk rule to state savings associations. Consistent with the proposal, the FDIC in this interim final rule has expanded the scope of the

market risk rule to state savings associations that meet the stated thresholds. The market risk rule applies to any state savings association 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. The FDIC retains the authority to apply its respective market risk rule to any entity under its jurisdiction, regardless of whether it meets the either of the thresholds described above, if the agency deems it necessary or appropriate for safe and sound banking practices.

Application of the market risk rule to all banking organizations with material exposure to market risk is particularly important because of banking organizations' increased exposure to traded credit products, such as CDSs, asset-backed securities and other structured products, as well as other less liquid products. In fact, many of the August 2012 revisions to the market risk rule were made in response to concerns that arose during the recent financial crisis when banking organizations holding certain trading assets suffered 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 and 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 rule must have a well-defined valuation process for all covered positions.

The FDIC received comments on the market risk rule. One commenter asserted that the agencies should establish standardized capital requirements for trading operations rather than relying on risk modeling techniques because there is no way for regulators or market participants to judge whether bank calculations of market risk are meaningful. Regarding the use of

standardized requirements for trading operations rather than reliance on risk modeling, banking organizations' models are subject to initial approval and ongoing review under the market risk rule. The FDIC is aware that the BCBS is considering, among other options, greater use of standardized approaches for market risk. The FDIC would consider modifications to the international market risk framework when and if it is revised.

The agencies received comments on the market risk rule. One commenter asserted that the effective date for application of the market risk rule (and the advanced approaches rule) to SLHCs should be deferred until at least July 21, 2015. This commenter also asserted that SLHCs with substantial insurance operations should be exempt from the advanced approaches and market risk rules if their subsidiary bank or savings association comprised less than 5 percent or 10 percent of the total assets of the SLHC. As a general matter, savings associations and SLHCs do not engage in trading activity to a substantial degree. However, the FDIC believes that any state savings association whose trading activity grows to the extent that it meets either of 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 rule. Therefore, it is appropriate to expand the scope of the market risk rule to apply to state savings associations as of January 1, 2015.

Another commenter asserted that regulations should increase the cost of excessive use of short-term borrowing to fund long maturity assets. The FDIC is considering the implications of short-term funding from several perspectives outside of the regulatory capital framework. Specifically, the FDIC expects short-term funding risks would be a potential area of focus in forthcoming Basel III liquidity and enhanced prudential standards regulations.

The FDIC also has adopted conforming changes to certain elements of the market risk rule to reflect changes that are being made to other aspects of the regulatory capital framework. These changes are designed to correspond to the changes to the CRC references and treatment of securitization exposures under subparts D and E of the interim final rule, which are discussed more fully in the standardized and advanced approaches sections. See sections VIII.B and XII.C of this preamble for a discussion of these changes.

More specifically, the market risk rule is being amended to incorporate a revised definition of parameter W in the SSFA. The agencies received comment on the existing definition, which assessed a capital penalty if borrowers exercised contractual rights to defer payment of principal or interest for more than 90 days on exposures underlying a securitization. In response to commenters, the FDIC is modifying this definition to exclude all loans issued under Federally-guaranteed student loan programs, and certain consumer loans (including non-Federally guaranteed student loans) from being included in this component of parameter W.

The FDIC has made a technical amendment to the market risk rule with respect to the covered position definition. Previously, the definition of covered position excluded equity positions that are not publicly traded. The FDIC has refined this exception such that a covered position may include a position in a non-publicly traded investment company, as defined in and registered with the SEC under the Investment Company Act of 1940 (15 U.S.C. 80 a-1 et seq.) (or its non-U.S. equivalent), provided that all the underlying equities held by the investment company are publicly traded. The FDIC believes that a “look-through” approach is appropriate in these circumstances because of the of the liquidity of the underlying positions, so long as the other conditions of a covered position are satisfied.

The FDIC also has clarified where an FDIC-supervised institution subject to the market risk rule must make its required market risk disclosures and require that these disclosures be timely. The FDIC-supervised institution must provide its quantitative disclosures after each calendar quarter. In addition, the interim final rule clarifies that an FDIC-supervised institution must provide its qualitative disclosures at least annually, after the end of the fourth calendar quarter, provided any significant changes are disclosed in the interim.

The FDIC acknowledges 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 FDIC considers those disclosures that are made within 45 days of the end of the calendar quarter (or within 60 days for the limited purpose of the FDIC-supervised institution's first reporting period in which it is subject to the rule) as timely. In general, where an FDIC-supervised institution's fiscal year-end coincides with the end of a calendar quarter, the FDIC considers qualitative and quantitative 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 FDIC 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 FDIC-supervised institution's capital adequacy and risk profile. In those cases, an FDIC-supervised institution needs to disclose the general nature of these changes and briefly describe how they are likely to affect public disclosures going forward. An FDIC-supervised

institution should make these interim disclosures as soon as practicable after the determination that a significant change has occurred.

The interim final rule also clarifies that an FDIC-supervised institution's management may provide all of the disclosures required by the market risk rule in one place on the FDIC-supervised institution's public website or may provide the disclosures in more than one public financial report or other regulatory reports, provided that the FDIC-supervised institution publicly provides a summary table specifically indicating the location(s) of all such disclosures.

XIII. Abbreviations

ABCP Asset-Backed Commercial Paper

ADC Acquisition, Development, or Construction

AFS Available For Sale

ALLL Allowance for Loan and Lease Losses

AOCI Accumulated Other Comprehensive Income

AVC Asset Value Correlation

BCBS Basel Committee on Banking Supervision

BCBS FAQ Basel Committee on Banking Supervision Frequently Asked Questions

BHC Bank Holding Company

CCF Credit Conversion Factor

CCP Central Counterparty

CDFI Community Development Financial Institution

CDS Credit Default Swap

CDSind Index Credit Default Swap

CEIO Credit-Enhancing Interest-Only Strip

CEM Current Exposure Method

CFR Code of Federal Regulations

CFPB Consumer Financial Protection Bureau

CFTC Commodity Futures Trading Commission

CPSS Committee on Payment and Settlement Systems

CRC Country Risk Classifications

CUSIP Committee on Uniform Securities Identification Procedures

CVA Credit Valuation Adjustment

DAC Deferred Acquisition Cost

DCO Derivatives Clearing Organizations

DTA Deferred Tax Asset

DTL Deferred Tax Liability

DvP Delivery-versus-Payment

E Measure of Effectiveness

EAD Exposure at Default

ECL Expected Credit Loss

EE Expected Exposure

EPE Expected Positive Exposure

ERISA Employee Retirement Income Security Act of 1974

ESOP Employee Stock Ownership Plan

FDIC Federal Deposit Insurance Corporation

FDICIA Federal Deposit Insurance Corporation Improvement Act of 1991

FFIEC Federal Financial Institutions Examination Council

FHA Federal Housing Authority

FHLB Federal Home Loan Bank

FHLMC Federal Home Loan Mortgage Corporation

FIRREA Financial Institutions, Reform, Recovery and Enforcement Act

FMU Financial Market Utility

FNMA Federal National Mortgage Association

FRFA Final Regulatory Flexibility Act

GAAP U.S. Generally Accepted Accounting Principles

GNMA Government National Mortgage Association

GSE Government-Sponsored Enterprise

HAMP Home Affordable Mortgage Program

HOLA Home Owners' Loan Act

HTM Held-To-Maturity

HVCRE High-Volatility Commercial Real Estate

IFRS International Financial Reporting Standards

IMM Internal Models Methodology

IOSCO International Organization of Securities Commissions

IRB Internal Ratings-Based

IRFA Initial Regulatory Flexibility Analysis

LGD Loss Given Default

LTV Loan-to-Value Ratio

M Effective Maturity

MBS Mortgage-backed Security

MDB Multilateral Development Bank

MDI Minority Depository Institution

MHC Mutual Holding Company

MSA Mortgage Servicing Assets

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

OMB Office of Management and Budget

OTC Over-the-Counter

OTS Office of Thrift Supervision

PCA Prompt Corrective Action

PCCR Purchased Credit Card Relationship

PD Probability of Default

PFE Potential Future Exposure

PMI Private Mortgage Insurance

PMSR Purchased Mortgage Servicing Right

PRA Paperwork Reduction Act of 1995

PSE Public Sector Entities

PvP Payment-versus-Payment

QCCP Qualifying Central Counterparty

QIS Quantitative Impact Study

QM Qualified Mortgages

QRE Qualified Revolving Exposure

RBA Ratings-Based Approach

RBC Risk-Based Capital

REIT Real Estate Investment Trust

Re-REMIC Resecuritization of Real Estate Mortgage Investment Conduit

RFA Regulatory Flexibility Act

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

RVC Ratio of Value Change

SAP Statutory Accounting Principles

SEC U.S. Securities and Exchange Commission

SFA Supervisory Formula Approach

SLHC Savings and Loan Holding Company

SPE Special Purpose Entity

SR Supervision and Regulation Letter

SRWA Simple Risk-Weight Approach

SSFA Simplified Supervisory Formula Approach

TruPS Trust Preferred Security

TruPS CDO Trust Preferred Security Collateralized Debt Obligation

UMRA Unfunded Mandates Reform Act of 1995

U.S.C. United States Code

VA Veterans Administration

VaR Value-at-Risk

VOBA Value of Business Acquired

WAM Weighted Average Maturity

XIV. Regulatory Flexibility Act

In general, section 4 of the Regulatory Flexibility Act (5 U.S.C. 604) (RFA) requires an agency to prepare a final regulatory flexibility analysis (FRFA), for a final rule unless the agency certifies that the rule will not, if promulgated, have a significant economic impact on a substantial number of small entities (defined for purposes of the RFA to include banking entities with total assets of $175 million or less and after July 22, 2013, total assets of $500 million or less). Pursuant to the RFA, the agency must make the FRFA available to members of the public and must publish the FRFA, or a summary thereof, in the Federal Register. In accordance with section 4 of the RFA, the FDIC is publishing the following summary of its FRFA.[186]

For purposes of the FRFA, the FDIC analyzed the potential economic impact on the entities it regulates with total assets of $175 million or less and $500 million or less, including state nonmember banks and state savings associations (small FDIC-supervised institutions).

As discussed in more detail in section E, below, the FDIC believes that this interim final rule may have a significant economic impact on a substantial number of the small entities under its jurisdiction. Accordingly, the FDIC has prepared the following FRFA pursuant to the RFA.

[186] The FDIC published a summary of its initial regulatory flexibility analysis (IRFA) in connection with each of the proposed rules in accordance with Section 3(a) of the Regulatory Flexibility Act, 5 U.S.C. 603 (RFA). In the IRFAs provided in connection with the proposed rules, the FDIC requested comment on all aspects of the IRFAs, and, in particular, on any significant alternatives to the proposed rules applicable to covered small FDIC-supervised institutions that would minimize their impact on those entities. In the IRFA provided by the FDIC in connection with the advanced approach proposed rule, the FDIC determined that there would not be a significant economic impact on a substantial number of small FDIC-supervised institutions and published a certification and a short explanatory statement pursuant to section 605(b) of the RFA.

A. Statement of the Need for, and Objectives of, the Interim Final Rule

As discussed in the Supplementary Information of the preamble to this interim final rule, the FDIC is revising its regulatory capital requirements to promote safe and sound banking practices, implement Basel III and other aspects of the Basel capital framework, harmonize capital requirements between types of FDIC-supervised institutions, and codify capital requirements.

Additionally, this interim final rule satisfies certain requirements under the Dodd-Frank Act by: (1) revising regulatory capital requirements to remove references to, and requirements of reliance on, credit ratings,[187] and (2) imposing new or revised minimum capital requirements on certain FDIC-supervised institutions.[188]

Under section 38(c)(1) of the Federal Deposit Insurance Act, the FDIC may prescribe capital standards for depository institutions that it regulates.[189] The FDIC also must establish capital requirements under the International Lending Supervision Act for institutions that it regulates.[190]

B. Summary and Assessment of Significant Issues Raised by Public Comments in response to the IRFAs, and a Statement of Changes Made as a Result of these Comments

The FDIC received three public comments directly addressing the IRFAs. One commenter questioned the FDIC's assumption that risk-weighted assets would increase only 10 percent and questioned reliance on Call Report data for this assumption, as the commenter asserted that existing Call Report data does not contain the information required to accurately

[187] See 15 U.S.C. 78o-7, note.
[188] See 12 U.S.C. 5371.
[189] See 12 U.S.C. 1831o(c).
[190] See 12 U.S.C. 3907.

analyze the proposal's impact on risk-weighted assets (for example, under the Standardized Approach NPR, an increase in the risk weights for 1-4 family residential mortgage exposures that are balloon mortgages). The commenters also expressed general concern that the FDIC was underestimating the compliance cost of the proposed rules. For instance, one commenter questioned whether small banking organizations would have the information required to determine the applicable risk weights for residential mortgage exposures, and stated that the cost of applying the proposed standards to existing exposures was underestimated. Another commenter stated that the FDIC did not adequately consider the additional costs relating to new reporting systems, assimilating data, and preparing reports required under the proposed rules.

To measure the potential impact on small entities for the purposes of its IRFAs, the FDIC used the most current reporting data available and, to address information gaps, applied conservative assumptions. The FDIC considered the comments it received on the potential impact of the proposed rules, and, as discussed in Item F, below, made significant revisions to the interim final rule in response to the concerns expressed regarding the potential burden on small FDIC-supervised institutions.

Commenters expressed concern that the FDIC, along with the OCC and Federal Reserve, did not use a uniform methodology for conducting their IRFAs and suggested that the agencies should have compared their analyses prior to publishing the proposed rules. The agencies coordinated closely in conducting the IRFAs to maximize consistency among the methodologies used for determining the potential impact on the entities regulated by each agency. However, the analyses differed as appropriate in light of the different entities each agency supervises. For their respective FRFAs, the agencies continued to coordinate closely in order to ensure maximum consistency and comparability.

One commenter questioned the alternatives described in the IRFAs. This commenter asserted that the alternatives were counter-productive and added complexity to the capital framework without any meaningful benefit. As discussed throughout the preamble and in Item F, below, the FDIC has responded to commenters' concerns and sought to reduce the compliance burden on FDIC-supervised institutions throughout this interim final rule.

The FDIC also received a number of more general comments regarding the overall burden of the proposed rules. For example, many commenters expressed concern that the complexity and implementation cost of the proposed rules would exceed the expected benefit. According to these commenters, implementation of the proposed rules would require software upgrades for new internal reporting systems, increased employee training, and the hiring of additional employees for compliance purposes.

A few commenters also urged the FDIC to recognize that compliance costs have increased significantly over recent years due to other regulatory changes. As discussed throughout the preamble and in Item F, below, the FDIC recognizes the potential compliance costs associated with the proposals. Accordingly, for purposes of the interim final rule the FDIC modified certain requirements of the proposals to reduce the compliance burden on small FDIC-supervised institutions. The FDIC believes the interim final rule maintains its objectives regarding the implementation of the Basel III framework while reducing costs for small FDIC-supervised institutions.

C. Response to Comments Filed by the Chief Counsel for Advocacy of the Small Business Administration, and Statement of Changes Made as a Result of the Comment

The Chief Counsel for Advocacy of the Small Business Administration (CCA) filed a letter with the FDIC providing comments on the proposed rules. The CCA generally commended the FDIC for the IRFAs provided with the proposed rules, and specifically commended the FDIC for considering the cumulative economic impact of the proposals on small FDIC-supervised institutions. The CCA acknowledged that the FDIC provided lists of alternatives being considered, but encouraged the FDIC to provide more detailed discussion of these alternatives and the potential burden reductions associated with the alternatives. The CCA acknowledged that the FDIC had certified that the advanced approaches proposed rule would not have a significant economic impact on a substantial number of small FDIC-supervised institutions.

The CCA stated that small FDIC-supervised institutions should be able to continue to use the current regulatory capital framework to compute their capital requirements. The FDIC recognizes that the new regulatory capital framework will carry costs, but believes that the supervisory interest in improved and uniform capital standards, and the resulting improvements in the safety and soundness of the U.S. banking system, outweighs the increased burden.

The CCA also urged the FDIC to give careful consideration to comments discussing the impact of the proposed rules on small FDIC-supervised institutions and to analyze possible alternatives to reduce this impact. The FDIC gave careful consideration to all comments received, in particular the comments that discussed the potential impact of the proposed rules on small FDIC-supervised institutions and made certain changes to reduce the potential impact of the interim final rule, as discussed throughout the preamble and in Item F, below.

The CCA expressed concern that aspects of the proposals could be problematic and onerous for small FDIC-supervised institutions. The CCA stated that the proposed rules were designed for large, international banks and not adapted to the circumstances of small FDIC-supervised institutions. Specifically, the CCA expressed concern over higher risk weights for certain products, which, the CCA argued, could drive small FDIC-supervised institutions into products carrying additional risks. The CCA also noted heightened compliance and technology costs associated with implementing the proposed rules and raised the possibility that small FDIC-supervised institutions may exit the mortgage market. As discussed throughout the preamble and in Item F below, the FDIC has made significant revisions to the proposed rules that address the concerns raised in the CCA's comment.

D. Description and Estimate of Small FDIC-supervised institutions Affected by the Interim Final Rule

Under regulations issued by the Small Business Administration,[191] a small entity includes a depository institution with total assets of $175 million or less and after July 22, 2013, total assets of $500 million or less.

As of March 31, 2013, the FDIC supervised approximately 2,453 small depository institutions with total assets of $175 million or less. 2,295 are small state nonmember banks, 112 are small state savings banks, and 46 are small state savings associations. As of March 31, 2013, the FDIC supervised approximately 3,711 small depository institutions with total assets of $500 million or less. 3,398 are small state nonmember banks, 259 are small state savings banks, and 54 are small state savings associations.

[191] See 13 CFR 121.201.

E. Projected Reporting, Recordkeeping, and other Compliance Requirements

The interim final rule may impact small FDIC-supervised institutions in several ways. The interim final rule affects small FDIC-supervised institutions' regulatory capital requirements by changing the qualifying criteria for regulatory capital, including required deductions and adjustments, and modifying the risk weight treatment for some exposures. The interim final rule also requires small FDIC-supervised institutions 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 interim final rule, all FDIC-supervised institutions would remain subject to a 4 percent minimum tier 1 leverage ratio.[192] The interim final rule imposes limitations on capital distributions and discretionary bonus payments for small FDIC-supervised institutions that do not hold a buffer of common equity tier 1 capital above the minimum ratios.

The interim final rule also includes changes to the general risk-based capital requirements that address the calculation of risk-weighted assets. The interim final rule:

- Introduces a higher risk weight for certain past due exposures and acquisition and development real estate loans;
- Provides a more risk sensitive approach to exposures to non- U.S. sovereigns and non-U.S. public sector entities;

[192] FDIC-supervised institutions subject to the advanced approaches rule 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 interim final rule and section II.B of the preamble for a more detailed discussion of the applicable minimum capital ratios.

- Replaces references to credit ratings with new measures of creditworthiness;[193]
- Provides more comprehensive recognition of collateral and guarantees; and
- Provides a more favorable capital treatment for transactions cleared through qualifying central counterparties.

As a result of the new requirements, some small FDIC-supervised institutions may have to alter their capital structure (including by raising new capital or increasing retention of earnings) in order to achieve compliance.

The FDIC has excluded from its analysis any burden associated with changes to the Consolidated Reports of Income and Condition for small FDIC-supervised institutions (FFIEC 031 and 041; OMB Nos. 7100-0036, 3064-0052, 1557-0081). The FDIC is proposing information collection changes to reflect the requirements of the interim final rule, and is publishing separately for comment on the regulatory reporting requirements that will include associated estimates of burden. Further analysis of the projected reporting requirements imposed by the interim final rule is located in the Paperwork Reduction Act section, below.

Most small FDIC-supervised institutions hold capital in excess of the minimum leverage and risk-based capital requirements set forth in the interim final rule. Although the capital requirements under the interim final rule are not expected to significantly impact the capital structure of these institutions, the FDIC expects that some may change internal capital allocation policies and practices to accommodate the requirements of the interim final rule. For example, a small FDIC-supervised institution may use excess common equity tier 1 capital to satisfy the

[193] Section 939A of the Dodd-Frank Act addresses the use of credit ratings in regulations of the FDIC. Accordingly, the interim final rule introduces alternative measures of creditworthiness for foreign debt, securitization positions, and re-securitization positions.

capital conservation buffer under section 11 of the interim final rule, or the new minimum common equity tier 1 capital requirement of 4.5 percent under section 10 of the interim final rule. Any capital allocated to satisfy new requirements would not remain available for other purposes and, as a result, an institution may elect to raise capital to return its excess capital position to the levels maintained prior to implementation of the interim final rule.

A comparison of the capital requirements in the interim final rule on a fully-implemented basis to the minimum requirements under the general risk-based capital rules shows that approximately 17 small FDIC-supervised institutions with total assets of $175 million or less currently do not hold sufficient capital to satisfy the requirements of the interim final rule. Those institutions, which represent approximately less than one percent of small FDIC-supervised institutions, collectively would need to raise approximately $19 million in regulatory capital to meet the minimum capital requirements under the interim final rule.

A comparison of the capital requirements in the interim final rule on a fully-implemented basis to the minimum requirements under the general risk-based capital rules shows that approximately 27 small FDIC-supervised institutions with total assets of $500 million or less currently do not hold sufficient capital to satisfy the requirements of the interim final rule. Those institutions, which represent approximately less than one percent of small FDIC-supervised institutions, collectively would need to raise approximately $163 million in regulatory capital to meet the minimum capital requirements under the interim final rule.

To estimate the cost to FDIC-supervised institutions of the new capital requirement, the FDIC examined the effect of this requirement on capital structure and the overall cost of

capital.[194] The cost of financing an FDIC-supervised institution is the weighted average cost of its various financing sources, which amounts to a weighted average cost of capital reflecting many different types of debt and equity financing. Because interest payments on debt are tax deductible, a more leveraged capital structure reduces corporate taxes, thereby lowering funding costs, and the weighted average cost of financing tends to decline as leverage increases. Thus, an increase in required equity capital would force an FDIC-supervised institution to deleverage and – all else equal – would increase the cost of capital for that institution.

This increased cost in the most burdensome year would be tax benefits foregone: the capital requirement, multiplied by the interest rate on the debt displaced and by the effective marginal tax rate for the FDIC-supervised institutions affected by the interim final rule. The effective marginal corporate tax rate is affected not only by the statutory federal and state rates, but also by the probability of positive earnings and the offsetting effects of personal taxes on required bond yields. Graham (2000) considers these factors and estimates a median marginal tax benefit of $9.40 per $100 of interest.[195] So, using an estimated interest rate on debt of 6 percent, the FDIC estimated that for institutions with total assets of $175 million or less, the annual tax benefits foregone on $19 million of capital switching from debt to equity is approximately $106,000 per year ($19 million * 0.06 (interest rate) * 0.094 (median marginal tax savings)). Averaged across 17 institutions, the cost is approximately $6,200 per institution per year. Similarly, for institutions with total assets of $500 million or less, the annual tax benefits foregone on $163 million of capital switching from debt to equity is approximately $920,000 per

[194] See Merton H. Miller, (1995), "Do the M & M propositions apply to banks?" Journal of Banking & Finance, Vol. 19, pp. 483-489.

[195] See John R. Graham, (2000), How Big Are the Tax Benefits of Debt?, Journal of Finance, Vol. 55, No. 5, pp. 1901-1941. Graham points out that ignoring the offsetting effects of personal taxes would increase the median marginal tax rate to $31.5 per $100 of interest.

year ($163 million * 0.06 (interest rate) * 0.094 (median marginal tax savings)). Averaged across 27 institutions, the cost is approximately $34,000 per institution per year.

Working with the other agencies, the FDIC also estimated the direct compliance costs related to financial reporting as a result of the interim final rule. This aspect of the interim final rule likely will require additional personnel training and expenses related to new systems (or modification of existing systems) for calculating regulatory capital ratios, in addition to updating risk weights for certain exposures. The FDIC assumes that small FDIC-supervised institutions will spend approximately $43,000 per institution to update reporting system and change the classification of existing exposures. Based on comments from the industry, the FDIC increased this estimate from the $36,125 estimate used in the proposed rules. The FDIC believes that this revised cost estimate is more conservative because it has increased even though many of the labor-intensive provisions of the interim final rule have been excluded. For example, small FDIC-supervised institutions have the option to maintain the current reporting methodology for gains and losses classified as Available for Sale (AFS) thus eliminating the need to update systems. Additionally the exposures where the risk-weights are changing typically represent a small portion of assets (less than 5 percent) on institutions' balance sheets. Additionally, small FDIC-supervised institutions can maintain existing risk-weights for residential mortgage exposures, eliminating the need for those institutions to reclassify existing exposure. This estimate of direct compliance costs is the same under both the $175 million and $500 million size thresholds.

The FDIC estimates that the $43,000 in direct compliance costs will represent a significant burden for approximately 37 percent of small FDIC-supervised institutions with total assets of $175 million or less. The FDIC estimates that the $43,000 in direct compliance costs

will represent a burden for approximately 25 percent of small FDIC-supervised institutions with total assets of $500 million or less. For purposes of this interim final rule, the FDIC defines significant burden as an estimated cost greater than 2.5 percent of total non-interest expense or 5 percent of annual salaries and employee benefits. The direct compliance costs are the most significant cost since few small FDIC-supervised institutions will need to raise capital to meet the minimum ratios, as noted above.

F. Steps taken to Minimize the Economic Impact on Small FDIC-Supervised Institutions; Significant Alternatives

In response to commenters' concerns about the potential implementation burden on small FDIC-supervised institutions, the FDIC has made several significant revisions to the proposals for purposes of the interim final rule. Under the interim final rule, non-advanced approaches FDIC-supervised institutions will be permitted to elect to exclude amounts reported as accumulated other comprehensive income (AOCI) when calculating regulatory capital, to the same extent currently permitted under the general risk-based capital rules.[196] In addition, for purposes of calculating risk-weighted assets under the standardized approach, the FDIC is not adopting the proposed treatment for 1-4 family residential mortgages, which would have required small FDIC-supervised institutions to categorize residential mortgage loans into one of two categories based on certain underwriting standards and product features, and then risk-weight each loan based on its loan-to-value ratio. The FDIC also is retaining the 120-day safe harbor from recourse treatment for loans transferred pursuant to an early default provision. The FDIC believes that these changes will meaningfully reduce the compliance burden of the interim

[196] For most non-advanced approaches banking organizations, this will be a one-time only election. However, in certain limited circumstances, such as a merger of organizations that have made different elections, the FDIC may permit the resultant entity to make a new election.

final rule for small FDIC-supervised institutions. For instance, in contrast to the proposal, the interim final rule does not require small FDIC-supervised institutions to review existing mortgage loan files, purchase new software to track loan-to-value ratios, train employees on the new risk-weight methodology, or hold more capital for exposures that would have been deemed category 2 under the proposed rule, removing the proposed distinction between risk weights for category 1 and 2 residential mortgage exposures. Similarly, the option to elect to retain the current treatment of AOCI will reduce the burden associated with managing the volatility in regulatory capital resulting from changes in the value of an FDIC-supervised institutions' AFS debt securities portfolio due to shifting interest rate environments. The FDIC believes these modifications to the proposed rule will substantially reduce compliance burden for small FDIC-supervised institutions.

XV. Paperwork Reduction Act

In accordance with the requirements of the Paperwork Reduction Act (PRA) of 1995 (44 U.S.C. 3501-3521), the FDIC 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.

In conjunction with the proposed rules, the FDIC submitted the information collection requirements contained therein to OMB for review. In response, OMB filed comments with the FDIC in accordance with 5 CFR 1320.11(c) withholding PRA approval and instructing that the collection should be resubmitted to OMB at the interim final rule stage. The information collection requirements contained in this interim final rule have been submitted by the FDIC to OMB for review under the PRA, under OMB Control No. 3064-0153.

The interim final rule contains requirements subject to the PRA. The information collection requirements are found in sections 324.2, 324.35, 324.37, 324.41, 324.42, 324.62, 324.63, Tables 1 through 10 in section 324.63 , sections 324.121, through 324.124, 324.132(b)(2)(iii), 324.132(b)(3), 324.132 (d)(1), 324.132(d)(1)(iii), 324.141(b)(3), 324.142(h)(2), 324.152(c)(2), 324.173, 324.203, through 324.210, 324.212, and Tables 1 through 3, 6 through 8, and 10 through 11 under section 324.173.

A total of nine comments were received concerning paperwork. Seven expressed concern regarding the increase in paperwork resulting from the rule. They addressed the concept of paperwork generally and not within the context of the PRA.

One comment addressed cost, competitiveness, and qualitative impact statements, and noted the lack of cost estimates. It was unclear whether the commenter was referring to cost estimates for regulatory burden, which are included in the preamble to the rule, or cost estimates regarding the PRA burden, which are included in the submissions (information collection requests) made to OMB by the agencies regarding the interim final rule. All of the agencies' submissions are publicly available at www.reginfo.gov.

One commenter seemed to indicate that the agencies' burden estimates are overstated. The commenter stated that, for their institution, the PRA burden will parallel that of interest rate risk (240 hours per year). The agencies' estimates far exceed that figure, so no change to the estimates would be necessary. The FDIC continues to believe that its estimates are reasonable averages that are not overstated.

The FDIC havs an ongoing interest in your comments. 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.

XVI. Plain Language

Section 722 of the Gramm-Leach-Bliley Act requires the FDIC to use plain language in all proposed and rules published after January 1, 2000. The agencies have sought to present the proposed rule in a simple and straightforward manner and did not receive any comments on the use of plain language.

XVII. Small Business Regulatory Enforcement Fairness Act of 1996

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996, or "SBREFA," the FDIC must advise the OMB as to whether the interim final rule constitutes a "major" rule.[197] If a rule is major, its effectiveness will generally be delayed for 60 days pending congressional review.

In accordance with SBREFA, the FDIC has advised the OMB that this interim final rule is a major rule for the purpose of congressional review. Following OMB's review, the FDIC will file the appropriate reports with Congress and the Government Accountability Office so that the final rule may be reviewed.

[197] 5 U.S.C. 801 et seq.

Text of Common Rule

Part [324] CAPITAL ADEQUACY OF FDIC-supervised institutions

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Subpart A – General Provisions

§ 324.1 Purpose, applicability, reservations of authority, and timing.

(a) Purpose. This part 324 establishes minimum capital requirements and overall capital adequacy standards for FDIC-supervised institutions. This part 324 includes methodologies for calculating minimum capital requirements, public disclosure requirements related to the capital requirements, and transition provisions for the application of this part 324.

(b) Limitation of authority. Nothing in this part 324 shall be read to limit the authority of the FDIC 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. Subject to the requirements in paragraphs (d) and (f) of this section:

(1) Minimum capital requirements and overall capital adequacy standards. Each FDIC-supervised institution must calculate its minimum capital requirements and meet the overall capital adequacy standards in subpart B of this part.

(2) Regulatory capital. Each FDIC-supervised institution must calculate its regulatory capital in accordance with subpart C of this part.

(3) Risk-weighted assets. (i) Each FDIC-supervised institution must use the methodologies in subpart D of this part (and subpart F of this part for a market risk FDIC-supervised institution) to calculate standardized total risk-weighted assets.

(ii) Each advanced approaches FDIC-supervised institution must use the methodologies in subpart E (and subpart F of this part for a market risk FDIC-supervised institution) to calculate advanced approaches total risk-weighted assets.

(4) Disclosures. (i) Except for an advanced approaches FDIC-supervised institution that is making public disclosures pursuant to the requirements in subpart E of this part, each FDIC-supervised institution with total consolidated assets of $50 billion or more must make the public disclosures described in subpart D of this part.

(ii) Each market risk FDIC-supervised institution must make the public disclosures described in subpart F of this part.

(iii) Each advanced approaches FDIC-supervised institution must make the public disclosures described in subpart E of this part.

(d) Reservation of authority. (1) Additional capital in the aggregate. The FDIC may require an FDIC-supervised institution to hold an amount of regulatory capital greater than otherwise required under this part if the FDIC determines that the FDIC-supervised institution's

capital requirements under this part are not commensurate with the FDIC-supervised institution's credit, market, operational, or other risks.

(2) Regulatory capital elements. (i) If the FDIC 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 FDIC may require the FDIC-supervised institution 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.

(ii) Notwithstanding the criteria for regulatory capital instruments set forth in subpart C of this part, the FDIC may find that a capital element may be included in an FDIC-supervised institution's common equity tier 1 capital, additional tier 1 capital, or tier 2 capital on a permanent or temporary basis consistent with the loss absorption capacity of the element and in accordance with § 324.20(e).

(3) Risk-weighted asset amounts. If the FDIC determines that the risk-weighted asset amount calculated under this part by the FDIC-supervised institution for one or more exposures is not commensurate with the risks associated with those exposures, the FDIC may require the FDIC-supervised institution 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 FDIC determines that the leverage exposure amount, or the amount reflected in the FDIC-supervised institution's reported average total consolidated assets, for an on- or off-balance sheet exposure calculated by an FDIC-supervised institution under § 324.10 is inappropriate for the exposure(s) or the circumstances of the FDIC-supervised institution, the FDIC may require the FDIC-supervised institution to adjust this exposure amount in the numerator and the denominator for purposes of the leverage ratio calculations.

(5) Consolidation of certain exposures. The FDIC may determine that the risk-based capital treatment for an exposure or the treatment provided to an entity that is not consolidated on the FDIC-supervised institution's balance sheet is not commensurate with the risk of the exposure or the relationship of the FDIC-supervised institution to the entity. Upon making this determination, the FDIC may require the FDIC-supervised institution to treat the exposure or entity as if it were consolidated on the balance sheet of the FDIC-supervised institution for purposes of determining the FDIC-supervised institution's risk-based capital requirements and calculating the FDIC-supervised institution's risk-based capital ratios accordingly. The FDIC will look to the substance of, and risk associated with, the transaction, as well as other relevant factors the FDIC 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 FDIC may require a different deduction or limitation, provided that such alternative deduction or limitation is commensurate with the FDIC-supervised institution's risk and consistent with safety and soundness.

(e) Notice and response procedures. In making a determination under this section, the FDIC will apply notice and response procedures in the same manner as the notice and response procedures in 12 CFR 324.5(c).

(f) Timing. (1) Subject to the transition provisions in subpart G of this part, an advanced approaches FDIC-supervised institution that is not a savings and loan holding company must:

(i) Except as described in paragraph (f)(1)(ii) of this section, beginning on January 1, 2014, calculate advanced approaches total risk-weighted assets in accordance with subpart E and,

if applicable, subpart F of this part and, beginning on January 1, 2015, calculate standardized total risk-weighted assets in accordance with subpart D and, if applicable, subpart F of this part;

(ii) From January 1, 2014 to December 31, 2014:

(A) Calculate risk-weighted assets in accordance with the general risk-based capital rules under 12 CFR part 325, appendix A, and, if applicable appendix C (state nonmember banks), or 12 CFR part 390, subpart Z and, if applicable, 12 CFR part 325, appendix C (state savings associations)[198] and substitute such risk-weighted assets for standardized total risk-weighted assets for purposes of § 324.10;

(B) If applicable, calculate general market risk equivalent assets in accordance with 12 CFR part 325, appendix C, section 4(a)(3) and substitute such general market risk equivalent assets for standardized market risk-weighted assets for purposes of § 324.20(d)(3); and

(C) Substitute the corresponding provision or provisions of 12 CFR part 325, appendix A, and, if applicable, appendix C (state nonmember banks), and 12 CFR part 390, subpart Z and, if applicable, 12 CFR part 325, appendix C (state savings associations) for any reference to subpart D of this part in: § 324.121(c); § 324.124(a) and (b); § 324.144(b); § 324.154(c) and (d); § 324.202(b) (definition of covered position in paragraph (b)(3)(iv)); and § 324.211(b);[199]

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[198] For the purpose of calculating its general risk-based capital ratios from January 1, 2014 to December 31, 2014, an advanced approaches FDIC-supervised institution shall adjust, as appropriate, its risk-weighted asset measure (as that amount is calculated under 12 CFR part 325, appendix A, (state nonmember banks), and 12 CFR part 390, subpart Z (state savings associations) in the general risk-based capital rules) by excluding those assets that are deducted from its regulatory capital under §324.22.

[199] In addition, for purposes of §324.201(c)(3), from January 1, 2014 to December 31, 2014, for any circumstance in which the FDIC may require an FDIC-supervised institution to calculate risk-based capital requirements for specific positions or portfolios under subpart D of this part, the FDIC will instead require the FDIC-supervised institution to make such calculations according to 12 CFR part 325, appendix A, and, if applicable, appendix C (state nonmember

(iii) Beginning on January 1, 2014, calculate and maintain minimum capital ratios in accordance with subparts A, B, and C of this part, provided, however, that such FDIC-supervised institution must:

(A) From January 1, 2014 to December 31, 2014, maintain a minimum common equity tier 1 capital ratio of 4 percent, a minimum tier 1 capital ratio of 5.5 percent, a minimum total capital ratio of 8 percent, and a minimum leverage ratio of 4 percent; and

(B) From January 1, 2015 to December 31, 2017, an advanced approaches FDIC-supervised institution:

(1) Is not required to maintain a supplementary leverage ratio; and

(2) Must calculate a supplementary leverage ratio in accordance with § 324.10(c), and must report the calculated supplementary leverage ratio on any applicable regulatory reports.

(2) Subject to the transition provisions in subpart G of this part, an FDIC-supervised institution that is not an advanced approaches FDIC-supervised institution or a savings and loan holding company that is an advanced approaches FDIC-supervised institution must:

(i) Beginning on January 1, 2015, calculate standardized total risk-weighted assets in accordance with subpart D, and if applicable, subpart F of this part; and

(ii) Beginning on January 1, 2015, calculate and maintain minimum capital ratios in accordance with subparts A, B and C of this part, provided, however, that from January 1, 2015, to December 31, 2017, a savings and loan holding company that is an advanced approaches FDIC-supervised institution:

(A) Is not required to maintain a supplementary leverage ratio; and

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banks), or 12 CFR part 390, subpart Z and, if applicable, 12 CFR part 325, appendix C (state savings associations).

(B) Must calculate a supplementary leverage ratio in accordance with § 324.10(c), and must report the calculated supplementary leverage ratio on any applicable regulatory reports.

(3) Beginning on January 1, 2016, and subject to the transition provisions in subpart G of this part, an FDIC-supervised institution is subject to limitations on distributions and discretionary bonus payments with respect to its capital conservation buffer and any applicable countercyclical capital buffer amount, in accordance with subpart B of this part.

§ 324.2 Definitions.

Additional tier 1 capital is defined in § 324.20(c).

Advanced approaches FDIC-supervised institution means an FDIC-supervised institution that is described in § 324.100(b)(1).

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 FDIC-supervised institution only, advanced market risk-weighted assets; minus

(2) Excess eligible credit reserves not included in the FDIC-supervised institution's tier 2 capital.

Advanced market risk-weighted assets means the advanced measure for market risk calculated under § 324.204 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 valuation allowances that have been established through a charge against earnings to cover estimated credit losses on loans, lease financing receivables or other extensions of credit as determined in accordance with GAAP. ALLL excludes "allocated transfer risk reserves." For purposes of this part, ALLL includes allowances that have been established through a charge against earnings to cover estimated credit losses associated with off-balance sheet exposures as determined in accordance with GAAP.

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 an FDIC-supervised institution 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.

Assets classified loss means:

(1) When measured as of the date of examination of an FDIC-supervised institution, those assets that have been determined by an evaluation made by a state or Federal examiner as of that date to be a loss; and

(2) When measured as of any other date, those assets:

(i) That have been determined--

(A) By an evaluation made by a state or Federal examiner at the most recent examination of an FDIC-supervised institution to be a loss; or

(B) By evaluations made by the FDIC-supervised institution since its most recent examination to be a loss; and

(ii) That have not been charged off from the FDIC-supervised institution's books or collected.

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)).

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 et seq.).

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.

Call Report means Consolidated Reports of Condition and Income.

Carrying value means, with respect to an asset, the value of the asset on the balance sheet of the FDIC-supervised institution, determined in accordance with GAAP.

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 FDIC-supervised institution or servicer to call securitization exposures before their stated maturity or call date.

Cleared transaction means an exposure associated with an outstanding derivative contract or repo-style transaction that an FDIC-supervised institution or clearing member has entered into with a central counterparty (that is, a transaction that a central counterparty has accepted).

(1) The following transactions are cleared transactions:

(i) A transaction between a CCP and an FDIC-supervised institution that is a clearing member of the CCP where the FDIC-supervised institution enters into the transaction with the CCP for the FDIC-supervised institution's own account;

(ii) A transaction between a CCP and an FDIC-supervised institution that is a clearing member of the CCP where the FDIC-supervised institution is acting as a financial intermediary on behalf of a clearing member client and the transaction offsets another transaction that satisfies the requirements set forth in § 324.3(a);

(iii) A transaction between a clearing member client FDIC-supervised institution 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 the requirements set forth in § 324.3(a) are met; or

(iv) A transaction between a clearing member client FDIC-supervised institution and a CCP where a clearing member guarantees the performance of the clearing member client FDIC-supervised institution to the CCP and the transaction meets the requirements of § 324.3(a)(2) and (3).

(2) The exposure of an FDIC-supervised institution that is a clearing member to its clearing member client is not a cleared transaction where the FDIC-supervised institution is either acting as a financial intermediary and enters into an offsetting transaction with a CCP or where the FDIC-supervised institution provides a guarantee to the CCP on the performance of the client.[200]

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 an FDIC-supervised institution for a single financial contract or for all financial contracts in a netting set and confers upon the FDIC-supervised institution a perfected, first-priority security interest (notwithstanding the prior security interest of any custodial agent), or the legal equivalent thereof, in the collateral

[200] For the standardized approach treatment of these exposures, see §324.34(e) (OTC derivative contracts) or §324.37(c) (repo-style transactions). For the advanced approaches treatment of these exposures, see §§324.132(c)(8) and (d) (OTC derivative contracts) or §§324.132(b) and 324.132(d) (repo-style transactions) and for calculation of the margin period of risk, see § 324.132(d)(5)(iii)(C) (OTC derivative contracts) and §324.132(d)(5)(iii)(A) (repo-style transactions).

posted by the counterparty under the agreement. This security interest must provide the FDIC-supervised institution 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 FDIC-supervised institution'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 an FDIC-supervised institution 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.

Commodity Exchange Act means the Commodity Exchange Act of 1936 (7 U.S.C. 1 et seq.)

Common equity tier 1 capital is defined in § 324.20(b).

Common equity tier 1 minority interest means the common equity tier 1 capital of a depository institution or foreign bank that is:

(1) A consolidated subsidiary of an FDIC-supervised institution; and

(2) Not owned by the FDIC-supervised institution.

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.

Core capital means Tier 1 capital, as defined in § 324.2 of subpart A of this part.

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.

Covered savings and loan holding company means a top-tier savings and loan holding company other than:

(1) A top-tier savings and loan holding company that is:

(i) A grandfathered unitary savings and loan holding company as defined in section 10(c)(9)(A) of HOLA; and

(ii) As of June 30 of the previous calendar year, derived 50 percent or more of its total consolidated assets or 50 percent of its total revenues on an enterprise-wide basis (as calculated under GAAP) from activities that are not financial in nature under section 4(k) of the Bank Holding Company Act (12 U.S.C. 1842(k));

(2) A top-tier savings and loan holding company that is an insurance underwriting company; or

(3)(i) A top-tier savings and loan holding company that, as of June 30 of the previous calendar year, held 25 percent or more of its total consolidated assets in subsidiaries that are insurance underwriting companies (other than assets associated with insurance for credit risk); and

(ii) For purposes of paragraph 3(i), the company must calculate its total consolidated assets in accordance with GAAP, or if the company does not calculate its total consolidated assets under GAAP for any regulatory purpose (including compliance with applicable securities laws), the company may estimate its total consolidated assets, subject to review and adjustment by the Federal Reserve.

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 an FDIC-supervised institution 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:

(1) Early default clauses and similar warranties that permit the return of, or premium refund clauses covering, 1-4 family residential first mortgage loans that qualify for a 50 percent risk weight for a period not to exceed 120 days from the date of transfer. These warranties may cover only those loans that were originated within 1 year of the date of transfer;

(2) Premium refund clauses that cover assets guaranteed, in whole or in part, by the U.S. Government, a U.S. Government agency or a government-sponsored enterprise, provided the premium refund clauses are for a period not to exceed 120 days from the date of transfer; or

(3) 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 as calculated under § 324.131;

(2) Risk-weighted assets for securitization exposures as calculated under § 324.142; and

(3) Risk-weighted assets for equity exposures as calculated under § 324.151.

Credit union means an insured credit union as defined under the Federal Credit Union Act (12 U.S.C. 1751 et seq.).

Current exposure means, with respect to a netting set, the larger of zero or the fair 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.

Current exposure methodology means the method of calculating the exposure amount for over-the-counter derivative contracts in § 324.34(a) and exposure at default (EAD) in § 324.132(c)(5) or (6), as applicable.

Custodian means a financial institution that has legal custody of collateral provided to a CCP.

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 an FDIC-supervised institution, where:

(1) The FDIC-supervised institution 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 FDIC-supervised institution 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.

Distribution means:

(1) A reduction of tier 1 capital through the repurchase of a tier 1 capital instrument or by other means, except when an FDIC-supervised institution, within the same quarter when the

repurchase is announced, fully replaces a tier 1 capital instrument it has repurchased by issuing another capital instrument that meets the eligibility criteria for: (i) a common equity tier 1 capital instrument if the instrument being repurchased was part of the FDIC-supervised institution's common equity tier 1 capital, or (ii) a common equity tier 1 or additional tier 1 capital instrument if the instrument being repurchased was part of the FDIC-supervised institution's tier 1 capital;

(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, except when an FDIC-supervised institution, within the same quarter when the repurchase or redemption is announced, fully replaces a tier 2 capital instrument it has repurchased by issuing another capital instrument that meets the eligibility criteria for a tier 1 or tier 2 capital instrument;

(3) A dividend declaration or payment on any tier 1 capital instrument;

(4) A dividend declaration or interest payment on any tier 2 capital instrument if the FDIC-supervised institution has full discretion to permanently or temporarily suspend such payments without triggering an event of default; or

(5) Any similar transaction that the FDIC determines to be in substance a distribution of capital.

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 FDIC-supervised institution (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 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 FDIC-supervised institution 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 FDIC, 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 FDIC-supervised institution records net payments received on the swap as net income, the FDIC-supervised institution 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 cover estimated credit losses associated with on- or off-balance sheet wholesale and retail exposures, including the 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 FDIC-supervised institution, unless the affiliate is an insured depository institution, foreign bank, securities broker or dealer, or insurance company that:

(i) Does not control the FDIC-supervised institution; 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, a foreign bank, or a qualifying central counterparty; 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:

(1) An extension of credit where:

(i) The extension of credit is collateralized exclusively by liquid and readily marketable debt or equity securities, or gold;

(ii) The collateral is marked to fair value daily, and the transaction is subject to daily margin maintenance requirements; and

(iii) The extension of credit is conducted under an agreement that provides the FDIC-supervised institution 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, 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.[201]

(2) In order to recognize an exposure as an eligible margin loan for purposes of this subpart, an FDIC-supervised institution must comply with the requirements of § 324.3(b) with respect to that exposure.

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

[201] 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.

Employee stock ownership plan has the same meaning as in 29 CFR 2550.407d-6.

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 FDIC-supervised institution under GAAP;

(ii) The FDIC-supervised institution 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. 1001 et seq.).

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 FDIC-supervised institution 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 FDIC-supervised institution'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 FDIC-supervised institution has applied the double default treatment in § 324.135.

Exposure amount means:

(1) For the on-balance sheet component of an exposure (other than an available-for-sale or held-to-maturity security, if the FDIC-supervised institution has made an AOCI opt-out election (as defined in § 324.22(b)(2)); an OTC derivative contract; a repo-style transaction or an eligible margin loan for which the FDIC-supervised institution determines the exposure amount under § 324.37; a cleared transaction; a default fund contribution; or a securitization exposure), the FDIC-supervised institution's carrying value of the exposure.

(2) For a security (that is not a securitization exposure or preferred stock that is equity under GAAP) classified as available-for-sale or held-to-maturity if the FDIC-supervised institution has made an AOCI opt-out election (as defined in § 324.22(b)(2)), the FDIC-supervised institution's carrying value (including net accrued but unpaid interest and fees) for the exposure less any net unrealized gains on the exposure and plus any net unrealized losses on the exposure.

(3) For available-for-sale preferred stock classified as an equity security under GAAP if the FDIC-supervised institution has made an AOCI opt-out election (as defined in § 324.22(b)(2)), the FDIC-supervised institution's carrying value of the exposure less any net

unrealized gains on the exposure that are reflected in such carrying value but excluded from the FDIC-supervised institution's regulatory capital components.

(4) 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 FDIC-supervised institution calculates the exposure amount under § 324.37; a cleared transaction; a default fund contribution; or a securitization exposure), the notional amount of the off-balance sheet component multiplied by the appropriate credit conversion factor (CCF) in § 324.33.

(5) For an exposure that is an OTC derivative contract, the exposure amount determined under § 324.34;

(6) For an exposure that is a derivative contract that is a cleared transaction, the exposure amount determined under § 324.35.

(7) For an exposure that is an eligible margin loan or repo-style transaction (including a cleared transaction) for which the FDIC-supervised institution calculates the exposure amount as provided in § 324.37, the exposure amount determined under § 324.37.

(8) For an exposure that is a securitization exposure, the exposure amount determined under § 324.42.

FDIC-supervised institution means any bank or state savings association.

Federal Deposit Insurance Act means the Federal Deposit Insurance Act (12 U.S.C. 1811 et seq.).

Federal Deposit Insurance Corporation Improvement Act means the Federal Deposit Insurance Corporation Improvement Act of 1991 ((Pub. L. 102-242, 105 Stat. 2236).

Federal Reserve means the Board of Governors of the Federal Reserve System.

Financial collateral means collateral:

(1) In the form of:

(i) Cash on deposit with the FDIC-supervised institution (including cash held for the FDIC-supervised institution 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 FDIC-supervised institution 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) A bank holding company; savings and loan holding company; nonbank financial institution supervised by the Federal Reserve under Title I of the Dodd-Frank Act; depository institution; foreign bank; credit union; industrial loan company, industrial bank, or other similar institution described in section 2 of the Bank Holding Company Act; national association, state member bank, or state non-member bank that is not a depository institution; insurance company; securities holding company as defined in section 618 of the Dodd-Frank Act; broker or dealer

registered with the SEC under section 15 of the Securities Exchange Act; futures commission merchant as defined in section 1a of the Commodity Exchange Act; swap dealer as defined in section 1a of the Commodity Exchange Act; or security-based swap dealer as defined in section 3 of the Securities Exchange Act;

(2) Any designated financial market utility, as defined in section 803 of the Dodd-Frank Act;

(3) Any entity not domiciled in the United States (or a political subdivision thereof) that is supervised and regulated in a manner similar to entities described in paragraphs (1) or (2) of this definition; or

(4) Any other company:

(i) Of which the FDIC-supervised institution owns:

(A) An investment in GAAP equity instruments of the company with an adjusted carrying value or exposure amount equal to or greater than $10 million; or

(B) More than 10 percent of the company's issued and outstanding common shares (or similar equity interest), and

(ii) Which is predominantly engaged in the following activities:

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

(B) Insuring, guaranteeing, 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; or

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

(5) 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 is 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.

(6) Any other company that the FDIC may determine is a financial institution based on activities similar in scope, nature, or operation to those of the entities included in (1) through (4).

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

(i) GSEs;

(ii) Small business investment companies, as defined in section 102 of the Small Business Investment Act of 1958 (15 U.S.C. 661 et seq.);

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

(iv) Entities registered with the SEC under the Investment Company Act or foreign equivalents thereof;

(v) Entities to the extent that the FDIC-supervised institution's investment in such entities would qualify as a community development investment under section 24 (Eleventh) of the National Bank Act; and

(vi) An employee benefit plan as defined in paragraphs (3) and (32) of section 3 of ERISA, a "governmental plan" (as defined in 29 U.S.C. 1002(32)) that complies with the tax deferral qualification requirements provided in the Internal Revenue Code, or any similar employee benefit plan established under the laws of a foreign jurisdiction.

First-lien residential mortgage exposure means a residential mortgage exposure secured by a first lien.

Foreign bank means a foreign bank as defined in § 211.2 of the Federal Reserve'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 an FDIC-supervised institution (as reported on Schedule RC of the Call Report) resulting from a traditional securitization (other than an increase in equity capital resulting from the FDIC-supervised institution's receipt of cash in connection with the securitization or reporting of a mortgage servicing asset on Schedule RC of the Call Report.

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, prior to conversion to permanent financing, finances or has financed the acquisition, development, or construction (ADC) of real property, unless the facility finances:

(1) One- to four-family residential properties;

(2) Real property that:

(i) Would qualify as an investment in community development under 12 USC 338a or 12 USC 24 (Eleventh), as applicable, or as a "qualified investment" under 12 CFR part 345, and

(ii) Is not an ADC loan to any entity described in 12 CFR 345.12(g)(3), unless it is otherwise described in paragraph (1), (2)(i), (3) or (4) of this definition;

(3) The purchase or development of agricultural land, which includes all land known to be used or usable for agricultural purposes (such as crop and livestock production), provided that the valuation of the agricultural land is based on its value for agricultural purposes and the valuation does not take into consideration any potential use of the land for non-agricultural commercial development or residential development; or

(4) 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 FDIC's real estate lending standards at 12 CFR part 365, subpart A (state nonmember banks), 12 CFR 390.264 and 390.265 (state savings associations);

(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 (4)(ii) of this definition before the FDIC-supervised institution 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 FDIC-supervised institution that provided the ADC facility as long as the permanent financing is subject to the FDIC-supervised institution's underwriting criteria for long-term mortgage loans.

Home country means the country where an entity is incorporated, chartered, or similarly established.

Identified losses means:

(1) When measured as of the date of examination of an FDIC-supervised institution, those items that have been determined by an evaluation made by a state or Federal examiner as of that date to be chargeable against income, capital and/or general valuation allowances such as the allowance for loan and lease losses (examples of identified losses would be assets classified loss, off-balance sheet items classified loss, any provision expenses that are necessary for the FDIC-supervised institution to record in order to replenish its general valuation allowances to an adequate level, liabilities not shown on the FDIC-supervised institution's books, estimated losses in contingent liabilities, and differences in accounts which represent shortages); and

(2) When measured as of any other date, those items:

(i) That have been determined—

(A) By an evaluation made by a state or Federal examiner at the most recent examination of an FDIC-supervised institution to be chargeable against income, capital and/or general valuation allowances; or

(B) By evaluations made by the FDIC-supervised institution since its most recent examination to be chargeable against income, capital and/or general valuation allowances; and

(ii) For which the appropriate accounting entries to recognize the loss have not yet been made on the FDIC-supervised institution's books nor has the item been collected or otherwise settled.

Indirect exposure means an exposure that arises from the FDIC-supervised institution's investment in an investment fund which holds an investment in the FDIC-supervised institution's own capital instrument or an investment in the capital of an unconsolidated financial institution.

Insurance company means an insurance company as defined in section 201 of the Dodd-Frank Act (12 U.S.C. 5381).

Insurance underwriting company means an insurance company as defined in section 201 of the Dodd-Frank Act (12 U.S.C. 5381) that engages in insurance underwriting activities.

Insured depository institution means an insured depository institution as defined in section 3 of the Federal Deposit Insurance Act.

Intangible Assets means those assets that are required to be reported as intangible assets in an FDIC-supervised institution's Call Report.

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. 3901 et seq.).

Investing bank means, with respect to a securitization, an FDIC-supervised institution that assumes the credit risk of a securitization exposure (other than an originating FDIC-supervised institution of the securitization). In the typical synthetic securitization, the investing FDIC-supervised institution sells credit protection on a pool of underlying exposures to the originating FDIC-supervised institution.

Investment Company Act means the Investment Company Act of 1940 (15 U.S.C. 80 a-1 et seq.)

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 FDIC-supervised institution 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 calculated in accordance with § 324.22(h) in an instrument that is recognized as capital for regulatory purposes by the primary supervisor of an unconsolidated regulated financial institution and is 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 FDIC-supervised institution for five or fewer business days.

Investment in the FDIC-supervised institution's own capital instrument means a net long position calculated in accordance with § 324.22(h) in the FDIC-supervised institution's own common stock instrument, own additional tier 1 capital instrument or own tier 2 capital instrument, including direct, indirect, or synthetic exposures to such capital instruments. An investment in the FDIC-supervised institution's own capital instrument includes any contractual obligation to purchase such capital instrument.

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 FDIC-supervised institution can demonstrate to the satisfaction of the FDIC 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 FDIC-supervised institution means an FDIC-supervised institution that is described in § 324.201(b).

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 an FDIC-supervised institution 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 FDIC determines poses comparable credit risk.

National Bank Act means the National Bank Act (12 U.S.C. 1 et seq.).

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, this term does not cover a transaction:

(1) That is not subject to such a master netting agreement, or

(2) Where the FDIC-supervised institution has identified specific wrong-way risk.

Non-significant investment in the capital of an unconsolidated financial institution means an investment in the capital of an unconsolidated financial institution where the FDIC-supervised institution owns 10 percent or less of the issued and outstanding common stock of the unconsolidated financial institution.

N^{th}-to-default credit derivative means a credit derivative that provides credit protection only for the nth-defaulting reference exposure in a group of reference exposures.

OCC means the Office of the Comptroller of the Currency, U.S. Treasury.

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 FDIC-supervised institution can, at its option, unconditionally cancel the commitment.

Originating FDIC-supervised institution, with respect to a securitization, means an FDIC-supervised institution 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 an FDIC-supervised institution that is a clearing member and a counterparty where the FDIC-supervised institution 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 an FDIC-supervised institution 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 an FDIC-supervised institution 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 (Public Law 102-233, 105 Stat. 1761) and the following criteria:

(1) The loan is made in accordance with prudent underwriting standards, meaning that the FDIC-supervised institution has obtained sufficient documentation that the buyer of the home has a legally binding written sales contract and has a firm written commitment for permanent financing of the home upon completion;

(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;

(5) 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;

(6) The earnest money deposit must be held in escrow by the FDIC-supervised institution or an independent party in a fiduciary capacity, and the escrow agreement must provide that in an event of default arising from the cancellation of the sales contract by the

purchaser of the residence, the escrow funds shall be used to defray any cost incurred by the FDIC-supervised institution;

(7) 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;

(8) The loan may not exceed 80 percent of the sales price of the presold residence; and

(9) The loan is not more than 90 days past due, or on nonaccrual.

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 § 324.36 or § 324.134, as appropriate).

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)(i) Is a designated financial market utility (FMU) under Title VIII of the Dodd-Frank Act;

(ii) If not located in the United States, is regulated and supervised in a manner equivalent to a designated FMU; or

(iii) Meets the following standards:

(A) The central counterparty requires all parties to contracts cleared by the counterparty to be fully collateralized on a daily basis;

(B) The FDIC-supervised institution demonstrates to the satisfaction of the FDIC that the central counterparty:

(1) Is in sound financial condition;

(2) Is subject to supervision by the Federal Reserve, 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

(3) Meets or exceeds the risk-management standards for central counterparties set forth in regulations established by the Federal Reserve, the CFTC, or the SEC under Title VII or Title VIII of the Dodd-Frank Act; or if the central counterparty is not located in the United States, meets or exceeds 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; and

(2)(i) Provides the FDIC-supervised institution with the central counterparty's hypothetical capital requirement or the information necessary to calculate such hypothetical capital requirement, and other information the FDIC-supervised institution is required to obtain under §§ 324.35(d)(3) and 324.133(d)(3);

(ii) Makes available to the FDIC and the CCP's regulator the information described in paragraph (2)(i) of this definition; and

(iii) Has not otherwise been determined by the FDIC 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 qualifying central counterparties under §§ 324.35 and 324.133.

(3) Exception. A QCCP that fails to meet the requirements of a QCCP in the future may still be treated as a QCCP under the conditions specified in § 324.3(f).

Qualifying master netting agreement means a 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 upon an event of receivership, insolvency, liquidation, or similar proceeding, of the counterparty;

(2) The agreement provides the FDIC-supervised institution 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 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); and

(4) In order to recognize an agreement as a qualifying master netting agreement for purposes of this subpart, an FDIC-supervised institution must comply with the requirements of § 324.3(d) with respect to that 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 Federal Reserve, 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 FDIC-supervised institution 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-fair value 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’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 FDIC-supervised institution 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 FDIC-supervised institution; and

(2) Executed under an agreement that provides the FDIC-supervised institution 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) In order to recognize an exposure as a repo-style transaction for purposes of this subpart, an FDIC-supervised institution must comply with the requirements of § 324.3(e) of this part with respect to that exposure.

Resecuritization means a securitization which has more than one underlying exposure and 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 of this part, 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. 78a et seq.).

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.

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:

(1) The account must be legally recognized as a separate account under applicable law;

(2) The assets in the account must be insulated from general liabilities of the insurance company under applicable law in the event of the insurance company'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 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.

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 an unconsolidated financial institution means an investment in the capital of an unconsolidated financial institution where the FDIC-supervised institution owns more than 10 percent of the issued and outstanding common stock of the unconsolidated financial institution.

Small Business Act means the Small Business Act (15 U.S.C. 631 et seq.).

Small Business Investment Act means the Small Business Investment Act of 1958 (15 U.S.C. 681 et seq.).

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 § 324.204 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 § 324.31;

(ii) Total risk-weighted assets for cleared transactions and default fund contributions as calculated under § 324.35;

(iii) Total risk-weighted assets for unsettled transactions as calculated under § 324.38;

(iv) Total risk-weighted assets for securitization exposures as calculated under § 324.42;

(v) Total risk-weighted assets for equity exposures as calculated under §§ 324.52 and 324.53; and

(vi) For a market risk FDIC-supervised institution only, standardized market risk-weighted assets; minus

(2) Any amount of the FDIC-supervised institution's allowance for loan and lease losses that is not included in tier 2 capital and any amount of allocated transfer risk reserves.

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.

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:[202]

(1) The loan is made in accordance with prudent underwriting standards;

(2) The principal amount of the loan at origination does not exceed 80 percent of the value of the property (or 75 percent of the value of the property if the loan is based on an interest rate that changes over the term of the loan) where the value of the property is the lower of the acquisition cost of the property or the appraised (or, if appropriate, evaluated) value of the property;

[202] The types of loans that qualify as loans secured by multifamily residential properties are listed in the instructions for preparation of the Call Report.

(3) All principal and interest payments on the loan must have been made on a timely basis in accordance with the terms of the loan 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 a timely basis in accordance with the terms of the loan 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 making any payment 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 FDIC-supervised institution; 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 exposure means an exposure whose value is linked to the value of an investment in the FDIC-supervised institution's own capital instrument or to the value of an investment in the capital of an unconsolidated financial institution.

Synthetic securitization means a transaction in which:

(1) All or a portion of the credit risk of one or more underlying exposures is retained or 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).

Tangible capital means the amount of core capital (Tier 1 capital), as defined in accordance with § 324.2 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 part, plus the amount of outstanding perpetual preferred stock (including related surplus) not included in Tier 1 capital.

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 an FDIC-supervised institution that is not owned by the FDIC-supervised institution.

Tier 2 capital is defined in § 324.20(d).

Total assets means quarterly average total assets as reported in an FDIC-supervised institution's Call Report, minus items deducted from tier 1 capital. At its discretion, the FDIC may calculate total assets using an FDIC-supervised institution’s period-end assets rather than quarterly average assets.

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 an FDIC-supervised institution that is not owned by the FDIC-supervised institution.

Total leverage exposure means the sum of the following:

(1) The balance sheet carrying value of all of the FDIC-supervised institution's on-balance sheet assets, less amounts deducted from tier 1 capital under § 324.22(a), (c), and (d);

(2) The potential future credit exposure (PFE) amount for each derivative contract to which the FDIC-supervised institution is a counterparty (or each single-product netting set of such transactions) determined in accordance with § 324.34, but without regard to § 324.34(b);

(3) 10 percent of the notional amount of unconditionally cancellable commitments made by the FDIC-supervised institution; and

(4) The notional amount of all other off-balance sheet exposures of the FDIC-supervised institution (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 defined 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 FDIC 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 FDIC 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 344.3 (state nonmember bank), and 12 CFR 390.203 (state savings association);

(iii) An employee benefit plan (as defined in paragraphs (3) and (32) of section 3 of ERISA), a "governmental plan" (as defined in 29 U.S.C. 1002(32)) that complies with the tax deferral qualification requirements provided in the Internal Revenue Code, or any similar employee benefit plan established under the laws of a foreign jurisdiction;

(iv) A synthetic exposure to the capital of a financial institution to the extent deducted from capital under § 324.22; or

(v) Registered with the SEC under the Investment Company Act or foreign equivalents 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 an FDIC-supervised institution 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.

Unregulated financial institution means, for purposes of § 324.131, a financial institution that is not a regulated financial institution, including any financial institution that would meet the definition of "financial institution" under this section but for the ownership interest thresholds set forth in paragraph (4)(i) of that definition.

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.

§ 324.3 Operational requirements for counterparty credit risk.

For purposes of calculating risk-weighted assets under subparts D and E of this part:

(a) Cleared transaction. In order to recognize certain exposures as cleared transactions pursuant to paragraphs (1)(ii), (iii), or (iv) of the definition of "cleared transaction" in § 324.2, the exposures must meet all of the requirements set forth in (1)-(4) this paragraph.

(1) The offsetting transaction must be identified by the CCP as a transaction for the clearing member client.

(2) The collateral supporting the transaction must be held in a manner that prevents the FDIC-supervised institution from facing any loss due to an event of default, including from a liquidation, receivership, insolvency, or similar proceeding of either the clearing member or the clearing member's other clients. Omnibus accounts established under 17 CFR parts 190 and 300 satisfy the requirements of this paragraph.

(3) The FDIC-supervised institution must conduct sufficient legal review to conclude with a well-founded basis (and maintain 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 (a)(2) of this section to be legal, valid, binding and enforceable under the law of the relevant jurisdictions.

(4) The offsetting transaction with a clearing member must be transferable under the transaction documents and 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 proceedings.

(b) Eligible margin loan. In order to recognize an exposure as an eligible margin loan as defined in § 324.2, an FDIC-supervised institution must conduct sufficient legal review to conclude with a well-founded basis (and maintain sufficient written documentation of that legal review) that the agreement underlying the exposure:

(1) Meets the requirements of paragraph (1)(iii) of the definition of eligible margin loan in § 324.2, and

(2) Is legal, valid, binding, and enforceable under applicable law in the relevant jurisdictions.

(c) Qualifying cross-product master netting agreement. In order to recognize an agreement as a qualifying cross-product master netting agreement as defined in § 324.101, an FDIC-supervised institution must obtain 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.

(d) Qualifying master netting agreement. In order to recognize an agreement as a qualifying master netting agreement as defined in § 324.2, an FDIC-supervised institution must:

(1) Conduct sufficient legal review to conclude with a well-founded basis (and maintain sufficient written documentation of that legal review) that:

(i) The agreement meets the requirements of paragraph (2) of the definition of qualifying master netting agreement in § 324.2; 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; and

(2) Establish and maintain written procedures to monitor possible changes in relevant law and to ensure that the agreement continues to satisfy the requirements of the definition of qualifying master netting agreement in § 324.2.

(e) Repo-style transaction. In order to recognize an exposure as a repo-style transaction as defined in § 324.2, an FDIC-supervised institution must conduct sufficient legal review to conclude with a well-founded basis (and maintain sufficient written documentation of that legal review) that the agreement underlying the exposure:

(1) Meets the requirements of paragraph (3) of the definition of repo-style transaction in § 324.2, and

(2) Is legal, valid, binding, and enforceable under applicable law in the relevant jurisdictions.

(f) Failure of a QCCP to satisfy the rule's requirements. If an FDIC-supervised institution 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 in paragraphs (2)(i) through (2)(iii) of the definition of a QCCP in § 324.2, the FDIC-supervised institution 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 (2)(i) through (2)(iii) of the definition of a QCCP continuously for a three-month period after remedying the relevant deficiency, an FDIC-supervised institution may not treat the CCP as a QCCP for the purposes of this part until after the FDIC-supervised institution has determined that the CCP has satisfied the requirements in paragraphs (2)(i) through (2)(iii) of the definition of a QCCP for three continuous months.

§ 324.4 Inadequate capital as an unsafe or unsound practice or condition.

(a) General. As a condition of Federal deposit insurance, all insured depository institutions must remain in a safe and sound condition.

(b) Unsafe or unsound practice. Any insured depository institution which has less than its minimum leverage capital requirement is deemed to be engaged in an unsafe or unsound practice pursuant to section 8(b)(1) and/or 8(c) of the Federal Deposit Insurance Act (12 U.S.C. 1818(b)(1) and/or 1818(c)). Except that such an insured depository institution which has entered into and is in compliance with a written agreement with the FDIC or has submitted to the FDIC and is in compliance with a plan approved by the FDIC to increase its leverage capital ratio to such level as the FDIC deems appropriate and to take such other action as may be necessary for the insured depository institution to be operated so as not to be engaged in such an unsafe or unsound practice will not be deemed to be engaged in an unsafe or unsound practice pursuant to section 8(b)(1) and/or 8(c) of the Federal Deposit Insurance Act (12 U.S.C. 1818(b)(1) and/or 1818(c)) on account of its capital ratios. The FDIC is not precluded from taking action under section 8(b)(1), section 8(c) or any other enforcement action against an insured depository institution with capital above the minimum requirement if the specific circumstances deem such action to be appropriate.

(c) Unsafe or unsound condition. Any insured depository institution with a ratio of tier 1 capital to total assets that is less than two percent is deemed to be operating in an unsafe or unsound condition pursuant to section 8(a) of the Federal Deposit Insurance Act (12 U.S.C. 1818(a)).

(1) An insured depository institution with a ratio of tier 1 capital to total assets of less than two percent which has entered into and is in compliance with a written agreement with the FDIC (or any other insured depository institution with a ratio of tier 1 capital to total assets of less than two percent which has entered into and is in compliance with a written agreement with its primary Federal regulator and to which agreement the FDIC is a party) to increase its tier 1 leverage capital ratio to such level as the FDIC deems appropriate and to take such other action as may be necessary for the insured depository institution to be operated in a safe and sound manner, will not be subject to a proceeding by the FDIC pursuant to 12 U.S.C. 1818(a) on account of its capital ratios.

(2) An insured depository institution with a ratio of tier 1 capital to total assets that is equal to or greater than two percent may be operating in an unsafe or unsound condition. The FDIC is not precluded from bringing an action pursuant to 12 U.S.C. 1818(a) where an insured depository institution has a ratio of tier 1 capital to total assets that is equal to or greater than two percent.

§ 324.5 Issuance of directives.

(a) General. A directive is a final order issued to an FDIC-supervised institution that fails to maintain capital at or above the minimum leverage capital requirement as set forth in §§ 324.4 and 324.10. A directive issued pursuant to this section, including a plan submitted under a

directive, is enforceable in the same manner and to the same extent as a final cease-and-desist order issued under section 8(b) of the Federal Deposit Insurance Act (12 U.S.C. 1818(b)).

(b) Issuance of directives. If an FDIC-supervised institution is operating with less than the minimum leverage capital requirement established by this regulation, the FDIC Board of Directors, or its designee(s), may issue and serve upon any FDIC-supervised institution a directive requiring the FDIC-supervised institution to restore its capital to the minimum leverage capital requirement within a specified time period. The directive may require the FDIC-supervised institution to submit to the appropriate FDIC regional director, or other specified official, for review and approval, a plan describing the means and timing by which the FDIC-supervised institution shall achieve the minimum leverage capital requirement. After the FDIC has approved the plan, the FDIC-supervised institution may be required under the terms of the directive to adhere to and monitor compliance with the plan. The directive may be issued during the course of an examination of the FDIC-supervised institution, or at any other time that the FDIC deems appropriate, if the FDIC-supervised institution is found to be operating with less than the minimum leverage capital requirement.

(c) Notice and opportunity to respond to issuance of a directive.

(1) If the FDIC makes an initial determination that a directive should be issued to an FDIC-supervised institution pursuant to paragraph (b) of this section, the FDIC, through the appropriate designated official(s), shall serve written notification upon the FDIC-supervised institution of its intent to issue a directive. The notice shall include the current leverage capital ratio, the basis upon which said ratio was calculated, the proposed capital injection, the proposed date for achieving the minimum leverage capital requirement and any other relevant information concerning the decision to issue a directive. When deemed appropriate, specific requirements of

a proposed plan for meeting the minimum leverage capital requirement may be included in the notice.

(2) Within 14 days of receipt of notification, the FDIC-supervised institution may file with the appropriate designated FDIC official(s) a written response, explaining why the directive should not be issued, seeking modification of its terms, or other appropriate relief. The FDIC-supervised institution's response shall include any information, mitigating circumstances, documentation, or other relevant evidence which supports its position, and may include a plan for attaining the minimum leverage capital requirement.

(3) After considering the FDIC-supervised institution's response, the appropriate designated FDIC official(s) shall serve upon the FDIC-supervised institution a written determination addressing the FDIC-supervised institution's response and setting forth the FDIC's findings and conclusions in support of any decision to issue or not to issue a directive. The directive may be issued as originally proposed or in modified form. The directive may order the FDIC-supervised institution to:

(i) Achieve the minimum leverage capital requirement established by this regulation by a certain date;

(ii) Submit for approval and adhere to a plan for achieving the minimum leverage capital requirement;

(iii) Take other action as is necessary to achieve the minimum leverage capital requirement; or

(iv) A combination of the above actions.

If a directive is to be issued, it may be served upon the FDIC-supervised institution along with the final determination.

(4) Any FDIC-supervised institution, upon a change in circumstances, may request the FDIC to reconsider the terms of a directive and may propose changes in the plan under which it is operating to meet the minimum leverage capital requirement. The directive and plan continue in effect while such request is pending before the FDIC.

(5) All papers filed with the FDIC must be postmarked or received by the appropriate designated FDIC official(s) within the prescribed time limit for filing.

(6) Failure by the FDIC-supervised institution to file a written response to notification of intent to issue a directive within the specified time period shall constitute consent to the issuance of such directive.

(d) Enforcement of a directive.

(1) Whenever an FDIC-supervised institution fails to follow the directive or to submit or adhere to its capital adequacy plan, the FDIC may seek enforcement of the directive in the appropriate United States district court, pursuant to 12 U.S.C. 3907(b)(2)(B)(ii), in the same manner and to the same extent as if the directive were a final cease-and-desist order. In addition to enforcement of the directive, the FDIC may seek assessment of civil money penalties for violation of the directive against any FDIC-supervised institution, any officer, director, employee, agent, or other person participating in the conduct of the affairs of the FDIC-supervised institution, pursuant to 12 U.S.C. 3909(d).

(2) The directive may be issued separately, in conjunction with, or in addition to, any other enforcement mechanisms available to the FDIC, including cease-and-desist orders, orders of correction, the approval or denial of applications, or any other actions authorized by law. In addition to addressing an FDIC-supervised institution's minimum leverage capital requirement, the capital directive may also address minimum risk-based capital requirements that are to be

maintained and calculated in accordance with § 324.10, and, for state savings associations, the minimum tangible capital requirements set for in § 324.10.

Subpart B – Capital Ratio Requirements and Buffers

§ 324.10 Minimum capital requirements.

(a) Minimum capital requirements. An FDIC-supervised institution 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 FDIC-supervised institutions, a supplementary leverage ratio of 3 percent.

(6) For state savings associations, a tangible capital ratio of 1.5 percent.

(b) Standardized capital ratio calculations. Other than as provided in paragraph (c), below:

(1) Common equity tier 1 capital ratio. An FDIC-supervised institution's common equity tier 1 capital ratio is the ratio of the FDIC-supervised institution's common equity tier 1 capital to standardized total risk-weighted assets;

(2) Tier 1 capital ratio. An FDIC-supervised institution's tier 1 capital ratio is the ratio of the FDIC-supervised institution's tier 1 capital to standardized total risk-weighted assets;

(3) Total capital ratio. An FDIC-supervised institution's total capital ratio is the ratio of the FDIC-supervised institution's total capital to standardized total risk-weighted assets; and

(4) Leverage ratio. An FDIC-supervised institution's leverage ratio is the ratio of the FDIC-supervised institution's tier 1 capital to the FDIC-supervised institution's average total consolidated assets as reported on the FDIC-supervised institution's Call Report minus amounts deducted from tier 1 capital under §§ 324.22(a), (c), and (d).

(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 assets.

(c) Advanced approaches capital ratio calculations. An advanced approaches FDIC-supervised institution that has completed the parallel run process and received notification from the FDIC pursuant to § 324.121(d) must determine its regulatory capital ratios as described in this paragraph (c).

(1) Common equity tier 1 capital ratio. The FDIC-supervised institution's common equity tier 1 capital ratio is the lower of:

(i) The ratio of the FDIC-supervised institution's common equity tier 1 capital to standardized total risk-weighted assets; and

(ii) The ratio of the FDIC-supervised institution's common equity tier 1 capital to advanced approaches total risk-weighted assets.

(2) Tier 1 capital ratio. The FDIC-supervised institution's tier 1 capital ratio is the lower of:

(i) The ratio of the FDIC-supervised institution's tier 1 capital to standardized total risk-weighted assets; and

(ii) The ratio of the FDIC-supervised institution's tier 1 capital to advanced approaches total risk-weighted assets.

(3) Total capital ratio. The FDIC-supervised institution's total capital ratio is the lower of:

(i) The ratio of the FDIC-supervised institution's total capital to standardized total risk-weighted assets; and

(ii) The ratio of the FDIC-supervised institution's advanced-approaches-adjusted total capital to advanced approaches total risk-weighted assets. An FDIC-supervised institution's advanced-approaches-adjusted total capital is the FDIC-supervised institution's total capital after being adjusted as follows:

(A) An advanced approaches FDIC-supervised institution must deduct from its total capital any allowance for loan and lease losses included in its tier 2 capital in accordance with § 324.20(d)(3); and

(B) An advanced approaches FDIC-supervised institution must add to its total capital any eligible credit reserves that exceed the FDIC-supervised institution's total expected credit losses to the extent that the excess reserve amount does not exceed 0.6 percent of the FDIC-supervised institution's credit risk-weighted assets.

(4) Supplementary leverage ratio. An advanced approaches FDIC-supervised institution'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, An FDIC-supervised institution must maintain capital commensurate with the level and nature of all risks to which the FDIC-supervised institution is exposed.

(2) An FDIC-supervised institution 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.

(3) Insured depository institutions with less than the minimum leverage capital requirement.

(i) An insured depository institution making an application to the FDIC operating with less than the minimum leverage capital requirement does not have adequate capital and therefore has inadequate financial resources.

(ii) Any insured depository institution operating with an inadequate capital structure, and therefore inadequate financial resources, will not receive approval for an application requiring the FDIC to consider the adequacy of its capital structure or its financial resources.

(iii) In any merger, acquisition, or other type of business combination where the FDIC must give its approval, where it is required to consider the adequacy of the financial resources of the existing and proposed institutions, and where the resulting entity is either insured by the FDIC or not otherwise federally insured, approval will not be granted when the resulting entity does not meet the minimum leverage capital requirement.

(iv) Exceptions. Notwithstanding the provisions of paragraphs (i), (ii) and (iii) of this subparagraph (d)(3):

(A) The FDIC, in its discretion, may approve an application pursuant to the Federal Deposit Insurance Act where it is required to consider the adequacy of capital if it finds that such approval must be taken to prevent the closing of a depository institution or to facilitate the acquisition of a closed depository institution, or, when severe financial conditions exist which threaten the stability of an insured depository institution or of a significant number of depository

institutions insured by the FDIC or of insured depository institutions possessing significant financial resources, if such action is taken to lessen the risk to the FDIC posed by an insured depository institution under such threat of instability.

(B) The FDIC, in its discretion, may approve an application pursuant to the Federal Deposit Insurance Act where it is required to consider the adequacy of capital or the financial resources of the insured depository institution where it finds that the applicant has committed to and is in compliance with a reasonable plan to meet its minimum leverage capital requirements within a reasonable period of time.

§ 324.11 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 an FDIC-supervised institution is the FDIC-supervised institution's net income for the four calendar quarters preceding the current calendar quarter, based on the FDIC-supervised institution's quarterly Call Reports, net of any distributions and associated tax effects not already reflected in net income.

(ii) Maximum payout ratio. The maximum payout ratio is the percentage of eligible retained income that an FDIC-supervised institution can pay out in the form of distributions and discretionary bonus payments during the current calendar quarter. The maximum payout ratio is based on the FDIC-supervised institution's capital conservation buffer, calculated as of the last day of the previous calendar quarter, as set forth in Table 1 to § 324.11.

(iii) Maximum payout amount. An FDIC-supervised institution's maximum payout amount for the current calendar quarter is equal to the FDIC-supervised institution's eligible

retained income, multiplied by the applicable maximum payout ratio, as set forth in Table 1 to § 324.11.

(iv) Private sector credit exposure. Private sector credit exposure means an exposure to a company or an individual 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 PSE, or a GSE.

(3) Calculation of capital conservation buffer. (i) An FDIC-supervised 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 FDIC-supervised institution's most recent Call Report:

(A) The FDIC-supervised institution's common equity tier 1 capital ratio minus the FDIC-supervised institution's minimum common equity tier 1 capital ratio requirement under § 324.10;

(B) The FDIC-supervised institution's tier 1 capital ratio minus the FDIC-supervised institution's minimum tier 1 capital ratio requirement under § 324.10; and

(C) The FDIC-supervised institution's total capital ratio minus the FDIC-supervised institution's minimum total capital ratio requirement under § 324.10; or

(ii) Notwithstanding paragraphs (3)(i)(A)-(C) of this section, if the FDIC-supervised institution's common equity tier 1, tier 1 or total capital ratio is less than or equal to the FDIC-supervised institution's minimum common equity tier 1, tier 1 or total capital ratio requirement under § 324.10, respectively, the FDIC-supervised institution's capital conservation buffer is zero.

(4) Limits on distributions and discretionary bonus payments. (i) An FDIC-supervised institution shall not make 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) An FDIC-supervised institution with a capital conservation buffer that is greater than 2.5 percent plus 100 percent of its applicable countercyclical capital buffer, in accordance with paragraph (b) of this section, is not subject to a maximum payout amount under this section.

(iii) Negative eligible retained income. Except as provided in paragraph (a)(4)(iv) of this section, an FDIC-supervised institution may not make distributions or discretionary bonus payments during the current calendar quarter if the FDIC-supervised institution'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 paragraphs (a)(4)(i) through (iii) of this section, the FDIC may permit an FDIC-supervised institution to make a distribution or discretionary bonus payment upon a request of the FDIC-supervised institution, if the FDIC determines that the distribution or discretionary bonus payment would not be contrary to the purposes of this section, or to the safety and soundness of the FDIC-supervised institution. In making such a determination, the FDIC will consider the nature and extent of the request and the particular circumstances giving rise to the request.

TABLE 1 to § 324.11 – CALCULATION OF MAXIMUM PAYOUT AMOUNT

Capital conservation buffer	**Maximum payout ratio (as a percentage of eligible retained**

	income)
Greater than 2.5 percent plus 100 percent of the FDIC-supervised institution's applicable countercyclical capital buffer amount	No payout ratio limitation applies
Less than or equal to 2.5 percent plus 100 percent of the FDIC-supervised institution's applicable countercyclical capital buffer amount, and greater than 1.875 percent plus 75 percent of the FDIC-supervised institution's applicable countercyclical capital buffer amount	60 percent
Less than or equal to 1.875 percent plus 75 percent of the FDIC-supervised institution's applicable countercyclical capital buffer amount, and greater than 1.25 percent plus 50 percent of the FDIC-supervised institution's applicable countercyclical capital buffer amount	40 percent
Less than or equal to 1.25 percent plus 50 percent of the FDIC-supervised institution's applicable countercyclical capital buffer amount, and greater than 0.625 percent plus 25 percent of the FDIC-supervised institution's applicable countercyclical capital	20 percent

buffer amount	
Less than or equal to 0.625 percent plus 25 percent of the FDIC-supervised institution's applicable countercyclical capital buffer amount	0 percent

(v) Other limitations on distributions. Additional limitations on distributions may apply to an FDIC-supervised institution under 12 CFR 303.241 and 12 CFR part 324, subpart H.

(b) Countercyclical capital buffer amount. (1) General. An advanced approaches FDIC-supervised institution must calculate a countercyclical capital buffer amount in accordance with the following paragraphs for purposes of determining its maximum payout ratio under Table 1 to § 324.11.

(i) Extension of capital conservation buffer. The countercyclical capital buffer amount is an extension of the capital conservation buffer as described in § 324.11(a).

(ii) Amount. An advanced approaches FDIC-supervised institution 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 FDIC-supervised institution's private sector credit exposures are located, as specified in paragraphs (b)(2) and (3) of this section.

(iii) Weighting. The weight assigned to a jurisdiction's countercyclical capital buffer amount is calculated by dividing the total risk-weighted assets for the FDIC-supervised institution's private sector credit exposures located in the jurisdiction by the total risk-weighted

assets for all of the FDIC-supervised institution's private sector credit exposures. The methodology an FDIC-supervised institution uses for determining risk-weighted assets for purposes of this paragraph must be the methodology that determines its risk-based capital ratios under § 324.10. Notwithstanding the previous sentence, the risk-weighted asset amount for a private sector credit exposure that is a covered position under subpart F of this part is its specific risk add-on as determined under § 324.210 multiplied by 12.5.

(iv) Location. (A) Except as provided in paragraphs (b)(1)(iv)(B) and (b)(1)(iv)(C) of this section, the location of a private sector credit 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 subparts D or E of this part, the FDIC-supervised institution 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 underlying exposures, or, if the underlying exposures are located in more than one national jurisdiction, the national jurisdiction where the underlying exposures with the largest aggregate unpaid principal balance are located. For purposes of this paragraph, the location of an underlying exposure shall be the location of the borrower, determined consistent with paragraph (b)(1)(iv)(A) of this section.

(2) Countercyclical capital buffer amount for credit exposures in the United States.

(i) Initial countercyclical capital 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 capital buffer amount. The FDIC will adjust the countercyclical capital buffer amount for credit exposures in the United States in accordance with applicable law.[203]

(iii) Range of countercyclical capital buffer amount. The FDIC will adjust the countercyclical capital buffer amount for credit exposures in the United States between zero percent and 2.5 percent of risk-weighted assets.

(iv) Adjustment determination. The FDIC 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 FDIC under paragraph (b)(2)(ii) of this section to increase the countercyclical capital buffer amount will be effective 12 months from the date of announcement, unless the FDIC establishes an earlier effective date and includes a statement articulating the reasons for the earlier effective date.

(B) Decrease adjustment. A determination by the FDIC to decrease the established countercyclical capital buffer amount under paragraph (b)(2)(ii) of this section will be effective

[203] The FDIC expects that any adjustment will be based on a determination made jointly by the Board, OCC, and FDIC.

on the day following announcement of the final determination or the earliest date permissible under applicable law or regulation, whichever is later.

(vi) Twelve month sunset. The countercyclical capital buffer amount will return to zero percent 12 months after the effective date that the adjusted countercyclical capital buffer amount is announced, unless the FDIC 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 FDIC 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 paragraph (b)(2) of this section.

Subpart C – Definition of Capital

§ 324.20 Capital components and eligibility criteria for regulatory capital instruments.

(a) Regulatory capital components. An FDIC-supervised institution'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 in paragraph (b) of this section, minus regulatory adjustments and deductions in § 324.22. The common equity tier 1 capital elements are:

(1) Any common stock instruments (plus any related surplus) issued by the FDIC-supervised institution, net of treasury stock, and any capital instruments issued by mutual banking organizations, that meet all the following criteria:

(i) The instrument is paid-in, issued directly by the FDIC-supervised institution, and represents the most subordinated claim in a receivership, insolvency, liquidation, or similar proceeding of the FDIC-supervised institution;

(ii) The holder of the instrument is entitled to a claim on the residual assets of the FDIC-supervised institution that is proportional with the holder's share of the FDIC-supervised institution'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 FDIC, and does not contain any term or feature that creates an incentive to redeem;

(iv) The FDIC-supervised institution 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 FDIC-supervised institution's net income and retained earnings and are not subject to a limit imposed by the contractual terms governing the instrument. An FDIC-supervised institution must obtain prior FDIC approval for any dividend payment involving a reduction or retirement of capital stock in accordance with section 303.241 of the FDIC's regulations;

(vi) The FDIC-supervised institution has full discretion at all times to refrain from paying any dividends and making any other 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 FDIC-supervised institution;

(vii) Dividend payments and any other distributions on the instrument may be paid only after all legal and contractual obligations of the FDIC-supervised institution 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 FDIC-supervised institution with greater priority in a receivership, insolvency, liquidation, or similar proceeding;

(ix) The paid-in amount is classified as equity under GAAP;

(x) The FDIC-supervised institution, or an entity that the FDIC-supervised institution controls, did not purchase or directly or indirectly fund the purchase of the instrument;

(xi) The instrument is not secured, not covered by a guarantee of the FDIC-supervised institution or of an affiliate of the FDIC-supervised institution, 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; and

(xiii) The instrument is reported on the FDIC-supervised institution's regulatory financial statements separately from other capital instruments.

(2) Retained earnings.

(3) Accumulated other comprehensive income (AOCI) as reported under GAAP.[204]

(4) Any common equity tier 1 minority interest, subject to the limitations in § 324.21(c).

(5) Notwithstanding the criteria for common stock instruments referenced above, an FDIC-supervised institution's common stock issued and held in trust for the benefit of its employees as part of an employee stock ownership plan does not violate any of the criteria in paragraph (b)(1)(iii), paragraph (b)(1)(iv) or paragraph (b)(1)(xi) above, provided that any repurchase of the stock is required solely by virtue of ERISA for an instrument of an FDIC-supervised institution that is not publicly-traded. In addition, an instrument issued by an FDIC-supervised institution to its employee stock ownership plan does not violate the criterion in paragraph (b)(1)(x) above.

(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 § 324.22. 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 FDIC-supervised institution in a receivership, insolvency, liquidation, or similar proceeding;

(iii) The instrument is not secured, not covered by a guarantee of the FDIC-supervised institution or of an affiliate of the FDIC-supervised institution, and not subject to any other arrangement that legally or economically enhances the seniority of the instrument;

[204] See §324.22 for specific adjustments related to AOCI.

(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; and

(v) If callable by its terms, the instrument may be called by the FDIC-supervised institution 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, a tax event, or if the issuing entity is required to register as an investment company pursuant to the Investment Company Act.

In addition:

(A) The FDIC-supervised institution must receive prior approval from the FDIC to exercise a call option on the instrument.

(B) The FDIC-supervised institution 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 FDIC-supervised institution must either: replace the instrument to be called with an equal amount of instruments that meet the criteria under paragraph (b) of this section or this paragraph (c);[205] or demonstrate to the satisfaction of the FDIC that following redemption, the FDIC-supervised institution will continue to hold capital commensurate with its risk.

(vi) Redemption or repurchase of the instrument requires prior approval from the FDIC.

(vii) The FDIC-supervised institution has full discretion at all times to cancel dividends or other distributions on the instrument without triggering an event of default, a requirement to

[205] Replacement can be concurrent with redemption of existing additional tier 1 capital instruments.

make a payment-in-kind, or an imposition of other restrictions on the FDIC-supervised institution except in relation to any distributions to holders of common stock or instruments that are pari passu with the instrument.

(viii) Any cash dividend payments on the instrument are paid out of the FDIC-supervised institution's net income and retained earnings and are not subject to a limit imposed by the contractual terms governing the instrument. An FDIC-supervised institution must obtain prior FDIC approval for any dividend payment involving a reduction or retirement of capital stock in accordance with section 303.241 of the FDIC's regulations.

(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 FDIC-supervised institution's credit quality, but may have a dividend rate that is adjusted periodically independent of the FDIC-supervised institution'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 FDIC-supervised institution, or an entity that the FDIC-supervised institution 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 FDIC-supervised institution, such as provisions that require the FDIC-supervised institution 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 FDIC-supervised institution or by a subsidiary of the FDIC-supervised institution that is an operating entity, the only asset of the issuing entity is its investment in the capital of the FDIC-supervised institution, and proceeds must be immediately available without limitation to the FDIC-supervised institution or to the

FDIC-supervised institution's top-tier holding company in a form which meets or exceeds all of the other criteria for additional tier 1 capital instruments.[206]

(xiv) For an advanced approaches FDIC-supervised institution, the governing agreement, offering circular, or prospectus of an instrument issued after the date upon which the FDIC-supervised institution becomes subject to this part as set forth in § 324.1(f) 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 FDIC-supervised institution enters into a receivership, insolvency, liquidation, or similar proceeding.

(2) Tier 1 minority interest, subject to the limitations in § 324.21(d), that is not included in the FDIC-supervised institution's common equity tier 1 capital.

(3) Any and all instruments that qualified as tier 1 capital under the FDIC's general risk-based capital rules under 12 CFR part 325, appendix A (state nonmember banks) and 12 CFR part 390, subpart Z (state savings associations) as then in effect, that were issued under the Small Business Jobs Act of 2010[207] or prior to October 4, 2010, under the Emergency Economic Stabilization Act of 2008.[208]

(4) Notwithstanding the criteria for additional tier 1 capital instruments referenced above:

(i) An instrument issued by an FDIC-supervised institution and held in trust for the benefit of its employees as part of an employee stock ownership plan does not violate any of the criteria in paragraph (c)(1)(iii) of this section, provided that any repurchase is required solely by

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

[207] Pub.L. 111-240; 124 Stat. 2504 (2010).

[208] Pub.L. 110-343, 122 Stat. 3765 (2008).

virtue of ERISA for an instrument of an FDIC-supervised institution that is not publicly-traded. In addition, an instrument issued by an FDIC-supervised institution to its employee stock ownership plan does not violate the criteria in paragraph (c)(1)(v) or paragraph (c)(1)(xi) above; and

(ii) An instrument with terms that provide that the instrument may be called earlier than five years upon the occurrence of a rating agency event does not violate the criterion in paragraph (c)(1)(v) of this section provided that the instrument was issued and included in an FDIC-supervised institution's tier 1 capital prior to the [insert effective date of the interim final rule], and that such instrument satisfies all other criteria under this § 324.20(c).

(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 § 324.22. 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 FDIC-supervised institution;

(iii) The instrument is not secured, not covered by a guarantee of the FDIC-supervised institution or of an affiliate of the FDIC-supervised institution, 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 the 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 FDIC-supervised institution to redeem the instrument prior to maturity;[209] and

(v) The instrument, by its terms, may be called by the FDIC-supervised institution 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, a tax event, or if the issuing entity is required to register as an investment company pursuant to the Investment Company Act. In addition:

(A) The FDIC-supervised institution must receive the prior approval of the FDIC to exercise a call option on the instrument.

(B) The FDIC-supervised institution does not create at issuance, through action or communication, an expectation the call option will be exercised.

(C) Prior to exercising the call option, or immediately thereafter, the FDIC-supervised institution must either: replace any amount called with an equivalent amount of an instrument that meets the criteria for regulatory capital under this section;[210] or demonstrate to the satisfaction of the FDIC that following redemption, the FDIC-supervised institution 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 FDIC-supervised institution.

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[209] An instrument that by its terms automatically converts into a tier 1 capital instrument prior to five years after issuance complies with the five-year maturity requirement of this criterion.

[210] A FDIC-supervised institution may replace tier 2 capital instruments concurrent with the redemption of existing tier 2 capital instruments.

(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 FDIC-supervised institution's credit standing, but may have a dividend rate that is adjusted periodically independent of the FDIC-supervised institution's credit standing, in relation to general market interest rates or similar adjustments.

(viii) The FDIC-supervised institution, or an entity that the FDIC-supervised institution 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 FDIC-supervised institution or by a subsidiary of the FDIC-supervised institution that is an operating entity, the only asset of the issuing entity is its investment in the capital of the FDIC-supervised institution, and proceeds must be immediately available without limitation to the FDIC-supervised institution or the FDIC-supervised institution's top-tier holding company in a form that meets or exceeds all the other criteria for tier 2 capital instruments under this section.[211]

(x) Redemption of the instrument prior to maturity or repurchase requires the prior approval of the FDIC.

(xi) For an advanced approaches FDIC-supervised institution, the governing agreement, offering circular, or prospectus of an instrument issued after the date on which the advanced approaches FDIC-supervised institution becomes subject to this part under § 324.1(f) must disclose that the holders of the instrument may be fully subordinated to interests held by the U.S.

[211] A FDIC-supervised institution may disregard de minimis assets related to the operation of the issuing entity for purposes of this criterion.

government in the event that the FDIC-supervised institution enters into a receivership, insolvency, liquidation, or similar proceeding.

(2) Total capital minority interest, subject to the limitations set forth in § 324.21(e), that is not included in the FDIC-supervised institution's tier 1 capital.

(3) ALLL up to 1.25 percent of the FDIC-supervised institution's standardized total risk-weighted assets not including any amount of the ALLL (and excluding in the case of a market risk FDIC-supervised institution, its standardized market risk-weighted assets).

(4) Any instrument that qualified as tier 2 capital under the FDIC's general risk-based capital rules under 12 CFR part 325, appendix A (state nonmember banks) and 12 CFR part 390, appendix Z (state saving associations) as then in effect, that were issued under the Small Business Jobs Act of 2010,[212] or prior to October 4, 2010, under the Emergency Economic Stabilization Act of 2008.[213]

(5) For an FDIC-supervised institution that makes an AOCI opt-out election (as defined in §324.22(b)(2), 45 percent of pretax net unrealized gains on available-for-sale preferred stock classified as an equity security under GAAP and equity exposures.

(6) Notwithstanding the criteria for tier 2 capital instruments referenced above, an instrument with terms that provide that the instrument may be called earlier than five years upon the occurrence of a rating agency event does not violate the criterion in paragraph (d)(1)(v) of this section provided that the instrument was issued and included in an FDIC-supervised institution's tier 1 or tier 2 capital prior to the [effective date of the rule], and that such instrument satisfies all other criteria under this § 324.20(d).

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[212] Pub. L. 111-240; 124 Stat. 2504 (2010)

[213] Pub. L. 110-343, 122 Stat. 3765 (2008)

(e) FDIC approval of a capital element. (1) An FDIC-supervised institution must receive FDIC prior approval to include a capital element (as listed in this section) in its common equity tier 1 capital, additional tier 1 capital, or tier 2 capital unless the element:

(i) Was included in an FDIC-supervised institution's tier 1 capital or tier 2 capital prior to May 19, 2010, in accordance with the FDIC's risk-based capital rules that were effective as of that date and the underlying instrument may continue to be included under the criteria set forth in this section; or

(ii) Is equivalent, in terms of capital quality and ability to absorb losses with respect to all material terms, to a regulatory capital element the FDIC determined may be included in regulatory capital pursuant to paragraph (e)(3) of this section.

(2) When considering whether an FDIC-supervised institution may include a regulatory capital element in its common equity tier 1 capital, additional tier 1 capital, or tier 2 capital, the FDIC will consult with the OCC and the Federal Reserve.

(3) After determining that a regulatory capital element may be included in an FDIC-supervised institution's common equity tier 1 capital, additional tier 1 capital, or tier 2 capital, the FDIC 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.

§ 324.21 Minority interest.

(a) Applicability. For purposes of § 324.20, an FDIC-supervised institution is subject to the minority interest limitations in this section if:

(1) A consolidated subsidiary of the FDIC-supervised institution has issued regulatory capital that is not owned by the FDIC-supervised institution; and

(2) For each relevant regulatory capital ratio of the consolidated subsidiary, the ratio exceeds the sum of the subsidiary's minimum regulatory capital requirements plus its capital conservation buffer.

(b) Difference in capital adequacy standards at the subsidiary level. For purposes of the minority interest calculations in this section, if the consolidated subsidiary issuing the capital is not subject to capital adequacy standards similar to those of the FDIC-supervised institution, the FDIC-supervised institution must assume that the capital adequacy standards of the FDIC-supervised institution apply to the subsidiary.

(c) Common equity tier 1 minority interest includable in the common equity tier 1 capital of the FDIC-supervised institution. For each consolidated subsidiary of an FDIC-supervised institution, the amount of common equity tier 1 minority interest the FDIC-supervised institution may include in common equity tier 1 capital is equal to:

(1) The common equity tier 1 minority interest of the subsidiary; minus

(2) The percentage of the subsidiary's common equity tier 1 capital that is not owned by the FDIC-supervised institution, 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, or would be required to hold pursuant to paragraph (b) of this section, to avoid restrictions on distributions and discretionary bonus payments under § 324.11 or equivalent standards established by the subsidiary's home country supervisor, or

(ii)(A) The standardized total risk-weighted assets of the FDIC-supervised institution that relate to the subsidiary multiplied by

(B) The common equity tier 1 capital ratio the subsidiary must maintain to avoid restrictions on distributions and discretionary bonus payments under § 324.11 or equivalent standards established by the subsidiary's home country supervisor.

(d) Tier 1 minority interest includable in the tier 1 capital of the FDIC-supervised institution. For each consolidated subsidiary of the FDIC-supervised institution, the amount of tier 1 minority interest the FDIC-supervised institution 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 FDIC-supervised institution 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, or would be required to hold pursuant to paragraph (b) of this section, to avoid restrictions on distributions and discretionary bonus payments under § 324.11 or equivalent standards established by the subsidiary's home country supervisor, or

(ii)(A) The standardized total risk-weighted assets of the FDIC-supervised institution that relate to the subsidiary multiplied by

(B) The tier 1 capital ratio the subsidiary must maintain to avoid restrictions on distributions and discretionary bonus payments under § 324.11 or equivalent standards established by the subsidiary's home country supervisor.

(e) Total capital minority interest includable in the total capital of the FDIC-supervised institution. For each consolidated subsidiary of the FDIC-supervised institution, the amount of total capital minority interest the FDIC-supervised institution 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 FDIC-supervised institution 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, or would be required to hold pursuant to paragraph (b) of this section, to avoid restrictions on distributions and discretionary bonus payments under § 324.11 or equivalent standards established by the subsidiary's home country supervisor, or

(ii)(A) The standardized total risk-weighted assets of the FDIC-supervised institution that relate to the subsidiary multiplied by

(B) The total capital ratio the subsidiary must maintain to avoid restrictions on distributions and discretionary bonus payments under § 324.11 or equivalent standards established by the subsidiary's home country supervisor.

§ 324.22 Regulatory capital adjustments and deductions.

(a) Regulatory capital deductions from common equity tier 1 capital. An FDIC-supervised institution must deduct from the sum of its common equity tier 1 capital elements the items set forth in this paragraph:

(1) Goodwill, net of associated deferred tax liabilities (DTLs) in accordance with paragraph (e) of this section, including goodwill that is embedded in the valuation of a significant investment in the capital of an unconsolidated financial institution in the form of common stock (and that is reflected in the consolidated financial statements of the FDIC-supervised institution), in accordance with paragraph (d) of this section;

(2) Intangible assets, other than MSAs, net of associated DTLs in accordance with paragraph (e) of this section;

(3) Deferred tax assets (DTAs) that arise from net operating loss and tax credit carryforwards net of any related valuation allowances and net of DTLs in accordance with paragraph (e) of this section;

(4) Any gain-on-sale in connection with a securitization exposure;

(5)(i) Any defined benefit pension fund net asset, net of any associated DTL in accordance with paragraph (e) of this section, held by a depository institution holding company. With the prior approval of the FDIC, this deduction is not required for any defined benefit pension fund net asset to the extent the depository institution holding company has unrestricted and unfettered access to the assets in that fund.

(ii) For an insured depository institution, no deduction is required.

(iii) An FDIC-supervised institution must risk weight any portion of the defined benefit pension fund asset that is not deducted under paragraphs (a)(5)(i) or (a)(5)(ii) as if the FDIC-supervised institution directly holds a proportional ownership share of each exposure in the defined benefit pension fund.

(6) For an advanced approaches FDIC-supervised institution that has completed the parallel run process and that has received notification from the FDIC pursuant to § 324.121(d) of subpart E of this part, the amount of expected credit loss that exceeds its eligible credit reserves; and

(7) With respect to a financial subsidiary, the aggregate amount of the FDIC-supervised institution's outstanding equity investment, including retained earnings, in its financial subsidiaries (as defined in 12 CFR 362.17). An FDIC-supervised institution must not

consolidate the assets and liabilities of a financial subsidiary with those of the parent bank, and no other deduction is required under paragraph (c) of this section for investments in the capital instruments of financial subsidiaries.

(8) (i) A state savings association must deduct the aggregate amount of its outstanding investments, (both equity and debt) in, and extensions of credit to, subsidiaries that are not includable subsidiaries as defined in paragraph (8)(iv) of this section and may not consolidate the assets and liabilities of the subsidiary with those of the state savings association. Any such deductions shall be from assets and common equity tier 1 capital, except as provided in paragraphs (a)(8)(ii) and (iii) of this section.

(ii) If a state savings association has any investments (both debt and equity) in, or extensions of credit to, 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 (a)(8)(iv) of this section may engage, it must deduct such investments and extensions of credit from assets and, thus, common equity tier 1 capital in accordance with paragraph (a)(8)(i) of this section.

(iii) If a state savings association holds a subsidiary (either directly or through a subsidiary) that is itself a 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 (a)(8)(i) and (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 (a)(8)(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)(1) Itself an insured depository institution or a company the sole investment of which is an insured depository institution, and

(2) 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 --

(1) Was chartered prior to October 15, 1982, as a savings bank or a cooperative bank under state law, or

(2) 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.

(9) Identified losses. An FDIC-supervised institution must deduct identified losses (to the extent that common equity tier 1 capital would have been reduced if the appropriate accounting entries to reflect the identified losses had been recorded on the FDIC-supervised institution’s books).

(b) Regulatory adjustments to common equity tier 1 capital. (1) An FDIC-supervised institution must adjust the sum of common equity tier 1 capital elements pursuant to the requirements set forth in this paragraph.

(i) An FDIC-supervised institution that makes an AOCI opt-out election (as defined in paragraph (b)(2) of this section), must make the adjustments required under § 324.22(b)(2)(i).

(ii) An FDIC-supervised institution that is an advanced approaches FDIC-supervised institution, and an FDIC-supervised institution that has not made an AOCI opt-out election (as defined in paragraph (b)(2) of this section), must deduct any accumulated net gain and add any accumulated net loss 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. Such adjustments to common equity tier 1 capital must be made net of the associated deferred tax effects.

(iii) An FDIC-supervised institution must deduct any net gain and add any net loss related to changes in the fair value of liabilities that are due to changes in the FDIC-supervised institution's own credit risk. An advanced approaches FDIC-supervised institution also must deduct the credit spread premium over the risk free rate for derivatives that are liabilities.

(2) AOCI opt-out election. (i) An FDIC-supervised institution that is not an advanced approaches FDIC-supervised institution may make a one-time election to opt-out of the requirement to include all components of AOCI (with the exception of accumulated net gains and losses on cash flow hedges related to items that are not fair-valued on the balance sheet) in common equity tier 1 capital (AOCI opt-out election). An FDIC-supervised institution that makes an AOCI opt-out election in accordance with this paragraph (b)(2) must adjust common equity tier 1 capital as follows:

(A) Subtract any net unrealized gains and add any net unrealized losses on available-for-sale securities;

(B) Subtract any net unrealized loss on available-for-sale preferred stock classified as an equity security under GAAP and equity exposures;

(C) Subtract any accumulated net gain and add any accumulated net loss on cash flow hedges;

(D) Subtract any amounts recorded in AOCI attributed to defined benefit postretirement plans resulting from the initial and subsequent application of the relevant GAAP standards that pertain to such plans (excluding, at the FDIC-supervised institution's option, the portion relating to pension assets deducted under paragraph (a)(5) of this section); and

(E) Subtract any net unrealized gains and add any net unrealized losses on held-to-maturity securities that are included in AOCI.

(ii) An FDIC-supervised institution that is not an advanced approaches FDIC-supervised institution must make its AOCI opt-out election in its first Call Report filed after the date required for such FDIC-supervised institution to comply with subpart A of this part as set forth in § 324.1(f).

(iii) With respect to an FDIC-supervised institution that is not an advanced approaches FDIC-supervised institution, each of its subsidiary banking organizations that is subject to regulatory capital requirements issued by the Federal Reserve, the FDIC, or the OCC[214] must elect the same option as the FDIC-supervised institution pursuant to paragraph (b)(2).

[214] These rules include the regulatory capital requirements set forth at 12 CFR part 3 (OCC); 12 CFR part 225 (Board); 12 CFR part 325, and 12 CFR part 390 (FDIC).

(iv) With prior notice to the FDIC, an FDIC-supervised institution resulting from a merger, acquisition, or purchase transaction and that is not an advanced approaches FDIC-supervised institution may change its AOCI opt-out election in its first Call Report filed after the date required for such FDIC-supervised institution to comply with subpart A of this part as set forth in § 324.1(f) if:

(A) Other than as set forth in paragraph (b)(2)(iv)(C), the merger, acquisition, or purchase transaction involved the acquisition or purchase of all or substantially all of either the assets or voting stock of another banking organization that is subject to regulatory capital requirements issued by the Federal Reserve, the FDIC, or the OCC;

(B) Prior to the merger, acquisition, or purchase transaction, only one of the banking organizations involved in the transaction made an AOCI opt-out election under this section; and

(C) An FDIC-supervised institution may, with the prior approval of the FDIC, change its AOCI opt-out election under this paragraph in the case of a merger, acquisition, or purchase transaction that meets the requirements set forth at paragraph (b)(2)(iv)(B) of this section, but does not meet the requirements of paragraph (b)(2)(iv)(A). In making such a determination, the FDIC may consider the terms of the merger, acquisition, or purchase transaction, as well as the extent of any changes to the risk profile, complexity, and scope of operations of the FDIC-supervised institution resulting from the merger, acquisition, or purchase transaction.

(c) Deductions from regulatory capital related to investments in capital instruments.[215]

[215] The FDIC-supervised institution must calculate amounts deducted under §§324.22(c) through 324.22(f) after it calculates the amount of ALLL includable in tier 2 capital under §324.20(d)(3).

(1) Investment in the FDIC-supervised institution's own capital instruments. An FDIC-supervised institution must deduct an investment in the FDIC-supervised institution's own capital instruments as follows:

(i) An FDIC-supervised institution must deduct an investment in the FDIC-supervised institution's own common stock instruments from its common equity tier 1 capital elements to the extent such instruments are not excluded from regulatory capital under § 324.20(b)(1);

(ii) An FDIC-supervised institution must deduct an investment in the FDIC-supervised institution's own additional tier 1 capital instruments from its additional tier 1 capital elements; and

(iii) An FDIC-supervised institution must deduct an investment in the FDIC-supervised institution's own tier 2 capital instruments from its tier 2 capital elements.

(2) Corresponding deduction approach. For purposes of subpart C of this part, the corresponding deduction approach is the methodology used for the deductions from regulatory capital related to reciprocal cross holdings (as described in paragraph (c)(3) of this section), non-significant investments in the capital of unconsolidated financial institutions (as described in paragraph (c)(4) of this section), and non-common stock significant investments in the capital of unconsolidated financial institutions (as described in paragraph (c)(5) of this section). Under the corresponding deduction approach, an FDIC-supervised institution must make deductions from the component of capital for which the underlying instrument would qualify if it were issued by the FDIC-supervised institution itself, as described in paragraphs (c)(2)(i)-(iii) of this section. If the FDIC-supervised institution does not have a sufficient amount of a specific component of capital to effect the required deduction, the shortfall must be deducted according to paragraph (f) of this section.

(i) If an investment is in the form of an instrument issued by a financial institution that is not a regulated financial institution, the FDIC-supervised institution 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 senior in liquidation only to common shareholders.

(ii) If an 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 § 324.20, the FDIC-supervised institution 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 supervisor of the financial institution.

(iii) If an investment is in the form of a non-qualifying capital instrument (as defined in § 324.300(c)), the FDIC-supervised institution must treat the instrument as:

(A) An additional tier 1 capital instrument if such instrument was included in the FDIC-supervised institution's tier 1 capital prior to May 19, 2010; or

(B) A tier 2 capital instrument if such instrument was included in the FDIC-supervised institution's tier 2 capital (but not includable in tier 1 capital) prior to May 19, 2010.

(3) Reciprocal cross holdings in the capital of financial institutions. An FDIC-supervised institution must deduct investments in the capital of other financial institutions it holds reciprocally, where such reciprocal cross holdings 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) An FDIC-supervised institution must deduct its non-significant investments in the capital of unconsolidated financial institutions (as defined in § 324.2) that, in the aggregate, exceed 10 percent of the sum of the FDIC-supervised institution's common equity tier 1 capital elements minus all deductions from and adjustments to common equity tier 1 capital elements required under paragraphs (a) through (c)(3) of this section (the 10 percent threshold for non-significant investments) by applying the corresponding deduction approach.[216] The deductions described in this section are net of associated DTLs in accordance with paragraph (e) of this section. In addition, an FDIC-supervised institution that underwrites a failed underwriting, with the prior written approval of the FDIC, for the period of time stipulated by the FDIC, is not required to deduct a non-significant investment in the capital of an unconsolidated financial institution pursuant to this paragraph to the extent the investment is related to the failed underwriting.[217]

[216] With the prior written approval of the FDIC, for the period of time stipulated by the FDIC, a FDIC-supervised institution is not required to deduct a non-significant investment in the capital instrument of an unconsolidated financial institution pursuant to this paragraph if the financial institution is in distress and if such investment is made for the purpose of providing financial support to the financial institution, as determined by the FDIC.

[217] 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 subparts D, E, or F of this part, as applicable.

(ii) The amount to be deducted under this section from a specific capital component is equal to:

(A) The FDIC-supervised institution's non-significant investments in the capital of unconsolidated financial institutions exceeding the 10 percent threshold for non-significant investments, multiplied by

(B) The ratio of the FDIC-supervised institution's non-significant investments in the capital of unconsolidated financial institutions in the form of such capital component to the FDIC-supervised institution's total non-significant investments in unconsolidated financial institutions.

(5) Significant investments in the capital of unconsolidated financial institutions that are not in the form of common stock. An FDIC-supervised institution 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.[218] The deductions described in this section are net of associated DTLs in accordance with paragraph (e) of this section. In addition, with the prior written approval of the FDIC, for the period of time stipulated by the FDIC, an FDIC-supervised institution that underwrites a failed underwriting is not required to deduct a significant investment in the capital of an unconsolidated financial institution pursuant to this paragraph if such investment is related to such failed underwriting.

(d) Items subject to the 10 and 15 percent common equity tier 1 capital deduction thresholds. (1) An FDIC-supervised institution must deduct from common equity tier 1 capital

[218] With prior written approval of the FDIC, for the period of time stipulated by the FDIC, a FDIC-supervised institution is not required to deduct a significant investment in the capital instrument of an unconsolidated financial institution in distress which is not in the form of common stock pursuant to this section if such investment is made for the purpose of providing financial support to the financial institution as determined by the FDIC.

elements the amount of each of the items set forth in this paragraph that, individually, exceeds 10 percent of the sum of the FDIC-supervised institution's common equity tier 1 capital elements, less adjustments to and deductions from common equity tier 1 capital required under paragraphs (a) through (c) of this section (the 10 percent common equity tier 1 capital deduction threshold).

(i) DTAs arising from temporary differences that the FDIC-supervised institution could not realize through net operating loss carrybacks, net of any related valuation allowances and net of DTLs, in accordance with paragraph (e) of this section. An FDIC-supervised institution is not required to deduct from the sum of its common equity tier 1 capital elements DTAs (net of any related valuation allowances and net of DTLs, in accordance with § 324.22(e)) arising from timing differences that the FDIC-supervised institution could realize through net operating loss carrybacks. The FDIC-supervised institution must risk weight these assets at 100 percent. For an FDIC-supervised institution 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 FDIC-supervised institution could reasonably expect to have refunded by its parent holding company.

(ii) MSAs net of associated DTLs, in accordance with paragraph (e) of this section.

(iii) Significant investments in the capital of unconsolidated financial institutions in the form of common stock, net of associated DTLs in accordance with paragraphs (e) of this section.[219] Significant investments in the capital of unconsolidated financial institutions in the

[219] With the prior written approval of the FDIC, for the period of time stipulated by the FDIC, a FDIC-supervised institution is not required to deduct a significant investment in the capital instrument of an unconsolidated financial institution in distress in the form of common stock

form of common stock subject to the 10 percent common equity tier 1 capital deduction threshold may be reduced by any goodwill embedded in the valuation of such investments deducted by the FDIC-supervised institution pursuant to § 324.22(a)(1). In addition, with the prior written approval of the FDIC, for the period of time stipulated by the FDIC, an FDIC-supervised institution that underwrites a failed underwriting is not required to deduct a significant investment in the capital of an unconsolidated financial institution in the form of common stock pursuant to this paragraph if such investment is related to such failed underwriting.

(2) An FDIC-supervised institution must deduct from common equity tier 1 capital elements the items listed in paragraph (d)(1) of this section 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, exceed 17.65 percent of the sum of the FDIC-supervised institution's common equity tier 1 capital elements, minus adjustments to and deductions from common equity tier 1 capital required under paragraphs (a) through (c) of this section, minus the items listed in paragraph (d)(1) of this section (the 15 percent common equity tier 1 capital deduction threshold). Any goodwill that has been deducted under § 324.22(a)(1) can be excluded from the significant investments in the capital of unconsolidated financial institutions in the form of common stock.[220]

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pursuant to this section if such investment is made for the purpose of providing financial support to the financial institution as determined by the FDIC.

[220] The amount of the items in paragraph (d) of this section that is not deducted from common equity tier 1 capital pursuant to this section must be included in the risk-weighted assets of the FDIC-supervised institution and assigned a 250 percent risk weight.

(3) For purposes of calculating the amount of DTAs subject to the 10 and 15 percent common equity tier 1 capital deduction thresholds, an FDIC-supervised institution may exclude DTAs and DTLs relating to adjustments made to common equity tier 1 capital under § 324.22(b). An FDIC-supervised institution that elects to exclude DTAs relating to adjustments under § 324.22(b) also must exclude DTLs and must do so consistently in all future calculations. An FDIC-supervised institution may change its exclusion preference only after obtaining the prior approval of the FDIC.

(e) Netting of DTLs against assets subject to deduction. (1) Except as described in paragraph (e)(3) of this section, netting of DTLs against assets that are subject to deduction under § 324.22 is permitted, but not required, if the following conditions are met:

(i) The DTL is associated with the asset; and

(ii) The DTL would be extinguished if the associated asset becomes impaired or is derecognized under GAAP.

(2) A DTL may only be netted against a single asset.

(3) For purposes of calculating the amount of DTAs subject to the threshold deduction in paragraph (d) of this section, the amount of DTAs that arise from net operating loss and tax credit carryforwards, net of any related valuation allowances, and of DTAs arising from temporary differences that the FDIC-supervised institution could not realize through net operating loss carrybacks, net of any related valuation allowances, may be offset by DTLs (that have not been netted against assets subject to deduction pursuant to paragraph (e)(1) of this section) subject to the conditions set forth in this paragraph.

(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 FDIC-supervised institution nets against DTAs that arise from net operating loss and tax credit carryforwards, net of any related valuation allowances, and against DTAs arising from temporary differences that the FDIC-supervised institution could not realize through net operating loss carrybacks, net of any related valuation allowances, must be allocated in proportion to the amount of DTAs that arise from net 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 FDIC-supervised institution could not realize through net operating loss carrybacks (net of any related valuation allowances, but before any offsetting of DTLs), respectively.

(4) An FDIC-supervised institution may offset DTLs embedded in the carrying value of a leveraged lease portfolio acquired in a business combination that are not recognized under GAAP against DTAs that are subject to § 324.22(d) in accordance with paragraph (e) of this section.

(5) An FDIC-supervised institution must net DTLs against assets subject to deduction under § 324.22 in a consistent manner from reporting period to reporting period. An FDIC-supervised institution may change its preference regarding the manner in which it nets DTLs against specific assets subject to deduction under § 324.22 only after obtaining the prior approval of the FDIC.

(f) Insufficient amounts of a specific regulatory capital component to effect deductions. Under the corresponding deduction approach, if an FDIC-supervised institution does not have a sufficient amount of a specific component of capital to effect the required deduction after completing the deductions required under § 324.22(d), the FDIC-supervised institution must

deduct the shortfall from the next higher (that is, more subordinated) component of regulatory capital.

(g) Treatment of assets that are deducted. An FDIC-supervised institution must exclude from standardized total risk-weighted assets and, as applicable, advanced approaches total risk-weighted assets any item deducted from regulatory capital under paragraphs (a), (c), and (d) of this section.

(h) Net long position. (1) For purposes of calculating an investment in the FDIC-supervised institution's own capital instrument and an investment in the capital of an unconsolidated financial institution under this section, the net long position is the gross long position in the underlying instrument determined in accordance with paragraph (h)(2) of this section, as adjusted to recognize a short position in the same instrument calculated in accordance with paragraph (h)(3) of this section.

(2) Gross long position. The gross long position is determined as follows:

(i) For an equity exposure that is held directly, the adjusted carrying value as that term is defined in § 324.51(b);

(ii) For an exposure that is held directly and is not an equity exposure or a securitization exposure, the exposure amount as that term is defined in § 324.2;

(iii) For an indirect exposure, the FDIC-supervised institution's carrying value of the investment in the investment fund, provided that, alternatively:

(A) An FDIC-supervised institution may, with the prior approval of the FDIC, use a conservative estimate of the amount of its investment in its own capital instruments or the capital of an unconsolidated financial institution held through a position in an index; or

(B) An FDIC-supervised institution may calculate the gross long position for the FDIC-supervised institution's own capital instruments or the capital of an unconsolidated financial institution by multiplying the FDIC-supervised institution's carrying value of its investment in the investment fund by either (1) the highest stated investment limit (in percent) for investments in the FDIC-supervised institution's own capital instruments or the capital of unconsolidated financial institutions as stated in the prospectus, partnership agreement, or similar contract defining permissible investments of the investment fund or (2) the investment fund's actual holdings of own capital instruments or the capital of unconsolidated financial institutions.

(iv) For a synthetic exposure, the amount of the FDIC-supervised institution's loss on the exposure if the reference capital instrument were to have a value of zero.

(3) Adjustments to reflect a short position. In order to adjust the gross long position to recognize a short position in the same instrument, the following criteria must be met:

(i) The maturity of the short position must match the maturity of the long position, or the short position has a residual maturity of at least one year (maturity requirement), or

(ii) For a position that is a trading asset or trading liability (whether on- or off-balance sheet) as reported on the FDIC-supervised institution's Call Report, if the FDIC-supervised institution has a contractual right or obligation to sell the long position at a specific point in time and the counterparty to the contract has an obligation to purchase the long position if the FDIC-supervised institution exercises its right to sell, this point in time may be treated as the maturity of the long position such that the maturity of the long position and short position are deemed to match for purposes of the maturity requirement, even if the maturity of the short position is less than one year; and

(iii) For an investment in the FDIC-supervised institution's own capital instrument under paragraph (c)(1) of this section or an investment in a capital of an unconsolidated financial institution under paragraphs (c)(4), (c)(5), and (d)(1)(iii) of this section:

(A) An FDIC-supervised institution may only net a short position against a long position in the FDIC-supervised institution's own capital instrument under paragraph (c)(1) if the short position involves no counterparty credit risk.

(B) A gross long position in an FDIC-supervised institution's own capital instrument or in a capital instrument of an unconsolidated financial institution resulting from a position in an index may be netted against a short position in the same index. Long and short positions in the same index without maturity dates are considered to have matching maturities.

(C) A short position in an index that is hedging a long cash or synthetic position in an FDIC-supervised institution's own capital instrument or in a capital instrument of an unconsolidated financial institution can be decomposed to provide recognition of the hedge. More specifically, the portion of the index that is composed of the same underlying instrument that is being hedged may be used to offset the long position if both the long position being hedged and the short position in the index are reported as a trading asset or trading liability (whether on- or off-balance sheet) on the FDIC-supervised institution's Call Report, and the hedge is deemed effective by the FDIC-supervised institution's internal control processes, which have not been found to be inadequate by the FDIC.

Subpart D – Risk-weighted Assets – Standardized Approach

§ 324.30 Applicability.

(a) This subpart sets forth methodologies for determining risk-weighted assets for purposes of the generally applicable risk-based capital requirements for all FDIC-supervised institutions.

(b) Notwithstanding paragraph (a), above, a market risk FDIC-supervised institution 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 of this part (except foreign exchange positions that are not trading positions, OTC derivative positions, cleared transactions, and unsettled transactions).

RISK-WEIGHTED ASSETS FOR GENERAL CREDIT RISK

§ 324.31 Mechanics for calculating risk-weighted assets for general credit risk.

(a) General risk-weighting requirements. An FDIC-supervised institution must apply risk weights to its exposures as follows:

(1) An FDIC-supervised institution 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 § 324.38;

(ii) A cleared transaction subject to § 324.35;

(iii) A default fund contribution subject to § 324.35;

(iv) A securitization exposure subject to §§ 324.41 through 324.45; or

(v) An equity exposure (other than an equity OTC derivative contract) subject to §§ 324.51 through 324.53.

(2) The FDIC-supervised institution 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.

§ 324.32 General risk weights.

(a) Sovereign exposures. (1) Exposures to the U.S. government. (i) Notwithstanding any other requirement in this subpart, an FDIC-supervised institution 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. This includes a deposit or other exposure, or the portion of a deposit or other exposure, that is insured or otherwise unconditionally guaranteed by the FDIC or National Credit Union Administration.

(ii) An FDIC-supervised institution 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. This includes an exposure, or the portion of an exposure, that is conditionally guaranteed by the FDIC or National Credit Union Administration.

(2) Other sovereign exposures. In accordance with Table 1 to § 324.32, an FDIC-supervised institution must assign a risk weight to a sovereign exposure based on the CRC

applicable to the sovereign or the sovereign's OECD membership status if there is no CRC applicable to the sovereign.

TABLE 1 TO § 324 .32– RISK WEIGHTS FOR SOVEREIGN EXPOSURES

		Risk Weight (in percent)
CRC	0-1	0
	2	20
	3	50
	4-6	100
	7	150
OECD Member with No CRC		0
Non-OECD Member with No CRC		100
Sovereign Default		150

(3) Certain sovereign exposures. Notwithstanding paragraph (a)(2) of this section, an FDIC-supervised institution may assign to a sovereign exposure a risk weight that is lower than the applicable risk weight in Table 1 to § 324.32 if:

(i) The exposure is denominated in the sovereign's currency;

(ii) The FDIC-supervised institution 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 home country supervisor allows FDIC-supervised institutions under its jurisdiction to assign to the same exposures to the sovereign.

(4) Exposures to a non-OECD member sovereign with no CRC. Except as provided in paragraphs (a)(3), (a)(5) and (a)(6) of this section, an FDIC-supervised institution must assign a 100 percent risk weight to an exposure to a sovereign if the sovereign does not have a CRC.

(5) Exposures to an OECD member sovereign with no CRC. Except as provided in paragraph (a)(6) of this section, an FDIC-supervised institution must assign a 0 percent risk weight to an exposure to a sovereign that is a member of the OECD if the sovereign does not have a CRC.

(6) Sovereign default. An FDIC-supervised institution 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). An FDIC-supervised institution 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) An FDIC-supervised institution must assign a 20 percent risk weight to an exposure to a GSE other than an equity exposure or preferred stock.

(2) An FDIC-supervised institution 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. An FDIC-supervised institution 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 paragraph (d)(3) of this section.

(2) Exposures to foreign banks. (i) Except as otherwise provided under paragraphs (d)(2)(iv) and (d)(3) of this section, an FDIC-supervised institution must assign a risk weight to an exposure to a foreign bank, in accordance with Table 2 to § 324.32, based on the CRC that corresponds to the foreign bank's home country or the OECD membership status of the foreign bank's home country if there is no CRC applicable to the foreign bank's home country.

TABLE 2 TO § 324 .32– RISK WEIGHTS FOR EXPOSURES TO FOREIGN BANKS

		Risk Weight (in percent)
CRC	0-1	20
	2	50
	3	100
	4-7	150
OECD Member with No CRC		20
Non-OECD Member with No CRC		100

Sovereign Default	150

(ii) An FDIC-supervised institution must assign a 20 percent risk weight to an exposure to a foreign bank whose home country is a member of the OECD and does not have a CRC.

(iii) An FDIC-supervised institution must assign a 100 percent risk weight to an exposure to a foreign bank whose home country is not a member of the OECD and 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.

(iv) An FDIC-supervised institution 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) An FDIC-supervised institution must assign a 100 percent risk weight to an exposure to a financial institution if the exposure may be included 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 § 324.22(d)(iii);

(iii) Deducted from regulatory capital under § 324.22; or

(iv) Subject to a 150 percent risk weight under paragraph (d)(2)(iv) or Table 2 of paragraph (d)(2) of this section.

(e) Exposures to public sector entities (PSEs). (1) Exposures to U.S. PSEs. (i) An FDIC-supervised institution 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) An FDIC-supervised institution 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 paragraphs (e)(1) and (e)(3) of this section, an FDIC-supervised institution must assign a risk weight to a general obligation exposure to a PSE, in accordance with Table 3 to § 324.32, based on the CRC that corresponds to the PSE's home country or the OECD membership status of the PSE's home country if there is no CRC applicable to the PSE's home country.

(ii) Except as provided in paragraphs (e)(1) and (e)(3) of this section, an FDIC-supervised institution must assign a risk weight to a revenue obligation exposure to a PSE, in accordance with Table 4 to § 324.32, based on the CRC that corresponds to the PSE's home country; or the OECD membership status of the PSE's home country if there is no CRC applicable to the PSE's home country.

(3) An FDIC-supervised institution may assign a lower risk weight than would otherwise apply under Tables 3 or 4 to § 324.32 to an exposure to a foreign PSE if:

(i) The PSE's home country supervisor 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 to § 324.32.

TABLE 3 TO § 324 .32 – RISK WEIGHTS FOR NON-U.S. PSE GENERAL OBLIGATIONS

		Risk Weight (in percent)
CRC	0-1	20
	2	50
	3	100
	4-7	150
OECD Member with No CRC		20
Non-OECD Member with No CRC		100
Sovereign Default		150

TABLE 4 TO § 324 .32– RISK WEIGHTS FOR NON-U.S. PSE REVENUE OBLIGATIONS

		Risk Weight (in percent)
CRC	0-1	50
	2-3	100
	4-7	150
OECD Member with No CRC		50

Non-OECD Member with No CRC	100
Sovereign Default	150

(4) Exposures to PSEs from an OECD member sovereign with no CRC. (i) An FDIC-supervised institution must assign a 20 percent risk weight to a general obligation exposure to a PSE whose home country is an OECD member sovereign with no CRC.

(ii) An FDIC-supervised institution must assign a 50 percent risk weight to a revenue obligation exposure to a PSE whose home country is an OECD member sovereign with no CRC.

(5) Exposures to PSEs whose home country is not an OECD member sovereign with no CRC. An FDIC-supervised institution must assign a 100 percent risk weight to an exposure to a PSE whose home country is not a member of the OECD and does not have a CRC.

(6) An FDIC-supervised institution 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. An FDIC-supervised institution must assign a 100 percent risk weight to all its corporate exposures.

(g) Residential mortgage exposures. (1) An FDIC-supervised institution must assign a 50 percent risk weight to a first-lien residential mortgage exposure that:

(i) Is secured by a property that is either owner-occupied or rented;

(ii) Is made in accordance with prudent underwriting standards, including standards relating to the loan amount as a percent of the appraised value of the property;

(iii) Is not 90 days or more past due or carried in nonaccrual status; and

(iv) Is not restructured or modified.

(2) An FDIC-supervised institution must assign a 100 percent risk weight to a first-lien residential mortgage exposure that does not meet the criteria in paragraph (g)(1) of this section, and to junior-lien residential mortgage exposures.

(3) For the purpose of this paragraph (g), if an FDIC-supervised institution holds the first-lien and junior-lien(s) residential mortgage exposures, and no other party holds an intervening lien, the FDIC-supervised institution must combine the exposures and treat them as a single first-lien residential mortgage exposure.

(4) A loan modified or restructured 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 construction loans. An FDIC-supervised institution must assign a 50 percent risk weight to a pre-sold construction loan unless the purchase contract is cancelled, in which case an FDIC-supervised institution must assign a 100 percent risk weight.

(i) Statutory multifamily mortgages. An FDIC-supervised institution must assign a 50 percent risk weight to a statutory multifamily mortgage.

(j) High-volatility commercial real estate (HVCRE) exposures. An FDIC-supervised institution 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, an FDIC-supervised institution must determine a risk weight for an exposure that is 90 days or more past due or on nonaccrual according to the requirements set forth in this paragraph.

(1) An FDIC-supervised institution must assign a 150 percent risk weight to the portion of the exposure that is not guaranteed or that is unsecured.

(2) An FDIC-supervised institution may assign a risk weight to the guaranteed portion of a past due exposure based on the risk weight that applies under § 324.36 if the guarantee or credit derivative meets the requirements of that section.

(3) An FDIC-supervised institution may assign a risk weight to the collateralized portion of a past due exposure based on the risk weight that applies under § 324.37 if the collateral meets the requirements of that section.

(l) Other assets. (1) An FDIC-supervised institution must assign a zero percent risk weight to cash owned and held in all offices of the FDIC-supervised institution or in transit; to gold bullion held in the FDIC-supervised 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; 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) An FDIC-supervised institution must assign a 20 percent risk weight to cash items in the process of collection.

(3) An FDIC-supervised institution must assign a 100 percent risk weight to DTAs arising from temporary differences that the FDIC-supervised institution could realize through net operating loss carrybacks.

(4) An FDIC-supervised institution must assign a 250 percent risk weight to the portion of each of the following items that is not deducted from common equity tier 1 capital pursuant to § 324.22(d):

(i) MSAs; and

(ii) DTAs arising from temporary differences that the FDIC-supervised institution could not realize through net operating loss carrybacks.

(5) An FDIC-supervised institution must assign a 100 percent risk weight to all assets not specifically assigned a different risk weight under this subpart and that are not deducted from tier 1 or tier 2 capital pursuant to § 324.22.

(6) Notwithstanding the requirements of this section, an FDIC-supervised institution 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 part 217, provided that all of the following conditions apply:

(i) The FDIC-supervised institution 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.

§ 324.33 Off-balance sheet exposures.

(a) General. (1) An FDIC-supervised institution must calculate the exposure amount of an off-balance sheet exposure using the credit conversion factors (CCFs) in paragraph (b) of this section.

(2) Where an FDIC-supervised institution commits to provide a commitment, the FDIC-supervised institution may apply the lower of the two applicable CCFs.

(3) Where an FDIC-supervised institution provides a commitment structured as a syndication or participation, the FDIC-supervised institution is only required to calculate the exposure amount for its pro rata share of the commitment.

(4) Where an FDIC-supervised institution provides a commitment, enters into a repurchase agreement, or provides a credit-enhancing representation and warranty, and such commitment, repurchase agreement, or credit-enhancing representation and warranty is not a securitization exposure, the exposure amount shall be no greater than the maximum contractual amount of the commitment, repurchase agreement, or credit-enhancing representation and warranty, as applicable.

(b) Credit conversion factors. (1) Zero percent CCF. An FDIC-supervised institution must apply a zero percent CCF to the unused portion of a commitment that is unconditionally cancelable by the FDIC-supervised institution.

(2) 20 percent CCF. An FDIC-supervised institution must apply a 20 percent CCF to the amount of:

(i) Commitments with an original maturity of one year or less that are not unconditionally cancelable by the FDIC-supervised institution; and

(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. An FDIC-supervised institution must apply a 50 percent CCF to the amount of:

(i) Commitments with an original maturity of more than one year that are not unconditionally cancelable by the FDIC-supervised institution; and

(ii) Transaction-related contingent items, including performance bonds, bid bonds, warranties, and performance standby letters of credit.

(4) 100 percent CCF. An FDIC-supervised institution must apply a 100 percent CCF to the amount of 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 fair values of all positions the FDIC-supervised institution has sold subject to repurchase);

(iii) Credit-enhancing representations and warranties that are not securitization exposures;

(iv) Off-balance sheet securities lending transactions (the off-balance sheet component of which equals the sum of the current fair values of all positions the FDIC-supervised institution has lent under the transaction);

(v) Off-balance sheet securities borrowing transactions (the off-balance sheet component of which equals the sum of the current fair values of all non-cash positions the FDIC-supervised institution has posted as collateral under the transaction);

(vi) Financial standby letters of credit; and

(vii) Forward agreements.

§ 324.34 OTC derivative contracts.

(a) Exposure amount. (1) Single OTC derivative contract. Except as modified by paragraph (b) of this section, 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 FDIC-supervised institution'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-fair 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-fair value, is calculated by multiplying the notional principal amount of the OTC derivative contract by the appropriate conversion factor in Table 1 to § 324.34.

(B) For purposes of calculating either the PFE under this paragraph or the gross PFE under paragraph (a)(2) of this section 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 1 to § 324.34, the PFE must be calculated using the appropriate "other" conversion factor.

(D) An FDIC-supervised institution 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 1 TO § 324 .34 – 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**	**Equity**	**Precious metals (except gold)**	**Other**

				asset)			
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 fair 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] An FDIC-supervised institution 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. An FDIC-supervised institution 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 paragraph (b) of this section, 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-fair 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 equals the gross PFE (that is, the sum of the PFE amounts as determined under paragraph (a)(1)(ii) of this section for each individual derivative contract subject to the qualifying master netting agreement); and

(B) Net-to-gross Ratio (NGR) equals 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 paragraph (a)(1)(i) of this section) of all individual derivative contracts subject to the qualifying master netting agreement.

(b) Recognition of credit risk mitigation of collateralized OTC derivative contracts: (1) An FDIC-supervised institution 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 § 324.37(b).

(2) As an alternative to the simple approach, an FDIC-supervised institution 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-fair value on a daily basis and subject to a daily margin maintenance requirement by applying a risk weight to the exposure as if it were uncollateralized and adjusting the exposure amount calculated under paragraph (a)(1)(i) or (ii) of this section using the collateral haircut approach in § 324.37(c). The FDIC-supervised institution

must substitute the exposure amount calculated under paragraph (a)(1)(i) or (ii) of this section for ∑E in the equation in § 324.37(c)(2).

(c) Counterparty credit risk for OTC credit derivatives. (1) Protection purchasers. An FDIC-supervised institution that purchases an OTC credit derivative that is recognized under § 324.36 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 § 324.32 provided that the FDIC-supervised institution does so consistently for all such credit derivatives. The FDIC-supervised institution 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) An FDIC-supervised institution 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 FDIC-supervised institution is not required to compute a counterparty credit risk capital requirement for the OTC credit derivative under § 324.32, provided that this treatment is applied consistently for all such OTC credit derivatives. The FDIC-supervised institution 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 paragraph (c)(2) of this section apply to all relevant counterparties for risk-based capital purposes unless the FDIC-supervised institution is treating the OTC credit derivative as a covered position under subpart F, in which case the FDIC-supervised institution must compute a supplemental counterparty credit risk capital requirement under this section.

(d) Counterparty credit risk for OTC equity derivatives. (1) An FDIC-supervised institution 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 §§ 324.51 through 324.53 (unless the FDIC-supervised institution is treating the contract as a covered position under subpart F).

(2) In addition, the FDIC-supervised institution must also calculate a risk-based capital requirement for the counterparty credit risk of an OTC equity derivative contract under this section if the FDIC-supervised institution is treating the contract as a covered position under subpart F of this part.

(3) If the FDIC-supervised institution risk weights the contract under the Simple Risk-Weight Approach (SRWA) in § 324.52, the FDIC-supervised institution 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, an FDIC-supervised institution using the SRWA must either include all or exclude all of the contracts from any measure used to determine counterparty credit risk exposure.

(e) Clearing member FDIC-supervised institution's exposure amount. A clearing member FDIC-supervised institution's exposure amount for an OTC derivative contract or netting set of OTC derivative contracts where the FDIC-supervised institution is either acting as a financial intermediary and enters into an offsetting transaction with a QCCP or where the FDIC-supervised institution provides a guarantee to the QCCP on the performance of the client equals the exposure amount calculated according to paragraph (a)(1) or (2) of this section multiplied by the scaling factor 0.71. If the FDIC-supervised institution determines that a longer

period is appropriate, the FDIC-supervised institution must use a larger scaling factor to adjust for a longer holding period as follows:

$$\text{Scaling factor} = \sqrt{\frac{H}{10}}$$

where H equals the holding period greater than five days. Additionally, the FDIC may require the FDIC-supervised institution to set a longer holding period if the FDIC determines that a longer period is appropriate due to the nature, structure, or characteristics of the transaction or is commensurate with the risks associated with the transaction.

§ 324.35 Cleared transactions.

(a) General requirements. (1) Clearing member clients. An FDIC-supervised institution that is a clearing member client must use the methodologies described in paragraph (b) of this section to calculate risk-weighted assets for a cleared transaction.

(2) Clearing members. An FDIC-supervised institution that is a clearing member must use the methodologies described in paragraph (c) of this section to calculate its risk-weighted assets for a cleared transaction and paragraph (d) of this section to calculate its risk-weighted assets for its default fund contribution to a CCP.

(b) Clearing member client FDIC-supervised institutions. (1) Risk-weighted assets for cleared transactions. (i) To determine the risk-weighted asset amount for a cleared transaction, an FDIC-supervised institution that is a clearing member client must multiply the trade exposure amount for the cleared transaction, calculated in accordance with paragraph (b)(2) of this section, by the risk weight appropriate for the cleared transaction, determined in accordance with paragraph (b)(3) of this section.

(ii) A clearing member client FDIC-supervised institution'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 either a derivative contract or a 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 § 324.34, plus

(B) The fair value of the collateral posted by the clearing member client FDIC-supervised institution and held by the CCP, clearing member, or custodian in a manner that is not bankruptcy remote.

(ii) For a cleared transaction that is a repo-style transaction or netting set of repo-style transactions, the trade exposure amount equals:

(A) The exposure amount for the repo-style transaction calculated using the methodologies under § 324.37(c), plus

(B) The fair value of the collateral posted by the clearing member client FDIC-supervised institution and held by the CCP, clearing member, or custodian 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 FDIC-supervised institution must apply a risk weight of:

(A) 2 percent if the collateral posted by the FDIC-supervised institution to the QCCP or clearing member is subject to an arrangement that prevents any losses to the clearing member client FDIC-supervised institution 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 FDIC-supervised institution 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 an event of default or from liquidation, insolvency, or receivership proceedings) 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 if the requirements of § 324.35(b)(3)(A) are not met.

(ii) For a cleared transaction with a CCP that is not a QCCP, a clearing member client FDIC-supervised institution must apply the risk weight appropriate for the CCP according to § 324.32.

(4) Collateral. (i) Notwithstanding any other requirements in this section, collateral posted by a clearing member client FDIC-supervised institution that is held by a custodian (in its capacity as custodian) in a manner that is bankruptcy remote from the CCP, the custodian, clearing member and other clearing member clients of the clearing member, is not subject to a capital requirement under this section.

(ii) A clearing member client FDIC-supervised institution must calculate a risk-weighted asset amount for any collateral provided to a CCP, clearing member, or custodian in connection with a cleared transaction in accordance with the requirements under § 324.32.

(c) Clearing member FDIC-supervised institutions. (1) Risk-weighted assets for cleared transactions.

(i) To determine the risk-weighted asset amount for a cleared transaction, a clearing member FDIC-supervised institution must multiply the trade exposure amount for the cleared transaction, calculated in accordance with paragraph (c)(2) of this section, by the risk weight

appropriate for the cleared transaction, determined in accordance with paragraph (c)(3) of this section.

(ii) A clearing member FDIC-supervised institution'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 FDIC-supervised institution must calculate its trade exposure amount for a cleared transaction as follows:

(i) For a cleared transaction that is either a derivative contract or a netting set of derivative contracts, 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 § 324.34, plus

(B) The fair value of the collateral posted by the clearing member FDIC-supervised institution and held by the CCP in a manner that is not bankruptcy remote.

(ii) For a cleared transaction that is a repo-style transaction or netting set of repo-style transactions, trade exposure amount equals:

(A) The exposure amount for repo-style transactions calculated using methodologies under § 324.37(c), plus

(B) The fair value of the collateral posted by the clearing member FDIC-supervised institution and held by the CCP in a manner that is not bankruptcy remote.

(3) Cleared transaction risk weight. (i) A clearing member FDIC-supervised institution must apply a risk weight of 2 percent to the trade exposure amount for a cleared transaction with a QCCP.

(ii) For a cleared transaction with a CCP that is not a QCCP, a clearing member FDIC-supervised institution must apply the risk weight appropriate for the CCP according to § 324.32.

(4) Collateral. (i) Notwithstanding any other requirement in this section, collateral posted by a clearing member FDIC-supervised institution 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 clearing member FDIC-supervised institution 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 § 324.32.

(d) Default fund contributions. (1) General requirement. A clearing member FDIC-supervised institution 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 FDIC-supervised institution or the FDIC, 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 FDIC-supervised institution'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, or an amount determined by the FDIC, based on factors such as size, structure and membership characteristics of the CCP and riskiness of its transactions, in cases where such default fund contributions may be unlimited.

(3) Risk-weighted asset amount for default fund contributions to QCCPs. A clearing member FDIC-supervised institution'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 the

methodology set forth in § 324.35(d)(3)(i) through (iii) (Method 1), multiplied by 1,250 percent or in § 324.35(d)(3)(iv) (Method 2).

(i) Method 1. 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) $EBRM_i$ equals the exposure amount for each transaction cleared through the QCCP by clearing member i, calculated in accordance with § 324.34 for OTC derivative contracts and § 324.37(c)(2) for repo-style transactions, provided that:

(1) For purposes of this section, in calculating the exposure amount the FDIC-supervised institution may replace the formula provided in § 324.34(a)(2)(ii) with the following: Anet = (0.15 x Agross) + (0.85 x NGR x Agross); and

(2) For option derivative contracts that are cleared transactions, the PFE described in § 324.34(a)(1)(ii) must be adjusted by multiplying the notional principal amount of the derivative contract by the appropriate conversion factor in Table 1 to § 324.34 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.

(3) For repo-style transactions, when applying § 324.37(c)(2), the FDIC-supervised institution must use the methodology in § 324.37(c)(3);

(B) VM_i equals 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 has actually received from clearing member i;

(C) IM_i equals the collateral posted as initial margin by clearing member i to the QCCP;

(D) DF_i equals 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;

(E) RW equals 20 percent, except when the FDIC has determined that a higher risk weight is more appropriate based on the specific characteristics of the QCCP and its clearing members; and

(F) Where a QCCP has provided its K_{CCP}, an FDIC-supervised institution must rely on such disclosed figure instead of calculating K_{CCP} under this paragraph, unless the FDIC-supervised institution determines that a more conservative figure is appropriate based on the nature, structure, or characteristics of the QCCP.

(ii) For an FDIC-supervised institution 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 § 324.34(a)(2)(ii) and for repo-style transactions, A_{Net} means the exposure amount as defined in § 324.37(c)(2) using the methodology in § 324.37(c)(3);

(B) N equals the number of clearing members in the QCCP;

(C) DF_{CCP} equals 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} equals 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 1.6 percent and 0.16 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 an FDIC-supervised institution 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 equals the FDIC-supervised institution's unfunded commitment to the default fund;

(2) DF_{CM} equals the total of all clearing members' unfunded commitment to the default fund; and

(3) K^*_{CM} as defined in paragraph (d)(3)(ii) of this section.

(B) For an FDIC-supervised institution 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 paragraph (d)(3)(iii) of this section, K_{CM} equals:

$$K_{CM_i} = \frac{IM_i}{IM_{CM}} \cdot K^*_{CM}$$

Where

(1) IM_i = the FDIC-supervised institution's initial margin posted to the QCCP;

(2) IM_{CM} equals the total of initial margin posted to the QCCP; and

(3) K^*_{CM} as defined in paragraph (d)(3)(ii) of this section.

(iv) Method 2. A clearing member FDIC-supervised institution's risk-weighted asset amount for its default fund contribution to a QCCP, RWA_{DF}, equals:

$$RWA_{DF} = \text{Min}\ \{12.5 * DF; (0.18 * TE\}$$

Where

(1) TE equals the FDIC-supervised institution's trade exposure amount to the QCCP, calculated according to § 324.35(c)(2);

(2) DF equals the funded portion of the FDIC-supervised institution's default fund contribution to the QCCP.

(4) Total risk-weighted assets for default fund contributions. Total risk-weighted assets for default fund contributions is the sum of a clearing member FDIC-supervised institution's risk-weighted assets for all of its default fund contributions to all CCPs of which the FDIC-supervised institution is a clearing member.

§ 324.36 Guarantees and credit derivatives: substitution treatment.

(a) Scope. (1) General. An FDIC-supervised institution 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 FDIC-supervised institution 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 §§ 324.41 through 324.45.

(4) If multiple eligible guarantees or eligible credit derivatives cover a single exposure described in this section, an FDIC-supervised institution 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 paragraph (c) of this section.

(5) If a single eligible guarantee or eligible credit derivative covers multiple hedged exposures described in paragraph (a)(2) of this section, an FDIC-supervised institution 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 paragraph (c) of this section.

(b) Rules of recognition. (1) An FDIC-supervised institution may only recognize the credit risk mitigation benefits of eligible guarantees and eligible credit derivatives.

(2) An FDIC-supervised institution 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 paragraphs (a) and (b) of this section and the protection amount (P) of the guarantee or credit derivative is greater than or equal to the exposure amount of the hedged exposure, an FDIC-supervised institution 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 § 324.32 for the risk weight assigned to the exposure.

(2) Partial coverage. If an eligible guarantee or eligible credit derivative meets the conditions in §§ 324.36(a) and 324.36(b) and the protection amount (P) of the guarantee or credit derivative is less than the exposure amount of the hedged exposure, the FDIC-supervised institution 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 FDIC-supervised institution may calculate the risk-weighted asset amount for the protected exposure under § 324.32, where the applicable risk weight is the risk weight applicable to the guarantor or credit derivative protection provider.

(ii) The FDIC-supervised institution must calculate the risk-weighted asset amount for the unprotected exposure under § 324.32, where the applicable risk weight is that of the unprotected portion of the hedged exposure.

(iii) 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 paragraphs (d), (e), or (f) of this section.

(d) Maturity mismatch adjustment. (1) An FDIC-supervised institution 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 FDIC-supervised institution (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 FDIC-supervised institution (protection purchaser), but the terms of the arrangement at origination of the credit risk mitigant contain a positive incentive for the FDIC-supervised institution 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 FDIC-supervised institution 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 equals effective notional amount of the credit risk mitigant, adjusted for maturity mismatch;

(ii) E equals effective notional amount of the credit risk mitigant;

(iii) t equals the lesser of T or the residual maturity of the credit risk mitigant, expressed in years; and

(iv) T equals 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 an FDIC-supervised institution 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 FDIC-supervised institution must apply the following adjustment to reduce the effective notional amount of the credit derivative: $Pr = Pm \times 0.60$, where:

(1) Pr equals effective notional amount of the credit risk mitigant, adjusted for lack of restructuring event (and maturity mismatch, if applicable); and

(2) Pm equals effective notional amount of the credit risk mitigant (adjusted for maturity mismatch, if applicable).

(f) Currency mismatch adjustment. (1) If an FDIC-supervised institution 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 FDIC-supervised institution must apply the following formula to the effective notional amount of the guarantee or credit derivative: Pc = Pr x (1-H_{FX}), where:

(i) Pc equals effective notional amount of the credit risk mitigant, adjusted for currency mismatch (and maturity mismatch and lack of restructuring event, if applicable);

(ii) Pr equals effective notional amount of the credit risk mitigant (adjusted for maturity mismatch and lack of restructuring event, if applicable); and

(iii) H_{FX} equals haircut appropriate for the currency mismatch between the credit risk mitigant and the hedged exposure.

(2) An FDIC-supervised institution 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. An FDIC-supervised institution 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 § 324.37(c)(4).

(3) An FDIC-supervised institution must adjust H_{FX} calculated in paragraph (f)(2) of this section upward if the FDIC-supervised institution revalues the guarantee or credit derivative less frequently than once every 10 business days using the following square root of time formula:

$H_{FX} = 8\%\sqrt{\frac{T_M}{10}}$, where T_M equals the greater of 10 or the number of days between revaluation.

§ 324.37 Collateralized transactions.

(a) General. (1) To recognize the risk-mitigating effects of financial collateral, an FDIC-supervised institution may use:

(i) The simple approach in paragraph (b) of this section for any exposure; or

(ii) The collateral haircut approach in paragraph (c) of this section for repo-style transactions, eligible margin loans, collateralized derivative contracts, and single-product netting sets of such transactions.

(2) An FDIC-supervised institution 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) An FDIC-supervised institution may recognize the credit risk mitigation benefits of financial collateral that secures any exposure.

(ii) To qualify for the simple approach, the financial 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) An FDIC-supervised institution may apply a risk weight to the portion of an exposure that is secured by the fair value of financial collateral (that meets the requirements of paragraph (b)(1) of this section) based on the risk weight assigned to the collateral under § 324.32. For repurchase agreements, reverse repurchase agreements, and securities lending and borrowing transactions, the collateral is the instruments, gold, and cash the FDIC-supervised institution has borrowed, purchased subject to resale, or taken as collateral from the counterparty under the transaction. Except as provided in paragraph (b)(3) of this

section, the risk weight assigned to the collateralized portion of the exposure may not be less than 20 percent.

(ii) An FDIC-supervised institution must apply a risk weight to the unsecured portion of the exposure based on the risk weight applicable to the exposure under this subpart.

(3) Exceptions to the 20 percent risk-weight floor and other requirements. Notwithstanding paragraph (b)(2)(i) of this section:

(i) An FDIC-supervised institution 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) An FDIC-supervised institution 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 § 324.32.

(iii) An FDIC-supervised institution 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 § 324.32, and the FDIC-supervised institution has discounted the fair value of the collateral by 20 percent.

(c) Collateral haircut approach. (1) General. An FDIC-supervised institution 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

FDIC-supervised institution's VaR-based measure under subpart F of this part by using the collateral haircut approach in this section. An FDIC-supervised institution may use the standard supervisory haircuts in paragraph (c)(3) of this section or, with prior written approval of the FDIC, its own estimates of haircuts according to paragraph (c)(4) of this section.

(2) Exposure amount equation. An FDIC-supervised institution 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 fair values of all instruments, gold, and cash the FDIC-supervised institution 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 §§ 324.34 (c) or (d).

(ii) $\sum C$ equals the value of the collateral (the sum of the current fair values of all instruments, gold and cash the FDIC-supervised institution 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 fair values of the instrument or gold the FDIC-supervised institution has lent, sold subject to repurchase, or posted as collateral to the counterparty minus the sum of the current fair values of that same instrument

or gold the FDIC-supervised institution 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 fair values of any instruments or cash in the currency the FDIC-supervised institution has lent, sold subject to repurchase, or posted as collateral to the counterparty minus the sum of the current fair values of any instruments or cash in the currency the FDIC-supervised institution 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) An FDIC-supervised institution must use the haircuts for market price volatility (Hs) provided in Table 1 to § 324.37, as adjusted in certain circumstances in accordance with the requirements of paragraphs (c)(3)(iii) and (iv) of this section.

TABLE 1 TO § 324.37 – STANDARD SUPERVISORY MARKET PRICE VOLATILITY HAIRCUTS[1]

Residual maturity	**Haircut (in percent) assigned based on:**						**Investment grade securitization exposures (in percent)**
	Sovereign issuers risk weight under § 324.32 (in percent)[2]			**Non-sovereign issuers risk weight under § 324.32 (in percent)**			
	Zero	20 or 50	100	20			
Less than or equal to 1 year	0.5	1.0	15.0	1.0	2.0	4.0	4.0
Greater than 1 year and less than or equal to 5 years	2.0	3.0	15.0	4.0	6.0	8.0	12.0
Greater than 5 years	4.0	6.0	15.0	8.0	12.0	16.0	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				Zero			
Other exposure types				25.0			

[1] The market price volatility haircuts in Table 1 to § 324.37 are based on a 10 business-day holding period.

[2] Includes a foreign PSE that receives a zero percent risk weight.

(ii) For currency mismatches, an FDIC-supervised institution must use a haircut for foreign exchange rate volatility (Hfx) of 8.0 percent, as adjusted in certain circumstances under paragraphs (c)(3)(iii) and (iv) of this section.

(iii) For repo-style transactions, an FDIC-supervised institution may multiply the standard supervisory haircuts provided in paragraphs (c)(3)(i) and (ii) of this section 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, an FDIC-supervised institution must adjust the supervisory haircuts provided in paragraphs (c)(3)(i) and (ii) of this section 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 § 324.35. If a netting set contains one or more trades involving illiquid collateral or an OTC derivative that cannot be easily replaced, an FDIC-supervised institution 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 FDIC-supervised institution 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. An FDIC-supervised institution 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 an FDIC-supervised institution has lent, sold subject to repurchase, or posted as collateral does not meet the definition of financial collateral, the FDIC-supervised institution 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 FDIC, an FDIC-supervised institution may calculate haircuts (Hs and Hfx) using its own internal estimates of the volatilities of market prices and foreign exchange rates:

(i) To receive FDIC approval to use its own internal estimates, an FDIC-supervised institution must satisfy the following minimum standards:

(A) An FDIC-supervised institution must use a 99th 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 paragraph (c)(4)(i)(C) of this section applies. When an FDIC-supervised institution 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:

$$H_M = H_N \sqrt{\frac{T_M}{T_N}}$$, 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 FDIC-supervised institution 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, an FDIC-supervised institution 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 § 324.35. If a netting set contains one or more trades involving illiquid collateral or an OTC derivative that cannot be easily replaced, an FDIC-supervised institution 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 FDIC-supervised institution 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) An FDIC-supervised institution 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) An FDIC-supervised institution must have policies and procedures that describe how it determines the period of significant financial stress used to calculate the FDIC-supervised institution's own internal estimates for haircuts under this section and must be able to provide empirical support for the period used. The FDIC-supervised institution must obtain the prior approval of the FDIC for, and notify the FDIC if the FDIC-supervised institution makes any material changes to, these policies and procedures.

(F) Nothing in this section prevents the FDIC from requiring an FDIC-supervised institution to use a different period of significant financial stress in the calculation of own internal estimates for haircuts.

(G) An FDIC-supervised institution 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, an FDIC-supervised institution may calculate haircuts for categories of securities. For a category of securities, the FDIC-supervised institution 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 FDIC-supervised institution has lent, sold subject to repurchase, posted as collateral, borrowed, purchased subject to resale, or taken as collateral. In determining relevant categories, the FDIC-supervised institution 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, an FDIC-supervised institution 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 FDIC-supervised institution 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) An FDIC-supervised institution'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

§ 324.38 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) 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 an FDIC-supervised institution 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 FDIC-supervised institution 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 § 324.34).

(c) System-wide failures. In the case of a system-wide failure of a settlement, clearing system or central counterparty, the FDIC 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. An FDIC-supervised institution must hold risk-based capital against any DvP or PvP transaction with a normal settlement period if the FDIC-supervised institution's counterparty has not made delivery or payment within five business days after the settlement date. The FDIC-supervised institution must determine its risk-weighted asset amount for such a transaction by multiplying the positive current exposure of the transaction for the FDIC-supervised institution by the appropriate risk weight in Table 1 to § 324.38.

TABLE 1 TO § 324.38– 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) An FDIC-supervised institution must hold risk-based capital against any non-DvP/non-PvP transaction with a normal settlement period if the FDIC-supervised institution 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 FDIC-supervised institution must continue to hold risk-based capital against the transaction until the FDIC-supervised institution has received its corresponding deliverables.

(2) From the business day after the FDIC-supervised institution has made its delivery until five business days after the counterparty delivery is due, the FDIC-supervised institution must calculate the risk-weighted asset amount for the transaction by treating the current fair value of the deliverables owed to the FDIC-supervised institution as an exposure to the counterparty and using the applicable counterparty risk weight under § 324.32.

(3) If the FDIC-supervised institution has not received its deliverables by the fifth business day after counterparty delivery was due, the FDIC-supervised institution must assign a 1,250 percent risk weight to the current fair value of the deliverables owed to the FDIC-supervised institution.

(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

§ 324.41 Operational requirements for securitization exposures.

(a) Operational criteria for traditional securitizations. An FDIC-supervised institution 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 is satisfied. An FDIC-supervised institution that meets these conditions must hold risk-based capital against any credit risk it retains in connection with the securitization. An FDIC-supervised institution 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 FDIC-supervised institution's consolidated balance sheet under GAAP;

(2) The FDIC-supervised institution has transferred to one or more 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) Contain an early amortization provision.

(b) Operational criteria for synthetic securitizations. For synthetic securitizations, an FDIC-supervised institution 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. An FDIC-supervised institution that meets these conditions must hold risk-based capital against any

credit risk of the exposures it retains in connection with the synthetic securitization. An FDIC-supervised institution 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:

(i) Financial collateral;

(ii) A guarantee that meets all criteria as set forth in the definition of "eligible guarantee" in § 324.2, except for the criteria in paragraph (3) of that definition; or

(iii) A credit derivative that meets all criteria as set forth in the definition of "eligible credit derivative" in § 324.2, except for the criteria in paragraph (3) of the definition of "eligible guarantee" in § 324.2.

(2) The FDIC-supervised institution 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 FDIC-supervised institution to alter or replace the underlying exposures to improve the credit quality of the underlying exposures;

(iii) Increase the FDIC-supervised institution'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 FDIC-supervised institution 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 FDIC-supervised institution after the inception of the securitization;

(3) The FDIC-supervised institution 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 § 324.42(h), if an FDIC-supervised institution is unable to demonstrate to the satisfaction of the FDIC a comprehensive understanding of the features of a securitization exposure that would materially affect the performance of the exposure, the FDIC-supervised institution must assign the securitization exposure a risk weight of 1,250 percent. The FDIC-supervised institution's analysis must be commensurate with the complexity of the securitization exposure and the materiality of the exposure in relation to its capital.

(2) An FDIC-supervised institution must demonstrate its comprehensive understanding of a securitization exposure under paragraph (c)(1) of this section, for each securitization exposure by:

(i) Conducting an analysis of the risk characteristics of a securitization exposure prior to acquiring the exposure, and documenting 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, fair 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) 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; and

(ii) On an on-going basis (no less frequently than quarterly), evaluating, reviewing, and updating as appropriate the analysis required under paragraph (c)(1) of this section for each securitization exposure.

§ 324.42 Risk-weighted assets for securitization exposures.

(a) Securitization risk weight approaches. Except as provided elsewhere in this section or in § 324.41:

(1) An FDIC-supervised institution must deduct from common equity tier 1 capital 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 paragraph (a)(1) of this section, an FDIC-supervised institution may assign a risk weight to the securitization exposure using the simplified supervisory formula approach (SSFA) in accordance with §§ 324.43(a)

through 324.43(d) and subject to the limitation under § 324.42(e). Alternatively, an FDIC-supervised institution that is not subject to subpart F of this part may assign a risk weight to the securitization exposure using the gross-up approach in accordance with § 324.43(e), provided, however, that such FDIC-supervised institution must apply either the SSFA or the gross-up approach consistently across all of its securitization exposures, except as provided in paragraphs (a)(1), (a)(3), and (a)(4) of this section.

(3) If a securitization exposure does not require deduction under paragraph (a)(1) of this section and the FDIC-supervised institution cannot, or chooses not to apply the SSFA or the gross-up approach to the exposure, the FDIC-supervised institution must assign a risk weight to the exposure as described in § 324.44.

(4) If a securitization exposure is a derivative contract (other than protection provided by an FDIC-supervised institution in the form of 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), an FDIC-supervised institution may choose to set the risk-weighted asset amount of the exposure equal to the amount of the exposure as determined in paragraph (c) of this section.

(b) Total risk-weighted assets for securitization exposures. An FDIC-supervised institution's total risk-weighted assets for securitization exposures equals the sum of the risk-weighted asset amount for securitization exposures that the FDIC-supervised institution risk weights under §§ 324.41(c), 324.42(a)(1), and 324.43, 324.44, or 324.45, and paragraphs (e) through (j) of this section, as applicable.

(c) Exposure amount of a securitization exposure. (1) On-balance sheet securitization exposures. The exposure amount of an on-balance sheet securitization exposure (excluding an

available-for-sale or held-to-maturity security where the FDIC-supervised institution has made an AOCI opt-out election under § 324.22(b)(2), a repo-style transaction, eligible margin loan, OTC derivative contract, or cleared transaction) is equal to the carrying value of the exposure.

(2) On-balance sheet securitization exposures held by an FDIC-supervised institution that has made an AOCI opt-out election. The exposure amount of an on-balance sheet securitization exposure that is an available-for-sale or held-to-maturity security held by an FDIC-supervised institution that has made an AOCI opt-out election under § 324.22(b)(2) is the FDIC-supervised institution's carrying value (including net accrued but unpaid interest and fees), less any net unrealized gains on the exposure and plus any net unrealized losses on the exposure.

(3) Off-balance sheet securitization exposures. (i) Except as provided in paragraph (j) of this section, the exposure amount of an off-balance sheet securitization exposure that is not a repo-style transaction, eligible margin loan, cleared transaction (other than a credit derivative), or an OTC derivative contract (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 FDIC-supervised institution 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) An FDIC-supervised institution 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) An FDIC-supervised institution 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.

(4) 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 § 324.34 or § 324.37, as applicable.

(d) Overlapping exposures. If an FDIC-supervised institution has multiple securitization exposures that provide duplicative coverage to the underlying exposures of a securitization (such as when an FDIC-supervised institution provides a program-wide credit enhancement and multiple pool-specific liquidity facilities to an ABCP program), the FDIC-supervised institution is not required to hold duplicative risk-based capital against the overlapping position. Instead, the FDIC-supervised institution 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 an FDIC-supervised institution provides support to a securitization in excess of the FDIC-supervised institution's contractual obligation to provide credit support to the securitization (implicit support):

(1) The FDIC-supervised institution 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 FDIC-supervised institution must disclose publicly:

(i) That it has provided implicit support to the securitization; and

(ii) The risk-based capital impact to the FDIC-supervised institution of providing such implicit support.

(f) Undrawn portion of a servicer cash advance facility.

(1) Notwithstanding any other provision of this subpart, an FDIC-supervised institution that is a servicer under an eligible servicer cash advance facility is not required to hold risk-based capital against potential future cash advance payments that it may be required to provide under the contract governing the facility.

(2) For an FDIC-supervised institution that acts as a servicer, the exposure amount for a servicer cash advance facility that is not an eligible servicer cash advance facility is equal to the amount of all potential future cash advance payments that the FDIC-supervised institution may be contractually required to provide during the subsequent 12 month period under the contract governing the facility.

(g) Interest-only mortgage-backed securities. Regardless of any other provision 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 provision of this subpart, an FDIC-supervised institution that has transferred small-business loans and leases on personal property (small-business obligations) with recourse 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 FDIC-supervised institution establishes and maintains, pursuant to GAAP, a non-capital reserve sufficient to meet the FDIC-supervised institution'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 section 3(a) of the Small Business Act (15 U.S.C. 632 et seq.).

(iv) The FDIC-supervised institution is well capitalized, as defined in subpart H of this part. For purposes of determining whether an FDIC-supervised institution is well capitalized for purposes of this paragraph, the FDIC-supervised institution’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 an FDIC-supervised institution on transfers of small-business obligations receiving the capital treatment specified in paragraph (h)(1) of this section cannot exceed 15 percent of the FDIC-supervised institution’s total capital.

(3) If an FDIC-supervised institution ceases to be well capitalized under subpart H of this part or exceeds the 15 percent capital limitation provided in paragraph (h)(2) of this section, the capital treatment under paragraph (h)(1) of this section will continue to apply to any transfers of small-business obligations with retained contractual exposure that occurred during the time that the FDIC-supervised institution was well capitalized and did not exceed the capital limit.

(4) The risk-based capital ratios of the FDIC-supervised institution must be calculated without regard to the capital treatment for transfers of small-business obligations specified in paragraph (h)(1) of this section for purposes of:

(i) Determining whether an FDIC-supervised institution is adequately capitalized, undercapitalized, significantly undercapitalized, or critically undercapitalized under subpart H of this part; and

(ii) Reclassifying a well-capitalized FDIC-supervised institution to adequately capitalized and requiring an adequately capitalized FDIC-supervised institution to comply with certain mandatory or discretionary supervisory actions as if the FDIC-supervised institution were in the next lower prompt-corrective-action category.

(i) N^{th}-to-default credit derivatives. (1) Protection provider. An FDIC-supervised institution may assign a risk weight using the SSFA in § 324.43 to an nth-to-default credit derivative in accordance with this paragraph. An FDIC-supervised institution must determine its exposure in the nth-to-default credit derivative as the largest notional 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 FDIC-supervised institution 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 FDIC-supervised institution's exposure to the total notional amount of all underlying exposures. The ratio is expressed as a decimal value between zero and one. In the case of a first-to-default credit derivative, there are no underlying exposures that are subordinated to the FDIC-supervised institution'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 FDIC-supervised institution's exposure.

(ii) The detachment point (parameter D) equals the sum of parameter A plus the ratio of the notional amount of the FDIC-supervised institution's exposure in the nth-to-default credit derivative to the total notional amount of all underlying exposures. The ratio is expressed as a decimal value between zero and one.

(3) An FDIC-supervised institution 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. An FDIC-supervised institution that obtains credit protection on a group of underlying exposures through a first-to-default credit derivative that meets the rules of recognition of § 324.36(b) must determine its risk-based capital requirement for the underlying exposures as if the FDIC-supervised institution synthetically securitized the underlying exposure with the smallest risk-weighted asset amount and had obtained no credit risk mitigant on the other underlying exposures. An FDIC-supervised institution must calculate a risk-based capital requirement for counterparty credit risk according to § 324.34 for a first-to-default credit derivative that does not meet the rules of recognition of § 324.36(b).

(ii) Second-or-subsequent-to-default credit derivatives. (A) An FDIC-supervised institution that obtains credit protection on a group of underlying exposures through a nth-to-default credit derivative that meets the rules of recognition of § 324.36(b) (other than a first-to-default credit derivative) may recognize the credit risk mitigation benefits of the derivative only if:

(1) The FDIC-supervised institution 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 an FDIC-supervised institution satisfies the requirements of paragraph (i)(4)(ii)(A) of this section, the FDIC-supervised institution must determine its risk-based capital requirement for the underlying exposures as if the FDIC-supervised institution had only synthetically securitized the underlying exposure with the nth smallest risk-weighted asset amount and had obtained no credit risk mitigant on the other underlying exposures.

(C) An FDIC-supervised institution must calculate a risk-based capital requirement for counterparty credit risk according to § 324.34 for a nth-to-default credit derivative that does not meet the rules of recognition of § 324.36(b).

(j) Guarantees and credit derivatives other than n^{th}-to-default credit derivatives. (1) Protection provider. (i) For a guarantee or credit derivative (other than an nth-to-default credit derivative) provided by an FDIC-supervised institution that covers the full amount or a pro rata share of a securitization exposure's principal and interest, the FDIC-supervised institution 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) An FDIC-supervised institution that purchases a guarantee or OTC credit derivative (other than an nth-to-default credit derivative) that is recognized under § 324.45 as a credit risk mitigant (including via collateral recognized under § 324.37) is not required to compute a separate counterparty credit risk capital requirement under § 324.31, in accordance with § 324.34(c).

(ii) If an FDIC-supervised institution cannot, or chooses not to, recognize a purchased credit derivative as a credit risk mitigant under § 324.45, the FDIC-supervised institution must determine the exposure amount of the credit derivative under § 324.34.

(A) If the FDIC-supervised institution purchases credit protection from a counterparty that is not a securitization SPE, the FDIC-supervised institution must determine the risk weight for the exposure according to general risk weights under § 324.32.

(B) If the FDIC-supervised institution purchases the credit protection from a counterparty that is a securitization SPE, the FDIC-supervised institution must determine the risk weight for the exposure according to section § 324.42, including § 324.42(a)(4) for a credit derivative that has a first priority claim on the cash flows from the underlying exposures of the securitization SPE (notwithstanding amounts due under interest rate or currency derivative contracts, fees due, or other similar payments).

§ 324.43 Simplified supervisory formula approach (SSFA) and the gross-up approach.

(a) General requirements for the SSFA. To use the SSFA to determine the risk weight for a securitization exposure, an FDIC-supervised institution 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; if the contracts governing the underlying exposures of the securitization require payments on a monthly or quarterly basis, the data used to assign the parameters described in paragraph (b) of this section must be no more than 91 calendar days old. An FDIC-supervised institution that does not have the appropriate data to assign the parameters described in paragraph (b) of this section 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, an FDIC-supervised institution 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 one (that is, an average risk weight of 100 percent represents a value of K_G equal to 0.08).

(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 of the securitization that meet any of the criteria as set forth in paragraphs (b)(2)(i) through (vi) of this section to the 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 payments for 90 days or more, other than principal or interest payments deferred on:

(A) Federally-guaranteed student loans, in accordance with the terms of those guarantee programs; or

(B) Consumer loans, including non-federally-guaranteed student loans, provided that such payments are deferred pursuant to provisions included in the contract at the time funds are disbursed that provide for period(s) of deferral that are not initiated based on changes in the creditworthiness of the borrower; 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. Except as provided in § 324.42(i)

for n^{th}-to-default credit derivatives, parameter A equals the ratio of the current dollar amount of underlying exposures that are subordinated to the exposure of the FDIC-supervised institution 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 FDIC-supervised institution'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. Except as provided in § 324.42(i) for n^{th}-to-default credit derivatives, 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 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 a securitization exposure, as appropriate, is the larger of the risk weight determined in accordance with this paragraph or 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 FDIC-supervised institution 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. 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:

$$RW = \left[\left(\frac{K_A - A}{D - A}\right) \cdot 1{,}250\ percent\right] + \left[\left(\frac{D - K_A}{D - A}\right) \cdot 1{,}250\ percent \cdot K_{SSFA}\right]$$

(d) <u>SSFA equation</u>. (1) The FDIC-supervised institution must define the following parameters:

$$K_A = (1 - W) \cdot K_G + (0.5 \cdot W)$$

$$a = -\frac{1}{p \cdot K_A}$$

$$u = D - K_A$$

$$l = max\ (A - K_A, 0)$$

$e = 2.71828$, the base of the natural logarithms.

(2) Then the FDIC-supervised institution 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. An FDIC-supervised institution that is not subject to subpart F of this part 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 to all of its securitization exposures, except as otherwise provided for certain securitization exposures in § 324.44 and 324.45.

(2) To use the gross-up approach, an FDIC-supervised institution must calculate the following four inputs:

(i) Pro rata share, which is the par value of the FDIC-supervised institution'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 par value of tranches that are more senior to the tranche in which the FDIC-supervised institution's securitization resides;

(iii) Exposure amount of the FDIC-supervised institution's securitization exposure calculated under § 324.42(c); and

(iv) Risk weight, which is the weighted-average risk weight of underlying exposures of the securitization as calculated under this subpart.

(3) Credit equivalent amount. The credit equivalent amount of a securitization exposure under this section equals the sum of:

(i) the exposure amount of the FDIC-supervised institution's securitization exposure and

(ii) the pro rata share multiplied by the enhanced amount, each calculated in accordance with paragraph (e)(2) of this section.

(4) Risk-weighted assets. To calculate risk-weighted assets for a securitization exposure under the gross-up approach, an FDIC-supervised institution must apply the risk weight required under paragraph (e)(2) of this section to the credit equivalent amount calculated in paragraph (e)(3) of this section.

(f) Limitations. Notwithstanding any other provision of this section, an FDIC-supervised institution must assign a risk weight of not less than 20 percent to a securitization exposure.

§ 324.44 Securitization exposures to which the SSFA and gross-up approach do not apply.

(a) General Requirement. An FDIC-supervised institution must assign a 1,250 percent risk weight to all securitization exposures to which the FDIC-supervised institution does not apply the SSFA or the gross-up approach under § 324.43, except as set forth in this section.

(b) Eligible ABCP liquidity facilities. An FDIC-supervised institution 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. An FDIC-supervised institution 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 paragraph (c)(2) of this section 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 FDIC-supervised institution holding the exposure must not retain or provide protection to the first loss position.

§ 324.45 Recognition of credit risk mitigants for securitization exposures.

(a) General. (1) An originating FDIC-supervised institution that has obtained a credit risk mitigant to hedge its exposure to a synthetic or traditional securitization that satisfies the operational criteria provided in § 324.41 may recognize the credit risk mitigant under §§ 324.36 or 324.37, but only as provided in this section.

(2) An investing FDIC-supervised institution that has obtained a credit risk mitigant to hedge a securitization exposure may recognize the credit risk mitigant under §§ 324.36 or 324.37, but only as provided in this section.

(b) Mismatches. An FDIC-supervised institution must make any applicable adjustment to the protection amount of an eligible guarantee or credit derivative as required in §§ 324.36(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 FDIC-supervised institution 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

§ 324.51 Introduction and exposure measurement.

(a) General. (1) To calculate its risk-weighted asset amounts for equity exposures that are not equity exposures to an investment fund, an FDIC-supervised institution must use the Simple Risk-Weight Approach (SRWA) provided in § 324.52. An FDIC-supervised institution must use the look-through approaches provided in § 324.53 to calculate its risk-weighted asset amounts for equity exposures to investment funds.

(2) An FDIC-supervised institution must treat an investment in a separate account (as defined in § 324.2) as if it were an equity exposure to an investment fund as provided in § 324.53.

(3) Stable value protection. (i) Stable value protection means a contract where the provider of the contract is obligated to pay:

(A) The policy owner of a separate account an amount equal to the shortfall between the fair value and cost basis of the separate account when the policy owner of the separate account surrenders the policy, or

(B) The beneficiary of the contract an amount equal to the shortfall between the fair value and book value of a specified portfolio of assets.

(ii) An FDIC-supervised institution that purchases stable value protection on its investment in a separate account must treat the portion of the carrying value of its investment in the separate account attributable to the stable value protection as an exposure to the provider of the protection and the remaining portion of the carrying value of its separate account as an equity exposure to an investment fund.

(iii) An FDIC-supervised institution that provides stable value protection must treat the exposure as an equity derivative according to § 324.51(b)(3).

(b) Adjusted carrying value. For purposes of §§ 324.51 through 324.53, the adjusted carrying value of an equity exposure is:

(1) For the on-balance sheet component of an equity exposure (other than an equity exposure that is classified as available-for-sale where the FDIC-supervised institution has made an AOCI opt-out election under § 324.22(b)(2)), the FDIC-supervised institution's carrying value of the exposure;

(2) For the on-balance sheet component of an equity exposure that is classified as available-for-sale where the FDIC-supervised institution has made an AOCI opt-out election under § 324.22(b)(2), the FDIC-supervised institution's carrying value of the exposure less any net unrealized gains on the exposure that are reflected in such carrying value but excluded from the FDIC-supervised institution's regulatory capital components;

(3) 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 paragraph (b)(1) of this section; and

(4) 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.

§ 324.52 Simple risk-weight approach (SRWA).

(a) General. Under the SRWA, an FDIC-supervised institution's total risk-weighted assets for equity exposures equals the sum of the risk-weighted asset amounts for each of the FDIC-supervised institution'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 FDIC-supervised institution's individual equity exposures to an investment fund as determined under § 324.53.

(b) SRWA computation for individual equity exposures. An FDIC-supervised institution 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 paragraph (c) of this section) 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 § 324.32 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 equity exposures set forth in this subparagraph (b)(3) must be 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 significant investments in the capital of an unconsolidated financial institution in the form of common stock and 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 in § 324.2 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 FDIC-supervised institution's total capital.

(A) To compute the aggregate adjusted carrying value of an FDIC-supervised institution's equity exposures for purposes of this section, the FDIC-supervised institution may exclude equity exposures described in paragraphs (b)(1), (b)(2), (b)(3)(i), and (b)(3)(ii) of this section, 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 paragraph (b)(3)(i) of this section. If an FDIC-supervised institution does not know the actual holdings of the investment fund, the FDIC-supervised institution 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 FDIC-supervised institution 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 an FDIC-supervised institution's equity exposures qualify for a 100 percent risk weight under this paragraph, an FDIC-supervised institution 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 in the form of common stock that are not deducted from capital pursuant to § 324.22(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 paragraph (b)(7) of this section 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 paragraph (b)(7) of this section) 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 FDIC-supervised institution acquires at least one of the equity exposures); the documentation specifies the measure of effectiveness (E) the FDIC-supervised institution 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. An FDIC-supervised institution must measure E at least quarterly and must use one of three alternative measures of E as set forth in this paragraph (c).

(i) Under the dollar-offset method of measuring effectiveness, the FDIC-supervised institution 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.

§ 324.53 Equity exposures to investment funds.

(a) Available approaches. (1) Unless the exposure meets the requirements for a community development equity exposure under § 324.52(b)(3)(i), an FDIC-supervised institution must determine the risk-weighted asset amount of an equity exposure to an investment fund under the full look-through approach described in paragraph (b) of this section, the simple modified look-through approach described in paragraph (c) of this section, or the alterative modified look-through approach described paragraph (d) of this section, provided, however, that

the minimum risk weight that may be assigned to an equity exposure under this section is 20 percent.

(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 § 324.52(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 FDIC-supervised institution does not use the full look-through approach, the FDIC-supervised institution must use the ineffective portion of the hedge pair as determined under § 324.52(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. An FDIC-supervised institution 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 the adjusted carrying value of each exposure were held directly by the FDIC-supervised institution) may set the risk-weighted asset amount of the FDIC-supervised institution'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 FDIC-supervised institution; and

(2) The FDIC-supervised institution'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 an FDIC-supervised institution'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, an FDIC-supervised institution 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 FDIC-supervised institution'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 FDIC-supervised institution 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 FDIC-supervised institution must use the highest applicable risk weight. An FDIC-supervised institution 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

§ 324.61 Purpose and scope.

(a) Sections 324.61- 324.63 of this subpart establish public disclosure requirements related to the capital requirements described in subpart B of this part for an FDIC-supervised institution with total consolidated assets of $50 billion or more as reported on the FDIC-supervised institution's most recent year-end Call Report that is not an advanced approaches FDIC-supervised institution making public disclosures pursuant to § 324.172. An advanced approaches FDIC-supervised institution that has not received approval from the FDIC to exit parallel run pursuant to section 121(d) of subpart E is subject to the disclosure requirements described in §§ 324.62 and 324_.63. Such an FDIC-supervised institution must comply with § 324.62 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 FDIC-supervised institution's total consolidated assets in the four most recent quarters as reported on the Call Report; or the average of the FDIC-supervised institution's total consolidated assets in the most recent consecutive quarters as reported quarterly on the FDIC-supervised institution's Call Report if the FDIC-supervised institution has not filed such a report for each of the most recent four quarters.

§ 324.62 Disclosure requirements.

(a) An FDIC-supervised institution described in § 324.61 must provide timely public disclosures each calendar quarter of the information in the applicable tables in § 324.63. If a significant change occurs, such that the most recent reported amounts are no longer reflective of the FDIC-supervised institution'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 FDIC-supervised institution's risk management objectives and policies, reporting system, and definitions) may be disclosed annually after the end of the fourth calendar quarter, provided that any significant changes are disclosed in the interim. The FDIC-supervised institution's management may provide all of the disclosures required by §§ 324.61 through 324.63 in one place on the FDIC-supervised institution's public website or may provide the disclosures in more than one public financial report or other regulatory reports, provided that the FDIC-supervised institution publicly provides a summary table specifically indicating the location(s) of all such disclosures.

(b) An FDIC-supervised institution described in § 324.61 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 FDIC-supervised institution must attest that the disclosures meet the requirements of this subpart.

(c) If an FDIC-supervised institution described in § 324.61 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 FDIC under the Freedom of Information Act (5 U.S.C. 552), then the FDIC-supervised institution 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.

§ 324.63 Disclosures by FDIC-supervised institutions described in § 324.61.

(a) Except as provided in § 324.62, an FDIC-supervised institution described in § 324.61 must make the disclosures described in Tables 1 through 10 of this section. The FDIC-supervised institution 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 of this part.

(b) An FDIC-supervised institution 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 1 TO § 324.63 – 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[1] for accounting and regulatory purposes, with a description of those entities: (1) That are fully consolidated; (2) That are deconsolidated and deducted from total capital; (3) For which the total capital requirement is deducted; and (4) 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.

[1] Entities include securities, insurance and other financial subsidiaries, commercial subsidiaries (where permitted), and significant minority equity investments in insurance, financial and commercial entities.

TABLE 2 TO § 324.63 – 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: (1) Common stock and related surplus; (2) Retained earnings; (3) Common equity minority interest; (4) AOCI; and (5) Regulatory adjustments and deductions made to common equity tier 1 capital.
	(c)	The amount of tier 1 capital, with separate disclosure of: (1) 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 (2) Regulatory adjustments and deductions made to tier 1 capital.
	(d)	The amount of total capital, with separate disclosure of: (1) Tier 2 capital elements, including tier 2 capital instruments and total capital minority interest not included in tier 1 capital; and (2) Regulatory adjustments and deductions made to total capital.

TABLE 3 TO § 324.63– CAPITAL ADEQUACY

Qualitative disclosures	(a)	A summary discussion of the FDIC-supervised institution's approach to assessing the adequacy of its capital to support current and future activities.
Quantitative disclosures	(b)	Risk-weighted assets for: (1) Exposures to sovereign entities; (2) Exposures to certain supranational entities and MDBs; (3) Exposures to depository institutions, foreign banks, and credit unions; (4) Exposures to PSEs; (5) Corporate exposures; (6) Residential mortgage exposures; (7) Statutory multifamily mortgages and pre-sold construction loans; (8) HVCRE loans; (9) Past due loans; (10) Other assets; (11) Cleared transactions; (12) Default fund contributions; (13) Unsettled transactions; (14) Securitization exposures; and (15) Equity exposures.

	(c)	Standardized market risk-weighted assets as calculated under subpart F of this part.
	(d)	Common equity tier 1, tier 1 and total risk-based capital ratios: (1) For the top consolidated group; and (2) For each depository institution subsidiary.
	(e)	Total standardized risk-weighted assets.

TABLE 4 TO § 324.63– CAPITAL CONSERVATION BUFFER

Quantitative Disclosures	(a)	At least quarterly, the FDIC-supervised institution must calculate and publicly disclose the capital conservation buffer as described under § 324.11.
	(b)	At least quarterly, the FDIC-supervised institution must calculate and publicly disclose the eligible retained income of the FDIC-supervised institution, as described under § 324.11.
	(c)	At least quarterly, the FDIC-supervised institution must calculate and publicly disclose any limitations it has on distributions and discretionary bonus payments resulting from the capital conservation buffer framework described under § 324.11, including the maximum payout amount for the quarter.

General qualitative disclosure requirement

For each separate risk area described in Tables 5 through 10, the FDIC-supervised institution 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.

TABLE 5 TO § 324.63[1] – 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 6 to § 324.63), including the: (1) Policy for determining past due or delinquency status; (2) Policy for placing loans on nonaccrual; (3) Policy for returning loans to accrual status; (4) Definition of and policy for identifying impaired loans (for financial accounting purposes); (5) Description of the methodology that the FDIC-supervised institution uses to estimate its allowance for loan and lease losses, including statistical methods used where applicable; (6) Policy for charging-off uncollectible amounts; and (7) Discussion of the FDIC-supervised institution's credit risk management policy.

Quantitative Disclosures	(b)	Total credit risk exposures and average credit risk exposures, after accounting offsets in accordance with GAAP, 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, FDIC-supervised institutions could use categories similar to that used for financial statement purposes. Such categories might include, for instance: (1) Loans, off-balance sheet commitments, and other non-derivative off-balance sheet exposures; (2) Debt securities; and (3) OTC derivatives.[2]
	(c)	Geographic distribution of exposures, categorized in significant areas by major types of credit exposure.[3]
	(d)	Industry or counterparty type distribution of exposures, categorized by major types of credit exposure.

	(e)	By major industry or counterparty type: (1) Amount of impaired loans for which there was a related allowance under GAAP; (2) Amount of impaired loans for which there was no related allowance under GAAP; (3) Amount of loans past due 90 days and on nonaccrual; (4) Amount of loans past due 90 days and still accruing;[4] (5) The balance in the allowance for loan and lease losses at the end of each period, disaggregated on the basis of the FDIC-supervised institution'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 (6) 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[5], further categorized as required by GAAP.
	(g)	Reconciliation of changes in ALLL.[6]
	(h)	Remaining contractual maturity delineation (for example, one year or less) of the whole portfolio, categorized by credit exposure.

[1] Table 5 to § 324.63 does not cover equity exposures, which should be reported in Table 9 to § 324.63.

[2] See, for example, ASC Topic 815-10 and 210, as they may be amended from time to time.

[3] Geographical areas may consist of individual countries, groups of countries, or regions within countries. An FDIC-supervised institution might choose to define the geographical areas based on the way the FDIC-supervised institution's portfolio is geographically managed. The criteria used to allocate the loans to geographical areas must be specified.

[4] An FDIC-supervised institution is encouraged also to provide an analysis of the aging of past-due loans.

[5] The portion of the general allowance that is not allocated to a geographical area should be disclosed separately.

[6] 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 6 TO § 324.63– 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: (1) The methodology used to assign credit limits for counterparty credit exposures; (2) Policies for securing collateral, valuing and managing collateral, and establishing credit reserves; (3) The primary types of collateral taken; and (4) The impact of the amount of collateral the FDIC-supervised institution would have to provide given a deterioration in the FDIC-supervised institution'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.[1] An FDIC-supervised institution 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.[2]
	(c)	Notional amount of purchased and sold credit derivatives, segregated between use for the FDIC-supervised institution'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.

[1] 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.

[2] 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 7 TO § 324.63– CREDIT RISK MITIGATION[1,2]

Qualitative Disclosures	(a)	The general qualitative disclosure requirement with respect to credit risk mitigation, including: (1) Policies and processes for collateral valuation and management; (2) A description of the main types of collateral taken by the FDIC-supervised institution; (3) The main types of guarantors/credit derivative counterparties and their creditworthiness; and (4) 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.

[1] At a minimum, an FDIC-supervised institution must provide the disclosures in Table 7 in relation to credit risk mitigation that has been recognized for the purposes of reducing capital requirements under this subpart. Where relevant, FDIC-supervised institutions are encouraged to give further information about mitigants that have not been recognized for that purpose.

[2] 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 8 to § 324.63).

TABLE 8 TO § 324.63– SECURITIZATION

Qualitative Disclosures	(a)	The general qualitative disclosure requirement with respect to a securitization (including synthetic securitizations), including a discussion of: (1) The FDIC-supervised institution's objectives for securitizing assets, including the extent to which these activities transfer credit risk of the underlying exposures away from the FDIC-supervised institution to other entities and including the type of risks assumed and retained with resecuritization activity;[1] (2) The nature of the risks (e.g. liquidity risk) inherent in the securitized assets; (3) The roles played by the FDIC-supervised institution in the securitization process[2] and an indication of the extent of the FDIC-supervised institution's involvement in each of them; (4) The processes in place to monitor changes in the credit and market risk of securitization exposures including how those processes differ for resecuritization exposures; (5) The FDIC-supervised institution's policy for mitigating the credit risk retained through securitization and resecuritization exposures; and (6) The risk-based capital approaches that the FDIC-supervised institution follows for its securitization exposures including the type of securitization exposure to which each approach applies.

	(b)	A list of: (1) The type of securitization SPEs that the FDIC-supervised institution, as sponsor, uses to securitize third-party exposures. The FDIC-supervised institution must indicate whether it has exposure to these SPEs, either on- or off- balance sheet; and (2) Affiliated entities: (i) That the FDIC-supervised institution manages or advises; and (ii) That invest either in the securitization exposures that the FDIC-supervised institution has securitized or in securitization SPEs that the FDIC-supervised institution sponsors.[3]
	(c)	Summary of the FDIC-supervised institution's accounting policies for securitization activities, including: (1) Whether the transactions are treated as sales or financings; (2) Recognition of gain-on-sale; (3) Methods and key assumptions applied in valuing retained or purchased interests; (4) Changes in methods and key assumptions from the previous period for valuing retained interests and impact of the changes; (5) Treatment of synthetic securitizations; (6) How exposures intended to be securitized are valued and whether they are recorded under subpart D of this part; and (7) Policies for recognizing liabilities on the balance sheet for arrangements

		that could require the FDIC-supervised institution 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 by the FDIC-supervised institution in securitizations that meet the operational criteria provided in § 324.41 (categorized into traditional and synthetic securitizations), by exposure type, separately for securitizations of third-party exposures for which the FDIC-supervised institution acts only as sponsor.[4]
	(f)	For exposures securitized by the FDIC-supervised institution in securitizations that meet the operational criteria in § 324.41: (1) Amount of securitized assets that are impaired/past due categorized by exposure type;[5] and (2) Losses recognized by the FDIC-supervised institution during the current period categorized by exposure type.[6]
	(g)	The total amount of outstanding exposures intended to be securitized categorized by exposure type.
	(h)	Aggregate amount of: (1) On-balance sheet securitization exposures retained or purchased categorized by exposure type; and (2) Off-balance sheet securitization exposures categorized by exposure type.

	(i)	(1) 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 (2) Exposures that have been deducted entirely from tier 1 capital, CEIOs deducted from total capital (as described in § 324.42(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: (1) Exposures to which credit risk mitigation is applied and those not applied; and (2) Exposures to guarantors categorized according to guarantor creditworthiness categories or guarantor name.

[1] The FDIC-supervised institution 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 FDIC-supervised institution is active.

[2] For example, these roles may include originator, investor, servicer, provider of credit enhancement, sponsor, liquidity provider, or swap provider.

[3] Such affiliated entities may include, for example, money market funds, to be listed individually, and personal and private trusts, to be noted collectively.

[4] "Exposures securitized" include underlying exposures originated by the FDIC-supervised institution, 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 FDIC-supervised institution's balance sheet and underlying exposures acquired by the FDIC-supervised institution 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. FDIC-supervised institutions are required to disclose exposures regardless of whether there is a capital charge under this part.

[5] Include credit-related other than temporary impairment (OTTI).

[6] For example, charge-offs/allowances (if the assets remain on the FDIC-supervised institution's balance sheet) or credit-related OTTI of interest-only strips and other retained residual interests, as well as recognition of liabilities for probable future financial support required of the FDIC-supervised institution with respect to securitized assets.

TABLE 9 TO § 324.63– 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: (1) Differentiation between holdings on which capital gains are expected and those taken under other objectives including for relationship and strategic reasons; and (2) 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: (1) Publicly traded; and (2) Non publicly traded.
	(d)	The cumulative realized gains (losses) arising from sales and liquidations in the reporting period.

	(e)	(1) Total unrealized gains (losses).[1] (2) Total latent revaluation gains (losses).[2] (3) Any amounts of the above included in tier 1 or tier 2 capital.
	(f)	Capital requirements categorized by appropriate equity groupings, consistent with the FDIC-supervised institution's methodology, as well as the aggregate amounts and the type of equity investments subject to any supervisory transition regarding regulatory capital requirements.

[1] Unrealized gains (losses) recognized on the balance sheet but not through earnings.

[2] Unrealized gains (losses) not recognized either on the balance sheet or through earnings.

TABLE 10 TO § 324.63 – 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).

Subpart E – Risk-weighted Assets – Internal Ratings-Based and Advanced Measurement Approaches

§ 324.100 Purpose, applicability, and principle of conservatism.

(a) Purpose. This subpart E establishes:

(1) Minimum qualifying criteria for FDIC-supervised institutions using institution-specific internal risk measurement and management processes for calculating risk-based capital requirements; and

(2) Methodologies for such FDIC-supervised institutions to calculate their total risk-weighted assets.

(b) Applicability. (1) This subpart applies to an FDIC-supervised institution that:

(i) Has consolidated total assets, as reported on its most recent year-end Call Report equal to $250 billion or more;

(ii) Has consolidated total on-balance sheet foreign exposure on its most recent year-end Call Report 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 this subpart or the advanced approaches pursuant to subpart E of 12 CFR part 3 (OCC), or 12 CFR part 217 (Federal Reserve) 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) An FDIC-supervised institution that is subject to this subpart shall remain subject to this subpart unless the FDIC determines in writing that application of this subpart is not appropriate in light of the FDIC-supervised institution's asset size, level of complexity, risk profile, or scope of operations. In making a determination under this paragraph, the FDIC will apply notice and response procedures in the same manner and to the same extent as the notice and response procedures in 12 CFR 324.5.

(3) A market risk FDIC-supervised institution 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 of this part (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, an FDIC-supervised institution may choose not to apply a provision of this subpart to one or more exposures provided that:

(1) The FDIC-supervised institution can demonstrate on an ongoing basis to the satisfaction of the FDIC 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 FDIC-supervised institution appropriately manages the risk of each such exposure;

(3) The FDIC-supervised institution notifies the FDIC in writing prior to applying this principle to each such exposure; and

(4) The exposures to which the FDIC-supervised institution applies this principle are not, in the aggregate, material to the FDIC-supervised institution.

§ 324.101 Definitions.

(a) Terms that are set forth in § 324.2 and used in this subpart have the definitions assigned thereto in § 324.2.

(b) For the purposes of this subpart, the following terms are defined as follows:

Advanced internal ratings-based (IRB) systems means an advanced approaches FDIC-supervised institution'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 FDIC-supervised institution'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 FDIC-supervised institution, 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 an FDIC-supervised institution'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 an FDIC-supervised institution'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 an FDIC-supervised institution's operational risk profile that reflect a current and forward-looking assessment of the FDIC-supervised institution'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 OTC derivative contracts.

Default – For the purposes of calculating capital requirements under this subpart:

(1) Retail. (i) A retail exposure of an FDIC-supervised institution 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 FDIC-supervised institution 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 FDIC-supervised institution 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 FDIC-supervised institution may elect to use the definition of default that is used in that jurisdiction, provided that the FDIC-supervised institution has obtained prior approval from the FDIC to use the definition of default in that jurisdiction.

(iii) A retail exposure in default remains in default until the FDIC-supervised institution has reasonable assurance of repayment and performance for all contractual principal and interest payments on the exposure.

(2) Wholesale. (i) An FDIC-supervised institution's wholesale obligor is in default if:

(A) The FDIC-supervised institution determines that the obligor is unlikely to pay its credit obligations to the FDIC-supervised institution in full, without recourse by the FDIC-supervised institution 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 FDIC-supervised institution.[221]

(ii) An obligor in default remains in default until the FDIC-supervised institution has reasonable assurance of repayment and performance for all contractual principal and interest payments on all exposures of the FDIC-supervised institution 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 FDIC-supervised institution, 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 FDIC-supervised institution) in the exposure's national jurisdiction (or subdivision of such jurisdiction selected by the FDIC-supervised institution) are significantly higher than average.

Effective maturity (M) of a wholesale exposure means:

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[221] Overdrafts are past due once the obligor has breached an advised limit or been advised of a limit smaller than the current outstanding balance.

(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 FDIC-supervised institution does not apply the internal models approach in § 324.132(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 FDIC-supervised institution applies the internal models approach in § 324.132(d), the value determined in § 324.132(d)(4).

Eligible double default guarantor, with respect to a guarantee or credit derivative obtained by an FDIC-supervised institution, 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 FDIC-supervised institution 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 FDIC-supervised institution 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 FDIC-supervised institution 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 fair values in the probability distribution of fair values to a counterparty at a specified future date are set to zero to convert the probability distribution of fair 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 FDIC-supervised institution'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 FDIC-supervised institution determines EAD under § 324.132, a cleared transaction, or default fund contribution), EAD means the FDIC-supervised institution'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 FDIC-supervised institution determines EAD under § 324.132, 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 FDIC-supervised institution's best estimate of net additions to the outstanding amount owed the FDIC-supervised institution, 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 FDIC-supervised institution determines EAD under § 324.132, 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 § 324.132. An FDIC-supervised institution also may determine EAD for repo-style transactions and eligible margin loans as described in § 324.132.

Exposure category means any of the wholesale, retail, securitization, or equity exposure categories.

External operational loss event data means, with respect to an FDIC-supervised institution, gross operational loss amounts, dates, recoveries, and relevant causal information for operational loss events occurring at organizations other than the FDIC-supervised institution.

IMM exposure means a repo-style transaction, eligible margin loan, or OTC derivative for which an FDIC-supervised institution calculates its EAD using the internal models methodology of § 324.132(d).

Internal operational loss event data means, with respect to an FDIC-supervised institution, gross operational loss amounts, dates, recoveries, and relevant causal information for operational loss events occurring at the FDIC-supervised institution.

Loss given default (LGD) means:

(1) For a wholesale exposure, the greatest of:

(i) Zero;

(ii) The FDIC-supervised institution's empirically based best estimate of the long-run default-weighted average economic loss, per dollar of EAD, the FDIC-supervised institution would expect to incur if the obligor (or a typical obligor in the loss severity grade assigned by the FDIC-supervised institution to the exposure) were to default within a one-year horizon over a mix of economic conditions, including economic downturn conditions; or

(iii) The FDIC-supervised institution's empirically based best estimate of the economic loss, per dollar of EAD, the FDIC-supervised institution would expect to incur if the obligor (or a typical obligor in the loss severity grade assigned by the FDIC-supervised institution 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 FDIC-supervised institution's empirically based best estimate of the long-run default-weighted average economic loss, per dollar of EAD, the FDIC-supervised institution 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 FDIC-supervised institution's empirically based best estimate of the economic loss, per dollar of EAD, the FDIC-supervised institution 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 an FDIC-supervised institution 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 FDIC-supervised institution, 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 99.9th percentile of the distribution of potential aggregate operational losses, as generated by the FDIC-supervised institution'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 FDIC-supervised institution'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 FDIC-supervised institution's empirically based best estimate of the long-run average one-year default rate for the rating grade assigned by the FDIC-supervised institution 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 FDIC-supervised institution'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 the underlying financial transactions are OTC derivative contracts, eligible margin loans, or repo-style transactions. In order to treat an agreement as a qualifying cross-product master netting agreement for purposes of this subpart, an FDIC-supervised institution must comply with the requirements of § 324.3(c) of this part with respect to that agreement.

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 a borrower's decision to borrow and repay up to a pre-established maximum amount, except for an outstanding amount that the borrower is required to pay in full every month);

(2) Is unsecured and unconditionally cancelable by the FDIC-supervised institution to the fullest extent permitted by Federal law; and

(3)(a) Has a maximum contractual exposure amount (drawn plus undrawn) of up to $100,000; or

(b) With respect to a product with an outstanding amount that the borrower is required to pay in full every month, the total an outstanding amount does not in practice exceed $100,000.

(4) A segment of exposures that contains one or more exposures that fails to meet paragraph (3)(b) of this definition must be treated as a segment of other retail exposures for the 24 month period following the month in which the total outstanding amount of one or more exposures individually exceeds $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 an FDIC-supervised institution's operational risk profile and control structure.

Total wholesale and retail risk-weighted assets means the sum of:

(1) 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;

(2) Risk-weighted assets for wholesale exposures to defaulted obligors and segments of defaulted retail exposures;

(3) Risk-weighted assets for assets not defined by an exposure category;

(4) Risk-weighted assets for non-material portfolios of exposures;

(5) Risk-weighted assets for IMM exposures (as determined in § 324.132(d));

(6) Risk-weighted assets for cleared transactions and risk-weighted assets for default fund contributions (as determined in § 324.133); and

(7) Risk-weighted assets for unsettled transactions (as determined in § 324.136).

Unexpected operational loss (UOL) means the difference between the FDIC-supervised institution's operational risk exposure and the FDIC-supervised institution's expected operational loss.

Unit of measure means the level (for example, organizational unit or operational loss event type) at which the FDIC-supervised institution'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, pre-sold construction loan, or equity exposure).

Wholesale exposure subcategory means the HVCRE or non-HVCRE wholesale exposure subcategory.

QUALIFICATION

§ 324.121 Qualification process.

(a) Timing. (1) An FDIC-supervised institution that is described in § 324.100(b)(1)(i) through (iv) must adopt a written implementation plan no later than six months after the date the FDIC-supervised 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 FDIC-supervised

institution meets at least one criterion under § 324.100(b)(1)(i) through (iv). The FDIC may extend the start date.

(2) An FDIC-supervised institution that elects to be subject to this subpart under § 324.100(b)(1)(v) must adopt a written implementation plan.

(b) Implementation plan. (1) The FDIC-supervised institution's implementation plan must address in detail how the FDIC-supervised institution complies, or plans to comply, with the qualification requirements in § 324.122. The FDIC-supervised institution 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 § 324.122 for the FDIC-supervised institution and each consolidated subsidiary (U.S. and foreign-based) of the FDIC-supervised institution with respect to all portfolios and exposures of the FDIC-supervised institution 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 FDIC-supervised institution);

(iii) Include the FDIC-supervised institution's self-assessment of:

(A) The FDIC-supervised institution's current status in meeting the qualification requirements in § 324.122; and

(B) The consistency of the FDIC-supervised institution's current practices with the FDIC's supervisory guidance on the qualification requirements;

(iv) Based on the FDIC-supervised institution's self-assessment, identify and describe the areas in which the FDIC-supervised institution proposes to undertake additional work to comply with the qualification requirements in § 324.122 or to improve the consistency of the FDIC-supervised institution's current practices with the FDIC's supervisory guidance on the qualification requirements (gap analysis);

(v) Describe what specific actions the FDIC-supervised institution 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 FDIC-supervised institution'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 FDIC-supervised institution's board of directors.

(2) The FDIC-supervised institution must submit the implementation plan, together with a copy of the minutes of the board of directors' approval, to the FDIC at least 60 days before the FDIC-supervised institution proposes to begin its parallel run, unless the FDIC waives prior notice.

(c) Parallel run. Before determining its risk-weighted assets under this subpart and following adoption of the implementation plan, the FDIC-supervised institution must conduct a satisfactory parallel run. A satisfactory parallel run is a period of no less than four consecutive calendar quarters during which the FDIC-supervised institution complies with the qualification requirements in § 324.122 to the satisfaction of the FDIC. During the parallel run, the FDIC-supervised institution must report to the FDIC on a calendar quarterly basis its risk-based capital

ratios determined in accordance with §§ 324.10(b)(1) through (3) and §§ 324.10(c)(1) through (3). During this period, the FDIC-supervised institution's minimum risk-based capital ratios are determined as set forth in subpart D of this part.

(d) Approval to calculate risk-based capital requirements under this subpart. The FDIC will notify the FDIC-supervised institution of the date that the FDIC-supervised institution must begin to use this subpart for purposes of § 324.10 if the FDIC determines that:

(1) The FDIC-supervised institution fully complies with all the qualification requirements in § 324.122;

(2) The FDIC-supervised institution has conducted a satisfactory parallel run under paragraph (c) of this section; and

(3) The FDIC-supervised institution has an adequate process to ensure ongoing compliance with the qualification requirements in § 324.122.

§ 324.122 Qualification requirements.

(a) Process and systems requirements. (1) An FDIC-supervised institution 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 an FDIC-supervised institution for risk-based capital purposes under this subpart must be consistent with the FDIC-supervised institution's internal risk management processes and management information reporting systems.

(3) Each FDIC-supervised institution must have an appropriate infrastructure with risk measurement and management processes that meet the qualification requirements of this section and are appropriate given the FDIC-supervised institution's size and level of complexity. Regardless of whether the systems and models that generate the risk parameters necessary for

calculating an FDIC-supervised institution's risk-based capital requirements are located at any affiliate of the FDIC-supervised institution, the FDIC-supervised institution 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) An FDIC-supervised institution must have an internal risk rating and segmentation system that accurately and reliably differentiates among degrees of credit risk for the FDIC-supervised institution's wholesale and retail exposures.

(2) For wholesale exposures:

(i) An FDIC-supervised institution 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). An FDIC-supervised institution may elect, however, not to assign to a rating grade an obligor to whom the FDIC-supervised institution extends credit based solely on the financial strength of a guarantor, provided that all of the FDIC-supervised institution's exposures to the obligor are fully covered by eligible guarantees, the FDIC-supervised institution applies the PD substitution approach in § 324.134(c)(1) to all exposures to that obligor, and the FDIC-supervised institution immediately assigns the obligor to a rating grade if a guarantee can no longer be recognized under this part. The FDIC-supervised institution'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 FDIC-supervised institution has chosen to directly assign LGD estimates to each wholesale exposure, the FDIC-supervised institution must have an internal risk rating system that accurately and reliably assigns each wholesale exposure to a loss severity rating

grade (reflecting the FDIC-supervised institution's estimate of the LGD of the exposure). An FDIC-supervised institution 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, an FDIC-supervised institution 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 FDIC-supervised institution's system must identify and group in separate segments by subcategories exposures identified in §§ 324.131(c)(2)(ii) and (iii).

(4) The FDIC-supervised institution's internal risk rating policy for wholesale exposures must describe the FDIC-supervised institution's rating philosophy (that is, must describe how wholesale obligor rating assignments are affected by the FDIC-supervised institution's choice of the range of economic, business, and industry conditions that are considered in the obligor rating process).

(5) The FDIC-supervised institution'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 FDIC-supervised institution receives new material information, but no less frequently than annually. The FDIC-supervised institution's retail exposure segmentation system must provide for the review and update (as appropriate) of assignments of retail exposures to segments whenever the FDIC-supervised institution receives new material information, but generally no less frequently than quarterly.

(c) Quantification of risk parameters for wholesale and retail exposures. (1) The FDIC-supervised institution must have a comprehensive risk parameter quantification process that produces accurate, timely, and reliable estimates of the risk parameters for the FDIC-supervised institution's wholesale and retail exposures.

(2) Data used to estimate the risk parameters must be relevant to the FDIC-supervised institution's actual wholesale and retail exposures, and of sufficient quality to support the determination of risk-based capital requirements for the exposures.

(3) The FDIC-supervised institution's risk parameter quantification process must produce appropriately conservative risk parameter estimates where the FDIC-supervised institution 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 FDIC-supervised institution'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 FDIC-supervised institution'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 FDIC-supervised institution 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 FDIC-supervised institution must adjust its estimates of risk parameters to compensate for the lack of data from periods of economic downturn conditions.

(8) The FDIC-supervised institution's PD, LGD, and EAD estimates must be based on the definition of default in § 324.101.

(9) The FDIC-supervised institution must review and update (as appropriate) its risk parameters and its risk parameter quantification process at least annually.

(10) The FDIC-supervised institution must, at least annually, conduct a comprehensive review and analysis of reference data to determine relevance of reference data to the FDIC-supervised institution's exposures, quality of reference data to support PD, LGD, and EAD estimates, and consistency of reference data to the definition of default in § 324.101.

(d) Counterparty credit risk model. An FDIC-supervised institution must obtain the prior written approval of the FDIC under § 324.132 to use the internal models methodology for counterparty credit risk and the advanced CVA approach for the CVA capital requirement.

(e) Double default treatment. An FDIC-supervised institution must obtain the prior written approval of the FDIC under § 324.135 to use the double default treatment.

(f) Equity exposures model. An FDIC-supervised institution must obtain the prior written approval of the FDIC under § 324.153 to use the internal models approach for equity exposures.

(g) Operational risk. (1) Operational risk management processes. An FDIC-supervised institution 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 FDIC-supervised institution'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 FDIC-supervised institution's operational risk profile) to identify, measure, monitor, and control operational risk in the FDIC-supervised institution's 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. An FDIC-supervised institution must have operational risk data and assessment systems that capture operational risks to which the FDIC-supervised institution is exposed. The FDIC-supervised institution's operational risk data and assessment systems must:

(i) Be structured in a manner consistent with the FDIC-supervised institution'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 FDIC-supervised institution must have a systematic process for capturing and using internal operational loss event data in its operational risk data and assessment systems.

(1) The FDIC-supervised institution'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 FDIC to address transitional situations, such as integrating a new business line).

(2) The FDIC-supervised institution must be able to map its internal operational loss event data into the seven operational loss event type categories.

(3) The FDIC-supervised institution may refrain from collecting internal operational loss event data for individual operational losses below established dollar threshold amounts if the FDIC-supervised institution can demonstrate to the satisfaction of the FDIC that the thresholds are reasonable, do not exclude important internal operational loss event data, and permit the FDIC-supervised institution to capture substantially all the dollar value of the FDIC-supervised institution's operational losses.

(B) External operational loss event data. The FDIC-supervised institution 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 FDIC-supervised institution 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 FDIC-supervised institution must incorporate business environment and internal control factors into its operational risk data and assessment systems. The FDIC-supervised institution 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 FDIC-supervised institution's operational risk quantification systems:

(A) Must generate estimates of the FDIC-supervised institution's operational risk exposure using its operational risk data and assessment systems;

(B) Must employ a unit of measure that is appropriate for the FDIC-supervised institution'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 an FDIC-supervised institution 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 FDIC-supervised institution can demonstrate to the satisfaction of the FDIC 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 FDIC-supervised institution 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 FDIC-supervised institution becomes aware of information that may have a material effect on the FDIC-supervised institution'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 FDIC, an FDIC-supervised institution may generate an estimate of its operational risk exposure using an alternative approach to that specified in paragraph (g)(3)(i) of this section. An FDIC-supervised institution proposing to use such an alternative operational risk quantification system must submit a proposal to the FDIC. In determining whether to approve an FDIC-supervised institution's proposal to use an alternative operational risk quantification system, the FDIC 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 FDIC-supervised institution;

(B) The FDIC-supervised institution 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) An FDIC-supervised institution 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) An FDIC-supervised institution 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) An FDIC-supervised institution must retain data using an electronic format that allows timely retrieval of data for analysis, validation, reporting, and disclosure purposes.

(3) An FDIC-supervised institution 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 FDIC-supervised institution's senior management must ensure that all components of the FDIC-supervised institution's advanced systems function effectively and comply with the qualification requirements in this section.

(2) The FDIC-supervised institution's board of directors (or a designated committee of the board) must at least annually review the effectiveness of, and approve, the FDIC-supervised institution's advanced systems.

(3) An FDIC-supervised institution 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 FDIC-supervised institution's advanced systems; and

(iii) Includes adequate governance and project management processes.

(4) The FDIC-supervised institution must validate, on an ongoing basis, its advanced systems. The FDIC-supervised institution'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 backtesting.

(5) The FDIC-supervised institution must have an internal audit function independent of business-line management that at least annually assesses the effectiveness of the controls supporting the FDIC-supervised institution's advanced systems and reports its findings to the FDIC-supervised institution's board of directors (or a committee thereof).

(6) The FDIC-supervised institution 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 FDIC-supervised institution must adequately document all material aspects of its advanced systems.

§ 324.123 Ongoing qualification.

(a) Changes to advanced systems. An FDIC-supervised institution must meet all the qualification requirements in § 324.122 on an ongoing basis. An FDIC-supervised institution must notify the FDIC when the FDIC-supervised institution makes any change to an advanced system that would result in a material change in the FDIC-supervised institution's advanced approaches total risk-weighted asset amount for an exposure type or when the FDIC-supervised institution makes any significant change to its modeling assumptions.

(b) Failure to comply with qualification requirements. (1) If the FDIC determines that an FDIC-supervised institution that uses this subpart and that has conducted a satisfactory parallel run fails to comply with the qualification requirements in § 324.122, the FDIC will notify the FDIC-supervised institution in writing of the FDIC-supervised institution's failure to comply.

(2) The FDIC-supervised institution must establish and submit a plan satisfactory to the FDIC to return to compliance with the qualification requirements.

(3) In addition, if the FDIC determines that the FDIC-supervised institution's advanced approaches total risk-weighted assets are not commensurate with the FDIC-supervised institution's credit, market, operational, or other risks, the FDIC may require such an FDIC-supervised institution to calculate its advanced approaches total risk-weighted assets with any modifications provided by the FDIC.

§ 324.124 Merger and acquisition transitional arrangements.

(a) Mergers and acquisitions of companies without advanced systems. If an FDIC-supervised institution merges with or acquires a company that does not calculate its risk-based capital requirements using advanced systems, the FDIC-supervised institution may use subpart D of this part 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 FDIC may extend this transition period for up to an additional 12 months. Within 90 days of consummating the merger or acquisition, the FDIC-supervised institution must submit to the FDIC an implementation plan for using its advanced systems for the acquired company. During the period in which subpart D of this part 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 FDIC-supervised institution'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 FDIC-supervised institution's eligible credit reserves. In addition, the risk-weighted assets of the merged or acquired company are not included in the FDIC-supervised

institution's credit-risk-weighted assets but are included in total risk-weighted assets. If an FDIC-supervised institution relies on this paragraph, the FDIC-supervised institution must disclose publicly the amounts of risk-weighted assets and qualifying capital calculated under this subpart for the acquiring FDIC-supervised institution and under subpart D of this part for the acquired company.

(b) Mergers and acquisitions of companies with advanced systems. (1) If an FDIC-supervised institution merges with or acquires a company that calculates its risk-based capital requirements using advanced systems, the FDIC-supervised institution 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 FDIC may extend this transition period for up to an additional 12 months. Within 90 days of consummating the merger or acquisition, the FDIC-supervised institution must submit to the FDIC an implementation plan for using its advanced systems for the merged or acquired company.

(2) If the acquiring FDIC-supervised institution is not subject to the advanced approaches in this subpart at the time of acquisition or merger, during the period when subpart D of this part applies to the acquiring FDIC-supervised institution, 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 FDIC-supervised institution'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

§ 324.131 Mechanics for calculating total wholesale and retail risk-weighted assets.

(a) Overview. An FDIC-supervised institution 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 FDIC-supervised institution must determine which of its exposures are wholesale exposures, retail exposures, securitization exposures, or equity exposures. The FDIC-supervised institution must categorize each retail exposure as a residential mortgage exposure, a QRE, or an other retail exposure. The FDIC-supervised 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, unsettled transactions to which § 324.136 applies, and eligible guarantees or eligible credit derivatives that are used as credit risk mitigants. The FDIC-supervised institution 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 FDIC-supervised institution 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 FDIC-supervised institution must identify which of its wholesale obligors are in default.

(2) Segmentation of retail exposures. (i) The FDIC-supervised institution must group the retail exposures in each retail subcategory into segments that have homogeneous risk characteristics.

(ii) The FDIC-supervised institution must identify which of its retail exposures are in default. The FDIC-supervised institution must segment defaulted retail exposures separately from non-defaulted retail exposures.

(iii) If the FDIC-supervised institution determines the EAD for eligible margin loans using the approach in § 324.132(b), the FDIC-supervised institution must identify which of its retail exposures are eligible margin loans for which the FDIC-supervised institution uses this EAD approach and must segment such eligible margin loans separately from other retail exposures.

(3) Eligible purchased wholesale exposures. An FDIC-supervised institution may group its eligible purchased wholesale exposures into segments that have homogeneous risk characteristics. An FDIC-supervised institution 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 FDIC-supervised institution 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 FDIC-supervised institution 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 may not be less than 10 percent, except for segments of residential mortgage exposures for which all or substantially all of the principal of each exposure is either (i) directly and unconditionally guaranteed by the full faith and credit of a sovereign entity; or (ii) guaranteed by 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).

(4) Eligible purchased wholesale exposures. An FDIC-supervised institution must assign a PD, LGD, EAD, and M to each segment of eligible purchased wholesale exposures. If the

FDIC-supervised institution can estimate ECL (but not PD or LGD) for a segment of eligible purchased wholesale exposures, the FDIC-supervised institution 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) An FDIC-supervised institution 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 § 324.134 or, if applicable, applying double default treatment to the exposure as provided in § 324.135. An FDIC-supervised institution may decide separately for each wholesale exposure that qualifies for the double default treatment under § 324.135 whether to apply the double default treatment or to use the PD substitution or LGD adjustment treatment without recognizing double default effects.

(ii) An FDIC-supervised institution 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, an FDIC-supervised institution 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. An FDIC-supervised institution must calculate its EAD for an OTC derivative contract as

provided in §§ 324.132 (c) and (d). An FDIC-supervised institution 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 FDIC-supervised institution's VaR-based measure under subpart F of this part through an adjustment to EAD as provided in §§ 324.132(b) and (d). An FDIC-supervised institution that takes collateral into account through such an adjustment to EAD under § 324.132 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 an FDIC-supervised institution's ongoing financing of the obligor. An exposure is not part of an FDIC-supervised institution's ongoing financing of the obligor if the FDIC-supervised institution:

(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. An FDIC-supervised institution may attribute an EAD of zero 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.

(e) Phase 4 − Calculation of risk-weighted assets. (1) Non-defaulted exposures.

(i) An FDIC-supervised institution 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 FDIC-supervised institution applies the double default treatment in § 324.135) 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 to § 324.131 and multiplying the output of the formula (K) by the EAD of the exposure or segment. Alternatively, an FDIC-supervised institution may apply a 300 percent risk weight to the EAD of an eligible margin loan if the FDIC-supervised institution is not able to meet the FDIC's requirements for estimation of PD and LGD for the margin loan.

TABLE 1 TO § 324.131 – IRB RISK-BASED CAPITAL FORMULAS FOR WHOLESALE EXPOSURES TO NON-DEFAULTED OBLIGORS AND SEGMENTS OF NON-DEFAULTED RETAIL EXPOSURES[1]

Retail	**Capital Requirement (K)**	$K = \left[LGD \times N\left(\frac{N^{-1}(PD) + \sqrt{R} \times N^{-1}(0.999)}{\sqrt{1-R}} \right) - \left(LGD \times PD \right) \right]$
	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)**	$K = \left[LGD \times N\left(\frac{N^{-1}(PD) + \sqrt{R} \times N^{-1}(0.999)}{\sqrt{1-R}} \right) - \left(LGD \times PD \right) \right] \times \left(\frac{1 + (M - 2.5) \times b}{1 - 1.5 \times b} \right)$
	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:

$$R = 1.25 \times \left(0.12 + 0.12 \times e^{-50 \times PD}\right)$$

For wholesale exposures to regulated financial institutions with total assets greater than or equal to $100 billion:

$$R = 1.25 \times \left(0.12 + 0.12 \times e^{-50 \times PD}\right)$$

For wholesale exposures other than HVCRE exposures, unregulated financial institutions, and regulated financial institutions with total assets greater than or equal to $100 billion:

$$R = 0.12 + 0.12 \times e^{-50 \times PD}$$

Maturity Adjustment (b)

$$b = \left(0.11852 - 0.05478 \times \ln(PD)\right)^2$$

[1]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 section and in § 324.135(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 in paragraph (e)(1)(ii) of this section multiplied by 12.5.

(2) Wholesale exposures to defaulted obligors and segments of defaulted retail exposures.

(i) Not covered by an eligible U.S. government guarantee: The dollar risk-based capital requirement for each wholesale exposure not covered by an eligible guarantee from the U.S. government to a defaulted obligor and each segment of defaulted retail exposures not covered by an eligible guarantee from the U.S. government equals 0.08 multiplied by the EAD of the exposure or segment.

(ii) Covered by an eligible U.S. government guarantee: The dollar risk-based capital requirement for each wholesale exposure to a defaulted obligor covered by an eligible guarantee from the U.S. government and each segment of defaulted retail exposures covered by an eligible guarantee from the U.S. government equals the sum of:

(A) The sum of the EAD of the portion of each wholesale exposure to a defaulted obligor covered by an eligible guarantee from the U.S. government plus the EAD of the portion of each segment of defaulted retail exposures that is covered by an eligible guarantee from the U.S. government and the resulting sum is multiplied by 0.016, and

(B) The sum of the EAD of the portion of each wholesale exposure to a defaulted obligor not covered by an eligible guarantee from the U.S. government plus the EAD of the portion of each segment of defaulted retail exposures that is not covered by an eligible guarantee from the U.S. government and the resulting sum is multiplied by 0.08.

(iii) The sum of all the dollar risk-based capital requirements for each wholesale exposure to a defaulted obligor and each segment of defaulted retail exposures calculated in paragraph (e)(2)(i) of this section plus the dollar risk-based capital requirements each wholesale exposure to a defaulted obligor and for each segment of defaulted retail exposures calculated in paragraph (e)(2)(ii) of this section 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 paragraph (e)(2)(iii) of this section multiplied by 12.5.

(3) Assets not included in a defined exposure category. (i) An FDIC-supervised institution may assign a risk-weighted asset amount of zero to cash owned and held in all offices of the FDIC-supervised institution or in transit and for gold bullion held in the FDIC-supervised 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) An FDIC-supervised institution must assign a risk-weighted asset amount equal to 20 percent of the carrying value of cash items in the process of collection.

(iii) An FDIC-supervised institution must assign a risk-weighted asset amount equal to 50 percent of the carrying value to a pre-sold construction loan unless the purchase contract is cancelled, in which case an FDIC-supervised institution must assign a risk-weighted asset amount equal to a 100 percent of the carrying value of the pre-sold construction loan.

(iv) The risk-weighted asset amount for the residual value of a retail lease exposure equals such residual value.

(v) The risk-weighted asset amount for DTAs arising from temporary differences that the FDIC-supervised institution could realize through net operating loss carrybacks equals the carrying value, netted in accordance with § 324.22.

(vi) The risk-weighted asset amount for MSAs, DTAs arising from temporary timing differences that the FDIC-supervised institution 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 § 324.22(a)(7) equals the amount not subject to deduction multiplied by 250 percent.

(vii) 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 and is not subject to deduction under § 324.22(a), (c), or (d) 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 FDIC-supervised institution has demonstrated to the FDIC's satisfaction that the portfolio (when combined with all other portfolios of exposures that the FDIC-supervised institution seeks to treat under this paragraph) is not material to the FDIC-supervised institution 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 § 324.132.

§ 324.132 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, an FDIC-supervised institution 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 an FDIC-supervised institution's VaR-based measure under subpart F of this part:

(i) The collateral haircut approach set forth in paragraph (b)(2) of this section;

(ii) The internal models methodology set forth in paragraph (d) of this section; and

(iii) For single product netting sets of repo-style transactions and eligible margin loans, the simple VaR methodology set forth in paragraph (b)(3) of this section.

(2) An FDIC-supervised institution 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) An FDIC-supervised institution must use the methodology in paragraph (c) of this section, or with prior written approval of the FDIC, the internal model methodology in paragraph (d) of this section, 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, an FDIC-supervised institution may only use the internal models methodology in paragraph (d) of this section.

(4) An FDIC-supervised institution must also use the methodology in paragraph (e) of this section to calculate the risk-weighted asset amounts for CVA for OTC derivatives.

(b) EAD for eligible margin loans and repo-style transactions. (1) General. An FDIC-supervised institution 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, an FDIC-supervised institution may estimate an unsecured LGD for the exposure, as well as for any repo-style transaction that is included in the FDIC-supervised institution's VaR-based measure under subpart F of this part, and determine the EAD of the exposure using:

(i) The collateral haircut approach described in paragraph (b)(2) of this section;

(ii) For netting sets only, the simple VaR methodology described in paragraph (b)(3) of this section; or

(iii) The internal models methodology described in paragraph (d) of this section.

(2) Collateral haircut approach. (i) EAD equation. An FDIC-supervised institution 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 fair values of all instruments, gold, and cash the FDIC-supervised institution 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 fair values of all instruments, gold, and cash the FDIC-supervised institution 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 fair values of the instrument or gold the FDIC-supervised institution has lent, sold subject to repurchase, or posted as collateral to the counterparty minus the sum of the current fair values of that same instrument or gold the FDIC-supervised institution 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 E_s;

(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 fair values of any instruments or cash in the currency the FDIC-supervised institution has lent, sold subject to repurchase, or posted as collateral to the counterparty minus the sum of the current fair values of any instruments or cash in the currency the FDIC-supervised institution has borrowed, purchased subject to resale, or taken as collateral from the counterparty); and

(F) H_{fx} equals the haircut appropriate to the mismatch between the currency referenced in E_{fx} and the settlement currency.

(ii) Standard supervisory haircuts. (A) Under the standard supervisory haircuts approach:

(1) An FDIC-supervised institution must use the haircuts for market price volatility (H_s) in Table 1 to § 324.132, as adjusted in certain circumstances as provided in paragraphs (b)(2)(ii)(A)(3) and (4) of this section;

TABLE 1 TO § 324.132 – STANDARD SUPERVISORY MARKET PRICE VOLATILITY HAIRCUTS[1]

Residual maturity	**Haircut (in percent) assigned based on:**						**Investment grade securitization exposures (in percent)**
	Sovereign issuers risk weight under this section[2] (in percent)			**Non-sovereign issuers risk weight under this section (in percent)**			
	Zero	20 or 50	100	20	50	100	
Less than or equal to 1 year	0.5	1.0	15.0	1.0	2.0	4.0	4.0
Greater than 1 year and less than or equal to 5 years	2.0	3.0	15.0	4.0	6.0	8.0	12.0
Greater than 5 years	4.0	6.0	15.0	8.0	12.0	16.0	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				Zero			
Other exposure types				25.0			

[1] The market price volatility haircuts in Table 1 to § 324.132 are based on a 10 business-day holding period.

[2] Includes a foreign PSE that receives a zero percent risk weight.

(2) For currency mismatches, an FDIC-supervised institution must use a haircut for foreign exchange rate volatility (H_{fx}) of 8 percent, as adjusted in certain circumstances as provided in paragraphs (b)(2)(ii)(A)(3) and (4) of this section.

(3) For repo-style transactions, an FDIC-supervised institution may multiply the supervisory haircuts provided in paragraphs (b)(2)(ii)(A)(1) and (2) of this section by the square root of ½ (which equals 0.707107).

(4) An FDIC-supervised institution 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, an FDIC-supervised institution must adjust the supervisory haircuts upward on the basis of a holding period of twenty business days for the following quarter (except when an FDIC-supervised institution is calculating EAD for a cleared transaction under § 324.133). If a netting set contains one or more trades involving illiquid collateral or an OTC derivative that cannot be easily replaced, an FDIC-supervised institution 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 FDIC-supervised institution 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. An FDIC-supervised institution 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 an FDIC-supervised institution has lent, sold subject to repurchase, or posted as collateral does not meet the definition of financial collateral, the FDIC-supervised institution 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 FDIC, an FDIC-supervised institution 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 FDIC approval to use its own internal estimates, an FDIC-supervised institution must satisfy the following minimum quantitative standards:

(1) An FDIC-supervised institution 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 paragraph (b)(2)(iii)(A)(3) of this section applies. When an FDIC-supervised institution 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:

$$H_M = H_N \sqrt{\frac{T_M}{T_N}}$$, 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 FDIC-supervised institution 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, an FDIC-supervised institution must calculate the haircut using a minimum holding period of twenty business days for the following quarter (except when an FDIC-supervised institution is calculating EAD for a cleared transaction under § 324.133). If a netting set contains one or more trades involving illiquid collateral or an OTC derivative that cannot be easily replaced, an FDIC-supervised institution 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 FDIC-supervised institution 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) An FDIC-supervised institution 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) An FDIC-supervised institution must have policies and procedures that describe how it determines the period of significant financial stress used to calculate the FDIC-supervised institution's own internal estimates for haircuts under this section and must be able to provide empirical support for the period used. The FDIC-supervised institution must obtain the prior approval of the FDIC for, and notify the FDIC if the FDIC-supervised institution makes any material changes to, these policies and procedures.

(6) Nothing in this section prevents the FDIC from requiring an FDIC-supervised institution to use a different period of significant financial stress in the calculation of own internal estimates for haircuts.

(7) An FDIC-supervised institution 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, an FDIC-supervised institution may calculate haircuts for categories of securities. For a category of securities, the FDIC-supervised institution 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 FDIC-supervised institution has lent, sold subject to repurchase, posted as collateral, borrowed, purchased subject to resale, or taken as collateral. In determining relevant categories, the FDIC-supervised institution 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, an FDIC-supervised institution 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 FDIC-supervised institution 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) An FDIC-supervised institution'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 FDIC, an FDIC-supervised institution may estimate EAD for a netting set using a VaR model that meets the requirements in paragraph (b)(3)(iii) of this section. In such event, the FDIC-supervised institution must set EAD equal to max $\{0, [(\sum E - \sum C) + PFE]\}$, where:

(i) $\sum E$ equals the value of the exposure (the sum of the current fair values of all instruments, gold, and cash the FDIC-supervised institution has lent, sold subject to repurchase, or posted as collateral to the counterparty under the netting set);

(ii) $\sum C$ equals the value of the collateral (the sum of the current fair values of all instruments, gold, and cash the FDIC-supervised institution 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 FDIC-supervised institution's empirically based best estimate of the 99th percentile, one-tailed confidence interval for an increase in the value of $(\sum E - \sum C)$ over a five-business-day holding period for repo-style transactions, or over a ten-business-day holding period for eligible margin loans except for netting sets for which paragraph (b)(3)(iv) of this section applies using a minimum one-year historical observation period of price data representing the instruments that the FDIC-supervised institution has lent,

sold subject to repurchase, posted as collateral, borrowed, purchased subject to resale, or taken as collateral. The FDIC-supervised institution must validate its VaR model by establishing and maintaining a rigorous and regular backtesting regime.

(iv) If the number of trades in a netting set exceeds 5,000 at any time during a quarter, an FDIC-supervised institution must use a twenty-business-day holding period for the following quarter (except when an FDIC-supervised institution is calculating EAD for a cleared transaction under § 324.133). If a netting set contains one or more trades involving illiquid collateral, an FDIC-supervised institution 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 FDIC-supervised institution 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) OTC derivative contracts not subject to a qualifying master netting agreement. An FDIC-supervised institution 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 paragraph (c)(5) of this section or using the internal models methodology described in paragraph (d) of this section.

(2) OTC derivative contracts subject to a qualifying master netting agreement. An FDIC-supervised institution must determine the EAD for multiple OTC derivative contracts that are subject to a qualifying master netting agreement using the current exposure methodology in paragraph (c)(6) of this section or using the internal models methodology described in paragraph (d) of this section.

(3) Credit derivatives. Notwithstanding paragraphs (c)(1) and (c)(2) of this section:

(i) An FDIC-supervised institution that purchases a credit derivative that is recognized under § 324.134 or § 324.135 as a credit risk mitigant for an exposure that is not a covered position under subpart F of this part is not required to calculate a separate counterparty credit risk capital requirement under this section so long as the FDIC-supervised institution 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) An FDIC-supervised institution 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 FDIC-supervised institution is treating the credit derivative as a covered position under subpart F of this part, in which case the FDIC-supervised institution must calculate a supplemental counterparty credit risk capital requirement under this section).

(4) Equity derivatives. An FDIC-supervised institution must treat an equity derivative contract as an equity exposure and compute a risk-weighted asset amount for the equity derivative contract under §§ 324.151 – 324.155 (unless the FDIC-supervised institution is treating the contract as a covered position under subpart F of this part). In addition, if the FDIC-supervised institution is treating the contract as a covered position under subpart F of this part, and under certain other circumstances described in § 324.155, the FDIC-supervised institution

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 paragraph (c)(7) of this section, 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 FDIC-supervised institution'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-fair value of the derivative contract or zero; and

(ii) PFE. The PFE for a single OTC derivative contract, including an OTC derivative contract with a negative mark-to-fair value, is calculated by multiplying the notional principal amount of the derivative contract by the appropriate conversion factor in Table 2 to § 324.132. For purposes of calculating either the PFE under paragraph (c)(5) of this section or the gross PFE under paragraph (c)(6) of this section 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 2 to § 324.132, the PFE must be calculated using the "other" conversion factors. An FDIC-supervised institution 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 2 TO § 324.132 – 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 fair 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] An FDIC-supervised institution 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. An FDIC-supervised institution 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 paragraph (c)(7) of this section, 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 fair values of the individual OTC derivative contracts subject to the qualifying master netting agreement; or

(B) Zero; and

(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} equals 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 equals 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 paragraph (c)(6)(i) of this section) of all individual derivative contracts subject to the qualifying master netting agreement.

(7) Collateralized OTC derivative contracts. An FDIC-supervised institution 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, an FDIC-supervised institution 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 paragraph (c)(5) or (c)(6) of this section using the collateral haircut approach in paragraph (b)(2) of this section. The FDIC-supervised institution must substitute the EAD calculated under paragraph (c)(5) or (c)(6) of this section for $\sum E$ in the equation in paragraph (b)(2)(i) of this section and must use a ten-business day minimum holding period (T_M = 10) unless a longer holding period is required by paragraph (b)(2)(iii)(A)(3) of this section.

(8) Clearing member FDIC-supervised institution's EAD. A clearing member FDIC-supervised institution's EAD for an OTC derivative contract or netting set of OTC derivative contracts where the FDIC-supervised institution is either acting as a financial intermediary and enters into an offsetting transaction with a QCCP or where the FDIC-supervised institution provides a guarantee to the QCCP on the performance of the client equals the exposure amount calculated according to paragraph (c)(5) or (6) of this section multiplied by the scaling factor 0.71. If the FDIC-supervised institution determines that a longer period is appropriate, it must use a larger scaling factor to adjust for a longer holding period as follows:

$$\text{Scaling factor} = \sqrt{\frac{H}{10}}$$

where H equals the holding period greater than five days. Additionally, the FDIC may require the FDIC-supervised institution to set a longer holding period if the FDIC determines that a longer period is appropriate due to the nature, structure, or characteristics of the transaction or is commensurate with the risks associated with the transaction.

(d) Internal models methodology. (1)(i) With prior written approval from the FDIC, an FDIC-supervised institution may use the internal models methodology in this paragraph (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.

(ii) An FDIC-supervised institution 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. An FDIC-supervised institution may choose to use the internal models methodology for one or two of these three types of exposures and not the other types.

(iii) An FDIC-supervised institution 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:

(A) The FDIC-supervised institution effectively integrates the risk mitigating effects of cross-product netting into its risk management and other information technology systems; and

(B) The FDIC-supervised institution obtains the prior written approval of the FDIC.

(iv) An FDIC-supervised institution that uses the internal models methodology for a transaction type must receive approval from the FDIC 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, an FDIC-supervised institution uses an internal model to estimate the expected exposure (EE) for a netting set and then calculates EAD based on that EE. An FDIC-supervised institution 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 paragraph (d)(3)(vii) of this section;

(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 FDIC-supervised institution's counterparties according to paragraph (d)(3)(viii) of this section;

(iii) The FDIC-supervised institution must use its internal model's probability distribution for changes in the fair value of a netting set that are attributable to changes in market variables to determine EE; and

(iv) Under the internal models methodology, EAD = Max (0, α x effective EPE - CVA), or, subject to the prior written approval of FDIC as provided in paragraph (d)(10) of this section, a more conservative measure of EAD.

(A) CVA equals the credit valuation adjustment that the FDIC-supervised institution 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 FDIC-supervised institution's liabilities that are due to changes in its own credit risk since the inception of the transaction with the counterparty.

(B) $Effective\ EPE_{t_k} = \sum_{k=1}^{n} Effective\ EE_k \times \Delta t_k$

(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) $EffectiveEE_{t_k} = \max\left(EffectiveEE_{t_{k-1}}, EE_{t_k}\right)$ (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 kth 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 paragraph (d)(5) of this section, or when the FDIC has determined that the FDIC-supervised institution must set α higher based on the FDIC-supervised institution's specific characteristics of counterparty credit risk or model performance.

(v) An FDIC-supervised institution may include financial collateral currently posted by the counterparty as collateral (but may not include other forms of collateral) when calculating EE.

(vi) If an FDIC-supervised institution hedges some or all of the counterparty credit risk associated with a netting set using an eligible credit derivative, the FDIC-supervised institution may take the reduction in exposure to the counterparty into account when estimating EE. If the FDIC-supervised institution 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 FDIC-supervised institution's exposure to the protection provider of the credit derivative.

(3) Prior approval relating to EAD calculation. To obtain FDIC approval to calculate the distributions of exposures upon which the EAD calculation is based, the FDIC-supervised institution must demonstrate to the satisfaction of the FDIC that it has been using for at least one year an internal model that broadly meets the following minimum standards, with which the FDIC-supervised institution 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 FDIC-supervised institution 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 FDIC-supervised institution must be able to measure and manage current exposures gross and net of collateral held, where appropriate. The FDIC-supervised institution must estimate expected exposures for OTC derivative contracts both with and without the effect of collateral agreements;

(vi) The FDIC-supervised institution 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 FDIC-supervised institution 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 FDIC-supervised institution should consider using model parameters based on forward-looking measures, where appropriate;

(viii) When estimating model parameters based on a stress period, the FDIC-supervised institution must use at least three years of historical data that include a period of stress to the credit default spreads of the FDIC-supervised institution's counterparties. The FDIC-supervised institution must review the data set and update the data as necessary, particularly for any material changes in its counterparties. The FDIC-supervised institution must demonstrate, at least quarterly, and maintain documentation of such demonstration, that the stress period coincides

with increased CDS or other credit spreads of the FDIC-supervised institution's counterparties. The FDIC-supervised institution 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 FDIC-supervised institution's portfolio. The FDIC may require the FDIC-supervised institution to modify its stress calibration to better reflect actual historic losses of the portfolio;

(ix) An FDIC-supervised institution 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 FDIC-supervised institution must have a backtesting program for its model that includes a process by which unacceptable model performance will be determined and remedied;

(x) An FDIC-supervised institution must have policies for the measurement, management and control of collateral and margin amounts; and

(xi) An FDIC-supervised institution 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) <u>Calculating the maturity of exposures</u>. (i) If the remaining maturity of the exposure or the longest-dated contract in the netting set is greater than one year, the FDIC-supervised institution must set M for the exposure or netting set equal to the lower of five years or M(EPE), where:

(A) $$M(EPE) = 1 + \frac{\sum_{t_k > 1year}^{maturity} EE_k \times \Delta t_k \times df_k}{\sum_{k=1}^{t_k \le 1year} effectiveEE_k \times \Delta t_k \times df_k};$$

(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 FDIC-supervised institution must set M for the exposure or netting set equal to one year, except as provided in § 324.131(d)(7).

(iii) Alternatively, an FDIC-supervised institution 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 paragraph (d)(4)(i) of this section.

(5) Effects of collateral agreements on EAD. An FDIC-supervised institution 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, as set forth in paragraphs (d)(5)(i) and (ii) of this section:

(i) With prior written approval from the FDIC, an FDIC-supervised institution may include the effect of a collateral agreement within its internal model used to calculate EAD. The FDIC-supervised institution 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 paragraph (d)(5)(iii) of this section; or

(ii) As an alternative to paragraph (d)(5)(i) of this section, an FDIC-supervised institution 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 FDIC-supervised institution 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 expected increase in the netting set's exposure over the margin period of risk (set in accordance with paragraph (d)(5)(iii) of this section); or

(B) Effective EPE without a collateral agreement plus any collateral the FDIC-supervised institution posts to the counterparty that exceeds the required margin amount.

(iii) For purposes of this subpart, including paragraphs (d)(5)(i) and (ii) of this section, 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 FDIC-supervised institution is calculating EAD for a cleared transaction under § 324.133). 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 FDIC-supervised institution 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.

(C) Five business days for an OTC derivative contract or netting set of OTC derivative contracts where the FDIC-supervised institution is either acting as a financial intermediary and enters into an offsetting transaction with a CCP or where the FDIC-supervised institution provides a guarantee to the CCP on the performance of the client. An FDIC-supervised institution must use a longer holding period if the FDIC-supervised institution determines that a longer period is appropriate. Additionally, the FDIC may require the FDIC-supervised institution to set a longer holding period if the FDIC determines that a longer period is appropriate due to the nature, structure, or characteristics of the transaction or is commensurate with the risks associated with the transaction.

(6) Own estimate of alpha. With prior written approval of the FDIC, an FDIC-supervised institution 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 FDIC-supervised institution must meet the following minimum standards to the satisfaction of the FDIC:

(i) The FDIC-supervised institution's own estimate of alpha must capture in the numerator the effects of:

(A) The material sources of stochastic dependency of distributions of fair 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 FDIC-supervised institution must assess the potential model uncertainty in its estimates of alpha.

(iii) The FDIC-supervised institution must calculate the numerator and denominator of alpha in a consistent fashion with respect to modeling methodology, parameter specifications, and portfolio composition.

(iv) The FDIC-supervised institution 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. An FDIC-supervised institution must determine if a repo-style transaction, eligible margin loan, bond option, or equity derivative contract or purchased credit derivative to which the FDIC-supervised institution applies the internal models methodology under paragraph (d) of this

section has specific wrong-way risk. If a transaction has specific wrong-way risk, the FDIC-supervised institution must treat the transaction as its own netting set and exclude it from the model described in § 324.132(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 § 324.131 using the PD of the counterparty and LGD equal to 100 percent, by

(B) The maximum amount the FDIC-supervised institution 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 § 324.131 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 § 324.131 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 § 324.131 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 § 324.131(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 an FDIC-supervised institution's risk-based capital requirement for purchased credit derivatives that are not bond options with specific wrong-way risk as calculated under paragraph (d)(7)(ii) of this section, an FDIC-supervised institution's risk-based capital requirement for equity derivatives with specific wrong-way risk as calculated under paragraph (d)(7)(i) of this section, an FDIC-supervised institution's risk-based capital requirement for bond options with specific wrong-way risk as calculated under paragraph (d)(7)(iii) of this section, and an FDIC-supervised institution's risk-based capital requirement for repo-style transactions and eligible margin loans with specific wrong-way risk as calculated under paragraph (d)(7)(iv) of this section, multiplied by 12.5.

(9) Risk-weighted assets for IMM exposures. (i) The FDIC-supervised institution must insert the assigned risk parameters for each counterparty and netting set into the appropriate formula specified in Table 1 of § 324.131 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. An FDIC-supervised institution that uses an advanced CVA approach that captures migrations in credit spreads under paragraph (e)(3) of this section 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 FDIC-supervised institution must insert the assigned risk parameters for each wholesale obligor and netting set into the appropriate formula specified in Table 1 of § 324.131 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. An FDIC-supervised institution that uses an advanced CVA approach that captures migrations in credit spreads under paragraph (e)(3) of this section 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 FDIC-supervised institution's dollar risk-based capital requirement under the internal models methodology equals the larger of $K_{unstressed}$ and $K_{stressed}$. An FDIC-supervised institution'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 paragraph (d)(8) of this section and those in paragraph (d)(10) of this section.

(10) Other measures of counterparty exposure. (i) With prior written approval of the FDIC, an FDIC-supervised institution 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 paragraph (d)(7)(iv)(C) of this section) 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 FDIC-supervised institution must demonstrate the conservatism of the measure of counterparty credit risk exposure used for EAD. With respect to paragraph (d)(10)(i) of this section:

(A) For material portfolios of new OTC derivative products, the FDIC-supervised institution may assume that the current exposure methodology in paragraphs (c)(5) and (c)(6) of

this section meets the conservatism requirement of this section for a period not to exceed 180 days.

(B) For immaterial portfolios of OTC derivative contracts, the FDIC-supervised institution generally may assume that the current exposure methodology in paragraphs (c)(5) and (c)(6) of this section meets the conservatism requirement of this section.

(ii) To calculate risk-weighted assets for purposes of the approach in paragraph (d)(10)(i) of this section, the FDIC-supervised institution must insert the assigned risk parameters for each counterparty and netting set into the appropriate formula specified in Table 1 of § 324.131, 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, an FDIC-supervised institution must calculate a CVA risk-weighted asset amount for its portfolio of OTC derivative transactions that are subject to the CVA capital requirement using the simple CVA approach described in paragraph (e)(5) of this section or, with prior written approval of the FDIC, the advanced CVA approach described in paragraph (e)(6) of this section. An FDIC-supervised institution that receives prior FDIC 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 FDIC in writing that the FDIC-supervised institution expects to begin calculating its CVA risk-weighted asset amount using the simple CVA approach. Such notice must include an explanation of the FDIC-supervised institution's rationale and the date upon which the FDIC-supervised institution will begin to calculate its CVA risk-weighted asset amount using the simple CVA approach.

(2) Market risk FDIC-supervised institutions. Notwithstanding the prior approval requirement in paragraph (e)(1) of this section, a market risk FDIC-supervised institution may calculate its CVA risk-weighted asset amount using the advanced CVA approach if the FDIC-supervised institution has FDIC approval to:

(i) Determine EAD for OTC derivative contracts using the internal models methodology described in paragraph (d) of this section; and

(ii) Determine its specific risk add-on for debt positions issued by the counterparty using a specific risk model described in § 324.207(b).

(3) Recognition of hedges. (i) An FDIC-supervised institution 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 paragraph (e)(5)(ii) of this section or paragraph (e)(6) of this section, provided that the position is managed as a CVA hedge in accordance with the FDIC-supervised institution's hedging policies.

(ii) An FDIC-supervised institution shall not recognize as a CVA hedge any tranched or n^{th}-to-default credit derivative.

(4) Total CVA risk-weighted assets. Total CVA risk-weighted assets is the CVA capital requirement, $K_{CVA,}$ calculated for an FDIC-supervised institution's entire portfolio of OTC derivative counterparties that are subject to the CVA capital requirement, 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 equals the weight applicable to counterparty *i* under Table 3 to § 324.132;

(B) M_i equals the EAD-weighted average of the effective maturity of each netting set with counterparty *i* (where each netting set's effective maturity can be no less than one year.)

(C) EAD_i^{total} equals the sum of the EAD for all netting sets of OTC derivative contracts with counterparty *i* calculated using the current exposure methodology described in paragraph (c) of this section or the internal models methodology described in paragraph (d) of this section. When the FDIC-supervised institution calculates EAD under paragraph (c) of this section, 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), where "exp" is the exponential function. When the FDIC-supervised institution calculates EAD under paragraph (d) of this section, EAD_i^{total} equals $EAD_{unstressed}$.

(D) M_i^{hedge} equals the notional weighted average maturity of the hedge instrument.

(E) B_i equals 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} 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*.

(G) B_{ind} equals the notional amount of one or more CDS_{ind} purchased to hedge CVA risk for counterparty *i* multiplied by (1-exp(-0.05 x M_{ind}))/(0.05 x M_{ind})

(H) w_{ind} equals the weight applicable to the CDS_{ind} based on the average weight of the underlying reference names that comprise the index under Table 3 to § 324.132.

(ii) The FDIC-supervised institution 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}. An FDIC-supervised institution must treat the CDS_{ind} hedge with the notional amount reduced by B_i as a CVA hedge.

TABLE 3 TO § 324.132 – ASSIGNMENT OF COUNTERPARTY WEIGHT

Internal PD (in percent)	**Weight w_i (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) An FDIC-supervised institution may use the VaR model that it uses to determine specific risk under § 324.207(b) or another VaR model that meets the quantitative requirements of § 324.205(b) and § 324.207(b)(1) to calculate its CVA capital requirement for a counterparty by modeling the impact of changes in the counterparties' credit

spreads, together with any recognized CVA hedges, on the CVA for the counterparties, subject to the following requirements:

(A) The VaR model must incorporate only changes in the counterparties' credit spreads, not changes in other risk factors. The VaR model does not need to capture jump-to-default risk;

(B) An FDIC-supervised institution 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 paragraph (c) of this section according to paragraph (e)(6)(viii) of this section; and

(C) An FDIC-supervised institution 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, $K_{CVA,}$ is calculated according to the following formulas:

$$K_{CVA} = 3 \times (VaR^{CVA}_{Unstressed} + VaR^{CVA}_{Stressed})$$

where VaR^{CVA}_{j} is the 99% VaR reflecting changes of CVA_j and fair value of eligible hedges (aggregated across all counterparties and eligible hedges) resulting from simulated changes of credit spreads over a 10-day time horizon. CVA_j for a given counterparty must be calculated according to

$$CVA_j = (LGD_{MKT}) \times \sum_{i=1}^{T} Max\left(0; \exp\left(-\frac{s_{i-1} \times t_{i-1}}{LGD_{MKT}}\right) - \exp\left(-\frac{s_i \times t_i}{LGD_{MKT}}\right)\right) \times \left(\frac{EE_{i-1} \times D_{i-1} + EE_i \times D_i}{2}\right)$$

Where

(A) t_i equals the time of the i-th revaluation time bucket starting from $t_0 = 0$.

(B) t_T equals the longest contractual maturity across the OTC derivative contracts with the counterparty.

(C) s_i equals 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 FDIC-supervised institution must use a proxy spread based on the credit quality, industry and region of the counterparty.

(D) LGD_{MKT} equals 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. Where no market information and no reliable proxy based on the credit quality, industry, and region of the counterparty are available to determine $\mathrm{LGD}_{\mathrm{MKT}}$, an FDIC-supervised institution may use a conservative estimate when determining $\mathrm{LGD}_{\mathrm{MKT}}$, subject to approval by the FDIC.

(E) EE_i equals the sum of the expected exposures for all netting sets with the counterparty at revaluation time t_i , calculated according to paragraphs (e)(6)(iv)(A) and (e)(6)(v)(A) of this section.

(F) D_i equals the risk-free discount factor at time $t_{i,}$ where $D_0 = 1$.

(G) Exp is the exponential function.

(H) The subscript j refers either to a stressed or an unstressed calibration as described in paragraphs (6)(iv) and (v).

(iii) Notwithstanding paragraphs (e)(6)(i) and (e)(6)(ii) of this section, an FDIC-supervised institution must use the formulas in paragraphs (e)(6)(iii)(A) or (e)(6)(iii)(B) of this section 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 FDIC-supervised institution must calculate each credit spread sensitivity according to the following formula:

$$\text{Regulatory CS01}^{222} = 0.0001 \times t_i \times exp\left(-\frac{s_i \times t_i}{LGD_{MKT}}\right) \times \left(\frac{EE_{i-1} \times D_{i-1} - EE_{i+1} \times D_{i+1}}{2}\right)$$

(B) If the VaR model uses credit spread sensitivities to parallel shifts in credit spreads, the FDIC-supervised institution 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 $CVA_{Unstressed}$ measure for purposes of paragraph (e)(6)(ii) of this section, the FDIC-supervised institution must:

(A) Use the EE_i calculated using the calibration of paragraph (d)(3)(vii) of this section, except as provided in § 324.132 (e)(6)(vi), and

(B) Use the historical observation period required under § 324.205(b)(2) of subpart F of this part.

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[222] For the final time bucket i = T, the corresponding formula is

$$\text{Regulatory CS01} = 0.0001 \times t_i \times \exp\left(-\frac{s_i \times t_i}{LGD_{MKT}}\right) \times \left(\frac{EE_{i-1} \times D_{i-1} + EE_T \times D_T}{2}\right)$$

(v) To calculate the $CVA_{Stressed}$ measure for purposes of paragraph (e)(6)(ii) of this section, the FDIC-supervised institution must:

(A) Use the EE_i calculated using the stress calibration in paragraph (d)(3)(viii) of this section except as provided in § 324.132(e)(6)(vi) of this section.

(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 FDIC may require an FDIC-supervised institution to use a different period of significant financial stress in the calculation of the $CVA_{Stressed}$ measure.

(vi) If an FDIC-supervised institution captures the effect of a collateral agreement on EAD using the method described in paragraph (d)(5)(ii) of this section, for purposes of paragraph (e)(6)(ii) of this section, the FDIC-supervised institution must calculate EE_i using the method in paragraph (d)(5)(ii) of this section 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) For purposes of paragraph (e)(6) of this section, the FDIC-supervised institution'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 FDIC-supervised institution must reflect only 50 percent of the notional amount of the CDS_{ind} hedge in the VaR model.

(viii) If an FDIC-supervised institution uses the current exposure methodology described in paragraphs (c)(5) and (c)(6) of this section to calculate the EAD for any immaterial portfolios

of OTC derivative contracts, the FDIC-supervised institution 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.

§ 324.133 Cleared transactions.

(a) General requirements. (1) An FDIC-supervised institution that is a clearing member client must use the methodologies described in paragraph (b) of this section to calculate risk-weighted assets for a cleared transaction.

(2) An FDIC-supervised institution that is a clearing member must use the methodologies described in paragraph (c) of this section to calculate its risk-weighted assets for cleared transactions and paragraph (d) of this section to calculate its risk-weighted assets for its default fund contribution to a CCP.

(b) Clearing member client FDIC-supervised institutions. (1) Risk-weighted assets for cleared transactions.

(i) To determine the risk-weighted asset amount for a cleared transaction, an FDIC-supervised institution that is a clearing member client must multiply the trade exposure amount for the cleared transaction, calculated in accordance with paragraph (b)(2) of this section, by the risk weight appropriate for the cleared transaction, determined in accordance with paragraph (b)(3) of this section.

(ii) A clearing member client FDIC-supervised institution'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 a netting set of derivative contracts, trade exposure amount equals the EAD for the derivative contract or netting set of derivative contracts calculated using the methodology used to calculate EAD for OTC derivative contracts set forth in §§ 324.132(c) or (d), plus the fair value of the collateral posted by the clearing member client FDIC-supervised institution and held by the CCP or a clearing member in a manner that is not bankruptcy remote. When the FDIC-supervised institution calculates EAD for the cleared transaction using the methodology in § 324.132(d), EAD equals $EAD_{unstressed}$.

(ii) For a cleared transaction that is a repo-style transaction or netting set of repo-style transactions, trade exposure amount equals the EAD for the repo-style transaction calculated using the methodology set forth in §§ 324.132(b)(2), (b)(3), or (d), plus the fair value of the collateral posted by the clearing member client FDIC-supervised institution and held by the CCP or a clearing member in a manner that is not bankruptcy remote. When the FDIC-supervised institution calculates EAD for the cleared transaction under § 324.132(d), EAD equals $EAD_{unstressed.}$

(3) Cleared transaction risk weights. (i) For a cleared transaction with a QCCP, a clearing member client FDIC-supervised institution must apply a risk weight of:

(A) 2 percent if the collateral posted by the FDIC-supervised institution to the QCCP or clearing member is subject to an arrangement that prevents any loss to the clearing member client FDIC-supervised institution 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 FDIC-supervised institution 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 an event of default or from liquidation, insolvency or receivership proceedings) 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) 4 percent, if the requirements of § 324.132(b)(3)(i)(A) are not met.

(ii) For a cleared transaction with a CCP that is not a QCCP, a clearing member client FDIC-supervised institution must apply the risk weight applicable to the CCP under § 324.32.

(4) Collateral. (i) Notwithstanding any other requirement of this section, collateral posted by a clearing member client FDIC-supervised institution that is held by a custodian (in its capacity as custodian) in a manner that is bankruptcy remote from the CCP, the custodian, clearing member, and other clearing member clients of the clearing member, is not subject to a capital requirement under this section.

(ii) A clearing member client FDIC-supervised institution 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 § 324.131.

(c) Clearing member FDIC-supervised institution. (1) Risk-weighted assets for cleared transactions. (i) To determine the risk-weighted asset amount for a cleared transaction, a clearing member FDIC-supervised institution must multiply the trade exposure amount for the cleared transaction, calculated in accordance with paragraph (c)(2) of this section by the risk weight appropriate for the cleared transaction, determined in accordance with paragraph (c)(3) of this section.

(ii) A clearing member FDIC-supervised institution'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 FDIC-supervised institution must calculate its trade exposure amount for a cleared transaction as follows:

(i) For a cleared transaction that is a derivative contract or a netting set of derivative contracts, trade exposure amount equals the EAD calculated using the methodology used to calculate EAD for OTC derivative contracts set forth in § 324.132(c) or § 324.132(d), plus the fair value of the collateral posted by the clearing member FDIC-supervised institution and held by the CCP in a manner that is not bankruptcy remote. When the clearing member FDIC-supervised institution calculates EAD for the cleared transaction using the methodology in § 324.132(d), EAD equals $EAD_{unstressed}$.

(ii) For a cleared transaction that is a repo-style transaction or netting set of repo-style transactions, trade exposure amount equals the EAD calculated under §§ 324.132(b)(2), (b)(3), or (d), plus the fair value of the collateral posted by the clearing member FDIC-supervised institution and held by the CCP in a manner that is not bankruptcy remote. When the clearing member FDIC-supervised institution calculates EAD for the cleared transaction under § 324.132(d), EAD equals $EAD_{unstressed}$.

(3) Cleared transaction risk weights. (i) A clearing member FDIC-supervised institution must apply a risk weight of 2 percent to the trade exposure amount for a cleared transaction with a QCCP.

(ii) For a cleared transaction with a CCP that is not a QCCP, a clearing member FDIC-supervised institution must apply the risk weight applicable to the CCP according to § 324.32.

(4) Collateral. (i) Notwithstanding any other requirement of this section, collateral posted by a clearing member FDIC-supervised institution 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 clearing member FDIC-supervised institution 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 § 324.131

(d) Default fund contributions. (1) General requirement. A clearing member FDIC-supervised institution 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 FDIC-supervised institution or the FDIC, 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 FDIC-supervised institution'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 or an amount determined by the FDIC, based on factors such as size, structure and membership characteristics of the CCP and riskiness of its transactions, in cases where such default fund contributions may be unlimited.

(3) Risk-weighted asset amount for default fund contributions to QCCPs. A clearing member FDIC-supervised institution'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 the methodology set forth in paragraph (d)(3)(i) of this section (Method 1), multiplied by 1,250 percent or (d)(3)(iv) if this section (Method 2).

(i) Method 1. 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) $EBRM_i$ equals 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 § 324.132(c)(5) and § 324.132.(c)(6) or the methodology used to calculate EAD for repo-style transactions set forth in § 324.132(b)(2) for repo-style transactions, provided that:

(1) For purposes of this section, when calculating the EAD, the FDIC-supervised institution may replace the formula provided in § 324.132 (c)(6)(ii) with the following formula:

Anet = (0.15 x A_{gross}) + (0.85 x NGR x A_{gross}); and

(2) For option derivative contracts that are cleared transactions, the PFE described in § 324.132(c)(5) must be adjusted by multiplying the notional principal amount of the derivative contract by the appropriate conversion factor in Table 2 to § 324.132 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.

(3) For repo-style transactions, when applying § 324.132(b)(2), the FDIC-supervised institution must use the methodology in § 324.132(b)(2)(ii).

(B) VM_i equals 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 has actually received from clearing member i;

(C) IM_i equals the collateral posted as initial margin by clearing member i to the QCCP;

(D) DF_i equals 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 equals 20 percent, except when the FDIC has determined that a higher risk weight is more appropriate based on the specific characteristics of the QCCP and its clearing members; and

(F) Where a QCCP has provided its K_{CCP}, an FDIC-supervised institution must rely on such disclosed figure instead of calculating K_{CCP} under this paragraph, unless the FDIC-supervised institution determines that a more conservative figure is appropriate based on the nature, structure, or characteristics of the QCCP.

(ii) For an FDIC-supervised institution 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 section, for cleared transactions that are derivatives, A_{Net} is defined using the definition set forth in § 324.132(c)(6)(ii) and for cleared transactions that are repo-style transactions, A_{Net} is the EAD equation max $\{0, [(\sum E - \sum C) + \sum(E_s \text{ x } H_s) + \sum(Efx]\}$ from § 324.132(b)(2(i)) using the methodology in § 324.132(b)(2)(ii);

(B) N equals the number of clearing members in the QCCP;

(C) DF_{CCP} equals 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} equals 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 1.6 percent and .16 percent, applied to the excess funded default funds provided by clearing members);

(J) c_2 = 100 percent; and

(K) μ= 1.2;

(iii) For an FDIC-supervised institution 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 equals the FDIC-supervised institution's unfunded commitment to the default fund;

(B) DF_{CM} equals the total of all clearing members' unfunded commitments to the default fund; and

(C) K^*_{CM} as defined in paragraph (d)(3)(ii) of this section.

(D) For an FDIC-supervised institution 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 paragraph (d)(3)(iii), K_{CM} equals:

$$K_{CM_i} = \frac{IM_i}{IM_{CM}} \cdot K^*_{CM}$$

Where

(1) IM_i equals the FDIC-supervised institution'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 paragraph (d)(3)(iii).

(iv) Method 2. A clearing member FDIC-supervised institution's risk-weighted asset amount for its default fund contribution to a QCCP, RWA_{DF}, equals:

$$RWA_{DF} = \text{Min}\ \{12.5 * DF;\ 0.18 * TE\}$$

Where

(A) TE equals the FDIC-supervised institution's trade exposure amount to the QCCP calculated according to section 133(c)(2);

(B) DF equals the funded portion of the FDIC-supervised institution's default fund contribution to the QCCP.

(v) Total risk-weighted assets for default fund contributions. Total risk-weighted assets for default fund contributions is the sum of a clearing member FDIC-supervised institution's risk-weighted assets for all of its default fund contributions to all CCPs of which the FDIC-supervised institution is a clearing member.

§ 324.134 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 FDIC-supervised institution 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 §§ 324.141 through 324.145.

(3) An FDIC-supervised institution may elect to recognize the credit risk mitigation benefits of an eligible guarantee or eligible credit derivative covering an exposure described in paragraph (a)(1) of this section by using the PD substitution approach or the LGD adjustment approach in paragraph (c) of this section or, if the transaction qualifies, using the double default treatment in § 324.135. An FDIC-supervised institution's PD and LGD for the hedged exposure may not be lower than the PD and LGD floors described in §§ 324.131(d)(2) and (d)(3).

(4) If multiple eligible guarantees or eligible credit derivatives cover a single exposure described in paragraph (a)(1) of this section, an FDIC-supervised institution 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 in paragraph (a)(3) of this section.

(5) If a single eligible guarantee or eligible credit derivative covers multiple hedged wholesale exposures described in paragraph (a)(1) of this section, an FDIC-supervised institution 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 paragraph (a)(3) of this section.

(6) An FDIC-supervised institution 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) An FDIC-supervised institution may only recognize the credit risk mitigation benefits of eligible guarantees and eligible credit derivatives.

(2) An FDIC-supervised institution 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 paragraphs (a) and (b) of this section and the protection amount (P) of the guarantee or credit derivative is greater than or equal to the EAD of the hedged exposure, an FDIC-supervised institution may recognize the guarantee or credit derivative in determining the FDIC-supervised institution'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 § 324.131 and using the appropriate LGD as described in paragraph (c)(1)(iii) of this section. If the FDIC-supervised institution determines that full substitution of the protection provider's PD leads to an inappropriate degree of risk mitigation, the FDIC-supervised institution 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 paragraphs (a) and (b) of this section and P of the guarantee or credit derivative is less than the EAD of the hedged exposure, the FDIC-supervised institution 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 FDIC-supervised institution must calculate its risk-based capital requirement for the protected exposure under § 324.131, where PD is the protection provider's PD, LGD is determined under paragraph (c)(1)(iii) of this section, and EAD is P. If the FDIC-supervised institution determines that full substitution leads to an inappropriate degree of risk mitigation, the FDIC-supervised institution may use a higher PD than that of the protection provider.

(B) The FDIC-supervised institution must calculate its risk-based capital requirement for the unprotected exposure under § 324.131, 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 paragraph (c)(1)(ii) of this section 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 paragraphs (d), (e), or (f) of this section.

(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 FDIC-supervised institution 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 FDIC-supervised institution 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 paragraphs (a) and (b) of this section and the protection amount (P) of the guarantee or credit derivative is greater than or equal to the EAD of the hedged exposure, the FDIC-supervised institution'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 § 324.131, 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 § 324.131, 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 paragraphs (a) and (b) of this section and the protection amount (P) of the guarantee or credit derivative is less than the EAD of the hedged exposure, the FDIC-supervised institution 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 FDIC-supervised institution'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 § 324.131, 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 § 324.131, using the PD for the protection provider, the LGD for the guarantee or credit derivative, and an EAD set equal to P.

(B) The FDIC-supervised institution must calculate its risk-based capital requirement for the unprotected exposure under § 324.131, 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. For purposes of this paragraph (c), the M of the hedged exposure is the same as the M of the exposure if it were unhedged.

(d) Maturity mismatch. (1) An FDIC-supervised institution 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 FDIC-supervised institution (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 FDIC-supervised institution (protection purchaser), but the terms of the arrangement at origination of the credit risk mitigant contain a positive incentive for the FDIC-supervised institution to call the transaction before contractual maturity, the remaining time to the first call date is the residual maturity of the credit risk mitigant.[223]

(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 FDIC-supervised institution 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 equals effective notional amount of the credit risk mitigant, adjusted for maturity mismatch;

(ii) E equals effective notional amount of the credit risk mitigant;

(iii) t equals the lesser of T or the residual maturity of the credit risk mitigant, expressed in years; and

(iv) T equals 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 an FDIC-supervised institution recognizes an eligible credit derivative that does not include as a credit event a

[223] 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.

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 FDIC-supervised institution 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 equals effective notional amount of the credit risk mitigant, adjusted for lack of restructuring event (and maturity mismatch, if applicable); and

(2) P_m equals effective notional amount of the credit risk mitigant adjusted for maturity mismatch (if applicable).

(f) Currency mismatch. (1) If an FDIC-supervised institution 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 FDIC-supervised institution 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 equals 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 equals effective notional amount of the credit risk mitigant (adjusted for maturity mismatch and lack of restructuring event, if applicable); and

(iii) H_{FX} equals haircut appropriate for the currency mismatch between the credit risk mitigant and the hedged exposure.

(2) An FDIC-supervised institution 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. An FDIC-supervised

institution qualifies for the use of its own internal estimates of foreign exchange volatility if it qualifies for:

(i) The own-estimates haircuts in § 324.132(b)(2)(iii);

(ii) The simple VaR methodology in § 324.132(b)(3); or

(iii) The internal models methodology in § 324.132(d).

(3) An FDIC-supervised institution must adjust H_{FX} calculated in paragraph (f)(2) of this section upward if the FDIC-supervised institution revalues the guarantee or credit derivative less frequently than once every ten business days using the square root of time formula provided in § 324.132(b)(2)(iii)(A)(2).

§ 324.135 Guarantees and credit derivatives: double default treatment.

(a) Eligibility and operational criteria for double default treatment. An FDIC-supervised institution may recognize the credit risk mitigation benefits of a guarantee or credit derivative covering an exposure described in § 324.134(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 § 324.134(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 nth-to-default credit derivative (subject to the requirements of § 324.142(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 FDIC-supervised institution 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 FDIC-supervised institution has implemented a process (which has received the prior, written approval of the FDIC) to detect excessive correlation between the creditworthiness of the obligor of the hedged exposure and the protection provider. If excessive correlation is present, the FDIC-supervised institution may not use the double default treatment for the hedged exposure.

(b) Full coverage. If a transaction meets the criteria in paragraph (a) of this section and the protection amount (P) of the guarantee or credit derivative is at least equal to the EAD of the hedged exposure, the FDIC-supervised institution may determine its risk-weighted asset amount for the hedged exposure under paragraph (e) of this section.

(c) Partial coverage. If a transaction meets the criteria in paragraph (a) of this section and the protection amount (P) of the guarantee or credit derivative is less than the EAD of the hedged exposure, the FDIC-supervised institution 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 FDIC-supervised institution must set EAD equal to P and calculate its risk-weighted asset amount as provided in paragraph (e) of this section; and

(2) For the unprotected exposure, the FDIC-supervised institution must set EAD equal to the EAD of the original exposure minus P and then calculate its risk-weighted asset amount as provided in § 324.131.

(d) Mismatches. For any hedged exposure to which an FDIC-supervised institution applies double default treatment under this part, the FDIC-supervised institution must make applicable adjustments to the protection amount as required in §§ 324.134(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 an FDIC-supervised institution 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 equals PD of the protection provider.

(3) PD_o equals PD of the obligor of the hedged exposure.

(4) LGD_g equals (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 FDIC-supervised institution 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 FDIC-supervised institution with the option to receive immediate payout on triggering the protection; and

(5) ρ_{os} (asset value correlation of the obligor) is calculated according to the appropriate formula for (R) provided in Table 1 in § 324.131, with PD equal to PD_o.

(6) b (maturity adjustment coefficient) is calculated according to the formula for b provided in Table 1 in § 324.131, with PD equal to the lesser of PD_o and PD_g; and

(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.

§ 324.136 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) 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) The positive current exposure of an FDIC-supervised institution 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 FDIC-supervised institution 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 §§ 324.131 and 324.132);

(3) One-way cash payments on OTC derivative contracts (which are addressed in §§ 324.131 and 324.132); 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 §§ 324.131 and 324.132).

(c) System-wide failures. In the case of a system-wide failure of a settlement or clearing system, or a central counterparty, the FDIC 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. An FDIC-supervised institution must hold risk-based capital against any DvP or PvP transaction with a normal settlement period if the FDIC-supervised institution's counterparty has not made delivery or payment within five business days after the settlement date. The FDIC-supervised institution must determine its risk-weighted asset amount for such a transaction by multiplying the positive current exposure of the transaction for the FDIC-supervised institution by the appropriate risk weight in Table 1 to § 324.136.

TABLE 1 TO § 324.136 – 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) An FDIC-supervised institution must hold risk-based capital against any non-DvP/non-PvP transaction with a normal settlement period if the FDIC-supervised institution 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 FDIC-supervised institution must continue to hold risk-based capital against the transaction until the FDIC-supervised institution has received its corresponding deliverables.

(2) From the business day after the FDIC-supervised institution has made its delivery until five business days after the counterparty delivery is due, the FDIC-supervised institution must calculate its risk-based capital requirement for the transaction by treating the current fair value of the deliverables owed to the FDIC-supervised institution as a wholesale exposure.

(i) An FDIC-supervised institution may use a 45 percent LGD for the transaction rather than estimating LGD for the transaction provided the FDIC-supervised institution uses the 45 percent LGD for all transactions described in §§ 324.135(e)(1) and (e)(2).

(ii) An FDIC-supervised institution may use a 100 percent risk weight for the transaction provided the FDIC-supervised institution uses this risk weight for all transactions described in §§ 324.135(e)(1) and (e)(2).

(3) If the FDIC-supervised institution has not received its deliverables by the fifth business day after the counterparty delivery was due, the FDIC-supervised institution must apply a 1,250 percent risk weight to the current fair value of the deliverables owed to the FDIC-supervised institution.

(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

§ 324.141 Operational criteria for recognizing the transfer of risk.

(a) Operational criteria for traditional securitizations. An FDIC-supervised institution 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 paragraph (a) is satisfied. An FDIC-supervised institution that meets these conditions must hold risk-based capital against any securitization exposures it retains in connection with the securitization. An FDIC-supervised institution that fails to meet these conditions or chooses not to recognize the credit risk mitigant for purposes of this section 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 FDIC-supervised institution's consolidated balance sheet under GAAP;

(2) The FDIC-supervised institution has transferred to one or more 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) Contain an early amortization provision.

(b) Operational criteria for synthetic securitizations. For synthetic securitizations, an FDIC-supervised institution may recognize for risk-based capital purposes under this subpart the use of a credit risk mitigant to hedge underlying exposures only if each of the conditions in this paragraph (b) is satisfied. An FDIC-supervised institution that meets these conditions must hold risk-based capital against any credit risk of the exposures it retains in connection with the synthetic securitization. An FDIC-supervised institution that fails to meet these conditions must hold risk-based capital under this subpart against the underlying exposures as if they had not been synthetically securitized. The conditions are:

(1) The credit risk mitigant is:

(i) Financial collateral; or

(ii) A guarantee that meets all of the requirements of an eligible guarantee in § 324.2 except for paragraph (3) of the definition; or

(iii) A credit derivative that meets all of the requirements of an eligible credit derivative except for paragraph (3) of the definition of eligible guarantee in § 324.2.

(2) The FDIC-supervised institution 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 FDIC-supervised institution to alter or replace the underlying exposures to improve the credit quality of the underlying exposures;

(iii) Increase the FDIC-supervised institution'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 FDIC-supervised institution 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 FDIC-supervised institution after the inception of the securitization;

(3) The FDIC-supervised institution 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 § 324.142(k), if an FDIC-supervised institution is unable to demonstrate to the satisfaction of the FDIC a comprehensive understanding of the features of a securitization exposure that would materially affect the performance of the exposure, the FDIC-supervised institution must assign a 1,250 percent risk weight to the securitization exposure. The FDIC-supervised institution's

analysis must be commensurate with the complexity of the securitization exposure and the materiality of the position in relation to regulatory capital according to this part.

(2) An FDIC-supervised institution must demonstrate its comprehensive understanding of a securitization exposure under paragraph (c)(1) of this section, for each securitization exposure by:

(i) 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, 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, fair 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, 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 this section for each securitization exposure.

§ 324.142 Risk-weighted assets for securitization exposures.

(a) Hierarchy of approaches. Except as provided elsewhere in this section and in § 324.141:

(1) An FDIC-supervised institution 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 paragraph (a)(1) of this section, the FDIC-supervised institution must apply the supervisory formula approach in § 324.143 to the exposure if the FDIC-supervised institution and the exposure qualify for the supervisory formula approach according to § 324.143(a);

(3) If a securitization exposure does not require deduction or a 1,250 percent risk weight under paragraph (a)(1) of this section and does not qualify for the supervisory formula approach, the FDIC-supervised institution may apply the simplified supervisory formula approach under § 324.144;

(4) If a securitization exposure does not require deduction or a 1,250 percent risk weight under paragraph (a)(1) of this section, does not qualify for the supervisory formula approach in § 324.143, and the FDIC-supervised institution does not apply the simplified supervisory formula approach in § 324.144, the FDIC-supervised institution must apply a 1,250 percent risk weight to the exposure; and

(5) If a securitization exposure is a derivative contract (other than protection provided by an FDIC-supervised institution in the form of 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), an FDIC-supervised institution may choose to set the risk-weighted asset amount of the exposure equal to the amount of the exposure as determined in paragraph (e) of this section rather than apply the hierarchy of approaches described in paragraphs (a)(1) through (4) of this section.

(b) Total risk-weighted assets for securitization exposures. An FDIC-supervised institution's total risk-weighted assets for securitization exposures is equal to the sum of its risk-weighted assets calculated using §§ 324.141 through 146.

(c) Deductions. An FDIC-supervised institution 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 § 324.141(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 FDIC-supervised institution associated with a single securitization (excluding any risk-based capital requirements that relate to the FDIC-supervised institution's gain-on-sale or CEIOs associated with the securitization) may not exceed the sum of:

(1) The FDIC-supervised institution's total risk-based capital requirement for the underlying exposures calculated under this subpart as if the FDIC-supervised institution directly held the underlying exposures; and

(2) The total ECL of the underlying exposures calculated under this subpart.

(e) Exposure amount of a securitization exposure. (1) The exposure amount of an on-balance sheet securitization exposure that is not a repo-style transaction, eligible margin loan,

OTC derivative contract, or cleared transaction is the FDIC-supervised institution's carrying value.

(2) Except as provided in paragraph (m) of this section, the exposure amount of an off-balance sheet securitization exposure that is not an OTC derivative contract (other than a credit derivative), repo-style transaction, eligible margin loan, 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 FDIC-supervised institution 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 exposure amount of a securitization exposure that is a repo-style transaction, eligible margin loan, or OTC derivative contract (other than a credit derivative) or cleared transaction (other than a credit derivative) is the EAD of the exposure as calculated in § 324.132 or § 324.133.

(f) Overlapping exposures. If an FDIC-supervised institution has multiple securitization exposures that provide duplicative coverage of the underlying exposures of a securitization (such as when an FDIC-supervised institution provides a program-wide credit enhancement and multiple pool-specific liquidity facilities to an ABCP program), the FDIC-supervised institution is not required to hold duplicative risk-based capital against the overlapping position. Instead, the FDIC-supervised institution may assign to the overlapping securitization exposure the applicable risk-based capital treatment under this subpart that results in the highest risk-based capital requirement.

(g) Securitizations of non-IRB exposures. Except as provided in § 324.141(c), if an FDIC-supervised institution has a securitization exposure where any underlying exposure is not a wholesale exposure, retail exposure, securitization exposure, or equity exposure, the FDIC-supervised institution:

(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 FDIC-supervised institution is an originating FDIC-supervised institution;

(2) May apply the simplified supervisory formula approach in § 324.144 to the exposure, if the securitization exposure does not require deduction or a 1,250 percent risk weight under paragraph (g)(1) of this section;

(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 paragraph (g)(1) of this section, does not qualify for the supervisory formula approach in § 324.143, and the FDIC-supervised institution does not apply the simplified supervisory formula approach in § 324.144 to the exposure.

(h) Implicit support. If an FDIC-supervised institution provides support to a securitization in excess of the FDIC-supervised institution's contractual obligation to provide credit support to the securitization (implicit support):

(1) The FDIC-supervised institution 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 FDIC-supervised institution must disclose publicly:

(i) That it has provided implicit support to the securitization; and

(ii) The regulatory capital impact to the FDIC-supervised institution of providing such implicit support.

(i) Undrawn portion of a servicer cash advance facility.

(1) Notwithstanding any other provision of this subpart, an FDIC-supervised institution that is a servicer under an eligible servicer cash advance facility is not required to hold risk-based capital against potential future cash advance payments that it may be required to provide under the contract governing the facility.

(2) For an FDIC-supervised institution that acts as a servicer, the exposure amount for a servicer cash advance facility that is not an eligible servicer cash advance facility is equal to the amount of all potential future cash advance payments that the FDIC-supervised institution may be contractually required to provide during the subsequent 12 month period under the contract governing the facility.

(j) Interest-only mortgage-backed securities. Regardless of any other provisions in this part, 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, an FDIC-supervised institution 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 FDIC-supervised institution establishes and maintains, pursuant to GAAP, a non-capital reserve sufficient to meet the FDIC-supervised institution'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 (15 U.S.C. 632 et seq.); and

(iv) The FDIC-supervised institution is well-capitalized, as defined in subpart H of this part. For purposes of determining whether an FDIC-supervised institution is well capitalized for purposes of this paragraph, the FDIC-supervised institution'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.

(2) The total outstanding amount of recourse retained by an FDIC-supervised institution on transfers of small-business obligations subject to paragraph (k)(1) of this section cannot exceed 15 percent of the FDIC-supervised institution's total capital.

(3) If an FDIC-supervised institution ceases to be well capitalized or exceeds the 15 percent capital limitation in paragraph (k)(2) of this section, the preferential capital treatment specified in paragraph (k)(1) of this section will continue to apply to any transfers of small-business obligations with recourse that occurred during the time that the FDIC-supervised institution was well capitalized and did not exceed the capital limit.

(4) The risk-based capital ratios of an FDIC-supervised institution 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.

(l) N^{th}-to-default credit derivatives. (1) Protection provider. An FDIC-supervised institution must determine a risk weight using the supervisory formula approach (SFA) pursuant to § 324.143 or the simplified supervisory formula approach (SSFA) pursuant to § 324.144 for an nth-to-default credit derivative in accordance with this paragraph. In the case of credit protection sold, an FDIC-supervised institution must determine its exposure in the nth-to-default credit derivative as the largest notional 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 FDIC-supervised institution 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 FDIC-supervised institution's exposure to the total notional amount of all underlying exposures. For purposes of the SSFA, parameter A is expressed as a decimal value between zero and one. 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 FDIC-supervised institution'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 FDIC-supervised institution's exposure.

(ii) The detachment point (parameter D) equals the sum of parameter A plus the ratio of the notional amount of the FDIC-supervised institution's exposure in the nth-to-default credit derivative to the total notional amount of all underlying exposures. For purposes of the SSFA,

parameter W is expressed as a decimal value between zero and one. For purposes of the SFA, parameter D must be set to equal L plus the thickness of tranche T input to the SFA formula.

(3) An FDIC-supervised institution 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. An FDIC-supervised institution that obtains credit protection on a group of underlying exposures through a first-to-default credit derivative that meets the rules of recognition of § 324.134(b) must determine its risk-based capital requirement under this subpart for the underlying exposures as if the FDIC-supervised institution synthetically securitized the underlying exposure with the lowest risk-based capital requirement and had obtained no credit risk mitigant on the other underlying exposures. An FDIC-supervised institution must calculate a risk-based capital requirement for counterparty credit risk according to § 324.132 for a first-to-default credit derivative that does not meet the rules of recognition of § 324.134(b).

(ii) Second-or-subsequent-to-default credit derivatives. (A) An FDIC-supervised institution that obtains credit protection on a group of underlying exposures through a nth -to-default credit derivative that meets the rules of recognition of § 324.134(b) (other than a first-to-default credit derivative) may recognize the credit risk mitigation benefits of the derivative only if:

(1) The FDIC-supervised institution 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 an FDIC-supervised institution satisfies the requirements of paragraph (l)(3)(ii)(A) of this section, the FDIC-supervised institution 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 smallest risk-based capital requirement and had obtained no credit risk mitigant on the other underlying exposures.

(C) An FDIC-supervised institution must calculate a risk-based capital requirement for counterparty credit risk according to § 324.132 for a nth-to-default credit derivative that does not meet the rules of recognition of § 324.134(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 nth-to-default credit derivative) provided by an FDIC-supervised institution that covers the full amount or a pro rata share of a securitization exposure's principal and interest, the FDIC-supervised institution 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) An FDIC-supervised institution that purchases an OTC credit derivative (other than an nth-to-default credit derivative) that is recognized under § 324.145 as a credit risk mitigant (including via recognized collateral) is not required to compute a separate counterparty credit risk capital requirement under § 324.131 in accordance with § 324132(c)(3).

(ii) If an FDIC-supervised institution cannot, or chooses not to, recognize a purchased credit derivative as a credit risk mitigant under § 324.145, the FDIC-supervised institution must determine the exposure amount of the credit derivative under § 324.132(c).

(A) If the FDIC-supervised institution purchases credit protection from a counterparty that is not a securitization SPE, the FDIC-supervised institution must determine the risk weight for the exposure according to § 324.131.

(B) If the FDIC-supervised institution purchases the credit protection from a counterparty that is a securitization SPE, the FDIC-supervised institution must determine the risk weight for the exposure according to section § 324.142, including § 324.142(a)(5) for a credit derivative that has a first priority claim on the cash flows from the underlying exposures of the securitization SPE (notwithstanding amounts due under interest rate or currency derivative contracts, fees due, or other similar payments.

§ 324.143 Supervisory formula approach (SFA).

(a) Eligibility requirements. An FDIC-supervised institution must use the SFA to determine its risk-weighted asset amount for a securitization exposure if the FDIC-supervised institution can calculate on an ongoing basis each of the SFA parameters in paragraph (e) of this section.

(b) Mechanics. The risk-weighted asset amount for a securitization exposure equals its SFA risk-based capital requirement as calculated under paragraph (c) and (d) of this section, multiplied by 12.5.

(c) The SFA risk-based capital requirement. (1) If K_{IRB} is greater than or equal to L+T, an exposure's SFA risk-based capital requirement equals the exposure amount.

(2) If K_{IRB} is less than or equal to L, an exposure's SFA risk-based capital requirement is UE multiplied by TP multiplied by the greater of:

(i) $F \cdot T$ (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 FDIC-supervised institution 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 · (T – (K_{IRB} – L)) (where F is 0.016 for all other securitization exposures); or

(ii) S[L + T] – S[K_{IRB}].

(d) <u>The supervisory formula</u>:

(1) $$S[Y] = \begin{cases} Y & \text{when } Y \le K_{IRB} \\ K_{IRB} + K[Y] - K[K_{IRB}] + \dfrac{d \cdot K_{IRB}}{20}\left(1 - e^{\frac{20 \cdot (K_{IRB} - Y)}{K_{IRB}}}\right) & \text{when } Y > K_{IRB} \end{cases}$$

(2) $$K[Y] = (1-h) \cdot \left[\left(1 - \beta[Y; a, b]\right) \cdot Y + \beta[Y; a+1, b] \cdot c\right]$$

(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. For purposes of the calculations in paragraphs (c) and (d) of this section:

(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 § 324.142(e)) plus the adjusted carrying value of any underlying exposures that are equity exposures (as defined in § 324.151(b)).

(2) Tranche percentage (TP). TP is the ratio of the amount of the FDIC-supervised institution'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 FDIC-supervised institution); 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 all of the 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 FDIC-supervised institution's securitization exposure; to

(B) UE.

(ii) An FDIC-supervised institution 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 FDIC-supervised institution'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 FDIC-supervised institution's securitization exposure; to

(ii) UE.

(6) Effective number of exposures (N). (i) Unless the FDIC-supervised institution elects to use the formula provided in paragraph (f) of this section,

$$N = \frac{(\sum_i EAD_i)^2}{\sum_i EAD_i^2}$$

where EAD_i represents the EAD associated with the ith instrument in the underlying exposures.

(ii) Multiple exposures to one obligor must be treated as a single underlying exposure.

(iii) In the case of a resecuritization, the FDIC-supervised institution 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 ith 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, an FDIC-supervised institution may apply the SFA using the following simplifications:

(i) h = 0; and

(ii) v = 0.

(2) Under the conditions in §§ 324.143(f)(3) and (f)(4), an FDIC-supervised institution may employ a simplified method for calculating N and EWALGD.

(3) If C_1 is no more than 0.03, an FDIC-supervised institution 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 FDIC-supervised institution.

(4) Alternatively, if only C_1 is available and C_1 is no more than 0.03, the FDIC-supervised institution 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 $N = 1/C_1$.

§ 324.144 Simplified supervisory formula approach (SSFA).

(a) General requirements for the SSFA. To use the SSFA to determine the risk weight for a securitization exposure, an FDIC-supervised institution 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; if the contracts governing the underlying exposures of the securitization require payments on a monthly or quarterly basis, the data used to assign the parameters described in paragraph (b)

of this section must be no more than 91 calendar days old. An FDIC-supervised institution that does not have the appropriate data to assign the parameters described in paragraph (b) of this section 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, an FDIC-supervised institution 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 subpart D of this part. K_G is expressed as a decimal value between zero and one (that is, an average risk weight of 100 percent represents a value of K_G equal to 0.08).

(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 of the securitization that meet any of the criteria as set forth in paragraphs (b)(2)(i) through (vi) of this section to the 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 payments for 90 days or more, other than principal or interest payments deferred on:

(A) Federally-guaranteed student loans, in accordance with the terms of those guarantee programs; or

(B) Consumer loans, including non-federally-guaranteed student loans, provided that such payments are deferred pursuant to provisions included in the contract at the time funds are disbursed that provide for period(s) of deferral that are not initiated based on changes in the creditworthiness of the borrower; 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. Except as provided in § 324.142(l) for n^{th}-to-default credit derivatives, parameter A equals the ratio of the current dollar amount of underlying exposures that are subordinated to the exposure of the FDIC-supervised institution 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 FDIC-supervised institution'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. Except as provided in § 324.142(l) for n^{th}-to-default credit derivatives, 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 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 a securitization exposure, as appropriate, is the larger of the risk weight determined in accordance with this paragraph, 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 FDIC-supervised institution 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. For the purpose of this weighted-average calculation:

(i) The weight assigned to 1,250 percent equals $\frac{K_A - A}{D - A}$; and

(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:

$$Risk\ Weight =$$

$$\left[\left(\frac{K_A - A}{D - A}\right) \cdot 1{,}250\ percent\right] + \left[\left(\frac{D - K_A}{D - A}\right) \cdot 1{,}250\ percent \cdot K_{SSFA}\right]$$

(d) SSFA equation. (1) The FDIC-supervised institution must define the following parameters:

$$K_A = (1 - W) \cdot K_G + (0.5 \cdot W)$$

$$a = -\frac{1}{p \cdot K_A}$$

$$u = D - K_A$$

$$l = \max(A - K_A, 0)$$

$e = 2.71828$, the base of the natural logarithms.

(2) Then the FDIC-supervised institution 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 $K_{SSFA} \times 1{,}250$.

§ 324.145 Recognition of credit risk mitigants for securitization exposures.

(a) General. An originating FDIC-supervised institution that has obtained a credit risk mitigant to hedge its securitization exposure to a synthetic or traditional securitization that satisfies the operational criteria in § 324.141 may recognize the credit risk mitigant, but only as provided in this section. An investing FDIC-supervised institution 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. An FDIC-supervised institution may recognize financial collateral in determining the FDIC-supervised institution'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 FDIC-supervised institution has reflected collateral in its determination of exposure amount under § 324.132) as follows. The FDIC-supervised institution'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 § 324.144 or under the SFA in § 324.143 multiplied by the ratio of adjusted exposure amount (SE*) to original exposure amount (SE), where:

(i) SE* equals max {0, [SE - C x (1 - H_s - H_{fx})]};

(ii) SE equals the amount of the securitization exposure calculated under § 324.142(e);

(iii) C equals the current fair value of the collateral;

(iv) H_s equals the haircut appropriate to the collateral type; and

(v) H_{fx} equals 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 fair value of the asset in the basket divided by the current fair value of all assets in the basket and H_i is the haircut applicable to that asset.

(3) Standard supervisory haircuts. Unless an FDIC-supervised institution qualifies for use of and uses own-estimates haircuts in paragraph (b)(4) of this section:

(i) An FDIC-supervised institution must use the collateral type haircuts (H_s) in Table 1 to § 324.132 of this subpart;

(ii) An FDIC-supervised institution must use a currency mismatch haircut (H_{fx}) of 8 percent if the exposure and the collateral are denominated in different currencies;

(iii) An FDIC-supervised institution must multiply the supervisory haircuts obtained in paragraphs (b)(3)(i) and (ii) of this section by the square root of 6.5 (which equals 2.549510); and

(iv) An FDIC-supervised institution 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 FDIC, an FDIC-supervised institution may calculate haircuts using its own internal estimates of market price volatility and foreign exchange volatility, subject to § 324.132(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. An FDIC-supervised institution may only recognize an eligible guarantee or eligible credit derivative provided by an eligible guarantor in determining the FDIC-supervised institution's risk-weighted asset amount for a securitization exposure.

(2) ECL for securitization exposures. When an FDIC-supervised institution recognizes an eligible guarantee or eligible credit derivative provided by an eligible guarantor in determining the FDIC-supervised institution's risk-weighted asset amount for a securitization exposure, the FDIC-supervised institution 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 paragraph (c)(3) of this section; and

(ii) Add the exposure's ECL to the FDIC-supervised institution's total ECL.

(3) Rules of recognition. An FDIC-supervised institution may recognize an eligible guarantee or eligible credit derivative provided by an eligible guarantor in determining the FDIC-supervised institution'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 FDIC-supervised institution 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 § 324.131), using the FDIC-supervised institution's PD for the guarantor, the FDIC-supervised institution's LGD for the guarantee or credit derivative, and an EAD equal to the amount of the securitization exposure (as determined in § 324.142(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 FDIC-supervised institution 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 § 324.131), using the FDIC-supervised institution's PD for the guarantor, the FDIC-supervised institution'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 §§ 324.142 through 324.146).

(4) Mismatches. The FDIC-supervised institution must make applicable adjustments to the protection amount as required in §§ 324.134(d), (e), and (f) 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 FDIC-supervised institution 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

§ 324.151 Introduction and exposure measurement.

(a) General. (1) To calculate its risk-weighted asset amounts for equity exposures that are not equity exposures to investment funds, an FDIC-supervised institution may apply either the Simple Risk Weight Approach (SRWA) in § 324.152 or, if it qualifies to do so, the Internal Models Approach (IMA) in § 324.153. An FDIC-supervised institution must use the look-through approaches provided in § 324.154 to calculate its risk-weighted asset amounts for equity exposures to investment funds.

(2) An FDIC-supervised institution must treat an investment in a separate account (as defined in § 324.2) , as if it were an equity exposure to an investment fund as provided in § 324.154.

(3) Stable value protection. (i) Stable value protection means a contract where the provider of the contract is obligated to pay:

(A) The policy owner of a separate account an amount equal to the shortfall between the fair value and cost basis of the separate account when the policy owner of the separate account surrenders the policy, or

(B) The beneficiary of the contract an amount equal to the shortfall between the fair value and book value of a specified portfolio of assets.

(ii) An FDIC-supervised institution that purchases stable value protection on its investment in a separate account must treat the portion of the carrying value of its investment in the separate account attributable to the stable value protection as an exposure to the provider of the protection and the remaining portion of the carrying value of its separate account as an equity exposure to an investment fund.

(iii) An FDIC-supervised institution that provides stable value protection must treat the exposure as an equity derivative according to § 324.151(b)(3).

(b) Adjusted carrying value. For purposes of this subpart, the adjusted carrying value of an equity exposure is:

(1) For the on-balance sheet component of an equity exposure, the FDIC-supervised institution's carrying value of the exposure;

(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.

(3) 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 FDIC-supervised institution's best estimate of the amount that would be funded under economic downturn conditions.

§ 324.152 Simple risk weight approach (SRWA).

(a) General. Under the SRWA, an FDIC-supervised institution'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 FDIC-supervised institution'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 FDIC-supervised institution's individual equity exposures to an investment fund as determined in § 324.154.

(b) SRWA computation for individual equity exposures. An FDIC-supervised institution 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 paragraph (c) of this section) 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 § 324.131(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 significant investments in the capital of an unconsolidated institution in the form of common stock and exposures to an investment firm that would meet the definition of a traditional securitization were it not for the FDIC's application of paragraph (8) of that definition in § 324.2 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 FDIC-supervised institution's total capital.

(A) To compute the aggregate adjusted carrying value of an FDIC-supervised institution's equity exposures for purposes of this section, the FDIC-supervised institution may exclude equity exposures described in paragraphs (b)(1), (b)(2), (b)(3)(i), and (b)(3)(ii) of this section, 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 paragraph (b)(3)(i) of this section. If an FDIC-supervised institution does not know the actual holdings of the investment fund, the FDIC-supervised institution 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 FDIC-supervised institution 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 an FDIC-supervised institution's equity exposures qualifies for a 100 percent risk weight under this section, an FDIC-supervised institution 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 in the form of common stock that are not deducted from capital pursuant to § 324.22(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 paragraph (b)(6) of this section 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 paragraph (b)(6) of this section) 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 FDIC's application of paragraph (8) of that definition in § 324.2; 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 FDIC-supervised institution acquires at least one of the equity exposures); the documentation specifies the measure of effectiveness (E) the FDIC-supervised institution 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. An FDIC-supervised institution 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 FDIC-supervised institution 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.

§ 324.153 Internal models approach (IMA).

(a) General. An FDIC-supervised institution 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 paragraph (c) of this section) or by modeling only publicly traded equity exposures (in accordance with paragraphs (c) and (d) of this section).

(b) Qualifying criteria. To qualify to use the IMA to calculate risk-weighted assets for equity exposures, an FDIC-supervised institution must receive prior written approval from the

FDIC. To receive such approval, the FDIC-supervised institution must demonstrate to the FDIC's satisfaction that the FDIC-supervised institution meets the following criteria:

(1) The FDIC-supervised institution 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 FDIC-supervised institution's modeled equity exposures; and

(iii) Adequately capture both general market risk and idiosyncratic risk.

(2) The FDIC-supervised institution'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 99th percentile one-tailed confidence interval of the distribution of quarterly returns for a benchmark portfolio of equity exposures comparable to the FDIC-supervised institution'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 FDIC-supervised institution's model and benchmarking exercise must be sufficient to provide confidence in the accuracy and robustness of the FDIC-supervised institution's estimates.

(4) The FDIC-supervised institution's model and benchmarking process must incorporate data that are relevant in representing the risk profile of the FDIC-supervised institution'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 FDIC-supervised institution's modeled equity exposures. In addition, the FDIC-supervised institution's benchmarking exercise must be based on daily market prices for the benchmark portfolio. If the FDIC-supervised institution's model uses a scenario methodology, the FDIC-supervised

institution must demonstrate that the model produces a conservative estimate of potential losses on the FDIC-supervised institution's modeled equity exposures over a relevant long-term market cycle. If the FDIC-supervised institution employs risk factor models, the FDIC-supervised institution must demonstrate through empirical analysis the appropriateness of the risk factors used.

(5) The FDIC-supervised institution must be able to demonstrate, using theoretical arguments and empirical evidence, that any proxies used in the modeling process are comparable to the FDIC-supervised institution's modeled equity exposures and that the FDIC-supervised institution has made appropriate adjustments for differences. The FDIC-supervised institution must derive any proxies for its modeled equity exposures and benchmark portfolio using historical market data that are relevant to the FDIC-supervised institution'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 FDIC-supervised institution's modeled equity exposures.

(c) Risk-weighted assets calculation for an FDIC-supervised institution using the IMA for publicly traded and non-publicly traded equity exposures. If an FDIC-supervised institution models publicly traded and non-publicly traded equity exposures, the FDIC-supervised institution'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 §§ 324.152(b)(1) through (b)(3)(i) (as determined under § 324.152) and each equity exposure to an investment fund (as determined under § 324.154); and

(2) The greater of:

(i) The estimate of potential losses on the FDIC-supervised institution's equity exposures (other than equity exposures referenced in paragraph (c)(1) of this section) generated by the FDIC-supervised institution'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 FDIC-supervised institution'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 §§ 324.152(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 FDIC-supervised institution's equity exposures that are not publicly traded, do not qualify for a 0 percent, 20 percent, or 100 percent risk weight under §§ 324.152(b)(1) through (b)(3)(i), and are not equity exposures to an investment fund.

(d) Risk-weighted assets calculation for an FDIC-supervised institution using the IMA only for publicly traded equity exposures. If an FDIC-supervised institution models only publicly traded equity exposures, the FDIC-supervised institution'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 §§ 324.152(b)(1) through (b)(3)(i) (as determined under § 324.152), each equity exposure that qualifies for a 400 percent risk weight under § 324.152(b)(5) or a 600 percent risk weight under § 324.152(b)(6) (as determined under § 324.152), and each equity exposure to an investment fund (as determined under § 324.154); and

(2) The greater of:

(i) The estimate of potential losses on the FDIC-supervised institution's equity exposures (other than equity exposures referenced in paragraph (d)(1) of this section) generated by the FDIC-supervised institution'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 FDIC-supervised institution'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 §§ 324.152(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.

§ 324.154 Equity exposures to investment funds.

(a) Available approaches. (1) Unless the exposure meets the requirements for a community development equity exposure in § 324.152(b)(3)(i), an FDIC-supervised institution must determine the risk-weighted asset amount of an equity exposure to an investment fund under the full look-through approach in paragraph (b) of this section, the simple modified look-through approach in paragraph (c) of this section, or the alternative modified look-through Approach in paragraph (d) of this section.

(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 § 324.152(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 FDIC-supervised institution does not use the full look-through approach, the FDIC-supervised institution may use the ineffective portion of the hedge pair as determined under § 324.152(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. An FDIC-supervised institution 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 of this part as if the proportional ownership share of each exposure were held directly by the FDIC-supervised institution) may either:

(1) Set the risk-weighted asset amount of the FDIC-supervised institution'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 FDIC-supervised institution; and

(ii) The FDIC-supervised institution's proportional ownership share of the fund; or

(2) Include the FDIC-supervised institution's proportional ownership share of each exposure held by the fund in the FDIC-supervised institution's IMA.

(c) Simple Modified Look-Through Approach. Under this approach, the risk-weighted asset amount for an FDIC-supervised institution'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 of this part 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, an FDIC-supervised institution 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 of this part 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 FDIC-supervised institution'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 FDIC-supervised institution 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 of this part, and continues to make investments in order of the exposure type with the next highest risk weight under subpart D of this part until the maximum total investment level is reached. If more than one exposure type applies to an exposure, the FDIC-supervised institution must use the highest applicable risk weight. An FDIC-supervised institution 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.

§ 324.155 Equity derivative contracts.

(a) Under the IMA, in addition to holding risk-based capital against an equity derivative contract under this part, an FDIC-supervised institution 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 § 324.132.

(b) Under the SRWA, an FDIC-supervised institution 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, an FDIC-supervised institution 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

§ 324.161 Qualification requirements for incorporation of operational risk mitigants.

(a) Qualification to use operational risk mitigants. An FDIC-supervised institution may adjust its estimate of operational risk exposure to reflect qualifying operational risk mitigants if:

(1) The FDIC-supervised institution's operational risk quantification system is able to generate an estimate of the FDIC-supervised institution's operational risk exposure (which does not incorporate qualifying operational risk mitigants) and an estimate of the FDIC-supervised institution's operational risk exposure adjusted to incorporate qualifying operational risk mitigants; and

(2) The FDIC-supervised institution's methodology for incorporating the effects of insurance, if the FDIC-supervised institution 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 FDIC-supervised institution deems to have strong capacity to meet its claims payment obligations and the obligor rating category to which the FDIC-supervised institution 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 FDIC has given prior written approval. In evaluating an operational risk mitigant other than insurance, the FDIC will consider whether the operational risk mitigant covers potential operational losses in a manner equivalent to holding total capital.

§ 324.162 Mechanics of risk-weighted asset calculation.

(a) If an FDIC-supervised institution does not qualify to use or does not have qualifying operational risk mitigants, the FDIC-supervised institution's dollar risk-based capital requirement for operational risk is its operational risk exposure minus eligible operational risk offsets (if any).

(b) If an FDIC-supervised institution qualifies to use operational risk mitigants and has qualifying operational risk mitigants, the FDIC-supervised institution's dollar risk-based capital requirement for operational risk is the greater of:

(1) The FDIC-supervised institution'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 FDIC-supervised institution's operational risk exposure; and

(ii) Eligible operational risk offsets (if any).

(c) The FDIC-supervised institution's risk-weighted asset amount for operational risk equals the FDIC-supervised institution's dollar risk-based capital requirement for operational risk determined under sections 162(a) or (b) multiplied by 12.5.

DISCLOSURES

§ 324.171 Purpose and scope.

§§ 324.171 through 324.173 establish public disclosure requirements related to the capital requirements of an FDIC-supervised institution that is an advanced approaches FDIC-supervised institution.

§ 324.172 Disclosure requirements.

(a) An FDIC-supervised institution that is an advanced approaches FDIC-supervised institution that has completed the parallel run process and that has received notification from the FDIC pursuant to § 324.121(d) 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) An FDIC-supervised institution that is an advanced approaches FDIC-supervised institution that has completed the parallel run process and that has received notification from the FDIC pursuant to section § 324.121(d) must comply with paragraph (c) of this section 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) An FDIC-supervised institution described in paragraph (b) of this section must provide timely public disclosures each calendar quarter of the information in the applicable tables in § 324.173. If a significant change occurs, such that the most recent reported amounts are no longer reflective of the FDIC-supervised institution'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 FDIC-supervised institution's risk management objectives and policies, reporting system, and definitions) may be disclosed annually after the end of the fourth calendar quarter, provided that any significant changes to these are disclosed in the interim. Management may provide all of the disclosures required by this subpart in one place on the FDIC-supervised institution's public website or may provide the disclosures in more than one public financial report or other regulatory reports, provided that the FDIC-supervised institution publicly provides a summary table specifically indicating the location(s) of all such disclosures.

(2) An FDIC-supervised institution described in paragraph (b) of this section 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 FDIC-supervised institution must attest that the disclosures meet the requirements of this subpart.

(3) If an FDIC-supervised institution described in paragraph (b) of this section 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 FDIC-supervised institution is not required to disclose those 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.

§ 324.173 Disclosures by certain advanced approaches FDIC-supervised institutions.

Except as provided in § 324.172(b), an FDIC-supervised institution described in § 324.172(b) must make the disclosures described in Tables 1 through 12 to § 324.173 below. The FDIC-supervised institution 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 1 TO § 324.173 – 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[1] for accounting and regulatory purposes, with a description of those entities: (1) That are fully consolidated; (2) That are deconsolidated and deducted from total capital; (3) For which the total capital requirement is deducted; and (4) That are neither consolidated nor deducted (for example, where the investment in the entity is assigned a risk weight in accordance with this subpart E).
	(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.

[1] 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 2 TO § 324.173 – 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: (1) Common stock and related surplus; (2) Retained earnings; (3) Common equity minority interest; (4) AOCI (net of tax) and other reserves; and (5) Regulatory adjustments and deductions made to common equity tier 1 capital.
	(c)	The amount of tier 1 capital, with separate disclosure of: (1) 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 (2) Regulatory adjustments and deductions made to tier 1 capital.
	(d)	The amount of total capital, with separate disclosure of: (1) Tier 2 capital elements, including tier 2 capital instruments and total capital minority interest not included in tier 1 capital; and (2) Regulatory adjustments and deductions made to total capital.

TABLE 3 TO § 324.173 – CAPITAL ADEQUACY

Qualitative disclosures	(a)	A summary discussion of the FDIC-supervised institution'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: (1) Wholesale exposures; (2) Residential mortgage exposures; (3) Qualifying revolving exposures; (4) Other retail exposures; (5) Securitization exposures; (6) Equity exposures: (7) Equity exposures subject to the simple risk weight approach; and (8) 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: (1) Standardized approach for specific risk; and (2) 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: (1) For the top consolidated group; and (2) For each depository institution subsidiary.
	(f)	Total risk-weighted assets.

TABLE 4 TO § 324.173 – CAPITAL CONSERVATION AND COUNTERCYCLICAL CAPITAL BUFFERS

Qualitative disclosures	(a)	The FDIC-supervised institution 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 FDIC-supervised institution must calculate and publicly disclose the capital conservation buffer and the countercyclical capital buffer as described under § 324.11 of subpart B.
	(c)	At least quarterly, the FDIC-supervised institution must calculate and publicly disclose the buffer retained income of the FDIC-supervised institution, as described under § 324.11 of subpart B.
	(d)	At least quarterly, the FDIC-supervised institution must calculate and publicly disclose any limitations it has on distributions and discretionary bonus payments resulting from the capital conservation buffer and the countercyclical capital buffer framework described under § 324.11 of subpart B, including the maximum payout amount for the quarter.

General Qualitative Disclosure Requirement

For each separate risk area described in Tables 5 through 12 to § 324.173, the FDIC-supervised institution must describe its risk management objectives and policies, including:

Answer: Strategies and processes;

Answer: The structure and organization of the relevant risk management function;

Answer: The scope and nature of risk reporting and/or measurement systems; and

Answer: Policies for hedging and/or mitigating risk and strategies and processes for monitoring the continuing effectiveness of hedges/mitigants.

TABLE 5[1] TO § 324.173– 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 7 to § 324.173), including: (1) Policy for determining past due or delinquency status; (2) Policy for placing loans on nonaccrual; (3) Policy for returning loans to accrual status; (4) Definition of and policy for identifying impaired loans (for financial accounting purposes). (5) Description of the methodology that the entity uses to estimate its allowance for loan and lease losses, including statistical methods used where applicable; (6) Policy for charging-off uncollectible amounts; and (7) Discussion of the FDIC-supervised institution's credit risk management policy

Quantitative disclosures	(b)	Total credit risk exposures and average credit risk exposures, after accounting offsets in accordance with GAAP,[2] 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, FDIC-supervised institutions could use categories similar to that used for financial statement purposes. Such categories might include, for instance: (1) Loans, off-balance sheet commitments, and other non-derivative off-balance sheet exposures; (2) Debt securities; and (3) OTC derivatives.
	(c)	Geographic[3] 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.

	(e)	By major industry or counterparty type: (1) Amount of impaired loans for which there was a related allowance under GAAP; (2) Amount of impaired loans for which there was no related allowance under GAAP; (3) Amount of loans past due 90 days and on nonaccrual; (4) Amount of loans past due 90 days and still accruing;[4] (5) The balance in the allowance for loan and lease 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 (6) 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[5], further categorized as required by GAAP.
	(g)	Reconciliation of changes in ALLL.[6]
	(h)	Remaining contractual maturity breakdown (for example, one year or less) of the whole portfolio, categorized by credit exposure.

[1] Table 5 to § 324.173 does not cover equity exposures, which should be reported in Table 9 to § 324.173.

[2] See, for example, ASC Topic 815-10 and 210-20, as they may be amended from time to time.

[3] Geographical areas may comprise individual countries, groups of countries, or regions within countries. An FDIC-supervised institution 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.

[4] An FDIC-supervised institution is encouraged also to provide an analysis of the aging of past-due loans.

[5] The portion of the general allowance that is not allocated to a geographical area should be disclosed separately.

[6] 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 6 TO § 324.173– CREDIT RISK: DISCLOSURES FOR PORTFOLIOS SUBJECT TO IRB RISK-BASED CAPITAL FORMULAS

Qualitative disclosures	(a)	Explanation and review of the: (1) Structure of internal rating systems and relation between internal and external ratings; (2) Use of risk parameter estimates other than for regulatory capital purposes; (3) Process for managing and recognizing credit risk mitigation (see Table 8 to § 324.173); and (4) 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: (1) Wholesale category; (2) Retail subcategories; (i) Residential mortgage exposures; (ii) Qualifying revolving exposures; and (iii) Other retail exposures. For each category and subcategory above the description should include: (A) The types of exposure included in the category/subcategories; and (B) The definitions, methods and data for estimation and validation of PD, LGD, and EAD, including assumptions employed in the derivation of these variables.[1]

Quantitative disclosures: risk assessment	(c)	(1) 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:[2] (i) Total EAD;[3] (ii) Exposure-weighted average LGD (percentage); (iii) Exposure-weighted average risk weight; and (iv) Amount of undrawn commitments and exposure-weighted average EAD including average drawdowns prior to default for wholesale exposures. (2) For each retail subcategory, present the disclosures outlined above across a sufficient number of segments to allow for a meaningful differentiation of credit risk.

	(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 FDIC-supervised institution experienced higher than average default rates, loss rates or EADs.
Quantitative disclosures: historical results	(e)	The FDIC-supervised institution's estimates compared against actual outcomes over a longer period.[4] 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.[5] Where appropriate, the FDIC-supervised institution should further decompose this to provide analysis of PD, LGD, and EAD outcomes against estimates provided in the quantitative risk assessment disclosures above.[6]

[1] 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 validating those variables set out in the quantitative risk disclosures below. This should be done for each of the four category/subcategories. The FDIC-supervised institution must disclose any significant differences in approach to estimating these variables within each category/subcategories.

[2] The PD, LGD and EAD disclosures in Table 6 (c) to § 324.173 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 an FDIC-supervised institution 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.

[3] Outstanding loans and EAD on undrawn commitments can be presented on a combined basis for these disclosures.

[4] 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 an FDIC-supervised institution sufficient time to build up a longer run of data that will make these disclosures meaningful.

[5] This disclosure item is not intended to be prescriptive about the period used for this assessment. Upon implementation, it is expected that an FDIC-supervised institution would provide these disclosures for as long a set of data as possible – for example, if an FDIC-supervised institution 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.

[6] An FDIC-supervised institution 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 FDIC-supervised institution must also provide explanations for such differences.

TABLE 7 TO § 324.173– 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: (1) Discussion of methodology used to assign economic capital and credit limits for counterparty credit exposures; (2) Discussion of policies for securing collateral, valuing and managing collateral, and establishing credit reserves; (3) Discussion of the primary types of collateral taken; (4) Discussion of policies with respect to wrong-way risk exposures; and (5) Discussion of the impact of the amount of collateral the FDIC-supervised institution would have to provide if the FDIC-supervised institution 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.[1] 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 FDIC-supervised institutions not using the internal models methodology in § 324.132(d) , the distribution of current credit exposure by types of credit exposure.[2]
	(c)	Notional amount of purchased and sold credit derivatives, segregated between use for the FDIC-supervised institution's own credit portfolio and for its intermediation activities, including the distribution of the credit derivative products used,

TABLE 8 TO § 324.173 – CREDIT RISK MITIGATION[1,2]

Qualitative disclosures	(a)	The general qualitative disclosure requirement with respect to credit risk mitigation, including: (1) Policies and processes for, and an indication of the extent to which the FDIC-supervised institution uses, on- or off-balance sheet netting; (2) Policies and processes for collateral valuation and management; (3) A description of the main types of collateral taken by the FDIC-supervised institution; (4) The main types of guarantors/credit derivative counterparties and their creditworthiness; and (5) 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.

[1] At a minimum, an FDIC-supervised institution must provide the disclosures in Table 8 to § 324.173 in relation to credit risk mitigation that has been recognized for the purposes of reducing capital requirements under this subpart. Where relevant, FDIC-supervised institutions are encouraged to give further information about mitigants that have not been recognized for that purpose.

[2] 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 8 to § 324.173) and included within those relating to securitization (in Table 9 to § 324.173).

TABLE 9 TO § 324.173– SECURITIZATION

Qualitative disclosures	(a)	The general qualitative disclosure requirement with respect to securitization (including synthetic securitizations), including a discussion of: (1) The FDIC-supervised institution's objectives for securitizing assets, including the extent to which these activities transfer credit risk of the underlying exposures away from the FDIC-supervised institution to other entities and including the type of risks assumed and retained with resecuritization activity;[1] (2) The nature of the risks (e.g. liquidity risk) inherent in the securitized assets; (3) The roles played by the FDIC-supervised institution in the securitization process[2] and an indication of the extent of the FDIC-supervised institution's involvement in each of them; (4) The processes in place to monitor changes in the credit and market risk of securitization exposures including how those processes differ for resecuritization exposures; (5) The FDIC-supervised institution's policy for mitigating the credit risk retained through securitization and resecuritization exposures; and (6) The risk-based capital approaches that the FDIC-supervised institution follows for its securitization exposures including the type of securitization exposure to which each approach applies.

(b)	A list of: (1) The type of securitization SPEs that the FDIC-supervised institution, as sponsor, uses to securitize third-party exposures. The FDIC-supervised institution must indicate whether it has exposure to these SPEs , either on- or off- balance sheet; and (2) Affiliated entities: (i) That the FDIC-supervised institution manages or advises; and (ii) That invest either in the securitization exposures that the FDIC-supervised institution has securitized or in securitization SPEs that the FDIC-supervised institution sponsors.[3]
(c)	Summary of the FDIC-supervised institution's accounting policies for securitization activities, including: (1) Whether the transactions are treated as sales or financings; (2) Recognition of gain-on-sale; (3) Methods and key assumptions and inputs applied in valuing retained or purchased interests; (4) Changes in methods and key assumptions and inputs from the previous period for valuing retained interests and impact of the changes; (5) Treatment of synthetic securitizations; (6) How exposures intended to be securitized are valued and whether they are recorded under subpart E of this part; and (7) Policies for recognizing liabilities on the balance sheet for arrangements

		that could require the FDIC-supervised institution 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[4] by the FDIC-supervised institution in securitizations that meet the operational criteria in § 324.141 (categorized into traditional/synthetic), by underlying exposure type[5] separately for securitizations of third-party exposures for which the FDIC-supervised institution acts only as sponsor.
	(f)	For exposures securitized by the FDIC-supervised institution in securitizations that meet the operational criteria in § 324.141: (1) Amount of securitized assets that are impaired[6]/past due categorized by exposure type; and (2) Losses recognized by the FDIC-supervised institution during the current period categorized by exposure type.[7]
	(g)	The total amount of outstanding exposures intended to be securitized categorized by exposure type.
	(h)	Aggregate amount of: (1) On-balance sheet securitization exposures retained or purchased categorized by exposure type; and (2) Off-balance sheet securitization exposures categorized by exposure type.

	(i)	(1) 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). (2) Exposures that have been deducted entirely from tier 1 capital, credit enhancing I/Os deducted from total capital (as described in § 324.42(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: (1) Exposures to which credit risk mitigation is applied and those not applied; and (2) Exposures to guarantors categorized according to guarantor creditworthiness categories or guarantor name.

[1] The FDIC-supervised institution 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 FDIC-supervised institution is active.

[2] For example, these roles would include originator, investor, servicer, provider of credit enhancement, sponsor, liquidity provider, or swap provider.

[3] For example, money market mutual funds should be listed individually, and personal and private trusts, should be noted collectively.

[4] "Exposures securitized" include underlying exposures originated by the FDIC-supervised institution, 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 FDIC-supervised institution's balance sheet and underlying exposures acquired by the FDIC-supervised institution 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.

[5] An FDIC-supervised institution is required to disclose exposures regardless of whether there is a capital charge under this part.

[6] An FDIC-supervised institution must include credit-related other than temporary impairment (OTTI).

[7] For example, charge-offs/allowances (if the assets remain on the FDIC-supervised institution'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 FDIC-supervised institution with respect to securitized assets.

TABLE 10 TO § 324.173 – 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 FDIC-supervised institution's measurement approach.
	(c)	A description of the use of insurance for the purpose of mitigating operational risk.

TABLE 11 TO § 324.173 – 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: (1) Differentiation between holdings on which capital gains are expected and those held for other objectives, including for relationship and strategic reasons; and (2) 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: (1) Publicly traded; and (2) Non-publicly traded.
	(d)	The cumulative realized gains (losses) arising from sales and liquidations in the reporting period.

	(e)	(1) Total unrealized gains (losses)[1] (2) Total latent revaluation gains (losses)[2] (3) 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 FDIC-supervised institution's methodology, as well as the aggregate amounts and the type of equity investments subject to any supervisory transition regarding total capital requirements.[3]

[1] Unrealized gains (losses) recognized in the balance sheet but not through earnings.

[2] Unrealized gains (losses) not recognized either in the balance sheet or through earnings.

[3] 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.

TABLE 12 TO § 324.173 – 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).

Subpart F – Risk-weighted Assets – Market Risk

§ 324.201 Purpose, applicability, and reservation of authority.

(a) Purpose. This subpart F establishes risk-based capital requirements for FDIC-supervised institutions with significant exposure to market risk, provides methods for these FDIC-supervised institutions 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 F applies to any FDIC-supervised institution with aggregate trading assets and trading liabilities (as reported in the FDIC-supervised institution's most recent quarterly Call Report), equal to:

(i) 10 percent or more of quarter-end total assets as reported on the most recent quarterly Call Report; or

(ii) $1 billion or more.

(2) The FDIC may apply this subpart to any FDIC-supervised institution if the FDIC deems it necessary or appropriate because of the level of market risk of the FDIC-supervised institution or to ensure safe and sound banking practices.

(3) The FDIC may exclude an FDIC-supervised institution that meets the criteria of paragraph (b)(1) of this section from application of this subpart if the FDIC determines that the exclusion is appropriate based on the level of market risk of the FDIC-supervised institution and is consistent with safe and sound banking practices.

(c) Reservation of authority (1) The FDIC may require an FDIC-supervised institution to hold an amount of capital greater than otherwise required under this subpart if the FDIC determines that the FDIC-supervised institution's capital requirement for market risk as calculated under this subpart is not commensurate with the market risk of the FDIC-supervised

institution's covered positions. In making determinations under paragraphs (c)(1) through (c)(3) of this section, the FDIC will apply notice and response procedures generally in the same manner as the notice and response procedures set forth in § 324.5(c).

(2) If the FDIC determines that the risk-based capital requirement calculated under this subpart by the FDIC-supervised institution for one or more covered positions or portfolios of covered positions is not commensurate with the risks associated with those positions or portfolios, the FDIC may require the FDIC-supervised institution 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 FDIC may also require an FDIC-supervised institution to calculate risk-based capital requirements for specific positions or portfolios under this subpart, or under subpart D or subpart E of this part, as appropriate, to more accurately reflect the risks of the positions.

(4) Nothing in this subpart limits the authority of the FDIC 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.

§ 324.202 Definitions.

(a) Terms set forth in § 324.2 and used in this subpart have the definitions assigned thereto in § 324.2.

(b) For the purposes of this subpart, the following terms are defined as follows:

Backtesting means the comparison of an FDIC-supervised institution'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 Call Report, that meets the following conditions:

(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 FDIC-supervised institution 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 FDIC-supervised institution 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 FDIC determines to be outside the scope of the FDIC-supervised institution's hedging strategy required in paragraph (a)(2) of § 324.203;

(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 FDIC-supervised institution recognizes as a guarantee for risk-weighted asset amount calculation purposes under subpart D or subpart E of this part;

(v) Any position that is recognized as a credit valuation adjustment hedge under § 324.132(e)(5) or § 324.132(e)(6), except as provided in § 324.132(e)(6)(vii);

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[1] Securities subject to repurchase and lending agreements are included as if they are still owned by the lender.

[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.

(vi) Any equity position that is not publicly traded, other than a derivative that references a publicly traded equity and other than a position in an investment company as defined in and registered with the SEC under the Investment Company Act, provided that all the underlying equities held by the investment company are publicly traded;

(vii) Any equity position that is not publicly traded, other than a derivative that references a publicly traded equity and other than a position in an entity not domiciled in the United States (or a political subdivision thereof) that is supervised and regulated in a manner similar to entities described in paragraph (3)(vi) of this definition;

(viii) Any position an FDIC-supervised institution holds with the intent to securitize; or

(ix) Any direct real estate holding.

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.

Default by a sovereign entity has the same meaning as the term sovereign default under § 324.2.

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.

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 FDIC 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 FDIC 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 344.3 (state nonmember bank) and 12 CFR 390.203 (state savings association));

(iii) An employee benefit plan as defined in paragraphs (3) and (32) of section 3 of ERISA, a "governmental plan" (as defined in 29 USC 1002(32)) that complies with the tax deferral qualification requirements provided in the Internal Revenue Code, or any similar employee benefit plan established under the laws of a foreign jurisdiction; or

(iv) Registered with the SEC under the Investment Company Act or foreign equivalents 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 FDIC-supervised institution's tier 1 or tier 2 capital; or

(4) A position designed to hedge an FDIC-supervised institution'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 FDIC-supervised institution 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.

§ 324.203 Requirements for application of this subpart F.

(a) Trading positions. (1) Identification of trading positions. An FDIC-supervised institution 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. An FDIC-supervised institution must have clearly defined trading and hedging strategies for its trading positions that are approved by senior management of the FDIC-supervised institution.

(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 FDIC-supervised institution is willing to accept and must detail the instruments, techniques, and strategies the FDIC-supervised institution will use to hedge the risk of the portfolio.

(b) Management of covered positions. (1) Active management. An FDIC-supervised institution 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 FDIC-supervised institution'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 FDIC-supervised institution 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) An FDIC-supervised institution must obtain the prior written approval of the FDIC before using any internal model to calculate its risk-based capital requirement under this subpart.

(2) An FDIC-supervised institution must meet all of the requirements of this section on an ongoing basis. The FDIC-supervised institution must promptly notify the FDIC when:

(i) The FDIC-supervised institution plans to extend the use of a model that the FDIC has approved under this subpart to an additional business line or product type;

(ii) The FDIC-supervised institution makes any change to an internal model approved by the FDIC under this subpart that would result in a material change in the FDIC-supervised institution's risk-weighted asset amount for a portfolio of covered positions; or

(iii) The FDIC-supervised institution makes any material change to its modeling assumptions.

(3) The FDIC may rescind its approval of the use of any internal model (in whole or in part) or of the determination of the approach under § 324.209(a)(2)(ii) for an FDIC-supervised institution’s modeled correlation trading positions and determine an appropriate capital

requirement for the covered positions to which the model would apply, if the FDIC determines that the model no longer complies with this subpart or fails to reflect accurately the risks of the FDIC-supervised institution's covered positions.

(4) The FDIC-supervised institution 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 FDIC’s standards for model approval and employ risk measurement methodologies that are most appropriate for the FDIC-supervised institution’s covered positions.

(5) The FDIC-supervised institution 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 an FDIC-supervised institution's internal models must be commensurate with the complexity and amount of its covered positions. An FDIC-supervised institution'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 FDIC-supervised institution's internal models must properly measure all the material risks in the covered positions to which they are applied.

(8) The FDIC-supervised institution'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 FDIC-supervised institution 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 an FDIC-supervised institution uses internal models to measure specific risk, the internal models must also satisfy the requirements in paragraph (b)(1) of § 324.207.

(d) Control, oversight, and validation mechanisms. (1) The FDIC-supervised institution must have a risk control unit that reports directly to senior management and is independent from the business trading units.

(2) The FDIC-supervised institution must validate its internal models initially and on an ongoing basis. The FDIC-supervised institution'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 FDIC-supervised institution'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 FDIC-supervised institution’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 FDIC-supervised institution 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 FDIC-supervised institution's trading activities that may not be adequately captured in its internal models.

(4) The FDIC-supervised institution must have an internal audit function independent of business-line management that at least annually assesses the effectiveness of the controls supporting the FDIC-supervised institution'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 FDIC-supervised institution’s measures for market risk under this subpart. At least annually, the internal audit function must report its findings to the FDIC-supervised institution’s board of directors (or a committee thereof).

(e) Internal assessment of capital adequacy. The FDIC-supervised institution 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 FDIC-supervised institution 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.

§ 324.204 Measure for market risk.

(a) General requirement. (1) An FDIC-supervised institution must calculate its standardized measure for market risk by following the steps described in paragraph (a)(2) of this section. An advanced approaches FDIC-supervised institution 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. An FDIC-supervised institution 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 FDIC-supervised institution may not use the SFA in §324.210(b)(2)(vii)(B) for purposes of this calculation), plus any additional capital requirement established by the FDIC. An advanced approaches FDIC-supervised institution that has completed the parallel run process and that has received notifications from the FDIC pursuant to § 324.121(d) 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), plus any additional capital requirement established by the FDIC.

(i) VaR-based capital requirement. An FDIC-supervised institution's VaR-based capital requirement equals the greater of:

(A) The previous day's VaR-based measure as calculated under § 324.205; or

(B) The average of the daily VaR-based measures as calculated under § 324.205 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. An FDIC-supervised institution's stressed VaR-based capital requirement equals the greater of:

(A) The most recent stressed VaR-based measure as calculated under § 324.206; or

(B) The average of the stressed VaR-based measures as calculated under § 324.206 for each of the preceding 12 weeks multiplied by three, except as provided in paragraph (b) of this section.

(iii) Specific risk add-ons. An FDIC-supervised institution's specific risk add-ons equal any specific risk add-ons that are required under § 324.207 and are calculated in accordance with § 324.210.

(iv) Incremental risk capital requirement. An FDIC-supervised institution's incremental risk capital requirement equals any incremental risk capital requirement as calculated under §324.208.

(v) Comprehensive risk capital requirement. An FDIC-supervised institution's comprehensive risk capital requirement equals any comprehensive risk capital requirement as calculated under §324.209.

(vi) Capital requirement for de minimis exposures. An FDIC-supervised institution's capital requirement for de minimis exposures equals:

(A) The absolute value of the fair value of those de minimis exposures that are not captured in the FDIC-supervised institution's VaR-based measure or under paragraph (a)(2)(vi)(B) of this section; and

(B) With the prior written approval of the FDIC, the capital requirement for any de minimis exposures using alternative techniques that appropriately measure the market risk associated with those exposures.

(b) Backtesting. An FDIC-supervised institution 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. An FDIC-supervised institution must begin backtesting as required by this paragraph no later than one year after the later of January 1, 2014, and the date on which the FDIC-supervised institution becomes subject to this subpart. In the interim, consistent with safety and soundness principles, an FDIC-supervised institution subject to this subpart as of its effective date should continue to follow backtesting procedures in accordance with the FDIC's supervisory expectations.

(1) Once each quarter, the FDIC-supervised institution 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) An FDIC-supervised institution 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 FDIC notifies the FDIC-supervised institution in writing that a different adjustment or other action is appropriate.

TABLE 1 TO § 324.204 – 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

§ 324.205 VaR-based measure.

(a) General requirement. An FDIC-supervised institution 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 FDIC-supervised institution's specific risk for one or more portfolios of debt and equity positions, if the internal models meet the requirements of § 324.207(b)(1). The daily VaR-based measure must also reflect the FDIC-supervised institution's specific risk for any portfolio of correlation trading positions that is modeled under § 324.209. An FDIC-supervised institution may elect to include term repo-style transactions in its VaR-based measure, provided that the FDIC-supervised institution includes all such term repo-style transactions consistently over time.

(1) The FDIC-supervised institution'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 FDIC-supervised institution 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 FDIC-supervised institution 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 fair value of the positions to changes in the volatility of the underlying rates, prices, or other material risk factors. An FDIC-supervised institution 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 FDIC-supervised institution must be able to justify to the satisfaction of the FDIC the omission of any risk factors from the calculation of its VaR-based measure that the FDIC-supervised institution uses in its pricing models.

(5) The FDIC-supervised institution must demonstrate to the satisfaction of the FDIC the appropriateness of any proxies used to capture the risks of the FDIC-supervised institution'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 FDIC-supervised institution 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. An FDIC-supervised institution 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 FDIC.

(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 FDIC-supervised institution's actual exposures and of sufficient quality to support the calculation of risk-based capital requirements. The FDIC-supervised institution must update data sets at least monthly or more frequently as changes in market conditions or portfolio composition warrant. For an FDIC-supervised institution that uses a weighting scheme or other method for the historical observation period, the FDIC-supervised institution 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 FDIC 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 FDIC-supervised institution's trading portfolio over a full business cycle. An FDIC-supervised institution using this option must update its data more frequently than monthly and in a manner appropriate for the type of weighting scheme.

(c) An FDIC-supervised institution must divide its portfolio into a number of significant subportfolios approved by the FDIC for subportfolio backtesting purposes. These subportfolios must be sufficient to allow the FDIC-supervised institution and the FDIC to assess the adequacy of the VaR model at the risk factor level; the FDIC will evaluate the appropriateness of these subportfolios relative to the value and composition of the FDIC-supervised institution's covered positions. The FDIC-supervised institution must retain and make available to the FDIC 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).

§ 324.206 Stressed VaR-based measure.

(a) General requirement. At least weekly, an FDIC-supervised institution 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) An FDIC-supervised institution 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 § 324.205, 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 FDIC-supervised institution's current portfolio.

(2) The stressed VaR-based measure must be calculated at least weekly and be no less than the FDIC-supervised institution's VaR-based measure.

(3) An FDIC-supervised institution must have policies and procedures that describe how it determines the period of significant financial stress used to calculate the FDIC-supervised institution's stressed VaR-based measure under this section and must be able to provide empirical support for the period used. The FDIC-supervised institution must obtain the prior approval of the FDIC for, and notify the FDIC if the FDIC-supervised institution makes any material changes to, these policies and procedures. The policies and procedures must address:

(i) How the FDIC-supervised institution 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 FDIC-supervised institution'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 FDIC-supervised institution's current portfolio.

(4) Nothing in this section prevents the FDIC from requiring an FDIC-supervised institution to use a different period of significant financial stress in the calculation of the stressed VaR-based measure.

§ 324.207 Specific risk.

(a) General requirement. An FDIC-supervised institution 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. An FDIC-supervised institution may use models to measure the specific risk of covered positions as provided in §324.205(a) (therefore, excluding securitization positions that are not modeled under §324.209). An FDIC-supervised institution must use models to measure the specific risk of correlation trading positions that are modeled under § 324.209.

(1) Requirements for specific risk modeling. (i) If an FDIC-supervised institution 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; and

(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 an FDIC-supervised institution calculates an incremental risk measure for a portfolio of debt or equity positions under §324.208, the FDIC-supervised institution 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 FDIC-supervised institution'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 FDIC-supervised institution has no specific risk add-on for those portfolios for purposes of § 324.204(a)(2)(iii).

(c) Specific risk not modeled. (1) If the FDIC-supervised institution's VaR-based measure does not capture all material aspects of specific risk for a portfolio of debt, equity, or correlation trading positions, the FDIC-supervised institution must calculate a specific-risk add-on for the portfolio under the standardized measurement method as described in § 324.210.

(2) An FDIC-supervised institution must calculate a specific risk add-on under the standardized measurement method as described in § 324.210 for all of its securitization positions that are not modeled under § 324.209.

§ 324.208 Incremental risk.

(a) General requirement. An FDIC-supervised institution that measures the specific risk of a portfolio of debt positions under § 324.207(b) 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 FDIC-supervised institution’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 FDIC, an FDIC-supervised institution 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 FDIC-supervised institution 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. An FDIC-supervised institution 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 FDIC-supervised institution 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 FDIC-supervised institution's initial risk level. The FDIC-supervised institution 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 an FDIC-supervised institution 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 FDIC-supervised institution maintains the same set of positions throughout the one-year horizon. If an FDIC-supervised institution uses this assumption, it must do so consistently across all portfolios.

(iii) An FDIC-supervised institution's selection of a constant position or a constant risk assumption must be consistent between the FDIC-supervised institution's incremental risk model and its comprehensive risk model described in §324.209, if applicable.

(iv) An FDIC-supervised institution's treatment of liquidity horizons must be consistent between the FDIC-supervised institution's incremental risk model and its comprehensive risk model described in §324.209, 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, an FDIC-supervised institution 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 FDIC-supervised institution'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.

§ 324.209 Comprehensive risk.

(a) General requirement. (1) Subject to the prior approval of the FDIC, an FDIC-supervised institution 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) An FDIC-supervised institution 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 FDIC-supervised institution's modeled measure of all price risk determined according to the requirements in paragraph (b) of this section; and

(B) A surcharge for the FDIC-supervised institution's modeled correlation trading positions equal to the total specific risk add-on for such positions as calculated under §324.210 multiplied by 8.0 percent; or

(ii) With approval of the FDIC and provided the FDIC-supervised institution 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 FDIC-supervised institution'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 §324.210 multiplied by 8.0 percent.

(b) Requirements for modeling all price risk. If an FDIC-supervised institution 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, an FDIC-supervised institution 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 FDIC-supervised institution must use market data that are relevant in representing the risk profile of the FDIC-supervised institution's correlation trading positions in order to ensure that the FDIC-supervised institution fully captures the material risks of the correlation trading positions in its comprehensive risk measure in accordance with this section; and

(4) The FDIC-supervised institution 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) An FDIC-supervised institution 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) An FDIC-supervised institution must retain and make available to the FDIC the results of the supervisory stress testing, including comparisons with the capital requirements generated by the FDIC-supervised institution's comprehensive risk model.

(ii) An FDIC-supervised institution must report to the FDIC 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.

§ 324.210 Standardized measurement method for specific risk

(a) General requirement. An FDIC-supervised institution must calculate a total specific risk add-on for each portfolio of debt and equity positions for which the FDIC-supervised institution's VaR-based measure does not capture all material aspects of specific risk and for all securitization positions that are not modeled under § 324.209. An FDIC-supervised institution must calculate each specific risk add-on in accordance with the requirements of this section.

Notwithstanding any other definition or requirement in this subpart, a position that would have qualified as a debt position or an equity position but for the fact that it qualifies as a correlation trading position under paragraph (2) of the definition of correlation trading position in § 324.2, shall be considered a debt position or an equity position, respectively, for purposes of this §324.210.

(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 fair 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, an FDIC-supervised institution must assign a specific risk-weighting factor to the fair value of the effective notional amount of the underlying instrument or index portfolio, except for a securitization position for which the FDIC-supervised institution 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, an FDIC-supervised institution must risk weight the fair 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, an FDIC-supervised institution may net long and short positions (including derivatives) in identical issues or identical indices. An FDIC-

supervised institution may also net positions in depositary receipts against an opposite position in an identical equity in different markets, provided that the FDIC-supervised institution 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 fair 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, an FDIC-supervised institution must multiply the absolute value of the current fair 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 accordance with Table 1 to § 324.210, an FDIC-supervised institution must assign a specific risk-weighting factor to a sovereign debt position based on the CRC applicable to the sovereign, and, as applicable, the remaining contractual maturity of the position, or if there is no CRC applicable to the sovereign, based on whether the sovereign entity is a member of the OECD. Notwithstanding any other provision in this subpart, 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 1 TO § 324.210 – SPECIFIC RISK-WEIGHTING FACTORS FOR SOVEREIGN DEBT POSITIONS

		Specific Risk-weighting Factor (in percent)	
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	1.0

		months	
		Remaining contractual maturity exceeds 24 months	1.6
	4-6	8.0	
	7	12.0	
OECD Member with No CRC		0.0	
Non-OECD Member with No CRC		8.0	
Sovereign Default		12.0	

(B) Notwithstanding paragraph (b)(2)(i)(A) of this section, an FDIC-supervised institution may assign to a sovereign debt position a specific risk-weighting factor that is lower than the applicable specific risk-weighting factor in Table 1 to § 324.210 if:

(1) The position is denominated in the sovereign entity's currency;

(2) The FDIC-supervised institution 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) An FDIC-supervised institution 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) An FDIC-supervised institution must assign a 0.0 percent specific risk-weighting factor to a sovereign debt position if the sovereign entity is a member of the OECD and does not have a CRC assigned to it, except as provided in paragraph (b)(2)(i)(C) of this section.

(E) An FDIC-supervised institution must assign an 8.0 percent specific risk-weighting factor to a sovereign debt position if the sovereign is not a member of the OECD and does not have a CRC assigned to it, except as provided in paragraph (b)(2)(i)(C) of this section.

(ii) Certain supranational entity and multilateral development bank debt positions. An FDIC-supervised institution 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. An FDIC-supervised institution must assign a 1.6 percent specific risk-weighting factor to a debt position that is an exposure to a GSE. Notwithstanding the foregoing, an FDIC-supervised institution 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, an FDIC-supervised institution 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, in accordance with Table 2 to § 324.210 of this section, based on the CRC that corresponds to that entity's home country or the OECD membership status of that entity's home country if there is no CRC applicable to the entity's home country, and, as applicable, the remaining contractual maturity of the position.

TABLE 2 TO § 324.210 – SPECIFIC RISK-WEIGHTING FACTORS FOR DEPOSITORY INSTITUTION, FOREIGN BANK, AND CREDIT UNION DEBT POSITIONS

	Specific Risk-weighting Factor (in percent)	
CRC 0-2 or	Remaining contractual	0.25

OECD Member with No CRC	maturity of 6 months or less	
	Remaining contractual maturity of greater than 6 and up to and including 24 months	1.0
	Remaining contractual maturity exceeds 24 months	1.6
CRC 3	8.0	
CRC 4-7	12.0	
Non-OECD Member with No CRC	8.0	
Sovereign Default	12.0	

(B) An FDIC-supervised institution 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 § 324.22.

(C) An FDIC-supervised institution 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, an FDIC-supervised institution must assign a specific risk-weighting factor to a debt position that is an exposure to a PSE in accordance with Tables 3 and 4 to § 324.210 depending on the position's categorization as a general obligation or revenue obligation based on the CRC that corresponds to the PSE's home country or the OECD membership status of the PSE's home

country if there is no CRC applicable to the PSE's home country, and, as applicable, the remaining contractual maturity of the position, as set forth in Tables 3 and 4 to §324.210.

(B) An FDIC-supervised institution may assign a lower specific risk-weighting factor than would otherwise apply under Tables 3 and 4 to §324.210 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 Table 1 to §324.210.

(C) An FDIC-supervised institution 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 3 TO § 324.210 – SPECIFIC RISK-WEIGHTING FACTORS FOR PSE GENERAL OBLIGATION DEBT POSITIONS

	General Obligation Specific Risk-weighting Factor (in percent)	
CRC 0-2 or OECD Member with No CRC	Remaining contractual maturity of 6 months or less	0.25
	Remaining contractual maturity of greater than 6 and up to and including 24	1.0

	months	
	Remaining contractual maturity exceeds 24 months	1.6
CRC 3	8.0	
CRC 4-7	12.0	
Non-OECD Member with No CRC	8.0	
Sovereign Default	12.0	

TABLE 4 TO § 324.210 – SPECIFIC RISK-WEIGHTING FACTORS FOR PSE REVENUE OBLIGATION DEBT POSITIONS

	Revenue Obligation Specific Risk-weighting Factor (in percent)	
CRC 0-1 or OECD Member with No CRC	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
CRC 2-3	8.0	

CRC 4-7	12.0
Non-OECD Member with No CRC	8.0
Sovereign Default	12.0

(vi) Corporate debt positions. Except as otherwise provided in paragraph (b)(2)(vi)(B) of this section, an FDIC-supervised institution 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, an FDIC-supervised institution must assign a specific risk-weighting factor based on the category and remaining contractual maturity of the position, in accordance with Table 5 to § 324.210. For purposes of this paragraph (b)(2)(vi)(A)(1), the FDIC-supervised institution must determine whether the position is in the investment grade or not investment grade category.

TABLE 5 TO § 324.210 – 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) An FDIC-supervised institution 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) An FDIC-supervised institution 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) An FDIC-supervised institution 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, if applicable, in Table 1 to §324.210.

(vii) Securitization positions. (A) General requirements. (1) An FDIC-supervised institution that is not an advanced approaches FDIC-supervised institution 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 § 324.211) or assign a specific risk-weighting factor of 100 percent to the position.

(2) An FDIC-supervised institution that is an advanced approaches FDIC-supervised institution must calculate a specific risk add-on for a securitization position in accordance with paragraph (b)(2)(vii)(B) of this section if the FDIC-supervised institution and the securitization position each qualifies to use the SFA in § 324.143. An FDIC-supervised institution that is an advanced approaches FDIC-supervised institution 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) An FDIC-supervised institution 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, an FDIC-supervised institution that is an advanced approaches FDIC-supervised institution must set the specific risk add-on for the position equal to the risk-based capital requirement as calculated under § 324.143.

(C) SSFA. To use the SSFA to determine the specific risk-weighting factor for a securitization position, an FDIC-supervised institution must calculate the specific risk-weighting factor in accordance with § 324.211.

(D) N^{th}-to-default credit derivatives. An FDIC-supervised institution 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 nth-to-default credit derivative in accordance with this paragraph (b)(2)(vii)(D), regardless of whether the FDIC-supervised institution is a net protection buyer or net protection seller. An FDIC-supervised institution must determine its position in the nth-to-default credit derivative as the largest notional 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 nth-to-default credit derivative using the SSFA in paragraph (b)(2)(vii)(C) of this section the FDIC-supervised institution 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 FDIC-supervised institution's position to the total notional amount of all underlying exposures. For purposes of the SSFA, parameter A is expressed as a decimal value between zero and one. 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 nth-to-default credit derivative, parameter A must be set equal to the credit enhancement level (L) input to the SFA formula in §324.143. In the case of a first-to-default credit derivative, there are no underlying exposures that are subordinated to the FDIC-supervised institution'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 FDIC-supervised institution's position.

(ii) The detachment point (parameter D) equals the sum of parameter A plus the ratio of the notional amount of the FDIC-supervised institution's position in the nth-to-default credit derivative to the total notional amount of all underlying exposures. For purposes of the SSFA, parameter A is expressed as a decimal value between zero and one. 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 nth-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 § 324.143.

(2) An FDIC-supervised institution 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 nth-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 § 324.209, the total specific risk add-on is the greater of:

(1) The sum of the FDIC-supervised institution's specific risk add-ons for each net long correlation trading position calculated under this section; or

(2) The sum of the FDIC-supervised institution'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 § 324.209, the total specific risk add-on is the greater of:

(1) The sum of the FDIC-supervised institution's specific risk add-ons for each net long securitization position calculated under this section; or

(2) The sum of the FDIC-supervised institution'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, an FDIC-supervised institution must multiply the absolute value of the current fair value of each net long or net short equity position by the appropriate specific risk-weighting factor as determined under this paragraph:

(1) The FDIC-supervised institution must multiply the absolute value of the current fair 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 fair 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, an FDIC-supervised institution 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, an FDIC-supervised institution 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.

(f) Due diligence requirements for securitization positions. (1) An FDIC-supervised institution must demonstrate to the satisfaction of the FDIC 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 FDIC-supervised institution's analysis must be commensurate with the complexity of the securitization position and the materiality of the position in relation to capital.

[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 fair value.

(2) An FDIC-supervised institution must demonstrate its comprehensive understanding for each securitization position by:

(i) Conducting 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, fair 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.

(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.

§ 324.211 Simplified supervisory formula approach (SSFA).

(a) General requirements. To use the SSFA to determine the specific risk-weighting factor for a securitization position, an FDIC-supervised institution 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; if the contracts governing the underlying exposures of the securitization require payments on a monthly or quarterly basis, the data used to assign the parameters described in paragraph (b) of this section must be no more than 91 calendar days old. An FDIC-supervised institution 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, an FDIC-supervised institution 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 one (that is, an average risk weight of 100 percent represents a value of K_G equal to 0.08).

(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 of the securitization that meet any of the criteria as set forth in paragraphs (i) through (vi) of this paragraph (b)(2) to the 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 payments for 90 days or more, other than principal or interest payments deferred on:

(A) Federally-guaranteed student loans, in accordance with the terms of those guarantee programs; or

(B) Consumer loans, including non-federally-guaranteed student loans, provided that such payments are deferred pursuant to provisions included in the contract at the time funds are disbursed that provide for period(s) of deferral that are not initiated based on changes in the creditworthiness of the borrower; 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. Except as provided in §324.210(b)(2)(vii)(D) for n^{th}-to-default credit derivatives, parameter A equals the ratio of the current dollar amount of underlying exposures that are subordinated to the position of the FDIC-supervised institution 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 FDIC-supervised institution'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. Except as provided in §324.210(b)(2)(vii)(D) for n^{th}-to-default credit derivatives,

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 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, 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 FDIC-supervised institution 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. 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:

$$SRWF = 100 \cdot \left[\left(\frac{K_A - A}{D - A} \right) \cdot 1.00 \right] + \left[\left(\frac{D - K_A}{D - A} \right) \cdot K_{SSFA} \right]$$

(d) SSFA equation. (1) The FDIC-supervised institution must define the following parameters:

$$K_A = (1 - W) \cdot K_G + (0.5 \cdot W)$$

$$a = -\frac{1}{p \cdot K_A}$$

$$u = D - K_A$$

$$l = \max(A - K_A, 0)$$

$e = 2.71828$, the base of the natural logarithms.

(2) Then the FDIC-supervised institution 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 $K_{SSFA} \times 100$.

§ 324.212 Market risk disclosures.

(a) Scope. An FDIC-supervised institution 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. An FDIC-supervised institution must make

timely public disclosures each calendar quarter. If a significant change occurs, such that the most recent reporting amounts are no longer reflective of the FDIC-supervised institution'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 an FDIC-supervised institution 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 FDIC-supervised institution 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. The FDIC-supervised institution's management may provide all of the disclosures required by this section in one place on the FDIC-supervised institution's public website or may provide the disclosures in more than one public financial report or other regulatory reports, provided that the FDIC-supervised institution publicly provides a summary table specifically indicating the location(s) of all such disclosures.

(b) Disclosure policy. The FDIC-supervised institution must have a formal disclosure policy approved by the board of directors that addresses the FDIC-supervised institution'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 FDIC-supervised institution 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 FDIC-supervised institution must provide timely public disclosures of 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 FDIC-supervised institution, with an analysis of important outliers.

(2) In addition, the FDIC-supervised institution 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. For each material portfolio of covered positions, the FDIC-supervised institution must provide timely public disclosures of the following information at least annually after the end of the fourth calendar quarter, or more frequently in the event of material changes for each portfolio:

(1) The composition of material portfolios of covered positions;

(2) The FDIC-supervised institution'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;

(3) 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:

(i) The approach used by the FDIC-supervised institution to determine liquidity horizons;

(ii) The methodologies used to achieve a capital assessment that is consistent with the required soundness standard; and

(iii) The specific approaches used in the validation of these models;

(4) A description of the approaches used for validating and evaluating the accuracy of internal models and modeling processes for purposes of this subpart;

(5) 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;

(6) The results of the comparison of the FDIC-supervised institution's internal estimates for purposes of this subpart with actual outcomes during a sample period not used in model development;

(7) The soundness standard on which the FDIC-supervised institution'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;

(8) A description of the FDIC-supervised institution's processes for monitoring changes in the credit and market risk of securitization positions, including how those processes differ for resecuritization positions; and

(9) A description of the FDIC-supervised institution's policy governing the use of credit risk mitigation to mitigate the risks of securitization and resecuritization positions.

Subpart G - Transition Provisions

§ 324.300 Transitions.

(a) Capital conservation and countercyclical capital buffer. (1) From January 1, 2014, through December 31, 2015, an FDIC-supervised institution is not subject to limits on distributions and discretionary bonus payments under § 324.11 notwithstanding the amount of its capital conservation buffer or any applicable countercyclical capital buffer amount.

(2) Beginning January 1, 2016, through December 31, 2018, an FDIC-supervised institution's maximum payout ratio shall be determined as set forth in Table 1 to § 324.300.

TABLE 1 TO § 324.300

Transition Period	Capital conservation buffer	Maximum payout ratio (as a percentage of eligible retained income)

Calendar year 2016	Greater than 0.625 percent (plus 25 percent of any applicable countercyclical capital buffer amount)	No payout ratio limitation applies under this section
	Less than or equal to 0.625 percent (plus 25 percent of any applicable countercyclical capital buffer amount), and greater than 0.469 percent (plus 17.25 percent of any applicable countercyclical capital buffer amount)	60 percent
	Less than or equal to 0.469 percent (plus 17.25 percent of any applicable countercyclical capital buffer amount), and greater than 0.313 percent (plus 12.5 percent of any applicable countercyclical capital buffer amount)	40 percent
	Less than or equal to	20 percent

	0.313 percent (plus 12.5 percent of any applicable countercyclical capital buffer amount), and greater than 0.156 percent (plus 6.25 percent of any applicable countercyclical capital buffer amount)	
	Less than or equal to 0.156 percent (plus 6.25 percent of any applicable countercyclical capital buffer amount)	0 percent
Calendar year 2017	Greater than 1.25 percent (plus 50 percent of any applicable countercyclical capital buffer amount)	No payout ratio limitation applies under this section
	Less than or equal to 1.25 percent (plus 50 percent of any applicable countercyclical capital buffer amount), and greater than 0.938 percent (plus	60 percent

	37.5 percent of any applicable countercyclical capital buffer amount)	
	Less than or equal to 0.938 percent (plus 37.5 percent of any applicable countercyclical capital buffer amount), and greater than 0.625 percent (plus 25 percent of any applicable countercyclical capital buffer amount)	40 percent
	Less than or equal to 0.625 percent (plus 25 percent of any applicable countercyclical capital buffer amount), and greater than 0.313 percent (plus 12.5 percent of any applicable countercyclical capital buffer amount)	20 percent
	Less than or equal to 0.313 percent (plus 12.5 percent	0 percent

	of any applicable countercyclical capital buffer amount)	
Calendar year 2018	Greater than 1.875 percent (plus 75 percent of any applicable countercyclical capital buffer amount)	No payout ratio limitation applies under this section
	Less than or equal to 1.875 percent (plus 75 percent of any applicable countercyclical capital buffer amount), and greater than 1.406 percent (plus 56.25 percent of any applicable countercyclical capital buffer amount)	60 percent
	Less than or equal to 1.406 percent (plus 56.25 percent of any applicable countercyclical capital buffer amount), and greater than 0.938 percent (plus 37.5 percent of any	40 percent

	applicable countercyclical capital buffer amount)	
	Less than or equal to 0.938 percent (plus 37.5 percent of any applicable countercyclical capital buffer amount), and greater than 0.469 percent (plus 18.75 percent of any applicable countercyclical capital buffer amount)	20 percent
	Less than or equal to 0.469 percent (plus 18.75 percent of any applicable countercyclical capital buffer amount)	0 percent

(b) Regulatory capital adjustments and deductions. Beginning January 1, 2014, for an advanced approaches FDIC-supervised institution, and beginning January 1, 2015, for an FDIC-supervised institution that is not an advanced approaches FDIC-supervised institution, and in each case through December 31, 2017, an FDIC-supervised institution must make the capital adjustments and deductions in § 324.22 in accordance with the transition requirements in this

paragraph (b). Beginning January 1, 2018, an FDIC-supervised institution must make all regulatory capital adjustments and deductions in accordance with § 324.22.

(1) Transition deductions from common equity tier 1 capital. Beginning January 1, 2014, for an advanced approaches FDIC-supervised institution, and beginning January 1, 2015, for an FDIC-supervised institution that is not an advanced approaches FDIC-supervised institution, and in each case through December 31, 2017, an FDIC-supervised institution, must make the deductions required under § 324.22(a)(1) – (6) from common equity tier 1 or tier 1 capital elements in accordance with the percentages set forth in Tables 2 and 3 to § 324.300.

(i) An FDIC-supervised institution must deduct the following items from common equity tier 1 and additional tier 1 capital in accordance with the percentages set forth in Table 2 to § 324.300: goodwill (§ 324.22(a)(1)), DTAs that arise from net operating loss and tax credit carryforwards (§ 324.22(a)(3)), a gain-on-sale in connection with a securitization exposure (§ 324.22(a)(4)), defined benefit pension fund assets (§ 324.22(a)(5)), expected credit loss that exceeds eligible credit reserves (for advanced approaches FDIC-supervised institutions that have completed the parallel run process and that have received notifications from the FDIC pursuant to § 324.121(d) of subpart E) (§ 324.22(a)(6)), and financial subsidiaries (§ 324.22(a)(7)).

TABLE 2 TO § 324.300

Transition Period	**Transition deductions under §324.22(a)(1), (a)(7), (a)(8), and (a)(9)**	**Transition deductions under § 324.22(a)(3) -- (6)**	
	Percentage of the deductions from	Percentage of the deductions from common	Percentage of the deductions from tier 1 capital

	common equity tier 1 capital	equity tier 1 capital	
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) An FDIC-supervised institution must deduct from common equity tier 1 capital any intangible assets other than goodwill and MSAs in accordance with the percentages set forth in Table 3 to § 324.300.

(iii) An FDIC-supervised institution 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 3 TO § 324.300

Transition Period	**Transition deductions under § 324.22(a)(2) – Percentage of the deductions from common equity tier 1 capital**

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. Beginning January 1, 2014, for an advanced approaches FDIC-supervised institution, and beginning January 1, 2015, for an FDIC-supervised institution that is not an advanced approaches FDIC-supervised institution, and in each case through December 31, 2017, an FDIC-supervised institution, must allocate the regulatory adjustments related to changes in the fair value of liabilities due to changes in the FDIC-supervised institution's own credit risk (§ 324.22(b)(1)(iii)) between common equity tier 1 capital and tier 1 capital in accordance with the percentages set forth in Table 4 to § 324.300.

(i) If the aggregate amount of the adjustment is positive, the FDIC-supervised institution must allocate the deduction between common equity tier 1 and tier 1 capital in accordance with Table 4 to § 324.300.

(ii) If the aggregate amount of the adjustment is negative, the FDIC-supervised institution must add back the adjustment to common equity tier 1 capital or to tier 1 capital, in accordance with Table 4 to § 324.300.

TABLE 4 TO § 324.300

Transition Period	**Transition adjustments under § 324.22(b)(2)**	
	Percentage of the adjustment applied to common equity tier 1 capital	Percentage of the adjustment applied to tier 1 capital
Calendar year 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 for an advanced approaches FDIC-supervised institution and an FDIC-supervised institution that has not made an AOCI opt-out election under § 324.22(b)(2). Beginning January 1, 2014, for an advanced approaches FDIC-supervised institution, and beginning January 1, 2015, for an FDIC-supervised institution that is not an

advanced approaches FDIC-supervised institution and that has not made an AOCI opt-out election under § 324.22(b)(2), and in each case through December 31, 2017, an FDIC-supervised institution must adjust common equity tier 1 capital with respect to the transitions AOCI adjustment amount (transitions AOCI adjustment amount):

(i) The transitions AOCI adjustment amount is the aggregate amount of an FDIC-supervised institution's:

(A) Unrealized gains on available-for-sale securities that are not preferred stock classified as an equity security under GAAP or equity exposures, plus

(B) Net unrealized gains or losses on available-for-sale securities that are not preferred stock classified as an equity security under GAAP or equity exposures, plus

(C) Any amounts recorded in AOCI attributed to defined benefit postretirement plans resulting from the initial and subsequent application of the relevant GAAP standards that pertain to such plans (excluding, at the FDIC-supervised institution's option, the portion relating to pension assets deducted under §324.22(a)(5)), plus

(D) Accumulated net gains or losses on cash flow hedges related to items that are reported on the balance sheet at fair value included in AOCI, plus

(E) Net unrealized gains or losses on held-to-maturity securities that are included in AOCI.

(ii) An FDIC-supervised institution must make the following adjustment to its common equity tier 1 capital:

(A) If the transition AOCI adjustment amount is positive, the appropriate amount must be deducted from common equity tier 1 capital in accordance with Table 5 to § 324.300.

(B) 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 5 to § 324.300.

TABLE 5 TO § 324.300

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

(iii) An FDIC-supervised institution may include in tier 2 capital the percentage of unrealized gains on available-for-sale preferred stock classified as an equity security under GAAP and equity exposures as set forth in Table 6 to § 324.300.

TABLE 6 TO § 324.300

Transition Period	**Percentage of unrealized gains on available-for-sale preferred stock classified as an equity security under GAAP and equity exposures that may be included in tier 2 capital**
Calendar year	36

2014	
Calendar year 2015	27
Calendar year 2016	18
Calendar year 2017	9
Calendar year 2018 and thereafter	0

(4) Additional transition deductions from regulatory capital. (i) Beginning January 1, 2014, for an advanced approaches FDIC-supervised institution, and beginning January 1, 2015, for an FDIC-supervised institution that is not an advanced approaches FDIC-supervised institution, and in each case through December 31, 2017, an FDIC-supervised institution must use Table 7 to § 324.300 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 (§ 324.22(d)) (that is, MSAs, DTAs arising from temporary differences that the FDIC-supervised institution 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 capital.

(ii) Beginning January 1, 2014, for an advanced approaches FDIC-supervised institution, and beginning January 1, 2015, for an FDIC-supervised institution that is not an advanced approaches FDIC-supervised institution, and in each case through December 31, 2017, an FDIC-supervised institution 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 § 324.22(d)(2), beginning January 1, 2018, an FDIC-supervised institution 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 7 TO § 324.300

Transition Period	**Transitions for deductions under § 324.22(c) and (d)– Percentage of additional deductions from regulatory capital**
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 paragraph (b)(4)(iii), beginning January 1, 2014, for an advanced approaches FDIC-supervised institution, and beginning January 1, 2015, for an FDIC-supervised institution that is not an advanced approaches FDIC-supervised institution, and in each case through December 31, 2017, an FDIC-

supervised institution's 15 percent common equity tier 1 capital deduction threshold for MSAs, DTAs arising from temporary differences that the FDIC-supervised institution 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 FDIC-supervised institution's common equity tier 1 elements, after regulatory adjustments and deductions required under § 324.22(a) through (c) (transition 15 percent common equity tier 1 capital deduction threshold).

(iv) Beginning January 1, 2018, an FDIC-supervised institution must calculate the 15 percent common equity tier 1 capital deduction threshold in accordance with § 324.22(d).

(c) Non-qualifying capital instruments. Depository institutions. (i) Beginning on January 1, 2014, a depository institution that is an advanced approaches FDIC-supervised institution, and beginning on January 1, 2015, all other depository institutions may include in regulatory capital debt or equity instruments issued prior to September 12, 2010, that do not meet the criteria for additional tier 1 or tier 2 capital instruments in § 324.20 but that were included in tier 1 or tier 2 capital respectively as of September 12, 2010 (non-qualifying capital instruments issued prior to September 12, 2010) up to the percentage of the outstanding principal amount of such non-qualifying capital instruments as of [insert effective date of the interim final rule] in accordance with Table 8 to § 324.300.

(ii) Table 8 to § 324.300 applies separately to 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 tier 2 capital without limitation, provided that the instruments meet the criteria for tier 2 capital instruments under § 324.20(d).

TABLE 8 TO § 324.300

Transition Period (Calendar year)	**Percentage of non-qualifying capital instruments includable in additional tier 1 or tier 2 capital**
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

(d) Minority interest. (1) Surplus minority interest. Beginning January 1, 2014, for an advanced approaches FDIC-supervised institution, and beginning January 1, 2015, for an FDIC-supervised institution that is not an advanced approaches FDIC-supervised institution, and in

each case through December 31, 2017, an FDIC-supervised institution may include in common equity tier 1 capital, tier 1 capital, or total capital the percentage of the common equity tier 1 minority interest, tier 1 minority interest and total capital minority interest outstanding as of [insert effective date of the interim final rule] that exceeds any common equity tier 1 minority interest, tier 1 minority interest or total capital minority interest includable under § 324.21 (surplus minority interest), respectively, as set forth in Table 9 to § 324.300.

(2) Non-qualifying minority interest. Beginning January 1, 2014, for an advanced approaches FDIC-supervised institution, and beginning January 1, 2015, for an FDIC-supervised institution that is not an advanced approaches FDIC-supervised institution, and in each case through December 31, 2017, an FDIC-supervised institution may include in tier 1 capital or total capital the percentage of the tier 1 minority interest and total capital minority interest outstanding as of [insert effective date of the interim final rule] that does not meet the criteria for additional tier 1 or tier 2 capital instruments in § 324.20 (non-qualifying minority interest), as set forth in Table 9 to § 324.300.

TABLE 9 TO § 324.300

Transition Period	**Percentage of the amount of surplus or non-qualifying minority interest that can be included in regulatory capital during the transition period**
Calendar year 2014	80
Calendar year 2015	60

Calendar year 2016	40
Calendar year 2017	20
Calendar year 2018 and thereafter	0

(e) Prompt Corrective Action. For purposes of subpart H of this part, an FDIC-supervised institution must calculate its capital measures and tangible equity ratio in accordance with the transition provisions in this section.

Subpart H – Prompt Corrective Action

§ 324.401 Authority, purpose, scope, other supervisory authority, disclosure of capital categories, and transition procedures.

(a) Authority. This subpart H is issued by the FDIC pursuant to 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-supervised institutions, 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 of the FDI Act.

(c) Scope. Until January 1, 2015, subpart B of part 325 of this chapter will continue to apply to 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. Beginning on, and thereafter, January 1, 2015, this subpart H implements the provisions of section 38 of the FDI Act as they apply to FDIC-supervised institutions 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 of the FDI Act nor this subpart H 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 H 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 an FDIC-supervised institution or an insured branch of a foreign bank for which the FDIC is the appropriate Federal banking agency under this subpart H within a particular capital category is for purposes of implementing and applying the provisions of section 38 of the FDI Act. Unless permitted by the FDIC or

otherwise required by law, no FDIC-supervised institution or insured branch of a foreign bank for which the FDIC is the appropriate Federal banking agency may state in any advertisement or promotional material its capital category under this subpart H or that the FDIC or any other Federal banking agency has assigned it to a particular capital category.

(f) Transition procedures. (1) Definitions applicable before January 1, 2015, for certain FDIC-supervised institutions. Before January 1, 2015, notwithstanding any other requirement in this subpart H and with respect to any FDIC-supervised institution that is not an advanced approaches FDIC-supervised institution:

(i) The definitions of leverage ratio, tangible equity, tier 1 capital, tier 1 risk-based capital, and total risk-based capital as calculated or defined under Appendix A to part 325 or Appendix B to part 325, as applicable, remain in effect for purposes of this subpart H; and

(ii) The term total assets shall have the meaning provided in 12 CFR 325.2(x).

(2) Timing. The calculation of the definitions of common equity tier 1 capital, the common equity tier 1 risk-based capital ratio, the leverage ratio, the supplementary leverage ratio, tangible equity, tier 1 capital, the tier 1 risk-based capital ratio, total assets, total leverage exposure, the total risk-based capital ratio, and total risk-weighted assets under this subpart H is subject to the timing provisions at 12 CFR § 324.1(f) and the transitions at 12 CFR part 324, subpart G.

§ 324.402 Notice of capital category.

(a) Effective date of determination of capital category. An FDIC-supervised institution shall be deemed to be within a given capital category for purposes of section 38 of the FDI Act and this subpart H as of the date the FDIC-supervised institution 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. An FDIC-supervised institution shall be deemed to have been notified of its capital levels and its capital category as of the most recent date:

(1) A Call Report is required to be filed with the FDIC;

(2) A final report of examination is delivered to the FDIC-supervised institution; or

(3) Written notice is provided by the FDIC to the FDIC-supervised institution of its capital category for purposes of section 38 of the FDI Act and this subpart or that the FDIC-supervised institution's capital category has changed as provided in § 324.403(d).

(c) Adjustments to reported capital levels and capital category -- (1) Notice of adjustment by bank or state savings association. An FDIC-supervised institution shall provide the appropriate FDIC regional director with written notice that an adjustment to the FDIC-supervised institution'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 FDIC-supervised institution to be placed in a lower capital category from the category assigned to the FDIC-supervised institution for purposes of section 38 of the FDI Act and this subpart H on the basis of the FDIC-supervised institution'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 FDIC-supervised institution and shall notify the bank or state savings association of the FDIC's determination.

§ 324.403 Capital measures and capital category definitions.

(a) Capital measures. For purposes of section 38 of the FDI Act and this subpart H, 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 January 1, 2018, the supplementary leverage ratio calculated in accordance with § 324.11 of subpart B of this part for advanced approaches FDIC-supervised institutions that are subject to subpart E of this part.

(b) Capital categories. For purposes of section 38 of the FDI Act and this subpart, an FDIC-supervised institution shall be deemed to be:

(1) "Well capitalized" if it:

(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

(iv) Has a leverage ratio of 5.0 percent or greater; and

(v) 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 it:

(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 FDIC-supervised institution will be deemed to be "adequately capitalized" if it satisfies paragraphs (b)(2)(i) through (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 it:

(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 FDIC-supervised institution will be deemed to be "undercapitalized" if it 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 it 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 of the FDI Act and this subpart H, 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, 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 FDIC-supervised institution as adequately capitalized and may require an adequately capitalized FDIC-supervised institution or an undercapitalized FDIC-supervised institution to comply with certain mandatory or discretionary supervisory actions as if the FDIC-supervised institution were in the next lower capital category (except that the FDIC may not reclassify a significantly undercapitalized FDIC-supervised institution 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 FDIC-supervised institution 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 FDIC-supervised institution, the FDIC-supervised institution received and has not corrected a

less-than-satisfactory rating for any of the categories of asset quality, management, earnings, or liquidity.

§ 324.404 Capital restoration plans.

(a) Schedule for filing plan-- (1) In general. An FDIC-supervised institution shall file a written capital restoration plan with the appropriate FDIC regional director within 45 days of the date that the FDIC-supervised institution receives notice or is deemed to have notice that the FDIC-supervised institution is undercapitalized, significantly undercapitalized, or critically undercapitalized, unless the FDIC notifies the FDIC-supervised institution in writing that the plan is to be filed within a different period. An adequately capitalized FDIC-supervised institution that has been required pursuant to §324.403(d) of this subpart to comply with supervisory actions as if the FDIC-supervised institution 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, an FDIC-supervised institution that has already submitted and is operating under a capital restoration plan approved under section 38 and this subpart H 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 §324.403 unless the FDIC notifies the FDIC-supervised institution that it must submit a new or revised capital plan. An FDIC-supervised institution 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 it 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. An FDIC-supervised institution that is required to submit a capital restoration plan as a result of its reclassification pursuant to § 324.403(d) of this subpart H shall include a description of the steps the FDIC-supervised institution 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 FDIC-supervised institution.

(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 FDIC-supervised institution 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 FDIC-supervised institution 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 FDIC-supervised institution (as defined in § 324.403(b) of this subpart H) shall be subject to all of the provisions of section 38 of the FDI Act and this subpart H applicable to significantly undercapitalized institutions. These provisions shall be applicable until such time as a new or revised capital restoration plan submitted by the FDIC-supervised institution has been approved by the FDIC.

(e) Failure to submit capital restoration plan. An FDIC-supervised institution that is undercapitalized (as defined in § 324.403(b) of this subpart H) 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 FDIC-supervised institution that fails in any material respect to implement a capital restoration plan shall be subject to all of the provisions of section 38 of the FDI Act and this subpart H applicable to significantly undercapitalized institutions.

(g) Amendment of capital restoration plan. An FDIC-supervised institution 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 FDIC-supervised institution shall implement the capital restoration plan as approved prior to the proposed amendment.

(h) Performance guarantee by companies that control an FDIC-supervised institution -- (1) Limitation on liability -- (i) Amount limitation. The aggregate liability under the guarantee provided under section 38 and this subpart H for all companies that control a specific FDIC-supervised institution that is required to submit a capital restoration plan under this subpart H shall be limited to the lesser of:

(A) An amount equal to 5.0 percent of the FDIC-supervised institution's total assets at the time the FDIC-supervised institution was notified or deemed to have notice that the FDIC-supervised institution was undercapitalized; or

(B) The amount necessary to restore the relevant capital measures of the FDIC-supervised institution to the levels required for the FDIC-supervised institution to be classified as adequately capitalized, as those capital measures and levels are defined at the time that the

FDIC-supervised institution initially fails to comply with a capital restoration plan under this subpart H.

(ii) Limit on duration. The guarantee and limit of liability under section 38 of the FDI Act and this subpart H shall expire after the FDIC notifies the FDIC-supervised institution 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 FDIC-supervised institution after expiration of the first guarantee.

(iii) Collection on guarantee. Each company that controls a given FDIC-supervised institution shall be jointly and severally liable for the guarantee for such FDIC-supervised institution as required under section 38 and this subpart H, 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 an FDIC-supervised institution 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 FDIC-supervised institution shall, upon submission of the plan, be subject to the provisions of section 38 and this subpart H that are applicable to FDIC-supervised institutions that have not submitted an acceptable capital restoration plan.

(3) Failure to perform guarantee. Failure by any company that controls an FDIC-supervised institution 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 FDIC-supervised institution shall be subject to the provisions of section 38 and this subpart H

that are applicable to FDIC-supervised institutions that have failed in a material respect to implement a capital restoration plan.

§ 324.405 Mandatory and discretionary supervisory actions.

(a) Mandatory supervisory actions-- (1) Provisions applicable to all FDIC-supervised institutions. All FDIC-supervised institution 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 FDIC-supervised institution. Immediately upon receiving notice or being deemed to have notice, as provided in § 324.402 of this subpart H, that the FDIC-supervised institution is undercapitalized, significantly undercapitalized, or critically undercapitalized, it 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) of the FDI Act);

(ii) Requiring that the FDIC monitor the condition of the FDIC-supervised institution (section 38(e)(1) of the FDI Act);

(iii) Requiring submission of a capital restoration plan within the schedule established in this subpart (section 38(e)(2) of the FDI Act);

(iv) Restricting the growth of the FDIC-supervised institution's assets (section 38(e)(3) of the FDI Act); and

(v) Requiring prior approval of certain expansion proposals (section 38(e)(4) of the FDI Act).

(3) Additional provisions applicable to significantly undercapitalized, and critically undercapitalized FDIC-supervised institutions. 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 § 324.402 of this subpart, that the FDIC-supervised institution is significantly undercapitalized, or critically undercapitalized, or that the FDIC-supervised institution is subject to the provisions applicable to institutions that are significantly undercapitalized because the FDIC-supervised institution failed to submit or implement in any material respect an acceptable capital restoration plan, the FDIC-supervised institution 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) of the FDI Act).

(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 § 324.402 of this subpart H, 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.

(iii) The FDIC-supervised institution must remain 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 of the FDI Act 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 of the FDI Act or this subpart H.

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 chapter III of title 12 of the Code of Federal Regulations as follows:

PART 303 – FILING PROCEDURES

1. The authority citation for part 303 continues to read as follows:

Authority: 12 U.S.C. 378, 1464, 1813, 1815, 1817, 1818, 1819 (Seventh and Tenth), 1820, 1823, 1828, 1831a, 1831e, 1831o, 1831p–1, 1831w, 1835a, 1843(l), 3104, 3105, 3108, 3207; 15 U.S.C. 1601–1607.

2. Section 303.2 is amended by revising paragraphs (b), (ee), and (ff) to read as follows:

§ 303.2 Definitions.

(b) Adjusted part 325 total assets means adjusted 12 CFR part 325 or part 324, as applicable, total assets as calculated and reflected in the FDIC's Report of Examination.

* * * * *

(ee) Tier 1 capital shall have the same meaning as provided in § 325.2(v) of this chapter (12 CFR 325.2(v)) or § 324.2, as applicable.

* * * * *

(ff) Total assets shall have the same meaning as provided in § 325.2(x) of this chapter (12 CFR 325.2(x)) or § 324.2, as applicable.

* * * * *

3. Section 303.64 is amended by revising paragraph (a)(4)(i) to read as follows:

§ 303.64 Processing.

(a) * * *

(4) * * *

(i) Immediately following the merger transaction, the resulting institution will be "well-capitalized" pursuant to subpart B of part 325 of this chapter (12 CFR part 325) or subpart H of part 324 of this chapter (12 CFR 324), as applicable; and

* * * * *

4. Section 303.181 is amended by revising paragraph (c)(4) to read as follows:

§ 303.181 Definitions

(c) * * *

(4) Is well-capitalized as defined in subpart B of part 325 of this chapter or subpart H of part 324, as applicable; and

* * * * *

5. Section 303.184 is amended by revising paragraph (d)(1)(ii) to read as follows:

§ 303.184 Moving an insured branch of a foreign bank.

(d) * * *

(1) * * *

(ii) The applicant is at least adequately capitalized as defined in subpart B of part 325 of this chapter or subpart H of part 324 of this chapter, as applicable;

* * * * *

6. Section 303.200 is amended by revising paragraphs (a)(2) and (b) to read as follows:

§ 303.200 Scope.

(a) * * *

(2) Definitions of the capital categories referenced in this Prompt Corrective Action subpart may be found in subpart B of part 325 of this chapter, § 325.103(b) for state nonmember

banks and § 325.103(c) for insured branches of foreign banks, or subpart H of part 324 of this chapter, § 324.403(b) for state nonmember banks and § 324.403(c) for insured branches of foreign banks, as applicable.

(b) Institutions covered. Restrictions and prohibitions contained in subpart B of part 325 of this chapter, and subpart H of part 324 of this chapter, as applicable, apply primarily to state nonmember banks and insured branches of foreign banks, as well as to directors and senior executive officers of those institutions. Portions of subpart B of part 325 of this chapter or subpart H of part 324 of this chapter, as applicable, also apply to all insured depository institutions that are deemed to be critically undercapitalized.

* * * * *

7. Section 303.207 is amended by revising paragraphs (b)(2) to read as follows:

§ 303.207 Restricted activities for critically undercapitalized institutions.

(b)* * *

(2) Extend credit for any highly leveraged transaction. A highly leveraged transaction means an extension of credit to or investment in a business by an insured depository institution where the financing transaction involves a buyout, acquisition, or recapitalization of an existing business and one of the following criteria is met:

(i) The transaction results in a liabilities-to-assets leverage ratio higher than 75 percent; or

(ii) The transaction at least doubles the subject company's liabilities and results in a liabilities-to-assets leverage ratio higher than 50 percent; or

(iii) The transaction is designated an highly leverage transaction by a syndication agent or a federal bank regulator.

(iv) Loans and exposures to any obligor in which the total financing package, including all obligations held by all participants is $20 million or more, or such lower level as the FDIC may establish by order on a case-by-case basis, will be excluded from this definition.

* * * * *

8. Section 303.241 is amended by revising paragraph (c)(4) to read as follows:

§ 303.241 Reduce or retire capital stock or capital debt instruments.

(c) * * *

(4) If the proposal involves a series of transactions affecting Tier 1 capital components which will be consummated over a period of time which shall not exceed twelve months, the application shall certify that the insured depository institution will maintain itself as a well-capitalized institution as defined in part 325 of this chapter or part 324 of this chapter, as applicable, both before and after each of the proposed transactions;

* * * * *

PART 308 – RULES OF PRACTICE AND PROCEDURE

9. The authority citation for part 308 continues to read as follows:

Authority: 5 U.S.C. 504, 554–557; 12 U.S.C. 93(b), 164, 505, 1815(e), 1817, 1818, 1820, 1828, 1829, 1829b, 1831i, 1831m(g)(4), 1831o, 1831p–1, 1832(c), 1884(b), 1972, 3102, 3108(a), 3349, 3909, 4717, 15 U.S.C. 78(h) and (i), 78o–4(c), 78o–5, 78q–1, 78s, 78u, 78u–2, 78u–3, and 78w, 6801(b), 6805(b)(1); 28 U.S.C. 2461 note; 31 U.S.C. 330, 5321; 42 U.S.C. 4012a; Sec. 3100(s), Pub.L. 104–134, 110 Stat. 1321–358; and Pub.L. 109–351.

10. Section 308.200 is revised to read as follows:

§ 308.200 Scope.

The rules and procedures set forth in this subpart apply to banks, insured branches of foreign banks and senior executive officers and directors of banks that are subject to the provisions of section 38 of the Federal Deposit Insurance Act (section 38) (12 U.S.C. 1831o) and subpart B of part 325 of this chapter or subpart H of part 324 of this chapter, as applicable.

* * * * *

11. Section 308.202 is amended by revising paragraphs (a)(1)(i)(A) and (a)(1)(ii) to read as follows:

§ 308.202 Procedures for reclassifying a bank based on criteria other than capital.

(a) * * *

(1) ***

(i) Grounds for reclassification. (A) Pursuant to § 325.103(d) of this chapter or § 324.403(d) of this chapter, as applicable, the FDIC may reclassify a well-capitalized bank as adequately capitalized or subject an adequately capitalized or undercapitalized institution to the supervisory actions applicable to the next lower capital category if:

(*1*) * * *

(*2*) * * *

(B) * * *

(ii) Prior notice to institution. Prior to taking action pursuant to § 325.103(d) of this chapter or § 324.403(d) of this chapter, as applicable, the FDIC shall issue and serve on the bank a written notice of the FDIC's intention to reclassify it.

* * * * *

12. Section 308.204 is amended by revising paragraphs (b)(2) and (c) to read as follows:

§ 308.204 Enforcement of directives.

(b) * * *

(2) Failure to implement capital restoration plan. The failure of a bank to implement a capital restoration plan required under section 38, or subpart B of part 325 of this chapter or subpart H of part 324 of this chapter, as applicable, or the failure of a company having control of a bank to fulfill a guarantee of a capital restoration plan made pursuant to section 38(e)(2) of the FDI Act shall subject the bank to the assessment of civil money penalties pursuant to section 8(i)(2)(A) of the FDI Act.

(c) Other enforcement action. In addition to the actions described in paragraphs (a) and (b) of this section, the FDIC may seek enforcement of the provisions of section 38 or subpart B of part 325 of this chapter or subpart H of part 324 of this chapter, as applicable, through any other judicial or administrative proceeding authorized by law.

* * * * *

PART 324 – CAPITAL ADEQUACY

13. The authority citation for part 324 is added to read 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).

14. Subparts A, B, C, D, E, F, and G are added to part 324 as set forth at the end of the preamble.

PART 327 – ASSESSMENTS

15. The authority citation for part 327 continues to read as follows:

Authority: 12 U.S.C. 1441, 1813, 1815, 1817–19, 1821.

16. Appendix A to subpart A of part 327-Method to Derive Pricing Multipliers and Uniform Amount is amended by revising footnote 5 in section VI. Description of Scorecard Measures to read as follows:

APPENDIX A TO SUBPART A OF PART 327--METHOD TO DERIVE PRICING MULTIPLIERS AND UNIFORM AMOUNT

VI. Description of Scorecard Measures

* * *

Footnote 5: Market risk capital is defined in Appendix C of part 325 of the FDIC Rules and Regulations or subpart F of pPart 324 of the FDIC Rules and Regulations, as applicable.

* * * * *

17. Appendix C to subpart A of part 327 is amended by revising the first paragraph in section I.A.5 to read as follows:

APPENDIX C TO SUBPART A TO PART 327

I. * * *

A. * * *

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5. Higher-Risk Securitizations

Higher-risk securitizations are defined as securitizations or securitization exposures (except securitizations classified as trading book), where, in aggregate, more than 50 percent of the assets backing the securitization meet either the criteria for higher-risk C & I loans or securities, higher-risk consumer loans, or nontraditional mortgage loans, except those classified as trading book. A securitization is as defined in 12 CFR part 325, Appendix A, Section

II(B)(16), or in 12 CFR 324.2, as applicable, as they may be amended from time to time. A higher-risk securitization excludes the maximum amount that is recoverable from the U.S. government under guarantee or insurance provisions.

* * * * *

PART 333 – EXTENSION OF CORPORATE POWERS

18. The authority citation for part 333 continues to read as follows:

Authority: 12 U.S.C. 1816, 1818, 1819 ("Seventh", "Eighth" and "Tenth"), 1828, 1828(m), 1831p–1(c).

19. Section 333.4 is amended by revising the third sentence in paragraph (a) to read as follows:

§ 333.4 Conversions from mutual to stock form.

(a) Scope. * * * As determined by the Board of Directors of the FDIC on a case-by-case basis, the requirements of paragraphs (d), (e), and (f) of this section do not apply to mutual-to-stock conversions of insured mutual state savings banks whose capital category under § 325.103 of this chapter or § 324.403, as applicable, is "undercapitalized", "significantly undercapitalized" or "critically undercapitalized". * * *

* * * * *

PART 337 UNSAFE AND UNSOUND BANKING PRACTICES

20. The authority citation for part 337 continues to read as follows:

Authority: 12 U.S.C. 375a(4), 375b, 1816, 1818(a), 1818(b), 1819, 1820(d)(10), 1821(f), 1828(j)(2), 1831, 1831f.

21. Section 337.6 is amended by revising footnotes 12 and 13 in paragraph (a) to read as follows:

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§ 337.6 Brokered deposits.

FN 12 For the most part, the capital measure terms are defined in the following regulations: FDIC--12 CFR part 325, subpart B or 12 CFR part 324, subpart H, as applicable; Board of Governors of the Federal Reserve System--12 CFR part 208; and Office of the Comptroller of the Currency--12 CFR part 6.

FN 13 The regulations implementing section 38 of the Federal Deposit Insurance Act and issued by the federal banking agencies generally provide that an insured depository institution is 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 is required to be filed with the appropriate federal banking agency; (2) A final report of examination is delivered to the institution; or (3) Written notice is provided by the appropriate federal banking agency to the institution of its capital category for purposes of section 38 of the Federal Deposit Insurance Act and implementing regulations or that the institution's capital category has changed. Provisions specifying the effective date of determination of capital category are generally published in the following regulations: FDIC--12 CFR 325.102 or 12 CFR 324.402, as applicable. Board of Governors of the Federal Reserve System--12 CFR 208.32. Office of the Comptroller of the Currency--12 CFR 6.3.

* * * * *

22. Section 337.12 is amended by revising paragraph (b)(2) to read as follows:

§ 337.12 Frequency of examination.

(b) * * *

(2) The bank is well capitalized as defined in § 325.103(b)(1) of this chapter or § 324.403(b)(1) of this chapter, as applicable.

* * * * *

PART 347 – INTERNATIONAL BANKING

23. The authority citation for part 347 continues to read as follows:

Authority: 12 U.S.C. 1813, 1815, 1817, 1819, 1820, 1828, 3103, 3104, 3105, 3108, 3109; Title IX, Pub.L. 98–181, 97 Stat. 1153.

24. Section 347.102 is amended by revising paragraphs (u) and (v) to read as follows:

§ 347.102 Definition.

(u) Tier 1 capital means Tier 1 capital as defined in § 325.2 of this chapter or § 324.2 of this chapter, as applicable.

(v) Well capitalized means well capitalized as defined in § 325.103 of this chapter or § 324.403 of this chapter, as applicable.

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* * * * *

PART 349 – RETAIL FOREIGN EXCHAGE TRANSACTIONS

25. The authority citation for part 349 continues to read as follows:

Authority: 12 U.S.C.1813(q), 1818, 1819, and 3108; 7 U.S.C. 2(c)(2)(E), 27 et seq.

26. Section 349.8 is revised as follows:

§ 349.8 Capital requirements.

An FDIC–supervised insured depository institution offering or entering into retail forex transactions must be well capitalized as defined by 12 CFR part 325 or 12 CFR part 324, as applicable, unless specifically exempted by the FDIC in writing.

* * * * *

PART 360 – RESOLUTION AND RECEIVERSHIP RULES

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27. The authority citation for part 360 continues to read as follows:

Authority: 12 U.S.C. 1817(b), 1818(a)(2), 1818(t), 1819(a) Seventh, Ninth and Tenth, 1820(b)(3), (4), 1821(d)(1), 1821(d)(10)(c), 1821(d)(11), 1821(e)(1), 1821(e)(8)(D)(i), 1823(c)(4), 1823(e)(2); Sec. 401(h), Pub.L. 101–73, 103 Stat. 357.

28. Section 360.5 is amended to revise paragraph (b) to read as follows:

§ 360.5 Definition of qualified financial contracts.

(b) Repurchase agreements. The following agreements shall be deemed "repurchase agreements" under section 11(e)(8)(D)(v) of the Federal Deposit Insurance Act, as amended (12 U.S.C. 1821(e)(8)(D)(v)): A repurchase agreement on qualified foreign government securities is an agreement or combination of agreements (including master agreements) which provides for the transfer of securities that are direct obligations of, or that are fully guaranteed by, the central governments (as set forth at 12 CFR part 325, appendix A, section II.C, n. 17, as may be amended from time to time or 12 CFR part 324.2 (definition of sovereign exposure), as applicable) of the OECD-based group of countries (as set forth at 12 CFR part 325, appendix A, section II.B.2., note 12 as may be amended from time to time or as generally discussed in 12 CFR 324.32) against the transfer of funds by the transferee of such securities with a simultaneous agreement by such transferee to transfer to the transferor thereof securities as described above, at a date certain not later than one year after such transfers or on demand, against the transfer of funds.

29. Section 360.9 is amended by revising the first sentence of paragraph (e)(6) to read as follows:

§ 360.9 Large-bank deposit insurance determination modernization.

(e) * * *

(6) Notwithstanding the general requirements of this paragraph (e), on a case-by-case basis, the FDIC may accelerate, upon notice, the implementation timeframe of all or part of the requirements of this section for a covered institution that: Has a composite rating of 3, 4, or 5 under the Uniform Financial Institution's Rating System, or in the case of an insured branch of a foreign bank, an equivalent rating; is undercapitalized, as defined under the prompt corrective action provisions of 12 CFR part 325 or 12 CFR part 324, as applicable; or is determined by the appropriate Federal banking agency or the FDIC in consultation with the appropriate Federal banking agency to be experiencing a significant deterioration of capital or significant funding difficulties or liquidity stress, notwithstanding the composite rating of the institution by its appropriate Federal banking agency in its most recent report of examination. * * *

* * * * *

PART 362 – ACTIVITIES OF INSURED STATE BANKS AND INSURED SAVINGS ASSOCIATIONS

30. The authority citation for part 362 continues to read as follows:

Authority: 12 U.S.C. 1816, 1818, 1819(a)(Tenth), 1828(j), 1828(m), 1828a, 1831a, 1831e, 1831w, 1843(l).

31. Section 362.2 is amended by revising paragraphs (s) and (t) to read as follows:

§ 362.2 Definitions.

(s) Tier one capital has the same meaning as set forth in part 324 or 325 of this chapter, as applicable, for an insured State nonmember bank. For other state-chartered depository institutions, the term “tier one capital” has the same meaning as set forth in the capital regulations adopted by the appropriate Federal banking agency.

(t) Well-capitalized has the same meaning set forth in part 324 or 325, as applicable, of this chapter for an insured State nonmember bank. For other state-chartered depository institutions, the term “well-capitalized” has the same meaning as set forth in the capital regulations adopted by the appropriate Federal banking agency.

* * * * *

32. Section 362.4 is amended by revising paragraph (e)(3) to read as follows:

§ 362.4 Subsidiaries of insured State banks.

(e) * * *

(3) Use such regulatory capital amount for the purposes of the bank's assessment risk classification under part 327 of this chapter and its categorization as a “well-capitalized”, an “adequately capitalized”, an “undercapitalized”, or a “significantly undercapitalized” institution as defined in § 325.103(b) of this chapter or § 324.403(b) of this chapter, as applicable, provided that the capital deduction shall not be used for purposes of determining whether the bank is “critically undercapitalized” under part 325 of this chapter or part 324 of this chapter, as applicable.

* * * * *

33. Section 362.17 is amended by revising paragraph (d) to read as follows:

§ 362.17 Definitions.

(d) Tangible equity and Tier 2 capital have the same meaning as set forth in part 325 of this chapter or part 324 of this chapter, as applicable.

34. Amend § 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 its total risk-based capital (this deduction shall be made equally from tier 1 and tier 2 capital) or from common equity tier 1 capital in accordance with 12 CFR part 324, subpart C, as applicable.

* * * * *

PART 363 – ANNUAL INDEPENDENT AUDITS AND REPORTING REQUIREMENTS

35. The authority citation for part 363 continues to read as follows:

Authority: 12 U.S.C. 1831m.

36. Appendix A to part 363-Guidelines and Interpretations is amended by revising Table 1 to Appendix A to read as follows:

Appendix A to Part 363 – Guidelines and Interpretations

Table 1 to Appendix A--Designated Federal Laws and Regulations Applicable to:

		National banks	State member banks	State non-member banks	Savings associations
Insider Loans--Parts and/or Sections of Title 12 of the United States Code					
375a	Loans to Executive Officers of Banks	√	√	(A)	(A)
375b	Extensions of Credit to Executive Officers, Directors, and Principal Shareholders of Banks	√	√	(A)	(A)
1468(b)	Extensions of Credit to Executive Officers, Directors, and Principal Shareholders				√
1828(j)(2)	Extensions of Credit to Officers, Directors, and Principal Shareholders			√	
1828(j)(3)(B)	Extensions of Credit to Officers,	(B)		(C)	

	Directors, and Principal Shareholders				
Parts and/or Sections of Title 12 of the Code of Federal Regulations					
31	Extensions of Credit to Insiders	√			
32	Lending Limits	√			
215	Loans to Executive Officers, Directors, and Principal Shareholders of Member Banks	√	√	(D)	(E)
337.3	Limits on Extensions of Credit to Executive Officers, Directors, and Principal Shareholders of Insured Nonmember Banks			√	
563.43	Loans by Savings Associations to Their Executive Officers, Directors, and Principal Shareholders				√
Dividend Restrictions--Parts and/or Sections of Title 12 of the United States Code					
56	Prohibition on Withdrawal of Capital and Unearned Dividends	√	√		
60	Dividends and Surplus Fund	√	√		
1467a(f)	Declaration of Dividend				√
1831o(d)(1)	Prompt Corrective Action--Capital Distributions Restricted	√	√	√	√
Parts and/or Sections of Title 12 of the Code of Federal Regulations					
5 Subpart E	Payment of Dividends	√			
6.6	Prompt Corrective Action--Restrictions on Undercapitalized Institutions	√			
208.5	Dividends and Other Distributions		√		
208.45	Prompt Corrective Action--Restrictions on Undercapitalized Institutions		√		
325.105 or 324.403, as applicable	Prompt Corrective Action--Restrictions on Undercapitalized Institutions			√	
563 Subpart E	Capital Distributions				√
565.6	Prompt Corrective Action--Restrictions on Undercapitalized Institutions				√

A. Subsections (g) and (h) of section 22 of the Federal Reserve Act [12 U.S.C. 375a, 375b]
B. Applies only to insured Federal branches of foreign banks.
C. Applies only to insured State branches of foreign banks.
D. See 12 CFR 337.3.
E. See 12 CFR 563.43.

* * * * *

PART 364 – STANDARDS FOR SAFETY AND SOUNDNESS

37. The authority citation in part 364 continues to read as follows:

Authority: 12 U.S.C. 1818 and 1819 (Tenth), 1831p–1; 15 U.S.C. 1681b, 1681s, 1681w, 6801(b), 6805(b)(1).

38. Appendix A to part 364-Interagency Guidelines Establishing Standards for Safety and Soundness is amended by revising the last sentence in section I.A. as follows:

Appendix A to part 364—Interagency Guidelines Establishing Standards for Safety and Soundness

I. Introduction

A. Preservation of Existing Authority

* * * Nothing in these Guidelines limits the authority of the FDIC pursuant to section 38(i)(2)(F) of the FDI Act (12 U.S.C. 1831(o)) and part 325 or part 324, as applicable, of Title 12 of the Code of Federal Regulations.

* * * * *

PART 365 – REAL ESTATE LENDING STANDARDS

39. The authority citation for part 365 continues to read as follows:

Authority: 12 U.S.C. 1828(o) and 5101 et seq.

40. Appendix A to subpart A of part 365—Interagency Guidelines for Real Estate Lending Policies is amended by revising footnote 2 as follows:

Appendix A to subpart A of part 365 – Interagency Guidelines for Real Estate Lending Policies

Footnote 2: For the state member banks, the term “total capital” means “total risk-based capital” as defined in appendix A to 12 CFR part 208. For insured state non-member banks,

"total capital" refers to that term described in table I of appendix A to 12 CFR part 325 or 12 CFR 324.2, as applicable. For national banks, the term "total capital" is defined at 12 CFR 3.2(e). For savings associations, the term "total capital" is defined at 12 CFR 390, subpart Z or 12 CFR 324.2, as applicable.

* * * * *

PART 390 – REGULATIONS TRANSFERRED FROM THE OFFICE OF THRIFT SUPERVISION

41. The authority citation for part 390 continues to read as follows:

Authority: 12 U.S.C. 1819.; Subpart A also issued under 12 U.S.C. 1820; Subpart B also issued under 12 U.S.C. 1818.; Subpart C also issued under 5 U.S.C. 504; 554–557; 12 U.S.C. 1464; 1467; 1468; 1817; 1818; 1820; 1829; 3349, 4717; 15 U.S.C. 78l; 78o–5; 78u–2; 28 U.S.C. 2461 note; 31 U.S.C. 5321; 42 U.S.C. 4012a.; Subpart D also issued under 12 U.S.C. 1817; 1818; 1820; 15 U.S.C. 78l; Subpart E also issued under 12 U.S.C. 1813; 1831m; 15 U.S.C. 78.; Subpart F also issued under 5 U.S.C. 552; 559; 12 U.S.C. 2901 et seq.; Subpart G also issued under 12 U.S.C. 2810 et seq., 2901 et seq.; 15 U.S.C. 1691; 42 U.S.C. 1981, 1982, 3601–3619.; Subpart H also issued under 12 U.S.C. 1464; 1831y; Subpart I also issued under 12 U.S.C. 1831x; Subpart J also issued under 12 U.S.C. 1831p–1; Subpart K also issued under 12 U.S.C. 1817; 1818; 15 U.S.C. 78c; 78l; Subpart L also issued under 12 U.S.C. 1831p–1; Subpart M also issued under 12 U.S.C. 1818; Subpart N also issued under 12 U.S.C. 1821; Subpart O also issued under 12 U.S.C. 1828; Subpart P also issued under 12 U.S.C. 1470; 1831e; 1831n; 1831p–1; 3339; Subpart Q also issued under 12 U.S.C. 1462.

42. Appendix A to section 390.265- Interagency Guidelines for Real Estate Lending Policies is amended by revising footnote 4 as follows:

Appendix A to part 390.265 – Interagency Guidelines for Real Estate Lending Policies

Footnote 4: For the state member banks, the term "total capital" means "total risk-based capital" as defined in appendix A to 12 CFR part 208. For insured state non-member banks, "total capital" refers to that term described in table I of appendix A to 12 CFR part 325 or 12 CFR 324.2, as applicable. For national banks, the term "total capital" is defined at 12 CFR 3.2(e). For savings associations, the term "total capital" is defined at 12 CFR 390, subpart Z or 12 CFR 324.2, as applicable.

PART 391 – FORMER OFFICE OF THRIFT SUPERVISION REGULATIONS

43. The authority citation for part 391 continues to read as follows:

Authority: 12 U.S.C. 1819 (Tenth); Subpart A also issued under 12 U.S.C. 1462a; 1463; 1464; 1828; 1831p–1; 1881–1884; 15 U.S.C. 1681w; 15 U.S.C. 6801; 6805; Subpart B also issued under 12 U.S.C. 1462a; 1463; 1464; 1828; 1831p–1; 1881–1884; 15 U.S.C.1681w; 15 U.S.C. 6801; 6805; Subpart C also issued under 12 U.S.C. 1462a; 1463; 1464; 1828; 1831p–1; and 1881–1884; 15 U.S.C. 1681m; 1681w; Subpart D also issued under 12 U.S.C. 1462; 1462a; 1463; 1464; 42 U.S.C. 4012a; 4104a; 4104b; 4106; 4128; Subpart E also issued under 12 U.S.C. 1467a; 1468; 1817; 1831i.

44. Appendix A to subpart B of part 391- Interagency Guidelines Establishing Standards for Safety and Soundness is amended by revising the last sentence in section I.A. as follows:

Appendix A to subpart B of part 391—Interagency Guidelines Establishing Standards for Safety and Soundness

I. Introduction

A. Preservation of Existing Authority

* * * Nothing in these Guidelines limits the authority of the FDIC pursuant to section 38(i)(2)(F) of the FDI Act (12 U.S.C. 1831(o)) and part 325 or part 324, as applicable of Title 12 of the Code of Federal Regulations.

[THIS SIGNATURE PAGE RELATES TO THE ISSUANCE OF THE JOINT NOTICE OF INTERIM FINAL RULEMAKING TITLED "REGULATORY CAPITAL RULES: REGULATORY CAPITAL, IMPLEMENTATION OF BASEL III, CAPITAL ADEQUACY, TRANSITION PROVISIONS, PROMPT CORRECTIVE ACTION, STANDARDIZED APPROACH FOR RISK-WEIGHTED ASSETS, MARKET DISCIPLINE AND DISCLOSURE REQUIREMENTS, ADVANCED APPROACHES RISK-BASED CAPITAL RULE, AND MARKET RISK CAPITAL RULE]

Dated at Washington, D.C., this xxth day of [June], 2013.

By order of the Board of Directors.

Federal Deposit Insurance Corporation.

Robert E. Feldman,

Executive Secretary.