

**DEPARTMENT OF THE TREASURY**

**Office of the Comptroller of the Currency**

**12 CFR Part 3**

**Docket ID: OCC-2009-0012**

**RIN 1557- AD26**

**FEDERAL RESERVE SYSTEM**

**12 CFR Parts 208 and 225**

**Regulations H and Y; Docket No. R-xxxx**

**FEDERAL DEPOSIT INSURANCE CORPORATION**

**12 CFR Part 325**

**RIN 3064- AD48**

**DEPARTMENT OF THE TREASURY**

**Office of Thrift Supervision**

**12 CFR Part 567**

**No. OTS-2009-0015**

**RIN 1550-AC36**

**Risk-Based Capital Guidelines; Capital Adequacy Guidelines; Capital Maintenance: Regulatory Capital; Impact of Modifications to Generally Accepted Accounting Principles; Consolidation of Asset-Backed Commercial Paper Programs; and Other Related Issues**

**AGENCIES:** Office of the Comptroller of the Currency, Department of the Treasury; Board of Governors of the Federal Reserve System; Federal Deposit

Insurance Corporation; and Office of Thrift Supervision, Department of the Treasury.

**ACTION:** Notice of proposed rulemaking with request for public comment.

**SUMMARY:** The Office of the Comptroller of the Currency (OCC), Board of Governors of the Federal Reserve System (Board), Federal Deposit Insurance Corporation (FDIC), and the Office of Thrift Supervision (OTS) (collectively, the agencies) are requesting comment on a proposal to (i) modify their general risk-based and advanced risk-based capital adequacy frameworks to eliminate the exclusion of certain consolidated asset-backed commercial paper programs from risk-weighted assets and (ii) provide a reservation of authority in their general risk-based and advanced risk-based capital adequacy frameworks to permit the agencies to require banking organizations to treat entities that are not consolidated under accounting standards as if they were consolidated for risk-based capital purposes, commensurate with the risk relationship of the banking organization to the structure. The agencies are issuing this proposal and request for comment to better align capital requirements with the actual risk of certain exposures and to obtain information and views from the public on the effect on regulatory capital that will result from the implementation of the Financial Accounting Standard Board's (FASB) Statement of Financial Accounting Standards No. 166, Accounting for Transfers of Financial Assets, an Amendment of FASB Statement No. 140 and Statement of Financial Accounting Standards No. 167, Amendments to FASB Interpretation No. 46(R).

**DATES:** Comments on this notice of proposed rulemaking must be received by [INSERT DATE **30** DAYS AFTER PUBLICATION IN THE FEDERAL REGISTER], 2009.

**ADDRESSES:** Comments should be directed to:

**OCC:** Because paper mail in the Washington, DC area and at the agencies is subject to delay, commenters are encouraged to submit comments by the Federal eRulemaking Portal or e-mail, if possible. Please use the title “Risk-Based Capital Guidelines; Capital Adequacy Guidelines; Capital Maintenance: Regulatory Capital; Impact of Modifications to Generally Accepted Accounting Principles; Consolidation of Asset-Backed Commercial Paper Programs; and Other Related Issues” to facilitate the organization and distribution of the comments. You may submit comments by any of the following methods:

- **Federal eRulemaking Portal – “Regulations.gov”:** Go to <http://www.regulations.gov>. Under the “More Search Options” tab click next to the “Advanced Docket Search” option where indicated, select “Comptroller of the Currency” from the agency drop-down menu, then click “Submit.” In the “Docket ID” column, select “OCC-2009-0012” to submit or view public comments and to view supporting and related materials for this proposed rule. The “How to Use This Site” link on the Regulations.gov home page provides information on using Regulations.gov, including instructions for submitting or viewing public comments, viewing other supporting and related materials, and viewing the docket after the close of the comment period.
- **E-mail:** [regs.comments@occ.treas.gov](mailto:regs.comments@occ.treas.gov).
- **Mail:** Office of the Comptroller of the Currency, 250 E Street, SW., Mail Stop 2-3, Washington, DC 20219.
- **Fax:** (202) 874-5274.
- **Hand Delivery/Courier:** 250 E Street, SW., Mail Stop 2-3, Washington, DC 20219.

*Instructions:* You must include “OCC” as the agency name and “Docket Number OCC-2009-0012” in your comment. In general, the OCC will enter all comments received into the docket and publish them on the Regulations.gov Web site without change, including any business or personal information that you provide such as name and address information, e-mail addresses, or phone numbers. Comments received, including attachments and other supporting materials, are part of the public record and subject to public disclosure. Do not enclose any information in your comment or supporting materials that you consider confidential or inappropriate for public disclosure.

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

- **Viewing Comments Electronically:** Go to <http://www.regulations.gov>, under the “More Search Options” tab click next to the “Advanced Document Search” option where indicated, select “Comptroller of the Currency” from the agency drop-down menu, then click “Submit.” In the “Docket ID” column, select “OCC-2009-0012” to view public comments for this rulemaking action.
- **Viewing Comments Personally:** You may personally inspect and photocopy comments at the OCC, 250 E Street, SW., Washington, DC. For security reasons, the OCC requires that visitors make an appointment to inspect comments. You may do so by calling (202) 874-4700. Upon arrival, visitors will be required to present valid government-issued photo identification and to submit to security screening in order to inspect and photocopy comments.
- **Docket:** You may also view or request available background documents and project summaries using the methods described above.

**Board:** You may submit comments, identified by Docket No. R-xxxx, by any of the following methods:

- **Agency Web Site:** <http://www.federalreserve.gov>. Follow the instructions for submitting comments at <http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm>.
- **Federal eRulemaking Portal:** <http://www.regulations.gov>. Follow the instructions for submitting comments.
- **E-mail:** [regs.comments@federalreserve.gov](mailto:regs.comments@federalreserve.gov). Include docket number in the subject line of the message.
- **FAX:** (202) 452-3819 or (202) 452-3102.
- **Mail:** Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, 20<sup>th</sup> Street and Constitution Avenue, NW, Washington, DC 20551.

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

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

- **Federal eRulemaking Portal:** <http://www.regulations.gov>. Follow the instructions for submitting comments.
- **Agency Web site:** <http://www.FDIC.gov/regulations/laws/federal/propose.html>

- **Mail:** Robert E. Feldman, Executive Secretary, Attention: Comments/Legal ESS, Federal Deposit Insurance Corporation, 550 17th Street, NW, Washington, DC 20429.
- **Hand Delivered/Courier:** The guard station at the rear of the 550 17th Street Building (located on F Street), on business days between 7:00 a.m. and 5:00 p.m.
- **E-mail:** [comments@FDIC.gov](mailto:comments@FDIC.gov).

Instructions: Comments submitted must include “FDIC” and “RIN 3064-AD48.”

Comments received will be posted without change to

<http://www.FDIC.gov/regulations/laws/federal/propose.html>, including any personal information provided.

**OTS:** You may submit comments, identified by OTS-2009-0015, by any of the following methods:

- **Federal eRulemaking Portal:** “Regulations.gov”: Go to <http://www.regulations.gov>. Under the “more Search Options” tab click next to the “Advanced Docket Search” option where indicated, select “Office of Thrift Supervision” from the agency dropdown menu, then click “Submit.” In the “Docket ID” column, select “OTS-2009-0015” to submit or view public comments and to view supporting and related materials for this proposed rulemaking. The “How to Use This Site” link on the Regulations.gov home page provides information on using Regulations.gov, including instructions for submitting or viewing public comments, viewing other supporting and related materials, and viewing the docket after the close of the comment period.
- **Mail:** Regulation Comments, Chief Counsel’s Office, Office of Thrift Supervision, 1700 G Street, NW., Washington, DC 20552, Attention: OTS-2009-0015.
- **Facsimile:** (202) 906-6518.

- **Hand Delivery/Courier:** Guard’s Desk, East Lobby Entrance, 1700 G Street, NW., from 9 a.m. to 4 p.m. on business days, Attention: Regulation Comments, Chief Counsel’s Office, Attention: OTS-2009-0015.
- **Instructions:** All submissions received must include the agency name and docket number for this rulemaking. All comments received will be posted without change, including any personal information provided. Comments, including attachments and other supporting materials received are part of the public record and subject to public disclosure. Do not enclose any information in your comment or supporting materials that you consider confidential or inappropriate for public disclosure.
- **Viewing Comments Electronically:** Go to <http://www.regulations.gov>, under the “More Search Options” tab click next to the “Advanced Document Search” option where indicated, select “Office of Thrift Supervision” from the agency drop-down menu, then click “Submit.” In the “Docket ID” column, select “OTS-2009-0015” to view public comments for this notice of proposed rulemaking action.
- **Viewing Comments On-Site:** You may inspect comments at the Public Reading Room, 1700 G Street, NW., by appointment. To make an appointment for access, call (202) 906–5922, send an e-mail to [public.info@ots.treas.gov](mailto:public.info@ots.treas.gov), or send a facsimile transmission to (202) 906–6518. (Prior notice identifying the materials you will be requesting will assist us in serving you.) We schedule appointments on business days between 10 a.m. and 4 p.m. In most cases, appointments will be available the next business day following the date we receive a request.

**FOR FURTHER INFORMATION CONTACT:**

*OCC:* Paul Podgorski, Risk Expert, Capital Policy Division, (202) 874-4755, or Carl Kaminski, Senior Attorney, 202 874-5405, or Ron Shimabukuro, Senior

Counsel, Legislative and Regulatory Activities Division, (202) 874-5090, Office of the Comptroller of the Currency, 250 E Street, SW, Washington, DC 20219.

*Board:* Barbara J. Bouchard, Associate Director, (202) 452-3072, or Anna Lee Hewko, (202) 530-6260, Manager, Supervisory Policy and Guidance, Division of Banking Supervision and Regulation; or April C. Snyder, Counsel, (202) 452-3099, or Benjamin W. McDonough, Senior Attorney, (202) 452-2036, Legal Division. For the hearing impaired only, Telecommunication Device for the Deaf (TDD), (202) 263-4869.

*FDIC:* Jim Weinberger, Senior Policy Analyst, (202) 898-7034, Christine Bouvier, Senior Policy Analyst (Bank Accounting), (202) 898-7289, Division of Supervision and Consumer Protection; or Mark Handzlik, Senior Attorney, (202) 898-3990, or Michael Phillips, Counsel, (202) 898-3581, Supervision Branch, Legal Division.

*OTS:* Teresa A. Scott, Senior Policy Analyst, (202) 906-6478, Capital Risk, Christine Smith, Senior Policy Analyst, (202) 906-5740, Capital Risk, or Marvin Shaw, Senior Attorney, (202) 906-6639, Legislation and Regulation Division, Office of Thrift Supervision, 1700 G Street, NW, Washington, DC 20552.

## **SUPPLEMENTARY INFORMATION:**

### **I. Background**

The agencies' regulatory capital regime for banking organizations<sup>2</sup> incorporates both leverage and risk-based measures. The leverage measure<sup>3</sup> uses

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<sup>2</sup> Unless otherwise indicated, the term "banking organization" includes banks, savings associations, and bank holding companies (BHCs).

<sup>3</sup> 12 CFR part 3 (OCC); 12 CFR part 208, appendix B and 12 CFR part 225 appendix D (Board); 12 CFR part 325.3 (FDIC); 12 CFR 567.8 (OTS).

on-balance sheet assets as the basis for setting capital requirements that are intended to limit the degree to which a banking organization can leverage its equity capital base. The risk-based measures (the general risk-based capital rules<sup>4</sup> and the advanced approaches rules<sup>5</sup>) establish capital requirements intended to reflect the risks associated with on-balance sheet exposures as well as off-balance sheet exposures, such as guarantees, commitments, and derivative transactions. The agencies use generally accepted accounting principles (GAAP), as established by FASB, as the initial basis for determining whether an exposure is treated as on- or off-balance sheet for regulatory capital purposes.

The GAAP treatment for structured finance transactions using a special purpose entity (SPE) generally has been governed by the requirements of Statement of Financial Accounting Standards No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities (FAS 140) and FASB Interpretation No. 46R, Consolidation of Variable Interest Entities (FIN 46(R)).<sup>6,7</sup> Under FAS 140 (as in effect through the end of 2009), transfers of assets to an entity that meets the definition of a qualifying special purpose entity (QSPE) are usually recognized as sales, which permits the transferor to remove the assets

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<sup>4</sup> 12 CFR part 3, appendix A (OCC); 12 CFR parts 208 and 225, appendix A (Board); 12 CFR part 325, appendix A (FDIC); and 12 CFR part 567, subpart B (OTS). The risk-based capital rules generally do not apply to bank holding companies with \$500 million or less in consolidated assets.

<sup>5</sup> 12 CFR part 3, appendix C (OCC); 12 CFR part 208, appendix F and 12 CFR part 225, appendix G (Board); 12 CFR part 325, appendix D (FDIC); 12 CFR 567, Appendix C (OTS).

<sup>6</sup> All references made to Statements of Financial Accounting Standards adopted by the FASB have been included in the FASB Accounting Standards Codification that became effective on July 1, 2009.

<sup>7</sup> Statement of Financial Accounting Standards No. 140 (FASB 2005) and Interpretation No. 46R (FASB 2003).

from its balance sheet.<sup>8</sup> In addition, FIN 46(R) specifically excludes QSPEs from its scope despite the fact that many QSPEs would have otherwise been deemed variable interest entities (VIEs) subject to FIN 46(R) and possible consolidation.

On June 12, 2009, FASB finalized modifications to FAS 140 and FIN 46(R) (the 2009 GAAP modifications) through Statement of Financial Accounting Standards No. 166, Accounting for Transfers of Financial Assets, an Amendment of FASB Statement No. 140 (FAS 166) and Statement of Financial Accounting Standards No. 167, Amendments to FASB Interpretation No. 46(R) (FAS 167). FAS 166 and FAS 167 are effective for the first annual financial statement reporting periods that begin after November 15, 2009 and for interim and annual periods thereafter.<sup>9</sup>

As discussed in further detail below, the 2009 GAAP modifications, among other things, remove the concept of a QSPE from GAAP and alter the consolidation analysis for VIEs, thereby subjecting many VIEs that are not consolidated under current GAAP standards to consolidation requirements. These changes will require some banking organizations to consolidate the assets, liabilities, and equity of certain VIEs onto their balance sheets for financial and regulatory reporting purposes.

## **II. The 2009 GAAP Modifications**

Under FAS 167, a VIE is an entity whose equity investment at risk is insufficient to permit the entity to finance its activities without additional subordinated financial support (for example, an entity with nominal common equity) and/or whose equity investors do not have rights or obligations with respect to the entity typical of equity investors. For example, a VIE generally exists when

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<sup>8</sup> The transfers are recognized as sales as long as they meet other criteria contained in the 2005 version of FAS 140, as amended. See FAS 140, paragraph 9.

<sup>9</sup> FAS 166 p. i. and FAS 167 p. i.

the administrators of an entity hold a nominal common equity interest, and debt holders hold the rest of the economic interests in the entity (which frequently are issued in various degrees of subordination). Similarly, an entity is a VIE if its equity holders, as a group, lack the right to make decisions about the entity's activities, the obligation to absorb the expected losses of the entity, or the right to receive the expected residual returns of the entity.<sup>10</sup> Thus, for example, an entity whose debt holders, rather than its common equity holders, have all essential voting rights and the rights to receive all revenue generated by the entity's assets, generally would be a VIE.

Determining whether a specific company is required to consolidate a VIE under FAS 167 depends on a qualitative analysis of whether that company has a "controlling financial interest" in the VIE. The analysis focuses on the company's power over and interest in the VIE, rather than on quantitative equity ownership thresholds. A company has a controlling financial interest in a VIE if it has (1) the power to direct matters that most significantly impact the activities of the VIE, including, but not limited to, activities that impact the VIE's economic performance (for example, servicing activities); and (2) either the obligation to absorb losses of the VIE that could potentially be significant to the VIE, or the right to receive benefits from the VIE that could potentially be significant to the VIE, or both.<sup>11</sup>

A company's analysis of whether it must consolidate a VIE must incorporate the above criteria and take into account the company's interest(s) in the VIE and the characteristics of the VIE, including the involvement of other VIE interest

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<sup>10</sup> FAS 167, appendix D, paragraphs 5 and 6.

<sup>11</sup> See FAS 167, appendix D, paragraphs 14 and 14A-14G.

holders.<sup>12</sup> FAS 167 also requires a company to conduct ongoing assessments using the above criteria to determine whether a VIE is subject to consolidation.<sup>13</sup>

FAS 166 amends FAS 140 by removing the QSPE concept from GAAP, strengthening the requirements for recognizing the transfer of financial assets to a third party, and requiring companies to make additional disclosures about any continuing involvement they may have in financial assets that they transfer.<sup>14</sup> As a result, a company that transferred financial assets to a SPE that previously met the definition of a QSPE must now evaluate whether it must consolidate the assets, liabilities, and equity of the SPE pursuant to FAS 167. Furthermore, under the additional disclosure requirements in FAS 166, companies must detail in their financial statements their continuing involvement -- through recourse or guarantee arrangements, servicing arrangements, or other relationships -- in any financial assets that they transfer to an SPE (whether or not a company is required to consolidate the SPE following the transfer). These disclosure requirements apply as long as a transferring company is involved in financial assets that it has transferred.<sup>15</sup>

The 2009 GAAP modifications do not provide for the grandfathering of existing financial structures. As of January 1, 2010, banking organizations will be

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<sup>12</sup> See FAS 167, appendix D, paragraphs 14C-14E. If a company determines that power is shared among multiple parties so that no one party is deemed to have a controlling financial interest, it is not required to consolidate the VIE. FAS 167, appendix D, paragraph 14D. It is expected that some VIEs will not be consolidated by any company.

<sup>13</sup> See FAS 167 p. ii.

<sup>14</sup> See FAS 166, appendix D, paragraphs 16A-17.

<sup>15</sup> See FAS 166, appendix D, paragraph 16D. FAS 166 also requires companies to periodically provide additional information about gains and losses resulting from transfers of financial assets. See *id.*, paragraph 17.

required to consolidate and recognize on their balance sheets many previously unconsolidated VIEs. These newly-consolidated entities will therefore be included in relevant regulatory reports of banking organizations, such as the bank Reports of Condition and Income (Call Reports), the Thrift Financial Report (TFR), and the bank holding company financial statements (FR Y-9C Report). A preliminary analysis of the 2009 GAAP modifications, as well as analysis derived from the agencies' supervisory information, indicates that the categories of off-balance sheet exposures likely to be subject to consolidation on an originating or servicing banking organization's balance sheet include:

- Certain asset-backed commercial paper (ABCP) conduits;
- Revolving securitizations structured as master trusts, including credit card and home equity line of credit (HELOC) securitizations;
- Certain mortgage loan securitizations not guaranteed by the U.S. government or a U.S. government-sponsored agency;
- Certain term loan securitizations in which a banking organization retains a residual interest and servicing rights, including some student loan and automobile loan securitizations; and
- Other SPEs, such as certain tender option bond (TOB) trusts that were designed as QSPEs.

The 2009 GAAP modifications may also require banking organizations to recognize on their balance sheets certain loan participations and other exposures not related to asset securitization. In addition, banking organizations may need to establish loan loss reserves<sup>16</sup> to cover incurred losses on the assets consolidated

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<sup>16</sup> Under GAAP, an allowance for loan losses (ALLL) should be recognized when events have occurred indicating that it is probable that an asset has been impaired or that a loss has been incurred as of the balance sheet date and that the amount of the loss can be reasonably estimated. Under the risk-based capital rules, the ALLL

pursuant to the 2009 GAAP modifications. Each banking organization must determine which structures and exposures must be consolidated onto its balance sheet, and assess other appropriate adjustments to relevant financial reports, as a result of the 2009 GAAP modifications.

**Question 1:** Which types of VIEs will banking organizations have to consolidate onto their balance sheets due to the 2009 GAAP modifications, which types are not expected to be subject to consolidation, and why? Which types are likely to be restructured to avoid consolidation?

### **III. Regulatory Capital and the 2009 GAAP Modifications**

The agencies' capital standards generally use GAAP treatment of an exposure as a starting point for assessing regulatory capital requirements for that exposure. For example, if certain assets of a banking organization are transferred to a VIE through a secured financing but remain on the banking organization's balance sheet under GAAP, the VIE's assets are risk-weighted like other consolidated assets. However, if the assets are securitized through sale to a VIE that the banking organization does not consolidate under GAAP, generally the banking organization is required to hold risk-based capital only against its contractual exposures to the VIE.<sup>17</sup> The contractual exposures may take the form of on-balance sheet exposures such as asset-backed securities and residual interests, and off-balance sheet exposures such as liquidity facilities. The 2009 GAAP modifications generally would increase the amount of exposures recognized on banking organizations' balance sheets. Accordingly, under the agencies'

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is a component of tier 2 capital and, therefore, included in the numerator of the total risk-based capital ratio. However, the amount of ALLL that may be included in tier 2 capital is limited to 1.25 percentage points of gross risk-weighted assets.

<sup>17</sup> 12 CFR part 3, appendix A, § 3(a)(5) (OCC); 12 CFR parts 208 and 225, appendix A § III.B.3.g (Board); 12 CFR part 325, appendix A, § II.B.6.b (FDIC); 12 CFR 567.6(a)(2)(vi)(B) (OTS).

current regulatory capital requirements, the 2009 GAAP modifications generally would result in higher regulatory capital requirements for those banking organizations that must consolidate VIEs.

Under the agencies' leverage capital requirements, tier 1 capital is assessed against a measure of a banking organization's total assets, net of the ALLL and certain other exposures.<sup>18</sup> Therefore, previously unconsolidated assets that now must be recognized on a banking organization's balance sheet due to the 2009 GAAP modifications will increase the denominator of the banking organization's leverage ratio. Although the 2009 GAAP modifications will also affect the numerator of the risk-based and leverage capital ratios, in many cases both the risk-based and leverage capital ratios of affected banking organizations will decrease following implementation of the 2009 GAAP modifications.

The risk-based capital rules specify the components of regulatory capital and recognize variations of risk levels among different exposures through different risk-weight assignments. Although since 1995 the agencies have used financial information reported under GAAP as the starting point for banking organizations' regulatory reporting requirements,<sup>19</sup> the risk-based capital rules adjust GAAP balance sheet inputs where appropriate to capture an exposure's risk or the ability of elements of capital to absorb loss.<sup>20</sup>

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<sup>18</sup> See 12 CFR 3.2(a) (OCC); 12 CFR part 208, appendix B §II.b and 12 CFR part 225, appendix D, § II.b (Board); 12 CFR 325.2(m) (FDIC); 12 CFR 567.5(b)(4) (OTS).

<sup>19</sup> Although Federal law requires that the accounting principles applicable to bank "reports or statements" be consistent with, or no less stringent than GAAP, it does not require the Federal banking agencies to adhere to GAAP when determining compliance with regulatory capital requirements. See 12 U.S.C. 1831n(a)(2) and 12 U.S.C. 1831n(b).

<sup>20</sup> A notable example where the risk-based capital rules differ from GAAP is in the requirement that banking organizations hold capital against the contingent risk of a

In their consideration of the 2009 GAAP modifications and the interaction of the modifications with the regulatory capital requirements, the agencies have determined that the qualitative analysis required under FAS 167, as well as enhanced requirements for recognizing transfers of financial assets under FAS 166, converge in many respects with the agencies' assessment of a banking organization's risk exposure to a structured finance transaction and other transactions affected by the 2009 GAAP modifications.

In the case of some structures that banking organizations were not required to consolidate prior to the 2009 GAAP modifications, the recent turmoil in the financial markets has demonstrated the extent to which the credit risk exposure of the sponsoring banking organization to such structures (and their related assets) has in fact been greater than the agencies estimated, and more associated with non-contractual considerations than the agencies had expected. For example, recent performance data on structures involving revolving assets<sup>21</sup> show that banking organizations have often provided non-contractual (implicit) support to prevent senior securities of the structure from being downgraded, thereby mitigating reputational risk and the associated alienation of investors, and preserving access to cost-efficient funding.

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number of off-balance sheet exposures, such as loan commitments and letters of credit, as well as against the counterparty credit risk of derivatives. As a further example, while GAAP includes goodwill and intangibles in total stockholders' equity, certain of these items are deducted from stockholders' equity when calculating regulatory capital. See 12 CFR part 3, appendix A, § 2(c) (OCC); 12 CFR parts 208 and 225, appendix A, §§ II and III.A (Board); 12 CFR part 325, appendix A, §§ I. and II.D. (FDIC); 12 CFR 567.5(a)(1)(v) and 567.5(a)(2) (OTS).

<sup>21</sup> Typical structures of this type include securitizations that are backed by credit card or HELOC receivables, single and multi-seller ABCP conduits, and structured investment vehicles.

In light of this recent experience, the agencies believe that the broader accounting consolidation requirements implemented by the 2009 GAAP modifications will result in a regulatory capital treatment that more appropriately reflects the risks to which banking organizations are exposed. Additionally, the 2009 GAAP modifications require that a banking organization regularly update its consolidation analysis with respect to VIEs, and the enhanced requirements for recognition of asset transfers and ongoing disclosure requirements for financial assets with which the banking organization maintains some relationship. These requirements are consistent with the agencies' view that the capital treatment of some previously unconsolidated VIEs do not reflect the actual risk to which the banking organization may be exposed.

**Question 2:** Are there features and characteristics of securitization transactions or other transactions with VIEs, other SPEs, or other entities that are more or less likely to elicit banking organizations' provision of non-contractual (implicit) support under stressed or other circumstances due to reputational risk, business model, or other reasons? Commenters should describe such features and characteristics and the methods of support that may be provided. The agencies are particularly interested in comments regarding credit card securitizations, structured investment vehicles, money market funds, hedge funds, and other entities that are likely beneficiaries of non-contractual support.

The banking agencies have carefully considered the probable effect on banking organizations' regulatory capital ratios that will result from the 2009 GAAP modifications, and the possible alignments between these effects and the risk-based principles of the risk-based capital rules. The agencies have also carefully considered the potential financial impact of the 2009 GAAP modifications on banking organizations. As part of this consideration, the agencies reviewed relevant data from banking organizations' public financial filings and

regulatory reports as well as information obtained from the supervisory process, including the results of the Supervisory Capital Assessment Program (SCAP). The SCAP evaluated the capital position of the nineteen largest U.S. banking organizations, which are also the banking organizations most involved in asset securitization. As part of the SCAP, participating banking organizations' capital adequacy was assessed using consolidation assumptions consistent with standards ultimately included in FAS 166 and FAS 167.<sup>22</sup>

Having considered this information, including the SCAP results, the agencies do not, at this time, find that a compelling basis exists for modifying their regulatory capital requirements to alter the effect of the 2009 GAAP modifications on banking organizations' minimum regulatory capital requirements. Furthermore, as discussed above, the banking agencies believe that the capital treatment of many exposures that would be consolidated under the new accounting standards aligns with risk-based capital principles and results in more appropriate risk-based capital charges. The agencies also believe that it is most appropriate for the leverage ratio to continue to reflect the total on-balance sheet assets of a banking organization, in keeping with its role as a supplement to the risk-based capital measure that limits the maximum degree to which a banking organization can leverage its equity capital base.<sup>23</sup>

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<sup>22</sup> A description of the design and implementation of the SCAP can be found at <http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20090424a1.pdf>.

Additionally, an overview of the results of the SCAP, including regulatory capital ratios calculated pro forma assuming implementation of the 2009 GAAP modifications, can be accessed at <http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20090507a1.pdf>.

<sup>23</sup> 12 CFR 3.6 (b) and (c) (OCC); 12 CFR part 208, appendix B, § I.a. and 12 CFR part 225, appendix D, § I.a (Board); 12 CFR part 325, appendix B (FDIC); 12 CFR 567.5 (OTS).

**Question 3:** What effect will the 2009 GAAP modifications have on banking organizations' financial positions, lending, and activities? How will the modifications impact lending typically financed by securitization and lending in general? How may the modifications affect the financial markets? What proportion of the impact is related to regulatory capital requirements? Commenters should provide specific responses and supporting data.

**Question 4:** As is generally the case with respect to changes in accounting rules, the 2009 GAAP modifications would immediately affect banking organizations' capital requirements. The agencies specifically request comment on the impact of immediate application of the 2009 GAAP modifications on the regulatory capital requirements of banking organizations that were not included in the SCAP. In light of the potential impact at this point in the economic cycle of the 2009 GAAP modifications on regulatory capital requirements, the agencies solicit comment on whether there are significant costs and burdens (or benefits) associated with immediate application of the 2009 GAAP modifications to regulatory capital requirements. If there are significant costs and burdens, or other relevant considerations, should the agencies consider a phase-in of the capital requirements that would result from the 2009 GAAP modifications? Commenters should provide specific and detailed rationales and supporting evidence and data to support their positions.

Additionally, if a phase-in of the impact of the GAAP modifications is appropriate, what type of phase-in should be considered? For example, would a phase-in over the course of a four-quarter period, as described below, for transactions entered into on or prior to December 31, 2009, reduce costs or burdens without reducing benefits?

Under a four-quarter phase-in approach, the amount of a newly-consolidated VIE's assets that would be subject to the phase-in would be limited to the

aggregate value of the assets held by the entity as of December 31, 2009. During such a phase-in, banking organizations would be required to hold capital (for purposes of calculating both the leverage and risk-based capital ratios) incrementally against 25 percent of exposures subject to consolidation due to the 2009 GAAP modifications for each of the first three quarters of 2010, and against 100 percent of the exposures thereafter. For example, if, as a result of the 2009 GAAP modifications, a banking organization would have to consolidate \$10 billion of assets associated with transactions entered into before December 31, 2009, it would be required to include \$2.5 billion of these assets in its regulatory capital ratios the first quarter 2010, \$5 billion the second, \$7.5 billion the third, and the full \$10 billion of assets in the fourth quarter and future reporting periods. During such a phase-in period, the amount of capital that an institution holds against all of its exposures to a single VIE as of December 31, 2009, would not be reduced as a result of this phase-in. For example, if a banking organization is effectively required to hold risk-based capital against all exposures in a VIE due to a provision of implicit recourse, that capital treatment would continue throughout 2010. For another example, if in the first quarter of the phase-in the amount of capital required for a banking organization's credit enhancements to a securitization on December 31, 2009, exceeds the amount of capital required for 25 percent (the first quarter phase-in amount) of the newly consolidated underlying assets, the banking organization would be required to hold the greater amount of capital.

Regulatory capital rules establish only a minimum capital requirement. In all cases, banking organizations should hold capital commensurate with the level and nature of the risks to which they are exposed. Supervisors will review a banking organization's securitization activities on an individual transaction and

business-line basis, and may require a banking organization to increase its capital if they conclude that its capital position is not commensurate with its risk.<sup>24</sup>

#### **IV. Asset-Backed Commercial Paper Programs**

The agencies propose to eliminate existing provisions in the risk-based capital rules that permit a banking organization that is required to consolidate under GAAP an ABCP program for which the banking organization acts as sponsor, to exclude the consolidated ABCP program assets from risk-weighted assets and instead assess the risk-based capital requirement against any contractual exposures of the organization arising from such ABCP programs.<sup>25</sup> The agencies also propose to eliminate the associated provision in the general risk-based capital rules (incorporated by reference in the advanced approaches) that excludes from tier 1 capital the minority interest in a consolidated ABCP program not included in a banking organization's risk-weighted assets.<sup>26</sup>

The agencies initially implemented these provisions in the general risk-based capital rules in 2004 in response to changes in GAAP that required consolidation of certain ABCP conduits by sponsors. The provisions were driven largely by the

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<sup>24</sup> 12 CFR part 3.4(b) (OCC); 12 CFR parts 208 and 225, appendix A §I (Board); 12 CFR part 325, appendix A § IIA (FDIC); 12 CFR 567.11 (OTS).

<sup>25</sup> 12 CFR part 3, appendix A, § 3(a)(5) and 12 CFR part 3, appendix C § 42(l) (OCC); 12 CFR part 208, appendix A, § III.B.6.b and appendix F § 42(l) and 12 CFR part 225, appendix A, § III.B.6.b and appendix G § 42(l) (Board); 12 CFR part 325, appendix A, § II.B.6.b and 12 CFR part 325, appendix D, § 424(l) (FDIC); 12 CFR 567.6(a)(2)(vi)(E) and 12 CFR part 567, appendix C, § 42(l) (OTS).

<sup>26</sup> 12 CFR part 3, appendix A, § 2(a)(3)(ii) (OCC); 12 CFR parts 208 and 225, appendix A, § II A.1.c (Board); 12 CFR part 325, appendix A, § I.A.1.(d) (FDIC); 12 CFR 567.5(a)(iii)(OTS). See 12 CFR part 3, appendix C § 11(a) (OCC); 12 CFR part 208, appendix F, § 11(a) and 12 CFR part 225, appendix G, § 11(a) (Board) ; 12 CFR part 325, appendix D, § 11(a) (FDIC); 12 CFR part 567, appendix C, § 11(a) (OTS).

agencies' belief at the time that banking organizations sponsoring ABCP conduits generally faced limited risk exposures to ABCP programs, because these exposures generally were confined to the credit enhancements and liquidity facility arrangements banking organizations provide to these programs.<sup>27</sup>

Additionally, the agencies believed previously that operational controls and structural provisions, as well as overcollateralization or other credit enhancements provided by the companies that sell assets into ABCP programs, could further mitigate the risk to which sponsoring banking organizations were exposed. However, in light of the increased incidence of banking organizations providing non-contractual support to these programs, as well as the general credit risk concerns discussed above, the agencies have reconsidered the appropriateness of excluding consolidated ABCP program assets from risk-weighted assets and have determined that continuing the exclusion is no longer justified. Under the proposal, if a banking organization is required to consolidate an entity associated with an ABCP program under GAAP, it must hold regulatory capital against the assets of the entity. It would not be permitted to calculate its risk-based capital requirements with respect to the entity based on its contractual exposure to the entity.

## **V. Reservation of Authority**

The agencies expect that there may be instances when a banking organization structures a financial transaction with an SPE to avoid consolidation under FAS 166 and FAS 167, and the resulting capital treatment is not commensurate with the actual risk relationship of the banking organization to the entity. Under this proposal, the banking organization's primary Federal supervisor would retain the authority to require the banking organization to treat the entity as

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<sup>27</sup> See 69 FR 44908 (July 28, 2004).

if it were consolidated onto the banking organization's balance sheet for risk-based capital purposes.

**Question 5:** The agencies request comment on all aspects of this proposed rule, including the proposal to remove the exclusion of consolidated ABCP program assets from risk-weighted assets under the risk-based capital rules, the proposed reservation of authority provisions, and the regulatory capital treatment that would result from the 2009 GAAP modifications absent changes to the agencies' regulatory capital requirements.

**Question 6:** Does this proposal raise competitive equity concerns with respect to accounting and regulatory capital treatments in other jurisdictions or with respect to international accounting standards?

Although the agencies believe that GAAP, as modified, should remain the starting point for calculating regulatory capital ratios and that the capital requirements resulting from the 2009 GAAP modifications generally will result in a more appropriate reflection of credit risk, the agencies recognize that the principles underlying the 2009 GAAP modifications -- power, benefits, and obligation to bear losses -- and the resulting consolidation treatment, may not in all situations and respects correspond to a treatment that would result from a more pure risk focus.

**Question 7:** Among the structures that likely will be consolidated under the 2009 GAAP modifications, for which types, if any, should the agencies consider assessing a different risk-based capital requirement than the capital treatment that will result from the implementation of the modifications? How are commenters' views influenced by proposals for reforming the securitization markets that require securitizers to retain a percentage of the credit risk on any asset that is transferred, sold or conveyed through a securitization? Commenters should provide a detailed explanation and supporting empirical analysis of why the features and

characteristics of these structure types merit an alternative treatment, how the risks of the structures should be measured, and what an appropriate alternative capital treatment would be. Responses should also discuss in detail with supporting evidence how such different capital treatment may or may not give rise to capital arbitrage opportunities.

**Question 8:** Servicers of securitized residential mortgages who participate in the Treasury's Making Home Affordable Program (MHAP) receive certain incentive payments in connection with loans modified under the program. If a structure must be consolidated solely due to loan modifications under MHAP, should these assets be included in the leverage and risk-based capital requirements? Commenters should specify the rationale for an alternative treatment and what an appropriate alternative capital requirement would be.

**Question 9:** Which features and characteristics of transactions that may not be subject to consolidation after the 2009 GAAP modifications become effective should be subject to risk-based capital requirements as if consolidated in order to more appropriately reflect risk?

**Question 10:** Will securitized loans that remain on the balance sheet be subjected to the same ALLL provisioning process, including applicable loss rates, as similar loans that are not securitized? If the answer is no, please explain. If the answer is yes, how would banking organizations reflect the benefits of risk sharing if investors in securitized, on-balance sheet loans absorb realized credit losses? Commenters should provide quantification of such benefits, and any other effects of loss sharing, wherever possible. Additionally, are there policy alternatives to address any unique challenges the pending change in accounting standards present with regard to the ALLL provisioning process including, for example, the current constraint on the amount of provisions that are includible in tier 2 capital? Commenters should provide quantification of the effects of the current limits on

the includibility of provisions in tier 2 capital and the extent to which the 2009 GAAP modifications and the changes in regulatory capital requirements proposed in this NPR effect those limits.

## **VI. Regulatory Analysis**

### *Regulatory Flexibility Act*

The Regulatory Flexibility Act, 5 U.S.C. 601 *et seq.* (RFA), generally requires that, in connection with a notice of proposed rulemaking, an agency prepare and make available for public comment an initial regulatory flexibility analysis that describes the impact of a proposed rule on small entities.<sup>28</sup> Under regulations issued by the Small Business Administration,<sup>29</sup> a small entity includes a commercial bank, bank holding company, or savings association with assets of \$175 million or less (a small banking organization). [As of [appropriate date], there were approximately 2,586 small bank holding companies, 394 small savings associations, 850 small national banks, 432 small state member banks, and 2,922 small state nonmember banks.] As a general matter, the Board's general risk-based capital rules apply only to a bank holding company that has consolidated assets of \$500 million or more. Therefore, the proposed changes to the Board's capital adequacy guidelines for bank holding companies will not affect small bank holding companies.

Other than the proposed modifications to the risk-based capital rules that would no longer allow banking organizations to exclude consolidated ABCP programs from risk-weighted assets, the proposed rule does not impose any additional obligations, restrictions, burdens, or reporting, recordkeeping or compliance requirements on banks or savings associations, including small

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<sup>28</sup> See 5 U.S.C. 603(a).

<sup>29</sup> See 13 CFR 121.201.

banking organizations, nor does it duplicate, overlap or conflict with other Federal rules. The agencies [expect] that the proposed modifications to the general risk-based capital rules would not materially affect small banking organizations because they do not sponsor ABCP programs. [Further analysis to come.]

#### *Paperwork Reduction Act*

In accordance with the requirements of the Paperwork Reduction Act of 1995 (44 U.S.C. 3506), the agencies have reviewed the proposed rule to assess any information collections. There are no collections of information as defined by the Paperwork Reduction Act in the proposed rule.

[PRA staff to discuss whether reservation of authority may require further analysis.]

#### *OCC/OTS Executive Order 12866*

Executive Order 12866 requires federal agencies to prepare a regulatory impact analysis for agency actions that are found to be “significant regulatory actions.” Significant regulatory actions include, among other things, rulemakings that “have an annual effect on the economy of \$100 million or more or adversely affect in a material way the economy, a sector of the economy, productivity, competition, jobs, the environment, public health or safety, or state, local, or tribal governments or communities.” The OCC and the OTS each determined that its portion of the proposed rule is not a significant regulatory action under Executive Order 12866.

#### *OCC/OTS Unfunded Mandates Reform Act of 1995 Determination*

The Unfunded Mandates Reform Act of 1995<sup>30</sup> (UMRA) requires that an agency prepare a budgetary impact statement before promulgating a rule that includes a federal mandate that may result in the expenditure by state, local, and

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<sup>30</sup> See Pub. L. 104-4.

tribal governments, in the aggregate, or by the private sector of \$100 million or more (adjusted annually for inflation) in any one year. If a budgetary impact statement is required, section 205 of the UMRA also requires an agency to identify and consider a reasonable number of regulatory alternatives before promulgating a rule. The OCC and the OTS each have determined that its proposed rule will not result in expenditures by State, local, and tribal governments, in the aggregate, or by the private sector, of \$100 million or more in any one year. Accordingly, neither the OCC nor the OTS has prepared a budgetary impact statement or specifically addressed the regulatory alternatives considered.

#### *Solicitation of Comments on Use of Plain Language*

Section 722 of the GLBA required the agencies to use plain language in all proposed and final rules published after January 1, 2000. The agencies invite comment on how to make this proposed rule easier to understand. For example:

- Have the agencies organized the material to suit your needs? If not, how could they present the rule more clearly?
- Are the requirements in the rule clearly stated? If not, how could the rule be more clearly stated?
- Do the regulations contain technical language or jargon that is not clear? If so, which language requires clarification?
- Would a different format (grouping and order of sections, use of headings, paragraphing) make the regulation easier to understand? If so, what changes would achieve that?
- Is this section format adequate? If not, which of the sections should be changed and how?
- What other changes can the agencies incorporate to make the regulation easier to understand?

## **List of Subjects**

### **12 CFR Part 3**

Administrative practice and procedure, Banks, Banking, Capital, National banks, Reporting and recordkeeping requirements, Risk.

### **12 CFR Part 208**

Confidential business information, Crime, Currency, Federal Reserve System, Mortgages, Reporting and recordkeeping requirements, Risk.

### **12 CFR Part 225**

Administrative Practice and Procedure, Banks, banking, Federal Reserve System, Holding companies, Reporting and recordkeeping requirements, Securities.

### **12 CFR Part 325**

Administrative practice and procedure, Banks, banking, Capital Adequacy, Reporting and recordkeeping requirements, Savings associations, State nonmember banks.

### **12 CFR Part 567**

Capital, Reporting and recordkeeping requirements, Risk, Savings associations.

## **Department of the Treasury**

### **Office of the Comptroller of the Currency**

### **12 CFR Chapter I**

### **Authority and Issuance**

For the reasons stated in the common preamble, the Office of the Comptroller of the Currency proposes to amend Part 3 of chapter I of Title 12, Code of Federal Regulations as follows:

**PART 3—MINIMUM CAPITAL RATIOS; ISSUANCE OF DIRECTIVES**

1. The authority citation for part 3 continues to read as follows:

**Authority:** 12 U.S.C. 93a, 161, 1818, 1828(n), 1828 note, 1831n note, 1835, 3907, and 3909.

2. Section 3.4 is amended by adding paragraph (c) to read as follows:

**§ 3.4 Reservation of authority.**

\* \* \* \* \*

(c) The OCC may find that that the capital treatment for an exposure not subject to consolidation on the bank’s balance sheet does not appropriately reflect the risks imposed on the bank. Accordingly, the OCC may require the bank to treat the exposure as if it were consolidated onto the bank’s balance sheet for the purpose of determining compliance with the bank’s minimum risk-based capital requirements set forth in Appendix A or Appendix C to this Part. The OCC will look to the substance of and risk associated with the transaction as well as other relevant factors the OCC deems appropriate in determining whether to require such treatment and in determining the bank’s compliance with minimum risk-based capital requirements.

## **Appendix A to Part 3 – Risk Based Capital Guidelines**

### **Section 2 [Amended]**

3. In appendix A to Part 3, in section 2, remove and reserve paragraph (a)(3)(ii).

4. In appendix A to Part 3, in section 3, remove and reserve paragraph (a)(5) and revise paragraph (a)(6) to read as follows.

### **Section 3. \* \* \***

\* \* \* \* \*

(a) \* \* \*

(6) Other variable interest entities subject to consolidation. If a bank is required to consolidate the assets of a variable interest entity under generally accepted accounting principles, the bank must assess a risk-based capital charge based on the appropriate risk weight of the consolidated assets in accordance with sections 3(a) and 4 of this appendix A. Any direct credit substitutes and recourse obligations (including residual interests), and loans that a bank may provide to such a variable interest entity are not subject to any capital charge under section 4 of this appendix A.

5. In appendix C to Part 3, in section 1, redesignate paragraph (c)(3) as paragraph (c)(4), and add a new paragraph (3) to read as follows:

### **Appendix C to Part 3—Capital Adequacy Guidelines for Banks: Internal-Ratings-Based and Advanced Measurement Approaches**

\* \* \* \* \*

*Section 1.* \* \* \*

(c) \* \* \*

\* \* \* \* \*

(3) Regulatory capital treatment of unconsolidated entities. If the OCC determines that the capital treatment for a banking organization’s exposure or other relationship to an entity not consolidated on the bank’s balance sheet is not commensurate with the actual risk relationship of the banking organization to the entity, for risk-based capital purposes, it may require the banking organization to treat the entity as if it were consolidated onto the bank’s balance sheet and require the bank to hold capital against the entity’s exposures. The OCC will look to the substance of and risk associated with the transaction as well as other relevant factors the OCC deems appropriate in determining whether to require such treatment and in determining the bank’s compliance with minimum risk-based capital requirements. In making a determination under this paragraph, the OCC will apply notice and response procedures in the same manner and to the same extent as the notice and response procedures in 12 CFR 3.12.

6. Revise Appendix C to part 3 by removing section 42(l) and redesignating section 42(m) as section 42(l) as follows:

**Appendix C to Part 3—Capital Adequacy Guidelines for Banks: Internal-Ratings-Based and Advanced Measurement Approaches**

\* \* \* \* \*

Part V. \* \* \* \* \*

Section 42. \* \* \* \* \*

(l) N<sup>th</sup>-to-default credit derivatives \* \* \*

**Board of Governors of the Federal Reserve System**

**12 CFR Chapter II**

**Authority and Issuance**

For the reasons stated in the common preamble, the Board of Governors of Federal Reserve System amends parts 208 and 225 of Chapter II of title 12 of the Code of Federal Regulations as follows:

**PART 208 – MEMBERSHIP OF STATE BANKING INSTITUTIONS IN THE FEDERAL RESERVE SYSTEM (REGULATION H)**

1. The authority for part 208 continues to read as follows:

**Authority** : 12 U.S.C. 24, 36, 92a, 93a, 248(a), 248(c), 321-338a, 371d, 461, 481-486, 601, 611, 1814, 1816, 1818, 1820(d)(9),1833(j), 1828(o)1831, 1831o, 1831p-1, 1831r-1, 1831w, 1831x 1835a, 1882, 2901-2907, 3105, 3310, 3331-3351, and 3905-3909; 15 U.S.C. 78b, 78I(b), 78l(i),780-4(c)(5), 78q, 78q-1, and 78w, 1681s, 1681w, 6801, and 6805; 31 U.S.C. 5318; 42 U.S.C. 4012a, 4104a, 4104b, 4106 and 4128.

2. In appendix A to part 208, amend section I by adding the following paragraph immediately prior to the last undesignated paragraph:

**Appendix A to Part 208 – Capital Adequacy Guidelines for State Member Banks: Risk-Based Measure**

I. \* \* \*

If the Federal Reserve determines that the capital treatment for a bank's exposure or other relationship to an entity not consolidated on the bank's balance sheet is not commensurate with the actual risk relationship of the bank to the entity, for risk-based capital purposes, it may require the bank to treat the entity as if it were consolidated onto the bank's balance sheet and require the bank to hold capital against the entity's exposures.

\* \* \* \* \*

3. In appendix A to part 208, revise paragraph (c) of section II.A.1 by removing the last sentence as follows:

**Appendix A to Part 208 – Capital Adequacy Guidelines for State Member Banks: Risk-Based Measure**

\* \* \* \* \*

II. \* \* \*

A. \* \* \*

1. \* \* \*

\* \* \* \* \*

c. Minority interest in equity accounts of consolidated subsidiaries. This element is included in tier 1 capital because, as a general rule, it represents equity that is freely available to absorb losses in operating subsidiaries whose assets are included in a bank's risk-weighted asset base. While not subject to an explicit sublimit within tier 1, banks are expected to avoid using minority interest in the equity accounts of consolidated subsidiaries as an avenue for introducing into their capital structures elements that might not otherwise qualify as tier 1 capital or that would, in effect, result in an excessive reliance on preferred stock within tier 1. Minority interests in small business investment companies, investment funds that hold nonfinancial equity investments (as defined in section II.B.5.b. of this appendix A),

and subsidiaries engaged in nonfinancial activities, are not included in the bank's tier 1 or total capital base if the bank's interest in the company or fund is held under one of the legal authorities listed in section II.B.5.b. [Removed]. \* \* \* \* \*

4. In appendix A to part 208, remove paragraph (b) of section III.B.6 and redesignate paragraph (c) of section III.B.6 as paragraph (b) as follows:

### **Appendix A to Part 208 – Capital Adequacy Guidelines for State Member**

#### **Banks: Risk-Based Measure**

\* \* \* \* \*

III. \* \* \*

B. \* \* \*

\* \* \* \* \*

6. \* \* \*

b. If a bank has multiple overlapping exposures (such as a program-wide credit enhancement and multiple pool-specific liquidity facilities) to an ABCP program that is not consolidated for risk-based capital purposes, the bank is not required to hold duplicative risk-based capital under this appendix against the overlapping position. Instead, the bank should apply to the overlapping position the applicable risk-based capital treatment that results in the highest capital charge.

c. [Removed]

5. In appendix F to part 208, add a new paragraph (3) to section 1(c) and redesignate paragraph (3) as paragraph (4) as follows:

### **Appendix F to Part 208 – Capital Adequacy Guidelines for Banks: Internal-Ratings-Based and Advanced Measurement Approaches**

\* \* \* \* \*

1. \* \* \*

(c) \* \* \*

\* \* \* \* \*

(3) Regulatory capital treatment of unconsolidated entities. If the Federal Reserve determines that the capital treatment for a bank's exposure or other relationship to an entity not consolidated on the bank's balance sheet is not commensurate with the actual risk relationship of the bank to the entity, for risk-based capital purposes, it may require the bank to treat the entity as if it were consolidated onto the bank's balance sheet and require the bank to hold capital against the entity's exposures.

(4) Other supervisory authority. Nothing in this appendix limits the authority of the Federal Reserve 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.

6. Revise appendix F to part 208 by removing section 42(l) and redesignating section 42(m) as section 42(l) as follows::

**Appendix F to Part 208 – Capital Adequacy Guidelines for Banks: Internal-Ratings-Based and Advanced Measurement Approaches**

\* \* \* \* \*

Part V. \* \* \* \* \*

Section 42. \* \* \* \* \*

(l) N<sup>th</sup>-to-default credit derivatives \* \* \*

**PART 225 – BANK HOLDING COMPANIES AND CHANGE IN BANK CONTROL (REGULATION Y)**

1. The authority for part 225 continues to read as follows:

**Authority** : 12 U.S.C. 1817(j)(13), 1818, 1828(o), 1831i, 1831p-1, 1843(c)(8), 1844(b), 1972(1), 3106, 3108, 3310, 3331-3351, 3907, and 3909; 15 U.S.C. 1681s, 1681w, 6801 and 6805.

2. In appendix A to part 225, amend section I by adding the following paragraph immediately prior to the last undesignated paragraph:

**Appendix A to Part 225 – Capital Adequacy Guidelines for Bank Holding Companies: Risk-Based Measure**

I.\* \* \*

If the Federal Reserve determines that the capital treatment for a banking organization’s exposure or other relationship to an entity not consolidated on the banking organization’s balance sheet is not commensurate with the actual risk relationship of the banking organization to the entity, for risk-based capital purposes, it may require the banking organization to treat the entity as if it were consolidated onto the banking organization’s balance sheet and require the banking organization to hold capital against the entity’s exposures.

3. In appendix A to part 225, revise paragraph (iii) of section II.A.1.c by removing the last sentence as follows:

**Appendix A to Part 225 – Capital Adequacy Guidelines for Bank Holding Companies: Risk-Based Measure**

\* \* \* \* \*

II. \* \* \*

A. \* \* \*

1. \* \* \*

\* \* \* \* \*

c. \* \* \*

\* \* \* \* \*

iii. Minority interest in equity accounts of consolidated subsidiaries. Minority interest in the common and preferred stockholders' equity accounts of a consolidated subsidiary (minority interest) represents stockholders' equity associated with common or preferred equity instruments issued by a banking organization's consolidated subsidiary that are held by investors other than the banking organization. Minority interest is included in tier 1 capital because, as a general rule, it represents equity that is freely available to absorb losses in the issuing subsidiary. Nonetheless, minority interest typically is not available to absorb losses in the banking organization as a whole, a feature that is a particular concern when the minority interest is issued by a subsidiary that is neither a U.S. depository institution nor a foreign bank. For this reason, this appendix distinguishes among three types of qualifying minority interest. Class A minority interest is minority interest related to qualifying common and noncumulative perpetual preferred equity instruments issued directly (that is, not through a subsidiary) by a consolidated U.S. depository institution<sup>31</sup> [change to 9] or foreign bank<sup>32</sup> [change to 10] subsidiary of a banking organization. Class A minority interest is not subject to a formal limitation within tier 1 capital. Class B minority

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<sup>31</sup> U.S. depository institutions are defined to include branches (foreign and domestic) of federally insured banks and depository institutions chartered and headquartered in the 50 states of the United States, the District of Columbia, Puerto Rico, and U.S. territories and possessions. The definition encompasses banks, mutual or stock savings banks, savings or building and loan associations, cooperative banks, credit unions, and international banking facilities of domestic banks.

<sup>32</sup> For this purpose, a foreign bank is defined as an institution that engages in the business of banking; is recognized as a bank by the bank supervisory or monetary authorities of the country of its organization or principal banking operations; receives deposits to a substantial extent in the regular course of business; and has the power to accept demand deposits.

interest is minority interest related to qualifying cumulative perpetual preferred equity instruments issued directly by a consolidated U.S. depository institution or foreign bank subsidiary of a banking organization. Class B minority interest is a restricted core capital element subject to the limitations set forth in section II.A.1.b.i. of this appendix, but is not subject to a tier 2 sub-limit. Class C minority interest is minority interest related to qualifying common or perpetual preferred stock issued by a banking organization's consolidated subsidiary that is neither a U.S. depository institution nor a foreign bank. Class C minority interest is eligible for inclusion in tier 1 capital as a restricted core capital element and is subject to the limitations set forth in sections II.A.1.b.i. and II.A.2.d.iv. of this appendix. Minority interest in small business investment companies, investment funds that hold nonfinancial equity investments (as defined in section II.B.5.b. of this appendix), and subsidiaries engaged in nonfinancial activities are not included in the banking organization's tier 1 or total capital if the banking organization's interest in the company or fund is held under one of the legal authorities listed in section II.B.5.b. of this appendix. [Removed].

\* \* \* \* \*

4. In appendix A to part 225, remove paragraph (b) of section III.B.6 and redesignate paragraph (c) of section III.B.6 as paragraph (b) as follows:

**Appendix A to Part 225 – Capital Adequacy Guidelines for Bank Holding Companies: Risk-Based Measure**

\* \* \* \* \*

III. \* \* \*

B. \* \* \*

\* \* \* \* \*

6. \* \* \*

b. If a bank holding company has multiple overlapping exposures (such as a program-wide credit enhancement and multiple pool-specific liquidity facilities) to an ABCP program that is not consolidated for risk-based capital purposes, the bank holding company is not required to hold duplicative risk-based capital under this appendix against the overlapping position. Instead, the bank holding company should apply to the overlapping position the applicable risk-based capital treatment that results in the highest capital charge.

c. [Removed]

5. In appendix G to part 225, add a new paragraph (3) to section 1(c) and redesignate paragraph (3) as paragraph (4) as follows:

**Appendix F to Part 208 – Capital Adequacy Guidelines for Banks: Internal-Ratings-Based and Advanced Measurement Approaches**

\* \* \* \* \*

1. \* \* \*

(c) \* \* \*

\* \* \* \* \*

(3) Regulatory capital treatment of unconsolidated entities. If the Federal Reserve determines that the capital treatment for a banking organization’s exposure or other relationship to an entity not consolidated on the banking organization’s balance sheet is not commensurate with the actual risk relationship of the banking organization to the entity, for risk-based capital purposes, it may require the banking organization to treat the entity as if it were consolidated onto the banking organization’s balance sheet and require the banking organization to hold capital against the entity’s exposures.

(4) Other supervisory authority. Nothing in this appendix limits the authority of the Federal Reserve 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.

6. Revise appendix G to part 225 by removing section 42(l) and redesignating section 42(m) as section 42(l) as follows::

**Appendix G to Part 225 – Capital Adequacy Guidelines for Bank Holding Companies: Internal-Ratings-Based and Advanced Measurement Approaches**

\* \* \* \* \*

Part V. \* \* \* \* \*

Section 42. \* \* \* \* \*

(l) N<sup>th</sup>-to-default credit derivatives \* \* \*

**Federal Deposit Insurance Corporation**

**12 CFR Chapter III**

**Authority for Issuance**

For the reasons stated in the common preamble, the Federal Deposit Insurance Corporation amends Part 325 of Chapter III of Title 12, Code of the Federal Regulations as follows:

**PART 325 – CAPITAL MAINTENANCE**

1. The authority citation for part 325 continues 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; Pub. L. 102-233, 105 Stat. 1761, 1789, 1790, (12 U.S.C. 1831n note); Pub. L. 102-242, 105 Stat. 2236, 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).

2. In Appendix A to part 325, revise section I.A.1.(d) to read as follows:

**Appendix A to Part 325 – Statement of Policy on Risk Based Capital**

\* \* \* \* \*

I. \* \* \*

A. \* \* \*

1. \* \* \* \* \*

(d) Minority interests in small business investment companies, investment funds that hold nonfinancial equity investments (as defined in section II.B.(6)(ii) of this appendix A), and subsidiaries that are engaged in non-financial activities are not included in the bank’s Tier 1 or total capital base if the bank’s interest in the company or fund is held under one of the legal authorities listed in section II.B.(6)(ii) of this appendix A.

3. In Appendix A to part 325, revise section II.A. by adding a new paragraph 4. as follows:

**Appendix A to Part 325 – Statement of Policy on Risk Based Capital**

\* \* \* \* \*

II. \* \* \*

A. \* \* \* \* \*

4. The Director of the Division of Supervision and Consumer Protection (DSC) may, on a case-by-case basis, determine that the regulatory capital treatment for an exposure to a transaction that is not subject to consolidation on the balance sheet is not commensurate with the risk of the exposure and the relationship of the bank to the transaction. In making this determination, the Director of DSC may require the bank to treat the transaction as if it were consolidated on the balance sheet of the bank for regulatory capital purposes and calculate the appropriate regulatory capital ratios accordingly.

4. Revise Appendix A to part 325 by removing section II.B.6.b. and redesignating section II.B.6.c. as section II.B.6.b. as follows:

**Appendix A to Part 325 – Statement of Policy on Risk Based Capital**

\* \* \* \* \*

II. \* \* \*

B. \* \* \* \* \*

6. \* \* \* \* \*

b. If a bank has multiple overlapping exposures (such as a program-wide credit enhancement and multiple pool-specific liquidity facilities) to an ABCP program that is not consolidated for risk-based capital purposes, the bank is not required to hold capital under duplicative risk-based capital requirements under this appendix against the overlapping position. \* \* \*

5. In Appendix D to part 325, revise section 1(c) by redesignating paragraph (3) as paragraph (4) and inserting a new paragraph (3) as follows:

**Appendix D to Part 325 – Capital Adequacy Guidelines for Banks:  
Internal-Ratings-Based and Advanced Measurement Approaches**

Part I. \* \* \*

Section 1. \* \* \* \* \*

(c) \* \* \* \* \*

(3) The FDIC may, on a case-by-case basis, determine that the regulatory capital treatment for an exposure to a transaction that is not subject to consolidation on the balance sheet is not commensurate with the risk of the exposure and the relationship of the bank to the transaction. In making this determination, the FDIC may require the bank to treat the transaction as if it were consolidated on the balance sheet of the bank for regulatory capital purposes and calculate the appropriate regulatory capital ratios accordingly.

(4) Other supervisory authority. \* \* \*

6. Revise Appendix D to part 325 by removing section 42(l) and redesignating section 42(m) as section 42(l) as follows:

**Appendix D to Part 325 – Capital Adequacy Guidelines for Banks: Internal-Ratings-Based and Advanced Measurement Approaches**

\* \* \* \* \*

Part V. \* \* \* \* \*

Section 42. \* \* \* \* \*

(l) N<sup>th</sup>-to-default credit derivatives \* \* \*

**Department of the Treasury**

## Office of Thrift Supervision

### 12 CFR Chapter V

For reasons set forth in the common preamble, the Office of Thrift Supervision amends part 567 of Chapter V of title 12 of the Code of Federal Regulations as follows:

#### **PART 567 – CAPITAL**

1. The authority for citation for part 567 continues to read as follows:

**Authority:** 12 U.S.C. 1462, 1462a, 1463, 1464, 1467a, 1828 (note)

2. Section 567.5 (a)(1)(iii) is amended to read as follows:

#### **§ 567.5 Components of capital.**

\* \* \* \* \*

(a) \* \* \*

(1) \* \* \*

(iii) Minority interests in the equity accounts of the subsidiaries that are fully consolidated.

\* \* \* \* \*

3. Section 567.6 is amended by deleting paragraphs (a)(2)(vi)(E)(3)(i) and (ii).

4. Section 567.6 is amended by redesignating paragraph (a)(2)(vi)(E)(3)(iii) as (a)(2)(vi)(E)(3).

\* \* \* \* \*

(a) \* \* \*

(3) If a savings association has multiple overlapping exposures (such as a program-wide credit enhancement and a liquidity facility) to an ABCP program that is not consolidated for risk-based capital purposes, the savings association is not required to hold duplicative risk-based capital under this

part against the overlapping position. Instead, the savings association should apply to the overlapping position the applicable risk-based capital treatment that results in the highest capital charge.

5. Section 567.11 is amended by adding paragraphs (c)(3) and redesignating paragraph (c)(3) as paragraph (c)(4). Section 567.11 is amended by adding paragraph (d) to read as follows:

**§ 567.11 Reservation of authority.**

\* \* \* \* \*

(c) \* \* \*

(3) OTS may find that the capital treatment for an exposure to a transaction not subject to consolidation on the savings association's balance sheet does not appropriately reflect the risks imposed on the savings association. Accordingly, OTS may require the savings association to treat the transaction as if it were consolidated on the savings association's balance sheet. OTS will look to the substance of and risk associated with the transaction as well as other relevant factors in determining whether to require such treatment and in calculating regulatory capital as OTS deems appropriate.

(4) If this part does not specifically assign a risk weight, credit equivalent amount, or credit conversion factor, OTS may assign any risk weight, credit equivalent amount or credit conversion factor that it deems appropriate. In making this determination, OTS will consider the risks associated with the asset or off-balance sheet item as well as other relevant factors.

(d) In making a determination under this paragraph (c) of this section, the OTS will notify the savings association of the determination and solicit a response from the savings association. After review of the response by the

savings association, the OTS shall issue a final supervisory decision regarding the determination made under paragraph (c) of this section.

6. In Appendix C to part 567, add a new paragraph (c)(3) to Part 1, Section 1 and redesignate paragraph (c)(3) as paragraph (c)(4) as follows:

**Appendix C to Part 567 - Risk-Based Capital Requirements – Internal Ratings-Based and Advanced Measurement Approaches**

\* \* \* \* \*

(c) \* \* \*

(3) Regulatory capital treatment of unconsolidated entities. OTS may find that the capital treatment for an exposure to a transaction not subject to consolidation on the savings association’s balance sheet does not appropriately reflect the risks imposed on the savings association. Accordingly, OTS may require the savings association to treat the transaction as if it were consolidated on the savings association’s balance sheet. OTS will look to the substance of and risk associated with the transaction as well as other relevant factors in determining whether to require such treatment and in calculating regulatory capital as OTS deems appropriate.

(4) Other supervisory authority. Nothing in this appendix limits the authority of the OTS 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.

7. Revise appendix C to part 567 by removing section 42(l) and redesignating section 42(m) as section 42(l) as follows:

**Appendix C to Part 567 – Risk-Based Capital Requirements: Internal-Ratings-Based and Advanced Measurement Approaches**

\* \* \* \* \*

Part V. \* \* \* \* \*

Section 42. \* \* \* \* \*

(1) N<sup>th</sup>-to-default credit derivatives \* \* \*