DEPARTMENT OF THE TREASURY

Office of the Comptroller of the Currency

12 CFR Part 3

Docket ID: OCC-2009-0020

RIN 1557-AD26

FEDERAL RESERVE SYSTEM

12 CFR Parts 208 and 225

Regulations H and Y; Docket No. R-[__]

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-[__]

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: Final rule.

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 amending their general risk-based and advanced risk-based capital adequacy frameworks by adopting a final rule that (1) eliminates the exclusion of certain consolidated asset-backed commercial paper programs from risk-weighted assets; (2) provides for an optional two-quarter implementation delay followed by an optional two-quarter partial implementation of the effect on risk-weighted assets that will result from changes to U.S. generally accepted accounting principles from the Financial Accounting Standard Board's 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); (3) provides for an optional two-quarter delay, followed by an optional two-quarter phase-in, of the application of the agencies' regulatory limit on the inclusion of the allowance for loan and lease losses (ALLL) in tier 2 capital for the portion of the ALLL associated with the assets a banking organization consolidates as a result of FAS 167; and (4) provides a reservation of authority 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 delay and subsequent phase-in periods of the implementation will apply only to the agencies' risk-based capital requirements, not the leverage ratio requirement.

DATES: This rule is effective [INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN FEDERAL REGISTER]. Banking organizations may elect to comply with this final rule before the effective date as of the beginning of their first annual reporting period that begins after November 15, 2009.

FOR FURTHER INFORMATION CONTACT:

OCC: Paul Podgorski, Risk Expert, Capital Policy Division, (202) 874-5070, or Carl Kaminski, Senior Attorney, 202 874-5405, or Hugh Carney, Attorney, 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, Manager, Supervisory Policy and Guidance, Division of Banking Supervision and Regulation, (202) 530-6260; or April C. Snyder, Counsel, (202) 452-3099, or Benjamin W. McDonough, Counsel, (202) 452-2036, Legal Division. For the hearing impaired only, Telecommunication Device for the Deaf (TDD), (202) 263-4869.

FDIC: James Weinberger, Senior Policy Analyst (Capital Markets), (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

A. Changes to U.S. Accounting Standards and the Effect on Regulatory Capital

On June 12, 2009, the Financial Accounting Standard Board (FASB) issued 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). Among other things, FAS 166 and FAS 167 modified the accounting treatment under U.S. generally accepted accounting principles (GAAP) of certain structured finance transactions involving a special purpose entity.[1] FAS 166 and FAS 167 are effective as of the beginning of a banking organization's[2] first annual reporting period that begins after November 15, 2009 (implementation date), including interim periods therein, and for interim and annual periods thereafter.[3]

---

[1] The accounting treatment of these transactions and structures was previously governed by the FASB's Statement of Financial Accounting Standards No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities (2000) (FAS 140) and FASB Interpretation No. 46R, Consolidation of Variable Interest Entities (2003) (FIN 46(R)). References herein to FASB Statements of Financial Accounting Standards and Interpretations are to the FASB's "pre-Codification standards" documents and do not reflect modifications that have been or will be made by the FASB as the related text is incorporated in the FASB Accounting Standards Codification that became effective on July 1, 2009.

[2] Unless otherwise indicated, the term "banking organization" includes banks, savings associations, and bank holding companies (BHCs). The terms "bank holding company" and "BHC" refer only to bank holding companies regulated by the Board.

[3] See relevant provisions in FAS 166 paragraphs 5-7, and FAS 167, paragraphs 7-10.

The agencies' risk-based measures for banking organizations (the general risk-based capital rules[4] and the advanced approaches rules,[5] collectively the risk-based capital rules) 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 GAAP as the initial basis for determining whether an exposure is treated as on- or off-balance sheet for risk-based capital purposes. Additionally, the agencies' leverage measure (leverage rule)[6] uses consolidated on-balance sheet assets as the basis for setting minimum capital requirements that are intended to limit the degree to which a banking organization can leverage its equity capital base.

FAS 166 and FAS 167, among other things, establish new standards for reporting companies' transfers of assets to special purpose entities, known as variable interest entities (VIEs) under GAAP, and for consolidating VIEs. Under FAS 167, banking organizations may be required to consolidate assets, liabilities, and equity in certain VIEs that were not consolidated under the standards that FAS 166 and FAS 167 replaced. Most banking organizations will be required to implement the new consolidation standards as of January 1, 2010.[7] The agencies'

---

[4] 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 BHCs with $500 million or less in consolidated assets.

[5] 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).

[6] 12 CFR part 3 (OCC);12 CFR part 208, appendix B and 12 CFR part 225 appendix D (Board); 12 CFR 325.3 (FDIC); 12 CFR 567.8 (OTS).

[7] While most banking organizations affected by FAS 166 and FAS 167 will implement the new standards on January 1, 2010, some banking organizations use annual reporting periods other than the calendar year and will implement the new

risk-based capital and leverage rules (collectively, the capital rules) generally would require banking organizations to include assets held by newly consolidated VIEs in their leverage and risk-based capital ratios determined under those rules. At the same time, consolidating banking organizations may need to establish an allowance for loan and lease losses (ALLL)[8] to cover estimated credit losses on the assets consolidated under FAS 167. As a consequence, absent a change in the capital rules and all other factors remaining constant, both the leverage and risk-based capital ratios of banking organizations that must consolidate due to FAS 167 VIEs that they did not previously consolidate are likely to fall by varying amounts.

B. Notice of Proposed Rulemaking

On September 15, 2009, in anticipation of banking organizations' implementation of FAS 166 and FAS 167, the agencies published a notice of proposed rulemaking (NPR) that solicited information and views from the public on the effect the accounting changes mandated by FAS 166 and FAS 167 would have on regulatory capital, the appropriateness of adjusting the risk-based capital treatment of some classes of assets that would be consolidated by banking organizations as a result of their implementation of FAS 167, and the utility of a

---

standards at the beginning of their first annual reporting period that starts after November 15, 2009.

[8] Under GAAP, an ALLL should be recognized when events have occurred indicating that it is probable that an asset has been impaired or that a liability has been incurred as of the balance sheet date and the amount of the loss can be reasonably estimated. Furthermore, under the risk-based capital rules, the ALLL is a component of tier 2 capital and, therefore, included in the numerator of the total risk-based capital ratio. However, the amount of the ALLL that may be included in tier 2 capital is limited to 1.25 percent of gross risk-weighted assets under the risk-based capital rules. 12 CFR part 208, appendix A § II.A.2.a and 12 CFR part 225, appendix A § II.A.2.a (Board); 12 CFR part 325, appendix A § I.A.2.i. (FDIC); 12 CFR 567.5 (OTS).

phase-in of the regulatory capital effects of the accounting changes, among other issues.[9]

In addition, the NPR proposed modifying the agencies' risk-based capital rules by eliminating provisions that permit a banking organization to exclude assets of consolidated asset-backed commercial paper (ABCP) programs from risk-weighted assets (ABCP exclusion) and instead assessing a risk-based capital requirement against any contractual exposures of the banking organization to such ABCP programs.[10] The NPR also proposed eliminating an 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.[11] In addition, the NPR proposed a new reservation of authority for the agencies' risk-based capital rules to permit a banking organization's primary federal supervisor to treat entities that are not consolidated under GAAP as if they were consolidated for risk-based capital purposes, commensurate with the risk relationship of the banking organization to the entity.

---

[9] 74 FR 47138 (September 15, 2009).

[10] 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, § 42(l) (FDIC); 12 CFR 567.6(a)(2)(vi)(E) and 12 CFR part 567, appendix C, § 42(l) (OTS).

[11] 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).

Collectively, the agencies received approximately 41 comment letters from banking organizations, banking industry associations, mortgage companies, investment and asset management firms, and individuals. Commenters generally agreed with the agencies' preliminary identification of VIEs that are likely to be consolidated by banking organizations as a result of FAS 167. Most notably, these included VIEs associated with (1) ABCP programs; (2) revolving securitizations structured as master trusts, including credit card and home equity line of credit (HELOC) securitizations; (3) certain mortgage loan securitizations not guaranteed by the U.S. government or a U.S. government-sponsored agency; and (4) certain term loan securitizations in which a banking organization retains a residual interest and servicing rights, including some student loan and automobile loan securitizations.[12]

A number of commenters asserted that the implementation of FAS 166 and FAS 167 without changes to the agencies' risk-based capital and leverage rules would increase regulatory capital requirements for banking organizations, as would the proposed elimination of the ABCP exclusion. They argued this would have a negative and procyclical impact on financial markets and the economy, particularly as banking organizations recover from the recent financial crises and recession, by increasing the cost of and ultimately curtailing lending. Most commenters also

---

[12] Many commenters also expressed concern regarding the possibility that VIEs used for asset management, money market, and private equity investments where the fund manager earns more than a non-significant performance fee could be subject to consolidation under FAS 167, and urged the agencies to implement alternative regulatory capital treatments for such funds. On November 11, 2009, FASB announced that the application of FAS 167 to such entities will be deferred for an undetermined period of time. As a result, both risk-based and leverage capital requirements related to these assets will remain unchanged for the duration of the deferral, and the agencies are taking no action with respect to these assets at this time.

argued that there would be negative competitive equity effects from increased regulatory capital requirements that would disadvantage U.S. banking organizations relative to foreign and domestic competitors not subject to similarly high capital requirements. A few commenters asserted that competitive equity concerns were most severe with respect to foreign banking competitors. Some commenters also expressed concern that higher capital requirements would provide incentives for banking organizations to conduct more activity in less stringently regulated foreign jurisdictions.

Many commenters also argued that such implementation would inappropriately align regulatory capital requirements with GAAP's control-based approach to consolidation, in contrast to the credit-risk focus of the agencies' risk-based capital rules. Commenters overwhelmingly supported a delay and/or phase-in of the regulatory capital requirements associated with the implementation of FAS 167 for a period of up to three years. A number of commenters asserted that the proposed elimination of the exclusion of consolidated ABCP program assets from risk-weighted assets would lead to an inappropriate capital requirement for ABCP programs with certain structural features.

II. Final Rule

A. Transition Mechanism for Risk-Based Capital Requirements Associated with the Implementation of FAS 166 and FAS 167

In the final rule, the agencies are instituting a transition mechanism consisting of: (1) an optional two-quarter delay, through the end of the second quarter after the implementation date of FAS 166 and FAS 167 for a banking organization, of recognition of the effect on risk-weighted assets and ALLL includable in tier 2 capital that results from a banking organization's implementation of FAS 167 and (2) an optional phase-in, for a banking organization that has opted for the delay, of those effects over the next two

quarters. A banking organization that chooses to implement this transition mechanism must apply it to all relevant VIEs. The effect of the transition mechanism on a banking organization's risk-based capital ratios would be reflected in the regulatory capital information the organization reports in its regulatory reports[13] for the four quarter-end regulatory report dates following the bank's implementation date.

In the NPR, the agencies requested comment on any significant costs or burdens, or other relevant considerations that the agencies should consider with respect to phasing-in the impact on capital requirements relating to banking organizations' implementation of FAS 167. The agencies also requested specific and detailed rationales, evidence, and data in support of commenters' positions and requested comment on one potential four-quarter phase-in method.

Almost every commenter asserted that a four-quarter phase-in of any additional capital requirements resulting from banking organizations' implementation of FAS 167 would be insufficient. The majority of commenters requested at least a three-year phase-in period.   The commenters offered three primary rationales for a longer phase-in period: (1) any shorter phase-in would unfairly penalize banking organizations given their already established businesses, practices, and programs conceived in good faith to comply with the current capital standards; (2) banking organizations need a longer period to phase out structures designed for current regulatory capital treatment and/or adopt the more risk-sensitive capital treatment of the advanced approaches rules; and (3) corporate financing and capital planning covers more than a four-quarter horizon. In

[13] For banks, Schedule RC-R of the Consolidated Reports of Condition and Income (Call Report); for savings associations, Schedule CCR of the Thrift Financial Report (TFR); and for bank holding companies, Schedule HC-R of the Consolidated Financial Statement for Bank Holding Companies (FR Y-9C).

addition, some commenters asserted that the cost of raising new capital in the current economic environment is high. Several commenters requested, in addition to the increased phase-in time, a six-month delay on the effect of implementation of FAS 167 on capital requirements, during which the agencies would further study the effects of FAS 166 and FAS 167 implementation, including the appropriate regulatory capital treatment for VIEs consolidated as a result of FAS 167 implementation. A few commenters indicated that there should be no phase-in or that any phase-in should be as short as possible, on the grounds that any phase-in would delay needed changes.

The agencies have long maintained that a banking organization should hold capital commensurate with the level and nature of the risks to which it is exposed. As described below, the agencies believe that the effects of FAS 166 and FAS 167 on banking organizations' risk-based capital ratios will result in regulatory capital requirements that better reflect, in many cases, banking organizations' exposure to credit risk. As a result, the agencies do not believe it is appropriate for banking organizations to delay recognizing VIEs consolidated under FAS 167 and the risks associated with them in their risk-based capital ratios for several years, as some commenters proposed. However, as discussed below, in order to avoid abrupt adjustments that could undermine or complicate government actions to support the provision of credit to U.S. households and businesses in the current economic environment, the agencies are providing banking organizations with an optional two-quarter implementation delay followed by an optional two-quarter partial implementation of the effect of FAS 167 on risk-weighted assets and ALLL includable in tier 2 capital.

Many commenters asserted that banking organizations' implementation of FAS 166 and FAS 167 without a change to the regulatory capital rules would decrease the volume and increase the cost of lending to consumers and businesses.

Commenters did not, however, provide adequate empirical analyses and projections of this impact. The agencies note that both the supply of and demand for credit has decreased over recent quarters due to many factors, including household, business, and financial sector deleveraging. As described in the NPR, affected banking organizations' risk-based and leverage capital ratios likely will decrease with their implementation of FAS 166 and FAS 167. However, based on public disclosures by some banking organizations and supervisory information, including the Supervisory Capital Assessment Program (SCAP),[14] risk-based and leverage capital ratios at the largest banking organizations (the banking organizations most affected by FAS 166 and FAS 167) will remain substantially in excess of regulatory minimums. The agencies thus believe that, based on available information, these banking organizations will not encounter an immediate or near-term need to decrease lending or raise substantial amounts of new capital for risk-based capital purposes related to the incremental effects of this final rule. In addition, smaller banking organizations, including community banking organizations, generally did not raise concerns about an adverse impact on smaller banking organizations from the implementation of FAS 166 and FAS 167.

Although the agencies believe that a banking organization's implementation of FAS 166 and FAS 167 will result in regulatory capital requirements that more appropriately reflect risks to which the banking organization is exposed, the agencies also recognize that government initiatives may affect the securitization

---

[14] The SCAP was a supervisory exercise conducted in the first half of 2009 to determine if the 19 largest banking organizations (the banking organizations most affected by FAS 166 and FAS 167 due to the volume of their securitization activities) held regulatory capital sufficient to absorb losses under a specified adverse scenario. The exercise included consideration of estimates of the impact of FAS 166 and FAS 167 on banking organizations' balance sheets and resulting risk-based capital requirements. Further information about SCAP results is available at < http://www.federalreserve.gov/bankinforeg/scap.htm>.

market in the near term. Several government programs supporting the securitization market, including the Commercial Paper Funding Facility and the non-commercial mortgage-backed securities portion of the Term Asset-Backed Securities Loan Facility, are scheduled to terminate in the first quarter of 2010. Moreover, the Congress and financial regulators, including the agencies, are considering a number of legislative and regulatory changes that would affect securitization activities. Because the agencies cannot fully assess the combined impact of these potential changes on the securitization market, and because securitization remains an important source of funding for banking organizations, the agencies are providing in the final rule an optional transition mechanism that permits a banking organization to phase-in the impact of FAS 167 on its risk-weighted assets and ALLL includable in tier 2 capital.

The transition mechanism consists of an optional two-quarter delay in implementation followed by an optional two-quarter partial implementation of the effect of FAS 167 on risk-weighted assets and ALLL includable in tier 2 capital.[15] The timing of the transition reflects the termination dates of the government programs supporting the securitization market and the potential for uncertainty regarding securitization reform initiatives to extend through 2010. The delay and partial implementation periods also provide time for financial market participants and the agencies to observe the effects of these changes on bank lending, financial markets and the overall economy. The transition mechanism is optional because it

---

[15] One commenter expressed concern about a statutory provision in the Home Owner's Lending Act (HOLA), uniquely applicable to savings associations, which limits the amount of consumer loans to 35 percent of the amount of a savings association's total assets. OTS notes that any provision under HOLA would be treated consistent with the transition mechanism. The transition mechanism of a two reporting period pass and then a two reporting period partial implementation for calculating risk weighted assets will also apply to calculating assets for the 35 percent HOLA limitation.

requires a banking organization choosing the option to prepare and maintain two sets of financial records for affected VIEs for the duration of the delay and partial implementation periods — to account separately for financial reporting under GAAP and for regulatory capital reporting based on contractual exposure to VIEs — a requirement that banking organizations in the past have asserted is unduly burdensome.

A banking organization generally would adopt the transition mechanism as of the date it implements FAS 166 and FAS 167, which is the starting date of its first annual reporting period beginning after November 15, 2009.

1. Transition for risk-weighted assets.

For the banking organization's first two quarters after the date it implements FAS 166 and FAS 167 (exclusion period), including for the two calendar quarter-end regulatory report dates within the exclusion period, the banking organization may choose to exclude from risk-weighted assets those assets held by VIEs the banking organization must consolidate after implementing FAS 167, provided that (1) the VIE existed prior to the banking organization's implementation date and (2) the banking organization did not consolidate the VIE on its balance sheet for quarter-end regulatory reporting dates prior to the implementation date. During the exclusion period, the banking organization may also exclude from risk-weighted assets those assets held by VIEs that are consolidated ABCP programs, provided that the banking organization is the sponsor of the ABCP program and the banking organization consolidated the VIE onto its balance sheet under GAAP prior to the implementation date. A banking organization electing to exclude assets pursuant to this transition mechanism may not, however, exclude from risk-weighted assets the assets of any VIEs to which the banking organization has provided recourse through credit enhancement beyond any contractual obligation to support assets it has sold (implicit support). Thus, during the exclusion period, the banking

organization would include in risk-weighted assets an amount equal to the risk-weighted assets it would have been required to calculate for its contractual exposures to these VIEs, including direct-credit substitutes, recourse obligations, residual interests, liquidity facilities, and loans, under the risk-based capital rules prior to its implementation of FAS 166 and FAS 167. The agencies expect banking organizations would calculate risk-weighted assets using methodology similar to the methodology used to calculate the risk weights of exposures to ABCP programs pursuant to the ABCP exclusion.

The amount of risk-weighted assets that would be added to a banking organization's risk-weighted assets as a result of its consolidation of VIEs pursuant to FAS 167 as of the implementation date of FAS 166 and FAS 167 (measurement date) as described above is the exclusion amount. For the first and second quarters after the implementation date, including for the two quarter-end regulatory report dates within those quarters, a banking organization that chooses to adopt the optional transition mechanism may exclude from risk-weighted assets the exclusion amount. For the third and fourth quarters after the implementation date (phase-in period), including for the two quarter-end regulatory report dates within those quarters, a banking organization that has adopted the optional transition mechanism for the first two quarters may exclude from risk-weighted assets 50 percent of the exclusion amount. Under no circumstances, however, may the banking organization include in risk-weighted assets an amount less than the aggregate risk-weighted assets it held based on its contractual exposures to these VIEs on the measurement date, had the VIEs not been consolidated. The floor on risk-weighted assets ensures that, notwithstanding these transition provisions, a banking organization always calculates risk-weighted assets in a manner that at a minimum reflects its contractual risk exposure to its consolidated VIEs on the measurement date.

2. Transition for Allowance for Loan and Lease Losses

During the exclusion period, including for the two calendar quarter-end regulatory report dates within the exclusion period, a banking organization that implements the transition mechanism for risk-weighted assets described in section II.A.1. above by excluding assets of consolidated VIEs from risk-weighted assets may also include without limit in tier 2 capital the full amount (inclusion amount) of the ALLL attributable to the assets it excluded pursuant to the transition mechanism for risk-weighted assets. That is, the ALLL included in tier 2 capital pursuant to this transition mechanism during the exclusion period would not be subject to the 1.25 percent of risk-weighted assets limit (1.25 percent limit) on the ALLL in tier 2 capital contained in the agencies' risk-based capital rules.[16]

During the phase-in period, including for the two quarter-end regulatory report dates within the phase-in period, a banking organization that implemented the transition mechanism for risk-weighted assets and the ALLL during the exclusion period may include in tier 2 capital without limit 50 percent of the inclusion amount (phase-in ALLL) it included in tier 2 capital on the measurement date that was attributable to assets the banking organization excluded during the exclusion period. The remaining 50 percent of the phase-in ALLL, together with the ALLL not attributable to consolidated VIEs to which the transition mechanism applies, may be included in tier 2 capital subject to the 1.25 percent limit. As with the transition for risk-weighted assets, a banking organization may not adopt the transition mechanism for ALLL for VIEs that it must consolidate after implementing FAS 167 to which it has provided implicit support. Therefore, a banking organization may not include in regulatory capital ALLL beyond the

---

[16] See footnote 8.

1.25 percent limit that is associated with assets of a VIE to which it has provided implicit support.

B. Regulatory Capital Requirements Associated with the Implementation of FAS 166 and FAS 167

1. Risk-based capital rules.

The agencies have concluded that it is appropriate to provide an optional delay of and then phase-in the effect of banking organizations' implementation of FAS 166 and FAS 167 on risk-weighted assets and ALLL included in tier 2 capital as described above. However, after careful consideration and analyses of commenters' arguments and supporting information, as well as banking organizations' financial disclosures, and supervisory data and analyses, the agencies have concluded that there is insufficient justification to warrant a permanent modification of the risk-based capital rules in response to banking organizations' implementation of FAS 166 and FAS 167.

a. Risk-weighted assets.

As the agencies noted in the NPR, 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 ongoing credit risk exposure to the VIEs that are required to be consolidated under FAS 167. Experience from the recent financial crisis demonstrates that credit risk exposure of sponsoring banking organizations to such structures (and to the assets of these structures) has in fact been greater than the agencies previously estimated, and more associated with non-contractual risks, including reputational risk, than the agencies had previously anticipated. In the NPR, the agencies noted situations in which banking organizations provided implicit support to some securitization structures, revolving structures in particular, to reduce the likelihood that senior securities of the structures would experience

credit ratings downgrades.[17] These examples were intended to demonstrate that risk-based capital requirements based solely on a banking organization's contractual exposure may underestimate the true exposure of a sponsoring banking organization to the credit risk of securitization structures and other VIEs.[18]

In the NPR, the agencies sought specific views from commenters, with supporting data and other documentation, regarding the types of VIEs and other special purpose entities that are more or less likely to elicit implicit support. The agencies also sought comment on any types of consolidated VIEs that might merit a different risk-based capital treatment than that which will result from the implementation of FAS 166 and FAS 167 without any change to regulatory capital requirements, together with a detailed explanation and supporting empirical analysis of why the features and characteristics of these structure types merit an alternative treatment, how the risks to the consolidating banking organization of the structures should be measured, and what an appropriate alternative capital treatment would be.

Many commenters identified reputational and operational risks as most likely to induce a banking organization to provide implicit support to a VIE. Some commenters noted that certain banking organizations did not follow their peers in providing implicit support during the recent crisis despite reputational risks.

---

[17] 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.

[18] Some commenters expressed concern that the accounting changes coupled with the agencies' proposal would result in duplicative capital requirements and excessive regulatory capital being held on a system-wide basis. The agencies recognize that there will be some overlap in regulatory capital held by sponsoring and investing banking organizations in relation to the same assets. However, the agencies believe this overlap results in a fair reflection of the risks to which sponsoring and investing banking organizations are exposed on an individual basis.

However, commenters generally argued that the risk-based capital rules should be modified to mitigate the effect of FAS 166 and FAS 167 on risk-based capital requirements, taking into account risks borne by third-party investors in VIEs; a substantial number of commenters asserted that risk-based capital requirements should be limited to a banking organization's contractual exposure to VIEs consolidated under FAS 167. Other commenters suggested that the agencies consider using a sliding-scale to risk weight assets subject to consolidation under FAS 167 based on the likelihood of the VIE holding the assets receiving implicit support, as demonstrated by historical experience. Some commenters suggested an implicit support trigger approach that would require higher capital requirements based on a decrease in a VIE's excess spread (that is, the amount of income the VIE receives from assets in excess of that it pays to holders of its obligations), deterioration in VIE asset quality, downward changes in the credit ratings of the VIE's obligations, or other adverse credit events.

Many commenters recommended an approach to risk weighting assets held by consolidated VIEs that would consider each structure independently, calculate a banking organization's "net exposure" to the structure by subtracting third-party investor interests in the structure from the structure's total assets, and then consider the appropriate risk weight to be applied to the resulting net exposure based on the risk characteristics of the structure. Some commenters similarly suggested the agencies adjust risk weights for securitized assets case-by-case on the basis of credit risk mitigation instruments supporting the assets, or include in regulatory capital some subordinated debt instruments issued by consolidated VIEs. Others argued that the agencies should separate regulatory capital reporting from GAAP when establishing regulatory capital requirements for banking organizations' exposures to VIEs and look to the way banking organizations manage VIE exposures internally to determine treatment as "on"-or-"off" balance sheet for

regulatory capital purposes. Some commenters suggested that the size and risk profile of a banking organization should determine capital requirements for consolidated assets. Other commenters suggested the agencies develop risk weights for consolidated VIEs based on the agencies' guidance on synthetic securitizations. With regard to specific types of structures, many commenters asserted that certain multi-seller ABCP conduits (as discussed further below) and non-revolving, amortizing asset securitizations with certain features, such as term residential mortgage-backed securities structures, should receive more favorable capital treatment based on their low historical loss levels to sponsoring banking organizations or low likelihood of implicit support. Some commenters also requested the agencies provide capital relief for consolidated residential and commercial mortgage-backed securities structures in order to aid the real estate market.

Although commenters provided some empirical data in support of their arguments for favorable treatment of ABCP conduits (as discussed below), they provided much less data in support of other proposed alternative risk-based capital treatments. Commenters provided some examples of structural features (such as tax consequences) that may effectively minimize the possibility that a sponsoring banking organization will provide implicit support to certain structures. They did not, however, provide an explicit set of criteria, supported by broad-based empirical evidence, that the agencies could use to identify structures with minimal likelihood of implicit support, particularly during times of financial market stress, nor did they identify alternative risk-based capital treatments that would appropriately identify and measure risk and allay the agencies' concerns regarding regulatory capital arbitrage (that is, the structuring of transactions to obtain lower regulatory capital requirements without a commensurate reduction in risk). Commenters also did not empirically demonstrate the degree of competitive harm

relative to foreign banks and other competitors that banking organizations would likely suffer as a result of the regulatory capital effects of their implementation of FAS 166 and FAS 167.

The agencies therefore are not implementing modifications to the risk-based capital rules to provide an alternative risk-based capital treatment for assets that will be newly consolidated on a banking organization's balance sheet following implementation of FAS 166 and FAS 167. The agencies believe that the optional interim relief provided by this final rule, through the delay and phase-in of the effects of FAS 167 upon risk-based capital requirements as described above, will give a banking organization that elects the option adequate time to adjust its risk profiles to address competitive concerns and to plan to develop structural features needed for future transactions with due consideration to its regulatory capital profiles.

b. Qualifying total capital.

In the NPR, the agencies sought comment on whether securitized loans subject to consolidation on banking organizations' balance sheets under FAS 167 would be subject to the same ALLL provisioning process, including applicable loss rates, as similar loans that are not securitized. The agencies asked for comment on how banking organizations would reflect the benefits of risk sharing in cases where investors in VIEs holding such loans absorb realized credit losses, and for a quantification of such benefits and any other effects of loss sharing, wherever possible. The agencies also asked whether they should consider policy alternatives with regard to the ALLL provisioning process, including the limit on ALLL that may be included in tier 2 capital.

Commenters indicated that the ALLL provisioning process and amounts for loans held in VIEs consolidated under FAS 167 would be the same as for loans not held in VIEs. Commenters asserted that the addition to ALLL that would result

from this consolidation would be significantly greater than the actual losses contractually borne by the consolidating banking organization and would distort the relationship of the ALLL to the contractual risk of the consolidating banking organization to the assets held in the affected VIEs. Commenters further noted that, because additions to ALLL are deducted from retained earnings, the additions have the effect of reducing tier 1 capital.

Many commenters also noted that a higher ALLL would result in higher deferred tax assets (DTAs)[19] and significantly affect banking organizations' regulatory capital ratios due to the capital rules' limits on including DTAs and the ALLL in regulatory capital.[20] Many commenters requested that the agencies relax or eliminate the restrictions on including DTAs in tier 1 capital and the ALLL in tier 2 capital to mitigate the effects of consolidation due to the implementation of FAS 167 on regulatory capital. Specifically, some commenters recommended that the current limit (1.25 percent of risk-weighted assets) on the inclusion of the ALLL in tier 2 capital be increased, or that the entire ALLL related to the assets supporting VIEs' contractual obligations to third parties be included in tier 2 capital. Other commenters recommended that all ALLL related to losses contractually borne by third parties be eligible for inclusion in tier 1 capital.

---

[19] Under GAAP, a DTA arises as a result of the recognition of an expense, in this case a loss provision, for financial reporting purposes in advance of its recognition as a deduction for income tax reporting purposes.

[20] The agencies' risk-based capital rules limit the amount of DTAs dependent upon future taxable income that may be included in tier 1 capital to the lesser of two measures: (a) the amount of such DTAs that a banking organization could reasonably expect to realize within one year; or (b) ten percent of tier 1 capital that exists before the deduction of any disallowed servicing assets, any disallowed purchased credit card relationships, any disallowed credit-enhancing interest-only strips, and any disallowed deferred tax assets. See 12 CFR part 3, Appendix A, § 2(c)(1)(iii) (OCC); 12 CFR parts 208 and 225, Appendix A § II.B.4 (Board); 12 CFR § 325.5(g) (FDIC); and 12 CFR § 567.12(h) (OTS).

Commenters also noted that DTA balances will increase along with the ALLL, and recommended that either the current limit on DTAs in regulatory capital be removed or that all DTAs arising from ALLL related to the contractual loss absorption responsibilities of third parties to consolidated VIEs be included in tier 1 capital.

Under FAS 167, banking organizations have several financial reporting methods for recognizing the initial and ongoing consolidation of VIEs. One method is the fair value option, under which the assets of the VIE are recorded at fair value upon consolidation and no associated ALLL is recognized. Another method is to record newly consolidated assets at carrying value, which requires the establishment of an ALLL at a level appropriate to cover estimated credit losses.[21] Commenters suggested that by not relaxing the limit on the amount of ALLL that may be included in tier 2 capital, the agencies may encourage banking organizations to elect the fair value option for initial consolidation and/or ongoing accounting of affected consolidated VIEs.

The agencies have considered the concerns raised by commenters with respect to ALLL provisioning and DTAs created as a result of a banking organization's implementation of FAS 167. The agencies recognize the effects on tier 1 and tier 2 capital of the increased ALLL provisioning that will result from the consolidation of VIEs, and note the concern of some commenters that, in some cases, the provisioning may be disproportionate to the contractual risks borne by a banking organization with respect to the consolidated assets. However, as described above, a regulatory focus on contractual exposures may understate a

---

[21] If a banking organization makes use of a practicability exception to record the assets at fair value as of the date FAS 166 and FAS 167 are first implemented, no associated ALLL is recognized on that date, but an associated ALLL will be recognized in future periods.

banking organization's exposure to loss with regard to a VIE's assets that the banking organization must consolidate under FAS 167. Moreover, the agencies have determined that the current limits on ALLL are appropriate given the policy benefits of maintaining consistency among international capital standards absent compelling policy justifications for deviating from such standards. The limit of 1.25 percent of risk-weighted assets on the amount of the ALLL that a banking organization may include in tier 2 capital is a standard included in the first capital accord of the Basel Committee on Banking Supervision (Basel Accord).[22] The agencies also note that the current limit on DTAs that a banking organization may include in tier 1 capital is currently being considered as part of an international review of the components of regulatory capital, including deductions from capital. Moreover, commenters generally did not quantify the effect of FAS 167 on banking organizations' ALLLs and DTAs, and the agencies believe that it may be difficult to identify on an ongoing basis the ALLLs and DTAs associated only with assets newly subject to consolidation under FAS 167.

For the above reasons, the agencies have decided not to modify current limits on the inclusion of the ALLL in tier 2 capital and of DTAs in tier 1 capital. However, as described in section II.A.2., this final rule provides substantial transitional relief from the agencies' limits on including ALLL in tier 2 capital to a banking organization implementing FAS 167 that elects to implement the transition mechanism for risk-weighted assets described in section (A)(1) above. The agencies believe that this relief, along with the transitional relief for risk-weighted assets included in the final rule, will aid banking organizations with capital planning as they implement FAS 166 and FAS 167 and adjust their business practices accordingly.

---

[22] Basel Committee on Banking Supervision, International Convergence of Capital Measurement and Capital Standards (1988), paragraph 21.

2. Leverage requirement.

Under the leverage rule, tier 1 capital is assessed against a measure of a banking organization's total on-balance sheet assets, net of ALLL and certain other exposures (leverage ratio).[23] Therefore, previously unconsolidated assets that now must be recognized on a banking organization's balance sheet as a result of its implementation of FAS 167 will increase the denominator of the banking organization's leverage ratio. The agencies have maintained the leverage rule as a balance-sheet assessment to supplement the risk-based capital rules and limit the degree to which a banking organization can leverage its equity capital base.[24] By design, the leverage rule does not recognize the risk profile of on-balance sheet exposures, including any risk transference associated with those exposures.

Some commenters suggested, based on the same risk transference arguments referred to above with respect to the risk-based capital rules, that the agencies exclude the assets of VIEs consolidated by banking organizations under FAS 167 from the leverage ratio. Other commenters urged that the agencies apply any phase in of capital requirements associated with the implementation of FAS 167 to the leverage rule as well as the risk-based capital rules.

Having considered commenters' views, the anticipated impact of the implementation of FAS 166 and FAS 167 on banking organizations' leverage ratios, and the history and purpose of the leverage rule, the agencies have concluded that a delay or phase in of the effect of consolidation under FAS 167 on the leverage rule is not appropriate or justified. The agencies believe the

---

[23] 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).

[24] 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 325.3 (FDIC); 12 CFR 567.5 (OTS).

maintenance of the leverage rule as a balance-sheet assessment separate from the assessment of relative risk is a particularly important feature of prudential regulation and did not find evidence that the impact of FAS 166 and FAS 167 on banking organizations' leverage ratios justifies any alteration of the leverage rule.

C. Asset-Backed Commercial Paper Programs

In the NPR, the agencies proposed to eliminate the ABCP exclusion, which permits a banking organization to exclude from risk-weighted assets the assets of an ABCP program that the banking organization is required to consolidate under GAAP and for which the banking organization acts as sponsor. Under the current risk-based capital rules, a banking organization that elects the ABCP exclusion must instead assess risk-based capital requirements only on its contractual exposures to the program. As proposed in the NPR, as with all other consolidated VIEs, a banking organization would be required to include the assets of a consolidated ABCP program in risk-weighted assets. The agencies also proposed 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.

Commenters generally opposed the proposal to eliminate the ABCP exclusion, particularly with respect to customer-focused, multi-seller ABCP programs (customer conduits). These commenters argued that such ABCP programs have a history of low loss rates (including during the recent financial crisis) and are important sources of funding for many businesses. These commenters also suggested that if the agencies eliminate the ABCP exclusion, the increased capital requirement associated with ABCP programs would increase the cost of funding and decrease credit availability for businesses that have used customer conduits to fund their operations, and therefore would adversely affect

the economy and financial markets. Commenters also argued that the proposed elimination of the ABCP exclusion would raise significant competitive equity concerns for domestic banking organizations relative to foreign banks and domestic entities not subject to banking regulation. Some commenters additionally argued that the elimination of the ABCP exclusion would decrease incentives for banking organizations to transfer risk and might encourage banking organizations to invest in riskier, higher yield assets than those typically associated with consumer conduits. One commenter suggested that elimination of the ABCP exclusion was appropriate where liquidity facilities act as credit enhancement or where affiliates of the conduit sponsor are the largest holder of the ABCP obligations.

Additionally, in response to the agencies' proposal, a number of commenters suggested that the agencies allow early adoption of the advanced approaches rules' Internal Assessment Approach (IAA) methodology[25] for risk-weighting these assets, or delay eliminating the ABCP exclusion until banking organizations could operate fully under the advanced approaches rules. Other commenters urged the agencies not to implement the proposal to eliminate the ABCP exclusion at all, particularly for customer conduits.

The agencies have weighed the concerns raised by commenters, as described above, related to the proposal to eliminate the ABCP exclusion from the risk-based capital rules, against the agencies' own concerns regarding the possibility of

---

[25] See 12 CFR part 3, appendix C, (OCC) § 44; 12 CFR part 208, appendix F, § 44; and 12 CFR part 225, appendix G, § 44 (Board); 12 CFR part 325, appendix D, § 44 (FDIC); 12 CFR 567, Appendix C, § 44 (OTS). Qualifying banking organizations using the IAA may calculate risk-weighted asset amounts for securitization exposures (as defined in the advanced approaches rule) to qualifying ABCP programs by using an internal credit assessment process mapped to equivalent external ratings.

sponsors providing implicit support to ABCP programs and regulatory capital arbitrage, among others. The agencies acknowledge that customer conduits appear to present a lower risk of loss to the sponsoring banking organization relative to other ABCP programs. However, recent events have raised serious questions about the original rationale for allowing the exclusion of consolidated ABCP programs from risk-weighted assets. As the agencies noted in the NPR, the 2004 implementation of the ABCP exclusion was based on the agencies' belief that sponsoring banking organizations' risk exposure to these entities was limited to their contractual exposure. However, as a result of some banking organizations having provided implicit support to a number of ABCP programs they sponsored during the recent financial turmoil, the agencies have observed that the premise of a contractual limit on risk was incorrect for some ABCP programs. In addition, and notwithstanding commenters' assertions to the contrary, the agencies believe that the type of customer conduit advocated by commenters to be considered for preferential exclusion from risk-weighted assets cannot be distinguished from other ABCP programs to a degree of certainty that would effectively mitigate the risk of regulatory arbitrage. Furthermore, commenters did not describe the features and characteristics of customer conduits that would effectively mitigate the risk of a banking organization providing implicit support to sponsored structures under the broadest range of circumstances. The agencies are sensitive to competitive concerns and recognize that some ABCP programs include generally high credit-quality assets. However, given the absence of a workable alternative proposal that satisfactorily addresses the agencies' concerns about regulatory capital arbitrage and implicit support, the agencies have decided to eliminate as proposed the ABCP exclusion, subject to the delay and phase-in described above.

With respect to the recommendation that the agencies allow early adoption of the IAA, the agencies note that the IAA is applicable exclusively to a banking

organization's exposures to off-balance sheet ABCP programs and not to a program's underlying assets when reported on balance sheet. Moreover, the IAA, like the ABCP exclusion, focuses on a banking organization's contractual exposures to an ABCP conduit. The IAA does not capture implicit support and thus an extension of the IAA to consolidated ABCP programs would not sufficiently reflect the risk to sponsoring banking organizations of such programs.

D. Reservation of Authority

The NPR proposed a new reservation of authority for the risk-based capital rules specifying that a banking organization's primary federal supervisor would have the authority to require the banking organization to treat an off-balance sheet VIE (or similar entity) as if it were consolidated onto the banking organization's balance sheet. The banking organization would have to hold capital against the entity's exposures for risk-based capital purposes if the primary federal supervisor determined that the banking organization's exposure or other relationship to the entity was not commensurate with the actual risk relationship of the banking organization to the entity.

The agencies received little comment with respect to the proposed reservation of authority. The few comments received regarding the proposed reservation of authority suggested that it be used in conjunction with recognition of contractual risk transfer. One commenter opposed the reservation of authority as proposed and requested that the agencies' specify standards for the exercise of the authority. The agencies asked in the NPR if there are any features and characteristics of transactions not subject to consolidation on banking organizations' balance sheets under GAAP as modified by FAS 166 and FAS 167 that should be recognized as on-balance sheet exposures for regulatory capital purposes to more appropriately reflect risk. Commenters generally stated that they

were not aware of any such transactions. Many commenters also asserted that such transactions were unlikely.

As stated in the NPR, the agencies believe the reservation of authority is essential to address instances when a banking organization structures a financial transaction with a VIE to avoid consolidation under FAS 167, and the resulting capital treatment is not commensurate with all risks of the banking organization to the VIE, including non-contractual risks. The agencies have therefore decided to incorporate the reservation of authority in their risk-based capital rules as proposed in the NPR.

E. Other Related Matters

1. Department of the Treasury's Home Affordable Mortgage Program

In the NPR, the agencies solicited comment on whether banking organizations that service securitized residential mortgages, participate in the United States Department of the Treasury's Home Affordable Mortgage Program (HAMP), and receive certain incentive payments in connection with the program, would be required under FAS 167 to consolidate VIEs holding such mortgages solely due to loan modifications under HAMP. The agencies also asked if such consolidation were required, whether such assets should be included in regulatory capital requirements and what alternative capital treatment may be appropriate.

Commenters generally did not think that incentive payments under HAMP would independently trigger consolidation under FAS 167. Most also argued that if such consolidation were to occur as a result of actions related to or required by HAMP participation, regulatory capital treatment should be modified with respect to the relevant consolidated mortgage loan assets.

The agencies agree with commenters' assessment that it is unlikely that incentive payments under HAMP independently would cause servicers participating in HAMP to consolidate VIEs holding mortgage loans modified

under HAMP. The agencies therefore do not see a basis for any modification of their capital requirements in relation to incentive payments made pursuant to HAMP.

2. Denial of Extension of Comment Period

A few commenters requested that the agencies extend the NPR comment period. As noted above, the agencies received approximately 41 comments following the publication of the NPR, which indicates that commenters had adequate time to express their views. Furthermore, the possible regulatory capital implications of FAS 166 and FAS 167 were publicly known for months prior to the NPR and several commenters expressed viewpoints on these matters to the agencies well before the publication of the NPR. The agencies therefore have concluded that the 30-day comment period provided adequate time for commenters to provide views to the agencies and deny requests to extend the NPR comment period.

VI. Regulatory Analysis

Riegle Community Development and Regulatory Improvement Act

Section 302 of Riegle Community Development and Regulatory Improvement Act[26] (RCDRIA) generally requires that regulations prescribed by federal banking agencies which impose additional reporting, disclosures or other new requirements on insured depository institutions take effect on the first day of a calendar quarter unless an agency finds good cause that the regulations should become effective sooner and publishes its finding with the rule. The effective date of this rule is [INSERT DATE 60 DAYS AFTER PUBLICATION IN THE

[26] 12 U.S.C. 4802.

FEDERAL REGISTER].[27] The agencies believe that it is important to make this final rule effective before banking organizations generally must calculate their regulatory risk-based capital ratios at the end of the first quarter of 2010. This will allow banking organizations to implement the rule prior to calculating their first quarter 2010 risk-based capital ratios and mitigate possible negative impacts on securitization and financial markets as described in section II.A above. The RCDRIA also provides that an entity that is subject to such a regulation may elect to comply with the regulation before its effective date.[28] Accordingly, banking organizations may elect to comply with this final rule before the effective date (as of the beginning of their first annual reporting period that begins after November 15, 2009).

Regulatory Flexibility Act

In accordance with Section 3(a) of the Regulatory Flexibility Act (RFA),[29] the agencies are publishing a final regulatory flexibility analysis for amendments to their capital rules. Under regulations issued by the Small Business Administration,[30] a small entity includes a commercial bank, BHC, or savings association with assets of $175 million or less (a small banking organization). As of September 30, 2009, there were approximately 2,484 small BHCs, 379 small savings associations, 722 small national banks, 419 small state member banks, and 2,818 small state nonmember banks. As a general matter, the Board's general risk-based capital rules apply only to a BHC that has consolidated assets of $500

[27] This final rule is a "major rule" under the Congressional Review Act and therefore may not take effect until at least 60 days after publication in the Federal Register. See 5 U.S.C. 801.

[28] 12 U.S.C. 4802(b)(2).

[29] 5 U.S.C. 601 et seq.

[30] See 13 CFR 121.201.

million or more. Therefore, the proposed changes to the Board's general risk-based capital rules for BHCs will not affect small BHCs.

The agencies have determined that the final rule will not have a significant impact on a substantial number of small banking organizations. Small banking organizations do not sponsor ABCP programs and very few will be required to consolidate VIEs as a result of implementing FAS 167. The agencies expect that few small banking organizations will elect to implement the transition mechanism set forth in the final rule and they will not be affected by the removal of the ABCP exclusion. Therefore, the agencies certify that the final rule will not have a significant economic impact on a substantial number of small banking organizations.

Paperwork Reduction Act

In accordance with the requirements of the Paperwork Reduction Act of 1995[31], the agencies have reviewed the final rule. The Board reviewed the final rule under the authority delegated to the Board by the Office of Management and Budget. The agencies note that instructions related to ABCP conduits in schedule RC-R of the Consolidated Reports of Condition and Income[32] and schedule HC-R of the Consolidated Financial Statements for Bank Holding Companies[33] will require revision. The agencies also note that the instructions for other items in Schedules RC-R and HC-R will require revisions related to the delay and phase-in options included in the final rule. If these revisions are determined to be significant, the revisions would be incorporated into a proposal that the agencies

[31] 44 U.S.C. 3506.

[32] OMB Nos. 7100-0036, 1557-0081, and 3064-0052; FFIEC 031 and 041.

[33] OMB No. 7100-0128; FR Y-9C.

would publish with a request for comment in accordance with the requirements of the PRA.

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.”

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." Regulatory actions that satisfy one or more of these criteria are referred to as "economically significant regulatory actions."

The OCC has determined that this rulemaking is an economically significant regulatory action for purposes of Executive Order 12866. However, because the rule addresses changes to accounting standards that will become effective for national banks for the reporting period beginning Jan. 1, 2010, the issuance of this rule is subject to the procedures set forth in Section 6(a)(3)(D) of Executive Order 12866.

OCC/OTS Unfunded Mandates Reform Act of 1995 Determination

The Unfunded Mandates Reform Act of 1995[34] (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 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.

Use of Plain Language

Section 722 of the Gramm-Leach-Bliley Act[35] requires the federal banking agencies to use plain language in all proposed and final rules published after January 1, 2000. The agencies invited comment on how to make the proposed rule easier to understand. The agencies received no comment on plain language.

Nevertheless, the agencies have endeavored to present this final rule, and all their capital rules, in a manner that is as brief, comprehensible, and straightforward as possible, in light of the nature and complexity of the subject matter.

---

[34] See Pub. L. 104-4.

[35] Pub. L. No. 106-102.

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:

[OCC RULE TEXT TO BE PROVIDED PRIOR TO PUBLICATION IN THE FEDERAL REGISTER.]

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:

[FRB RULE TEXT TO BE PROVIDED PRIOR TO PUBLICATION IN THE FEDERAL REGISTER.]

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 new paragraphs 4. and 5. 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 or other relationship to an entity 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 entity. In making this determination, the Director of DSC may require the bank to treat the entity as if it were consolidated on the balance sheet of the bank for regulatory capital purposes and calculate the appropriate regulatory capital ratios accordingly.

5. Optional transition provisions related to the implementation of consolidation requirements under FAS 167

Section II.A.5. of this appendix provides optional transition provisions for a state nonmember bank that is required for financial reporting purposes, as a result of its implementation of Statement of Financial Accounting Standards No. 167, Amendments to FASB Interpretation No. 46(R) (FAS 167), to consolidate certain variable interest entities (VIEs) as defined under GAAP. These transition provisions apply through the end of the fourth quarter following the date of a bank's implementation of FAS 167 (implementation date).

i. Exclusion period.

(a) Exclusion of risk-weighted assets for the first and second quarters. For the first two quarters, including for the two calendar quarter-end regulatory report dates within those quarters, after the implementation date (exclusion period), a bank may exclude from risk-weighted assets:

(1) Assets held by a VIE, provided that the following conditions are met:

(i) The VIE existed prior to the implementation date,

(ii) The bank did not consolidate the VIE on its balance sheet for quarter-end regulatory reporting dates prior to the implementation date,

(iii) The bank must consolidate the VIE on its balance sheet for quarter-end regulatory report dates after the implementation date as a result of its implementation of FAS 167, and

(iv) The bank excludes all assets held by VIEs described in this paragraphs i.(a)(1)(i) through (iii) of this section II.A.5. other than assets it may not exclude from risk-weighted assets pursuant to paragraph iii. of this section; and

(2) Assets held by a VIE that is a consolidated asset-backed commercial paper (ABCP) program, provided that the following conditions are met:

(i) The bank is the sponsor of the ABCP program,

(ii) Prior to the implementation date, the bank consolidated the VIE onto its balance sheet under GAAP for quarter-end regulatory report dates and excluded the VIE's assets from the bank's risk-weighted assets, and

(iii) The bank chooses to exclude all assets held by ABCP program VIEs described in this paragraphs i.(a)(2)(i) and (ii) of this section other than assets it may not exclude from risk-weighted assets pursuant to paragraph iii. of this section.

(b) Risk-weighted assets during exclusion period. During the exclusion period, a bank adopting the optional provisions of this paragraph i. must calculate risk-weighted assets for its contractual exposures to the VIEs referenced in paragraph i.(a). Such contractual exposures may include direct-credit substitutes, recourse obligations, residual interests, liquidity facilities, and loans.

(c) Inclusion of ALLL in tier 2 capital for the first and second quarters. During the exclusion period, including for the two calendar quarter-end regulatory report dates within the exclusion period, a bank that excludes VIE assets from risk-weighted assets pursuant to paragraph i.(a) of this section may include in tier 2 capital the full amount (inclusion amount) of the (ALLL) attributable to the assets it excludes pursuant to paragraph i.(a) of this section. The amount of ALLL

includable in Tier 2 capital in accordance with this paragraph shall not be subject to the limitations set forth in paragraph i. of section I.A.2. of this Appendix A.

ii. Phase-in period.

(a) Exclusion amount. For purposes of this paragraph ii., exclusion amount is defined as the amount of risk-weighted assets excluded in paragraph i.(a) of this section as of the first day of the first quarter on or after the implementation date (measurement date).

(b) Risk-weighted assets for the third and fourth quarters. A bank that excludes assets of consolidated VIEs from risk-weighted assets pursuant to paragraph i.(a) of this section may, for the third and fourth quarters, including for the two calendar quarter-end regulatory report dates within those quarters, after the implementation date (phase-in period), exclude from risk-weighted assets 50 percent of the exclusion amount, provided that under no circumstances may the bank include in risk-weighted assets pursuant to this paragraph an amount less than the aggregate risk-weighted assets it held under paragraph i. on the measurement date.

(c) Inclusion of ALLL in Tier 2 capital for the third and fourth quarters. A bank that excludes assets of consolidated VIEs from risk-weighted assets pursuant to paragraph i.(a) of this section may, for the phase-in period, include in tier 2 capital 50 percent of the inclusion amount it included in tier 2 capital pursuant to paragraph i.(c) on the measurement date, notwithstanding the limit on including ALLL in tier 2 capital in paragraph i. of section I.A.2. of this Appendix.

iii. Implicit recourse limitation. Notwithstanding any other provision in this section II.A.5., assets held by a VIE to which the bank has provided recourse through credit enhancement beyond any contractual obligation to support assets it has sold may not be excluded from risk-weighted assets.

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 the Table of Contents by adding a new Part IX and Section 81 as follows:

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

Part I General Provisions

* * * * *

Part IX Transition Provisions

Section 81 Optional transition provisions related to the implementation of consolidation requirements under FAS 167

6. In Appendix D to part 325, revise section 1(c) by redesignating paragraph (3) as paragraph (4) and inserting 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 or other relationship to an entity 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 entity. In making this determination, the FDIC may require the bank to treat the entity 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) <u>Other supervisory authority</u>. * * *

7. 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. * * * * *

<u>Section 42.</u> * * * * *

(l) Nth-to-default credit derivatives * * *

8. Revise Appendix D to part 325 by inserting a new part IX and section 81 to read as follows:

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

* * * * *

Part IX. Transition Provisions

Section 81. Optional transition provisions related to the implementation of consolidation requirements under FAS 167

(a) Scope, applicability, and purpose. This section 81 provides optional transition provisions for state nonmember bank that is required for financial reporting purposes, as a result of its implementation of Statement of Financial Accounting Standards No. 167, Amendments to FASB Interpretation No. 46(R) (FAS 167), to consolidate certain variable interest entities (VIEs) as defined under United States generally accepted accounting principles (GAAP). These transition provisions apply through the end of the fourth quarter following the date of a bank's implementation of FAS 167 (implementation date).

(b) Exclusion period.

(1) Exclusion of risk-weighted assets for the first and second quarters. For the first two quarters, including for the two calendar quarter-end regulatory report dates within those quarters, after the implementation date (exclusion period), a bank may exclude from risk-weighted assets:

(i) Assets held by a VIE, provided that the following conditions are met:

(A) The VIE existed prior to the implementation date,

(B) The bank did not consolidate the VIE on its balance sheet for quarter-end regulatory reporting dates prior to the implementation date,

(C) The bank must consolidate the VIE on its balance sheet for quarter-end regulatory report dates after the implementation date as a result of its implementation of FAS 167, and

(D) The bank excludes all assets held by VIEs described in this paragraphs (b)(1)(i)(A) through (C) of this section other than assets it may not exclude from risk-weighted assets pursuant to paragraph (d) of this section; and

(ii) Assets held by a VIE that is a consolidated asset-backed commercial paper (ABCP) program, provided that the following conditions are met:

(A) The bank is the sponsor of the ABCP program,

(B) Prior to the implementation date, the bank consolidated the VIE onto its balance sheet under GAAP for quarter-end regulatory report dates and excluded the VIE's assets from the bank's risk-weighted assets, and

(C) The bank chooses to exclude all assets held by ABCP program VIEs described in this paragraphs (b)(1)(ii)(A) and (B) of this paragraph other than assets it may not exclude from risk-weighted assets pursuant to paragraph (d) of this section.

(2) Risk-weighted assets during exclusion period. During the exclusion period, a bank adopting the optional provisions in paragraph (b) of this section must calculate risk-weighted assets for its contractual exposures to the VIEs referenced in paragraph (b)(1) of this section. Such contractual exposures may include direct-credit substitutes, recourse obligations, residual interests, liquidity facilities, and loans.

(3) Inclusion of ALLL in tier 2 capital for the first and second quarters. During the exclusion period, including for the two calendar quarter-end regulatory

report dates within the exclusion period, a bank that excludes VIE assets from risk-weighted assets pursuant to paragraph (b)(1) of this section may include in tier 2 capital the full amount (inclusion amount) of the (ALLL) attributable to the assets it excludes pursuant to paragraph (b)(1) of this section. The amount of ALLL includable in tier 2 capital in accordance with this paragraph shall not be subject to the limitations set forth in paragraph i. of section I.A.2. of Appendix A.

(c) Phase-in period.

(1) Exclusion amount. For purposes of this paragraph (c), exclusion amount is defined as the amount of risk-weighted assets excluded in paragraph (b)(1) of this section as of the first day of the first quarter on or after the implementation date (measurement date).

(2) Risk-weighted assets for the third and fourth quarters. A bank that excludes assets of consolidated VIEs from risk-weighted assets pursuant to paragraph (b)(1) of this section may, for the third and fourth calendar quarters, including for the two calendar quarter-end regulatory report dates within those quarters, after the implementation date (phase-in period), exclude from risk-weighted assets 50 percent of the exclusion amount, provided that under no circumstances may the bank include in risk-weighted assets pursuant to this paragraph an amount less than the aggregate risk-weighted assets it held under paragraph (b) on the measurement date.

(3) Inclusion of ALLL in tier 2 capital for the third and fourth quarters. A bank that excludes assets of consolidated VIEs from risk-weighted assets pursuant to paragraph (b)(1) of this section may, for the phase-in period, include in tier 2 capital 50 percent of the inclusion amount it included in tier 2 capital pursuant to paragraph (b)(3) on the measurement date, notwithstanding the limit on including ALLL in tier 2 capital in paragraph i. of section I.A.2. of Appendix A.

(d) Implicit recourse limitation. Notwithstanding any other provision in this section 81, assets held by a VIE to which the bank has provided recourse through credit enhancement beyond any contractual obligation to support assets it has sold may not be excluded from risk-weighted assets.

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:

[OTS RULE TEXT TO BE PROVIDED PRIOR TO PUBLICATION IN THE FEDERAL REGISTER.]