## Separate Account and Equity Exposures to Investment Funds

**1. A banking organization has an equity exposure to an investment fund. The investment guidelines of the fund permit it to hold securitization positions up to a specified limit. Under the standardized approach, can the banking organization use the alternative modified look-through approach of section 53(d) of the regulatory capital rule to calculate the risk weight for its equity exposure to the investment fund? What risk weight should the banking organization assign to the portion of its investment in the fund that, according to the investment limits of the fund, would be securitization exposures?**

The banking organization may use the alternative modified look-through approach set forth in section 53(d) of the regulatory capital rule to assign the adjusted carrying value of its equity exposure to an investment fund on a pro rata basis to different risk-weight categories based on the investment limits for various asset types contained in the fund's prospectus, partnership agreement, or similar contract that defines the fund's permissible investments (investment guidelines). If all due diligence requirements under section 41(c) of the regulatory capital rule are met, the banking organization may assign a risk weight to the securitization portion using either the gross-up approach or the simplified supervisory formula approach (SSFA) under section 43 of the regulatory capital rule depending on which of these approaches the banking organization has chosen to use across all of its securitization exposures, among other factors specified in section 42 of the regulatory capital rule. The banking organization may use the SSFA for all of its directly owned securitization exposures and the securitization exposures held by the investment fund, if the investment guidelines limit the investment fund's holdings of securitization exposures to only exposures that would be subject to a specific risk weight under the SSFA in section 43 of the regulatory capital rule. For example, the investment guidelines could limit the fund's holdings of securitization exposures only to exposures that would be subject to a 20 percent risk weight under the SSFA. Importantly, the investment guidelines would have to specify that any securitization exposure would be divested promptly if its risk weight calculated under the SSFA goes above the specified threshold.

In order for the banking organization to apply the risk weight limit specified in the investment guidelines, it also would need to meet the due diligence requirements in section 41(c) of the regulatory capital rule, which require the banking organization to demonstrate a comprehensive understanding of the features of the securitization exposure that would materially affect its performance. The banking organization could rely on a third party (for example, the fund manager) to conduct the due diligence on the securitization exposures held by the investment fund and provide the analysis to the banking organization, provided that the banking organization has a process to assess and manage the risk of using a third party. (See, for example, the guidance issued by each agency related to outsourcing risk. Refer to www.occ.gov/news-issuances/bulletins/2013/bulletin-2013-29.html, http://www.fdic.gov/news/news/financial/2008/fil08044.html, and http://www.federalreserve.gov/bankinforeg/srletters/sr1319.htm.)

**2. Could an investment in a bank-owned life insurance (BOLI) hybrid product in which the gains and losses on the pool of assets are reflected in the cash surrender value recorded on the banking organization's balance sheet meet the definition of separate account under the regulatory capital rule?**

Yes, as long as the account meets all the requirements of a separate account as defined in section 2 of the regulatory capital rule, which refers to a legally segregated pool of assets owned and

held by an insurance company for the benefit of an individual contract holder. Paragraph 4 of the definition of a separate account requires, in part, that all investment gains and losses, net of contract fees and assessments, be passed through to the contract holder. Paragraph 4 would be satisfied if the gains and losses on the investment are passed through to a banking organization via changes in the on-balance sheet cash surrender value of the investment. The banking organization must not receive cash payments of any gains or earnings of the assets in the pool.