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Office of the Comptroller of the Currency
12 CFR Parts 3, 5, 6, *et al.*

Federal Reserve System

12 CFR Parts 208, 217, and 225

Federal Deposit Insurance Corporation

12 CFR Parts 324, 325, and 362

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

DEPARTMENT OF THE TREASURY

Office of the Comptroller of the Currency

12 CFR Parts 3, 5, 6, 165, and 167

[Docket ID OCC–2012–0008]

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FEDERAL RESERVE SYSTEM

12 CFR Parts 208, 217, and 225 Regulations H, Q, and Y

[Docket No. R–1442]

RIN 7100–AD87

FEDERAL DEPOSIT INSURANCE CORPORATION

12 CFR Parts 324, 325, and 362

RIN 3064–AD95

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

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

ACTION: Joint notice of proposed rulemaking.

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

In connection with the proposed changes to the agencies' capital rules in this NPR, the agencies are also seeking comment on the two related NPRs published elsewhere in today's **Federal Register**. The two related NPRs are discussed further in the **SUPPLEMENTARY INFORMATION**.

DATES: Comments must be submitted on or before October 22, 2012.

ADDRESSES: Comments should be directed to:

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

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

- Click on the ''Help'' tab on the Regulations.gov home page to get information on using Regulations.gov, including instructions for submitting or viewing public comments, viewing other supporting and related materials, and viewing the docket after the close of the comment period.
- *Email: 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 ID OCC–2012–0008'' in your comment. In general, the OCC will enter all comments received into the docket and publish them on Regulations.gov without change, including any business or personal information that you provide such as name and address information, email addresses, or phone numbers. Comments received, including attachments and other supporting materials, are part of the public record and subject to public disclosure. Do not enclose any information in your comment or supporting materials that you consider confidential or inappropriate for public disclosure.

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

- *Viewing Comments Electronically:* Go to *http://www.regulations.gov*. Click ''Advanced Search''. Select ''Document Type'' of ''Public Submission'' and in ''By Keyword or ID'' box enter Docket ID ''OCC–2012–0008,'' and click ''Search.'' If comments from more than one agency are listed, the ''Agency'' column will indicate which comments were received by the OCC. Comments can be filtered by Agency using the filtering tools on the left side of the screen.
- *Viewing Comments Personally:* You may personally inspect and photocopy comments at the OCC, 250 E Street SW., Washington, DC 20219. For security reasons, the OCC requires that visitors make an appointment to inspect comments. You may do so by calling (202) 874–4700. Upon arrival, visitors will be required to present valid government-issued photo identification and to submit to security screening in order to inspect and photocopy comments.
- *Docket:* You may also view or request available background documents and project summaries using the methods described previously.

Board: When submitting comments, please consider submitting your comments by email or fax because paper mail in the Washington, DC, area and at the Board may be subject to delay. You may submit comments, identified by Docket No. R–1430; RIN No. 7100–AD87, 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.
- *Email: regs.comments@federalreserve.gov.* Include docket number in the subject line of the message.
- *Fax:* (202) 452–3819 or (202) 452–3102.
- *Mail:* Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue NW., Washington, DC 20551.

All public comments are available from the Board's Web site at *http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm* as submitted, unless modified for technical reasons. Accordingly, your comments will not be edited to remove any identifying or contact information. Public comments may also be viewed electronically or in paper form in Room MP–500 of the Board's Martin Building (20th and C Street NW., Washington, DC 20551) between 9 a.m. and 5 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.
- *Email: comments@FDIC.gov.*
- *Instructions:* Comments submitted must include ''FDIC'' and ''RIN 3064–AD95.'' Comments received will be posted without change to *http://www.FDIC.gov/regulations/laws/federal/propose.html*, including any personal information provided.

FOR FURTHER INFORMATION CONTACT: *OCC:* Margot Schwadron, Senior Risk Expert, (202) 874–6022; David Elkes, Risk Expert, (202) 874–3846; Mark Ginsberg, Risk Expert, (202) 927–4580; or Ron Shimabukuro, Senior Counsel, Patrick Tierney, Counsel, or Carl Kaminski, Senior Attorney, Legislative and Regulatory Activities Division, (202) 874–5090, Office of the Comptroller of the Currency, 250 E Street SW., Washington, DC 20219.

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

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

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

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

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

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

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I. Introduction

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

The Office of the Comptroller of the Currency (OCC), Board of Governors of the Federal Reserve System (Board), and the Federal Deposit Insurance Corporation (FDIC) (collectively, the agencies) are proposing comprehensive revisions to their regulatory capital framework through three concurrent notices of proposed rulemaking (NPR). These proposals would revise the agencies' current general risk-based rules, advanced approaches risk-based capital rules (advanced approaches), and leverage capital rules (collectively, the current capital rules).[2] The proposed

[1] Sections marked with an asterisk generally would not apply to less-complex banking organizations.

[2] The agencies' general risk-based capital rules are at 12 CFR part 3, appendix A, 12 CFR part 167 (OCC); 12 CFR parts 208 and 225, appendix A (Board); and 12 CFR part 325, appendix A, and 12 CFR part 390, subpart Z (FDIC). The agencies'

revisions incorporate changes made by the Basel Committee on Banking Supervision (BCBS) to the Basel capital framework, including those in ''Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems'' (Basel III).[3] The proposed revisions also would implement relevant provisions of the Dodd-Frank Act and restructure the agencies' capital rules into a harmonized, codified regulatory capital framework.[4]

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

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

The agencies are publishing all the proposed changes to the agencies' current capital rules at the same time in these three NPRs so that banking organizations can read the three NPRs together and assess the potential cumulative impact of the proposals on their operations and plan appropriately. The overall proposal is being divided into three separate NPRs to reflect the distinct objectives of each proposal and to allow interested parties to better understand the various aspects of the overall capital framework, including which aspects of the rules will apply to which banking organizations, and to help interested parties better focus their comments on areas of particular interest. The agencies believe that separating the proposals into three NPRs makes it easier for banking organizations of all sizes to more easily understand which proposed changes are related to the agencies' objective to improve the quality and increase the quantity of capital (Basel III NPR) and which are related to the agencies' objective to enhance the overall risk-sensitivity of the calculation of a banking organization's total risk-weighted assets (Standardized Approach NPR).

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

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

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

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

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

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

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

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

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

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

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

establishing a robust and comprehensive capital framework.

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

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

Basel III NPR

In 2010, the BCBS published Basel III, a comprehensive reform package that is designed to improve the quality and the quantity of regulatory capital and to build additional capacity into the banking system to absorb losses in times of future market and economic stress.[11] This NPR proposes the majority of the revisions to international capital standards in Basel III, including a more restrictive definition of regulatory capital, higher minimum regulatory capital requirements, and a capital conservation and a countercyclical capital buffer, to enhance the ability of banking organizations to absorb losses and continue to operate as financial intermediaries during periods of economic stress.[12] The proposal would place limits on banking organizations' capital distributions and certain discretionary bonuses if they do not hold specified ''buffers'' of common equity tier 1 capital in excess of the new minimum capital requirements.

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

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

Standardized Approach NPR

The Standardized Approach NPR aims to enhance the risk-sensitivity of the agencies' capital requirements by revising the calculation of risk-weighted assets. It would do this by incorporating aspects of the Basel II Standardized Approach, including aspects of the 2009 ''Enhancements to the Basel II Framework'' (2009 Enhancements), and other changes designed to improve the risk-sensitivity of the general risk-based capital requirements. The proposed changes are described in further detail in the preamble to the Standardized Approach NPR.[14] As compared to the general risk-based capital rules, the Standardized Approach NPR includes a greater number of exposure categories for purposes of calculating total risk-weighted assets, provides for greater recognition of financial collateral, and permits a wider range of eligible guarantors. In addition, to increase transparency in the derivatives market, the Standardized Approach NPR would provide a more favorable capital treatment for derivative and repo-style transactions cleared through central counterparties (as compared to the treatment for bilateral transactions) in order to create an incentive for banking organizations to enter into cleared transactions. Further, to promote transparency and market discipline, the Standardized Approach NPR proposes disclosure requirements that would apply to top-tier banking organizations domiciled in the United States with $50 billion or more in total assets that are not subject to disclosure requirements under the advanced approaches rule.

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

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

Advanced Approaches and Market Risk NPR

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

[10] The Standardized Approach NPR also contains a second addendum to the preamble, which contains the definitions proposed under the Basel III NPR. Many of the proposed definitions also are applicable to the Standardized Approach NPR, which is published elsewhere in today's **Federal Register**.

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

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

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

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

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

advanced approaches rules to achieve consistency with relevant provisions of the Dodd-Frank Act.

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

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

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

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

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

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

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

TABLE 1—PROPOSED STRUCTURE OF THE AGENCIES' CAPITAL RULES AND PROPOSED REVISIONS TO THE PCA FRAMEWORK

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

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

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

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

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

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

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

TABLE 2—KEY PROVISIONS OF THE BASEL III AND STANDARDIZED APPROACH NPRS AS COMPARED WITH THE CURRENT RISK-BASED AND LEVERAGE CAPITAL RULES

Aspect of proposed requirements	Proposed treatment
Basel III NPR	
Minimum Capital Ratios:	
Common equity tier 1 capital ratio (section 10)	Introduces a minimum requirement of 4.5 percent.
Tier 1 capital ratio (section 10)	Increases the minimum requirement from 4.0 percent to 6.0 percent.
Total capital ratio (section 10)	Minimum unchanged (remains at 8.0 percent).
Leverage ratio (section 10)	Modifies the minimum leverage ratio requirement based on the new definition of tier 1 capital. Introduces a supplementary leverage ratio requirement for advanced approaches banking organizations.
Components of Capital and Eligibility Criteria for Regulatory Capital Instruments (sections 20–22).	Enhances the eligibility criteria for regulatory capital instruments and adds certain adjustments to and deductions from regulatory capital, including increased deductions for mortgage servicing assets (MSAs) and deferred tax assets (DTAs) and new limits on the inclusion of minority interests in capital. Provides that unrealized gains and losses on all available for sale (AFS) securities and gains and losses associated with certain cash flow hedges flow through to common equity tier 1 capital.
Capital Conservation Buffer (section 11)	Introduces a capital conservation buffer of common equity tier 1 capital above the minimum risk-based capital requirements, which must be maintained to avoid restrictions on capital distributions and certain discretionary bonus payments.
Countercyclical Capital Buffer (section 11)	Introduces for advanced approaches banking organizations a mechanism to increase the capital conservation buffer during times of excessive credit growth.
Standardized Approach NPR Risk-Weighted Assets	
Credit exposures to: U.S. government and its agencies. U.S. government-sponsored entities. U.S. depository institutions and credit unions. U.S. public sector entities, such as states and municipalities (section 32).	Unchanged.
Credit exposures to: Foreign sovereigns Foreign banks Foreign public sector entities (section 32)	Introduces a more risk-sensitive treatment using the Country Risk Classification measure produced by the Organization for Economic Cooperation and Development.
Corporate exposures (section 32)	Assigns a 100 percent risk weight to corporate exposures, including exposures to securities firms.

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

TABLE 2—KEY PROVISIONS OF THE BASEL III AND STANDARDIZED APPROACH NPRS AS COMPARED WITH THE CURRENT RISK-BASED AND LEVERAGE CAPITAL RULES—Continued

Aspect of proposed requirements	Proposed treatment
Residential mortgage exposures (section 32)	Introduces a more risk-sensitive treatment based on several criteria, including certain loan characteristics and the loan-to-value-ratio of the exposure.
High volatility commercial real estate exposures (section 32)	Applies a 150 percent risk weight to certain credit facilities that finance the acquisition, development or construction of real property.
Past due exposures (section 32)	Applies a 150 percent risk weight to exposures that are not sovereign exposures or residential mortgage exposures and that are more than 90 days past due or on nonaccrual.
Securitization exposures (sections 41–45)	Maintains the gross-up approach for securitization exposures. Replaces the current ratings-based approach with a formula-based approach for determining a securitization exposure's risk weight based on the underlying assets and exposure's relative position in the securitization's structure.
Equity exposures (sections 51–53)	Introduces more risk-sensitive treatment for equity exposures.
Off-balance Sheet Items (sections 33)	Revises the measure of the counterparty credit risk of repo-style transactions. Raises the credit conversion factor for most short-term commitments from zero percent to 20 percent.
Derivative Contracts (section 34)	Removes the 50 percent risk weight cap for derivative contracts.
Cleared Transactions (section 35)	Provides preferential capital requirements for cleared derivative and repo-style transactions (as compared to requirements for non-cleared transactions) with central counterparties that meet specified standards. Also requires that a clearing member of a central counterparty calculate a capital requirement for its default fund contributions to that central counterparty.
Credit Risk Mitigation (section 36)	Provides a more comprehensive recognition of collateral and guarantees.
Disclosure Requirements (sections 61–63)	Introduces qualitative and quantitative disclosure requirements, including regarding regulatory capital instruments, for banking organizations with total consolidated assets of $50 billion or more that are not subject to the separate advanced approaches disclosure requirements.

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

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

B. Background

In 1989, the agencies established a risk-based capital framework for U.S. national banks, state member and nonmember banks, and bank holding companies with the general risk-based capital rules.[21] The agencies based the framework on the ''International Convergence of Capital Measurement and Capital Standards'' (Basel I), released by the BCBS in 1988.[22] The general risk-based capital rules instituted a uniform risk-based capital system that was more risk-sensitive than, and addressed several shortcomings in, the regulatory capital rules in effect prior to 1989. The agencies' capital rules also included a minimum leverage measure of capital to total assets, established in the early 1980s, to place a constraint on the maximum degree to which a banking organization can leverage its capital base.

In 2004, the BCBS introduced a new international capital adequacy framework (Basel II) that was intended

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

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

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

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

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

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

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

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

Quality and Quantity of Capital

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

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

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

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

Capital Conservation and Countercyclical Capital Buffer

As noted previously, some banking organizations continued to pay dividends and substantial discretionary bonuses even as their financial condition weakened as a result of the recent financial crisis and economic downturn. Such capital distributions had a significant negative impact on the overall strength of the banking sector. To encourage better capital conservation by banking organizations and to improve the resiliency of the banking system, Basel III and this proposal include limits on capital distributions and discretionary bonuses for banking organizations that do not hold a specified amount of common equity tier 1 capital in addition to the common equity necessary to meet the minimum risk-based capital requirements (capital conservation buffer).

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

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

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

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

Basel III Leverage Ratio

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

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

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

Additional Revisions to the Basel Capital Framework

To facilitate the implementation of Basel III, the BCBS issued a series of releases in 2011 in the form of frequently asked questions.[26] In addition, in 2011, the BCBS proposed to revise the treatment of counterparty credit risk and specific capital requirements for derivative and repo-style transaction exposures to central counterparties (CCP) to address concerns related to the interconnectedness and complexity of the derivatives markets.[27] The proposed revisions provide incentives for banking organizations to clear derivatives and repo-style transactions through qualifying central counterparties (QCCP) to help promote market transparency and improve the ability of market participants to unwind their positions quickly and efficiently. The agencies have incorporated these provisions in the Standardized Approach NPR and the Advanced Approaches and Market Risk NPR.

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

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

Consistent with Basel III, the agencies are proposing to require that banking organizations comply with the following minimum capital ratios: (1) A common equity tier 1 capital ratio of 4.5 percent; (2) a tier 1 capital ratio of 6 percent; (3) a total capital ratio of 8 percent; and (4) a tier 1 capital to average consolidated assets of 4 percent and, for advanced approaches banking organizations only, an additional requirement tier 1 capital to total leverage exposure ratio of 3 percent.[28] As noted above, the common equity tier 1 capital ratio would be a new minimum requirement. It is designed to ensure that banking organizations hold high-quality regulatory capital that is available to absorb losses. The proposed capital ratios would apply to a banking organization on a consolidated basis.

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

In addition, a banking organization would be subject to a capital conservation buffer in excess of the risk-based capital requirements that would impose limitations on its capital distributions and certain discretionary bonuses, as described in sections II.C and II.D of this preamble. Because the regulatory capital buffer would apply in addition to the regulatory minimum requirements, the restrictions on capital distributions and discretionary bonus payments associated with the regulatory capital buffer would not give rise to any applicable restrictions under section 38 of the Federal Deposit Insurance Act and the agencies' implementing PCA rules, which apply when an insured institution's capital levels drop below certain regulatory thresholds.[29]

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

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

B. Leverage Ratio

1. Minimum Tier 1 Leverage Ratio

Under the proposal, all banking organizations would remain subject to a 4 percent tier 1 leverage ratio, which would be calculated by dividing an organization's tier 1 capital by its average consolidated assets, minus amounts deducted from tier 1 capital. The numerator for this ratio would be a banking organization's tier 1 capital as defined in section 2 of the proposal. The denominator would be its average total on-balance sheet assets as reported on

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

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

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

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

the banking organization's regulatory report, net of amounts deducted from tier 1 capital.[30]

In this NPR, the agencies are proposing to remove the tier 1 leverage ratio exception for banking organizations with a supervisory composite rating of 1 that exists under the current leverage rules.[31] This exception provides for a 3 percent tier 1 leverage measure for such institutions.[32] The current exception would also be eliminated for bank holding companies with a supervisory composite rating of 1 and subject to the market risk rule. Accordingly, as proposed, all banking organizations would be subject to a 4 percent minimum tier 1 leverage ratio.

2. Supplementary Leverage Ratio for Advanced Approaches Banking Organizations

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

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

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

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

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

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

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

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

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

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

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

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

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

Question 5: The agencies solicit comments on the advantages and disadvantages of including off-balance sheet exposures in the supplementary leverage ratio. The agencies seek

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

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

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

detailed comments, with supporting data, on the proposed method of calculating exposures and estimates of burden, particularly for off-balance sheet exposures.

C. Capital Conservation Buffer

Consistent with Basel III, the proposal incorporates a capital conservation buffer that is designed to bolster the resilience of banking organizations throughout financial cycles. The buffer would provide incentives for banking organizations to hold sufficient capital to reduce the risk that their capital levels would fall below their minimum requirements during stressful conditions. The capital conservation buffer would be composed of common equity tier 1 capital and would be separate from the minimum risk-based capital requirements.

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

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

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

In a scenario where a banking organization's risk-based capital ratios fall below its minimum risk-based capital ratios plus 2.5 percent of total risk-weighted assets, the maximum payout ratio would also decline, in accordance with table 3. A banking organization that becomes subject to a maximum payout ratio would remain subject to restrictions on capital distributions and certain discretionary bonus payments until it is able to build up its capital conservation buffer through retained earnings, raising additional capital, or reducing its risk-weighted assets. In addition, as a general matter, a banking organization would not be able to make capital distributions or certain discretionary bonus payments during the current calendar quarter if the banking organization's eligible retained income is negative and its capital conservation buffer is less than 2.5 percent as of the end of the previous quarter.

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

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

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

An executive officer would be defined as a person who holds the title or, without regard to title, salary, or compensation, performs the function of one or more of the following positions: president, chief executive officer, executive chairman, chief operating officer, chief financial officer, chief investment officer, chief legal officer, chief lending officer, chief risk officer, or head of a major business line, and other staff that the board of directors of the banking organization deems to have

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

[34] *See* 12 CFR 225.8.

equivalent responsibility.[35] The purpose of limiting restrictions on discretionary bonus payments to executive officers is to focus these measures on the individuals within a banking organization who could expose the organization to the greatest risk. The agencies note that a banking organization may otherwise be subject to limitations on capital distributions under other laws or regulations.[36]

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

TABLE 3—CAPITAL CONSERVATION BUFFER AND MAXIMUM PAYOUT RATIO [37]

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

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

A banking organization with a capital conservation buffer of less than or equal to 0.625 percent (for example, a banking organization with a common equity tier 1 capital ratio of 5.0 percent, a tier 1 capital ratio of 6.5 percent, or a total capital ratio of 8.5 percent) as of the end of the previous calendar quarter would not be permitted to make any capital distributions or discretionary bonus payments during the current calendar quarter.

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

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

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

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

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

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

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

provide data and analysis to support your views.

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

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

D. Countercyclical Capital Buffer

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

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

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

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

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

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

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

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

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

The geographic location of a private sector credit exposure (that is not a securitization exposure) would be the national jurisdiction where the borrower is located (that is, where the borrower

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

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

is incorporated, chartered, or similarly established or, if it is an individual, where the borrower resides). If, however, the decision to issue the private sector credit exposure is based primarily on the creditworthiness of the protection provider, the location of the non-securitization exposure would be the location of the protection provider. The location of a securitization exposure would be the location of the borrowers of the underlying exposures. If the borrowers on the underlying exposures are located in multiple jurisdictions, the location of a securitization exposure would be the location of the borrowers of the underlying exposures in one jurisdiction with the largest proportion of the aggregate unpaid principal balance of the underlying exposures.

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

TABLE 4—EXAMPLE OF WEIGHTED AVERAGE COUNTERCYCLICAL CAPITAL BUFFER CALCULATION FOR ADVANCED APPROACHES BANKING ORGANIZATIONS

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

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

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

Question 11: The agencies recognize that a banking organization's risk-weighted assets for private sector credit exposures should include relevant covered positions under the market risk capital rule and solicit comment regarding appropriate methodologies for incorporating these positions; specifically, what position-specific or portfolio-specific methodologies should be used for covered positions with specific risk and particularly those for which a banking organization uses models to measure specific risk?

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

E. Prompt Corrective Action Requirements

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

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

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

FDIC, would better achieve the purpose of PCA.[42]

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

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

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

TABLE 5—CURRENT PCA LEVELS

Requirement	Total Risk-Based Capital (RBC) measure (total RBC ratio—percent)	Tier 1 RBC measure (tier 1 RBC ratio—percent)	Leverage measure (tier 1 (standard) leverage ratio—percent)	PCA requirements
Well Capitalized	≥10	≥6	≥5	None.
Adequately Capitalized	≥8	≥4	[44] ≥4 (or ≥3)	May limit nonbanking activities at DI's FHC and includes limits on brokered deposits.
Undercapitalized	<8	<4	<4 (or <3)	Includes adequately capitalized restrictions, and also includes restrictions on asset growth; dividends; requires a capital plan.
Significantly undercapitalized	<6	<3	<3	Includes undercapitalized restrictions, and also includes restrictions on sub-debt payments.
Critically undercapitalized	Tangible Equity to Total Assets ≤2			Generally receivership/conservatorship within 90 days.

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

TABLE 6—PROPOSED PCA LEVELS FOR INSURED DEPOSITORY INSTITUTIONS NOT SUBJECT TO THE ADVANCED APPROACHES RULE

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

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

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

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

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

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

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

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

TABLE 7—PROPOSED PCA LEVELS FOR INSURED DEPOSITORY INSTITUTIONS SUBJECT TO THE ADVANCED APPROACHES RULE

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

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

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

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

Question 13: The agencies seek comment regarding the proposed incorporation of the supplementary leverage ratio into the PCA framework, as well as the proposed ranges of PCA categories for the supplementary leverage ratio. Within the proposed ranges, what is the appropriate percentage for each PCA category? Please provide data to support your answer.

As discussed in section II of this preamble, the current PCA framework permits an insured depository institution that is rated composite 1 under the CAMELS rating system and not experiencing or anticipating significant growth to maintain a 3 percent ratio of tier 1 capital to average total consolidated assets (leverage ratio) rather than the 4.0 percent minimum

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

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

leverage ratio that is otherwise required for an institution to be adequately capitalized under PCA. The agencies believe that it would be appropriate for all insured depository institutions, regardless of their CAMELS rating, to meet the same minimum leverage ratio requirements. Accordingly, the agencies propose to eliminate the 3 percent leverage ratio requirement for insured depository institutions with composite 1 CAMELS ratings.

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

The determination of whether an insured depository institution is critically undercapitalized for PCA purposes is based on its ratio of tangible equity to total assets. This is a statutory requirement within the PCA framework, and the experience of the recent financial crisis has confirmed that tangible equity is of critical importance in assessing the viability of an insured depository institution. Tangible equity for PCA purposes is currently defined as including core capital elements, which consist of (1) Common stock holder's equity, (2) qualifying noncumulative perpetual preferred stock (including related surplus), and (3) minority interest in the equity accounts of consolidated subsidiaries; plus outstanding cumulative preferred perpetual stock; minus all intangible assets except mortgage servicing rights that are included in tier 1 capital. The current PCA definition of tangible equity does not address the treatment of DTAs in determining whether an insured depository institution is critically undercapitalized.

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

Question 14: The agencies solicit comment on the proposed regulatory capital requirements in the PCA framework, the introduction of a common equity tier 1 ratio as a new capital measure for purposes of PCA, and the proposed PCA thresholds for each PCA category.

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

F. Supervisory Assessment of Overall Capital Adequacy

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

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

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

Section 10(d) of the proposal would maintain and reinforce these supervisory expectations by requiring that a banking organization maintain capital commensurate with the level

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

and nature of all risks to which it is exposed and that a banking organization have a process for assessing its overall capital adequacy in relation to its risk profile, as well as a comprehensive strategy for maintaining an appropriate level of capital.

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

In addition, a banking organization should have an appropriately rigorous process for assessing its overall capital adequacy in relation to its risk profile and a comprehensive strategy for maintaining an appropriate level of capital, consistent with the longstanding approach employed by the agencies in their supervision of banking organizations. Supervisors also would evaluate the comprehensiveness and effectiveness of a banking organization's capital planning in light of its activities and capital levels. An effective capital planning process would require a banking organization to assess the risks to which it is exposed and its processes for managing and mitigating those risks, evaluate its capital adequacy relative to its risks, and consider potential impact on its earnings and capital base from current and prospective economic conditions.[48]

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

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

G. Tangible Capital Requirement for Federal Savings Associations

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

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

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

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

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

[51] ''Tangible capital'' is defined in section 5(t)(9)(B) to mean ''core capital minus any intangible assets (as intangible assets are defined by the Comptroller of the Currency for national banks.)'' Section 5(t)(9)(A) defines ''core capital'' to mean ''core capital as defined by the Comptroller of the Currency for national banks, less any unidentifiable intangible assets [goodwill]'' unless the OCC prescribes a more stringent definition.

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

[53] *See* 12 CFR 6.2.

III. Definition of Capital

A. Capital Components and Eligibility Criteria for Regulatory Capital Instruments

1. Common Equity Tier 1 Capital

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

a. Criteria

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

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

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

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

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

(5) Any cash dividend payments on the instrument are paid out of the banking organization's net income and retained earnings and are not subject to

a limit imposed by the contractual terms governing the instrument.

(6) The banking organization has full discretion at all times to refrain from paying any dividends and making any other capital distributions on the instrument without triggering an event of default, a requirement to make a payment-in-kind, or an imposition of any other restrictions on the banking organization.

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

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

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

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

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

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

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

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

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

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

Question 15: The agencies solicit comments on the eligibility criteria for common equity tier 1 capital instruments. Which, if any, criteria could be problematic given the main characteristics of outstanding common stock instruments and why? Please provide supporting data and analysis.

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

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

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

Accordingly, the agencies propose to require unrealized gains and losses on all AFS securities to flow through to common equity tier 1 capital. However, the agencies recognize that including unrealized gains and losses related to certain debt securities whose valuations primarily change as a result of fluctuations in a benchmark interest rate could introduce substantial volatility in a banking organization's regulatory capital ratios. The potential increased volatility could significantly change a banking organization's risk-based capital ratios, in some cases, due primarily to fluctuations in a benchmark interest rate and could result in a change in the banking organization's PCA category. Likewise, the agencies recognize that such volatility could discourage some banking organizations from holding highly liquid instruments with very low levels of credit risk even where prudent for liquidity risk management.

The agencies seek comment on alternatives to the proposed treatment of unrealized gains and losses on AFS securities, including an approach where the unrealized gains and losses related to debt securities whose valuations primarily change as a result of fluctuations in a benchmark interest rate would be excluded from a banking organization's regulatory capital. In particular, the agencies seek comment on an approach that would not include in regulatory capital unrealized gains and losses on U.S. government and agency debt obligations, U.S. GSE debt obligations and other sovereign debt obligations that would qualify for a zero

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

percent risk weight under the proposed standardized approach. The agencies also seek comment on whether unrealized gains and losses on general obligations issued by states or other political subdivisions of the United States should receive similar treatment, even though unrealized gains and losses on these obligations are more likely to result from changes in credit risk and not primarily from fluctuations in a benchmark interest rate.

Question 16: To what extent would a requirement to include unrealized gains and losses on all debt securities whose changes in fair value are recognized in AOCI (1) result in excessive volatility in regulatory capital; (2) impact the levels of liquid assets held by banking organizations; (3) affect the composition of the banking organization's securities portfolios; and (4) pose challenges for banking organizations' asset-liability management? Please provide supporting data and analysis.

Question 17: What are the pros and cons of an alternative treatment that would allow U.S. banking organizations to exclude from regulatory capital unrealized gains and losses on debt securities whose changes in fair value are predominantly attributable to fluctuations in a benchmark interest rate (for example, U.S. government and agency debt obligations and U.S. GSE debt obligations)? In the context of such an alternative treatment, what other categories of securities should be considered and why? Are there other alternatives that the agencies should consider (for example, retaining the current treatment for unrealized gains and losses on AFS debt and equity securities)?

2. Additional Tier 1 Capital

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

(1) The instrument is issued and paid in.

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

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

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

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

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

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

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

(A) Replace the instrument to be called with an equal amount of instruments that meet the criteria under section 20(b) or (c) of the proposal (replacement can be concurrent with redemption of existing additional tier 1 capital instruments); or

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

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

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

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

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

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

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

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

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

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

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

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

The agencies are also proposing to allow banking organizations to include in additional tier 1 capital instruments that were (1) issued under the Small Business Jobs Act of 2010 or, prior to October 4, 2010, under the Emergency Economic Stabilization Act of 2008, and (2) included in tier 1 capital under the agencies' current general risk-based capital rules.[56] These instruments would be included in tier 1 capital whether or not they meet the proposed qualifying criteria for common equity tier 1 or additional tier 1 capital instruments. The agencies believe that continued tier 1 capital treatment of these instruments is important to promote financial recovery and stability following the recent financial crisis.[57]

Question 18: The agencies solicit comments and views on the eligibility criteria for additional tier 1 capital instruments. Is there any specific criterion that could potentially be problematic given the main characteristics of outstanding non-cumulative perpetual preferred instruments? If so, please explain.

Additional Criterion Regarding Certain Institutional Investors' Minimum Dividend Payment Requirements

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

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

Question 19: What is the potential impact of such a requirement on the traditional hierarchy of capital instruments and on the market dynamics and cost of issuing additional tier 1 capital instruments?

Question 20: What mechanisms could be used to ensure, contractually, that such a requirement would not result in an additional tier 1 capital instrument being effectively more loss absorbent than common stock?

3. Tier 2 Capital

Under the proposal, tier 2 capital would be the sum of: Tier 2 capital instruments that satisfy certain criteria, related surplus, total capital minority interests not included in a banking organization's tier 1 capital (subject to the limitations and requirements on minority interests set forth in section 21 of the proposal), and limited amounts of the allowance for loan and lease losses (ALLL); less any applicable regulatory adjustments and deductions. Consistent with the general risk-based capital rules, when calculating its standardized total capital ratio, a banking organization would be able to include in tier 2 capital the amount of ALLL that does not exceed 1.25 percent of its total standardized risk-weighted assets not including any amount of the ALLL (a banking organization subject to the market risk capital rules would exclude its standardized market risk-weighted assets from the calculation).[58]

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

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

(1) The instrument is issued and paid in.

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

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

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

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

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

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

[56] Public Law 110–343, 122 Stat. 3765 (October 3, 2008).

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

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

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

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

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

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

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

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

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

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

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

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

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

As explained previously, under the proposed eligibility criteria for additional tier 1 capital instruments, trust preferred securities and cumulative perpetual preferred securities would not qualify for inclusion in additional tier 1 capital. However, many of these instruments could qualify for inclusion in tier 2 capital under the proposed eligibility criteria for tier 2 capital instruments.

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

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

Question 21: The agencies solicit comments on the eligibility criteria for tier 2 capital instruments. Is there any specific criterion that could potentially be problematic? If so, please explain.

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

4. Capital Instruments of Mutual Banking Organizations

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

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

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

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

Question 23: What impact, if any, would the exclusion of such instruments or accounts have on the regulatory capital ratios of mutual banking organizations? Please provide data supporting your answer.

Question 24: Would such instruments be unable to meet any of the proposed criteria? Could the terms of such instruments be modified to align with the proposed criteria for capital instruments? Please explain.

Question 25: Would the proposed criteria for capital instruments affect the ability of mutual banking organizations to increase regulatory capital levels going forward?

5. Grandfathering of Certain Capital Instruments

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

As discussed above, as proposed, capital investments by the U.S.

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

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

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

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

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

6. Agency Approval of Capital Elements

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

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

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

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

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

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

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

On January 13, 2011, the BCBS issued international standards for all additional tier 1 and tier 2 capital instruments issued by internationally active banking organizations, to ensure that such regulatory capital instruments fully absorb losses before taxpayers are exposed to such losses (Basel non-viability standard). Under the Basel non-viability standard, all non-common stock regulatory capital instruments issued by an internationally active banking organization must include terms that subject the instruments to write-off or conversion to common equity at the point that either (1) the write-off or conversion of those instruments occurs or (2) a government (or public sector) injection of capital would be necessary to keep the banking organization solvent. Alternatively, if the governing jurisdiction of the banking organization has established laws that require such tier 1 and tier 2 capital instruments to be written off or otherwise fully absorb losses before tax payers are exposed to loss, the standard is already met. If the governing jurisdiction has such laws in place, the Basel non-viability standard states that documentation for such instruments should disclose that information to investors and market participants, and should clarify that the holders of such instruments would fully absorb losses before taxpayers are exposed to loss.[66]

The agencies believe that U.S. law generally is consistent with the Basel non-viability standard. The resolution regime established in Title 2, section 210 of the Dodd-Frank Act provides the FDIC with the authority necessary to place failing financial companies that pose a significant risk to the financial stability of the United States into receivership.[67] The Dodd-Frank Act provides that this authority shall be exercised in the manner that minimizes systemic risk and moral hazard, so that (1) Creditors and shareholders will bear the losses of the financial company; (2) management responsible for the condition of the financial company will not be retained; and (3) the FDIC and other appropriate agencies will take steps necessary and appropriate to ensure that all parties, including holders of capital instruments, management, directors, and third parties having responsibility for the condition of the financial company, bear losses consistent with their respective ownership or responsibility.[68] Section 11 of the Federal Deposit Insurance Act has similar provisions for the resolution of depository institutions.[69] Additionally, under U.S. bankruptcy law, regulatory capital instruments issued by a company in bankruptcy would absorb losses before more senior unsecured creditors.

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

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

Investments by third parties in a consolidated subsidiary of a banking organization may significantly improve the overall capital adequacy of that subsidiary. However, as became apparent during the financial crisis, while capital issued by consolidated subsidiaries and not owned by the

[64] Public Law 111–240 (September 27, 2010).

[65] Public Law 110–343, 122 Stat. 3765 (October 3, 2008).

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

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

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

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

parent banking organization (minority interest) is available to absorb losses at the subsidiary level, that capital does not always absorb losses at the consolidated level. Therefore, inclusion of minority interests in the regulatory capital at the consolidated level should be limited to prevent highly capitalized subsidiaries from overstating the amount of capital available to absorb losses at the consolidated level.

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

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

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

The steps for determining the amount of minority interest includable in a banking organization's regulatory capital are described in this section below and are illustrated in a numerical example that follows. For example, the amount of common equity tier 1 minority interest includable in the common equity tier 1 capital of a banking organization under the proposal would be: the common equity tier 1 minority interest of the subsidiary minus the ratio of the subsidiary's common equity tier 1 capital owned by third parties to the total common equity tier 1 capital of the subsidiary, multiplied by the difference between the common equity tier 1 capital of the subsidiary and the lower of: (1) The amount of common equity tier 1 capital the subsidiary must hold to avoid restrictions on capital distributions and discretionary bonus payments, or (2) the total risk-weighted assets of the banking organization that relate to the subsidiary, multiplied by the common equity tier 1 capital ratio needed by the banking organization subsidiary to avoid restrictions on capital distributions and discretionary bonus payments. If the subsidiary were not subject to the same minimum regulatory capital requirements or capital conservation buffer framework of the banking organization, the banking organization would need to assume, for purposes of the calculation described above, that the subsidiary is subject to the minimum capital requirements and to the capital conservation buffer framework of the banking organization.

To determine the amount of tier 1 minority interest includable in the tier 1 capital of the banking organization and the total capital minority interest includable in the total capital of the banking organization, a banking organization would follow the same methodology as the one outlined previously for common equity tier 1 minority interest. Section 21 of the proposal sets forth the precise calculations. The amount of tier 1 minority interest that can be included in the additional tier 1 capital of the banking organization is equivalent to the banking organization's tier 1 minority interest, subject to the limitations outlined above, less any tier 1 minority interest that is included in the banking organization's common equity tier 1 capital. Likewise, the amount of total capital minority interest that can be included in the tier 2 capital of the banking organization is equivalent to its total capital minority interest, subject to the limitations outlined previously, less any tier 1 minority interest that is included in the banking organization's tier 1 capital.

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

TABLE 8— EXAMPLE OF THE CALCULATION OF THE PROPOSED LIMITS ON MINORITY INTEREST

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

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

In this example, the surplus common equity tier 1 capital of the subsidiary equals $10 ($80 − $70), the amount of the surplus common equity tier 1 minority interest is equal to $3 ($10*$24/$80), and therefore the amount of common equity tier 1 minority interest that may be included at the consolidated level is equal to $21 ($24 − $3).

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

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

Question 26: The agencies solicit comments on the proposed qualitative restrictions and quantitative limits for including minority interest in regulatory capital. What is the potential impact of these restrictions and limitations on the issuance of certain types of capital instruments (for example, subordinated debt) by depository institution subsidiaries of banking organizations? Please provide data to support your answer.

Real Estate Investment Trust Preferred Capital

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

Under the agencies' general risk-based capital rules, preferred shares issued by a REIT subsidiary generally may be included in a banking organization's tier 1 capital as minority interest if the preferred shares meet the eligibility requirements for tier 1 capital.[70] The agencies have interpreted this requirement to entail that the REIT preferred shares must be exchangeable automatically into noncumulative perpetual preferred stock of the banking organization under certain circumstances. Specifically the primary federal supervisor may direct the banking organization in writing to convert the REIT preferred shares into noncumulative perpetual preferred stock of the banking organization because the banking organization: (1) Became undercapitalized under the PCA regulations;[71] (2) was placed into conservatorship or receivership; or (3) was expected to become undercapitalized in the near term.[72]

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

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

Question 27: The agencies are seeking comment on the proposed treatment of REIT preferred capital. Specifically, how would the proposed minority interest limitations and interpretation of criterion (7) of the proposed eligibility criteria for additional tier 1 capital instruments affect the future issuance of REIT preferred capital instruments?

B. Regulatory Adjustments and Deductions

1. Regulatory Deductions From Common Equity Tier 1 Capital

The proposed rule would require a banking organization to make the deductions described in this section from the sum of its common equity tier 1 capital elements. Amounts deducted would be excluded from the banking organization's risk-weighted assets and leverage exposure.

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

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

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

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

Goodwill and Other Intangibles (Other Than MSAs)

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

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

DTAs

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

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

DTAs arising from temporary differences that the banking organization could realize through net operating loss carrybacks are not subject to deduction, and instead receive a 100 percent risk weight. For a banking organization that is a member of a consolidated group for tax purposes, the amount of DTAs that could be realized through net operating loss carrybacks may not exceed the amount that the banking organization could reasonably expect to have refunded by its parent holding company.

Gain-on-Sale Associated With a Securitization Exposure

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

Defined Benefit Pension Fund Assets

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

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

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

Activities by Savings Association Subsidiaries That Are Impermissible for National Banks

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

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

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

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

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

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

Question 28: The OCC and FDIC request comments on all aspects of this proposal to incorporate the current deduction requirement for federal and state, savings association subsidiaries that engage in activities impermissible for national banks. In particular, the OCC and FDIC are interested in whether this statutorily required deduction can be revised to reduce burden on federal and state savings associations.

2. Regulatory Adjustments to Common Equity Tier 1 Capital

Unrealized Gains and Losses on Certain Cash Flow Hedges

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

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

Question 29: How would a requirement to exclude unrealized net gains and losses on cash flow hedges related to the hedging of items that are not measured at fair value in the balance sheet (in the context of a framework where the unrealized gains and losses on AFS debt securities would flow through to regulatory capital) change the way banking organizations currently hedge against interest rate risk? Please explain and provide supporting data and analysis.

Question 30: Could this adjustment potentially introduce excessive volatility in regulatory capital predominantly as a result of fluctuations in a benchmark interest rate for institutions that are effectively hedged against interest rate risk? Please explain and provide supporting data and analysis.

Question 31: What are the pros and cons of an alternative treatment where floating rate liabilities are deemed to be fair valued for purposes of the proposed adjustment for unrealized gains and losses on cash flow hedges? Please explain and provide supporting data and analysis.

Changes in the Banking Organization's Creditworthiness

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

3. Regulatory Deductions Related to Investments in Capital Instruments

Deduction of Investments in own Regulatory Capital Instruments

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

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

Definition of Financial Institution

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

Under the proposal, ''financial institution'' would mean bank holding companies, savings and loan holding companies, non-bank financial institutions supervised by the Board under Title I of the Dodd-Frank Act, depository institutions, foreign banks, credit unions, insurance companies, securities firms, commodity pools (as defined in the Commodity Exchange Act), covered funds under section 619 of the Dodd-Frank Act (and regulations issued thereunder), benefit plans, and other companies predominantly engaged in certain financial activities, as set forth in the proposal. See the definition of ''financial institution'' in section 2 of the proposed rules.

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

Question 32: The agencies seek comment on the proposed definition of financial institution. The agencies have sought to achieve consistency in the definition of financial institution with similar definitions proposed in other proposed regulations. The agencies seek comment on the appropriateness of this standard for purposes of the proposal and whether a different threshold, such as greater than 50 percent, would be more appropriate. The agencies ask that commenters provide detailed explanations in their responses.

The Corresponding Deduction Approach

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

If the banking organization invests in an instrument issued by a non-regulated financial institution, the banking organization would treat the instrument as common equity tier 1 capital if the instrument is common stock (or if it is otherwise the most subordinated form of capital of the financial institution) and as additional tier 1 capital if the instrument is subordinated to all creditors of the financial institution except common shareholders. If the investment is in the form of an instrument issued by a regulated financial institution and the instrument does not meet the criteria for any of the regulatory capital components for banking organizations, the banking organization would treat the instrument as (1) Common equity tier 1 capital if the instrument is common stock included in GAAP equity or represents the most subordinated claim in liquidation of the financial institution; (2) additional tier 1 capital if the instrument is GAAP equity and is subordinated to all creditors of the financial institution and is only senior in liquidation to common shareholders; and (3) tier 2 capital if the instrument is not GAAP equity but it is considered regulatory capital by the primary regulator of the financial institution.

Deduction of Reciprocal Cross Holdings in the Capital Instruments of Financial Institutions

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

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

Determining the Exposure Amount for Investments in the Capital of Unconsolidated Financial Institutions

Under the proposal, the exposure amount of an investment in the capital of an unconsolidated financial institution would refer to a net long position in an instrument that is recognized as capital for regulatory purposes by the primary supervisor of an unconsolidated regulated financial institution or in an instrument that is part of the GAAP equity of an unconsolidated unregulated financial

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

institution. It would include direct, indirect, and synthetic exposures to capital instruments, and exclude underwriting positions held by the banking organization for five business days or less. It would be equivalent to the banking organization's potential loss on such exposure should the underlying capital instrument have a value of zero.

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

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

An indirect exposure would result from the banking organization's investment in an unconsolidated entity that has an exposure to a capital instrument of a financial institution. A synthetic exposure results from the banking organization's investment in an instrument where the value of such instrument is linked to the value of a capital instrument of a financial institution. Examples of indirect and synthetic exposures would include: (1) An investment in the capital of an unconsolidated entity that has an investment in the capital of an unconsolidated financial institution; (2) a total return swap on a capital instrument of another financial institution; (3) a guarantee or credit protection, provided to a third party, related to the third party's investment in the capital of another financial institution; (4) a purchased call option or a written put option on the capital instrument of another financial institution; and (5) a forward purchase agreement on the capital of another financial institution.

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

Question 33: The agencies solicit comments on the scope of indirect exposures for purposes of determining the exposure amount for investments in the capital of unconsolidated financial institutions. Specifically, what parameters (for example, a specific percentage of the issued and outstanding common shares of the unconsolidated financial institution) would be appropriate for purposes of limiting the scope of indirect exposures in this context and why?

Question 34: What are the pros and cons of the proposed exclusion from the exposure amount of an investment in the capital of an unconsolidated financial institution for underwriting positions held by the banking organization for 5 business days or fewer? Would limiting the exemption to 5 days affect banking organizations' willingness to underwrite stock offerings by smaller banking organizations? Please provide data to support your answer.

Deduction of Non-Significant Investments in the Capital of Unconsolidated Financial Institutions

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

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

The amount to be deducted from a specific capital component would be equal to the amount of a banking organization's non-significant investments in the capital of unconsolidated financial institutions exceeding the 10 percent threshold for non-significant investments multiplied by the ratio of (1) the amount of non-significant investments in the capital of

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

unconsolidated financial institutions in the form of such capital component to (2) the amount of the banking organization's total non-significant investments in the capital of unconsolidated financial institutions. The amount of a banking organization's non-significant investments in the capital of unconsolidated financial institutions that does not exceed the 10 percent threshold for non-significant investments would generally be assigned the applicable risk weight under sections 32 (in the case of non-common stock instruments), 52 (in the case of common stock instruments), or 53 (in the case of indirect investments via a mutual fund) of the proposal, as appropriate.

For example, if a banking organization has a total of $200 in non-significant investments in the capital of unconsolidated financial institutions (of which 50 percent is in the form of common stock, 30 percent is in the form of an additional tier 1 capital instrument, and 20 percent is in the form of tier 2 capital subordinated debt) and $100 of these investments exceed the 10 percent threshold for non-significant investments, the banking organization would need to deduct $50 from its common equity tier 1 capital elements, $30 from its additional tier 1 capital elements and $20 from its tier 2 capital elements.

Deduction of Significant Investments in the Capital of Unconsolidated Financial Institutions That Are Not in the Form of Common Stock

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

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

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

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

Under the proposal, a banking organization would deduct from the sum of its common equity tier 1 capital elements the amount of each of the following items that individually exceeds the 10 percent common equity tier 1 capital deduction threshold described below: (1) DTAs arising from temporary differences that could not be realized through net operating loss carrybacks (net of any related valuation allowances and net of DTLs, as described in section 22(e) of the proposal); (2) MSAs net of associated DTLs; and (3) significant investments in the capital of financial institutions in the form of common stock (referred to herein as items subject to the threshold deductions).

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

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

In addition, the aggregate amount of the items subject to the threshold deductions that are not deducted as a result of the 10 percent common equity tier 1 capital deduction threshold described above would not be permitted to exceed 15 percent of a banking organization's common equity tier 1 capital, as calculated after applying all regulatory adjustments and deductions required under the proposal (the 15 percent common equity tier 1 capital deduction threshold). That is, a banking organization would be required to deduct the amounts of the items subject to the threshold deductions that exceed 17.65 percent (the proportion of 15 percent to 85 percent) of common equity tier 1 capital elements, less all regulatory adjustments and deductions required for the calculation of the 10 percent common equity tier 1 capital deduction threshold mentioned above, and less the items subject to the 10 and 15 percent common equity tier 1 capital

[80] Public Law 106–102, 113 Stat. 1338, 1373 (Nov. 12, 1999).

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

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

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

deduction thresholds in full. As described below, banking organization would be required to include the amounts of these three items that are not deducted from common equity tier 1 capital in its risk-weighted assets and assign a 250 percent risk weight to them.

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

Question 35: The agencies solicit comments and supporting data on the additional regulatory capital deductions outlined in this section above.

5. Netting of DTLs Against DTAs and Other Deductible Assets

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

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

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

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

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

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

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

Under the Volcker Rule proposal, a banking organization subject to the Volcker Rule [88] would be required to deduct from tier 1 capital the aggregate value of its investments in hedge funds and private equity funds that the banking organization organizes and offers pursuant to section 13(d)(1)(G) of the Bank Holding Company Act. As proposed, the Volcker Rule deduction would not apply to an ownership interest in a hedge fund or private

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

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

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

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

[88] The Volcker rule regulations apply to ''banking entities,'' as defined in section 13(h)(1) of the Bank Holding Company Act (BHC Act), as amended by section 619 of the Dodd-Frank Act. This term generally includes all banking organizations subject to the Federal banking agencies' capital regulations with the exception of limited purpose trust institutions that are not affiliated with a depository institution or bank holding company.

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

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

IV. Denominator Changes Related to the Proposed Regulatory Changes

Consistent with Basel III, for purposes of calculating total risk-weighted assets, the proposal would require a banking organization to assign a 250 percent risk weight to (1) MSAs, (2) DTAs arising from temporary differences that a banking organization could not realize through net operating loss carrybacks (net of any related valuation allowances and net of DTLs, as described in section 22(e) of the proposal), and (3) significant investments in the capital of unconsolidated financial institutions in the form of common stock that are not deducted from tier 1 capital pursuant to section 22 of the proposal.

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

V. Transitions Provisions

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

The transition provisions would apply to the following areas: (1) The minimum regulatory capital ratios; (2) the capital conservation and countercyclical capital buffers; (3) the regulatory capital adjustments and deductions; and (4) non-qualifying capital instruments. In the Standardized Approach NPR, the agencies are proposing changes to the calculation of risk-weighted assets that would be effective January 1, 2015, with an option to early adopt.

A. Minimum Regulatory Capital Ratios

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

TABLE 9—TRANSITION FOR MINIMUM CAPITAL RATIOS

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

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

B. Capital Conservation and Countercyclical Capital Buffer

As explained in more detail in section 11 of the proposed rule, a banking organization's applicable capital conservation buffer would be the lowest of the following three ratios: the banking organization's common equity tier 1, tier 1 and total capital ratio less its minimum common equity tier 1, tier 1 and total capital ratio requirement, respectively. Table 10 shows the regulatory capital levels banking organizations would generally need to meet during the transition period to avoid becoming subject to limitations on capital distributions and discretionary bonus payments from January 1, 2016 until January 1, 2019.

TABLE 10—PROPOSED REGULATORY CAPITAL LEVELS

	Jan. 1, 2013 (percent)	Jan. 1, 2014 (percent)	Jan. 1, 2015 (percent)	Jan. 1, 2016 (percent)	Jan. 1, 2017 (percent)	Jan. 1, 2018 (percent)	Jan. 1, 2019 (percent)
Capital conservation buffer				0.625	1.25	1.875	2.5
Minimum common equity tier 1 capital ratio + capital conservation buffer	3.5	4.0	4.5	5.125	5.75	6.375	7.0
Minimum tier 1 capital ratio + capital conservation buffer	4.5	5.5	6.0	6.625	7.25	7.875	8.5
Minimum total capital ratio + capital conservation buffer	8.0	8.0	8.0	8.625	9.25	9.875	10.5
Maximum potential countercyclical capital buffer				0.625	1.25	1.875	2.5

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

TABLE 11—TRANSITION PROVISION FOR THE CAPITAL CONSERVATION AND COUNTERCYCLICAL CAPITAL BUFFER

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

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

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

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

percentage points, to reach its fully phased-in maximum of 2.5 percent on January 1, 2019.

C. Regulatory Capital Adjustments and Deductions

Banking organizations are currently subject to a series of deductions from and adjustments to regulatory capital, most of which apply at the tier 1 capital level, including deductions for goodwill, MSAs, certain DTAs, and adjustments for net unrealized gains and losses on AFS securities and for accumulated net gains and losses on cash flow hedges and defined benefit pension obligations. Under section 22 of the proposed rule, banking organizations would become subject to a series of deductions and adjustments, the bulk of which will be applied at the common equity tier 1 capital level. In order to give sufficient time to banking organizations to adapt to the new regulatory capital adjustments and deductions, the proposed rule incorporates transition provisions for such adjustments and deductions. From January 1, 2013 through December 31, 2017, a banking organization would be required to make the regulatory capital adjustments to and deductions from regulatory capital in section 22 of the proposed rule in accordance with the proposed transition provisions for such adjustments and deductions outlined below. Starting on January 1, 2018, banking organizations would apply all regulatory capital adjustments and deductions as outlined in section 22 of the proposed rule.

Deductions for Certain Items in Section 22(a) of the Proposed Rule

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

TABLE 12—PROPOSED TRANSITION DEDUCTIONS UNDER SECTION 22(a)(1) AND SECTIONS 22(a)(3)–(a)(6) OF THE PROPOSAL

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

In accordance with table 12, starting in 2013, banking organizations would be required to deduct the full amount of goodwill (net of any associated DTLs), including any goodwill embedded in the valuation of significant investments in the capital of unconsolidated financial institutions, from common equity tier 1 capital elements. This approach is stricter than that under Basel III, which transitions the goodwill deduction from common equity tier 1 capital in line with the rest of the deductible items. Under U.S. law, goodwill cannot be included in a banking organization's regulatory capital. Additionally, the agencies believe that fully deducting goodwill from common equity tier 1 capital elements starting on January 1, 2013 would result in a more meaningful common equity tier 1 capital ratio from a supervisory and market perspective.

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

Deductions for Intangibles Other Than Goodwill and MSAs

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

TABLE 13—PROPOSED TRANSITION DEDUCTIONS UNDER SECTION 22(a)(2) OF THE PROPOSAL

Transition period	Transition deductions under section 22(a)(2)—Percentage of the deductions from common equity tier 1 capital
Calendar year 2013	0
Calendar year 2014	20

TABLE 13—PROPOSED TRANSITION DEDUCTIONS UNDER SECTION 22(a)(2) OF THE PROPOSAL—Continued

Transition period	Transition deductions under section 22(a)(2)—Percentage of the deductions from common equity tier 1 capital
Calendar year 2015	40
Calendar year 2016	60
Calendar year 2017	80
Calendar year 2018 and thereafter	100

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

Regulatory Adjustments Under Section 22(b)(2) of the Proposed Rule

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

TABLE 14—PROPOSED TRANSITION ADJUSTMENTS UNDER SECTION 22(b)(2)

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

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

Phase Out of Current AOCI Regulatory Capital Adjustments

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

TABLE 15—PROPOSED PERCENTAGE OF THE TRANSITION AOCI ADJUSTMENT AMOUNT

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

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

Phase Out of Unrealized Gains on AFS Equity Securities in Tier 2 Capital

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

TABLE 16—PROPOSED PERCENTAGE OF UNREALIZED GAINS ON AFS EQUITY SECURITIES THAT MAY BE INCLUDED IN TIER 2 CAPITAL

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

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

Deductions Under Sections 22(c) and 22(d) of the Proposed Rule

From January 1, 2013 through December 31, 2017, a banking organization would calculate the appropriate deductions under sections 22(c) and 22(d) of the proposed rule related to investments in capital instruments and to the items subject to the 10 and 15 percent common equity tier 1 capital deduction thresholds (that is, MSAs, DTAs arising from temporary differences that the banking organization could not realize through net operating loss carrybacks, and significant investments in the capital of unconsolidated financial institutions in the form of common stock) as set forth in table 17. Specifically, during such transition period, the banking organization would make the percentage of the aggregate common equity tier 1 capital deductions related to these items in accordance with the percentages outlined in table 17 and would apply a 100 percent risk-weight to the aggregate amount of such items that are not deducted under this section. Beginning on January 1, 2018, a banking organization would be required to apply a 250 percent risk-weight to the aggregate amount of the items subject to the 10 and 15 percent common equity tier 1 capital deduction thresholds that are not deducted from common equity tier 1 capital.

TABLE 17—PROPOSED TRANSITION DEDUCTIONS UNDER SECTIONS 22(c) AND 22(d) OF THE PROPOSAL

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

However, banking organizations would not be subject to the methodology to calculate the 15 percent common equity deduction threshold for DTAs arising from temporary differences that the banking organization could not realize through net operating loss carrybacks, MSAs, and significant investments in the capital of unconsolidated financial institutions in the form of common stock described in section 22(d) of the proposed rule from January 1, 2013 through December 31, 2017. During this transition period, a banking organization would be required to deduct from its common equity tier 1 capital elements a specified percentage of the amount by which the aggregate sum of the items subject to the 10 and 15 percent common equity tier 1 capital deduction thresholds exceeds 15 percent of the sum of the banking organization's common equity tier 1 capital elements after making the deductions required under sections 22(a) through (c) of the proposed rule. These deductions include goodwill, intangibles other than goodwill and MSAs, DTAs that arise from operating loss and tax credit carryforwards cash flow hedges associated with items that are not fair valued, excess ECLs (for advanced approaches banking organizations), gains-on-sale on certain securitization exposures, defined benefit pension fund net assets for banks that are not insured by the FDIC, and reciprocal cross holdings, gains (or adding back losses) due to changes in own credit risk on fair valued financial liabilities, and after applying the appropriate common equity tier 1 capital deductions related to non-significant investments in the capital of unconsolidated financial institutions (the 15 percent common equity deduction threshold for transition purposes).

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

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

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

Numerical Example for the Transition Provisions

The following example illustrates the potential impact from regulatory capital adjustments and deductions on the common equity tier 1 capital ratios of a banking organization. As outlined in table 18, the banking organization in this example has common equity tier 1 capital elements (before any deductions) and total risk weighted assets of $200 and $1000 respectively, and also has goodwill, DTAs that arise from operating loss and tax credit carryforwards, non-significant investments in the capital of unconsolidated financial institutions, DTAs arising from temporary differences that could not be realized through net operating loss carrybacks, MSAs, and significant investments in the capital of unconsolidated financial institutions in the form of common stock of $40, $30, $10, $30, $20, and $10, respectively. For simplicity, this example only focuses on common equity tier 1 capital and assumes that the risk weight applied to all assets is 100 percent (the only exception being the 250 percent risk weight applied in 2018 to the ''items subject to an aggregate 15% threshold'').

TABLE 18—EXAMPLE—IMPACT OF REGULATORY DEDUCTIONS DURING TRANSITION PERIOD

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

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

TABLE 19—EXAMPLE—IMPACT OF REGULATORY DEDUCTIONS DURING TRANSITION PERIOD

Transition calendar years	*Base case*	2013	2014	2015	2016	2017	2018
Percentage of deduction	....	....	20%	40%	60%	80%	100%
CET1 before deductions	200	200	200	200	200	200	200
Deduction of goodwill	40	40	40	40	40	40	40
Deduction of DTAs from operating loss carryforwards	30	0	6	12	18	24	30
CET1 after non-threshold deductions	130	160	154	148	142	136	130
10% limit for non-significant investments	*13.0*	*16.0*	*15.4*	*14.8*	*14.2*	*13.6*	*13.0*
Deduction of non-significant investments	0	0	0	0	0	0	0
CET1 after non-threshold deductions and deduction of non-significant investments	130	160	154	148	142	136	130
10% CET1 limit for items subject to 15% threshold	*13.0*	*16.0*	*15.4*	*14.8*	*14.2*	*13.6*	*13.0*
Deduction of significant investments due to 10% limit	0	0	0	0	0	0	0
Deduction of temporary differences DTAs due to 10% limit	17.0	0	3.4	6.8	10.2	13.6	17.0
Deduction of MSAs due to 10% limit	7.0	0	1.4	2.8	4.2	5.6	7.0
CET1 after deductions related to 10% limit	106	160	149.2	138.4	127.6	116.8	106.0
Outstanding significant investments	10	10	10	10	10	10	10

TABLE 19—EXAMPLE—IMPACT OF REGULATORY DEDUCTIONS DURING TRANSITION PERIOD—Continued

Transition calendar years	*Base case*	2013	2014	2015	2016	2017	2018
Outstanding temporary differences DTAs	13	30	27	23	20	16	13
Outstanding MSAs	13	20	19	17	16	14	13
Sum of outstanding items subject to 15% threshold	36	60	55	50	46	41	36
15% CET1 limit (for items subject to 15% threshold) (pre-2018)	19.5	24.0	23.1	22.2	21.3	20.4	19.5
Deduction of outstanding items subject to 15% threshold due to 15% limit (pre-2018)	16.5	0.0	3.3	6.6	9.9	13.2	
Additional MSA deduction as of the statutory limit (*i.e.,* 10% of FV of MSAs)	*0*	*2*	*0*	*0*	*0*	*0*	*0*
CET1 after all deductions (pre-2018)	89.5	158.0	145.9	131.8	117.7	103.6	
Total New RWAs (pre-2018)	889.5	928.0	921.9	913.8	905.7	897.6	
15% CET1 limit (for items subject to 15% threshold) (2018)							*12*
Deduction of outstanding items subject to 15% threshold due to 15% limit (2018)							*24*
CET1 after all deductions—starting 2018							*82.4*
2018 RWAs							*901*
CET1 ratio		17.0%	15.8%	14.4%	13.0%	11.5%	9.1%

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

After applying the required deduction as a result of the 10 and 15 percent common equity tier 1 deduction thresholds outlined in table 17 of this section and after making the additional $2 deduction of MSAs during 2013 as a result of the MSA minimum statutory deduction (that is, 10 percent of the fair value of the MSAs), the common equity tier 1 capital elements would be $158, $146, $132, $118, $104, and $82 as of January 1, 2013, January 1, 2014, January 1, 2015, January 1, 2016, January 1, 2017, and January 1, 2018, respectively. After adjusting the total risk weighted assets measure as a result of the numerator deductions, the common equity tier 1 capital ratios would be 17.0 percent, 15.8 percent, 14.4 percent, 13.0 percent, 11.5 percent and 9.1 percent as of January 1, 2013, January 1, 2014, January 1, 2015, January 1, 2016, January 1, 2017, and January 1, 2018, respectively. Any DTAs arising from temporary differences that could not be realized through net operating loss carrybacks, MSAs, or significant investments in the capital of unconsolidated financial institutions in the form of common stock that are not deducted from common equity tier 1 capital elements as a result of the transitional arrangements would be risk weighted at 100 percent during the transition period and would be risk weighted at 250 percent starting on 2018.

D. Non-Qualifying Capital Instruments

Under the NPR, non-qualifying capital instruments, including instruments that are part of minority interest, would be phased out from regulatory capital depending on the size of the issuing banking organization and the type of capital instrument involved. Under the proposed rule, and in line with the requirements under the Dodd-Frank Act, instruments like cumulative perpetual preferred stock and trust preferred securities, which bank holding companies have historically included (subject to limits) in tier 1 capital under the ''restricted core capital elements'' bucket generally would not comply with either the eligibility criteria for additional tier 1 capital instruments outlined in section 20 of the proposed rule or the general risk-based capital rules for depository institutions and therefore would be phased out from tier 1 capital as outlined in more detail below. However, these instruments would generally be included without limits in tier 2 capital if they meet the eligibility criteria for tier 2 capital instruments outlined in section 20 of the proposed rule.

Phase-Out Schedule for Non-Qualifying Capital Instruments of Depository Institution Holding Companies of $15 Billion or More in Total Consolidated Assets

Under section 171 of the Dodd-Frank Act, depository institution holding companies with total consolidated assets greater than or equal to $15 billion as of December 31, 2009 (depository institution holding companies of $15 billion or more) would be required to phase out their non-qualifying capital instruments as set forth in table 20 below. In the case of depository institution holding companies of $15 billion or more, non-qualifying capital instruments are debt or equity instruments issued before May 19, 2010, that do not meet the criteria in section 20 of the proposed rule and were included in tier 1 or tier 2 capital as of May 19, 2010. Table 20 would apply separately to additional tier 1 and tier 2 non-qualifying capital instruments but the amount of non-qualifying capital instruments that would be excluded from additional tier 1 capital under this section would be included in tier 2

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

capital without limitation if they meet the eligibility criteria for tier 2 capital instruments under section 20 of the proposed rule. If a depository institution holding company of $15 billion or more acquires a depository institution holding company with total consolidated assets of less than $15 billion as of December 31, 2009 (depository institution holding company under $15 billion) or a depository institution holding company that was a mutual holding company as of May 19, 2010 (2010 MHC), the non-qualifying capital instruments of the resulting organization would be subject to the phase-out schedule outlined in table 20. Likewise, if a depository institution holding company under $15 billion makes an acquisition and the resulting organization has total consolidated assets of $15 billion or more, its non-qualifying capital instruments would also be subject to the phase-out schedule outlined in table 20.

TABLE 20—PROPOSED PERCENTAGE OF NON-QUALIFYING CAPITAL INSTRUMENTS INCLUDED IN ADDITIONAL TIER 1 OR TIER 2 CAPITAL

Transition period (calendar year)	Percentage of non-qualifying capital instruments included in additional tier 1 or tier 2 capital for depository institution holding companies of $15 billion or more
Calendar year 2013	75
Calendar year 2014	50
Calendar year 2015	25
Calendar year 2016 and thereafter	0

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

Phase-Out Schedule for Non-Qualifying Capital Instruments of Depository Institution Holding Companies Under $15 Billion, 2010 MHCs, and Depository Institutions

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

TABLE 21—PROPOSED PERCENTAGE OF NON-QUALIFYING CAPITAL INSTRUMENTS INCLUDED IN ADDITIONAL TIER 1 OR TIER 2 CAPITAL

Transition period (calendar year)	Percentage of non-qualifying capital instruments included in additional tier 1 or tier 2 capital for depository institution holding companies under $15 billion, depository institutions, and 2010 MHCs
Calendar year 2013	90
Calendar year 2014	80
Calendar year 2015	70
Calendar year 2016	60
Calendar year 2017	50
Calendar year 2018	40
Calendar year 2019	30
Calendar year 2020	20
Calendar year 2021	10
Calendar year 2022 and thereafter	0

For example, a banking organization that issued a tier 1 non-qualifying capital instrument in August 2010 would be able to count 90 percent of the notional outstanding amount of the instrument as of January 1, 2013 during calendar year 2013 and 80 percent during calendar year 2014. As of January 1, 2022, no tier 1 non-qualifying capital instruments would be recognized in tier 1 capital.

Phase-Out Schedule for Surplus and Non-Qualifying Minority Interest

From January 1, 2013 through December 31, 2018, a banking organization would be allowed to include in regulatory capital a portion of the common equity tier 1, tier 1, or total capital minority interest that would be disqualified from regulatory capital as a result of the requirements and limitations outlined in section 21 (surplus minority interest). If a banking organization has surplus minority interest outstanding as of January 1, 2013, such surplus minority interest would be subject to the phase-out schedule outlined in table 22. For example, if a banking organization has $10 of surplus common equity tier 1 minority interest as of January 1, 2013, it would be allowed to include all such surplus in its common equity tier 1 capital during calendar year 2013, $8 during calendar year 2014, $6 during calendar year 2015, $4 during calendar year 2016, $2 during calendar year 2017 and $0 starting in January 1, 2018. Likewise, from January 1, 2013 through December 31, 2018, a banking organization would be able to include in tier 1 or total capital a portion of the instruments issued by a consolidated subsidiary that qualified as tier 1 or total capital of the banking organization as of December 31, 2012 but that would not qualify as tier 1 or total minority interest as of January 1, 2013 (non-qualifying minority interest) in accordance with Table 22. For example, if a banking organization has $10 of non-qualifying minority interest that previously qualified as tier 1 capital, it would be allowed to include $10 in its tier 1 capital during calendar year 2013, $8 during calendar year 2014, $6 during calendar year 2015, $4 during calendar year 2016, $2 during calendar year 2017 and $0 starting in January 1, 2018.

TABLE 22—PERCENTAGE OF THE AMOUNT OF SURPLUS OR NON-QUALIFYING MINORITY INTEREST INCLUDABLE IN REGULATORY CAPITAL DURING TRANSITION PERIOD

Transition period	Percentage of the amount of surplus or non-qualifying minority interest that can be included in regulatory capital during the transition period
Calendar year 2013	100
Calendar year 2014	80
Calendar year 2015	60
Calendar year 2015	60
Calendar year 2016	40
Calendar year 2017	20
Calendar year 2018 and thereafter	0

Transition Provisions for Standardized Approach NPR

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

Question 36: The agencies solicit comments on the transition arrangements outlined previously. In particular, what specific regulatory reporting burden or complexities would result from the application of the transition arrangements described in this section of the preamble, and what specific alternatives exist to deal with such burden or complexity while still adhering to the general transitional provisions required under the Dodd-Frank Act?

Question 37: What are the pros and cons of a potentially stricter (but less complex) alternative transitions approach for the regulatory adjustments and deductions outlined in this section C under which banking organizations would be required to (1) apply all the regulatory adjustments and deductions currently applicable to tier 1 capital under the general risk-based capital rules to common equity tier 1 capital from January 1, 2013 through December 31, 2015; and (2) fully apply all the regulatory adjustments and deductions proposed in section 22 of the proposed rule starting on January 1, 2016? Please provide data to support your views.

E. Leverage Ratio

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

Question 38: The agencies solicit comment on the proposed transition arrangements for the supplementary leverage ratio. In particular, what specific challenges do banking organizations anticipate with regard to the proposed arrangements and what specific alternative arrangements would address these challenges?

VI. Additional OCC Technical Amendments

In addition to the changes described above, the OCC is proposing to redesignate subpart C, Establishment of Minimum Capital Ratios for an Individual Bank, subpart D, Enforcement, and subpart E, Issuance of a Directive, as subparts H, I, and J, respectively. The OCC is also proposing to redesignate section 3.100, Capital and Surplus, as subpart K, Capital and Surplus. The OCC is carrying over redesignated subpart K, which includes definitions of the terms ''capital'' and ''surplus'' and related definitions that are used for determining statutory limits applicable to national banks that are based on capital and surplus. The agencies have systematically adopted a definition of capital and surplus that is based on tier 1 and tier 2 capital. The OCC believes that the definitions in redesignated subpart K may no longer be necessary and is considering whether to delete these definitions in the final rule. Finally, as part of the integration of the rules governing national banks and federal savings associations, the OCC proposes to make part 3 applicable to federal savings associations, make other non-substantive, technical amendments, and rescind part 167, Capital.

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

Question 39: The OCC requests comment on all aspects of these proposed changes, but is specifically interested in whether it is necessary to retain the definitions of capital and surplus and related terms in redesignated subpart K.

VII. Abbreviations

ABCP Asset-Backed Commercial Paper
ABS Asset Backed Security
AD.C. Acquisition, Development, or Construction
AFS Available For Sale

AOCI Accumulated Other Comprehensive Income
BCBS Basel Committee on Banking Supervision
BHC Bank Holding Company
BIS Bank for International Settlements
CAMELS Capital Adequacy, Asset Quality, Management, Earnings, Liquidity, and Sensitivity to Market Risk
CCF Credit Conversion Factor
CCP Central Counterparty
CD.C. Community Development Corporation
CDFI Community Development Financial Institution
CDO Collateralized Debt Obligation
CDS Credit Default Swap
CDSind Index Credit Default Swap
CEIO Credit-Enhancing Interest-Only Strip
CF Conversion Factor
CFR Code of Federal Regulations
CFTC Commodity Futures Trading Commission
CMBS Commercial Mortgage Backed Security
CPSS Committee on Payment and Settlement Systems
CRC Country Risk Classifications
CRAM Country Risk Assessment Model
CRM Credit Risk Mitigation
CUSIP Committee on Uniform Securities Identification Procedures
D.C.O Derivatives Clearing Organizations
DFA Dodd-Frank Act
DI Depository Institution
DPC Debts Previously Contracted
DTA Deferred Tax Asset
DTL Deferred Tax Liability
DVA Debit Valuation Adjustment
DvP Delivery-versus-Payment
E Measure of Effectiveness
EAD Exposure at Default
ECL Expected Credit Loss
EE Expected Exposure
E.O. Executive Order
EPE Expected Positive Exposure
FASB Financial Accounting Standards Board
FDIC Federal Deposit Insurance Corporation
FFIEC Federal Financial Institutions Examination Council
FHLMC Federal Home Loan Mortgage Corporation
FMU Financial Market Utility
FNMA Federal National Mortgage Association
FR **Federal Register**
GAAP Generally Accepted Accounting Principles
GDP Gross Domestic Product
GLBA Gramm-Leach-Bliley Act
GSE Government-Sponsored Entity
HAMP Home Affordable Mortgage Program
HELOC Home Equity Line of Credit
HOLA Home Owners' Loan Act
HVCRE High-Volatility Commercial Real Estate
IFRS International Reporting Standards
IMM Internal Models Methodology
I/O Interest-Only
IOSCO International Organization of Securities Commissions
LTV Loan-to-Value Ratio
M Effective Maturity
MDB Multilateral Development Banks
MSA Mortgage Servicing Assets
NGR Net-to-Gross Ratio
NPR Notice of Proposed Rulemaking
NRSRO Nationally Recognized Statistical Rating Organization
OCC Office of the Comptroller of the Currency
OECD Organization for Economic Co-operation and Development
OIRA Office of Information and Regulatory Affairs
OMB Office of Management and Budget
OTC Over-the-Counter
PCA Prompt Corrective Action
PCCR Purchased Credit Card Receivables
PFE Potential Future Exposure
PMI Private Mortgage Insurance
PSE Public Sector Entities
PvP Payment-versus-Payment
QCCP Qualifying Central Counterparty
RBA Ratings-Based Approach
REIT Real Estate Investment Trust
RFA Regulatory Flexibility Act
RMBS Residential Mortgage Backed Security
RTCRRI Act Resolution Trust Corporation Refinancing, Restructuring, and Improvement Act of 1991
RVC Ratio of Value Change
RWA Risk-Weighted Asset
SEC Securities and Exchange Commission
SFA Supervisory Formula Approach
SFT Securities Financing Transactions
SBLF Small Business Lending Facility
SLHC Savings and Loan Holding Company
SPE Special Purpose Entity
SPV Special Purpose Vehicle
SR Supervision and Regulation Letter
SRWA Simple Risk-Weight Approach
SSFA Simplified Supervisory Formula Approach
UMRA Unfunded Mandates Reform Act of 1995
U.S. United States
U.S.C. United States Code
VaR Value-at-Risk

VIII. Regulatory Flexibility Act

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

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

Board

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

As discussed previously in the Supplementary Information, the Board is proposing in this NPR to revise its capital requirements to promote safe and sound banking practices, implement Basel III, and codify its capital requirements. The proposals also satisfy certain requirements under the Dodd-Frank Act by imposing new or revised minimum capital requirements on certain depository institution holding companies.[90] Under section 38(c)(1) of the Federal Deposit Insurance Act, the agencies may prescribe capital standards for depository institutions that they regulate.[91] In addition, among other authorities, the Board may establish capital requirements for state member banks under the Federal Reserve Act,[92] for state member banks and bank holding companies under the International Lending Supervision Act and Bank Holding Company Act,[93] and for savings and loan holding companies under the Home Owners Loan Act.[94]

B. Small Entities Potentially Affected by the Proposal

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

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

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

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

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

[92] *See* 12 CFR 208.43.

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

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

[95] *See* 13 CFR 121.201.

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

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

C. Impact on Covered Small Banking Organizations

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

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

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

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

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

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

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

D. Transitional Arrangements To Ease Compliance Burden

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

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

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

F. Discussion of Significant Alternatives

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

- Covered small banking organizations would not be subject to the proposed enhanced disclosure requirements.
- Covered small banking organizations would not be subject to possible increases in the capital conservation buffer through the countercyclical buffer.
- Covered small banking organizations would not be subject to the new supplementary leverage ratio.
- Covered small institutions that have issued capital instruments to the U.S. Treasury through the Small Business Lending Fund (a program for banking organizations with less than $10 billion in consolidated assets) or under the Emergency Economic Stabilization Act of 2008 prior to October 4, 2010, would be able to continue to include those

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

instruments in tier 1 or tier 2 capital (as applicable) even if not all criteria for inclusion under the proposed requirements are met.

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

The Board welcomes comment on any significant alternatives to the proposed requirements applicable to covered small banking organizations that would minimize their impact on those entities, as well as on all other aspects of its analysis. A final regulatory flexibility analysis will be conducted after consideration of comments received during the public comment period.

OCC

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

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

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

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

B. Small Entities Affected by the Proposal

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

C. Projected Reporting, Recordkeeping, and Other Compliance Requirements

This NPR includes changes to the general risk-based capital requirements that affect small banking organizations. Under this NPR, the changes to minimum capital requirements that would impact small national banks and federal savings associations include a more conservative definition of regulatory capital, a new common equity tier 1 capital ratio, a higher minimum tier 1 capital ratio, new thresholds for prompt corrective action purposes, and a new capital conservation buffer. To estimate the impact of this NPR on national banks' and federal savings associations' capital needs, the OCC estimated the amount of capital the banks will need to raise to meet the new minimum standards relative to the amount of capital they currently hold. To estimate new capital ratios and requirements, the OCC used currently available data from banks' quarterly Consolidated Report of Condition and Income (Call Reports) to approximate capital under the proposed rule, which shows that most banks have raised their capital levels well above the existing minimum requirements. After comparing existing levels with the proposed new requirements, the OCC has determined that 28 small institutions that it regulates would fall short of the proposed increased capital requirements. Together, those institutions would need to raise approximately $82 million in regulatory capital to meet the proposed minimum requirements. The OCC estimates that the cost of lost tax benefits associated with increasing total capital by $82 million will be approximately $0.5 million per year. Averaged across the 28 affected institutions, the cost is approximately $18,000 per institution per year.

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

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

1. Changing the denominator of the risk-based capital ratios by revising the asset risk weights;
2. Revising the treatment of counterparty credit risk;
3. Replacing references to credit ratings with alternative measures of creditworthiness;
4. Providing more comprehensive recognition of collateral and guarantees; and
5. Providing a more favorable capital treatment for transactions cleared through qualifying central counterparties.

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

The Basel Committee on Banking Supervision has been conducting periodic reviews of the potential quantitative impact of the Basel III framework.[103] Although these reviews monitor the impact of implementing the Basel III framework rather than the proposed rule, the OCC is using estimates consistent with the Basel Committee's analysis, including a conservative estimate of a 20 percent increase in risk-weighted assets, to gauge the impact of the Standardized Approach NPR on risk-weighted assets. Using this assumption, the OCC estimates that a total of 56 small national banks and federally chartered savings associations will need to raise additional capital to meet their regulatory minimums. The OCC

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

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

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

[102] *See* 13 CFR 121.201.

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

estimates that this total projected shortfall will be $143 million and that the cost of lost tax benefits associated with increasing total capital by $143 million will be approximately $0.8 million per year. Averaged across the 56 affected institutions, the cost is approximately $14,000 per institution per year.

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

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

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

Some covered small banking organizations may hold significant residential mortgage exposures. However, if the small banking organization originated the exposure, it should have sufficient information to determine the applicable risk weight under the proposed rule. If the small banking organization acquired the exposure from another institution, the information it would need to determine the applicable risk weight is consistent with information that it should normally collect for portfolio monitoring purposes and internal risk management.

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

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

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

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

E. Discussion of Significant Alternatives to the Proposed Rule

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

- Covered small banking organizations are not subject to the enhanced disclosure requirements of the proposed rules.
- Covered small banking organizations would continue to apply a 100 percent risk weight to corporate exposures (as described in section __.32 of the Standardized Approach NPR).
- Covered small banking organizations may choose to apply the simpler gross-up method for securitization exposures rather than the Simplified Supervisory Formula Approach (SSFA) (as described in section __.43 of the Standardized Approach NPR).
- The proposed rule offers covered small banking organizations a choice between a simpler and more complex methods of risk weighting equity exposures to investment funds (as described in section __.53 of the Standardized Approach NPR).

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

FDIC

Regulatory Flexibility Act

Summary of the FDIC's Initial Regulatory Flexibility Analysis (IRFA)

In accordance with section 3(a) of the Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*) (RFA), the FDIC is publishing this summary of the IRFA for this NPR. The RFA requires an agency to publish in the **Federal Register** an IRFA or a summary of its IRFA at the time of the publication of its general notice of proposed rulemaking [104] or to certify that the proposed rule will not have a significant economic impact on a substantial number of small entities.[105] For purposes of this IRFA, the FDIC analyzed the potential economic impact of this NPR on the small entities that it regulates.

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

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

As discussed in the Supplementary Information section above, the agencies are proposing to revise their capital requirements to promote safe and sound banking practices, implement Basel III and certain aspects of the Dodd-Frank Act, and harmonize capital requirements across charter type. Federal law authorizes each of the agencies to prescribe capital standards for the banking organizations that it regulates.[106]

B. Small Entities Affected by the Proposal

Under regulations issued by the Small Business Administration,[107] a small entity includes a depository institution or bank holding company with total assets of $175 million or less (a small banking organization). As of March 31, 2012, there were approximately 2,433 small state nonmember banks, 115 small state savings banks, and 45 small state savings associations (collectively, small banks and savings associations).

C. Projected Reporting, Recordkeeping, and Other Compliance Requirements

This NPR includes changes to the general risk-based capital requirements that affect small banking organizations. Under this NPR, the changes to minimum capital requirements that would impact small banks and savings associations include a more conservative definition of regulatory capital, a new common equity tier 1 capital ratio, a higher minimum tier 1 capital ratio, new thresholds for prompt corrective action purposes, and a new capital conservation buffer. To estimate the impact of this NPR on the capital needs of small banks and savings associations, the FDIC estimated the amount of capital such institutions will need to raise to meet the new minimum standards relative to the amount of capital they currently hold. To estimate new capital ratios and requirements, the FDIC used currently available data from the quarterly Consolidated Report of Condition and Income (Call Reports) filed by small banks and savings associations to approximate capital under the proposed rule. The Call Reports show that most small banks and savings associations have raised their capital to levels well above the existing minimum requirements. After comparing existing levels with the proposed new requirements, the FDIC has determined that 62 small banks and savings associations that it regulates would fall short of the proposed increased capital requirements. Together, those institutions would need to raise approximately $164 million in regulatory capital to meet the proposed minimum requirements. The FDIC estimates that the cost of lost tax benefits associated with increasing total capital by $164 million will be approximately $0.9 million per year. Averaged across the 62 affected institutions, the cost is approximately $15,000 per institution per year.

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

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

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

2. Revising the treatment of counterparty credit risk;

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

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

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

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

In order to estimate the impact of the Standardized Approach NPR on small banks and savings associations, the FDIC used currently available data from the quarterly Consolidated Report of Condition and Income (Call Reports) filed by small banks and savings associations to approximate the change in capital under the proposed rule. After comparing the existing risk-based capital rules with the proposed rule, the FDIC estimates that risk-weighted assets may increase by 10 percent under the proposed rule. Using this assumption, the FDIC estimates that a total of 76 small national banks and federally chartered savings associations will need to raise additional capital to meet their regulatory minimums. The FDIC estimates that this total projected shortfall will be $34 million and that the cost of lost tax benefits associated with increasing total capital by $34 million will be approximately $0.2 million per year. Averaged across the 76 affected institutions, the cost is approximately $2,500 per institution per year.

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

Additionally, small banks and savings associations that hold certain exposures would be required to obtain additional information under the proposed rules in order to determine the applicable risk weights. For example, small banks and savings associations that hold exposures to sovereign entities other than the United States, foreign depository institutions, or foreign public sector entities would have to acquire Country Risk Classification ratings produced by the OECD to determine the applicable risk weights. Small banks and savings

[104] 5 U.S.C. 603(a).

[105] 5 U.S.C. 605(b).

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

[107] *See* 13 CFR 121.201.

associations that hold residential mortgage exposures would need to have and maintain information about certain underwriting features of the mortgage as well as the LTV ratio to determine the applicable risk weight. Generally, small banks and savings associations that hold securitization exposures would need to obtain sufficient information about the underlying exposures to satisfy due diligence requirements and apply either the simplified supervisory formula or the gross-up approach described in section __.43 of the Standardized Approach NPR to calculate the appropriate risk weight, or be required to assign a 1,250 percent risk weight to the exposure.

Small banks and savings associations typically do not hold significant exposures to foreign entities or securitization exposures, and the agencies expect any additional burden related to calculating risk weights for these exposures, or holding capital against these exposures, would be relatively modest. The FDIC estimates that, for small banks and savings associations, the cost of implementing the alternative measures of creditworthiness will be approximately $39,000 per institution.

Small banks and savings associations may hold significant residential mortgage exposures. If the institution originated the exposure, it should have sufficient information to determine the applicable risk weight under the proposed rule. However, if the exposure is acquired from another institution, the information that would be needed to determine the applicable risk weight is consistent with information that should normally be collected for portfolio monitoring purposes and internal risk management.

Small banks and savings associations would not be subject to the disclosure requirements in subpart D of the proposed rule. However, the agencies expect to modify regulatory reporting requirements that apply to such institutions to reflect the changes made to the agencies' capital requirements in the proposed rules. The agencies expect to propose these changes to the relevant reporting forms in a separate notice.

To determine if a proposed rule has a significant economic impact on small entities the FDIC compared the estimated annual cost with annual noninterest expense and annual salaries and employee benefits for each small bank and savings association. If the estimated annual cost was greater than or equal to 2.5 percent of total noninterest expense or 5 percent of annual salaries and employee benefits the FDIC classified the impact as significant. As noted above, the FDIC has concluded for purposes of this IRFA that the proposed rules in this NPR, when considered without regard to changes in the Standardized NPR, would not exceed these thresholds and therefore would not result in a significant economic impact on a substantial number of small banks and savings associations. However, the FDIC has concluded that the proposed rules in the Standardized Approach NPR would have a significant impact on a substantial number of small banks and savings associations. The FDIC estimates that together, the changes proposed in this NPR and the Standardized Approach NPR will exceed these thresholds for 2,413 small state nonmember banks, 114 small savings banks, and 45 small savings associations. Accordingly, when considered together, this NPR and the Standardized Approach NPR appear to have a significant economic impact on a substantial number of small entities.

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

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

E. Discussion of Significant Alternatives to the Proposed Rule

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

- Small banks and savings associations are not subject to the enhanced disclosure requirements of the proposed rules.
- Small banks and savings associations would continue to apply a 100 percent risk weight to corporate exposures (as described in section __.32 of the Standardized Approach NPR).
- Small banks and savings associations may choose to apply the simpler gross-up method for securitization exposures rather than the SSFA (as described in section __.43 of the Standardized Approach NPR).
- The proposed rule offers small banks and savings associations a choice between a simpler and more complex methods of risk weighting equity exposures to investment funds (as described in section __.53 of the Standardized Approach NPR).

The agencies welcome comment on any significant alternatives to the proposed rules applicable to small banks and savings associations that would minimize their impact on those entities.

IX. Paperwork Reduction Act

Paperwork Reduction Act

A. Request for Comment on Proposed Information Collection

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

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

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

Comments are invited on:

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

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

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

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

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

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

OCC: Communications Division, Office of the Comptroller of the Currency, Public Information Room, Mail Stop 1–5, Attention: 1557–0234, 250 E Street SW., Washington, DC 20219. In addition, comments may be sent by fax to (202) 874–4448, or by electronic mail to *regs.comments@occ.treas.gov*. You can inspect and photocopy the comments at the OCC's Public Information Room, 250 E Street, SW., Washington, DC 20219. You can make an appointment to inspect the comments by calling (202) 874–5043.

Board: You may submit comments, identified by R–1442, by any of the following methods:

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

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

• *Email: regs.comments@federalreserve.gov*. Include docket number in the subject line of the message.

• *Fax:* 202–452–3819 or 202–452–3102.

• *Mail:* Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue NW., Washington, DC 20551. All public comments are available from the Board's Web site at *http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm* as submitted, unless modified for technical reasons. Accordingly, your comments will not be edited to remove any identifying or contact information. Public comments may also be viewed electronically or in paper in Room MP–500 of the Board's Martin Building (20th and C Streets NW.) between 9 a.m. and 5 p.m. on weekdays.

FDIC: You may submit written comments, which should refer to RIN 3064–AD95 Implementation of Basel III 0153, by any of the following methods:

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

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

• *Email: Comments@FDIC.gov*.

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

• *Hand Delivery/Courier:* Guard station at the rear of the 550 17th Street Building (located on F Street) on business days between 7 a.m. and 5 p.m.

Public Inspection: All comments received will be posted without change to *http://www.fdic.gov/regulations/laws/federal/propose/html* including any personal information provided. Comments may be inspected at the FDIC Public Information Center, Room 100, 801 17th Street NW., Washington, DC, between 9 a.m. and 4:30 p.m. on business days.

B. Proposed Information Collection

Title of Information Collection: Basel III.

Frequency of Response: On occasion.

Affected Public:

OCC: National banks and federally chartered savings associations.

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

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

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

Estimated Burden: The burden estimates below exclude any regulatory reporting burden associated with changes to the Consolidated Reports of Income and Condition for banks (FFIEC 031 and FFIEC 041; OMB Nos. 7100–0036, 3064–0052, 1557–0081), the Financial Statements for Bank Holding Companies (FR Y–9; OMB No. 7100–0128), and the Capital Assessments and Stress Testing information collection (FR Y–14A/Q/M; OMB No. 7100–0341). The agencies are still considering whether to revise these information collections or to implement a new information collection for the regulatory reporting requirements. In either case, a separate notice would be published for comment on the regulatory reporting requirements.

OCC

Estimated Number of Respondents: Independent national banks, 172; federally chartered savings banks, 603.

Estimated Burden per Respondent: 16 hours.

Total Estimated Annual Burden: 12,400 hours.

Board

Estimated Number of Respondents: SMBs, 831; BHCs, 933; SLHCs, 438.

Estimated Burden per Respondent: 16 hours.

Total Estimated Annual Burden: 35,232 hours.

FDIC

Estimated Number of Respondents: 4,571.

Estimated Burden per Respondent: 16 hours.

Total Estimated Annual Burden: 73,136 hours.

X. Plain Language

Section 722 of the Gramm-Leach-Bliley Act requires the Federal banking agencies to use plain language in all proposed and final rules published after January 1, 2000. The agencies have sought to present the proposed rule in a simple and straightforward manner, and invite comment on the use of plain language.

XI. OCC Unfunded Mandates Reform Act of 1995 Determinations

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

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

Addendum 1: Summary of This NPR for Community Banking Organizations

Overview

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

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

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

1. Revisions to the Minimum Capital Requirements

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

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

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

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

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

(4) A ratio of tier 1 capital to adjusted average total assets of 4 percent.[108]

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

2. Capital Conservation Buffer

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

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

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

TABLE 1—CAPITAL CONSERVATION BUFFER

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

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

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

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

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

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

3. Adjustments to Prompt Corrective Action (PCA) Thresholds

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

TABLE 2—PROPOSED PCA THRESHOLD REQUIREMENTS *

PCA capital category	Threshold ratios			
	Total risk-based capital ratio	Tier 1 risk-based capital ratio	Common equity tier 1 risk-based capital ratio	Tier 1 leverage ratio
Well capitalized	10%	8%	6.5%	5%
Adequately capitalized	8%	6%	4.5%	4%
Undercapitalized	<8%	<6%	<4.5%	<4%
Significantly undercapitalized	<6%	<4%	<3%	<3%
Critically undercapitalized	Tangible Equity/Total Assets </=2%			

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

4. Definition of Capital

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

a. Common Equity Tier 1 Capital

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

1. Common stock instruments (that satisfy specified criteria in the proposed rule) and related surplus (net of any treasury stock);
2. Retained earnings;
3. Accumulated other comprehensive income (AOCI); and
4. Common equity minority interest (as defined in the proposed rule) subject to the limitations outlined in section 21 of the proposed rule.

b. Additional Tier 1 Capital

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

1. Noncumulative perpetual preferred stock (that satisfy specified criteria in the proposed rule) and related surplus;
2. Tier 1 minority interest (as defined in the proposed rule), subject to limitations described in section 21 of the proposed rule, not included in the banking organization's common equity tier 1 capital; and
3. Instruments that currently qualify as tier 1 capital under the agencies' general risk-based capital rules and that were issued under the Small Business Job's Act of 2010, or, prior to October 4, 2010, under the Emergency Economic Stabilization Act of 2008.

c. Tier 2 Capital

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

1. Subordinated debt and preferred stock (that satisfy specified criteria in the proposed rule). This will include most of the subordinated debt currently included in tier 2 capital according to the agencies' existing risk-based capital rules;
2. Total capital minority interest (as defined in the proposed rule), subject to the limitations described in section 21 of the proposed rule, and not included in the banking organization's tier 1 capital;
3. Allowance for loan and lease losses (ALLL) not exceeding 1.25 percent of the banking organization's total risk-weighted assets; and
4. Instruments that currently qualify as tier 2 capital under the agencies' general risk-based capital rules and that were issued under the Small Business Job's Act of 2010, or, prior to October 4, 2010, under the Emergency Economic Stabilization Act of 2008.

d. Minority Interest

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

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

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

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

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

The common equity tier 1 minority interest of the subsidiary minus

(*The percentage of the subsidiary's common equity tier 1 capital that is not owned by the banking organization*)

multiplied by the difference between

(*common equity tier 1 capital of the subsidiary*

and the lower of:

- *7% of the risk weighted assets of the banking organization that relate to the subsidiary*, or

7% of the risk weighted assets of the subsidiary)

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

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

e. Regulatory Capital Adjustments and Deductions

A. Regulatory Deductions From Common Equity Tier 1 Capital

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

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

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

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

○ Any defined benefit pension fund net asset[109], net of any associated deferred tax liability.[110] (The pension deduction does *not* apply to insured depository institutions that have their own defined benefit pension plan.)

B. Regulatory Adjustments to Common Equity Tier 1 Capital

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

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

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

C. Additional Deductions From Regulatory Capital

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

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

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

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

D. Corresponding Deduction Approach

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

○ Reciprocal cross-holdings;

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

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

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

Reciprocal crossholdings in the capital of financial institutions: The NPR would require a banking organization to deduct investments in the capital of other financial institutions it holds reciprocally.[111]

Non-significant investments in the capital of unconsolidated financial institutions[112]: The proposed rule would require a banking organization to deduct any non-significant investments in the capital of unconsolidated financial institutions that, in the aggregate, exceed 10 percent of the sum of the banking organization's common equity tier 1 capital elements less all deductions and other regulatory adjustments required under sections 22(a) through 22(c)(3) of the proposed rule (the 10 percent threshold for non-significant investments in unconsolidated financial institutions).

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

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

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

E. Threshold Deductions

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

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

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

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

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

percent common equity deduction threshold):

○ DTAs arising from temporary differences that the banking organization could not realize through net operating loss carrybacks, net of any associated valuation allowance, and DTLs, subject to the following limitations:

▪ Only the DTAs and DTLs that relate to taxes levied by the same taxation authority and that are eligible for offsetting by that authority may be offset for purposes of this deduction.

▪ The DTLs offset against DTAs must exclude amounts that have already been netted against other items that are either fully deducted (such as goodwill) or subject to deduction (such as MSA).

○ MSAs, net of associated DTLs.

○ Significant investments in the capital of unconsolidated financial institutions in the form of common stock.

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

5. Changes in Risk-weighted Assets

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

6. Timeline and Transition Period

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

TABLE 3—PHASE-IN SCHEDULE

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

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

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

Components and tiers	Explanation
(1) COMMON EQUITY TIER 1 CAPITAL:	
(a) + Qualifying common stock instruments	Instruments must meet all of the common equity tier 1 criteria (Note 1)
(b) + Retained earnings.	
(c) + AOCI	With the exception in Note 2 below, AOCI flows through to common equity tier 1 capital.
(d) + Qualifying common equity tier 1 minority interest	Subject to specific calculation method and limitation.
(e) − Regulatory deductions from common equity tier 1 capital	Deduct: Goodwill and intangible assets (other than MSAs); DTAs that arise from operating loss and tax credit carryforwards; any gain on sale from a securitization; investments in the banking organization's own common stock instruments.
(f) +/− Regulatory adjustments to common equity tier 1 capital	See explanation below (Note 2).
(g) − common equity tier 1 capital deductions per the corresponding deduction approach.	See section 4.e.D above.
(h) − Threshold deductions	Deduct amount of threshold items that are above the 10 and 15 percent common equity tier 1 thresholds. (See section 4.e. above).
= common equity tier 1 capital.	
(2) ADDITIONAL TIER 1 CAPITAL:	
(a) + additional tier 1 capital instruments	Instruments must meet all of the additional tier 1 criteria (Note 1).
(b) + Tier 1 minority interest that is not included in common equity tier 1 capital.	Subject to specific calculation and limitation.
(c) + Non-qualifying tier 1 capital instruments subject to transition phase-out and SBLF related instruments.	(Note 3)
(d) − Investments in a banking organization's own additional tier 1 capital instruments.	
(e) − Additional tier 1 capital deductions per the corresponding deduction approach.	See section 4.e.D above.
= Additional tier 1 capital.	
(3) TIER 2 CAPITAL:	
(a) + Tier 2 capital instruments	Instruments must meet all of the tier 2 criteria (Note 1).

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

Notes to Table:

Note 1: Includes surplus related to the instruments.

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

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

Attachment 2: Comparison of Current Rules vs. Proposal

Minimum regulatory capital requirements

	Current minimum ratios	Proposed minimum ratios	Comments
Common equity tier 1 capital/ risk weighted assets.	N/A	4.5%	
Tier 1 capital/risk weighted assets.	4%	6%	
Total capital/risk weighted assets.	8%	8%	
Leverage ratio	≥4% (or ≥3%)	≥4%	Minimum required level will not vary depending on the supervisory rating.

Capital buffers

	Current treatment	Proposed treatment	Comment
Capital conservation buffer	N/A	Capital conservation buffer equivalent to 2.5% of risk-weighted assets; composed of common equity tier 1 capital.	Not holding the capital conservation buffer may result in restrictions on capital distributions and certain discretionary bonus payments.

Prompt corrective action

	Current PCA levels	Proposed PCA levels	Comment
Common equity tier 1 capital	N/A	Well capitalized: ≥6.5%; Adequately capitalized: ≥4.5%; Undercapitalized: <4.5%; Significantly undercapitalized: <3%.	Proposed adequately capitalized PCA level aligned to new minimum ratio.
Tier 1 capital	Well capitalized: ≥6%; Adequately capitalized: ≥4%; Undercapitalized <4%; Significantly undercapitalized: <3%.	Well capitalized: ≥8%; Adequately capitalized: ≥6%; Undercapitalized <6%; Significantly undercapitalized: <4%.	Proposed adequately capitalized PCA level aligned to new minimum ratio.
Total capital	Well capitalized: ≥10%; Adequately capitalized: ≥8%; Undercapitalized <8%; Significantly undercapitalized: <6%.	Well capitalized: ≥10%; Adequately capitalized: ≥8%; Undercapitalized <8%; Significantly undercapitalized: <6%.	
Leverage ratio	Well capitalized: ≥5%; Adequately capitalized: ≥4% (or ≥3%); Undercapitalized <4% (or <3%); Significantly undercapitalized: <3%.	Well capitalized: ≥5%; Adequately capitalized: ≥4%; Undercapitalized <4%; Significantly undercapitalized: <3%.	PCA adequately capitalized level will not vary depending on the supervisory rating.
Critically undercapitalized category.	*Tangible equity to total assets ratio ≤2.*	*Tangible equity to total assets ≤2.*	*Tangible equity under the proposal would be defined as tier 1 capital plus non-tier 1 perpetual preferred stock.*

ATTACHMENT 2: COMPARISON OF CURRENT RULES VS. PROPOSAL—CONTINUED

Regulatory capital components

	Current definition/instruments	Proposed definition/ instruments	Comments
Common equity tier 1 capital	No specific definition	Mostly retained earnings and common stock that meet specified eligibility criteria (plus limited amounts of minority interest in the form of common stock) less the majority of the regulatory deductions.	Common stock instruments traditionally issued by U.S. banking organizations expected generally to qualify as common equity tier 1 capital.
Additional tier 1 capital	No specific definition	Equity capital instruments that meet specified eligibility criteria (plus limited amounts of minority interest in the form of tier 1 capital instruments).	Non-cumulative perpetual preferred stock traditionally issued by U.S. banking organizations expected to generally qualify; trust preferred instruments traditionally issued by certain bank holding companies would not qualify.
Tier 2 capital	Certain capital instruments (*e.g.,* subordinated debt) and limited amounts of ALLL.	Capital instruments that meet specified eligibility criteria (*e.g.,* subordinated debt) and limited amounts of ALLL.	Traditional subordinated debt instruments are expected to remain tier 2 eligible; there is no specific limitation on the amount of tier 2 capital that can be included in total capital under the proposal.

Regulatory deductions and adjustments

	Current treatment	Proposed treatment	Comment
Regulatory deductions	Current deductions from regulatory capital include goodwill and other intangibles, DTAs (above certain levels), and MSAs (above certain levels).	Proposed deductions from common equity tier 1 capital include goodwill and other intangibles, DTAs (above certain levels), MSAs (above certain levels) and investments in unconsolidated financial institutions (above certain levels).	Vast majority of regulatory deductions are made at the common equity tier 1 capital level (as opposed to the tier 1 level); the proposed deductions for MSAs and DTAs in the proposed rule are significantly more stringent than the current deductions.
Regulatory adjustments	Current adjustments include the neutralization of unrealized gains and losses on available for sale debt securities for regulatory capital purposes.	Under the proposal, AOCI would generally flow through to regulatory capital.	Under the proposed treatment unrealized gains and losses on available for sale debt securities would not be neutralized for regulatory capital purposes.
MSAs, certain DTAs arising from temporary differences, and certain significant investments in the common stock of unconsolidated financial institutions.	MSAs and DTAs that are not deducted are subject to a 100 percent risk weight.	Items that are not deducted are subject to a 250 percent risk weight.	Under the proposal, these items are subject to deduction if they exceed certain specified common equity deduction thresholds.
The portion of a CEIO that does not constitute an after-tax-gain-on-sale.	Dollar-for-dollar capital requirement for amounts not deducted based on a concentration limit.	Subject to a 1250 percent risk weight.	

Text of Common Rule

PART [__] CAPITAL ADEQUACY OF [BANK]s

Sec.

Subpart A—General

§ __.1 Purpose, applicability, and reservations of authority.
§ __.2 Definitions.

Subpart B—Minimum Capital Requirements and Buffers

§ __.10 Minimum capital requirements.
§ __.11 Capital conservation buffer and countercyclical capital buffer amount.

Subpart C—Definition of Capital

§ __.20 Capital components and eligibility criteria for regulatory capital instruments. § __.21 Minority interest.
§ __.22 Regulatory capital adjustments and deductions.

Subpart G—Transition Provisions

§ __.300 Transitions.

Subpart A—General Provisions

§ __.1 Purpose, applicability, and reservations of authority

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

§ __.2 Definitions.

Additional tier 1 capital is defined in § __.20 of subpart C of this part.

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

Advanced approaches total risk-weighted assets means:

(1) The sum of:

(i) Credit-risk-weighted assets;

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

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

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

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

Advanced market risk-weighted assets means the advanced measure for market risk calculated under § __.204 of subpart F of this part multiplied by 12.5.

Affiliate with respect to a company means any company that controls, is controlled by, or is under common control with, the company.

Allocated transfer risk reserves means reserves that have been established in accordance with section 905(a) of the International Lending Supervision Act, against certain assets whose value U.S. supervisory authorities have found to be significantly impaired by protracted transfer risk problems.

Allowances for loan and lease losses (ALLL) means reserves that have been established through a charge against earnings to absorb future losses on loans, lease financing receivables or other extensions of credit. ALLL excludes ''allocated transfer risk reserves.'' For purposes of this [PART], ALLL includes reserves that have been established through a charge against earnings to absorb future credit losses associated with off-balance sheet exposures.

Asset-backed commercial paper (ABCP) program means a program established primarily for the purpose of issuing commercial paper that is investment grade and backed by underlying exposures held in a bankruptcy-remote special purpose entity (SPE).

Asset-backed commercial paper (ABCP) program sponsor means a [BANK] that:

(1) Establishes an ABCP program;

(2) Approves the sellers permitted to participate in an ABCP program;

(3) Approves the exposures to be purchased by an ABCP program; or

(4) Administers the ABCP program by monitoring the underlying exposures, underwriting or otherwise arranging for the placement of debt or other obligations issued by the program, compiling monthly reports, or ensuring compliance with the program documents and with the program's credit and investment policy.

Bank holding company means a bank holding company as defined in section 2 of the Bank Holding Company Act.

Bank Holding Company Act means the Bank Holding Company Act of 1956, as amended (12 U.S.C. 1841).

Bankruptcy remote means, with respect to an entity or asset, that the entity or asset would be excluded from an insolvent entity's estate in receivership, insolvency, liquidation, or similar proceeding.

Capital distribution means:

(1) A reduction of tier 1 capital through the repurchase of a tier 1 capital instrument or by other means;

(2) A reduction of tier 2 capital through the repurchase, or redemption prior to maturity, of a tier 2 capital instrument or by other means;

(3) A dividend declaration on any tier 1 capital instrument;

(4) A dividend declaration or interest payment on any tier 2 capital instrument if such dividend declaration or interest payment may be temporarily or permanently suspended at the discretion of the [BANK]; or

(5) Any similar transaction that the [AGENCY] determines to be in substance a distribution of capital.

Carrying value means, with respect to an asset, the value of the asset on the balance sheet of the [BANK], determined in accordance with generally accepted accounting principles (GAAP).

Category 1 residential mortgage exposure means a residential mortgage exposure with the following characteristics:

(1) The duration of the mortgage exposure does not exceed 30 years;

(2) The terms of the mortgage exposure provide for regular periodic payments that do not:

(i) Result in an increase of the principal balance;

(ii) Allow the borrower to defer repayment of principal of the residential mortgage exposure; or

(iii) Result in a balloon payment;

(3) The standards used to underwrite the residential mortgage exposure:

(i) Took into account all of the borrower's obligations, including for mortgage obligations, principal, interest, taxes, insurance (including mortgage guarantee insurance), and assessments; and

(ii) Resulted in a conclusion that the borrower is able to repay the exposure using:

(A) The maximum interest rate that may apply during the first five years after the date of the closing of the residential mortgage exposure transaction; and

(B) The amount of the residential mortgage exposure is the maximum possible contractual exposure over the life of the mortgage as of the date of the closing of the transaction;

(4) The terms of the residential mortgage exposure allow the annual rate of interest to increase no more than two percentage points in any twelve-month period and no more than six percentage points over the life of the exposure;

(5) For a first-lien home equity line of credit (HELOC), the borrower must be qualified using the principal and interest payments based on the maximum contractual exposure under the terms of the HELOC;

(6) The determination of the borrower's ability to repay is based on documented, verified income;

(7) The residential mortgage exposure is not 90 days or more past due or on non-accrual status; and

(8) The residential mortgage exposure is

(i) Not a junior-lien residential mortgage exposure, and

(ii) If the residential mortgage exposure is a first-lien residential mortgage exposure held by a single banking organization and secured by first and junior lien(s) where no other party holds an intervening lien, each residential mortgage exposure must have the characteristics of a category 1 residential mortgage exposure as set forth in this definition. Notwithstanding paragraphs (1) through (8) of this definition, the [AGENCY] may determine that a residential mortgage exposure that is not prudently underwritten does not qualify as a category 1 residential mortgage exposure.

Category 2 residential mortgage exposure means a residential mortgage exposure that is not a Category 1 residential mortgage exposure.

Central counterparty (CCP) means a counterparty (for example, a clearing house) that facilitates trades between counterparties in one or more financial markets by either guaranteeing trades or novating contracts.

CFTC means the U.S. Commodity Futures Trading Commission.

Clean-up call means a contractual provision that permits an originating [BANK] or servicer to call securitization exposures before their stated maturity or call date.

Cleared transaction means an outstanding derivative contract or repo-style transaction that a [BANK] or clearing member has entered into with a central counterparty (that is, a transaction that a central counterparty has accepted). A cleared transaction includes:

(1) A transaction between a CCP and a [BANK] that is a clearing member of the CCP where the [BANK] enters into the transaction with the CCP for the [BANK]'s own account;

(2) A transaction between a CCP and a [BANK] that is a clearing member of the CCP where the [BANK] is acting as a financial intermediary on behalf of a clearing member client and the transaction offsets a transaction that satisfies the requirements of paragraph (3) of this definition.

(3) A transaction between a clearing member client [BANK] and a clearing member where the clearing member acts as a financial intermediary on behalf of the clearing member client and enters into an offsetting transaction with a CCP provided that:

(i) The offsetting transaction is identified by the CCP as a transaction for the clearing member client;

(ii) The collateral supporting the transaction is held in a manner that prevents the [BANK] from facing any loss due to the default, receivership, or insolvency of either the clearing member or the clearing member's other clients;

(iii) The [BANK] has conducted sufficient legal review to conclude with a well-founded basis (and maintains sufficient written documentation of that legal review) that in the event of a legal challenge (including one resulting from a default or receivership, insolvency, liquidation, or similar proceeding) the relevant court and administrative authorities would find the arrangements of paragraph (3)(ii) of this definition to be legal, valid, binding and enforceable under the law of the relevant jurisdictions; and

(iv) The offsetting transaction with a clearing member is transferable under the transaction documents or applicable laws in the relevant jurisdiction(s) to another clearing member should the clearing member default, become insolvent, or enter receivership, insolvency, liquidation, or similar proceeding.

(4) A transaction between a clearing member client and a CCP where a clearing member guarantees the performance of the clearing member client to the CCP and the transaction meets the requirements of paragraphs (3)(ii) and (iii) of this definition.

(5) A cleared transaction does not include the exposure of a [BANK] that is a clearing member to its clearing member client where the [BANK] is either acting as a financial intermediary and enters into an offsetting transaction with a CCP or where the [BANK] provides a guarantee to the CCP on the performance of the client.

Clearing member means a member of, or direct participant in, a CCP that is entitled to enter into transactions with the CCP.

Clearing member client means a party to a cleared transaction associated with a CCP in which a clearing member acts either as a financial intermediary with respect to the party or guarantees the performance of the party to the CCP.

Collateral agreement means a legal contract that specifies the time when, and circumstances under which, a counterparty is required to pledge collateral to a [BANK] for a single financial contract or for all financial contracts in a netting set and confers upon the [BANK] a perfected, first-priority security interest (notwithstanding the prior security interest of any custodial agent), or the legal equivalent thereof, in the collateral posted by the counterparty under the agreement. This security interest must provide the [BANK] with a right to close out the financial positions and liquidate the collateral upon an event of default of, or failure to perform by, the counterparty under the collateral agreement. A contract would not satisfy this requirement if the [BANK]'s exercise of rights under the agreement may be stayed or avoided under applicable law in the relevant jurisdictions, other than in receivership, conservatorship, resolution under the Federal Deposit Insurance Act, Title II of the Dodd-Frank Act, or under any similar insolvency law applicable to GSEs.

Commitment means any legally binding arrangement that obligates a [BANK] to extend credit or to purchase assets.

Commodity derivative contract means a commodity-linked swap, purchased commodity-linked option, forward commodity-linked contract, or any other instrument linked to commodities that gives rise to similar counterparty credit risks.

Common equity tier 1 capital is defined in § ____.20 of subpart C of this part.

Common equity tier 1 minority interest means the common equity tier 1 capital of a depository institution or foreign bank that is:

(1) A consolidated subsidiary of a [BANK]; and

(2) Not owned by the [BANK].

Company means a corporation, partnership, limited liability company, depository institution, business trust, special purpose entity, association, or similar organization.

Control. A person or company *controls* a company if it:

(1) Owns, controls, or holds with power to vote 25 percent or more of a class of voting securities of the company; or

(2) Consolidates the company for financial reporting purposes.

Corporate exposure means an exposure to a company that is not:

(1) An exposure to a sovereign, the Bank for International Settlements, the European Central Bank, the European Commission, the International Monetary Fund, a multi-lateral development bank (MDB), a depository institution, a foreign bank, a credit union, or a public sector entity (PSE);

(2) An exposure to a government-sponsored entity (GSE);

(3) A residential mortgage exposure;

(4) A pre-sold construction loan;

(5) A statutory multifamily mortgage;

(6) A high volatility commercial real estate (HVCRE) exposure;

(7) A cleared transaction;

(8) A default fund contribution;

(9) A securitization exposure;

(10) An equity exposure; or

(11) An unsettled transaction.

Country risk classification (CRC) with respect to a sovereign means the most recent consensus CRC published by the Organization for Economic Cooperation and Development (OECD) as of December 31st of the prior calendar year that provides a view of the likelihood that the sovereign will service its external debt.

Credit derivative means a financial contract executed under standard industry credit derivative documentation that allows one party (the protection purchaser) to transfer the credit risk of one or more exposures (reference exposure(s)) to another party (the protection provider) for a certain period of time.

Credit-enhancing interest-only strip (CEIO) means an on-balance sheet asset that, in form or in substance:

(1) Represents a contractual right to receive some or all of the interest and no more than a minimal amount of principal due on the underlying exposures of a securitization; and

(2) Exposes the holder of the CEIO to credit risk directly or indirectly associated with the underlying exposures that exceeds a pro rata share of the holder's claim on the underlying exposures, whether through subordination provisions or other credit-enhancement techniques.

Credit-enhancing representations and warranties means representations and warranties that are made or assumed in connection with a transfer of underlying exposures (including loan servicing assets) and that obligate a [BANK] to protect another party from losses arising from the credit risk of the underlying exposures. Credit enhancing representations and warranties include provisions to protect a party from losses resulting from the default or nonperformance of the counterparties of the underlying exposures or from an insufficiency in the value of the collateral backing the underlying exposures. Credit enhancing representations and warranties do not include warranties that permit the return of underlying exposures in instances of misrepresentation, fraud, or incomplete documentation.

Credit risk mitigant means collateral, a credit derivative, or a guarantee.

Credit-risk-weighted assets means 1.06 multiplied by the sum of:

(1) Total wholesale and retail risk-weighted assets;

(2) Risk-weighted assets for securitization exposures; and

(3) Risk-weighted assets for equity exposures.

Credit union means an insured credit union as defined under the Federal Credit Union Act (12 U.S.C. 1752).

Current exposure means, with respect to a netting set, the larger of zero or the market value of a transaction or portfolio of transactions within the netting set that would be lost upon default of the counterparty, assuming no recovery on the value of the transactions. Current exposure is also called replacement cost.

Custodian means a financial institution that has legal custody of collateral provided to a CCP.

Debt-to-assets ratio means the ratio calculated by dividing a public company's total liabilities by its equity market value (as defined herein) plus total liabilities as reported as of the end of the most recently reported calendar quarter.

Default fund contribution means the funds contributed or commitments made by a clearing member to a CCP's mutualized loss sharing arrangement.

Depository institution means a depository institution as defined in section 3 of the Federal Deposit Insurance Act.

Depository institution holding company means a bank holding company or savings and loan holding company.

Derivative contract means a financial contract whose value is derived from the values of one or more underlying assets, reference rates, or indices of asset values or reference rates. Derivative contracts include interest rate derivative contracts, exchange rate derivative contracts, equity derivative contracts, commodity derivative contracts, credit derivative contracts, and any other instrument that poses similar counterparty credit risks. Derivative contracts also include unsettled securities, commodities, and foreign exchange transactions with a contractual settlement or delivery lag that is longer than the lesser of the market standard for the particular instrument or five business days.

Discretionary bonus payment means a payment made to an executive officer of a [BANK], where:

(1) The [BANK] retains discretion as to whether to make, and the amount of, the payment until the payment is awarded to the executive officer;

(2) The amount paid is determined by the [BANK] without prior promise to, or agreement with, the executive officer; and

(3) The executive officer has no contractual right, whether express or implied, to the bonus payment.

Dodd-Frank Act means the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Pub. L. 111–203, 124 Stat. 1376).

Early amortization provision means a provision in the documentation governing a securitization that, when triggered, causes investors in the securitization exposures to be repaid before the original stated maturity of the securitization exposures, unless the provision:

(1) Is triggered solely by events not directly related to the performance of the underlying exposures or the originating [BANK] (such as material changes in tax laws or regulations); or

(2) Leaves investors fully exposed to future draws by borrowers on the underlying exposures even after the provision is triggered.

Effective notional amount means for an eligible guarantee or eligible credit derivative, the lesser of the contractual notional amount of the credit risk mitigant and the exposure amount of the hedged exposure, multiplied by the percentage coverage of the credit risk mitigant.

Eligible asset-backed commercial paper (ABCP) liquidity facility means a liquidity facility supporting ABCP, in form or in substance, that is subject to an asset quality test at the time of draw that precludes funding against assets that are 90 days or more past due or in default. Notwithstanding the preceding sentence, a liquidity facility is an eligible ABCP liquidity facility if the assets or exposures funded under the liquidity facility that do not meet the eligibility requirements are guaranteed by a sovereign that qualifies for a 20 percent risk weight or lower.

Eligible clean-up call means a clean-up call that:

(1) Is exercisable solely at the discretion of the originating [BANK] or servicer;

(2) Is not structured to avoid allocating losses to securitization exposures held by investors or otherwise structured to provide credit enhancement to the securitization; and

(3)(i) For a traditional securitization, is only exercisable when 10 percent or less of the principal amount of the underlying exposures or securitization exposures (determined as of the inception of the securitization) is outstanding; or

(ii) For a synthetic securitization, is only exercisable when 10 percent or less of the principal amount of the reference portfolio of underlying exposures (determined as of the inception of the securitization) is outstanding.

Eligible credit derivative means a credit derivative in the form of a credit default swap, nth-to-default swap, total return swap, or any other form of credit derivative approved by the [AGENCY], provided that:

(1) The contract meets the requirements of an eligible guarantee and has been confirmed by the protection purchaser and the protection provider;

(2) Any assignment of the contract has been confirmed by all relevant parties;

(3) If the credit derivative is a credit default swap or nth-to-default swap, the contract includes the following credit events:

(i) Failure to pay any amount due under the terms of the reference exposure, subject to any applicable minimal payment threshold that is consistent with standard market practice and with a grace period that is closely in line with the grace period of the reference exposure; and

(ii) Receivership, insolvency, liquidation, conservatorship or inability of the reference exposure issuer to pay its debts, or its failure or admission in writing of its inability generally to pay its debts as they become due, and similar events;

(4) The terms and conditions dictating the manner in which the contract is to be settled are incorporated into the contract;

(5) If the contract allows for cash settlement, the contract incorporates a robust valuation process to estimate loss reliably and specifies a reasonable period for obtaining post-credit event valuations of the reference exposure;

(6) If the contract requires the protection purchaser to transfer an exposure to the protection provider at settlement, the terms of at least one of the exposures that is permitted to be transferred under the contract provide that any required consent to transfer may not be unreasonably withheld;

(7) If the credit derivative is a credit default swap or nth-to-default swap, the contract clearly identifies the parties responsible for determining whether a credit event has occurred, specifies that this determination is not the sole responsibility of the protection provider, and gives the protection purchaser the right to notify the protection provider of the occurrence of a credit event; and

(8) If the credit derivative is a total return swap and the [BANK] records net payments received on the swap as net income, the [BANK] records offsetting deterioration in the value of the hedged exposure (either through reductions in fair value or by an addition to reserves).

Eligible credit reserves means all general allowances that have been established through a charge against earnings to absorb credit losses associated with on- or off-balance sheet wholesale and retail exposures, including the allowance for loan and lease losses (ALLL) associated with such exposures but excluding allocated transfer risk reserves established pursuant to 12 U.S.C. 3904 and other specific reserves created against recognized losses.

Eligible guarantee means a guarantee from an eligible guarantor that:

(1) Is written;

(2) Is either:

(i) Unconditional, or

(ii) A contingent obligation of the U.S. government or its agencies, the enforceability of which is dependent upon some affirmative action on the part of the beneficiary of the guarantee or a third party (for example, meeting servicing requirements);

(3) Covers all or a pro rata portion of all contractual payments of the obligated party on the reference exposure;

(4) Gives the beneficiary a direct claim against the protection provider;

(5) Is not unilaterally cancelable by the protection provider for reasons other than the breach of the contract by the beneficiary;

(6) Except for a guarantee by a sovereign, is legally enforceable against the protection provider in a jurisdiction where the protection provider has sufficient assets against which a judgment may be attached and enforced;

(7) Requires the protection provider to make payment to the beneficiary on the occurrence of a default (as defined in the guarantee) of the obligated party on the reference exposure in a timely manner without the beneficiary first having to take legal actions to pursue the obligor for payment;

(8) Does not increase the beneficiary's cost of credit protection on the

guarantee in response to deterioration in the credit quality of the reference exposure; and

(9) Is not provided by an affiliate of the [BANK], unless the affiliate is an insured depository institution, foreign bank, securities broker or dealer, or insurance company that:

(i) Does not control the [BANK]; and

(ii) Is subject to consolidated supervision and regulation comparable to that imposed on depository institutions, U.S. securities broker-dealers, or U.S. insurance companies (as the case may be).

Eligible guarantor means:

(1) A sovereign, the Bank for International Settlements, the International Monetary Fund, the European Central Bank, the European Commission, a Federal Home Loan Bank, Federal Agricultural Mortgage Corporation (Farmer Mac), a multilateral development bank (MDB), a depository institution, a bank holding company, a savings and loan holding company, a credit union, or a foreign bank; or

(2) An entity (other than a special purpose entity):

(i) That at the time the guarantee is issued or anytime thereafter, has issued and outstanding an unsecured debt security without credit enhancement that is investment grade;

(ii) Whose creditworthiness is not positively correlated with the credit risk of the exposures for which it has provided guarantees; and

(iii) That is not an insurance company engaged predominately in the business of providing credit protection (such as a monoline bond insurer or re-insurer).

Eligible margin loan means an extension of credit where:

(1) The extension of credit is collateralized exclusively by liquid and readily marketable debt or equity securities, or gold;

(2) The collateral is marked-to-market daily, and the transaction is subject to daily margin maintenance requirements;

(3) The extension of credit is conducted under an agreement that provides the [BANK] the right to accelerate and terminate the extension of credit and to liquidate or set-off collateral promptly upon an event of default (including upon an event of receivership, insolvency, liquidation, conservatorship, or similar proceeding) of the counterparty, provided that, in any such case, any exercise of rights under the agreement will not be stayed or avoided under applicable law in the relevant jurisdictions; [1] and

(4) The [BANK] has conducted sufficient legal review to conclude with a well-founded basis (and maintains sufficient written documentation of that legal review) that the agreement meets the requirements of paragraph (3) of this definition and is legal, valid, binding, and enforceable under applicable law in the relevant jurisdictions, other than in receivership, conservatorship, resolution under the Federal Deposit Insurance Act, Title II of the Dodd-Frank Act, or under any similar insolvency law applicable to GSEs.

Eligible servicer cash advance facility means a servicer cash advance facility in which:

(1) The servicer is entitled to full reimbursement of advances, except that a servicer may be obligated to make non-reimbursable advances for a particular underlying exposure if any such advance is contractually limited to an insignificant amount of the outstanding principal balance of that exposure;

(2) The servicer's right to reimbursement is senior in right of payment to all other claims on the cash flows from the underlying exposures of the securitization; and

(3) The servicer has no legal obligation to, and does not make advances to the securitization if the servicer concludes the advances are unlikely to be repaid.

Equity derivative contract means an equity-linked swap, purchased equity-linked option, forward equity-linked contract, or any other instrument linked to equities that gives rise to similar counterparty credit risks.

Equity exposure means:

(1) A security or instrument (whether voting or non-voting) that represents a direct or an indirect ownership interest in, and is a residual claim on, the assets and income of a company, unless:

(i) The issuing company is consolidated with the [BANK] under GAAP;

(ii) The [BANK] is required to deduct the ownership interest from tier 1 or tier 2 capital under this [PART];

(iii) The ownership interest incorporates a payment or other similar obligation on the part of the issuing company (such as an obligation to make periodic payments); or

(iv) The ownership interest is a securitization exposure;

(2) A security or instrument that is mandatorily convertible into a security or instrument described in paragraph (1) of this definition;

(3) An option or warrant that is exercisable for a security or instrument described in paragraph (1) of this definition; or

(4) Any other security or instrument (other than a securitization exposure) to the extent the return on the security or instrument is based on the performance of a security or instrument described in paragraph (1) of this definition.

ERISA means the Employee Retirement Income and Security Act of 1974 (29 U.S.C. 1002).

Exchange rate derivative contract means a cross-currency interest rate swap, forward foreign-exchange contract, currency option purchased, or any other instrument linked to exchange rates that gives rise to similar counterparty credit risks.

Executive officer means a person who holds the title or, without regard to title, salary, or compensation, performs the function of one or more of the following positions: president, chief executive officer, executive chairman, chief operating officer, chief financial officer, chief investment officer, chief legal officer, chief lending officer, chief risk officer, or head of a major business line, and other staff that the board of directors of the [BANK] deems to have equivalent responsibility.

Expected credit loss (ECL) means:

(1) For a wholesale exposure to a non-defaulted obligor or segment of non-defaulted retail exposures that is carried at fair value with gains and losses flowing through earnings or that is classified as held-for-sale and is carried at the lower of cost or fair value with losses flowing through earnings, zero.

(2) For all other wholesale exposures to non-defaulted obligors or segments of non-defaulted retail exposures, the product of the probability of default (PD) times the loss given default (LGD) times the exposure at default (EAD) for the exposure or segment.

(3) For a wholesale exposure to a defaulted obligor or segment of defaulted retail exposures, the [BANK]'s impairment estimate for allowance purposes for the exposure or segment.

(4) Total ECL is the sum of expected credit losses for all wholesale and retail exposures other than exposures for which the [BANK] has applied the double default treatment in § ____.135 of subpart E of this part.

Exposure amount means:

(1) For the on-balance sheet component of an exposure (other than an OTC derivative contract; a repo-style transaction or an eligible margin loan

[1] This requirement is met where all transactions under the agreement are (i) executed under U.S. law and (ii) constitute ''securities contracts'' under section 555 of the Bankruptcy Code (11 U.S.C. 555), qualified financial contracts under section 11(e)(8) of the Federal Deposit Insurance Act, or netting contracts between or among financial institutions under sections 401–407 of the Federal Deposit Insurance Corporation Improvement Act or the Federal Reserve Board's Regulation EE (12 CFR part 231).

for which the [BANK] determines the exposure amount under § ____.37 of subpart D of this part; cleared transaction; default fund contribution; or a securitization exposure), exposure amount means the [BANK]'s carrying value of the exposure.

(2) For the off-balance sheet component of an exposure (other than an OTC derivative contract; a repo-style transaction or an eligible margin loan for which the [BANK] calculates the exposure amount under § ____.37 of subpart D of this part; cleared transaction, default fund contribution or a securitization exposure), exposure amount means the notional amount of the off-balance sheet component multiplied by the appropriate credit conversion factor (CCF) in § ____.33 of subpart D of this part.

(3) If the exposure is an OTC derivative contract or derivative contract that is a cleared transaction, the exposure amount determined under § ____.34 of subpart D of this part.

(4) If the exposure is an eligible margin loan or repo-style transaction (including a cleared transaction) for which the [BANK] calculates the exposure amount as provided in § ____.37 of subpart D of this part, the exposure amount determined under § ____.37 of subpart D.

(5) If the exposure is a securitization exposure, the exposure amount determined under § ____.42 of subpart D of this part.

Federal Deposit Insurance Act means the Federal Deposit Insurance Act (12 U.S.C. 1813). *Federal Deposit Insurance Corporation Improvement Act* means the Federal Deposit Insurance Corporation Improvement Act of 1991 (12 U.S.C. 4401).

Financial collateral means collateral:

(1) In the form of:

(i) Cash on deposit with the [BANK] (including cash held for the [BANK] by a third-party custodian or trustee);

(ii) Gold bullion;

(iii) Long-term debt securities that are not resecuritization exposures and that are investment grade;

(iv) Short-term debt instruments that are not resecuritization exposures and that are investment grade;

(v) Equity securities that are publicly-traded;

(vi) Convertible bonds that are publicly-traded; or

(vii) Money market fund shares and other mutual fund shares if a price for the shares is publicly quoted daily; and

(2) In which the [BANK] has a perfected, first-priority security interest or, outside of the United States, the legal equivalent thereof (with the exception of cash on deposit and notwithstanding the prior security interest of any custodial agent).

Financial institution means:

(1)(i) A bank holding company, savings and loan holding company, nonbank financial institution supervised by the Board under Title I of the Dodd-Frank Act, depository institution, foreign bank, credit union, insurance company, or securities firm;

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

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

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

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

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

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

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

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

(E) Acting as a futures commission merchant.

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

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

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

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

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

(3) For the purpose of this [PART], ''financial institution'' does not include the following entities:

(i) GSEs;

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

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

First-lien residential mortgage exposure means a residential mortgage exposure secured by a first lien or a residential mortgage exposure secured by first and junior lien(s) where no other party holds an intervening lien.

Foreign bank means a foreign bank as defined in § 211.2 of the Federal Reserve Board's Regulation K (12 CFR 211.2) (other than a depository institution).

Forward agreement means a legally binding contractual obligation to purchase assets with certain drawdown at a specified future date, not including commitments to make residential mortgage loans or forward foreign exchange contracts.

GAAP means generally accepted accounting principles as used in the United States.

Gain-on-sale means an increase in the equity capital of a [BANK] (as reported on Schedule RC of the Call Report or Schedule HC of the FR Y–9C) resulting from a securitization (other than an increase in equity capital resulting from the [BANK]'s receipt of cash in connection with the securitization).

General obligation means a bond or similar obligation that is backed by the full faith and credit of a public sector entity (PSE).

Government-sponsored entity (GSE) means an entity established or chartered by the U.S. government to serve public purposes specified by the U.S. Congress but whose debt obligations are not explicitly guaranteed by the full faith and credit of the U.S. government.

Guarantee means a financial guarantee, letter of credit, insurance, or other similar financial instrument (other than a credit derivative) that allows one party (beneficiary) to transfer the credit risk of one or more specific exposures (reference exposure) to another party (protection provider).

High volatility commercial real estate (HVCRE) exposure means a credit facility that finances or has financed the acquisition, development, or construction (ADC) of real property, unless the facility finances:

(1) One- to four-family residential properties; or

(2) Commercial real estate projects in which:

(i) The loan-to-value ratio is less than or equal to the applicable maximum supervisory loan-to-value ratio in the [AGENCY]'s real estate lending standards at 12 CFR part 34, subpart D and 12 CFR part 160, subparts A and B (OCC); 12 CFR part 208, Appendix C (Board); 12 CFR part 365, subpart D and 12 CFR 390.264 and 390.265 (FDIC);

(ii) The borrower has contributed capital to the project in the form of cash or unencumbered readily marketable assets (or has paid development expenses out-of-pocket) of at least 15 percent of the real estate's appraised ''as completed'' value; and

(iii) The borrower contributed the amount of capital required by paragraph (2)(ii) of this definition before the [BANK] advances funds under the credit facility, and the capital contributed by the borrower, or internally generated by the project, is contractually required to remain in the project throughout the life of the project. The life of a project concludes only when the credit facility is converted to permanent financing or is sold or paid in full. Permanent financing may be provided by the [BANK] that provided the ADC facility as long as the permanent financing is subject to the [BANK]'s underwriting criteria for long-term mortgage loans.

Home country means the country where an entity is incorporated, chartered, or similarly established.

Interest rate derivative contract means a single-currency interest rate swap, basis swap, forward rate agreement, purchased interest rate option, when-issued securities, or any other instrument linked to interest rates that gives rise to similar counterparty credit risks.

International Lending Supervision Act means the International Lending Supervision Act of 1983 (12 U.S.C. 3907).

Investing bank means, with respect to a securitization, a [BANK] that assumes the credit risk of a securitization exposure (other than an originating [BANK] of the securitization). In the typical synthetic securitization, the investing [BANK] sells credit protection on a pool of underlying exposures to the originating [BANK].

Investment fund means a company:

(1) Where all or substantially all of the assets of the company are financial assets; and

(2) That has no material liabilities.

Investment grade means that the entity to which the [BANK] is exposed through a loan or security, or the reference entity with respect to a credit derivative, has adequate capacity to meet financial commitments for the projected life of the asset or exposure. Such an entity or reference entity has adequate capacity to meet financial commitments if the risk of its default is low and the full and timely repayment of principal and interest is expected.

Investment in the capital of an unconsolidated financial institution means a net long position in an instrument that is recognized as capital for regulatory purposes by the primary supervisor of an unconsolidated regulated financial institutions and in an instrument that is part of the GAAP equity of an unconsolidated unregulated financial institution, including direct, indirect, and synthetic exposures to capital instruments, excluding underwriting positions held by the [BANK] for five business days or less.[2] An indirect exposure results from the [BANK]'s investment in an unconsolidated entity that has an exposure to a capital instrument of a financial institution. A synthetic exposure results from the [BANK]'s investment in an instrument where the value of such instrument is linked to the value of a capital instrument of a financial institution. For purposes of this definition, the amount of the exposure resulting from the investment in the capital of an unconsolidated financial institution is the [BANK]'s loss on such exposure should the underlying capital instrument have a value of zero. In addition, for purposes of this definition:

(1) The net long position is the gross long position in the exposure to the capital of the financial institution (including covered positions under subpart F of this part) net of short positions in the same exposure where the maturity of the short position either matches the maturity of the long position or has a residual maturity of at least one year;

(2) Long and short positions in the same index without a maturity date are considered to have matching maturity. Gross long positions in investments in the capital instruments of unconsolidated financial institutions resulting from holdings of index securities may be netted against short positions in the same underlying index. However, short positions in indexes that are hedging long cash or synthetic positions can be decomposed to provide recognition of the hedge. More specifically, the portion of the index that is composed of the same underlying exposure that is being hedged may be used to offset the long position as long as both the exposure being hedged and the short position in the index are positions subject to the market risk rule, the positions are fair valued on the banking organization's balance sheet, and the hedge is deemed effective by the banking organization's internal control processes assessed by the primary supervisor of the banking organization; and

(3) Instead of looking through and monitoring its exact exposure to the capital of unconsolidated financial institutions included in an index security, a [BANK] may, with the prior approval of the [AGENCY], use a conservative estimate of the amount of its investment in the capital of unconsolidated financial institutions held through the index security.

Junior-lien residential mortgage exposure means a residential mortgage exposure that is not a first-lien residential mortgage exposure.

Main index means the Standard & Poor's 500 Index, the FTSE All-World Index, and any other index for which the [BANK] can demonstrate to the satisfaction of the [AGENCY] that the equities represented in the index have comparable liquidity, depth of market, and size of bid-ask spreads as equities in the Standard & Poor's 500 Index and FTSE All-World Index.

Market risk [BANK] means a [BANK] that is described in § ____.201(b) of subpart F of this part.

Money market fund means an investment fund that is subject to 17 CFR 270.2a–7 or any foreign equivalent thereof.

Mortgage servicing assets (MSAs) means the contractual rights owned by a [BANK] to service for a fee mortgage loans that are owned by others.

Multilateral development bank (MDB) means the International Bank for Reconstruction and Development, the Multilateral Investment Guarantee Agency, the International Finance Corporation, the Inter-American Development Bank, the Asian Development Bank, the African Development Bank, the European Bank for Reconstruction and Development, the European Investment Bank, the European Investment Fund, the Nordic Investment Bank, the Caribbean Development Bank, the Islamic Development Bank, the Council of Europe Development Bank, and any

[2] If the [BANK] is an underwriter of a failed underwriting, the [BANK] can request approval from its primary federal supervisor to exclude underwriting positions related to such failed underwriting for a longer period of time.

other multilateral lending institution or regional development bank in which the U.S. government is a shareholder or contributing member or which the [AGENCY] determines poses comparable credit risk.

National Bank Act means the National Bank Act (12 U.S.C. 24).

Netting set means a group of transactions with a single counterparty that are subject to a qualifying master netting agreement or a qualifying cross-product master netting agreement. For purposes of calculating risk-based capital requirements using the internal models methodology in subpart E, a transaction—

(1) That is not subject to such a master netting agreement or

(2) Where the [BANK] has identified specific wrong-way risk is its own netting set.

Non-significant investment in the capital of an unconsolidated financial institution means an investment where the [BANK] owns 10 percent or less of the issued and outstanding common shares of the unconsolidated financial institution.

N^{th}-to-default credit derivative means a credit derivative that provides credit protection only for the nth-defaulting reference exposure in a group of reference exposures.

Operating entity means a company established to conduct business with clients with the intention of earning a profit in its own right.

Original maturity with respect to an off-balance sheet commitment means the length of time between the date a commitment is issued and:

(1) For a commitment that is not subject to extension or renewal, the stated expiration date of the commitment; or

(2) For a commitment that is subject to extension or renewal, the earliest date on which the [BANK] can, at its option, unconditionally cancel the commitment.

Originating [BANK], with respect to a securitization, means a [BANK] that:

(1) Directly or indirectly originated or securitized the underlying exposures included in the securitization; or

(2) Serves as an ABCP program sponsor to the securitization.

Over-the-counter (OTC) derivative contract means a derivative contract that is not a cleared transaction. An OTC derivative includes a transaction:

(1) Between a [BANK] that is a clearing member and a counterparty where the [BANK] is acting as a financial intermediary and enters into a cleared transaction with a CCP that offsets the transaction with the counterparty; or

(2) In which a [BANK] that is a clearing member provides a CCP a guarantee on the performance of the counterparty to the transaction.

Performance standby letter of credit (or performance bond) means an irrevocable obligation of a [BANK] to pay a third-party beneficiary when a customer (account party) fails to perform on any contractual nonfinancial or commercial obligation. To the extent permitted by law or regulation, performance standby letters of credit include arrangements backing, among other things, subcontractors' and suppliers' performance, labor and materials contracts, and construction bids.

Pre-sold construction loan means any one-to-four family residential construction loan to a builder that meets the requirements of section 618(a)(1) or (2) of the Resolution Trust Corporation Refinancing, Restructuring, and Improvement Act of 1991 and the following criteria:

(1) The loan is made in accordance with prudent underwriting standards;

(2) The purchaser is an individual(s) that intends to occupy the residence and is not a partnership, joint venture, trust, corporation, or any other entity (including an entity acting as a sole proprietorship) that is purchasing one or more of the residences for speculative purposes;

(3) The purchaser has entered into a legally binding written sales contract for the residence;

(4) The purchaser has not terminated the contract; however, if the purchaser terminates the sales contract the [BANK] must immediately apply a 100 percent risk weight to the loan and report the revised risk weight in [BANK]'s next quarterly [REGULATORY REPORT];

(5) The purchaser of the residence has a firm written commitment for permanent financing of the residence upon completion;

(6) The purchaser has made a substantial earnest money deposit of no less than 3 percent of the sales price, which is subject to forfeiture if the purchaser terminates the sales contract; provided that, the earnest money deposit shall not be subject to forfeiture by reason of breach or termination of the sales contract on the part of the builder;

(7) The earnest money deposit must be held in escrow by the [BANK] or an independent party in a fiduciary capacity, and the escrow agreement must provide that in the event of default the escrow funds shall be used to defray any cost incurred by [BANK] relating to any cancellation of the sales contract by the purchaser of the residence;

(8) The builder must incur at least the first 10 percent of the direct costs of construction of the residence (that is, actual costs of the land, labor, and material) before any drawdown is made under the loan;

(9) The loan may not exceed 80 percent of the sales price of the presold residence; and

(10) The loan is not more than 90 days past due, or on nonaccrual.

Private company means a company that is not a public company.

Private sector credit exposure means an exposure to a company or an individual that is included in credit risk-weighted assets and is not an exposure to a sovereign, the Bank for International Settlements, the European Central Bank, the European Commission, the International Monetary Fund, a MDB, a PSE, or a GSE.

Protection amount (P) means, with respect to an exposure hedged by an eligible guarantee or eligible credit derivative, the effective notional amount of the guarantee or credit derivative, reduced to reflect any currency mismatch, maturity mismatch, or lack of restructuring coverage (as provided in § ____.36 of subpart D of this part or § ____.134 of subpart E, as appropriate).

Public company means a company that has issued publicly-traded debt or equity.

Publicly-traded means traded on:

(1) Any exchange registered with the SEC as a national securities exchange under section 6 of the Securities Exchange Act; or

(2) Any non-U.S.-based securities exchange that:

(i) Is registered with, or approved by, a national securities regulatory authority; and

(ii) Provides a liquid, two-way market for the instrument in question.

Public sector entity (PSE) means a state, local authority, or other governmental subdivision below the sovereign level.

Qualifying central counterparty (QCCP) means a central counterparty that:

(1) Is a designated financial market utility (FMU) under Title VIII of the Dodd-Frank Act;

(2) If not located in the United States, is regulated and supervised in a manner equivalent to a designated FMU; or

(3) Meets the following standards:

(i) The central counterparty requires all parties to contracts cleared by the counterparty to be fully collateralized on a daily basis;

(ii) The [BANK] demonstrates to the satisfaction of the [AGENCY] that the central counterparty:

(A) Is in sound financial condition;

(B) Is subject to supervision by the Board, the CFTC, or the Securities Exchange Commission (SEC), or if the central counterparty is not located in the United States, is subject to effective oversight by a national supervisory authority in its home country; and

(C) Meets or exceeds:

(*1*) The risk-management standards for central counterparties set forth in regulations established by the Board, the CFTC, or the SEC under Title VII or Title VIII of the Dodd-Frank Act; or

(*2*) If the central counterparty is not located in the United States, similar risk-management standards established under the law of its home country that are consistent with international standards for central counterparty risk management as established by the relevant standard setting body of the Bank of International Settlements;

(4) Provides the [BANK] with the central counterparty's hypothetical capital requirement or the information necessary to calculate such hypothetical capital requirement, and other information the [BANK] is required to obtain under § ____.35(d)(3) of this part;

(5) Makes available to the [AGENCY] and the CCP's regulator the information described in paragraph (4) of this definition; and

(6) Has not otherwise been determined by the [AGENCY] to not be QCCP due to its financial condition, risk profile, failure to meet supervisory risk management standards, or other weaknesses or supervisory concerns that are inconsistent with the risk weight assigned to qualifying central counterparties under § ____.35 of subpart D of this part; and

(7) If a [BANK] determines that a CCP ceases to be a QCCP due to the failure of the CCP to satisfy one or more of the requirements set forth at paragraphs (1) through (6) of this definition, the [BANK] may continue to treat the CCP as a QCCP for up to three months following the determination. If the CCP fails to remedy the relevant deficiency within three months after the initial determination, or the CCP fails to satisfy the requirements set forth in paragraphs (1) through (6) of this definition continuously for a three month period after remedying the relevant deficiency, a [BANK] may not treat the CCP as a QCCP for the purposes of this [PART] until after the [BANK] has determined that the CCP has satisfied the requirements in paragraphs (1) through (6) of this definition for three continuous months.

Qualifying master netting agreement means any written, legally enforceable agreement provided that:

(1) The agreement creates a single legal obligation for all individual transactions covered by the agreement upon an event of default, including receivership, insolvency, liquidation, or similar proceeding, of the counterparty;

(2) The agreement provides the [BANK] the right to accelerate, terminate, and close-out on a net basis all transactions under the agreement and to liquidate or set-off collateral promptly upon an event of default, including upon an event of receivership, insolvency, liquidation, or similar proceeding, of the counterparty, provided that, in any such case, any exercise of rights under the agreement will not be stayed or avoided under applicable law in the relevant jurisdictions, other than in receivership, conservatorship, resolution under the Federal Deposit Insurance Act, Title II of the Dodd-Frank Act, or under any similar insolvency law applicable to GSEs;

(3) The [BANK] has conducted sufficient legal review to conclude with a well-founded basis (and maintains sufficient written documentation of that legal review) that:

(i) The agreement meets the requirements of paragraph (2) of this definition; and

(ii) In the event of a legal challenge (including one resulting from default or from receivership, insolvency, liquidation, or similar proceeding) the relevant court and administrative authorities would find the agreement to be legal, valid, binding, and enforceable under the law of the relevant jurisdictions;

(4) The [BANK] establishes and maintains procedures to monitor possible changes in relevant law and to ensure that the agreement continues to satisfy the requirements of this definition; and

(5) The agreement does not contain a walkaway clause (that is, a provision that permits a non-defaulting counterparty to make a lower payment than it otherwise would make under the agreement, or no payment at all, to a defaulter or the estate of a defaulter, even if the defaulter or the estate of the defaulter is a net creditor under the agreement).

Regulated financial institution means a financial institution subject to consolidated supervision and regulation comparable to that imposed on the following U.S. financial institutions: depository institutions, depository institution holding companies, nonbank financial companies supervised by the Board, designated financial market utilities, securities broker-dealers, credit unions, or insurance companies.

Repo-style transaction means a repurchase or reverse repurchase transaction, or a securities borrowing or securities lending transaction, including a transaction in which the [BANK] acts as agent for a customer and indemnifies the customer against loss, provided that:

(1) The transaction is based solely on liquid and readily marketable securities, cash, or gold;

(2) The transaction is marked-to-market daily and subject to daily margin maintenance requirements;

(3)(i) The transaction is a ''securities contract'' or ''repurchase agreement'' under section 555 or 559, respectively, of the Bankruptcy Code (11 U.S.C. 555 or 559), a qualified financial contract under section 11(e)(8) of the Federal Deposit Insurance Act, or a netting contract between or among financial institutions under sections 401–407 of the Federal Deposit Insurance Corporation Improvement Act or the Federal Reserve Board's Regulation EE (12 CFR part 231); or

(ii) If the transaction does not meet the criteria set forth in paragraph (3)(i) of this definition, then either:

(A) The transaction is executed under an agreement that provides the [BANK] the right to accelerate, terminate, and close-out the transaction on a net basis and to liquidate or set-off collateral promptly upon an event of default (including upon an event of receivership, insolvency, liquidation, or similar proceeding) of the counterparty, provided that, in any such case, any exercise of rights under the agreement will not be stayed or avoided under applicable law in the relevant jurisdictions, other than in receivership, conservatorship, resolution under the Federal Deposit Insurance Act, Title II of the Dodd-Frank Act, or under any similar insolvency law applicable to GSEs; or

(B) The transaction is:

(*1*) Either overnight or unconditionally cancelable at any time by the [BANK]; and

(*2*) Executed under an agreement that provides the [BANK] the right to accelerate, terminate, and close-out the transaction on a net basis and to liquidate or set-off collateral promptly upon an event of counterparty default; and

(4) The [BANK] has conducted sufficient legal review to conclude with a well-founded basis (and maintains sufficient written documentation of that legal review) that the agreement meets the requirements of paragraph (3) of this definition and is legal, valid, binding, and enforceable under applicable law in the relevant jurisdictions.

Resecuritization means a securitization in which one or more of the underlying exposures is a securitization exposure.

Resecuritization exposure means:

(1) An on- or off-balance sheet exposure to a resecuritization;

(2) An exposure that directly or indirectly references a resecuritization exposure.

(3) An exposure to an asset-backed commercial paper program is not a resecuritization exposure if either:

(i) The program-wide credit enhancement does not meet the definition of a resecuritization exposure; or

(ii) The entity sponsoring the program fully supports the commercial paper through the provision of liquidity so that the commercial paper holders effectively are exposed to the default risk of the sponsor instead of the underlying exposures.

Residential mortgage exposure means an exposure (other than a securitization exposure, equity exposure, statutory multifamily mortgage, or presold construction loan) that is:

(1) An exposure that is primarily secured by a first or subsequent lien on one-to-four family residential property; or

(2)(i) An exposure with an original and outstanding amount of $1 million or less that is primarily secured by a first or subsequent lien on residential property that is not one-to-four family; and

(ii) For purposes of calculating capital requirements under subpart E, is managed as part of a segment of exposures with homogeneous risk characteristics and not on an individual-exposure basis.

Revenue obligation means a bond or similar obligation that is an obligation of a PSE, but which the PSE is committed to repay with revenues from the specific project financed rather than general tax funds.

Savings and loan holding company means a savings and loan holding company as defined in section 10 of the Home Owners' Loan Act (12 U.S.C. 1467a).

Securities and Exchange Commission (SEC) means the U.S. Securities and Exchange Commission.

Securities Exchange Act means the Securities Exchange Act of 1934 (15 U.S.C. 78).

Securitization exposure means:

(1) An on-balance sheet or off-balance sheet credit exposure (including credit-enhancing representations and warranties) that arises from a traditional securitization or synthetic securitization (including a resecuritization), or

(2) An exposure that directly or indirectly references a securitization exposure described in paragraph (1) of this definition.

Securitization special purpose entity (securitization SPE) means a corporation, trust, or other entity organized for the specific purpose of holding underlying exposures of a securitization, the activities of which are limited to those appropriate to accomplish this purpose, and the structure of which is intended to isolate the underlying exposures held by the entity from the credit risk of the seller of the underlying exposures to the entity.

Servicer cash advance facility means a facility under which the servicer of the underlying exposures of a securitization may advance cash to ensure an uninterrupted flow of payments to investors in the securitization, including advances made to cover foreclosure costs or other expenses to facilitate the timely collection of the underlying exposures.

Significant investment in the capital of unconsolidated financial institutions means an investment where the [BANK] owns more than 10 percent of the issued and outstanding common shares of the unconsolidated financial institution.

Small Business Act means the Small Business Act (15 U.S.C. 632).

Small Business Investment Act means the Small Business Investment Act of 1958 (15 U.S.C. 682).

Sovereign means a central government (including the U.S. government) or an agency, department, ministry, or central bank of a central government.

Sovereign default means noncompliance by a sovereign with its external debt service obligations or the inability or unwillingness of a sovereign government to service an existing loan according to its original terms, as evidenced by failure to pay principal and interest timely and fully, arrearages, or restructuring.

Sovereign exposure means:

(1) A direct exposure to a sovereign; or

(2) An exposure directly and unconditionally backed by the full faith and credit of a sovereign.

Specific wrong-way risk means wrong-way risk that arises when either:

(1) The counterparty and issuer of the collateral supporting the transaction; or

(2) The counterparty and the reference asset of the transaction, are affiliates or are the same entity.

Standardized market risk-weighted assets means the standardized measure for market risk calculated under § ____.204 of subpart F of this part multiplied by 12.5.

Standardized total risk-weighted assets means:

(1) The sum of:

(i) Total risk-weighted assets for general credit risk as calculated under § ____.31 of subpart D of this part;

(ii) Total risk-weighted assets for cleared transactions and default fund contributions as calculated under § ____.35 of subpart D of this part;

(iii) Total risk-weighted assets for unsettled transactions as calculated under § ____.38 of subpart D of this part;

(iv) Total risk-weighted assets for securitization exposures as calculated under § ____.42 of subpart D of this part;

(v) Total risk-weighted assets for equity exposures as calculated under § ____.52 and § ____.53 of subpart D of this part; and

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

(2) Any amount of the [BANK]'s allowance for loan and lease losses that is not included in tier 2 capital.

Statutory multifamily mortgage means a loan secured by a multifamily residential property that meets the requirements under section 618(b)(1) of the Resolution Trust Corporation Refinancing, Restructuring, and Improvement Act of 1991, and that meets the following criteria:

(1) The loan is made in accordance with prudent underwriting standards;

(2) The loan-to-value (LTV) ratio of the loan, calculated in accordance with § ____.32(g)(3) of subpart D of this part, does not exceed 80 percent (or 75 percent if the loan is based on an interest rate that changes over the term of the loan);

(3) All principal and interest payments on the loan must have been made on time for at least one year prior to applying a 50 percent risk weight to the loan, or in the case where an existing owner is refinancing a loan on the property, all principal and interest payments on the loan being refinanced must have been made on time for at least one year prior to applying a 50 percent risk weight to the loan;

(4) Amortization of principal and interest on the loan must occur over a period of not more than 30 years and the minimum original maturity for repayment of principal must not be less than 7 years;

(5) Annual net operating income (before debt service on the loan) generated by the property securing the loan during its most recent fiscal year must not be less than 120 percent of the loan's current annual debt service (or 115 percent of current annual debt service if the loan is based on an interest rate that changes over the term of the

loan) or, in the case of a cooperative or other not-for-profit housing project, the property must generate sufficient cash flow to provide comparable protection to the [BANK]; and

(6) The loan is not more than 90 days past due, or on nonaccrual.

Subsidiary means, with respect to a company, a company controlled by that company.

Synthetic securitization means a transaction in which:

(1) All or a portion of the credit risk of one or more underlying exposures is transferred to one or more third parties through the use of one or more credit derivatives or guarantees (other than a guarantee that transfers only the credit risk of an individual retail exposure);

(2) The credit risk associated with the underlying exposures has been separated into at least two tranches reflecting different levels of seniority;

(3) Performance of the securitization exposures depends upon the performance of the underlying exposures; and

(4) All or substantially all of the underlying exposures are financial exposures (such as loans, commitments, credit derivatives, guarantees, receivables, asset-backed securities, mortgage-backed securities, other debt securities, or equity securities).

Tier 1 capital means the sum of common equity tier 1 capital and additional tier 1 capital.

Tier 1 minority interest means the tier 1 capital of a consolidated subsidiary of a [BANK] that is not owned by the [BANK].

Tier 2 capital is defined in § ____.20 of subpart C of this part.

Total capital means the sum of tier 1 capital and tier 2 capital.

Total capital minority interest means the total capital of a consolidated subsidiary of a [BANK] that is not owned by the [BANK].

Total leverage exposure means the sum of the following:

(1) The balance sheet carrying value of all of the [BANK]'s on-balance sheet assets, *less* amounts deducted from tier 1 capital;

(2) The potential future exposure amount for each derivative contract to which the [BANK] is a counterparty (or each single-product netting set of such transactions) determined in accordance with § ____.34 of this part;

(3) 10 percent of the notional amount of unconditionally cancellable commitments made by the [BANK]; and

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

Traditional securitization means a transaction in which:

(1) All or a portion of the credit risk of one or more underlying exposures is transferred to one or more third parties other than through the use of credit derivatives or guarantees;

(2) The credit risk associated with the underlying exposures has been separated into at least two tranches reflecting different levels of seniority;

(3) Performance of the securitization exposures depends upon the performance of the underlying exposures;

(4) All or substantially all of the underlying exposures are financial exposures (such as loans, commitments, credit derivatives, guarantees, receivables, asset-backed securities, mortgage-backed securities, other debt securities, or equity securities);

(5) The underlying exposures are not owned by an operating company;

(6) The underlying exposures are not owned by a small business investment company described in section 302 of the Small Business Investment Act;

(7) The underlying exposures are not owned by a firm an investment in which qualifies as a community development investment under section 24 (Eleventh) of the National Bank Act;

(8) The [AGENCY] may determine that a transaction in which the underlying exposures are owned by an investment firm that exercises substantially unfettered control over the size and composition of its assets, liabilities, and off-balance sheet exposures is not a traditional securitization based on the transaction's leverage, risk profile, or economic substance;

(9) The [AGENCY] may deem a transaction that meets the definition of a traditional securitization, notwithstanding paragraph (5), (6), or (7) of this definition, to be a traditional securitization based on the transaction's leverage, risk profile, or economic substance; and

(10) The transaction is not:

(i) An investment fund;

(ii) A collective investment fund (as defined in 12 CFR 208.34 (Board), 12 CFR 9.18 (OCC), and 12 CFR 344.3 (FDIC));

(iii) A pension fund regulated under the ERISA or a foreign equivalent thereof; or

(iv) Regulated under the Investment Company Act of 1940 (15 U.S.C. 80a–1) or a foreign equivalent thereof.

Tranche means all securitization exposures associated with a securitization that have the same seniority level.

Two-way market means a market where there are independent bona fide offers to buy and sell so that a price reasonably related to the last sales price or current bona fide competitive bid and offer quotations can be determined within one day and settled at that price within a relatively short time frame conforming to trade custom.

Unconditionally cancelable means with respect to a commitment, that a [BANK] may, at any time, with or without cause, refuse to extend credit under the commitment (to the extent permitted under applicable law).

Underlying exposures means one or more exposures that have been securitized in a securitization transaction.

U.S. Government agency means an instrumentality of the U.S. Government whose obligations are fully and explicitly guaranteed as to the timely payment of principal and interest by the full faith and credit of the U.S. Government.

Value-at-Risk (VaR) means the estimate of the maximum amount that the value of one or more exposures could decline due to market price or rate movements during a fixed holding period within a stated confidence interval.

Wrong-way risk means the risk that arises when an exposure to a particular counterparty is positively correlated with the probability of default of such counterparty itself.

Subpart B—Capital Ratio Requirements and Buffers

§ ____.10 Minimum capital requirements.

(a) *Minimum capital requirements.* A [BANK] must maintain the following minimum capital ratios:

(1) A common equity tier 1 capital ratio of 4.5 percent.

(2) A tier 1 capital ratio of 6 percent.

(3) A total capital ratio of 8 percent.

(4) A leverage ratio of 4 percent.

(5) For advanced approaches [BANK]s, a supplementary leverage ratio of 3 percent.

(b) *Standardized capital ratio calculations.* All [BANK]s must calculate standardized capital ratios as follows:

(1) *Common equity tier 1 capital ratio.* A [BANK]'s common equity tier 1 capital ratio is the ratio of the [BANK]'s common equity tier 1 capital to standardized total risk-weighted assets.

(2) *Tier 1 capital ratio.* A [BANK]'s tier 1 capital ratio is the ratio of the [BANK]'s tier 1 capital to standardized total risk-weighted assets.

(3) *Total capital ratio.* A [BANK]'s total capital ratio is the ratio of the

[BANK]'s total capital to standardized total risk-weighted assets.

(4) *Leverage ratio.* A [BANK]'s leverage ratio is the ratio of the [BANK]'s tier 1 capital to the [BANK]'s average consolidated assets as reported on the [BANK]'s [REGULATORY REPORT] minus amounts deducted from tier 1 capital.

(c) *Advanced approaches capital ratio calculations.* (1) *Common equity tier 1 capital ratio.* An advanced approaches [BANK]'s common equity tier 1 capital ratio is the lower of:

(i) The ratio of the [BANK]'s common equity tier 1 capital to standardized total risk-weighted assets; and

(ii) The ratio of the [BANK]'s common equity tier 1 capital to advanced approaches total risk-weighted assets.

(2) *Tier 1 capital ratio.* An advanced approaches [BANK]'s tier 1 capital ratio is the lower of:

(i) The ratio of the [BANK]'s tier 1 capital to standardized total risk-weighted assets; and

(ii) The ratio of the [BANK]'s tier 1 capital to advanced approaches total risk-weighted assets.

(3) *Total capital ratio.* An advanced approaches [BANK]'s total capital ratio is the lower of:

(i) The ratio of the [BANK]'s total capital to standardized total risk-weighted assets; and

(ii) The ratio of the [BANK]'s advanced-approaches-adjusted total capital to advanced approaches total risk-weighted assets. A [BANK]'s advanced-approaches-adjusted total capital is the [BANK]'s total capital after being adjusted as follows:

(A) An advanced approaches [BANK] must deduct from its total capital any allowance for loan and lease losses included in its tier 2 capital in accordance with § ____.20(d)(3) of subpart C of this part; and

(B) An advanced approaches [BANK] must add to its total capital any eligible credit reserves that exceed the [BANK]'s total expected credit losses to the extent that the excess reserve amount does not exceed 0.6 percent of the [BANK]'s credit risk-weighted assets.

(4) *Supplementary leverage ratio.* An advanced approaches [BANK]'s supplementary leverage ratio is the simple arithmetic mean of the ratio of its tier 1 capital to total leverage exposure calculated as of the last day of each month in the reporting quarter.

(d) *Capital adequacy.* (1) Notwithstanding the minimum requirements in this [PART] a [BANK] must maintain capital commensurate with the level and nature of all risks to which the [BANK] is exposed. The supervisory evaluation of a [BANK]'s capital adequacy is based on an individual assessment of numerous factors, including those listed at 12 CFR 3.10 (for national banks), 12 CFR 167.3(c) (for Federal savings associations) and 12 CFR 208.4 (for state member banks).

(2) A [BANK] must have a process for assessing its overall capital adequacy in relation to its risk profile and a comprehensive strategy for maintaining an appropriate level of capital.

§ ____.11 Capital conservation buffer and countercyclical capital buffer amount.

(a) *Capital conservation buffer.* (1) *Composition of the capital conservation buffer.* The capital conservation buffer is composed solely of common equity tier 1 capital.

(2) *Definitions.* For purposes of this section, the following definitions apply:

(i) *Eligible retained income.* The eligible retained income of a [BANK] is the [BANK]'s net income for the four calendar quarters preceding the current calendar quarter, based on the [BANK]'s most recent quarterly [REGULATORY REPORT], net of any capital distributions and associated tax effects not already reflected in net income.[1]

(ii) *Maximum payout ratio.* The maximum payout ratio is the percentage of eligible retained income that a [BANK] can pay out in the form of capital distributions and discretionary bonus payments during the current calendar quarter. The maximum payout ratio is based on the [BANK]'s capital conservation buffer, calculated as of the last day of the previous calendar quarter, as set forth in Table 1.

(iii) *Maximum payout amount.* A [BANK]'s maximum payout amount for the current calendar quarter is equal to the [BANK]'s eligible retained income, multiplied by the applicable maximum payout ratio, as set forth in Table 1.

(3) *Calculation of capital conservation buffer.*[2] A [BANK]'s capital conservation buffer is equal to the lowest of the following ratios, calculated as of the last day of the previous calendar quarter based on the [BANK]'s most recent [REGULATORY REPORT]:

(i) The [BANK]'s common equity tier 1 capital ratio minus the [BANK]'s minimum common equity tier 1 capital ratio requirement under § ____.10 of this part;

(ii) The [BANK]'s tier 1 capital ratio minus the [BANK]'s minimum tier 1 capital ratio requirement under § ____.10 of this part; and

(iii) The [BANK]'s total capital ratio minus the [BANK]'s minimum total capital ratio requirement under § ____.10 of this part.

(iv) If the [BANK]'s common equity tier 1, tier 1 or total capital ratio is less than or equal to the [BANK]'s minimum common equity tier 1, tier 1 or total capital ratio requirement under § ____.10 of this part, respectively, the [BANK]'s capital conservation buffer is zero.

(4) *Limits on capital distributions and discretionary bonus payments.* (i) A [BANK] shall not make capital distributions or discretionary bonus payments or create an obligation to make such distributions or payments during the current calendar quarter that, in the aggregate, exceed the maximum payout amount.

(ii) A [BANK] with a capital conservation buffer that is greater than 2.5 percent plus 100 percent of its applicable countercyclical buffer, in accordance with paragraph (b) of this section, is not subject to a maximum payout amount under this section.

(iii) *Negative eligible retained income.* Except as provided in paragraph (a)(4)(iv), a [BANK] may not make capital distributions or discretionary bonus payments during the current calendar quarter if the [BANK]'s:

(A) Eligible retained income is negative; and

(B) Capital conservation buffer was less than 2.5 percent as of the end of the previous calendar quarter.

(iv) *Prior approval.* Notwithstanding the limitations in paragraphs (a)(4)(i) through (iii) of this section the [AGENCY] may permit a [BANK] to make a capital distribution or discretionary bonus payment upon a request of the [BANK], if the [AGENCY] determines that the capital distribution or discretionary bonus payment would not be contrary to the purposes of this section, or the safety and soundness of the [BANK]. In making such a determination, the [AGENCY] will consider the nature and extent of the request and the particular circumstances giving rise to the request.

[1] Net income, as reported in the [REGULATORY REPORT], reflects discretionary bonus payments and certain capital distributions that are expense items (and their associated tax effects).

[2] For purposes of the capital conservation buffer calculations, a [BANK] must use standardized total risk weighted assets if it is a standardized approach [BANK] and it must use advanced total risk weighted assets if it is an advanced approaches [BANK].

TABLE TO § ____.11—CALCULATION OF MAXIMUM PAYOUT AMOUNT

Capital conservation buffer (as a percentage of total risk-weighted assets)	Maximum payout ratio (as a percentage of eligible retained income)
Greater than 2.5 percent plus 100 percent of the [BANK]'s applicable countercyclical capital buffer amount.	No payout ratio limitation applies.
Less than or equal to 2.5 percent plus 100 percent of the [BANK]'s applicable countercyclical capital buffer amount, and greater than 1.875 percent plus 75 percent of the [BANK]'s applicable countercyclical capital buffer amount.	60 percent.
Less than or equal to 1.875 percent plus 75 percent of the [BANK]'s applicable countercyclical capital buffer amount, and greater than 1.25 percent plus 50 percent of the [BANK]'s applicable countercyclical capital buffer amount.	40 percent.
Less than or equal to 1.25 percent plus 50 percent of the [BANK]'s applicable countercyclical capital buffer amount, and greater than 0.625 percent plus 25 percent of the [BANK]'s applicable countercyclical capital buffer amount.	20 percent.
Less than or equal to 0.625 percent plus 25 percent of the [BANK]'s applicable countercyclical capital buffer amount.	0 percent.

(v) *Other limitations on capital distributions.* Additional limitations on capital distributions may apply to a [BANK] under 12 CFR 225.4; 12 CFR 225.8; and 12 CFR 263.202.

(b) *Countercyclical capital buffer amount.* (1) *General.* An advanced approaches [BANK] must apply, calculate, and maintain a countercyclical capital buffer amount in accordance with the following paragraphs.

(i) *Composition.* The countercyclical capital buffer amount is composed solely of common equity tier 1 capital.

(ii) *Amount.* An advanced approaches [BANK] has a countercyclical capital buffer amount determined by calculating the weighted average of the countercyclical capital buffer amounts established for the national jurisdictions where the [BANK]'s private sector credit exposures are located, as specified in paragraphs (b)(2) and (3) of this section.

(iii) *Weighting.* The weight assigned to a jurisdiction's countercyclical capital buffer amount is calculated by dividing the total risk-weighted assets for the [BANK]'s private sector credit exposures located in the jurisdiction by the total risk-weighted assets for all of the [BANK]'s private sector credit exposures.

(iv) *Location.* (A) Except as provided in paragraph (b)(1)(iv)(B) of this section, the location of a private sector credit exposure (other than a securitization exposure) is the national jurisdiction where the borrower is located (that is, where it is incorporated, chartered, or similarly established or, if the borrower is an individual, where the borrower resides).

(B) If, in accordance with subpart D or subpart E of this part, the [BANK] has assigned to a private sector credit exposure a risk weight associated with a protection provider on a guarantee or credit derivative, the location of the exposure is the national jurisdiction where the protection provider is located.

(C) The location of a securitization exposure is the location of the borrowers of underlying exposures in a single jurisdiction with the largest aggregate unpaid principal balance.

(2) *Countercyclical capital buffer amount for credit exposures in the United States.* (i) *Initial countercyclical buffer amount with respect to credit exposures in the United States.* The initial countercyclical capital buffer amount in the United States is zero.

(ii) *Adjustment of the countercyclical buffer amount.* The [AGENCY] will adjust the countercyclical capital buffer amount for credit exposures in the United States in accordance with applicable law.[3]

(iii) *Range of countercyclical buffer amount.* The [AGENCY] will adjust the countercyclical capital buffer amount for credit exposures in the United States between zero percent and 2.5 percent of total risk-weighted assets. Generally, a zero percent countercyclical capital buffer amount will reflect an assessment that economic and financial conditions are consistent with a period of little or no excessive ease in credit markets associated with no material increase in system-wide credit risk. A 2.5 percent countercyclical capital buffer amount will reflect an assessment that financial markets are experiencing a period of excessive ease in credit markets associated with a material increase in credit system-wide risk.

(iv) *Adjustment Determination.* The [AGENCY] will base its decision to adjust the countercyclical capital buffer amount under this section on a range of macroeconomic, financial, and supervisory information indicating an increase in systemic risk including, but not limited to, the ratio of credit to gross domestic product, a variety of asset prices, other factors indicative of relative credit and liquidity expansion or contraction, funding spreads, credit condition surveys, indices based on credit default swap spreads, options implied volatility, and measures of systemic risk.

(v) *Effective date of adjusted countercyclical capital buffer amount.* (A) *Increase adjustment.* A determination by the [AGENCY] under paragraph (b)(2)(ii) of this section to increase the countercyclical capital buffer amount will be effective 12 months from the date of announcement, unless the [AGENCY] establishes an earlier effective date and includes a statement articulating the reasons for the earlier effective date.

(B) *Decrease adjustment.* A determination by the [AGENCY] to decrease the established countercyclical capital buffer amount under paragraph (b)(2)(ii) of this section will be effective at the later of the day following announcement of the final determination or the earliest date permissible under applicable law or regulation.

(vi) *Twelve month sunset.* The countercyclical capital buffer amount will return to zero percent 12 months after the effective date of the adjusted countercyclical capital buffer amount announced, unless the [AGENCY] announces a decision to maintain the adjusted countercyclical capital buffer amount or adjust it again before the expiration of the 12-month period.

(3) *Countercyclical capital buffer amount for foreign jurisdictions.* The [AGENCY] will adjust the countercyclical capital buffer amount for private sector credit exposures to reflect decisions made by foreign jurisdictions consistent with due process requirements described in paragraph (b)(2) of this section.

[3] The [AGENCY] expects that any adjustment will be based on a determination made jointly by the Board, OCC, and FDIC.

Subpart C—Definition of Capital

§ ____.20 Capital components and eligibility criteria for regulatory capital instruments.

(a) *Regulatory capital components.* A [BANK]'s regulatory capital components are: (1) Common equity tier 1 capital;

(2) Additional tier 1 capital; and

(3) Tier 2 capital.

(b) *Common equity tier 1 capital.* Common equity tier 1 capital is the sum of the common equity tier 1 capital elements as set forth in paragraph (b) of this section, minus regulatory adjustments and deductions as set forth in § ____.22 of this part.[1] The common equity tier 1 capital elements are:

(1) Any common stock instruments (plus any related surplus) issued by the [BANK], net of treasury stock, that meet all the following criteria: [2]

(i) The instrument is paid-in, issued directly by the [BANK], and represents the most subordinated claim in a receivership, insolvency, liquidation, or similar proceeding of the [BANK].

(ii) The holder of the instrument is entitled to a claim on the residual assets of the [BANK] that is proportional with the holder's share of the [BANK]'s issued capital after all senior claims have been satisfied in a receivership, insolvency, liquidation, or similar proceeding.

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

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

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

(vi) The [BANK] has full discretion at all times to refrain from paying any dividends and making any other capital distributions on the instrument without triggering an event of default, a requirement to make a payment-in-kind, or an imposition of any other restrictions on the [BANK].

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

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

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

(x) The [BANK], or an entity that the [BANK] controls, did not purchase or directly or indirectly fund the purchase of the instrument.

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

(xii) The instrument has been issued in accordance with applicable laws and regulations.

(xiii) The instrument is reported on the [BANK]'s regulatory financial statements separately from other capital instruments.

(2) Retained earnings.

(3) Accumulated other comprehensive income.

(4) Common equity tier 1 minority interest subject to the limitations in § ____.21(a) of this part.

(c) *Additional tier 1 capital.* Additional tier 1 capital is the sum of additional tier 1 capital elements and any related surplus, minus the regulatory adjustments and deductions in § ____.22 of this part. Additional tier 1 capital elements are:

(1) Instruments (plus any related surplus) that meet the following criteria:

(i) The instrument is issued and paid in.

(ii) The instrument is subordinated to depositors, general creditors, and subordinated debt holders of the [BANK] in a receivership, insolvency, liquidation, or similar proceeding.

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

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

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

(A) The [BANK] must receive prior approval from the [AGENCY] to exercise a call option on the instrument.

(B) The [BANK] does not create at issuance of the instrument, through any action or communication, an expectation that the call option will be exercised.

(C) Prior to exercising the call option, or immediately thereafter, the [BANK] must either:

(*1*) Replace the instrument to be called with an equal amount of instruments that meet the criteria under paragraph (b) or (c) of this section; [3] or

(*2*) Demonstrate to the satisfaction of the [AGENCY] that following redemption, the [BANK] will continue to hold capital commensurate with its risk.

(vi) Redemption or repurchase of the instrument requires prior approval from the [AGENCY].

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

(viii) Any capital distributions on the instrument are paid out of the [BANK]'s net income and retained earnings.

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

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

(xi) The [BANK], or an entity that the [BANK] controls, did not purchase or directly or indirectly fund the purchase of the instrument.

(xii) The instrument does not have any features that would limit or discourage additional issuance of capital by the [BANK], such as

[1] Voting common stockholders' equity, which is the most desirable capital element from a supervisory standpoint, generally should be the dominant element within common equity tier 1 capital.

[2] Capital instruments issued by mutual banking organizations may qualify as common equity tier 1 capital provided that the instruments meet all of the criteria in this section.

[3] Replacement can be concurrent with redemption of existing additional tier 1 capital instruments.

provisions that require the [BANK] to compensate holders of the instrument if a new instrument is issued at a lower price during a specified time frame.

(xiii) If the instrument is not issued directly by the [BANK] or by a subsidiary of the [BANK] that is an operating entity, the only asset of the issuing entity is its investment in the capital of the [BANK], and proceeds must be immediately available without limitation to the [BANK] or to the [BANK]'s top-tier holding company in a form which meets or exceeds all of the other criteria for additional tier 1 capital instruments.[4]

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

(2) Tier 1 minority interest, subject to the limitations in § ____.21(b) of this part, that is not included in the [BANK]'s common equity tier 1 capital.

(3) Any and all instruments that qualified as tier 1 capital under the [AGENCY]'s general risk-based capital rules under 12 CFR part 3, appendix A, 12 CFR 167 (OCC); 12 CFR part 208, appendix A, 12 CFR part 225, appendix A (Board); and 12 CFR part 325, appendix A, 12 CFR part 390, subpart Z (FDIC) as then in effect, that were issued under the Small Business Jobs Act of 2010[5] or prior to October 4, 2010, under the Emergency Economic Stabilization Act of 2008.[6]

(d) *Tier 2 Capital.* Tier 2 capital is the sum of tier 2 capital elements and any related surplus, minus regulatory adjustments and deductions in § ____.22 of this part. Tier 2 capital elements are:

(1) Instruments (plus related surplus) that meet the following criteria:

(i) The instrument is issued and paid in.

(ii) The instrument is subordinated to depositors and general creditors of the [BANK].

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

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

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

(A) The [BANK] must receive the prior approval of the [AGENCY] to exercise a call option on the instrument.

(B) The [BANK] does not create at issuance, through action or communication, an expectation the call option will be exercised.

(C) Prior to exercising the call option, or immediately thereafter, the [BANK] must either:

(*1*) Replace any amount called with an equivalent amount of an instrument that meets the criteria for regulatory capital under this section,[7] or

(*2*) Demonstrate to the satisfaction of the [AGENCY] that following redemption, the [BANK] would continue to hold an amount of capital that is commensurate with its risk.

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

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

(viii) The [BANK], or an entity that the [BANK] controls, has not purchased and has not directly or indirectly funded the purchase of the instrument.

(ix) If the instrument is not issued directly by the [BANK] or by a subsidiary of the [BANK] that is an operating entity, the only asset of the issuing entity is its investment in the capital of the [BANK], and proceeds must be immediately available without limitation to the [BANK] or the [BANK]'s top-tier holding company in a form that meets or exceeds all the other criteria for tier 2 capital instruments under this section.[8]

(x) Redemption of the instrument prior to maturity or repurchase requires the prior approval of the [AGENCY].

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

(2) Total capital minority interest, subject to the limitations set forth in § ____.21(c) of this part, that is not included in the [BANK]'s tier 1 capital.

(3) Allowance for loan and lease losses (ALLL) up to 1.25 percent of the [BANK]'s standardized total risk-weighted assets not including any amount of the ALLL (and excluding in the case of a market risk [BANK], its standardized market risk-weighted assets).

(4) Any instrument that qualified as tier 2 capital under the [AGENCY]'s general risk-based capital rules under 12 CFR part 3, appendix A, 12 CFR 167 (OCC); 12 CFR part 208, appendix A, 12 CFR part 225, appendix A (Board); 12 CFR part 325, appendix A, 12 CFR part 390 (FDIC) as then in effect, that were issued under the Small Business Jobs Act of 2010 (Pub. L. 111–240; 124 Stat. 2504 (2010)) or prior to October 4, 2010, under the Emergency Economic Stabilization Act of 2008 (Pub. L. 110–343, 122 Stat. 3765 (2008)).

(e) *[AGENCY] approval of a capital element.* (1) Notwithstanding the criteria for regulatory capital instruments set forth in this section, the [AGENCY] may find that a capital element may be included in a [BANK]'s common equity tier 1 capital, additional tier 1 capital, or tier 2 capital on a permanent or temporary basis.

(2) A [BANK] must receive [AGENCY] prior approval to include a capital element (as listed in this section) in its common equity tier 1 capital, additional tier 1 capital, or tier 2 capital unless the element:

(i) Was included in a [BANK]'s tier 1 capital or tier 2 capital as of May 19,

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

[5] Public Law 111–240; 124 Stat. 2504 (2010).

[6] Public Law 110–343, 122 Stat. 3765 (2008).

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

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

2010 in accordance with the [AGENCY]'s risk-based capital rules that were effective as of that date and the underlying instrument continues to be includable under the criteria set forth in this section; or

(ii) Is equivalent in terms of capital quality and ability to absorb credit losses with respect to all material terms to a regulatory capital element described in a decision made publicly available under paragraph (e)(3) of this section by the [AGENCY].

(3) When considering whether a [BANK] may include a regulatory capital element in its common equity tier 1 capital, additional tier 1 capital, or tier 2 capital, the [AGENCY] will consult with the other federal banking agencies.

(4) After determining that a regulatory capital element may be included in a [BANK]'s common equity tier 1 capital, additional tier 1 capital, or tier 2 capital, the [AGENCY] will make its decision publicly available, including a brief description of the material terms of the regulatory capital element and the rationale for the determination.

§ ____.21 Minority interest.

(a) *Common equity tier 1 minority interest*[9] *includable in the common equity tier 1 capital of the [BANK].* For each consolidated subsidiary of a [BANK], the amount of common equity tier 1 minority interest the [BANK] may include in common equity tier 1 capital is equal to:

(1) The common equity tier 1 minority interest of the subsidiary; minus

(2) The percentage of the subsidiary's common equity tier 1 capital that is not owned by the [BANK], multiplied by the difference between the common equity tier 1 capital of the subsidiary and the lower of:

(i) The amount of common equity tier 1 capital the subsidiary must hold to not be subject to restrictions on capital distributions and discretionary bonus payments under § ____.11 of subpart B of this part or equivalent regulations established by the subsidiary's home country supervisor, or

(ii)(A) The standardized total risk-weighted assets of the [BANK] that relate to the subsidiary multiplied by

(B) The common equity tier 1 capital ratio the subsidiary must maintain to not be subject to restrictions on capital distributions and discretionary bonus payments under § ____.11 of subpart B of this part or equivalent regulations established by the subsidiary's home country supervisor.

(b) *Tier 1 minority interest includable in the tier 1 capital of the [BANK].* For each consolidated subsidiary of the [BANK], the amount of tier 1 minority interest the [BANK] may include in tier 1 capital is equal to:

(1) The tier 1 minority interest of the subsidiary; minus

(2) The percentage of the subsidiary's tier 1 capital that is not owned by the [BANK] multiplied by the difference between the tier 1 capital of the subsidiary and the lower of:

(i) The amount of tier 1 capital the subsidiary must hold to not be subject to restrictions on capital distributions and discretionary bonus payments under § ____.11 of subpart B of this part or equivalent standards established by the subsidiary's home country supervisor, or

(ii)(A) The standardized total risk-weighted assets of the [BANK] that relate to the subsidiary multiplied by

(B) The tier 1 capital ratio the subsidiary must maintain to avoid restrictions on capital distributions and discretionary bonus under § ____.11 of subpart B of this part or equivalent standards established by the subsidiary's home country supervisor.

(c) *Total capital minority interest includable in the total capital of the [BANK].* For each consolidated subsidiary of the [BANK], the amount of total capital minority interest the [BANK] may include in total capital is equal to:

(1) The total capital minority interest of the subsidiary; minus

(2) The percentage of the subsidiary's total capital that is not owned by the [BANK] multiplied by the difference between the total capital of the subsidiary and the lower of:

(i) The amount of total capital the subsidiary must hold to not be subject to restrictions on capital distributions and discretionary bonus payments under § ____.11 of subpart B of this part or equivalent standards established by the subsidiary's home country supervisor, or

(ii)(A) The standardized total risk-weighted assets of the [BANK] that relate to the subsidiary multiplied by

(B) The total capital ratio the subsidiary must maintain to avoid restrictions on capital distributions and discretionary bonus payments under § ____.11 of subpart B of this part or equivalent standards established by the subsidiary's home country supervisor.

§ ____.22 Regulatory capital adjustments and deductions.

(a) *Regulatory capital deductions from common equity tier 1 capital.* A [BANK] must deduct the following items from the sum of its common equity tier 1 capital elements:

(1) Goodwill, net of associated deferred tax liabilities (DTLs), in accordance with paragraph (e) of this section, and goodwill embedded in the valuation of a significant investment in the capital of an unconsolidated financial institution in the form of common stock, in accordance with paragraph (d) of this section.

(2) Intangible assets, other than MSAs, net of associated DTLs, in accordance with paragraph (e) of this section.

(3) Deferred tax assets (DTAs) that arise from operating loss and tax credit carryforwards net of any related valuation allowances and net of DTLs, in accordance with paragraph (e) of this section.

(4) Any gain-on-sale associated with a securitization exposure.

(5) For a [BANK] that is not an insured depository institution, any defined benefit pension fund asset, net of any associated DTL, in accordance with paragraph (e) of this section. With the prior approval of the [AGENCY], the [BANK] may reduce the amount to be deducted by the amount of assets of the defined benefit pension fund to which it has unrestricted and unfettered access, provided that the [BANK] includes such assets in its risk-weighted assets as if the [BANK] held them directly.[10]

(6) For a [BANK] subject to subpart E of this [PART], the amount of expected credit loss that exceeds its eligible credit reserves.

(7) Financial subsidiaries:

(i) A [BANK] must deduct the aggregate amount of its outstanding equity investment, including retained earnings, in its financial subsidiaries (as defined in 12 CFR 5.39 (OCC); 12 CFR 208.77 (Board); and 12 CFR 362.17 (FDIC)) and may not consolidate the assets and liabilities of a financial subsidiary with those of the national bank.

(ii) No other deduction is required under paragraph (c) of this section for investments in the capital instruments of financial subsidiaries.

(b) *Regulatory adjustments to common equity tier 1 capital.* A [BANK] must make the following adjustments to

[9] For purposes of the minority interest calculations, if the consolidated subsidiary issuing the capital is not subject to the same minimum capital requirements or capital conservation buffer framework of the [BANK], the [BANK] must assume that the minimum capital requirements and capital conservation buffer framework of the [BANK] apply to the subsidiary.

[10] For this purpose, unrestricted and unfettered access means that the excess assets of the defined benefit pension fund would be available to protect depositors or creditors of the [BANK] in the event of receivership, insolvency, liquidation, or similar proceeding.

the sum of common equity tier 1 capital elements:

(1) Deduct any unrealized gain and add any unrealized loss on cash flow hedges included in accumulated other comprehensive income (AOCI), net of applicable tax effects, that relate to the hedging of items that are not recognized at fair value on the balance sheet.

(2) Deduct any unrealized gain and add any unrealized loss related to changes in the fair value of liabilities that are due to changes in the [BANK]'s own credit risk. Advanced approaches [BANK]s must deduct the credit spread premium over the risk free rate for derivatives that are liabilities.

(c) *Deductions from regulatory capital related to investments in capital instruments.* (1) Investments in the [BANK]'s own capital instruments.

(i) A [BANK] must deduct investments in (including any contractual obligation to purchase) its own common stock instruments, whether held directly or indirectly, from its common equity tier 1 capital elements to the extent such instruments are not excluded from regulatory capital under § ____.20(b)(1) of this part.

(ii) A [BANK] must deduct investments in (including any contractual obligation to purchase) its own additional tier 1 capital instruments, whether held directly or indirectly, from its additional tier 1 capital elements.

(iii) A [BANK] must deduct investments in (including any contractual obligation to purchase) its own tier 2 capital instruments, whether held directly or indirectly, from its tier 2 capital elements.

(iv) For any deduction required under this section, gross long positions may be deducted net of short positions in the same underlying instrument only if the short positions involve no counterparty risk.

(v) For any deduction required under this section, a [BANK] must look through any holdings of index securities to deduct investments in its own capital instruments. In addition:

(A) Gross long positions in investments in a [BANK]'s own regulatory capital instruments resulting from holdings of index securities may be netted against short positions in the same index;

(B) Short positions in index securities that are hedging long cash or synthetic positions can be decomposed to recognize the hedge; and

(C) The portion of the index that is composed of the same underlying exposure that is being hedged may be used to offset the long position if both the exposure being hedged and the short position in the index are covered positions under subpart F of this part, and the hedge is deemed effective by the banking organization's internal control processes.

(2) *Corresponding deduction approach.* For purposes of this subpart, the corresponding deduction approach is the methodology used for the deductions from regulatory capital related to reciprocal cross holdings, non-significant investments in the capital of unconsolidated financial institutions, and non-common stock significant investments in the capital of unconsolidated financial institutions. Under the corresponding deduction approach, a [BANK] must make any such deductions from the component of capital for which the underlying instrument would qualify if it were issued by the [BANK] itself. In addition:

(i) If the [BANK] does not have a sufficient amount of a specific component of capital to effect the required deduction, the shortfall must be deducted from the next higher (that is, more subordinated) component of regulatory capital.

(ii) If the investment is in the form of an instrument issued by a non-regulated financial institution, the [BANK] must treat the instrument as:

(A) A common equity tier 1 capital instrument if it is common stock or represents the most subordinated claim in liquidation of the financial institution; and

(B) An additional tier 1 capital instrument if it is subordinated to all creditors of the financial institution and is only senior in liquidation to common shareholders.

(iii) If the investment is in the form of an instrument issued by a regulated financial institution and the instrument does not meet the criteria for common equity tier 1, additional tier 1 or tier 2 capital instruments under § ____.20 of this part, the [BANK] must treat the instrument as:

(A) A common equity tier 1 capital instrument if it is common stock included in GAAP equity or represents the most subordinated claim in liquidation of the financial institution;

(B) An additional tier 1 capital instrument if it is included in GAAP equity, subordinated to all creditors of the financial institution, and senior in a receivership, insolvency, liquidation, or similar proceeding only to common shareholders; and

(C) A tier 2 capital instrument if it is not included in GAAP equity but considered regulatory capital by the primary regulator of the financial institution.

(3) *Reciprocal crossholdings in the capital of financial institutions.* A [BANK] must deduct investments in the capital of other financial institutions it holds reciprocally, where such reciprocal crossholdings result from a formal or informal arrangement to swap, exchange, or otherwise intend to hold each other's capital instruments, by applying the corresponding deduction approach.

(4) *Non-significant investments in the capital of unconsolidated financial institutions.* (i) A [BANK] must deduct its non-significant investments in the capital of unconsolidated financial institutions that, in the aggregate, exceed 10 percent of the sum of the [BANK]'s common equity tier 1 capital elements minus all deductions from and adjustments to common equity tier 1 capital elements required under paragraphs (a) through (c)(3) of this section (the 10 percent threshold for non-significant investments) by applying the corresponding deduction approach.[11]

(ii) The amount to be deducted under this section from a specific capital component is equal to:

(A) The amount of a [BANK]'s non-significant investments exceeding the 10 percent threshold for non-significant investments multiplied by

(B) The ratio of the non-significant investments in unconsolidated financial institutions in the form of such capital component to the amount of the [BANK]'s total non-significant investments in unconsolidated financial institutions.

(iii) Any non-significant investments in the capital of unconsolidated financial institutions that do not exceed the 10 percent threshold for non-significant investments under this section must be assigned the appropriate risk weight under subpart D, E, or F of this part, as applicable.

(5) *Significant investments in the capital of unconsolidated financial institutions that are not in the form of common stock.* The [BANK] must deduct its significant investments in the capital of unconsolidated financial institutions that are not in the form of common stock by applying the corresponding deduction approach.[12]

[11] With prior written approval of the [AGENCY], for the period of time stipulated by the [AGENCY], a [BANK] is not required to deduct exposures to the capital instruments of unconsolidated financial institutions pursuant to this section if the investment is made in connection with the [BANK] providing financial support to a financial institution in distress.

[12] With prior written approval of the [AGENCY], for the period of time stipulated by the [AGENCY], a [BANK] is not required to deduct exposures to the capital instruments of unconsolidated financial

(d) *Items subject to the 10 and 15 percent common equity tier 1 capital deduction thresholds.* (1) A [BANK] must deduct from common equity tier 1 capital elements the amount of each of the following items that, individually, exceeds 10 percent of the sum of the [BANK]'s common equity tier 1 capital elements, less adjustments to and deductions from common equity tier 1 capital required under paragraphs (a) through (c) of this section (the 10 percent common equity tier 1 capital deduction threshold): [13]

(i) DTAs arising from temporary differences that the [BANK] could not realize through net operating loss carrybacks, net of any related valuation allowances and net of DTLs, in accordance with paragraph (e) of this section.[14]

(ii) MSAs net of associated DTLs, in accordance with paragraph (e) of this section.

(iii) Significant investments in the capital of unconsolidated financial institutions in the form of common stock net of associated DTLs, in accordance with paragraph (e) of this section.[15]

(2) A [BANK] must deduct from common equity tier 1 capital elements the amount of the items listed in paragraph (d)(1) of this section that are not deducted as a result of the application of the 10 percent common equity tier 1 capital deduction threshold, and that, in aggregate, exceeds 17.65 percent of the sum of the [BANK]'s common equity tier 1 capital elements, minus adjustments to and deductions from common equity tier 1 capital required under paragraphs (a) through (c) of this section, minus the items listed in paragraph (d)(1) of this section (the 15 percent common equity tier 1 capital deduction threshold).[16]

(3) If the total amount of MSAs deducted under paragraphs (d)(1) and (2) of this section is less than 10 percent of the fair value of MSAs, a [BANK] must deduct an additional amount of MSAs equal to the difference between 10 percent of the fair value of MSAs and the amount of MSAs deducted under paragraphs (d)(1) and (2).

(4) The amount of the items in paragrapn (d)(1) of this section that is not deducted from common equity tier 1 capital pursuant to this section must be included in the risk-weighted assets of the [BANK] and assigned a 250 percent risk weight.

(e) *Netting of DTLs against assets subject to deduction.* (1) Except as described in paragraph (e)(3) of this section, netting of DTLs against assets that are subject to deduction under § ____.22 is permitted if the following conditions are met:

(i) The DTL is associated with the asset.

(ii) The DTL would be extinguished if the associated asset becomes impaired or is derecognized under GAAP.

(2) A DTL can only be netted against a single asset.

(3) The amount of DTAs that arise from operating loss and tax credit carryforwards, net of any related valuation allowances, and of DTAs arising from temporary differences that the [BANK] could not realize through net operating loss carrybacks, net of any related valuation allowances, may be netted against DTLs (that have not been netted against assets subject to deduction pursuant to paragraph (e)(1) of this section subject to the following conditions:

(i) Only the DTAs and DTLs that relate to taxes levied by the same taxation authority and that are eligible for offsetting by that authority may be offset for purposes of this deduction.

(ii) The amount of DTLs that the [BANK] nets against DTAs that arise from operating loss and tax credit carryforwards, net of any related valuation allowances, and against DTAs arising from temporary differences that the [BANK] could not realize through net operating loss carrybacks, net of any related valuation allowances, must be allocated in proportion to the amount of DTAs that arise from operating loss and tax credit carryforwards (net of any related valuation allowances, but before any offsetting of DTLs) and of DTAs arising from temporary differences that the [BANK] could not realize through net operating loss carrybacks (net of any related valuation allowances, but before any offsetting of DTLs), respectively.

(f) *Treatment of assets that are deducted.* A [BANK] need not include in risk-weighted assets any asset that is deducted from regulatory capital under this section.

(g) *Items subject to a 1250 percent risk weight.* A [BANK] must apply a 1250 percent risk weight to the portion of a CEIO that does not constitute an after-tax-gain-on-sale.

Subpart G—Transition Provisions

§ ____.300 Transitions.

(a) *Common equity tier 1 and tier 1 capital minimum ratios.* From January 1, 2013 through December 31, 2015, a [BANK] must calculate its capital ratios in accordance with this subpart and maintain at least the transition minimum capital ratios set forth in Table 1.

TABLE 1 TO § ____.300

Transition Minimum Common Equity Tier 1 and Tier 1 Capital Ratios

Transition period	Common equity tier 1 capital ratio	Tier 1 capital ratio
Calendar year 2013	3.5	4.5
Calendar year 2014	4.0	5.5
Calendar year 2015	4.5	6.0

institutions pursuant to this section if the investment is made in connection with the [BANK] providing financial support to a financial institution in distress.

[13] For purposes of calculating the 10 and 15 percent common equity tier 1 capital deduction thresholds, any goodwill embedded in the valuation of a significant investments in the capital of unconsolidated financial institutions in the form of common stock that is deducted under § ____.22(a)(1) can be excluded.

[14] A [BANK] is not required to deduct from the sum of its common equity tier 1 capital elements net DTAs arising from timing differences that the [BANK] could realize through net operating loss carrybacks. The [BANK] must risk weight these assets at 100 percent. Likewise, for a [BANK] that is a member of a consolidated group for tax purposes, the amount of DTAs that could be realized through net operating loss carrybacks may not exceed the amount that the [BANK] could reasonably expect to have refunded by its parent holding company.

[15] With the prior written approval of the [AGENCY], for the period of time stipulated by the [AGENCY], a [BANK] is not required to deduct exposures to the capital instruments of unconsolidated financial institutions pursuant to this section if the investment is made in connection with the [BANK] providing financial support to a financial institution in distress.

[16] For purposes of calculating the 15 percent common equity tier 1 capital deduction threshold, any goodwill that has already been deducted under § ____.22(a)(1) can be excluded from the amount of the significant investments in the capital of unconsolidated financial institutions in the form of common stock.

(b) *Capital conservation and countercyclical capital buffer.* From January 1, 2013 through December 31, 2018, a [BANK] is subject to limitations on capital distributions and discretionary bonus payments with respect to its capital conservation buffer and any applicable countercyclical capital buffer amount, as set forth in this section.

(1) From January 1, 2013 through December 31, 2015, a [BANK] is not subject to limits on capital distributions and discretionary bonus payments under § ____.11 of subpart B of this part notwithstanding the amount of its capital conservation buffer.

(2) From January 1, 2016 through December 31, 2018:

(i) A [BANK] that maintains a capital conservation buffer above 0.625 percent during calendar year 2016, above 1.25 percent during calendar year 2017, and above 1.875 percent during calendar year 2018 is not subject to limits on capital distributions and discretionary bonus payments under § ____.11 of subpart B.

(ii) A [BANK] that maintains a capital conservation buffer that is less than 0.625 percent during calendar year 2016, less than 1.25 percent during calendar year 2017, and less than 1.875 percent during calendar year 2018 cannot make capital distributions and discretionary bonus payments above the maximum payout amount (as defined under § ____.11 of subpart B of this part) as described in Table 2.

TABLE 2 TO § ____.300

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

(c) *Regulatory capital adjustments and deductions.* From January 1, 2013 through December 31, 2017, a [BANK] must make the capital adjustments and deductions in § ____.22 of subpart C of this part in accordance with the transition requirements in paragraph (c) of this part. Beginning on January 1, 2018, a [BANK] must make all regulatory capital adjustments and deductions in accordance with § ______.22 of subpart C of this part.

(1) *Transition deductions from common equity tier 1 capital.* From January 1, 2013 through December 31, 2017, a [BANK] must allocate the deductions required under § ____.22(a) of subpart C of this part from common equity tier 1 or tier 1 capital elements as described below.

(i) A [BANK] must deduct goodwill (§ ____.22(a)(1) of subpart C of this part), DTAs that arise from operating loss and tax credit carryforwards (§ ____.22(a)(3) of subpart C), gain-on-sale associated with a securitization exposure (§ ____.22(a)(4) of subpart C), defined benefit pension fund assets (§ ____.22(a)(5) of subpart C), and expected credit loss that exceeds eligible credit reserves (for [BANK]s subject to subpart E of this [PART]) (§ ____.22(a)(6) of subpart C), from common equity tier 1 and additional tier 1 capital in accordance with the percentages set forth in Table 3.

TABLE 3 TO § ____.300

Transition period	*Transition deductions under § ____.22(a)(1) of subpart C* of this part	*Transition deductions under § ____.22(a)(3)–(6) of subpart C* of this part	
	Percentage of the deductions from common equity tier 1 capital	Percentage of the deductions from common equity tier 1 capital	Percentage of the deductions from tier 1 capital
Calendar year 2013	100	0	100
Calendar year 2014	100	20	80
Calendar year 2015	100	40	60
Calendar year 2016	100	60	40
Calendar year 2017	100	80	20
Calendar year 2018, and thereafter	100	100	0

(ii) A [BANK] must deduct from common equity tier 1 capital any intangible assets other than goodwill and MSAs in accordance with the percentages set forth in Table 4.

(iii) A [BANK] must apply a 100 percent risk-weight to the aggregate amount of intangible assets other than goodwill and MSAs that are not required to be deducted from common equity tier 1 capital under this section.

TABLE 4 TO § ____.300

Transition period	*Transition deductions under § ____.22(a)(2) of subpart C—Percentage of the deductions from common equity tier 1 capital*
Calendar year 2013	0
Calendar year 2014	20
Calendar year 2015	40
Calendar year 2016	60
Calendar year 2017	80
Calendar year 2018 and thereafter	100

(2) *Transition adjustments to common equity tier 1 capital.* From January 1, 2013 through December 31, 2017, a [BANK] must allocate the regulatory adjustments related to changes in the fair value of liabilities due to changes in the [BANK]'s own credit risk (§ ____ 22(b)(2) of subpart C of this part) between common equity tier 1 capital and tier 1 capital in accordance with the percentages described in Table 5.

(i) If the aggregate amount of the adjustment is positive, the [BANK] must allocate the deduction between common equity tier 1 and tier 1 capital in accordance with Table 5.

(ii) If the aggregate amount of the adjustment is negative, the [BANK] must add back the adjustment to common equity tier 1 capital or to tier 1 capital, in accordance with Table 5.

TABLE 5 TO § ____.300

Transition period	*Transition adjustments under § ____.22(b)(2) of subpart C* of this part	
	Percentage of the adjustment applied to common equity tier 1 capital	Percentage of the adjustment applied to tier 1 capital
Calendar year 2013	0	100
Calendar year 2014	20	80
Calendar year 2015	40	60
Calendar year 2016	60	40
Calendar year 2017	80	20
Calendar year 2018, and thereafter	100	0

(3) *Transition adjustments to AOCI.* From January 1, 2013 through December 31, 2017, a [BANK] must adjust common equity tier 1 capital with respect to the aggregate amount of:

(i) Unrealized gains on AFS equity securities, plus

(ii) Net unrealized gains or losses on AFS debt securities, plus

(iii) Accumulated net unrealized gains and losses on defined benefit pension obligations, plus

(iv) Accumulated net unrealized gains or losses on cash flow hedges related to items that are reported on the balance sheet at fair value included in AOCI (the transition AOCI adjustment amount) as reported on the [BANK's] [REGULATORY REPORT] as follows:

(A) If the transition AOCI adjustment amount is positive, the appropriate amount must be deducted from common equity tier 1 capital in accordance with Table 6.

(B) If the transition AOCI adjustment amount is negative, the appropriate amount must be added back to common equity tier 1 capital in accordance with Table 6.

TABLE 6 TO § ____.300

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

(iii) A [BANK] may include a certain amount of unrealized gains on AFS equity securities in tier 2 capital during the transition period in accordance with Table 7.

TABLE 7 TO § ____.300

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

(4) *Additional deductions from regulatory capital.* (i) From January 1, 2013 through December 31, 2017, a [BANK] must use Table 8 to determine the amount of investments in capital instruments and the items subject to the 10 and 15 percent common equity tier 1 capital deduction thresholds (§ ____.22(d) of subpart C of this part) (that is, MSAs, DTAs arising from temporary differences that the [BANK] could not realize through net operating loss carrybacks, and significant investments in the capital of unconsolidated financial institutions in the form of common stock) that must be deducted from common equity tier 1.

(ii) From January 1, 2013 through December 31, 2017, a [BANK] must apply a 100 percent risk-weight to the aggregate amount of the items subject to the 10 and 15 percent common equity tier 1 capital deduction thresholds that are not deducted under this section. As set forth in § ____.22(d)(4) of subpart C of this part, beginning on January 1, 2018, a [BANK] must apply a 250 percent risk-weight to the aggregate amount of the items subject to the 10 and 15 percent common equity tier 1 capital deduction thresholds that are not deducted from common equity tier 1 capital.

TABLE 8 TO § ____. 300

Transition period	Transition deductions under § ____.22(c) and (d) of subpart C of this part—Percentage of the deductions from common equity tier 1 capital
Calendar year 2013	0
Calendar year 2014	20
Calendar year 2015	40
Calendar year 2016	60
Calendar year 2017	80
Calendar year 2018 and thereafter	100

(iii) For purposes of calculating the transition deductions in this section, from January 1, 2013 through December 31, 2017, a [BANK]'s 15 percent common equity tier 1 capital deduction threshold for MSAs, DTAs arising from temporary differences that the [BANK] could not realize through net operating loss carrybacks, and significant investments in the capital of unconsolidated financial institutions in the form of common stock is equal to 15 percent of the sum of the [BANK]'s common equity tier 1 elements, after deductions required under § ____.22(a) through (c) of subpart C of this part (transition 15 percent common equity tier 1 capital deduction threshold).

(iv) If the amount of MSAs the [BANK] deducts after the application of the appropriate thresholds is less than 10 percent of the fair value of the [BANK]'s MSAs, the [BANK] must deduct an additional amount of MSAs so that the total amount of MSAs deducted is at least 10 percent of the fair value of the [BANK]'s MSAs.

(v) Beginning on January 1, 2018, a [BANK] must calculate the 15 percent common equity tier 1 capital deduction threshold in accordance with § ____.22(d) of subpart C of this part.

(d) *Transition arrangements for capital instruments.* (1) A depository institution holding company with total consolidated assets greater than or equal to $15 billion as of December 31, 2009 (depository institution holding company of $15 billion or more) may include in capital the percentage indicated in Table 9 of the aggregate outstanding principal amount of debt or equity instruments issued before May 19, 2010, that do not meet the criteria in § ____.20 of subpart C of this part for additional tier 1 or tier 2 capital instruments (non-qualifying capital instruments), but that were included in tier 1 or tier 2 capital, respectively, as of May 19, 2010.

(i) The [BANK] must apply Table 9 separately to additional tier 1 and tier 2 non-qualifying capital instruments.

(ii) The amount of non-qualifying capital instruments that may not be included in additional tier 1 capital under this section may be included in tier 2 capital without limitation, provided the instrument meets the criteria for tier 2 capital under § ____.20(d) of subpart C of this part.

(iii) A depository institution holding company of $15 billion or more that acquires either a depository institution holding company with total consolidated assets of less than $15 billion as of December 31, 2009 (depository institution holding company under $15 billion) or a depository institution holding company that was a mutual holding company as of May 19, 2010, may include in regulatory capital non-qualifying capital instruments issued prior to May 19, 2010, by the acquired organization only to the extent provided in Table 9.

(iv) If a depository institution holding company under $15 billion acquires a depository institution holding company under $15 billion or a 2010 MHC and the resulting organization has total consolidated assets of $15 billion or more as reported on the resulting organization's FR Y–9C for the period in which the transaction occurred, the resulting organization may include in regulatory capital non-qualifying capital instruments issued prior to May 19, 2010 (2010 MHC) to the extent provided in Table 9.

TABLE 9 TO § ____. 300

Transition period (Calendar year)	*Percentage of non-qualifying capital instruments included in additional tier 1 or tier 2 capital for depository institution holding companies of $15 billion or more*
Calendar year 2013	75
Calendar year 2014	50
Calendar year 2015	25
Calendar year 2016 and thereafter	0

(2) Depository institution holding companies under $15 billion, depository institutions, and 2010 MHCs that are not subject to paragraph (d)(1)(iii) of this section may include in regulatory capital non-qualifying capital instruments issued prior to May 19, 2010 subject to the transition

arrangements described in paragraph (d)(2).

(i) Non-qualifying capital instruments issued before September 12, 2010, that were outstanding as of January 1, 2013 may be included in a [BANK]'s capital up to the percentage of the outstanding principal amount of such non-qualifying capital instruments as of January 1, 2013 in accordance with Table 10.

(ii) Table 10 applies separately to additional tier 1 and tier 2 non-qualifying capital instruments.

(iii) The amount of non-qualifying capital instruments that cannot be included in additional tier 1 capital under this section may be included in the tier 2 capital, provided the instruments meet the criteria for tier 2 capital instruments under § ____.20(d) of subpart C of this part.

TABLE 10 TO § ____. 300

Transition period (Calendar year)	*Percentage of non-qualifying capital instruments included in additional tier 1 or tier 2 capital for depository institution holding companies under $15 billion, depository institutions, and 2010 MHCs*
Calendar year 2013	90
Calendar year 2014	80
Calendar year 2015	70
Calendar year 2016	60
Calendar year 2017	50
Calendar year 2018	40
Calendar year 2019	30
Calendar year 2020	20
Calendar year 2021	10
Calendar year 2022 and thereafter	0

(3) *Transitional arrangements for minority interest.* (i) *Surplus minority interest.* From January 1, 2013 through December 31, 2018, a [BANK] may include in common equity tier 1 capital, tier 1 capital, or total capital the portion of the common equity tier 1, tier 1 and total capital minority interest outstanding as of January 1, 2013 that exceeds any common equity tier 1, tier 1 or total capital minority interest includable under section 21 (surplus minority interest), respectively, in accordance with Table 11.

(ii) *Non-qualifying minority interest.* From January 1, 2013 through December 31, 2018, a [BANK] may include in tier 1 capital or total capital the portion of the instruments issued by a consolidated subsidiary that qualified as tier 1 capital or total capital of the [BANK] as of December 31, 2012 but that do not qualify as tier 1 capital or total capital minority interest as of January 1, 2013 (non-qualifying minority interest) in accordance with Table 11.

TABLE 11 TO § ____. 300

Transition period	*Percentage of the amount of surplus or non-qualifying minority interest that can be included in regulatory capital during the transition period*
Calendar year 2013	100
Calendar year 2014	80
Calendar year 2015	60
Calendar year 2016	40
Calendar year 2017	20
Calendar year 2018 and thereafter	0

End of Common Rule

List of Subjects

12 CFR Part 3

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

12 CFR Part 5

Administrative practice and procedure, National banks, Reporting and recordkeeping requirements, Securities.

12 CFR Part 6

National banks.

12 CFR Part 165

Administrative practice and procedure, Savings associations.

12 CFR Part 167

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

12 CFR Part 208

Confidential business information, Crime, Currency, Federal Reserve System, Mortgages, reporting and recordkeeping requirements, Securities.

12 CFR Part 217

Administrative practice and procedure, Banks, banking, Federal Reserve System, Holding companies, Reporting and recordkeeping requirements, Securities.

12 CFR Part 225

Administrative practice and procedure, Banks, banking, Federal Reserve System, Holding companies, Reporting and recordkeeping requirements, Securities.

12 CFR Part 325

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

12 CFR Part 362

Administrative practice and procedure, Authority delegations (Government agencies), Bank deposit insurance, Banks, banking, Investments, Reporting and recordkeeping requirements.

The adoption of the final common rules by the agencies, as modified by the agency-specific text, is set forth below:

DEPARTMENT OF THE TREASURY

Office of the Comptroller of the Currency

12 CFR Chapter I

Authority and Issuance

For the reasons set forth in the common preamble and under the authority of 12 U.S.C. 93a and 5412(b)(2)(B), the Office of the Comptroller of the Currency proposes to amend part 3 of chapter I of title 12, Code of Federal Regulations as follows:

PART 3—CAPITAL ADEQUACY STANDARDS

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

Authority: 12 U.S.C. 93a, 161, 1462, 1462a, 1463, 1464, 1818, 1828(n), 1828 note, 1831n note, 1835, 3907, 3909, and 5412(b)(2)(B).

2a. Revise the heading of part 3 to read as set forth above.

Subpart A [Removed]

2b. Remove subpart A, consisting of §§ 3.1 through 3.4.

Subpart B [Removed]

2c. Remove subpart B, consisting of §§ 3.5 through 3.8.

Subparts C through E [Redesignated as Subparts H through J]

3. Redesignate subparts C through E as subparts H through J.

4. Add subparts A through C and G as set forth at the end of the common preamble.

§ 3.100 [Redesignated as § 3.600]

5a. Redesignate § 3.100 in newly redesignated subpart J as § 3.600.

Subpart K—Definition of Capital for Other Statutory Purposes

5b. Add subpart K, consisting of newly redesignated § 3.600, with the heading set forth above.

Appendices A, B, and C to Part 3 [Removed]

6. Remove appendices A through C.

Subparts A through C and G [Amended]

7. Subparts A through C and G, as set forth at the end of the common preamble, are amended as set follows:

i. Remove ''[AGENCY]'' and add ''OCC'' in its place, wherever it appears;

ii. Remove ''[BANK]'' and add ''national bank or Federal savings association'' in its place, wherever it appears;

iii. Remove ''[BANKS]'' and ''[BANK]s'' and add ''national banks and Federal savings associations'' in their places, wherever they appear;

iv. Remove ''[BANK]'s'' and ''[BANK'S]'' and add ''national bank's and Federal savings association's'' in their places, wherever they appear;

v. Remove ''[PART]'' and add ''Part 3'' in its place, wherever it appears; and

vi. Remove ''[REGULATORY REPORT]'' and add ''Call Report'' in its place, wherever it appears.

8. Section 3.2, as set forth at the end of the common preamble, is amended by adding the following definitions in alphabetical order:

§ 3.2 Definitions.

* * * * *

Core capital means Tier 1 capital, as calculated in accordance with § XX of subpart XX.

* * * * *

Federal savings association means an insured Federal savings association or an insured Federal savings bank chartered under section 5 of the Home Owners' Loan Act of 1933.

* * * * *

Tangible capital means the amount of core capital (Tier 1 capital), as calculated in accordance with subpart B of this part, plus the amount of outstanding perpetual preferred stock (including related surplus) not included in Tier 1 capital.

* * * * *

9. Section 3.10, as set forth at the end of the common preamble, is amended by adding paragraphs (a)(6), (b)(5), and (c)(5) to read as follows:

§ 3.10 Minimum Capital Requirements.

(a) * * *

(6) For Federal savings associations, a tangible capital ratio of 1.5 percent.

(b) * * *

(5) *Federal savings association tangible capital ratio.* A Federal savings association's tangible capital ratio is the ratio of the Federal savings association's core capital (Tier 1 capital) to total adjusted assets as calculated under subpart B of this part.

(c) * * *

(5) *Federal savings association tangible capital ratio.* A Federal savings association's tangible capital ratio is the ratio of the Federal savings association's core capital (Tier 1 capital) to total adjusted assets as calculated under subpart B of this part.

* * * * *

10. Section 3.22, as set forth at the end of the common preamble, is amended by adding paragraph (a)(8) to read as follows:

§ 3.22 Regulatory capital adjustments and deductions.

(a) * * *

(8)(i) A Federal savings association must deduct the aggregate amount of its outstanding investments, (both equity and debt) as well as retained earnings in subsidiaries that are not includable subsidiaries as defined in paragraph (a)(8)(iv) of this section (including those subsidiaries where the Federal savings association has a minority ownership interest) and may not consolidate the assets and liabilities of the subsidiary with those of the Federal savings association. Any such deductions shall be deducted from common equity tier 1 except as provided in paragraphs (a)(8)(ii) and (iii) of this section.

(ii) If a Federal savings association has any investments (both debt and equity) in one or more subsidiaries engaged in any activity that would not fall within the scope of activities in which includable subsidiaries as defined in paragraph (a)(8)(iv) of this section may engage, it must deduct such investments from assets and, thus, common equity tier 1 in accordance with paragraph (a)(8)(i) of this section. The Federal savings association must first deduct from assets and, thus, common equity tier 1 the amount by which any investments in such subsidiary(ies) exceed the amount of such investments held by the Federal savings association as of April 12, 1989. Next the Federal savings association must deduct from assets and, thus, common equity tier 1 the Federal savings association's investments in and extensions of credit to the subsidiary on the date as of which the savings association's capital is being determined.

(iii) If a Federal savings association holds a subsidiary (either directly or through a subsidiary) that is itself a domestic depository institution, the OCC may, in its sole discretion upon determining that the amount of Common Equity Tier 1 that would be required would be higher if the assets and liabilities of such subsidiary were consolidated with those of the parent Federal savings association than the amount that would be required if the parent Federal savings association's investment were deducted pursuant to paragraphs (a)(8)(i) and (ii) of this section, consolidate the assets and liabilities of that subsidiary with those of the parent Federal savings association in calculating the capital adequacy of the parent Federal savings association, regardless of whether the subsidiary would otherwise be an includable subsidiary as defined in paragraph (a)(8)(iv) of this section.

(iv) For purposes of this section, the term includable subsidiary means a subsidiary of a Federal savings association that is:

(A) Engaged solely in activities not impermissible for a national bank;

(B) Engaged in activities not permissible for a national bank, but only if acting solely as agent for its customers and such agency position is clearly documented in the Federal savings association's files;

(C) Engaged solely in mortgage-banking activities;

(D)(*1*) Itself an insured depository institution or a company the sole investment of which is an insured depository institution, and

(*2*) Was acquired by the parent Federal savings association prior to May 1, 1989; or

(E) A subsidiary of any Federal savings association existing as a Federal savings association on August 9, 1989 that

(*1*) Was chartered prior to October 15, 1982, as a savings bank or a cooperative bank under state law, or

(*2*) Acquired its principal assets from an association that was chartered prior to October 15, 1982, as a savings bank or a cooperative bank under state law.

* * * * *

Subpart H—Establishment of Minimum Capital Ratios for an Individual National Bank or Individual Federal Savings Association

11. Revise the heading of newly redesignated subpart H as set forth above.

§ 3.300 [Amended]

12. Amend § 3.300, as set forth at the end of the common preamble, by:

a. Removing the word ''bank'', wherever it appears, and adding in its place the phrase ''national bank or Federal savings association''; and

b. Removing ''§ 3.6'', wherever it appears, and adding in its place the phrase ''subpart B of this part''.

§ 3.301 [Amended]

13. Amend § 3.301, as set forth at the end of the common preamble, by removing the word ''bank'', wherever it appears, and adding in its place the phrase ''national bank or Federal savings association''.

§ 3.302 [Amended]

14. Amend § 3.302, as set forth at the end of the common preamble, by:

a. Removing the word ''bank'', wherever it appears, and adding in its place the phrase ''national bank or Federal savings association''; and

b. Removing the word ''bank's'', wherever it appears, and adding in its place the phrase ''national bank's or Federal savings association's''.

§ 3.303 [Amended]

15. Amend § 3.303, as set forth at the end of the common preamble, by:

a. Removing from paragraph (a)''§ 3.6'' and adding in its place ''subpart B of this part'';

b. Removing the word ''bank'', wherever it appears, and adding in its place the phrase ''national bank or Federal savings association'';

c. Removing the word ''bank's'', wherever it appears, and adding in its place the phrase ''national bank's or Federal savings association's'';

d. Removing the word ''Office'', wherever it appears, and adding in its place the word ''OCC'';

e. Removing the word ''Office's'', wherever it appears, and adding in its place the word ''OCC's''; and

§ 3.304 [Amended]

16. Amend § 3.304, as set forth at the end of the common preamble, by:

a. Removing the word ''bank'' and adding in its place the phrase ''national bank or Federal savings association''; and

b. Adding the phrase ''for national banks and 12 CFR 109.1 through 109.21 for Federal savings associations'' after ''19.21''.

§ 3.400 [Amended]

17. Section 3.400, as set forth at the end of the common preamble, is amended:

a. In the first sentence, by removing the word ''bank'', wherever it appears, and adding in its place the phrase ''national bank or Federal savings association'', and removing the phrase ''subpart C'' and adding in its place the phrase ''subpart H''; and

b. In the second sentence, by removing the phrase ''subpart E'' and adding in its place the phrase ''subpart J''; and

c. In the third sentence by adding the phrase ''or Federal savings association's'' after the word ''bank's'', and removing the phrase ''§ 3.6(a) or (b)'' and adding in its place ''subpart B of this part''.

§ 3.500 [Amended]

18. Amending § 3.500, as set forth at the end of the common preamble, by:

a. Removing the word ''bank'', wherever it appears, and adding in its place the phrase ''national bank or Federal savings association'';

b. Removing the word ''Office'', wherever it appears, and adding in its place the word ''OCC''; and

c. In the introductory text, removing the phrase ''subpart C'' and adding in its place the phrase ''subpart H''.

§ 3.501 [Amended]

19. Amending, as set forth at the end of the common preamble, § 3.501 by:

a. Removing the word ''bank'', and adding in its place the phrase ''national bank or Federal savings association''; and

b. Removing the word ''Office'', and adding in its place the word ''OCC''.

§ 3.502 [Amended]

20. Amending, as set forth at the end of the common preamble, § 3.502 by:

a. Removing the word ''bank'', and adding in its place the phrase ''national bank or Federal savings association''; and

b. Removing the word ''Office'', and adding in its place the word ''OCC''.

§ 3.503 [Amended]

21. Amending, as set forth at the end of the common preamble, § 3.503 by:

a. Removing the word ''bank's'', wherever it appears, and adding in its place the phrase ''national bank's or Federal savings association's''; and

b. Removing the word ''Office'', and adding in its place the word ''OCC''.

§ 3.504 [Amended]

22a. Amend, as set forth at the end of the common preamble, § 3.504 by:

a. Removing the word ''bank'', wherever it appears, and adding in its place the phrase ''national bank or Federal savings association'';

b. Removing the word ''bank's'', wherever it appears, and adding in its place the phrase ''national bank's or Federal savings association's''; and

c. Removing the word ''Office'', wherever it appears, and adding in its place the word ''OCC''.

§ 3.505 [Amended]

22b. Amend § 3.505, as set forth at the end of the common preamble, by:

a. Removing the word ''bank'', wherever it appears, and adding in its place the phrase ''national bank or Federal savings association'';

b. Removing the word ''bank's'', wherever it appears, and adding in its place the phrase ''national bank's or Federal savings association's''; and

c. Removing the word ''Office'', wherever it appears, and adding in its place the word ''OCC''.

§ 3.506 [Amended]

22c. Amend, as set forth at the end of the common preamble, § 3.506 by:

a. Removing the word ''bank'', wherever it appears, and adding in its place the phrase ''national bank or Federal savings association'';

b. Removing the word ''bank's'', wherever it appears, and adding in its place the phrase ''national bank's or Federal savings association's''; and

c. Removing the word ''Office'', wherever it appears, and adding in its place the word ''OCC''.

§ 3.600 [Amended]

23. Amend newly redesignated § 3.600:

a. In paragraphs (a) through (d), by removing the phrase ''national banking associations'', wherever it appears, and adding in its place the phrase ''national banks'';

b. By removing the word ''bank'', wherever it appears, and adding in its place the phrase ''national bank'';

c. In paragraph (a), by removing the word ''bank's'' and adding in its place the phrase ''national bank's'', and removing ''§ 3.2'' and adding in its place the phrase ''subparts A–J of this part''; and

d. In paragraph (e)(7), by removing the word ''bank-owned'' and adding in its place the word ''national bank-owned''.

PART 5—RULES, POLICIES, AND PROCEDURES FOR CORPORATE ACTIVITIES

24. The authority citation for part 5 continues to read as follows:

Authority: 12 U.S.C. 1 *et seq.,* 93a, 215a–2, 215a–3, 481, and section 5136A of the Revised Statutes (12 U.S.C. 24a).

20. Section 5.39 is amended by revising paragraph (h)(1) and republishing paragraph (h)(2) for reader reference to read as follows:

§ 5.39 Financial subsidiaries.

* * * * *

(h) * * *

(1) For purposes of determining regulatory capital the national bank may

not consolidate the assets and liabilities of a financial subsidiary with those of the bank and must deduct the aggregate amount of its outstanding equity investment, including retained earnings, in its financial subsidiaries from regulatory capital as provided by § 3.22(a)(7);

(2) Any published financial statement of the national bank shall, in addition to providing information prepared in accordance with generally accepted accounting principles, separately present financial information for the bank in the manner provided in paragraph (h)(1) of this section;

* * * * *

21. Part 6 is revised to read as follows:

PART 6—PROMPT CORRECTIVE ACTION

Subpart A—Capital Categories

Subpart B—Directives To Take Prompt Corrective Action

Authority: 12 U.S.C. 93a, 1831o, 5412(b)(2)(B).

§ 6.1 Authority, purpose, scope, other supervisory authority, and disclosure of capital categories.

(a) *Authority.* This part is issued by the Office of the Comptroller of the Currency (OCC) pursuant to section 38 (section 38) of the Federal Deposit Insurance Act (FDI Act) as added by section 131 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (Pub. L. 102–242, 105 Stat. 2236 (1991)) (12 U.S.C. 1831o).

(b) *Purpose.* Section 38 of the FDI Act establishes a framework of supervisory actions for insured depository institutions that are not adequately capitalized. The principal purpose of this subpart is to define, for insured national banks and insured Federal savings associations, the capital measures and capital levels, and for insured federal branches, comparable asset-based measures and levels, that are used for determining the supervisory actions authorized under section 38 of the FDI Act. This part 6 also establishes procedures for submission and review of capital restoration plans and for issuance and review of directives and orders pursuant to section 38.

(c) *Scope.* This subpart implements the provisions of section 38 of the FDI Act as they apply to insured national banks, insured federal branches, and insured Federal savings associations. Certain of these provisions also apply to officers, directors and employees of these insured institutions. Other provisions apply to any company that controls an insured national bank, insured Federal branch or insured Federal savings association and to the affiliates of an insured national bank, insured Federal branch, or insured Federal savings association.

(d) *Other supervisory authority.* Neither section 38 nor this part in any way limits the authority of the OCC under any other provision of law to take supervisory actions to address unsafe or unsound practices, deficient capital levels, violations of law, unsafe or unsound conditions, or other practices. Action under section 38 of the FDI Act and this part may be taken independently of, in conjunction with, or in addition to any other enforcement action available to the OCC, including issuance of cease and desist orders, capital directives, approval or denial of applications or notices, assessment of civil money penalties, or any other actions authorized by law.

(e) *Disclosure of capital categories.* The assignment of an insured national bank, insured federal branch, or insured Federal savings association under this subpart within a particular capital category is for purposes of implementing and applying the provisions of section 38. Unless permitted by the OCC or otherwise required by law, no national bank or Federal savings association may state in any advertisement or promotional material its capital category under this subpart or that the OCC or any other federal banking agency has assigned the national bank or Federal savings association to a particular capital category.

§ 6.2 Definitions.

For purposes of section 38 and this part, the definitions in part 3 of this chapter shall apply. In addition, except as modified in this section or unless the context otherwise requires, the terms used in this subpart have the same meanings as set forth in section 38 and section 3 of the FDI Act.

Advanced approaches national bank or advanced approaches Federal savings association means a national bank or Federal savings association that is subject to subpart E of part 3 of this chapter.

Common equity Tier 1 capital means common equity Tier 1 capital, as defined in accordance with the OCC's definition in § 3.2 of this chapter.

Common equity tier 1 risk-based capital ratio means the ratio of common equity tier 1 capital to total risk-weighted assets, as calculated in accordance with subpart B of part 3, as applicable.

Control. (1) *Control* has the same meaning assigned to it in section 2 of the Bank Holding Company Act (12 U.S.C. 1841), and the term controlled shall be construed consistently with the term control.

(2) *Exclusion for fiduciary ownership.* No insured depository institution or company controls another insured depository institution or company by virtue of its ownership or control of shares in a fiduciary capacity. Shares shall not be deemed to have been acquired in a fiduciary capacity if the acquiring insured depository institution or company has sole discretionary authority to exercise voting rights with respect thereto.

(3) *Exclusion for debts previously contracted.* No insured depository institution or company controls another insured depository institution or company by virtue of its ownership or control of shares acquired in securing or collecting a debt previously contracted in good faith, until two years after the date of acquisition. The two-year period may be extended at the discretion of the appropriate federal banking agency for up to three one-year periods.

Controlling person means any person having control of an insured depository institution and any company controlled by that person.

Federal savings association means an insured Federal savings association or an insured Federal savings bank chartered under section 5 of the Home Owners' Loan Act of 1933.

Leverage ratio means the ratio of Tier 1 capital to average total consolidated assets, as calculated in accordance with subpart B of part 3.

Management fee means any payment of money or provision of any other thing of value to a company or individual for the provision of management services or advice to the national bank or Federal savings association or related overhead expenses, including payments related to supervisory, executive, managerial, or policymaking functions, other than compensation to an individual in the individual's capacity as an officer or employee of the national bank or Federal savings association.

National bank means all insured national banks and all insured federal branches, except where otherwise provided in this subpart.

Supplementary leverage ratio means the ratio of Tier 1 capital to total leverage exposure, as calculated in accordance with subpart B of part 3.

Tangible equity means the amount of Tier 1 capital, as calculated in accordance with subpart B of part 3, plus the amount of outstanding perpetual preferred stock (including related surplus) not included in Tier 1 capital.

Tier 1 capital means the amount of Tier 1 capital as defined in subpart B of this chapter.

Tier 1 risk-based capital ratio means the ratio of Tier 1 capital to risk weighted assets, as calculated in accordance with subpart B of part 3.

Total assets means quarterly average total assets as reported in a national bank's or Federal savings association's Consolidated Reports of Condition and Income (Call Report), minus any deduction of assets as provided in the definition of tangible equity. The OCC reserves the right to require a national bank or Federal savings association to compute and maintain its capital ratios on the basis of actual, rather than average, total assets when computing tangible equity.

Total leverage exposure means the total leverage exposure, as calculated in accordance with subpart B of part 3.

Total risk-based capital ratio means the ratio of total capital to total risk-weighted assets, as calculated in accordance with subpart B of part 3.

Total risk-weighted assets means standardized total risk-weighted assets, and for an advanced approaches bank or advanced approaches Federal savings association also includes advanced approaches total risk-weighted assets, as defined in subpart B of part 3.

§ 6.3 Notice of capital category.

(a) *Effective date of determination of capital category.* A national bank or Federal savings association shall be deemed to be within a given capital category for purposes of section 38 of the FDI Act and this part as of the date the national bank or Federal savings association is notified of, or is deemed to have notice of, its capital category pursuant to paragraph (b) of this section.

(b) *Notice of capital category.* A national bank or Federal savings association shall be deemed to have been notified of its capital levels and its capital category as of the most recent date:

(1) A Consolidated Report of Condition and Income (Call Report) is required to be filed with the OCC;

(2) A final report of examination is delivered to the national bank or Federal savings association; or

(3) Written notice is provided by the OCC to the national bank or Federal savings association of its capital category for purposes of section 38 of the FDI Act and this part or that the national bank's or Federal savings association's capital category has changed as provided in paragraph (c) of this section or § 6.1 of this subpart and subpart M of part 19 of this chapter with respect to national banks and § 165.8 with respect to Federal savings associations.

(c) *Adjustments to reported capital levels and capital category.* (1) *Notice of adjustment by national bank or Federal savings association.* A national bank or Federal savings association shall provide the OCC with written notice that an adjustment to the national bank's or Federal savings association's capital category may have occurred no later than 15 calendar days following the date that any material event has occurred that would cause the national bank or Federal savings association to be placed in a lower capital category from the category assigned to the national bank or Federal savings association for purposes of section 38 and this part on the basis of the national bank's or Federal savings association's most recent Call Report or report of examination.

(2) *Determination to change capital category.* After receiving notice pursuant to paragraph (c)(1) of this section, the OCC shall determine whether to change the capital category of the national bank or Federal savings association and shall notify the national bank or Federal savings association of the OCC's determination.

§ 6.4 Capital measures and capital category definition.

(a) *Capital measures.* (1) *Capital measures applicable before January 1, 2015.* On or before December 31, 2014, for purposes of section 38 and this part, the relevant capital measures for all national banks and Federal savings associations are:

(i) Total Risk-Based Capital Measure: the total risk-based capital ratio;

(ii) Tier 1 Risk-Based Capital Measure: the tier 1 risk-based capital ratio; and

(iii) Leverage Measure: the leverage ratio.

(2) *Capital measures applicable on and after January 1, 2015.* On January 1, 2015 and thereafter, for purposes of section 38 and this part, the relevant capital measures are:

(i) Total Risk-Based Capital Measure: the total risk-based capital ratio;

(ii) Tier 1 Risk-Based Capital Measure: the tier 1 risk-based capital ratio;

(iii) Common Equity Tier 1 Capital Measure: the common equity tier 1 risk-based capital ratio; and

(iv) The Leverage Measure: (A) the leverage ratio, and (B) with respect to an advanced approaches national bank or advanced approaches Federal savings association, on January 1, 2018, and thereafter, the supplementary leverage ratio.

(b) *Capital categories applicable before January 1, 2015.* On or before December 31, 2014, for purposes of the provisions of section 38 and this part, a national bank or Federal savings association shall be deemed to be:

(1) ''Well capitalized'' if:

(i) Total Risk-Based Capital Measure: the national bank or Federal savings association has a total risk-based capital ratio of 10.0 percent or greater;

(ii) Tier 1 Risk-Based Capital Measure: the bank or Federal savings association has a tier 1 risk-based capital ratio of 6.0 percent or greater;

(iii) Leverage Measure: the national bank or Federal savings association has a leverage ratio of 5.0 percent or greater; and

(iv) The national bank or Federal savings association is not subject to any written agreement, order or capital directive, or prompt corrective action directive issued by the OCC pursuant to section 8 of the FDI Act, the International Lending Supervision Act of 1983 (12 U.S.C. 3907), the Home Owners' Loan Act (12 U.S.C. 1464(t)(6)(A)(ii)), or section 38 of the FDI Act, or any regulation thereunder, to meet and maintain a specific capital level for any capital measure.

(2) ''Adequately capitalized'' if:

(i) Total Risk-Based Capital Measure: the national bank or Federal savings association has a total risk-based capital ratio of 8.0 percent or greater;

(ii) Tier 1 Risk-Based Capital Measure: the national bank or Federal savings association has a tier 1 risk-based capital ratio of 4.0 percent or greater;

(iii) Leverage Measure:

(A) The national bank or Federal savings association has a leverage ratio of 4.0 percent or greater; or

(B) The national bank or Federal savings association has a leverage ratio of 3.0 percent or greater if the national bank or Federal savings association is rated composite 1 under the CAMELS rating system in the most recent examination of the national bank and or

Federal savings association is not experiencing or anticipating any significant growth; and

(iv) Does not meet the definition of a ''well capitalized'' national bank or Federal savings association.

(3) ''Undercapitalized'' if:

(i) Total Risk-Based Capital Measure: the national bank or Federal savings association has a total risk-based capital ratio of less than 8.0 percent; or

(ii) Tier 1 Risk-Based Capital Measure: the national bank or Federal savings association has a tier 1 risk-based capital ratio of less than 4.0 percent; or

(iii) Leverage Measure:

(A) Except as provided in paragraph (b)(2)(iii)(B) of this section, the national bank or Federal savings association has a leverage ratio of less than 4.0 percent; or

(iv) The national bank or Federal savings association has a leverage ratio of less than 3.0 percent, if the national bank or Federal savings association is rated composite 1 under the CAMELS rating system in the most recent examination of the national bank or Federal savings association and is not experiencing or anticipating significant growth.

(4) ''Significantly undercapitalized'' if:

(i) Total Risk-Based Capital Measure: the national bank or Federal savings association has a total risk-based capital ratio of less than 6.0 percent; or

(ii) Tier 1 Risk-Based Capital Measure: the national bank or Federal savings association has a tier 1 risk-based capital ratio of less than 3.0 percent; or

(iii) Leverage Measure: the national bank or Federal savings association has a leverage ratio of less than 3.0 percent.

(5) ''Critically undercapitalized'' if the national bank or Federal savings association has a ratio of tangible equity to total assets that is equal to or less than 2.0 percent.

(c) *Capital categories applicable on and after January 1, 2015.* On January 1, 2015, and thereafter, for purposes of the provisions of section 38 and this part, a national bank or Federal savings association shall be deemed to be:

(1) ''Well capitalized'' if:

(i) Total Risk-Based Capital Measure: the national bank or Federal savings association has a total risk-based capital ratio of 10.0 percent or greater;

(ii) Tier 1 Risk-Based Capital Measure: the national bank or Federal savings association has a tier 1 risk-based capital ratio of 8.0 percent or greater;

(iii) Common Equity Tier 1 Capital Measure: the national bank or Federal savings association has a common equity tier 1 risk-based capital ratio of 6.5 percent or greater;

(iv) Leverage Measure: the national bank or Federal savings association has a leverage ratio of 5.0 or greater; and

(iv) The national bank or Federal savings association is not subject to any written agreement, order or capital directive, or prompt corrective action directive issued by the OCC pursuant to section 8 of the FDI Act, the International Lending Supervision Act of 1983 (12 U.S.C. 3907), the Home Owners' Loan Act (12 U.S.C. 1464(t)(6)(A)(ii)), or section 38 of the FDI Act, or any regulation thereunder, to meet and maintain a specific capital level for any capital measure.

(2) ''Adequately capitalized'' if:

(i) Total Risk-Based Capital Measure: the national bank or Federal savings association has a total risk-based capital ratio of 8.0 percent or greater;

(ii) Tier 1 Risk-Based Capital Measure: the national bank or Federal savings association has a tier 1 risk-based capital ratio of 6.0 percent or greater;

(iii) Common Equity Tier 1 Capital Measure: the national bank or Federal savings association has a common equity tier 1 risk-based capital ratio of 4.5 percent or greater;

(iv) Leverage Measure:

(A) The national bank or Federal savings association has a leverage ratio of 4.0 percent or greater; and

(B) With respect to an advanced approaches national bank or advanced approaches Federal savings association, on January 1, 2018 and thereafter, the national bank or Federal savings association has a supplementary leverage ratio of 3.0 percent or greater; and

(v) The national bank or Federal savings association does not meet the definition of a ''well capitalized'' national bank or Federal savings association.

(3) ''Undercapitalized'' if:

(i) Total Risk-Based Capital Measure: the national bank or Federal savings association has a total risk-based capital ratio of less than 8.0 percent;

(ii) Tier 1 Risk-Based Capital Measure: the national bank or Federal savings association has a tier 1 risk-based capital ratio of less than 6.0 percent;

(iii) Common Equity Tier 1 Capital Measure: the national bank or Federal savings association has a common equity tier 1 risk-based capital ratio of less than 4.5 percent; or

(iv) Leverage Measure: (A) The national bank or Federal savings association has a leverage ratio of less than 4.0 percent; or

(B) With respect to an advanced approaches national bank or advanced approaches Federal savings association, on January 1, 2018, and thereafter, the national bank or Federal savings association has a supplementary leverage ratio of less than 3.0 percent.

(4) ''Significantly undercapitalized'' if:

(i) Total Risk-Based Capital Measure: the national bank or Federal savings association has a total risk-based capital ratio of less than 6.0 percent;

(ii) Tier 1 Risk-Based Capital Measure: the national bank or Federal savings association has a tier 1 risk-based capital ratio of less than 4.0 percent;

(iii) Common Equity Tier 1 Capital Measure: the national bank or Federal savings association has a common equity tier 1 risk-based capital ratio of less than 3.0 percent; or

(iv) Leverage Measure: the national bank or Federal savings association has a leverage ratio of less than 3.0 percent.

(5) ''Critically undercapitalized'' if the national bank or Federal savings association has a ratio of tangible equity to total assets that is equal to or less than 2.0 percent.

(d) *Capital categories for insured federal branches.* For purposes of the provisions of section 38 of the FDI Act and this part, an insured federal branch shall be deemed to be:

(1) *Well capitalized* if the insured federal branch:

(i) Maintains the pledge of assets required under 12 CFR 347.209; and

(ii) Maintains the eligible assets prescribed under 12 CFR 347.210 at 108 percent or more of the preceding quarter's average book value of the insured branch's third-party liabilities; and

(iii) Has not received written notification from:

(A) The OCC to increase its capital equivalency deposit pursuant to § 28.15 of this chapter, or to comply with asset maintenance requirements pursuant to § 28.20 of this chapter; or

(B) The FDIC to pledge additional assets pursuant to 12 CFR 346.209 or to maintain a higher ratio of eligible assets pursuant to 12 CFR 346.210.

(2) *Adequately capitalized* if the insured federal branch:

(i) Maintains the pledge of assets prescribed under 12 CFR 346.209; and

(ii) Maintains the eligible assets prescribed under 12 CFR 346.210 at 106 percent or more of the preceding quarter's average book value of the insured branch's third-party liabilities; and

(iii) Does not meet the definition of a well capitalized insured federal branch.

(3) *Undercapitalized* if the insured federal branch:

(i) Fails to maintain the pledge of assets required under 12 CFR 346.209; or

(ii) Fails to maintain the eligible assets prescribed under 12 CFR 346.210 at 106 percent or more of the preceding quarter's average book value of the insured branch's third-party liabilities.

(4) *Significantly undercapitalized* if it fails to maintain the eligible assets prescribed under 12 CFR 346.210 at 104 percent or more of the preceding quarter's average book value of the insured federal branch's third-party liabilities.

(5) *Critically undercapitalized* if it fails to maintain the eligible assets prescribed under 12 CFR 346.210 at 102 percent or more of the preceding quarter's average book value of the insured federal branch's third-party liabilities.

(e) *Reclassification based on supervisory criteria other than capital.* The OCC may reclassify a well capitalized national bank or Federal savings association as adequately capitalized and may require an adequately capitalized or an undercapitalized national bank or Federal savings association to comply with certain mandatory or discretionary supervisory actions as if the national bank or Federal savings association were in the next lower capital category (except that the OCC may not reclassify a significantly undercapitalized national bank or Federal savings association as critically undercapitalized) (each of these actions are hereinafter referred to generally as reclassifications) in the following circumstances:

(1) *Unsafe or unsound condition.* The OCC has determined, after notice and opportunity for hearing pursuant to subpart M of part 19 of this chapter with respect to national banks and § 165.8 with respect to Federal savings associations, that the national bank or Federal savings association is in unsafe or unsound condition; or

(2) *Unsafe or unsound practice.* The OCC has determined, after notice and opportunity for hearing pursuant to subpart M of part 19 of this chapter with respect to national banks and § 165.8 with respect to Federal savings associations, that in the most recent examination of the national bank or Federal savings association, the national bank or Federal savings association received, and has not corrected a less-than-satisfactory rating for any of the categories of asset quality, management, earnings, or liquidity.

§ 6.5 Capital restoration plan.

(a) *Schedule for filing plan.* (1) *In general.* A national bank or Federal savings association shall file a written capital restoration plan with the OCC within 45 days of the date that the national bank or Federal savings association receives notice or is deemed to have notice that the national bank or Federal savings association is undercapitalized, significantly undercapitalized, or critically undercapitalized, unless the OCC notifies the national bank or Federal savings association in writing that the plan is to be filed within a different period. An adequately capitalized national bank or Federal savings association that has been required pursuant to § 6.4 and subpart M of part 19 of this chapter with respect to national banks and § 165.8 with respect to Federal savings associations to comply with supervisory actions as if the national bank or Federal savings association were undercapitalized is not required to submit a capital restoration plan solely by virtue of the reclassification.

(2) *Additional capital restoration plans.* Notwithstanding paragraph (a)(1) of this section, a national bank or Federal savings association that has already submitted and is operating under a capital restoration plan approved under section 38 and this subpart is not required to submit an additional capital restoration plan based on a revised calculation of its capital measures or a reclassification of the institution under § 6.4 and subpart M of part 19 of this chapter with respect to national banks and §§ 6.4 and 165.8 with respect to Federal savings associations unless the OCC notifies the national bank or Federal savings association that it must submit a new or revised capital plan. A national bank or Federal savings association that is notified that it must submit a new or revised capital restoration plan shall file the plan in writing with the OCC within 45 days of receiving such notice, unless the OCC notifies the national bank or Federal savings association in writing that the plan must be filed within a different period.

(b) *Contents of plan.* All financial data submitted in connection with a capital restoration plan shall be prepared in accordance with the instructions provided on the Call Report, unless the OCC instructs otherwise. The capital restoration plan shall include all of the information required to be filed under section 38(e)(2) of the FDI Act. A national bank or Federal savings association that is required to submit a capital restoration plan as the result of a reclassification of the national bank or Federal savings association, pursuant to § 6.4 for both national banks and Federal savings associations and subpart M of part 19 of this chapter with respect to national banks and § 165.8 with respect to Federal savings associations, shall include a description of the steps the national bank or Federal savings association will take to correct the unsafe or unsound condition or practice. No plan shall be accepted unless it includes any performance guarantee described in section 38(e)(2)(C) of that Act by each company that controls the national bank or Federal savings association.

(c) *Review of capital restoration plans.* Within 60 days after receiving a capital restoration plan under this subpart, the OCC shall provide written notice to the national bank or Federal savings association of whether the plan has been approved. The OCC may extend the time within which notice regarding approval of a plan shall be provided.

(d) *Disapproval of capital restoration plan.* If a capital restoration plan is not approved by the OCC, the national bank or Federal savings association shall submit a revised capital restoration plan within the time specified by the OCC. Upon receiving notice that its capital restoration plan has not been approved, any undercapitalized national bank or Federal savings association (as defined in § 6.4) shall be subject to all of the provisions of section 38 and this part applicable to significantly undercapitalized institutions. These provisions shall be applicable until such time as a new or revised capital restoration plan submitted by the national bank or Federal savings association has been approved by the OCC.

(e) *Failure to submit a capital restoration plan.* A national bank or Federal savings association that is undercapitalized (as defined in § 6.4) and that fails to submit a written capital restoration plan within the period provided in this section shall, upon the expiration of that period, be subject to all of the provisions of section 38 and this part applicable to significantly undercapitalized national banks or Federal savings associations.

(f) *Failure to implement a capital restoration plan.* Any undercapitalized national bank or Federal savings association that fails, in any material respect, to implement a capital restoration plan shall be subject to all of the provisions of section 38 and this part applicable to significantly undercapitalized national banks or Federal savings associations.

(g) *Amendment of capital restoration plan.* A national bank or Federal savings association that has submitted an approved capital restoration plan may, after prior written notice to and approval by the OCC, amend the plan to reflect a change in circumstance. Until such time as a proposed amendment has been approved, the national bank or Federal savings association shall implement the capital restoration plan as approved prior to the proposed amendment.

(h) *Notice to FDIC.* Within 45 days of the effective date of OCC approval of a capital restoration plan, or any amendment to a capital restoration plan, the OCC shall provide a copy of the plan or amendment to the Federal Deposit Insurance Corporation.

(i) *Performance guarantee by companies that control a bank or Federal savings association.* (1) *Limitation on liability.*(i) *Amount limitation.* The aggregate liability under the guarantee provided under section 38 and this subpart for all companies that control a specific national bank or Federal savings association that is required to submit a capital restoration plan under this subpart shall be limited to the lesser of:

(A) An amount equal to 5.0 percent of the national bank's or Federal savings association's total assets at the time the national bank or Federal savings association was notified or deemed to have notice that the national bank or Federal savings association was undercapitalized; or

(B) The amount necessary to restore the relevant capital measures of the national bank or Federal savings association to the levels required for the national bank or Federal savings association to be classified as adequately capitalized, as those capital measures and levels are defined at the time that the national bank or Federal savings association initially fails to comply with a capital restoration plan under this subpart.

(ii) *Limit on duration.* The guarantee and limit of liability under section 38 and this subpart shall expire after the OCC notifies the national bank or Federal savings association that it has remained adequately capitalized for each of four consecutive calendar quarters. The expiration or fulfillment by a company of a guarantee of a capital restoration plan shall not limit the liability of the company under any guarantee required or provided in connection with any capital restoration plan filed by the same national bank or Federal savings association after expiration of the first guarantee.

(iii) *Collection on guarantee.* Each company that controls a given national bank or Federal savings association shall be jointly and severally liable for the guarantee for such national bank or Federal savings association as required under section 38 and this subpart, and the OCC may require payment of the full amount of that guarantee from any or all of the companies issuing the guarantee.

(2) *Failure to provide guarantee.* In the event that a national bank or Federal savings association that is controlled by any company submits a capital restoration plan that does not contain the guarantee required under section 38(e)(2) of the FDI Act, the national bank or Federal savings association shall, upon submission of the plan, be subject to the provisions of section 38 and this part that are applicable to national banks or Federal savings associations that have not submitted an acceptable capital restoration plan.

(3) *Failure to perform guarantee.* Failure by any company that controls a national bank or Federal savings association to perform fully its guarantee of any capital plan shall constitute a material failure to implement the plan for purposes of section 38(f) of the FDI Act. Upon such failure, the national bank or Federal savings association shall be subject to the provisions of section 38 and this part that are applicable to national banks or Federal savings associations that have failed in a material respect to implement a capital restoration plan.

(j) *Enforcement of capital restoration plan.* The failure of a national bank or Federal savings association to implement, in any material respect, a capital restoration plan required under section 38 and this section shall subject the national bank or Federal savings association to the assessment of civil money penalties pursuant to section 8(i)(2)(A) of the FDI Act.

§ 6.6 Mandatory and discretionary supervisory actions.

(a) *Mandatory supervisory actions.* (1) *Provisions applicable to all national banks and Federal savings associations.* All national banks and Federal savings associations are subject to the restrictions contained in section 38(d) of the FDI Act on payment of capital distributions and management fees.

(2) *Provisions applicable to undercapitalized, significantly undercapitalized, and critically undercapitalized national banks or Federal savings associations.* Immediately upon receiving notice or being deemed to have notice, as provided in § 6.3, that the national bank or Federal savings association is undercapitalized, significantly undercapitalized, or critically undercapitalized, the national bank or Federal savings association shall become subject to the provisions of section 38 of the FDI Act—

(i) Restricting payment of capital distributions and management fees (section 38(d));

(ii) Requiring that the OCC monitor the condition of the national bank or Federal savings association (section 38(e)(1));

(iii) Requiring submission of a capital restoration plan within the schedule established in this subpart (section 38(e)(2));

(iv) Restricting the growth of the national bank's or Federal savings association's assets (section 38(e)(3)); and

(v) Requiring prior approval of certain expansion proposals (section 38(e)(4)).

(3) *Additional provisions applicable to significantly undercapitalized, and critically undercapitalized national banks or Federal savings associations.* In addition to the provisions of section 38 of the FDI Act described in paragraph (a)(2) of this section, immediately upon receiving notice or being deemed to have notice, as provided in this subpart, that the national bank or Federal savings association is significantly undercapitalized, or critically undercapitalized or that the national bank or Federal savings association is subject to the provisions applicable to institutions that are significantly undercapitalized because it has failed to submit or implement, in any material respect, an acceptable capital restoration plan, the national bank or Federal savings association shall become subject to the provisions of section 38 of the FDI Act that restrict compensation paid to senior executive officers of the institution (section 38(f)(4)).

(4) *Additional provisions applicable to critically undercapitalized national banks or Federal savings associations.* In addition to the provisions of section 38 of the FDI Act described in paragraphs (a)(2) and (3) of this section, immediately upon receiving notice or being deemed to have notice, as provided in § 6.3, that the national bank or Federal savings association is critically undercapitalized, the national bank or Federal savings association shall become subject to the provisions of section 38 of the FDI Act—

(i) Restricting the activities of the national bank or Federal savings association (section 38 (h)(1)); and

(ii) Restricting payments on subordinated debt of the national bank or Federal savings association (section 38 (h)(2)).

(b) *Discretionary supervisory actions.* In taking any action under section 38 that is within the OCC's discretion to take in connection with a national bank or Federal savings association that is deemed to be undercapitalized, significantly undercapitalized, or critically undercapitalized, or has been reclassified as undercapitalized or significantly undercapitalized; an officer or director of such national bank or Federal savings association; or a company that controls such national bank or Federal savings association, the OCC shall follow the procedures for issuing directives under subpart B of this part for both national banks and Federal savings associations and subpart N of part 19 of this chapter with respect to national banks and subpart B and 12 CFR 165.9 with respect to Federal savings associations, unless otherwise provided in section 38 of the FDI Act or this part.

Subpart B—Directives to Take Prompt Corrective Action

§ 6.20 Scope.

The rules and procedures set forth in this subpart apply to insured national banks, insured federal branches, Federal savings associations, and senior executive officers and directors of national banks and Federal savings associations that are subject to the provisions of section 38 of the Federal Deposit Insurance Act (section 38) and subpart A of this part.

§ 6.21 Notice of intent to issue a directive.

(a) *Notice of intent to issue a directive.* (1) *In general.* The OCC shall provide an undercapitalized, significantly undercapitalized, or critically undercapitalized national bank or Federal savings association prior written notice of the OCC's intention to issue a directive requiring such national bank, Federal savings association, or company to take actions or to follow proscriptions described in section 38 that are within the OCC's discretion to require or impose under section 38 of the FDI Act, including section 38(e)(5), (f)(2), (f)(3), or (f)(5). The national bank or Federal savings association shall have such time to respond to a proposed directive as provided under § 6.22.

(2) *Immediate issuance of final directive.* If the OCC finds it necessary in order to carry out the purposes of section 38 of the FDI Act, the OCC may, without providing the notice prescribed in paragraph (a)(1) of this section, issue a directive requiring a national bank or Federal savings association immediately to take actions or to follow proscriptions described in section 38 that are within the OCC's discretion to require or impose under section 38 of the FDI Act, including section 38(e)(5), (f)(2), (f)(3), or (f)(5). A national bank or Federal savings association that is subject to such an immediately effective directive may submit a written appeal of the directive to the OCC. Such an appeal must be received by the OCC within 14 calendar days of the issuance of the directive, unless the OCC permits a longer period. The OCC shall consider any such appeal, if filed in a timely matter, within 60 days of receiving the appeal. During such period of review, the directive shall remain in effect unless the OCC, in its sole discretion, stays the effectiveness of the directive.

(b) *Contents of notice.* A notice of intention to issue a directive shall include:

(1) A statement of the national bank's or Federal savings association's capital measures and capital levels;

(2) A description of the restrictions, prohibitions or affirmative actions that the OCC proposes to impose or require;

(3) The proposed date when such restrictions or prohibitions would be effective or the proposed date for completion of such affirmative actions; and

(4) The date by which the national bank or Federal savings association subject to the directive may file with the OCC a written response to the notice.

§ 6.22 Response to notice.

(a) *Time for response.* A national bank or Federal savings association may file a written response to a notice of intent to issue a directive within the time period set by the OCC. The date shall be at least 14 calendar days from the date of the notice unless the OCC determines that a shorter period is appropriate in light of the financial condition of the national bank or Federal savings association or other relevant circumstances.

(b) *Content of response.* The response should include:

(1) An explanation why the action proposed by the OCC is not an appropriate exercise of discretion under section 38;

(2) Any recommended modification of the proposed directive; and

(3) Any other relevant information, mitigating circumstances, documentation, or other evidence in support of the position of the national bank or Federal savings association regarding the proposed directive.

(c) *Failure to file response.* Failure by a national bank or Federal savings association to file with the OCC, within the specified time period, a written response to a proposed directive shall constitute a waiver of the opportunity to respond and shall constitute consent to the issuance of the directive.

§ 6.23 Decision and issuance of a prompt corrective action directive.

(a) *OCC consideration of response.* After considering the response, the OCC may:

(1) Issue the directive as proposed or in modified form;

(2) Determine not to issue the directive and so notify the national bank or Federal savings association; or

(3) Seek additional information or clarification of the response from the national bank or Federal savings association, or any other relevant source.

(b) [Reserved]

§ 6.24 Request for modification or rescission of directive.

Any national bank or Federal savings association that is subject to a directive under this subpart may, upon a change in circumstances, request in writing that the OCC reconsider the terms of the directive, and may propose that the directive be rescinded or modified. Unless otherwise ordered by the OCC, the directive shall continue in place while such request is pending before the OCC.

§ 6.25 Enforcement of directive.

(a) *Judicial remedies.* Whenever a national bank or Federal savings association fails to comply with a directive issued under section 38, the OCC may seek enforcement of the directive in the appropriate United States district court pursuant to section 8(i)(1) of the FDI Act.

(b) *Administrative remedies.* Pursuant to section 8(i)(2)(A) of the FDI Act, the OCC may assess a civil money penalty against any national bank or Federal savings association that violates or otherwise fails to comply with any final directive issued under section 38 and against any institution-affiliated party who participates in such violation or noncompliance.

(c) *Other enforcement action.* In addition to the actions described in paragraphs (a) and (b) of this section, the OCC may seek enforcement of the provisions of section 38 or this part through any other judicial or administrative proceeding authorized by law.

PART 165—PROMPT CORRECTIVE ACTION

22. The authority citation for part 165 continues to read as follows:

Authority: 12 U.S.C. 1831o, 5412(b)(2)(B).

§ 165.1—165.7, 165.10 [Removed]

23. Sections 165.1—165.7 and 165.10 are removed.

§ 165.8 [Amended]

24. Section 165.8 is amended in paragraphs (a)(1)(i)(A) introductory text and (a)(1)(ii) by removing the phrases ''§ 165.4(c) of this part'' and ''§ 165.4(c)(1)'' respectively, and adding in their place the phrase ''12 CFR 6.4(d)''.

PART 167—[REMOVED]

25. Under the authority of 12 U.S.C. 93a and 5412(b)(2)(B), part 167 is removed.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

12 CFR Chapter II

Authority and Issuance

For the reasons set forth in the common preamble, parts 208 and 225 of chapter II of title 12 of the Code of Federal Regulations are proposed to be amended as follows:

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

26. The authority citation for part 208 is revised 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, 3905–3909, and 5371; 15 U.S.C. 78b, 78I(b), 78l(i), 780–4(c)(5), 78q, 78q–1, and 78w, 1681s, 1681w, 6801, and 6805; 31 U.S.C. 5318; 42 U.S.C. 4012a, 4104a, 4104b, 4106 and 4128.

Subpart A—General Membership and Branching Requirements

27. In § 208.2, revise paragraph (d) to read as follows:

§ 208.2 Definitions.

* * * * *

(d) *Capital stock and surplus* means, unless otherwise provided in this part, or by statute, tier 1 and tier 2 capital included in a member bank's risk-based capital (as defined in § 217.2 of Regulation Q) and the balance of a member bank's allowance for loan and lease losses not included in its tier 2 capital for calculation of risk-based capital, based on the bank's most recent Report of Condition and Income filed under 12 U.S.C. 324.

* * * * *

28. Revise § 208.4 to read as follows:

§ 208.4 Capital adequacy.

(a) *Adequacy.* A member bank's capital, calculated in accordance with Part 217, shall be at all times adequate in relation to the character and condition liabilities and other corporate responsibilities. If at any time, in light of all the circumstances, the bank's capital appears inadequate in relation to its assets, liabilities, and responsibilities, the bank shall increase the amount of its capital, within such period as the Board deems reasonable, to an amount which, in the judgment of the Board, shall be adequate.

(b) *Standards for evaluating capital adequacy.* Standards and measures, by which the Board evaluates the capital adequacy of member banks for risk-based capital purposes and for leverage measurement purposes, are located in part 217.

Subpart B—Investments and Loans

29. In § 208.23, revise paragraph (c) to read as follows:

§ 208.23 Agricultural loan loss amortization.

* * * * *

(c) *Accounting for amortization.* Any bank that is permitted to amortize losses in accordance with paragraph (b) of this section may restate its capital and other relevant accounts and account for future authorized deferrals and authorization in accordance with the instructions to the FFIEC Consolidated Reports of Condition and Income. Any resulting increase in the capital account shall be included in capital pursuant to part 217.

* * * * *

Subpart D—Prompt Corrective Action

30. The authority citation for subpart D continues to read as follows:

Authority: Subpart D of Regulation H (12 CFR part 208, Subpart D) is issued by the Board of Governors of the Federal Reserve System (Board) under section 38 (section 38) of the FDI Act as added by section 131 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (Pub. L. 102–242, 105 Stat. 2236 (1991)) (12 U.S.C. 1831o).

31. Revise § 208.41 to read as follows:

§ 208.41 Definitions for purposes of this subpart.

For purposes of this subpart, except as modified in this section or unless the context otherwise requires, the terms used have the same meanings as set forth in section 38 and section 3 of the FDI Act.

(a) *Advanced approaches bank* means a bank that is described in § 217.100(b)(1) of Regulation Q (12 CFR 217.100(b)(1)).

(b) *Bank* means an insured depository institution as defined in section 3 of the FDI Act (12 U.S.C. 1813).

(c) *Common equity tier 1 capital* means the amount of capital as defined in § 217.2 of Regulation Q (12 CFR 217.2).

(d) *Common equity tier 1 risk-based capital ratio* means the ratio of common equity tier 1 capital to total risk-weighted assets, as calculated in accordance with § 217.10(b)(1) or § 217.10(c)(1) of Regulation Q (12 CFR 217.10(b)(1), 12 CFR 217.10(c)(1)), as applicable.

(e) *Control*—(1) *Control* has the same meaning assigned to it in section 2 of the Bank Holding Company Act (12 U.S.C. 1841), and the term *controlled* shall be construed consistently with the term *control.*

(2) *Exclusion for fiduciary ownership.* No insured depository institution or company controls another insured depository institution or company by virtue of its ownership or control of shares in a fiduciary capacity. Shares shall not be deemed to have been acquired in a fiduciary capacity if the acquiring insured depository institution or company has sole discretionary authority to exercise voting rights with respect to the shares.

(3) *Exclusion for debts previously contracted.* No insured depository institution or company controls another insured depository institution or company by virtue of its ownership or control of shares acquired in securing or collecting a debt previously contracted in good faith, until two years after the date of acquisition. The two-year period may be extended at the discretion of the appropriate Federal banking agency for up to three one-year periods.

(f) *Controlling person* means any person having control of an insured depository institution and any company controlled by that person.

(g) *Leverage ratio* means the ratio of tier 1 capital to average total consolidated assets, as calculated in accordance with § 217.10 of Regulation Q (12 CFR 217.10).

(h) *Management fee* means any payment of money or provision of any other thing of value to a company or individual for the provision of management services or advice to the bank, or related overhead expenses, including payments related to supervisory, executive, managerial, or policy making functions, other than compensation to an individual in the individual's capacity as an officer or employee of the bank.

(i) *Supplementary leverage ratio* means the ratio of tier 1 capital to total leverage exposure, as calculated in accordance with § 217.10 of Regulation Q (12 CFR 217.10).

(j) *Tangible equity* means the amount of tier 1 capital, plus the amount of outstanding perpetual preferred stock (including related surplus) not included in tier 1 capital.

(k) *Tier 1 capital* means the amount of capital as defined in § 217.20 of Regulation Q (12 CFR 217.20).

(l) *Tier 1 risk-based capital ratio* means the ratio of tier 1 capital to total risk-weighted assets, as calculated in accordance with § 217.10(b)(2) or § 217.10(c)(2) of Regulation Q (12 CFR 217.10(b)(2), 12 CFR 217.10(c)(2)), as applicable.

(m) *Total assets* means quarterly average total assets as reported in a bank's Report of Condition and Income (Call Report), minus items deducted from tier 1 capital. At its discretion the Federal Reserve may calculate total assets using a bank's period-end assets rather than quarterly average assets.

(n) *Total leverage exposure* means the total leverage exposure, as calculated in accordance with § 217.11 of Regulation Q (12 CFR 217.11).

(o) *Total risk-based capital ratio* means the ratio of total capital to total risk-weighted assets, as calculated in accordance with § 217.10(b)(3) or § 217.10(c)(3) of Regulation Q (12 CFR 217.10(b)(3), 12 CFR 217.10(c)(3)), as applicable.

(p) *Total risk-weighted assets* means standardized total risk-weighted assets, and for an advanced approaches bank also includes advanced approaches total risk-weighted assets, as defined in § 217.2 of Regulation Q (12 CFR 217.2).

32. In § 208.43, revise paragraphs (a) and (b), redesignate paragraph (c) as paragraph (d), and add a new paragraph (c) to read as follows:

§ 208.43 Capital measures and capital category definitions.

(a) *Capital measures.* (1) Capital measures applicable before January 1, 2015. On or before December 31, 2014, for purposes of section 38 and this subpart, the relevant capital measures for all banks are:

(i) Total Risk-Based Capital Measure: The total risk-based capital ratio;

(ii) Tier 1 Risk-Based Capital Measure: The tier 1 risk-based capital ratio; and

(iii) Leverage Measure: The leverage ratio.

(2) Capital measures applicable on and after January 1, 2015. On January 1, 2015 and thereafter, for purposes of section 38 and this subpart, the relevant capital measures are:

(i) Total Risk-Based Capital Measure: The total risk-based capital ratio;

(ii) Tier 1 Risk-Based Capital Measure: The tier 1 risk-based capital ratio;

(iii) Common Equity Tier 1 Capital Measure: The common equity tier 1 risk-based capital ratio; and

(iv) Leverage Measure:

(A) The leverage ratio, and

(B) With respect to an advanced approaches bank, on January 1, 2018, and thereafter, the supplementary leverage ratio.

(b) *Capital categories applicable before January 1, 2015.* On or before December 31, 2014, for purposes of section 38 of the FDI Act and this subpart, a member bank is deemed to be:

(1) ''Well capitalized'' if:

(i) Total Risk-Based Capital Measure: The bank has a total risk-based capital ratio of 10.0 percent or greater;

(ii) Tier 1 Risk-Based Capital Measure: The bank has a tier 1 risk-based capital ratio of 6.0 percent or greater;

(iii) Leverage Measure: The bank has a leverage ratio of 5.0 percent or greater; and

(iv) The bank is not subject to any written agreement, order, capital directive, or prompt corrective action directive issued by the Board pursuant to section 8 of the FDI Act, the International Lending Supervision Act of 1983 (12 U.S.C. 3907), or section 38 of the FDI Act, or any regulation thereunder, to meet and maintain a specific capital level for any capital measure.

(2) ''Adequately capitalized'' if:

(i) Total Risk-Based Capital Measure: The bank has a total risk-based capital ratio of 8.0 percent or greater;

(ii) Tier 1 Risk-Based Capital Measure: The bank has a tier 1 risk-based capital ratio of 4.0 percent or greater;

(iii) Leverage Measure:

(A) The bank has a leverage ratio of 4.0 percent or greater; or

(B) The bank has a leverage ratio of 3.0 percent or greater if the bank is rated composite 1 under the CAMELS rating system in the most recent examination of the bank and is not experiencing or anticipating any significant growth; and

(iv) Does not meet the definition of a ''well capitalized'' bank.

(3) ''Undercapitalized'' if:

(i) Total Risk-Based Capital Measure: The bank has a total risk-based capital ratio of less than 8.0 percent; or

(ii) Tier 1 Risk-Based Capital Measure: The bank has a tier 1 risk-based capital ratio of less than 4.0 percent; or

(iii) Leverage Measure:

(A) Except as provided in paragraph (b)(2)(iii)(B) of this section, the bank has a leverage ratio of less than 4.0 percent; or

(B) The bank has a leverage ratio of less than 3.0 percent, if the bank is rated composite 1 under the CAMELS rating system in the most recent examination of the bank and is not experiencing or anticipating significant growth.

(4) ''Significantly undercapitalized'' if:

(i) Total Risk-Based Capital Measure: The bank has a total risk-based capital ratio of less than 6.0 percent; or

(ii) Tier 1 Risk-Based Capital Measure: The bank has a tier 1 risk-based capital ratio of less than 3.0 percent; or

(iii) Leverage Measure: The bank has a leverage ratio of less than 3.0 percent.

(5) ''Critically undercapitalized'' if the bank has a ratio of tangible equity to total assets that is equal to or less than 2.0 percent.

(c) *Capital categories applicable on and after January 1, 2015.* On January 1, 2015, and thereafter, for purposes of section 38 and this subpart, a member bank is deemed to be:

(1) ''Well capitalized'' if:

(i) Total Risk-Based Capital Measure: The bank has a total risk-based capital ratio of 10.0 percent or greater;

(ii) Tier 1 Risk-Based Capital Measure: The bank has a tier 1 risk-based capital ratio of 8.0 percent or greater;

(iii) Common Equity Tier 1 Capital Measure: The bank has a common equity tier 1 risk-based capital ratio of 6.5 percent or greater;

(iv) Leverage Measure: The bank has a leverage ratio of 5.0 or greater; and

(iv) The bank is not subject to any written agreement, order, capital directive, or prompt corrective action directive issued by the Board pursuant to section 8 of the FDI Act, the International Lending Supervision Act of 1983 (12 U.S.C. 3907), or section 38 of the FDI Act, or any regulation thereunder, to meet and maintain a specific capital level for any capital measure.

(2) ''Adequately capitalized'' if:

(i) Total Risk-Based Capital Measure: The bank has a total risk-based capital ratio of 8.0 percent or greater;

(ii) Tier 1 Risk-Based Capital Measure: The bank has a tier 1 risk-based capital ratio of 6.0 percent or greater;

(iii) Common Equity Tier 1 Capital Measure: The bank has a common equity tier 1 risk-based capital ratio of 4.5 percent or greater;

(iv) Leverage Measure:

(A) The bank has a leverage ratio of 4.0 percent or greater; and

(B) With respect to an advanced approaches bank, on January 1, 2018, and thereafter, the bank has a supplementary leverage ratio of 3.0 percent or greater; and

(v) The bank does not meet the definition of a ''well capitalized'' bank.

(3) ''Undercapitalized'' if:

(i) Total Risk-Based Capital Measure: The bank has a total risk-based capital ratio of less than 8.0 percent;

(ii) Tier 1 Risk-Based Capital Measure: The bank has a tier 1 risk-based capital ratio of less than 6.0 percent;

(iii) Common Equity Tier 1 Capital Measure: The bank has a common equity tier 1 risk-based capital ratio of less than 4.5 percent; or

(iv) Leverage Measure:

(A) The bank has a leverage ratio of less than 4.0 percent; or

(B) With respect to an advanced approaches bank, on January 1, 2018, and thereafter, the bank has a supplementary leverage ratio of less than 3.0 percent.

(4) ''Significantly undercapitalized'' if:

(i) Total Risk-Based Capital Measure: The bank has a total risk-based capital ratio of less than 6.0 percent;

(ii) Tier 1 Risk-Based Capital Measure: The bank has a tier 1 risk-based capital ratio of less than 4.0 percent;

(iii) Common Equity Tier 1 Capital Measure: The bank has a common equity tier 1 risk-based capital ratio of less than 3.0 percent; or

(iv) Leverage Measure: The bank has a leverage ratio of less than 3.0 percent.

(5) ''Critically undercapitalized'' if the bank has a ratio of tangible equity to total assets that is equal to or less than 2.0 percent.

* * * * *

Subpart G—Financial Subsidiaries of State Member Banks

33. In § 208.73, revise paragraph (a) introductory text to read as follows:

§ 208.73 What additional provisions are applicable to state member banks with financial subsidiaries?

(a) *Capital deduction required.* A state member bank that controls or holds an interest in a financial subsidiary must comply with the rules set forth in § 217.22(a)(7) of Regulation Q (12 CFR 217.22(a)(7)) in determining its compliance with applicable regulatory capital standards (including the well capitalized standard of § 208.71(a)(1)).

* * * * *

§ 208.77 [Amended]

34. In § 208.77, remove and reserve paragraph (c).

Appendix A to Part 208—[Amended]

35. Amend appendix A by removing ''appendix E to this part'' and add ''12 CFR part 217, subpart F'' in its place wherever it appears; and by removing ''appendix E of this part'' and adding in its place ''12 CFR part 217, subpart F'' in its place wherever it appears.

36. Effective January 1, 2015, appendix A to part 208 is removed and reserved.

Appendix B to Part 208—[Removed and Reserved]

37. Appendix B to part 208 is removed and reserved.

38. In Appendix C to part 208, Note 2 is revised to read as follows:

Appendix C to Part 208—Interagency Guidelines for Real Estate Lending Policies

* * * * *

[2] For the state member banks, the term ''total capital'' refers to that term as defined in subpart A of 12 CFR part 217. For insured state nonmember banks and state savings associations, ''total capital'' refers to that term defined in subpart A of 12 CFR part 324. For national banks and Federal savings associations, the term ''total capital'' refers to that term as defined in subpart A of 12 CFR part 3.

* * * * *

Appendix E to Part 208—[Removed and Reserved]

39. Appendix E to part 208 is removed and reserved.

Appendix F to Part 208—[Removed and Reserved]

40. Appendix F to part 208 is removed and reserved.

PART 217—CAPITAL ADEQUACY OF BANK HOLDING COMPANIES, SAVINGS AND LOAN HOLDING COMPANIES, AND STATE MEMBER BANKS (REGULATION Q)

41. The authority citation for part 217 shall read as follows:

Authority: 12 U.S.C. 248(a), 321–338a, 481–486, 1462a, 1467a, 1818, 1828, 1831n, 1831o, 1831p–l, 1831w, 1835, 1844(b), 1851, 3904, 3906–3909, 4808, 5365, 5371.

42. Part 217 is added as set forth at the end of the common preamble.

43. Part 217 is amended as set forth below:

i. Remove ''[AGENCY]'' and add ''Board'' in its place wherever it appears.

ii. Remove ''[BANK]'' and add ''Board-regulated institution'' in its place wherever it appears.

iii. Remove ''[PART]'' and add ''part'' wherever it appears.

44. In § 217.1, redesignate paragraphs (c)(1) through (c)(4) as paragraphs (c)(2) through (c)(5) respectively, add new paragraph (c)(1), and revise paragraph (e) to read as follows:

* * * * *

§ 217.1 Purpose, applicability, and reservations of authority.

* * * * *

(c)(1) *Scope.* This part applies on a consolidated basis to every Board-regulated institution that is:

(i) A state member bank;

(ii) A bank holding company domiciled in the United States that is not subject to 12 CFR part 225, Appendix C, provided that the Board may by order subject any bank holding company to this part, in whole or in part, based on the institution's size, level of complexity, risk profile, scope of operations, or financial condition; or

(iii) A savings and loan holding company domiciled in the United States.

* * * * *

(e) *Notice and response procedures.* In making a determination under this section, the Board will apply notice and response procedures in the same manner and to the same extent as the notice and response procedures in 12 CFR 263.202.

45. In § 217.2:

i. Add definitions of Board, Board-regulated institution, non-guaranteed separate account, policy loan, separate account, state bank, and state member bank or member bank;

ii. Add paragraphs (12) and (13) to the definition of corporate exposure, and

iii. Revise the definition of gain-on-sale, paragraph (2)(i) of the definition of high volatility commercial real estate (HVCRE) exposure, paragraph (4) of the definition of pre-sold construction loan, and paragraph (1) of the definition of total leverage exposure, to read as follows:

* * * * *

§ 217.2 Definitions.

* * * * *

Board means the Board of Governors of the Federal Reserve System.

Board-regulated institution means a state member bank, bank holding company, or savings and loan holding company.

* * * * *

Corporate exposure * * *

(12) A policy loan; or

(13) A separate account.

* * * * *

Gain-on-sale means an increase in the equity capital of a Board-regulated institution (as reported on Schedule RC of the Call Report, for a state member bank, or Schedule HC of the FR Y–9C, for a bank holding company or savings and loan holding company,[1] as applicable) resulting from a securitization (other than an increase in equity capital resulting from the [BANK]'s receipt of cash in connection with the securitization).

* * * * *

[1] Savings and loan holding companies that do not file the FR Y–9C should follow the instructions to the FR Y–9C.

High volatility commercial real estate (HVCRE) exposure * * *

(2) * * *

(i) The loan-to-value ratio is less than or equal to the applicable maximum supervisory loan-to-value ratio in the Board's real estate lending standards at 12 CFR part 208, Appendix C;

* * * * *

Non-guaranteed separate account means a separate account where the insurance company:

(1) Does not contractually guarantee either a minimum return or account value to the contract holder; and

(2) Is not required to hold reserves (in the general account) pursuant to its contractual obligations to a policyholder.

* * * * *

Policy loan means a loan by an insurance company to a policy holder pursuant to the provisions of an insurance contract that is secured by the cash surrender value or collateral assignment of the related policy or contract. A policy loan includes:

(1) A cash loan, including a loan resulting from early payment benefits or accelerated payment benefits, on an insurance contract when the terms of contract specify that the payment is a policy loan secured by the policy; and

(2) An automatic premium loan, which is a loan that is made in accordance with policy provisions which provide that delinquent premium payments are automatically paid from the cash value at the end of the established grace period for premium payments.

Pre-sold construction loan means * * *

(4) The purchaser has not terminated the contract; however, if the purchaser terminates the sales contract, the Board must immediately apply a 100 percent risk weight to the loan and report the revised risk weight in the next quarterly Call Report, for a state member bank, or the FR Y–9C, for a bank holding company or savings and loan holding company, as applicable,

* * * * *

Separate account means a legally segregated pool of assets owned and held by an insurance company and maintained separately from the insurance company's general account assets for the benefit of an individual contract holder. To be a separate account:

(1) The account must be legally recognized under applicable law;

(2) The assets in the account must be insulated from general liabilities of the insurance company under applicable law in the event of the company's insolvency;

(3) The insurance company must invest the funds within the account as directed by the contract holder in designated investment alternatives or in accordance with specific investment objectives or policies, and

(4) All investment gains and losses, net of contract fees and assessments, must be passed through to the contract holder, provided that the contract may specify conditions under which there may be a minimum guarantee but must not include contract terms that limit the maximum investment return available to the policyholder.

* * * * *

State bank means any bank incorporated by special law of any State, or organized under the general laws of any State, or of the United States, including a Morris Plan bank, or other incorporated banking institution engaged in a similar business.

State member bank or member bank means a state bank that is a member of the Federal Reserve System.

* * * * *

Total leverage exposure * * *

(1) The balance sheet carrying value of all of the Board-regulated institution's on-balance sheet assets, as reported on the Call Report, for a state member bank, or the FR Y–9C, for a bank holding company or savings and loan holding company,[2] as applicable, less amounts deducted from tier 1 capital under § 217.22;

* * * * *

46. In § 217.10, revise paragraph (b)(4) to read as follows:

§ 217.10 Minimum capital requirements.

* * * * *

(b) * * *

(4) *Leverage ratio.* A Board-regulated institution's leverage ratio is the ratio of the Board-regulated institution's tier 1 capital to its average consolidated assets as reported on the Call Report, for a state member bank, or FR Y–9C, for a bank holding company or savings and loan holding company [3], as applicable, less amounts deducted from tier 1 capital.

* * * * *

47. In § 217.11, revise paragraphs (a)(2)(i) and (a)(3) as follows

§ 217.11 Capital conservation buffer and countercyclical capital buffer amount.

* * * * *

(a) * * *

(2) *Definitions.* * * *

(i) *Eligible retained income.* The eligible retained income of a Board-regulated institution is the Board-regulated institution's net income for the four calendar quarters preceding the current calendar quarter, based on the Board-regulated institution's most recent quarterly Call Report, for a state member bank, or the FR Y–9C, for a bank holding company or savings and loan holding company, as applicable, net of any capital distributions and associated tax effects not already reflected in net income.[4]

* * * * *

(3) *Calculation of capital conservation buffer.* A Board-regulated institution's capital conservation buffer is equal to the lowest of the following ratios, calculated as of the last day of the previous calendar quarter based on the Board-regulated institution's most recent Call Report, for a state member bank, or the FR Y–9C, for a bank holding company or savings and loan holding company,[5] as applicable:

* * * * *

48. In § 217.22, revise paragraph (a)(7) and add paragraph (b)(3) to read as follows:

§ 217.22 Regulatory capital adjustments and deductions.

* * * * *

(a) * * *

(7) *Financial subsidiaries.* (i) A state member bank must deduct the aggregate amount of its outstanding equity investment, including retained earnings, in its financial subsidiaries (as defined in 12 CFR 208.77) and may not consolidate the assets and liabilities of a financial subsidiary with those of the state member bank.

(ii) No other deduction is required under § 217.22(c) for investments in the capital instruments of financial subsidiaries.

(b) * * *

(3) Regulatory capital requirement of insurance underwriting subsidiary. A bank holding company or savings and loan holding company must deduct an amount equal to the minimum regulatory capital requirement established by the regulator of any insurance underwriting subsidiary of the holding company. For U.S.-based

[2] Savings and loan holding companies that do not file the FR Y–9C should follow the instructions to the FR Y–9C.

[3] Savings and loan holding companies that do not file the FR Y–9C should follow the instructions to the FR Y–9C.

[4] Savings and loan holding companies that do not file FR Y–9C should follow the instructions to the FR Y–9C. Net income, as reported in the Call Report or the FR Y–9C, as applicable, reflects discretionary bonus payments and certain capital distributions that are expense items (and their associated tax effects).

[5] Savings and loan holding companies that do not file FR Y–9C should follow the instructions to the FR Y–9C.

insurance underwriting subsidiaries, this amount generally would be 200 percent of the subsidiary's Authorized Control Level as established by the appropriate state regulator of the insurance company. The bank holding company or savings and loan holding company must take the deduction 50 percent from tier 1 capital and 50 percent from tier 2 capital. If the amount deductible from tier 2 capital exceeds the Board regulated institution's tier 2 capital, the Board regulated institution must deduct the excess from tier 1 capital.

* * * * *

49. In § 217.300, revise paragraph (c)(3) introductory text and add new paragraph (e) to read as follows:

§ 217.300 Transitions.

* * * * *

(3) *Transition adjustments to AOCI.* From January 1, 2013 through December 31, 2017, a Board-regulated institution must adjust common equity tier 1 capital with respect to the aggregate amount of unrealized gains on AFS equity securities, plus net unrealized gains or losses on AFS debt securities, plus accumulated net unrealized gains and losses on defined benefit pension obligations, plus accumulated net unrealized gains or losses on cash flow hedges related to items that are reported on the balance sheet at fair value included in AOCI (the transition AOCI adjustment amount) as reported on the Board-regulated institution's most recent Call Report, for a state member bank, or the FR Y–9C, for a bank holding company or savings and loan holding company,[6] as applicable, as follows:

* * * * *

(e) Until July 21, 2015, this part will not apply to any bank holding company subsidiary of a foreign banking organization that is currently relying on Supervision and Regulation Letter SR 01–01 issued by the Board (as in effect on May 19, 2010).

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

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

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

[6] Savings and loan holding companies that do not file FR Y–9C should follow the instructions to the FR Y–9C.

Subpart A—General Provisions

50. In § 225.1, on January 1, 2015, remove and reserve paragraphs (c)(12), (c)(13) and (c)(15) to read as follows:

§ 225.1 Authority, purpose, and scope.

* * * * *

(c) *Scope* * * *

(12) [Reserved]

* * * * *

(14) [Reserved]

(15) [Reserved]

* * * * *

51. In § 225.2, revise paragraphs (r)(1)(i) and (ii) to read as follows:

§ 225.2 Definitions.

* * * * *

(r) * * *

(1) * * *

(i) On a consolidated basis, the bank holding company maintains a total risk-based capital ratio of 10.0 percent or greater, as defined in 12 CFR 217.10;

(ii) On a consolidated basis, the bank holding company maintains a tier 1 risk-based capital ratio of 6.0 percent or greater, as defined in 12 CFR 217.10; and

* * * * *

52. In § 225.4, revise paragraph (b)(4)(ii) to read as follows:

§ 225.4 Corporate practices.

* * * * *

(b) * * *

(4) * * *

(ii) In determining whether a proposal constitutes an unsafe or unsound practice, the Board shall consider whether the bank holding company's financial condition, after giving effect to the proposed purchase or redemption, meets the financial standards applied by the Board under section 3 of the BHC Act, including 12 CFR part 217 and the Board's Policy Statement for Small Bank Holding Companies (appendix C of this part).

* * * * *

53. In § 225.8, revise paragraphs (c)(5) and (c)(7) through (c)(10) to read as follows:

§ 225.8 Capital planning.

* * * * *

(c) * * *

(5) *Minimum regulatory capital ratio* means any minimum regulatory capital ratio that the Federal Reserve may require of a bank holding company, by regulation or order, including any minimum capital ratio required under 12 CFR 217.10(a).

* * * * *

(7) *Tier 1 capital* has the same meaning as under 12 CFR 217.2.

(8) *Tier 1 common capital* means tier 1 capital less the non-common elements of tier 1 capital, including perpetual preferred stock and related surplus, minority interest in subsidiaries, trust preferred securities and mandatory convertible preferred securities.

(9) *Tier 1 common ratio* means the ratio of a bank holding company's tier 1 common capital to total risk-weighted assets. This definition will remain in effect until the Board adopts an alternative tier 1 common ratio definition as a minimum regulatory capital ratio.

(10) *Total risk-weighted assets* has the same meaning as under 12 CFR 217.2.

* * * * *

Subpart B—Acquisition of Bank Securities or Assets

54. In § 225.12, revise paragraph (d)(2)(iv) to read as follows:

§ 225.12 Transactions not requiring Board approval.

* * * * *

(d) * * *

(2) * * *

(iv) Both before and after the transaction, the acquiring bank holding company meets the requirements of 12 CFR part 217;

* * * * *

Subpart C—Nonbanking Activities and Acquisitions by Bank Holding Companies

55. In § 225.22, revise paragraph (d)(8)(v) to read as follows:

§ 225.22 Exempt nonbanking activities and acquisitions.

* * * * *

(d) * * *

(8) * * *

(v) The acquiring company, after giving effect to the transaction, meets the requirements of 12 CFR part 217, and the Board has not previously notified the acquiring company that it may not acquire assets under the exemption in this paragraph (d).

* * * * *

Subpart J—Merchant Banking Investments

56. In § 225.172, revise paragraph (b)(6)(i)(A) to read as follows:

§ 225.22 What are the holding periods permitted for merchant banking investments?

* * * * *

(b) * * *

(6) * * *

(i) * * *

(A) Higher than the maximum marginal tier 1 capital charge applicable under part 217 to merchant banking investments held by that financial holding company; and

* * * * *

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

57. Amend appendix A to remove ''appendix E of this part'' and add ''12 CFR part 217, subpart F'' in its place wherever it appears.

58. On January 1, 2015, appendix A to part 225 is removed and reserved.

Appendix B to Part 225—Capital Adequacy Guidelines for Bank Holding Companies and State Member Banks: Leverage Measure

59. Appendix B to part 225 is removed and reserved.

Appendix D to Part 225—Capital Adequacy Guidelines for Bank Holding Companies: Tier 1 Leverage Measure

60. Appendix D to part 225 is removed and reserved.

Appendix E to Part 225—Capital Adequacy Guidelines for Bank Holding Companies: Market Risk Measure

61. Appendix E to part 225 is removed and reserved.

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

62. Appendix G to part 225 is removed and reserved.

FEDERAL DEPOSIT INSURANCE CORPORATION

12 CFR Chapter III

Authority and Issuance

For the reasons set forth in the common preamble, the Federal Deposit Insurance Corporation amends chapter III of title 12 of the Code of Federal Regulations as follows:

PART 324—CAPITAL ADEQUACY

63. The authority citation for part 324 is added to read as follows:

Authority: 12 U.S.C. 1815(a), 1815(b), 1816, 1818(a), 1818(b), 1818(c), 1818(t), 1819 (Tenth), 1828(c), 1828(d), 1828(i), 1828(n), 1828(o), 1831o, 1835, 3907, 3909, 4808; 5371; 5412; Pub. L. 102–233, 105 Stat. 1761, 1789, 1790 (12 U.S.C. 1831n note); Pub. L. 102–242, 105 Stat. 2236, 2355, as amended by Pub. L. 103–325, 108 Stat. 2160, 2233 (12 U.S.C. 1828 note); Pub. L. 102–242, 105 Stat. 2236, 2386, as amended by Pub. L. 102–550, 106 Stat. 3672, 4089 (12 U.S.C. 1828 note); Pub. L. 111–203, 124 Stat. 1376, 1887 (15 U.S.C. 78o–7 note).

64. Subparts A, B, C, and G of part 324 are added as set forth at the end of the common preamble.

65. Subparts A, B, C, and G of part 324 are amended as set forth below:

a. Remove ''[AGENCY]'' and add ''FDIC'' in its place, wherever it appears;

b. Remove ''[BANK]'' and add ''bank and state savings association'' in its place, wherever it appears in the phrase ''Each [BANK]'' or ''each [BANK]'';

c. Remove ''[BANK]'' and add ''bank or state savings association'' in its place, wherever it appears in the phrases ''A [BANK]'', ''a [BANK]'', ''The [BANK]'', or ''the [BANK]'';

d. Remove ''[BANKS]'' and add ''banks and state savings associations'' in its place, wherever it appears;

e. Remove ''[PART]'' and add ''Part 324'' in its place, wherever it appears;

f. Remove ''[AGENCY]'' and add ''FDIC'' in its place, wherever it appears; and

g. Remove ''[REGULATORY REPORT]'' and add ''Call Report'' in its place, wherever it appears.

66. New § 324.2 is amended by adding the following definitions in alphabetical order:

§ 324.2 Definitions.

* * * * *

Bank means an FDIC-insured, state-chartered commercial or savings bank that is not a member of the Federal Reserve System and for which the FDIC is the appropriate federal banking agency pursuant to section 3(q) of the Federal Deposit Insurance Act (12 U.S.C. 1813(q)).

* * * * *

Core capital means Tier 1 capital, as defined in § 324.2 of subpart A of this part.

* * * * *

State savings association means a State savings association as defined in section 3(b)(3) of the Federal Deposit Insurance Act (12 U.S.C. 1813(b)(3)), the deposits of which are insured by the Corporation. It includes a building and loan, savings and loan, or homestead association, or a cooperative bank (other than a cooperative bank which is a State bank as defined in section 3(a)(2) of the Federal Deposit Insurance Act) organized and operating according to the laws of the State in which it is chartered or organized, or a corporation (other than a bank as defined in section 3(a)(1) of the Federal Deposit Insurance Act) that the Board of Directors of the Federal Deposit Insurance Corporation determine to be operating substantially in the same manner as a State savings association.

* * * * *

Tangible capital means the amount of core capital (Tier 1 capital), as defined in accordance with § 324.2 of subpart A of this part, plus the amount of outstanding perpetual preferred stock (including related surplus) not included in Tier 1 capital.

Tangible equity means the amount of Tier 1 capital, as calculated in accordance with § 324.2 of subpart A of this chapter, plus the amount of outstanding perpetual preferred stock (including related surplus) not included in Tier 1 capital.

* * * * *

67. New § 324.10 is amended by adding paragraphs (a)(6), (b)(5), and (c)(5) to read as follows:

§ 324.10 Minimum capital requirements.

(a) * * *

(6) For state savings associations, a tangible capital ratio of 1.5 percent.

(b) * * *

(5) *State savings association tangible capital ratio.* A state savings association's tangible capital ratio is the ratio of the state savings association's core capital (Tier 1 capital) to total adjusted assets as calculated under § 390.461.

(c) * * *

(5) *State savings association tangible capital ratio.* A state savings association's tangible capital ratio is the ratio of the state savings association's core capital (Tier 1 capital) to total adjusted assets as calculated under § 390.461.

* * * * *

68. New § 324.22 is amended to add new paragraph (a)(8), to read as follows:

§ 324.22 Regulatory capital adjustments and deductions.

(a) * * *

(8) (i) A state savings association must deduct the aggregate amount of its outstanding investments, (both equity and debt) as well as retained earnings in subsidiaries that are not includable subsidiaries as defined in paragraph 7(iv) of this section (including those subsidiaries where the state savings association has a minority ownership interest) and may not consolidate the assets and liabilities of the subsidiary with those of the state savings association. Any such deductions shall be deducted from common equity tier 1 capital, except as provided in paragraphs (a)(7)(ii) and (a)(7)(iii) of this section.

(ii) If a state savings association has any investments (both debt and equity) in one or more subsidiaries engaged in any activity that would not fall within the scope of activities in which includable subsidiaries as defined in paragraph 7(iv) of this section may engage, it must deduct such investments from assets and common equity tier 1 capital in accordance with paragraph (c)(7)(i) of this section. The state savings association must first deduct from assets and common equity tier 1 capital the amount by which any investments in such subsidiary(ies) exceed the amount of such investments held by the state savings association as of April 12, 1989. Next the state savings association must deduct from assets and common equity tier 1 the state savings association's investments in and extensions of credit to the subsidiary on the date as of which the state savings association's capital is being determined.

(iii) If a state savings association holds a subsidiary (either directly or through a subsidiary) that is itself a [insured] domestic depository institution, the FDIC may, in its sole discretion upon determining that the amount of common equity tier 1 capital that would be required would be higher if the assets and liabilities of such subsidiary were consolidated with those of the parent state savings association than the amount that would be required if the parent state savings association's investment were deducted pursuant to paragraphs (c)(6)(i) and (c)(6)(ii) of this section, consolidate the assets and liabilities of that subsidiary with those of the parent state savings association in calculating the capital adequacy of the parent state savings association, regardless of whether the subsidiary would otherwise be an includable subsidiary as defined in paragraph (c)(7)(iv) of this section.

(iv) For purposes of this section, the term includable subsidiary means a subsidiary of a state savings association that is:

(A) Engaged solely in activities that are permissible for a national bank;

(B) Engaged in activities not permissible for a national bank, but only if acting solely as agent for its customers and such agency position is clearly documented in the state savings association's files;

(C) Engaged solely in mortgage-banking activities;

(D)(*1*) Itself an insured depository institution or a company the sole investment of which is an insured depository institution, and

(*2*) Was acquired by the parent state savings association prior to May 1, 1989; or

(E) A subsidiary of any state savings association existing as a state savings association on August 9, 1989 that —

(*1*) Was chartered prior to October 15, 1982, as a savings bank or a cooperative bank under state law, or

(*2*) Acquired its principal assets from an association that was chartered prior to October 15, 1982, as a savings bank or a cooperative bank under state law.

* * * * *

69. Subpart H is added to part 324 to read as follows:

Subpart H—Prompt Corrective Action

Sec.

Subpart H—Prompt Corrective Action

§ 324.301 Authority, purpose, scope, other supervisory authority, and disclosure of capital categories.

(a) *Authority.* This subpart is issued by the FDIC pursuant to section 38 of the Federal Deposit Insurance Act (FDI Act), as added by section 131 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (Pub. L. 102–242, 105 Stat. 2236 (1991)) (12 U.S.C. 1831o).

(b) *Purpose.* Section 38 of the FDI Act establishes a framework of supervisory actions for insured depository institutions that are not adequately capitalized. The principal purpose of this subpart is to define, for FDIC-insured state-chartered nonmember banks and state-chartered savings associations, the capital measures and capital levels, and for insured branches of foreign banks, comparable asset-based measures and levels, that are used for determining the supervisory actions authorized under section 38 of the FDI Act. This subpart also establishes procedures for submission and review of capital restoration plans and for issuance and review of directives and orders pursuant to section 38 of the FDI Act.

(c) *Scope.* Until January 1, 2015, subpart B of part 325 of this chapter will continue to apply to FDIC-insured state-chartered nonmember banks and insured branches of foreign banks for which the FDIC is the appropriate Federal banking agency. Until January 1, 2015, subpart Y of part 390 of this chapter will continue to apply to state savings associations. As of January 1, 2015, this subpart implements the provisions of section 38 of the FDI Act as they apply to FDIC-insured state-chartered nonmember banks, state savings associations, and insured branches of foreign banks for which the FDIC is the appropriate Federal banking agency. Certain of these provisions also apply to officers, directors and employees of those insured institutions. In addition, certain provisions of this subpart apply to all insured depository institutions that are deemed critically undercapitalized.

(d) *Other supervisory authority.* Neither section 38 of the FDI Act nor this subpart in any way limits the authority of the FDIC under any other provision of law to take supervisory actions to address unsafe or unsound practices, deficient capital levels, violations of law, unsafe or unsound conditions, or other practices. Action under section 38 of the FDI Act and this subpart may be taken independently of, in conjunction with, or in addition to any other enforcement action available to the FDIC, including issuance of cease and desist orders, capital directives, approval or denial of applications or notices, assessment of civil money penalties, or any other actions authorized by law.

(e) *Disclosure of capital categories.* The assignment of a bank, a state savings association, or an insured branch under this subpart within a particular capital category is for purposes of implementing and applying the provisions of section 38 of the FDI Act. Unless permitted by the FDIC or otherwise required by law, no bank or state savings association may state in any advertisement or promotional material its capital category under this subpart or that the FDIC or any other federal banking agency has assigned the bank or state savings association to a particular capital category.

§ 324.302 Notice of capital category.

(a) *Effective date of determination of capital category.* A bank or state savings association shall be deemed to be within a given capital category for purposes of section 38 of the FDI Act and this subpart as of the date the bank or state savings association is notified of, or is deemed to have notice of, its capital category, pursuant to paragraph (b) of this section.

(b) *Notice of capital category.* A bank or state savings association shall be deemed to have been notified of its capital levels and its capital category as of the most recent date:

(1) A Consolidated Report of Condition and Income or Thrift Financial Report (Call Report) is required to be filed with the FDIC;

(2) A final report of examination is delivered to the bank or state savings association; or

(3) Written notice is provided by the FDIC to the bank or state savings association of its capital category for purposes of section 38 of the FDI Act and this subpart or that the bank's or

state savings association's capital category has changed as provided in § 324.303(d).

(c) *Adjustments to reported capital levels and capital category*—(1) *Notice of adjustment by bank or state savings association.* A bank or state savings association shall provide the appropriate FDIC regional director with written notice that an adjustment to the bank's or state savings association's capital category may have occurred no later than 15 calendar days following the date that any material event has occurred that would cause the bank or state savings association to be placed in a lower capital category from the category assigned to the bank or state savings association for purposes of section 38 of the FDI Act and this subpart on the basis of the bank's or state savings association's most recent Call Report or report of examination.

(2) *Determination by the FDIC to change capital category.* After receiving notice pursuant to paragraph (c)(1) of this section, the FDIC shall determine whether to change the capital category of the bank or state savings association and shall notify the bank or state savings association of the FDIC's determination.

§ 324.303 Capital measures and capital category definitions.

(a) *Capital measures.* For purposes of section 38 of the FDI Act and this subpart, the relevant capital measures shall be:

(1) The total risk-based capital ratio;

(2) The Tier 1 risk-based capital ratio; and

(3) The common equity tier 1 ratio;

(4) The leverage ratio;

(5) The tangible equity to total assets ratio; and

(6) Beginning on January 1, 2018, the supplementary leverage ratio calculated in accordance with § 324.11 of subpart B of this part for banks or state savings associations that are subject to subpart E of part 324.

(b) *Capital categories.* For purposes of section 38 of the FDI Act and this subpart, a bank or state savings association shall be deemed to be:

(1) ''Well capitalized'' if the bank or state savings association:

(i) Has a total risk-based capital ratio of 10.0 percent or greater; and

(ii) Has a Tier 1 risk-based capital ratio of 8.0 percent or greater; and

(iii) Has a common equity tier 1 capital ratio of 6.5 percent or greater; and

(iv) Has a leverage ratio of 5.0 percent or greater; and

(v) Is not subject to any written agreement, order, capital directive, or prompt corrective action directive issued by the FDIC pursuant to section 8 of the FDI Act (12 U.S.C. 1818), the International Lending Supervision Act of 1983 (12 U.S.C. 3907), or the Home Owners' Loan Act (12 U.S.C. 1464(t)(6)(A)(ii)), or section 38 of the FDI Act (12 U.S.C. 1831o), or any regulation thereunder, to meet and maintain a specific capital level for any capital measure.

(2) ''Adequately capitalized'' if the bank or state savings association:

(i) Has a total risk-based capital ratio of 8.0 percent or greater; and

(ii) Has a Tier 1 risk-based capital ratio of 6.0 percent or greater; and

(iii) Has a common equity tier 1 capital ratio of 4.5 percent or greater; and

(iv) Has a leverage ratio of 4.0 percent or greater; and

(v) Does not meet the definition of a well capitalized bank.

(vi) Beginning January 1, 2018, an advanced approaches bank or state savings association will be deemed to be ''adequately capitalized'' if the bank or state savings association satisfies paragraphs (b)(2)(i) through (v) of this section and has a supplementary leverage ratio of 3.0 percent or greater, as calculated in accordance with § 324.11 of subpart B of this part.

(3) ''Undercapitalized'' if the bank or state savings association:

(i) Has a total risk-based capital ratio that is less than 8.0 percent; or

(ii) Has a Tier 1 risk-based capital ratio that is less than 6.0 percent; or

(iii) Has a common equity tier 1 capital ratio that is less than 4.5 percent; or

(iv) Has a leverage ratio that is less than 4.0 percent.

(v) Beginning January 1, 2018, an advanced approaches bank or state savings association will be deemed to be ''undercapitalized'' if the bank or state savings association has a supplementary leverage ratio of less than 3.0 percent, as calculated in accordance with § 324.11 of subpart B of this part.

(4) ''Significantly undercapitalized'' if the bank or state savings association has:

(i) A total risk-based capital ratio that is less than 6.0 percent; or

(ii) A Tier 1 risk-based capital ratio that is less than 4.0 percent; or

(iii) A common equity tier 1 capital ratio that is less than 3.0 percent; or

(iv) A leverage ratio that is less than 3.0 percent.

(5) ''Critically undercapitalized'' if the insured depository institution has a ratio of tangible equity to total assets that is equal to or less than 2.0 percent.

(c) *Capital categories for insured branches of foreign banks.* For purposes of the provisions of section 38 of the FDI Act and this subpart, an insured branch of a foreign bank shall be deemed to be:

(1) ''Well capitalized'' if the insured branch:

(i) Maintains the pledge of assets required under § 347.209 of this chapter; and

(ii) Maintains the eligible assets prescribed under § 347.210 of this chapter at 108 percent or more of the preceding quarter's average book value of the insured branch's third-party liabilities; and

(iii) Has not received written notification from:

(A) The OCC to increase its capital equivalency deposit pursuant to 12 CFR 28.15(b), or to comply with asset maintenance requirements pursuant to 12 CFR 28.20; or

(B) The FDIC to pledge additional assets pursuant to § 347.209 of this chapter or to maintain a higher ratio of eligible assets pursuant to § 347.210 of this chapter.

(2) ''Adequately capitalized'' if the insured branch:

(i) Maintains the pledge of assets required under § 347.209 of this chapter; and

(ii) Maintains the eligible assets prescribed under § 347.210 of this chapter at 106 percent or more of the preceding quarter's average book value of the insured branch's third-party liabilities; and

(iii) Does not meet the definition of a well capitalized insured branch.

(3) ''Undercapitalized'' if the insured branch:

(i) Fails to maintain the pledge of assets required under § 347.209 of this chapter; or

(ii) Fails to maintain the eligible assets prescribed under § 347.210 of this chapter at 106 percent or more of the preceding quarter's average book value of the insured branch's third-party liabilities.

(4) ''Significantly undercapitalized'' if it fails to maintain the eligible assets prescribed under § 347.210 of this chapter at 104 percent or more of the preceding quarter's average book value of the insured branch's third-party liabilities.

(5) ''Critically undercapitalized'' if it fails to maintain the eligible assets prescribed under § 347.210 of this chapter at 102 percent or more of the preceding quarter's average book value of the insured branch's third-party liabilities.

(d) *Reclassifications based on supervisory criteria other than capital.* The FDIC may reclassify a well capitalized bank or state savings association as adequately capitalized and may require an adequately capitalized bank or state savings association or an undercapitalized bank or state savings association to comply with certain mandatory or discretionary supervisory actions as if the bank or state savings association were in the next lower capital category (except that the FDIC may not reclassify a significantly undercapitalized bank or state savings association as critically undercapitalized) (each of these actions are hereinafter referred to generally as ''reclassifications'') in the following circumstances:

(1) *Unsafe or unsound condition.* The FDIC has determined, after notice and opportunity for hearing pursuant to § 308.202(a) of this chapter, that the bank or state savings association is in unsafe or unsound condition; or

(2) *Unsafe or unsound practice.* The FDIC has determined, after notice and opportunity for hearing pursuant to § 308.202(a) of this chapter, that, in the most recent examination of the bank or state savings association, the bank or state savings association received and has not corrected a less-than-satisfactory rating for any of the categories of asset quality, management, earnings, or liquidity.

§ 324.304 Capital restoration plans.

(a) *Schedule for filing plan*—(1) *In general.* A bank or state savings association shall file a written capital restoration plan with the appropriate FDIC regional director within 45 days of the date that the bank or state savings association receives notice or is deemed to have notice that the bank or state savings association is undercapitalized, significantly undercapitalized, or critically undercapitalized, unless the FDIC notifies the bank or state savings association in writing that the plan is to be filed within a different period. An adequately capitalized bank or state savings association that has been required pursuant to § 324.303(d) of this subpart to comply with supervisory actions as if the bank or state savings association were undercapitalized is not required to submit a capital restoration plan solely by virtue of the reclassification.

(2) *Additional capital restoration plans.* Notwithstanding paragraph (a)(1) of this section, a bank or state savings association that has already submitted and is operating under a capital restoration plan approved under section 38 and this subpart is not required to submit an additional capital restoration plan based on a revised calculation of its capital measures or a reclassification of the institution under § 324.303 unless the FDIC notifies the bank or state savings association that it must submit a new or revised capital plan. A bank or state savings association that is notified that it must submit a new or revised capital restoration plan shall file the plan in writing with the appropriate FDIC regional director within 45 days of receiving such notice, unless the FDIC notifies the bank or state savings association in writing that the plan must be filed within a different period.

(b) *Contents of plan.* All financial data submitted in connection with a capital restoration plan shall be prepared in accordance with the instructions provided on the Call Report, unless the FDIC instructs otherwise. The capital restoration plan shall include all of the information required to be filed under section 38(e)(2) of the FDI Act. A bank or state savings association that is required to submit a capital restoration plan as a result of a reclassification of the bank or state savings association pursuant to § 324.303(d) of this subpart shall include a description of the steps the bank or state savings association will take to correct the unsafe or unsound condition or practice. No plan shall be accepted unless it includes any performance guarantee described in section 38(e)(2)(C) of the FDI Act by each company that controls the bank or state savings association.

(c) *Review of capital restoration plans.* Within 60 days after receiving a capital restoration plan under this subpart, the FDIC shall provide written notice to the bank or state savings association of whether the plan has been approved. The FDIC may extend the time within which notice regarding approval of a plan shall be provided.

(d) *Disapproval of capital plan.* If a capital restoration plan is not approved by the FDIC, the bank or state savings association shall submit a revised capital restoration plan within the time specified by the FDIC. Upon receiving notice that its capital restoration plan has not been approved, any undercapitalized bank or state savings association (as defined in § 324.303(b) of this subpart) shall be subject to all of the provisions of section 38 of the FDI Act and this subpart applicable to significantly undercapitalized institutions. These provisions shall be applicable until such time as a new or revised capital restoration plan submitted by the bank has been approved by the FDIC.

(e) *Failure to submit capital restoration plan.* A bank or state savings association that is undercapitalized (as defined in § 324.303(b) of this subpart) and that fails to submit a written capital restoration plan within the period provided in this section shall, upon the expiration of that period, be subject to all of the provisions of section 38 and this subpart applicable to significantly undercapitalized institutions.

(f) *Failure to implement capital restoration plan.* Any undercapitalized bank or state savings association that fails in any material respect to implement a capital restoration plan shall be subject to all of the provisions of section 38 of the FDI Act and this subpart applicable to significantly undercapitalized institutions.

(g) *Amendment of capital restoration plan.* A bank or state savings association that has filed an approved capital restoration plan may, after prior written notice to and approval by the FDIC, amend the plan to reflect a change in circumstance. Until such time as a proposed amendment has been approved, the bank or state savings association shall implement the capital restoration plan as approved prior to the proposed amendment.

(h) *Performance guarantee by companies that control a bank or state savings association*—(1) *Limitation on liability*—(i) *Amount limitation.* The aggregate liability under the guarantee provided under section 38 and this subpart for all companies that control a specific bank or state savings association that is required to submit a capital restoration plan under this subpart shall be limited to the lesser of:

(A) An amount equal to 5.0 percent of the bank or state savings association's total assets at the time the bank or state savings association was notified or deemed to have notice that the bank or state savings association was undercapitalized; or

(B) The amount necessary to restore the relevant capital measures of the bank or state savings association to the levels required for the bank or state savings association to be classified as adequately capitalized, as those capital measures and levels are defined at the time that the bank or state savings association initially fails to comply with a capital restoration plan under this subpart.

(ii) *Limit on duration.* The guarantee and limit of liability under section 38 of the FDI Act and this subpart shall expire after the FDIC notifies the bank or state savings association that it has remained adequately capitalized for each of four consecutive calendar quarters. The expiration or fulfillment by a company of a guarantee of a capital restoration plan shall not limit the liability of the company under any guarantee required or provided in connection with any capital restoration plan filed by the same bank or state savings association after expiration of the first guarantee.

(iii) *Collection on guarantee.* Each company that controls a given bank or state savings association shall be jointly and severally liable for the guarantee for such bank or state savings association as required under section 38 and this subpart, and the FDIC may require and collect payment of the full amount of that guarantee from any or all of the companies issuing the guarantee.

(2) *Failure to provide guarantee.* In the event that a bank or state savings association that is controlled by any company submits a capital restoration plan that does not contain the guarantee required under section 38(e)(2) of the FDI Act, the bank or state savings association shall, upon submission of the plan, be subject to the provisions of section 38 and this subpart that are applicable to banks and state savings associations that have not submitted an acceptable capital restoration plan.

(3) *Failure to perform guarantee.* Failure by any company that controls a bank or state savings association to perform fully its guarantee of any capital plan shall constitute a material failure to implement the plan for purposes of section 38(f) of the FDI Act. Upon such failure, the bank or state savings association shall be subject to the provisions of section 38 and this subpart that are applicable to banks and state savings associations that have failed in a material respect to implement a capital restoration plan.

§ 324.305 Mandatory and discretionary supervisory actions.

(a) *Mandatory supervisory actions*—(1) *Provisions applicable to all banks and state savings associations.* All banks and state savings associations are subject to the restrictions contained in section 38(d) of the FDI Act on payment of capital distributions and management fees.

(2) *Provisions applicable to undercapitalized, significantly undercapitalized, and critically undercapitalized banks and state savings associations.* Immediately upon receiving notice or being deemed to have notice, as provided in § 324.302 of this subpart, that the bank or state savings association is undercapitalized, significantly undercapitalized, or critically undercapitalized, the bank or state savings association shall become subject to the provisions of section 38 of the FDI Act:

(i) Restricting payment of capital distributions and management fees (section 38(d) of the FDI Act);

(ii) Requiring that the FDIC monitor the condition of the bank or state savings association (section 38(e)(1) of the FDI Act);

(iii) Requiring submission of a capital restoration plan within the schedule established in this subpart (section 38(e)(2) of the FDI Act);

(iv) Restricting the growth of the bank or state savings association's assets (section 38(e)(3) of the FDI Act); and

(v) Requiring prior approval of certain expansion proposals (section 38(e)(4) of the FDI Act).

(3) *Additional provisions applicable to significantly undercapitalized, and critically undercapitalized banks and state savings associations.* In addition to the provisions of section 38 of the FDI Act described in paragraph (a)(2) of this section, immediately upon receiving notice or being deemed to have notice, as provided in § 324.302 of this subpart, that the bank or state savings association is significantly undercapitalized, or critically undercapitalized, or that the bank or state savings association is subject to the provisions applicable to institutions that are significantly undercapitalized because the bank or state savings association failed to submit or implement in any material respect an acceptable capital restoration plan, the bank or state savings association shall become subject to the provisions of section 38 of the FDI Act that restrict compensation paid to senior executive officers of the institution (section 38(f)(4) of the FDI Act).

(4) *Additional provisions applicable to critically undercapitalized institutions.* (i) In addition to the provisions of section 38 of the FDI Act described in paragraphs (a)(2) and (a)(3) of this section, immediately upon receiving notice or being deemed to have notice, as provided in § 324.302 of this subpart, that the insured depository institution is critically undercapitalized, the institution is prohibited from doing any of the following without the FDIC's prior written approval:

(A) Entering into any material transaction other than in the usual course of business, including any investment, expansion, acquisition, sale of assets, or other similar action with respect to which the depository institution is required to provide notice to the appropriate Federal banking agency;

(B) Extending credit for any highly leveraged transaction;

(C) Amending the institution's charter or bylaws, except to the extent necessary to carry out any other requirement of any law, regulation, or order;

(D) Making any material change in accounting methods;

(E) Engaging in any covered transaction (as defined in section 23A(b) of the Federal Reserve Act (12 U.S.C. 371c(b)));

(F) Paying excessive compensation or bonuses;

(G) Paying interest on new or renewed liabilities at a rate that would increase the institution's weighted average cost of funds to a level significantly exceeding the prevailing rates of interest on insured deposits in the institution's normal market areas; and

(H) Making any principal or interest payment on subordinated debt beginning 60 days after becoming critically undercapitalized except that this restriction shall not apply, until July 15, 1996, with respect to any subordinated debt outstanding on July 15, 1991, and not extended or otherwise renegotiated after July 15, 1991.

(ii) In addition, the FDIC may further restrict the activities of any critically undercapitalized institution to carry out the purposes of section 38 of the FDI Act.

(5) Exception for certain savings associations. The restrictions in paragraph (a)(4) of this section shall not apply, before July 1, 1994, to any insured savings association if:

(i) The savings association had submitted a plan meeting the requirements of section 5(t)(6)(A)(ii) of the Home Owners' Loan Act (12 U.S.C. 1464(t)(6)(A)(ii)) prior to December 19, 1991;

(ii) The Director of Office of Thrift Supervision (OTS) had accepted the plan prior to December 19, 1991; and

(iii) The savings association remains in compliance with the plan or is operating under a written agreement with the appropriate federal banking agency.

(b) Discretionary supervisory actions. In taking any action under section 38 of the FDI Act that is within the FDIC's discretion to take in connection with:

(1) An insured depository institution that is deemed to be undercapitalized, significantly undercapitalized, or critically undercapitalized, or has been reclassified as undercapitalized, or significantly undercapitalized; or

(2) An officer or director of such institution, the FDIC shall follow the procedures for issuing directives under §§ 308.201 and 308.203 of this chapter, unless otherwise provided in section 38 of the FDI Act or this subpart.

PART 362—ACTIVITIES OF INSURED STATE BANKS AND INSURED SAVINGS ASSOCIATIONS

70. The authority citation for part 362 continues to read as follows:

Authority: 12 U.S.C. 1816, 1818, 1819(a)(Tenth), 1828(j), 1828(m), 1828a, 1831a, 1831e, 1831w, 1843(l).

71. Revise § 362.18(a)(3) to read as follows:

§ 362.18 Financial subsidiaries of insured state nonmember banks

(a) * * *

(3) The insured state nonmember bank will deduct the aggregate amount of its outstanding equity investment, including retained earnings, in all financial subsidiaries that engage in activities as principal pursuant to section 46(a) of the Federal Deposit Act (12 U.S.C. 1831w(a)), from the bank's total assets and tangible equity and deduct such investment from common equity tier 1 capital in accordance with 12 CFR part 324, subpart C.

* * * * *

Dated: June 11, 2012

Thomas J. Curry,

Comptroller of the Currency.

By order of the Board of Directors.

Dated at Washington, DC, this 12th day of June, 2012.

Robert E. Feldman,

Executive Secretary.

Federal Deposit Insurance Corporation.

By order of the Board of Governors of the Federal Reserve System, July 3, 2012.

Jennifer J. Johnson

Secretary of the Board.

[FR Doc. 2012–16757 Filed 8–10–12; 8:45 am]

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