



FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, DC 20429

OFFICE OF THE CHAIRMAN

July 27, 2011

Honorable Harry Reid
Majority Leader
United States Senate
Washington, D.C. 20510

Dear Senator Reid:

In accordance with the Dodd-Frank Wall Street Reform and Consumer Protection Act, Section 939A(c), the Federal Deposit Insurance Corporation submits the enclosed report on the review of regulations that reference credit ratings and the status of modifications to replace such references.

As required under Section 939A(a), the FDIC reviewed its regulations and identified those that (1) require an assessment of the creditworthiness of a security or money market instrument and (2) contain references to or requirements regarding credit ratings. In addition, Section 939A(b) directs federal agencies to modify such regulations to remove references to or requirements of reliance on credit ratings, and to substitute in their place an appropriate standard of credit-worthiness, which should be uniform across agencies, to the extent feasible.

The enclosed report describes the results of the FDIC's review under Section 939A(a) of its regulations for references to the use of or reliance on credit ratings. The report also discusses the modifications the FDIC has made or plans to make to these regulations to comply with Section 939A(b). For example, the FDIC removed the references to credit ratings in its deposit insurance assessment regulations in its final rule adopted on February 7, 2011. The changes under the revised deposit insurance assessment regulation became effective on April 1, 2011. The FDIC is working with the other federal banking agencies to develop uniform alternative standards of creditworthiness for capital standards and investment securities. We have solicited input from industry, experts, and market participants in efforts to identify alternative standards of creditworthiness, and we continue to work with the other federal banking agencies with the goal of issuing concrete proposals for public comment.

If you have any questions on the report and our efforts to remove credit ratings as required by Section 939A(b), please contact Paul Nash, Deputy for External Affairs, at (202) 898-6962.

Sincerely,

Martin J. Gruenberg
Acting Chairman

Enclosure

References to Credit Ratings in FDIC Regulations

Submitted to the Congress pursuant to Section 939A of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act)

FDIC Regulations

As required by Section 939A(a), the FDIC reviewed its regulations to identify which ones (1) require an assessment of the credit-worthiness of a security or money market instrument and (2) contain references to or requirements regarding credit ratings.

The FDIC identified 6 regulations with references to credit ratings. Within these regulations, there were 66 sections containing specific references to credit ratings or credit rating agencies, including references to “investment grade,” “not of investment grade,” “externally rated,” “external ratings,” “long-term debt issuer rating,” that directly relate to credit ratings. Attachment A contains further details, including legal citations and hyperlinks to regulations.

Generally, the references to credit ratings are for four purposes:

- *Capital* calculations to determine risk-based capital standards.
- *Permissibility* standards to determine if investments are appropriate for financial institutions to purchase.
- *Risk assessments* for deposit insurance purposes.
- *Disclosure* to customers or others.

All the FDIC’s regulatory references to credit ratings are described in detail in the Appendix.

12 CFR Part 325 (Regulatory Capital Rules)

Among the FDIC’s codified regulations, the FDIC’s regulatory capital rules and statements of policy in 12 CFR Part 325 contain the largest number of references to external credit ratings. The FDIC is working with the other banking agencies to develop uniform alternative standards of credit-worthiness to replace the use of external credit ratings in these capital rules.

The existing risk-based capital standards in 12 CFR Part 325 reference external credit ratings in four general areas:

- the assignment of risk weights for securitization exposures under the general risk-based capital rules and advanced approaches rules,
- the assignment of risk weights for claims on, or guaranteed by, qualifying securities firms under the general risk-based capital rules,

- the assignment of standardized specific risk add-ons under the market risk rule, and
- the determination of eligibility for certain guarantors and collateral for purposes of the credit risk mitigation framework under advanced approaches rules.

Additionally, in 2008, the FDIC issued a notice of proposed rulemaking that sought comment on implementation in the United States of certain aspects of the standardized approach in the capital adequacy framework published by the Basel Committee on Banking Supervision (Basel) in 2006. The Basel standardized approach for credit risk relies extensively on credit ratings to assign risk weights to various exposures. (Because the standardized approach has not been adopted, it is not further referenced in this report.)

Modification of 12 CFR Part 325; Progress Update

Along with the other federal banking agencies, the FDIC is considering a wide range of approaches of varying complexity and risk sensitivity for developing alternative standards of credit-worthiness for the risk-based capital standards. These include the development of risk weights for exposure categories based on objective criteria established by regulators, similar to the current risk bucketing approach of the general risk-based capital rules. Other potential approaches also include the development of broad quantitative and qualitative standards of credit-worthiness that banking organizations could use, subject to supervisory oversight, to measure the credit risk associated with exposures within a particular exposure category.

The FDIC, together with the Federal Reserve Board and the Office of the Comptroller of the Currency, issued on August 25, 2010, the *Advance Notice of Proposed Rulemaking Regarding Alternatives to the Use of External Credit Ratings in the Risk-Based Capital Guidelines of the Federal Banking Agencies* (ANPR). The ANPR solicited comment on various alternative credit-worthiness standards and any other standards that may be used for risk-based capital purposes. When considering different approaches, the agencies noted that they would evaluate the extent to which any alternative standard of credit-worthiness would:

- Appropriately distinguish the credit risk associated with a particular exposure within an asset class;
- Be sufficiently transparent, unbiased, replicable, and defined to allow banking organizations of varying size and complexity to arrive at the same assessment of creditworthiness for similar exposures and to allow for appropriate supervisory review;
- Provide for the timely and accurate measurement of negative and positive changes in creditworthiness;
- Minimize opportunities for regulatory capital arbitrage;
- Be reasonably simple to implement and not add undue burden on banking organizations; and,
- Foster prudent risk management.

The FDIC received 23 comment letters from various sources, including industry associations, banks, and rating agencies. Generally, comments received did not concretely identify or suggest alternative standards of credit-worthiness that are appropriately robust for risk-based capital rules. Most commenters expressed concern that credit ratings would no longer be permitted as an input into the risk-based capital rules; they argued that credit ratings are valuable tools in evaluating credit risk. Commenters generally argued that alternative standards of credit-worthiness need not only be risk-sensitive, but also internationally consistent to ensure a level playing field across jurisdictions.

The agencies also hosted a roundtable discussion with industry, market participants and credit assessment experts to discuss alternatives to credit ratings on November 10, 2010. Roundtable panelists presented their views on factors and methodologies that the agencies may consider in formulating alternative standards of credit-worthiness. While there was no clear solution developed that could meet the needs for determining risk-based capital requirements (or permissibility standards), panelists' comments generally mirrored those received from the ANPR. Generally, panelists asserted that in order to be implemented by banking organizations of all sizes and levels of complexity, alternative standards of credit-worthiness need to be simple and risk-sensitive without adding undue burden.

Taking into consideration comments received from the ANPR as well as comments provided at the roundtable discussion, the FDIC, in conjunction with the Federal Reserve Board and the Office of the Comptroller of the Currency, continues to evaluate alternative standards of credit-worthiness that do not rely on or reference credit ratings. This effort is taking place while the banking agencies work to implement revisions to minimum capital requirements as a result of agreements reached by the Basel Committee on Banking Supervision (BCBS), including "Basel III: a global regulatory framework for more resilient banks and banking systems." Consistent with the requirements in section 939A(b) of the Act, the FDIC is seeking to implement the provisions under Basel III and other enhancements to the risk-based capital guidelines, and other regulations as required, using alternative standards of credit-worthiness that do not rely on or reference credit ratings.

Identifying alternatives to credit ratings that are suitable for regulatory capital determinations is challenging and involves policy tradeoffs. For example, effectively reflecting the risk of certain exposures without the use of credit ratings may increase data requirements and be difficult for institutions to implement. Conversely, simple risk-bucketing approaches would be easier to implement, but in some cases may not meet objectives for risk-sensitivity. Finally, relying on banks' own risk estimates to set the capital requirements of a class of exposures in lieu of credit ratings could result in inconsistency across institutions and could be contrary to supervisory and legislative goals for capital adequacy. The FDIC continues to work with the other federal banking agencies to develop workable alternatives to credit ratings for public comment that will appropriately balance these potentially competing objectives.

12 CFR Part 327 (Assessments)

The references in 12 CFR Part 327 to credit ratings were for purposes of stratifying the risks posed by financial institutions for deposit insurance purposes. These regulations on deposit insurance assessments are unique to the FDIC.

Modification of 12 CFR Part 327; Progress Update

The FDIC removed the references in 12 CFR Part 327 to financial institution credit ratings and substituted a scorecard approach that relies on confidential financial and supervisory information. On February 7, 2011, the FDIC Board approved a final rule that amended 12 CFR Part 327 to remove references to credit ratings for purposes of determining deposit insurance assessments. Changes were effective April 1, 2011. Prior to the enactment of the Dodd-Frank Act, the FDIC had already decided to eliminate reliance on credit ratings in deposit insurance assessment calculations because of concerns with the reliability of ratings.

12 CFR Part 362 (Activities of Savings Associations)

The FDIC's regulations in 12 CFR Part 362 (Activities and Investments of Insured State Banks) implement Section 24 of the Federal Deposit Insurance Act (FDI Act). This regulation sets standards for permissible investments for state banks. The regulations in 12 CFR Part 362 generally prohibit investment activities for state banks that are not permissible for national banks, with certain exceptions. National bank investment activities are governed by the National Bank Act (12 USC 21 et seq.) and Office of the Comptroller of the Currency regulations (12 CFR Part 1). The only direct reference to credit ratings is the reference to "investment grade" contained in 12 CFR Part 362, Subpart C, Activities of Insured State Savings Associations, which implements Section 28 of the FDI Act.

Modification of 12 CFR Part 362 Progress Update

The FDIC intends to modify 12 CFR Part 362 and is working with the other banking agencies to develop uniform standards of credit-worthiness.

The Office of the Comptroller of the Currency issued an Advanced Notice of Proposed Rulemaking on August 13, 2010, titled *Alternatives to the Use of Credit Ratings in the Regulations of the OCC* to seek comment on standards alternative standards of credit-worthiness for 12 CFR Part 1 and other regulations (securities offerings, international banking). The public comments received did not identify a strong alternative solution for the purposes of a permissibility credit-worthiness standard.

12 CFR Part 347, Subpart A and Subpart B (International Banking)

FDIC regulations in 12 CFR Part 347 cover the international banking activities of state nonmember banks that operate foreign branches or subsidiaries. The reference in this regulation is to the credit quality of assets that may be pledged and mentions “investment grade” and “Nationally Recognized Statistical Rating Organization (NRSRO)” ratings.

Modification of 12 CFR Part 347, Subpart A and Subpart B; Progress Update

FDIC regulations in 12 CFR Part 347 reference credit ratings to determine a standard of credit-worthiness for pledged assets. As with the regulatory capital and permissible activity regulations, the FDIC is working to remove the references to credit ratings in Part 347 and determine an alternative standard of credit-worthiness. The FDIC plans to ensure the standards it adopts to replace the credit ratings are consistent with the other banking agencies. We expect the alternative standard of credit-worthiness for the international banking regulation will be similar to those developed for the permissible activity standards.

12 CFR Part 344 (Recordkeeping and Confirmation Requirements for Securities Transactions)

FDIC regulations in 12 CFR part 344 ensure that purchasers of securities in transactions effected by a FDIC regulated banks are provided adequate information and disclosures. This regulation also requires banks to maintain adequate records and controls with respect to the securities transactions they effect. Under this rule, banks customers should be notified when a security is unrated by a NRSRO, if that is the case. Because this regulation is intended to foster accountability and suitability of the transaction for the customer and is unrelated to the credit-worthiness standard of the underlying security, the FDIC is considering whether the references in part 344 are prohibited and we have not amended this regulation.

12 CFR Part 360 (Resolution and Receivership Rules)

Among other things, FDIC regulations in 12 CFR Part 360 describe the treatment of securitization exposures transferred in connection with a resolution and receivership. Specifically, section 360.6 references the disclosure of compensation paid to rating agencies, servicers and other third parties in a securitization transaction. Furthermore, this section addresses how compensation paid to rating agencies and other third parties in a securitization should be structured. Similar to FDIC regulations in 12 CFR part 344, the FDIC has not amended this regulation because the references to credit ratings are unrelated to the credit-worthiness of the underlying security and hence do not appear to be prohibited references.

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References to Credit Ratings in FDIC Regulations

The following represents the references to credit ratings (also referred to as external ratings, externally rated, or long-term debt issuer ratings), credit rating agencies (also referred to as nationally recognized statistical rating organizations, or NRSROs), “not of investment grade,” or “investment grade” in FDIC regulations. The FDIC conducted the regulation review to comply with the requirements of Sections 939A(a) and (b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act).

FDIC RULES AND REGULATIONS		
Regulation Reviewed	Purpose	References to Using Credit Ratings
<p>12 CFR Part 327 - Assessments 12 CFR Part 327</p> <p>12 CFR Part 327 Appendix B to Subpart A http://www.fdic.gov/regulations/laws/rules/2000-5060.html#fdic2000appendixbtopart327</p> <p>12 CFR Part 327, Appendix C to Subpart A http://www.fdic.gov/regulations/laws/rules/2000-5070.html#fdic2000appendixctopart327</p> <p>Note: 12 CFR Part 327 was amended by final rule adopted February 7, 2011, by the FDIC Board of Directors. The changes implemented by the final rule became effective April 1, 2011. The changes to 12 CFR Part 327 included eliminating references to credit ratings.</p> <p>Financial Institution Letter Introducing the Final Rule (FIL 8-2011) http://www.fdic.gov/news/news/financial/2011/fil11008.html</p> <p>12 CFR Part 327 Final Rule, Assessments, Large</p>	<p>The regulation discusses the time and manner of payment of the assessments by insured institutions, describes the risk classification of depository institutions, and outlines the process for review of assessments</p>	<p>The following references to credit ratings have been removed per the changes approved in the final rule adopted February 7, 2011, and effective April 1, 2011. (Refer to the links in first column.)</p> <p><u>12 CFR § 327.4 (f)(2) – Assessment Rates - Effective Date for Changes to Risk Assignment.</u> This section states that changes to an insured institution’s risk assignment resulting from a change in a long-term debt issuer rating become effective as of the date the change is announced by the rating agency.</p> <p><u>12 CFR § 327.8(i) – Assessments - Definitions. Long-Term Debt Issuer Rating.</u> This section defines a long-term debt issuer rating as a rating of an insured depository institution’s long-term debt obligations by Moody’s Investor Services, Standard & Poor’s, or Fitch Ratings that has not been withdrawn before the end of the quarter being assessed.</p> <p><u>12 CFR § 327.9(d) – Determining Initial Base Assessment Rates for Risk Category I Institutions.</u> This section addresses how to determine initial base assessment rates for large insured depository institutions in Risk Category I that have at least one long-term debt issuer rating.</p> <p><u>12 CFR § 327.9(d)(2), (d)(2)(i), (d)(2)(ii) – Assessments - Large Bank Method:</u></p> <p><u>(d)(2) Large Bank Method.</u> This section provides that a large insured depository institution in Risk Category I that has at least one long-term debt issuer rating will have its initial base assessment rate determined using the large bank method. The initial base assessment rate under the large bank method will be derived from 3 components. One of the</p>

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<p>Bank Pricing http://www.fdic.gov/news/news/financial/2011/fil11008.html</p>		<p>3 components is derived using long-term debt issuer ratings.</p> <p><u>(d)(2)(i) Implementation of Large Bank Method Changes between Risk Categories.</u> This section addresses changes between risk categories, and references how to calculate assessment rates for a large institution with a long-term debt issuer rating that has experienced a risk category change during the quarter.</p> <p><u>(d)(2)(ii) Implementation of Large Bank Method Changes within Risk Category I.</u> This section addresses how to determine the assessment rate for a Risk Category I institution that has a long-term debt issuer rating change, financial ratios score or CAMELS component change, which would affect the institution's initial base assessment rate.</p> <p><u>12 CFR § 327.9(d)(4)(iv),(v) – Adjustment for Large Banks or Insured Branches of Foreign Banks:</u></p> <p><u>(d)(4)(iv) Determination Whether to Adjust Upward; Effective Period of Adjustment.</u> This section states that long-term debt issuer ratings are one factor the FDIC will use to determine whether the large bank adjustment to an institution's initial base assessment rate is warranted.</p> <p><u>(d)(4)(v) Determination Whether to Adjust Downward; Effective Period of Adjustment.</u> This section states that long-term debt issuer ratings are one factor the FDIC will use to determine whether the large bank adjustment to an institution's initial base assessment rate is warranted.</p> <p><u>12 CFR § 327.9(d)(8)(i) – Request to be treated as a large institution; Procedure.</u> This section states that the absence of long-term debt issuer ratings alone will not preclude the FDIC from granting a request from a Risk Category I institution with assets between \$5 billion and \$10 billion to be treated as a large institution.</p> <p>NOTE: It is the opinion of the FDIC that it was not the intent of Section 939A of the Dodd-Frank Act to eliminate references such as 12 CFR § 327.9(d)(8)(i). However, this reference was removed with the revisions of the regulation which became effective April 1, 2011.</p> <p><u>12 CFR § 327.9(d)(9)(iii) – New and Established Institutions and Exceptions - Rate Applicable to Institutions Subject to Subsidiary or Credit Union Exception.</u> This section addresses how to calculate assessment rates for a large institution subject to the subsidiary or credit</p>
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		<p>union exception. The minimum initial base assessment rate for large institutions subject to this section will change once the institution receives a long-term debt issuer rating.</p> <p><u>12 CFR § 327.12(b)(ii)(2) – Prepayment of Quarterly Risk-Based Assessments - Prepaid Assessment Rate.</u> This section references long-term debt issuer ratings as a consideration.</p> <p><u>12 CFR § 327 Appendix B to Subpart A- Numerical Conversion of Long-Term Debt Issuer Ratings.</u> This section references long-term debt issuer ratings and how they are used in assessment calculations.</p> <p><u>12 CFR § 327, Appendix C to Subpart A- Market Information.</u> This section references rating agency watch lists.</p>
<p>12 CFR Part 347 – International Banking, Subpart A, Foreign Banking and Investment by Insured State Nonmember Banks http://www.fdic.gov/regulations/laws/rules/2000-6800.html#fdic2000part347102</p> <p>12 CFR Part 347- International Banking, Subpart B, Foreign Branches http://www.fdic.gov/regulations/laws/rules/2000-6900.html#fdic2000part347209</p>	<p>International banking rules for state nonmember banks operating foreign branches or subsidiaries</p>	<p><u>12 CFR § 347.102(o), (r) – Definitions:</u></p> <p><u>(o) Investment Grade.</u> Investment grade is defined as a security that is rated in one of the four highest categories by two or more NRSROs, or one NRSRO if the security is rated by only one NRSRO.</p> <p><u>(r) NRSRO.</u> NRSRO is defined as a nationally recognized statistical rating organization as designated by the Securities and Exchange Commission.</p> <p><u>12 CFR § 347.209(d)(3),(d)(5),(d)(7) – Pledge of Assets - Assets That May Be Pledged:</u></p> <p><u>(d)(3)</u> Commercial paper that is rated P-1 or P-2, or their equivalent by a nationally recognized rating service, provided that any conflict in a rating shall be resolved in favor of the lower rating.</p> <p><u>(d)(5)</u> General obligations of any state of the United States and other municipal debt provided that such obligations have a credit rating within the top two rating bands of a nationally recognized rating service, with any conflict in a rating resolved in favor of the lower rating.</p> <p><u>(d)(7)</u> Notes issued by bank and thrift holding companies, banks, or savings associations and other notes provided that the notes have a credit rating within the top two rating bands of a nationally recognized rating service, with any conflict in a rating resolved in favor of the</p>

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		lower rating, among other requirements.
12 CFR Part 344 - Recordkeeping and Confirmation Requirements for Securities Transactions http://www.fdic.gov/regulations/laws/rules/2000-6400.html#fdic2000part3445	Disclosure to customers required	<p><u>12 CFR § 344.5(b)(12) - Content and Time of Notification.</u> Under this section, customers should be notified that the security is unrated by a nationally recognized statistical rating organization, if that is the case.</p> <p>NOTE: Because § 344.5(b)(12) is intended to foster accountability and suitability of the transaction for the customer and is unrelated to the creditworthiness standard of the underlying security, the FDIC is considering whether the reference in that regulation is prohibited. Therefore, the FDIC has not amended that regulation.</p>
12 CFR Part 360 – Resolution and Receivership Rules http://www.fdic.gov/regulations/laws/federal/2010/10finalAD55.pdf	Disclosure of compensation paid to ratings agencies	<p><u>12 CFR § 360.6 – Treatment of Financial Assets Transferred in Connection With a Securitization or Participation:</u></p> <p><u>12 CFR § 360.6(b)(2)(i)(D) – Disclosures.</u> This section references the disclosure of compensation paid to rating agencies, servicers and other third parties in a securitization.</p> <p><u>12 CFR § 360.6(b)(4)(i) – Compensation.</u> This section addresses how compensation paid to rating agencies and other third parties in a securitization should be structured. In general, compensation should occur over a longer-term period and should not be recognized fully at the beginning of the deal.</p> <p>NOTE The FDIC has not amended § 360.6, as amended by a new FDIC rule on September 30, 2010, because the references to credit ratings in that section are unrelated to the credit-worthiness of the underlying security and hence do not appear to be prohibited references..</p>
<p>12 CFR Part 362 – Activities of Insured State Banks and Insured State Savings Associations http://www.fdic.gov/regulations/laws/rules/2000-8000.html#fdic2000part3622</p> <p>12 CFR Part 362, Subpart C - Activities of Insured State Savings Associations http://www.fdic.gov/regulations/laws/rules/2000-8200.html#fdic2000part3629</p>	Proscribes the standards for permissible investment securities and other permissible holdings / activities for state nonmember banks	<p><u>12 CFR Part 362</u> references what is permissible for a national bank, but these are an <i>indirect</i> reference to investment grade:</p> <p><u>12 CFR § 362.1 – Activities of Insured State Banks - Purpose and Scope.</u> (a) This subpart, along with the notice and application procedures in subpart G of part 303 of this chapter, implements the provisions of Section 24 of the Federal Deposit Insurance Act (12 USC 1831a) that restrict and prohibit insured state banks and their subsidiaries from engaging in activities and investments that are not permissible for national banks and their subsidiaries. The phrase "activity permissible for a national bank" means any activity authorized for national banks under any statute</p>

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		<p>including the National Bank Act (12 USC 21 <i>et seq.</i>), as well as activities recognized as permissible for a national bank in regulations, official circulars, bulletins, orders or written interpretations issued by the Office of the Comptroller of the Currency. These regulations and guidance reference credit ratings and investment grade.</p> <p><u>12 CFR Part 362, Subpart C, Activities of Insured State Savings Associations.</u> There are references to credit ratings in 12 CFR Part 362, Subpart C, which implements Section 28 of the FDI Act.</p> <p><u>12 CFR § 362.10(b) – Definitions – Corporate Debt Securities Not of Investment Grade.</u> This section defines “not of investment grade” as a security not rated in the four highest bands by one of the NRSROs.</p> <p><u>12 CFR § 362.11(b)(1) – Activities Other Than Equity Investments.</u> This section restricts bank investments in corporate debt securities that are not of investment grade.</p>
<p>Statement of Policy on Risk-Based Capital – Risk-Based Capital Guidelines 12 CFR Part 325, Appendix A http://www.fdic.gov/regulations/laws/rules/2000-4600.html</p>	<p>Risk-based capital adequacy guidelines applicable to state nonmember banks</p>	<p><u>12 CFR Part 325, Appendix A</u></p> <p><u>§ II.B.5(a) – Recourse, Direct Credit Substitutes, Residual Interests and Mortgage- and Asset-Backed Securities – Definitions:</u></p> <p><u>§ II.B.5(a) (5) - Eligible ABCP (Asset-Backed Commercial Paper) Liquidity Facility.</u> This definition references external ratings and assets or exposures that are rated investment grade at the time of funding.</p> <p><u>§ II.B.5(a) (6) - Externally Rated.</u> Externally rated is an instrument or obligation that has received a credit rating from at least one nationally recognized statistical rating organization.</p> <p><u>§ II.B.5(a) (12) – Nationally Recognized Statistical Rating Organization (NRSRO).</u> An NRSRO is an entity recognized by the Division of Market Regulation of the Securities and Exchange Commission (Commission) as a nationally recognized statistical rating organization for various purposes, including the Commission’s uniform net capital requirements for brokers and dealers</p>

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<p>Statement of Policy on Risk-Based Capital – Risk-Based Capital Guidelines 12 CFR Part 325, Appendix A (continued)</p>	<p>Risk-based capital adequacy guidelines applicable to state nonmember banks</p>	<p>(17 CFR 240.15c3—1).</p> <p><u>§ II.B.5(a) (19) – Traded Position.</u> To be considered a traded position, the position must be externally rated and there must be a reasonable expectation that the rating will be relied upon by an unaffiliated investor or third party.</p> <p><u>§ II.B.5(d)(1), (d)(2) - Externally Rated Positions; Credit-Equivalent Amounts and Risk Weights.</u> This section references risk weighting tables that contain credit ratings: Table A and Table B. Traded positions and non-traded positions are addressed.</p> <p><u>§ II.B.5(e) – Senior Positions Not Externally Rated.</u> Unrated positions that are senior in all respects to externally rated positions may receive a risk weight according to the risk weight applicable to the externally rated position. This section allows the use of the table in § II.B.5(d)(1) for senior positions that are not externally rated. The table references external ratings.</p> <p><u>§ II.B.5(g) - Positions that are Not Rated by an NRSRO.</u> Under this section, a bank’s position (other than a residual interest) in a securitization or structured finance program that is not rated by an NRSRO may be risk-weighted based on the bank’s determination of the credit rating of the position, as specified in Table C. The table references investment grade and below investment grade.</p> <p><u>§ II.B.5(g)(1)(ix) – Internal Risk Rating Used for Asset-Backed Programs.</u> The internal credit risk rating system must make credit risk rating assumptions that are consistent with, or more conservative than, the credit rating assumptions and methodologies of NRSROs.</p> <p><u>§ II.B.5(g)(2) – Program Ratings.</u> This section addresses the bank’s ability to use an NRSRO rating for an ABCP program when calculating exposures for direct credit substitute or when it retains a recourse obligation (but not a residual interest) in connection with a structured finance program.</p>
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<p>Statement of Policy on Risk-Based Capital – Risk-Based Capital Guidelines 12 CFR Part 325, Appendix A (continued)</p>	<p>Risk-based capital adequacy guidelines applicable to state nonmember banks</p>	<p><u>§ II.B.5(g)(3) – Computer Program.</u> This section addresses when a bank using an acceptable credit assessment computer program that has been developed by an NRSRO to determine the rating of a direct credit substitute or recourse obligation can rely on the rating.</p> <p><u>§ II.B.6(a) – Asset-Backed Commercial Paper Programs.</u> These are defined as a program that primarily issues externally rated commercial paper.</p> <p><u>§ II.B.6(b) – Asset-Backed Commercial Paper Programs.</u> While this section does not explicitly referencing ratings, it references back to other Appendix A sections that contain ratings references and the risk weight tables (§ II.B.5, II.C, II.D).</p> <p><u>12 CFR Part 325, Appendix A, § II.C – Risk Weights for Balance Sheet Assets (see Table II) - Category 2 – 20 Percent Risk Weight - (a).</u> This section describes risk weights for balance sheet assets. A 20 percent risk weight applies based on the credit rating of the issuer.</p> <p><u>12 CFR Part 325, Appendix A, § II.D – Conversion Factors for Off-Balance Sheet Items (see Table III).</u> Under this section, asset-or mortgage- backed securities that are externally rated receive a risk weight of 20, 50, 100, or 200 percent, depending on their external ratings. This section also refers back to earlier sections of the Appendix (for example, risk weighting and tables: § II.B.5(d)(1) Tables A &B, and § II.B.5(g) Table C.)</p> <p>The second step of the two-step process to determine the risk weight assigned to an off-balance sheet item may use an external credit rating:</p> <p><u>12 CFR Part 325, Appendix A, § II.D(2)(c)(i), (c)(ii).</u> Under this section, an unused portion of an eligible asset-backed commercial paper liquidity facility may be eligible for either a 50 percent or a 10 percent (§ II.D(4)) credit conversion factor, provided it meets certain requirements. The definition of an eligible asset-backed commercial paper program (cited earlier in this report) references credit ratings.</p>
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<p>Statement of Policy on Risk-Based Capital – Risk-Based Capital Guidelines 12 CFR Part 325, Appendix A (continued)</p>	<p>Risk-based capital adequacy guidelines applicable to state nonmember banks</p>	<p><u>12 CFR Part 325, Appendix A, Table II – Summary of Risk Weights and Risk Categories. Review of Risk Weighting Categories.</u> The following sections reference credit ratings for determining risk weights for recourse obligations, direct credit substitutes, residual interests (other than credit-enhancing interest-only strips) and asset- or mortgage-backed securities. Risk weights vary depending on the credit rating of the exposure.</p> <p><u>Category 2 – 20 Percent Risk Weight -(12)</u> <u>Category 3 – 50 Percent Risk Weight - (3)</u> <u>Category 4 – 100 Percent Risk Weight -(9)</u> <u>Category 5 – 200 Percent Risk Weight - (1), (2)</u></p>
<p>Risk-Based Capital for State-Nonmember Banks: Market Risk 12 CFR Part 325, Appendix C http://www.fdic.gov/regulations/laws/rules/2000-4800.html</p>	<p>Market risk capital guidelines applicable to state nonmember banks with significant exposure to market risk</p>	<p><u>12 CFR Part 325, Appendix C:</u></p> <p><u>§ 5, Specific Risk.</u> Under this section debt instruments that are rated investment grade by two or more NRSROs are considered “qualifying” and receive a lower specific risk add-on under the standard option.</p> <p><u>§ 5 (B) -</u> Under this section, the “qualifying” category includes a listing of various debt instruments (for example, U.S. government-sponsored agencies) that are: (1) Rated investment-grade by at least two nationally recognized credit rating services; (2) Rated investment-grade by one nationally recognized credit rating agency and not rated less than investment-grade by any other credit rating agency; or (3) Unrated, but deemed to be of comparable investment quality by the reporting bank and meets other criteria.</p>
<p>Capital Adequacy Guidelines for Banks: Internal-Ratings-Based and Advanced Measurement Approaches 12 CFR Part 325, Appendix D http://www.fdic.gov/regulations/laws/rules/2000-4850.html#fdic2000appendixdtopart325sec11</p>	<p>Risk-based capital adequacy guidelines for Basel II advanced approaches applicable to state nonmember banks</p>	<p><u>12 CFR Part 325, Appendix D, § 2 – Definitions:</u></p> <p><u>Applicable External Rating – (1),(2).</u> This definition references external NRSRO ratings.</p> <p><u>Applicable Inferred Rating –(1), (2).</u> This definition references external ratings for determining the inferred rating.</p>

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<p>Capital Adequacy Guidelines for Banks: Internal-Ratings-Based and Advanced Measurement Approaches 12 CFR Part 325, Appendix D (continued)</p>	<p>Risk-based capital adequacy guidelines for Basel II advanced approaches applicable to state nonmember banks</p>	<p><u>Asset-Backed Commercial Paper (ABCP) Program - (1).</u> According to this section, for the purposes of the Basel II rule, an ABCP program must have an external rating.</p> <p><u>Eligible Double Default Guarantor –(1),(2).</u> According to this section, in some cases in order to recognize a double default guarantor, the bank must assign a probability of default (PD) to the guarantor’s rating grade that is equal to or lower than the PD associated with a long-term external rating of at least investment grade.</p> <p><u>Eligible securitization guarantor - (2),(3).</u> To be considered an eligible securitization guarantor, an entity must have an external rating in one of the three highest investment-grade categories.</p> <p><u>External Rating –(1), (2).</u> Under this definition, for the purposes of the Basel II rule, an external rating is a rating from an NRSRO that reflects the entire amount of credit risk with regard to all payments owed, is published in an accessible form, and is or will be included in the NRSRO’s publicly available transition matrices.</p> <p><u>Financial Collateral – (iii), (iv).</u> This section addresses the requirements for financial collateral and lists various types of securities. To be considered financial collateral the securities are required to have applicable external ratings of one category below investment grade or higher (long-term debt securities) or at least investment grade (short-term debt instruments), respectively.</p> <p><u>Inferred Rating – (1), (2)(i).</u> This definition references external ratings when determining the inferred rating of a securitization exposure.</p> <p><u>NRSRO.</u> This definition is substantially the same as the earlier definitions cited in Appendix A.</p> <p><u>§ 32. Counterparty Credit Risk of Repo-Style Transactions, Eligible Margin Loans, and OTC (Over-the-Counter) Derivative Contracts:</u></p> <p><u>§ 32(b)(2) – EAD (Exposure at Default) for Eligible Margin Loans and Repo-Style Transactions – Collateral Haircut Approach.</u> This section addresses supervisory market price volatility haircuts and references</p>
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<p>Capital Adequacy Guidelines for Banks: Internal-Ratings-Based and Advanced Measurement Approaches 12 CFR Part 325, Appendix D (continued)</p>	<p>Risk-based capital adequacy guidelines for Basel II advanced approaches applicable to state nonmember banks</p>	<p>applicable external rating grade categories for debt securities. Table 3 under § 32(b)(2)(F)(ii)(1) includes references to credit rating bands.</p> <p><u>§ 32(c)(5)(ii), (Footnote #3 to Table 4) – EAD for OTC Derivative Contracts – Single OTC Derivative Contract – PFE (Potential Future Exposure).</u> This section contains a table on the conversion factor matrix for OTC derivative contracts that references external ratings for certain credit derivatives.</p> <p><u>§ 35(e)(2)(i) – Risk-Based Capital Requirement for Unsettled Transactions - Non-DvP/Non-PvP (non-delivery-versus-payment/non-payment-versus-payment) Transactions.</u> According to this section a bank may assign an obligor rating to a counterparty dependant on the applicable external rating of certain debt issued by the counterparty.</p> <p><u>§ 43(a), (b) – Ratings-Based Approach (RBA):</u></p> <p><u>§ 43(a) – Eligibility Requirements for Use of the RBA.</u> This section requires an originating bank to use the RBA for a securitization exposure that has at least two external ratings, while an investing bank must use the approach for a securitization exposure that has at least one external rating. Banks may not use the RBA for exposures that do not meet the eligibility requirements.</p> <p><u>§ 43(b) – Ratings-Based Approach.</u> The RBA references applicable external or inferred ratings of certain securitization exposures in order to determine the appropriate risk weights, as shown in Tables 6 and 7. Risk weights range from 7 percent for AAA-rated securities that are both senior and granular, to deduction for securities that are rated more than one category below investment grade.</p> <p><u>§ 44 – Internal Assessment Approach (IAA).</u> A bank’s eligibility to use the IAA is dependant, in part, on referring to the rating criteria of NRSROs and the actual external ratings of NRSROs.</p> <p><u>§ 46 – Recognition of Credit Risk Mitigants for Securitization Exposures.</u> This section limits the recognition of a credit risk mitigant where a bank is applying the RBA and the external rating used to determine the</p>
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Capital Adequacy Guidelines for Banks: Internal-Ratings-Based and Advanced Measurement Approaches 12 CFR Part 325, Appendix D (continued)	Risk-based capital adequacy guidelines for Basel II advanced approaches applicable to state nonmember banks	<p>appropriate risk weight already reflects the benefits of the credit risk mitigant.</p> <p><u>§ 54(c), (e) – Equity Exposures to Investment Funds:</u></p> <p><u>§ 54(c) – Simple Modified Look-Through Approach.</u> The modified look-through approach for equity exposures to investment funds references applicable external ratings. See Table 10.</p> <p><u>§ 54(e) – Money Market Fund Approach.</u> The money market fund approach references applicable external ratings.</p> <p><u>§ 61(b)(1)(i) – Qualification Requirements for Incorporation of Operational Risk Mitigants.</u> Under this section, in order to qualify as an operational risk mitigant, insurance must be provided by an insurer with a claims payment ability rated in one of the three highest ratings categories by an NRSRO.</p>
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