Text of Common Appendix (All Agencies)

The text of the agencies' common appendix appears below:

[Appendix __ to Part __] – Capital Adequacy Guidelines for [Banks]:[1] Internal-Ratings-Based and Advanced Measurement Approaches

[1] For simplicity, and unless otherwise noted, this final rule uses the term [bank] to include banks, savings associations, and bank holding companies. [AGENCY] refers to the primary Federal supervisor of the bank applying the rule.

Part I. General Provisions

Section 1. Purpose, Applicability, Reservation of Authority, and Principle of Conservatism

(a) Purpose. This appendix establishes:

(1) Minimum qualifying criteria for [banks] using [bank]-specific internal risk measurement and management processes for calculating risk-based capital requirements;

(2) Methodologies for such [banks] to calculate their risk-based capital requirements; and

(3) Public disclosure requirements for such [banks].

(b) Applicability. (1) This appendix applies to a [bank] that:

(i) Has consolidated total assets, as reported on the most recent year-end Consolidated Report of Condition and Income (Call Report) or Thrift Financial Report (TFR), equal to $250 billion or more;

(ii) Has consolidated total on-balance sheet foreign exposure at the most recent year-end equal to $10 billion or more (where total on-balance sheet foreign exposure equals total cross-border claims less claims with head office or guarantor located in another country plus redistributed guaranteed amounts to the country of head office or guarantor plus local country claims on local residents plus revaluation gains on foreign exchange and derivative products, calculated in accordance with the Federal Financial Institutions Examination Council (FFIEC) 009 Country Exposure Report);

(iii) Is a subsidiary of a depository institution that uses 12 CFR part 3, Appendix C, 12 CFR part 208, Appendix F, 12 CFR part 325, Appendix D, or 12 CFR part 567, Appendix C, to calculate its risk-based capital requirements; or

(iv) Is a subsidiary of a bank holding company that uses 12 CFR part 225, Appendix G, to calculate its risk-based capital requirements.

(2) Any [bank] may elect to use this appendix to calculate its risk-based capital requirements.

(3) A [bank] that is subject to this appendix must use this appendix unless the [AGENCY] determines in writing that application of this appendix is not appropriate in light of the [bank]'s asset size, level of complexity, risk profile, or scope of operations. In making a determination under this paragraph, the [AGENCY] will apply notice and response procedures in the same manner and to the same extent as the notice and response procedures in 12 CFR 3.12 (for national banks), 12 CFR 263.202 (for bank holding companies and state member banks), 12 CFR 325.6(c) (for state nonmember banks), and 12 CFR 567.3(d) (for savings associations).

(c) Reservation of authority - (1) Additional capital in the aggregate. The [AGENCY] may require a [bank] to hold an amount of capital greater than otherwise required under this appendix if the [AGENCY] determines that the [bank]'s risk-based capital requirement under this appendix is not commensurate with the [bank]'s credit, market, operational, or other risks. In making a determination under this paragraph, the [AGENCY] will apply notice and response procedures in the same manner and to the same extent as the notice and response procedures in 12 CFR 3.12 (for national banks), 12 CFR 263.202 (for bank holding companies and state member banks), 12 CFR 325.6(c) (for state nonmember banks), and 12 CFR 567.3(d) (for savings associations).

(2) Specific risk-weighted asset amounts. (i) If the [AGENCY] determines that the risk-weighted asset amount calculated under this appendix 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 exposures, to assign different risk parameters to the exposures (if the exposures are wholesale or retail exposures), or to use different model assumptions for the exposures (if relevant), all as specified by the [AGENCY].

(ii) If the [AGENCY] determines that the risk-weighted asset amount for operational risk produced by the [bank] under this appendix is not commensurate with the operational risks of the [bank], the [AGENCY] may require the [bank] to assign a different risk-weighted asset amount for operational risk, to change elements of its operational risk analytical framework, including distributional and dependence assumptions, or to make other changes to the [bank]'s operational risk management

processes, data and assessment systems, or quantification systems, all as specified by the [AGENCY].

(3) Other supervisory authority. Nothing in this appendix limits the authority of the [AGENCY] under any other provision of law or regulation to take supervisory or enforcement action, including action to address unsafe or unsound practices or conditions, deficient capital levels, or violations of law.

(d) Principle of conservatism. Notwithstanding the requirements of this appendix, a [bank] may choose not to apply a provision of this appendix to one or more exposures, provided that:

(1) The [bank] can demonstrate on an ongoing basis to the satisfaction of the [AGENCY] that not applying the provision would, in all circumstances, unambiguously generate a risk-based capital requirement for each such exposure greater than that which would otherwise be required under this appendix;

(2) The [bank] appropriately manages the risk of each such exposure;

(3) The [bank] notifies the [AGENCY] in writing prior to applying this principle to each such exposure; and

(4) The exposures to which the [bank] applies this principle are not, in the aggregate, material to the [bank].

Section 2. Definitions

Advanced internal ratings-based (IRB) systems means a [bank]'s internal risk rating and segmentation system; risk parameter quantification system; data management and maintenance system; and control, oversight, and validation system for credit risk of wholesale and retail exposures.

Advanced systems means a [bank]'s advanced IRB systems, operational risk management processes, operational risk data and assessment systems, operational risk quantification systems, and, to the extent the [bank] uses the following systems, the internal models methodology, double default excessive correlation detection process, IMA for equity exposures, and IAA for securitization exposures to ABCP programs.

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

Applicable external rating means:

(1) With respect to an exposure that has multiple external ratings assigned by NRSROs, the lowest solicited external rating assigned to the exposure by any NRSRO; and

(2) With respect to an exposure that has a single external rating assigned by an NRSRO, the external rating assigned to the exposure by the NRSRO.

Applicable inferred rating means:

(1) With respect to an exposure that has multiple inferred ratings, the lowest inferred rating based on a solicited external rating; and

(2) With respect to an exposure that has a single inferred rating, the inferred rating.

Asset-backed commercial paper (ABCP) program means a program that primarily issues commercial paper that:

(1) Has an external rating; and

(2) Is backed by underlying exposures held in a bankruptcy-remote 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.

Backtesting means the comparison of a [bank]'s internal estimates with actual outcomes during a sample period not used in model development. In this context, backtesting is one form of out-of-sample testing.

Bank holding company is defined in section 2 of the Bank Holding Company Act (12 U.S.C. 1841).

Benchmarking means the comparison of a [bank]'s internal estimates with relevant internal and external data or with estimates based on other estimation techniques.

Business environment and internal control factors means the indicators of a [bank]'s operational risk profile that reflect a current and forward-looking assessment of the [bank]'s underlying business risk factors and internal control environment.

Carrying value means, with respect to an asset, the value of the asset on the balance sheet of the [bank], determined in accordance with GAAP.

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. See also eligible clean-up call.

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.

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.

Controlled early amortization provision means an early amortization provision that meets all the following conditions:

(1) The originating [bank] has appropriate policies and procedures to ensure that it has sufficient capital and liquidity available in the event of an early amortization;

(2) Throughout the duration of the securitization (including the early amortization period), there is the same pro rata sharing of interest, principal, expenses, losses, fees, recoveries, and other cash flows from the underlying exposures based on the originating [bank]'s and the investors' relative shares of the underlying exposures outstanding measured on a consistent monthly basis;

(3) The amortization period is sufficient for at least 90 percent of the total underlying exposures outstanding at the beginning of the early amortization period to be repaid or recognized as in default; and

(4) The schedule for repayment of investor principal is not more rapid than would be allowed by straight-line amortization over an 18-month period.

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) to another party (the protection provider). See also eligible credit derivative.

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 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 obligors 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:

(1) Early default clauses and similar warranties that permit the return of, or premium refund clauses that cover, first-lien residential mortgage exposures for a period

not to exceed 120 days from the date of transfer, provided that the date of transfer is within one year of origination of the residential mortgage exposure;

(2) Premium refund clauses that cover underlying exposures guaranteed, in whole or in part, by the U.S. government, a U.S. government agency, or a U.S. government sponsored enterprise, provided that the clauses are for a period not to exceed 120 days from the date of transfer; or

(3) 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.

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.

Default - (1) Retail. (i) A retail exposure of a [bank] is in default if:

(A) The exposure is 180 days past due, in the case of a residential mortgage exposure or revolving exposure;

(B) The exposure is 120 days past due, in the case of all other retail exposures; or

(C) The [bank] has taken a full or partial charge-off, write-down of principal, or material negative fair value adjustment of principal on the exposure for credit-related reasons.

(ii) Notwithstanding paragraph (1)(i) of this definition, for a retail exposure held by a non-U.S. subsidiary of the [bank] that is subject to an internal ratings-based approach to capital adequacy consistent with the Basel Committee on Banking Supervision's "International Convergence of Capital Measurement and Capital Standards: A Revised Framework" in a non-U.S. jurisdiction, the [bank] may elect to use the definition of default that is used in that jurisdiction, provided that the [bank] has obtained prior approval from the [AGENCY] to use the definition of default in that jurisdiction.

(iii) A retail exposure in default remains in default until the [bank] has reasonable assurance of repayment and performance for all contractual principal and interest payments on the exposure.

(2) Wholesale. (i) A [bank]'s wholesale obligor is in default if:

(A) The [bank] determines that the obligor is unlikely to pay its credit obligations to the [bank] in full, without recourse by the [bank] to actions such as realizing collateral (if held); or

(B) The obligor is past due more than 90 days on any material credit obligation(s) to the [bank].[2]

(ii) An obligor in default remains in default until the [bank] has reasonable assurance of repayment and performance for all contractual principal and interest

[2] Overdrafts are past due once the obligor has breached an advised limit or been advised of a limit smaller than the current outstanding balance.

payments on all exposures of the [bank] to the obligor (other than exposures that have been fully written-down or charged-off).

Dependence means a measure of the association among operational losses across and within units of measure.

Depository institution is defined in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813).

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 derivatives, 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.

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 obligors on the underlying exposures even after the provision is triggered.

Economic downturn conditions means, with respect to an exposure held by the [bank], those conditions in which the aggregate default rates for that exposure's wholesale or retail exposure subcategory (or subdivision of such subcategory selected by the [bank]) in the exposure's national jurisdiction (or subdivision of such jurisdiction selected by the [bank]) are significantly higher than average.

Effective maturity (M) of a wholesale exposure means:

(1) For wholesale exposures other than repo-style transactions, eligible margin loans, and OTC derivative contracts described in paragraph (2) or (3) of this definition:

(i) The weighted-average remaining maturity (measured in years, whole or fractional) of the expected contractual cash flows from the exposure, using the undiscounted amounts of the cash flows as weights; or

(ii) The nominal remaining maturity (measured in years, whole or fractional) of the exposure.

(2) For repo-style transactions, eligible margin loans, and OTC derivative contracts subject to a qualifying master netting agreement for which the [bank] does not apply the internal models approach in paragraph (d) of section 32, the weighted-average remaining maturity (measured in years, whole or fractional) of the individual transactions subject to the qualifying master netting agreement, with the weight of each individual transaction set equal to the notional amount of the transaction.

(3) For repo-style transactions, eligible margin loans, and OTC derivative contracts for which the [bank] applies the internal models approach in paragraph (d) of section 32, the value determined in paragraph (d)(4) of section 32.

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 EAD of the hedged exposure, multiplied by the percentage coverage of the credit risk mitigant. For example, the effective notional amount of an eligible guarantee that covers, on a pro rata basis, 40 percent of any losses on a $100 bond would be $40.

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, n^{th}-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 n^{th}-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) Bankruptcy, insolvency, or inability of the obligor on the reference exposure 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 provides that any required consent to transfer may not be unreasonably withheld;

(7) If the credit derivative is a credit default swap or n^{th}-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 double default guarantor, with respect to a guarantee or credit derivative obtained by a [bank], means:

(1) U.S.-based entities. A depository institution, a bank holding company, a savings and loan holding company (as defined in 12 U.S.C. 1467a) provided all or substantially all of the holding company's activities are permissible for a financial holding company under 12 U.S.C. 1843(k), a securities broker or dealer registered with the SEC under the Securities Exchange Act of 1934 (15 U.S.C. 78o et seq.), or an insurance company in the business of providing credit protection (such as a monoline bond insurer or re-insurer) that is subject to supervision by a State insurance regulator, if:

(i) At the time the guarantor issued the guarantee or credit derivative or at any time thereafter, the [bank] assigned a PD to the guarantor's rating grade that was equal to or lower than the PD associated with a long-term external rating in the third-highest investment-grade rating category; and

(ii) The [bank] currently assigns a PD to the guarantor's rating grade that is equal to or lower than the PD associated with a long-term external rating in the lowest investment-grade rating category; or

(2) Non-U.S.-based entities. A foreign bank (as defined in section 211.2 of the Federal Reserve Board's Regulation K (12 CFR 211.2)), a non-U.S.-based securities firm, or a non-U.S.-based insurance company in the business of providing credit protection, if:

(i) The [bank] demonstrates that the guarantor is subject to consolidated supervision and regulation comparable to that imposed on U.S. depository institutions, securities broker-dealers, or insurance companies (as the case may be), or has issued and outstanding an unsecured long-term debt security without credit enhancement that has a long-term applicable external rating of at least investment grade;

(ii) At the time the guarantor issued the guarantee or credit derivative or at any time thereafter, the [bank] assigned a PD to the guarantor's rating grade that was equal to or lower than the PD associated with a long-term external rating in the third-highest investment-grade rating category; and

(iii) The [bank] currently assigns a PD to the guarantor's rating grade that is equal to or lower than the PD associated with a long-term external rating in the lowest investment-grade rating category.

Eligible guarantee means a guarantee that:

(1) Is written and unconditional;

(2) Covers all or a pro rata portion of all contractual payments of the obligor on the reference exposure;

(3) Gives the beneficiary a direct claim against the protection provider;

(4) Is not unilaterally cancelable by the protection provider for reasons other than the breach of the contract by the beneficiary;

(5) 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;

(6) Requires the protection provider to make payment to the beneficiary on the occurrence of a default (as defined in the guarantee) of the obligor on the reference exposure in a timely manner without the beneficiary first having to take legal actions to pursue the obligor for payment;

(7) 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

(8) Is not provided by an affiliate of the [bank], unless the affiliate is an insured depository institution, 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 U.S. depository institutions, securities broker-dealers, or insurance companies (as the case may be).

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, gold, or conforming residential mortgages;

(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 bankruptcy, insolvency, 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;[3] 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.

Eligible operational risk offsets means amounts, not to exceed expected operational loss, that:

(1) Are generated by internal business practices to absorb highly predictable and reasonably stable operational losses, including reserves calculated consistent with GAAP; and

(2) Are available to cover expected operational losses with a high degree of certainty over a one-year horizon.

Eligible purchased wholesale exposure means a purchased wholesale exposure that:

[3] 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 (12 U.S.C. 1821(e)(8)), or netting contracts between or among financial institutions under sections 401-407 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (12 U.S.C. 4401-4407) or the Federal Reserve Board's Regulation EE (12 CFR part 231).

(1) The [bank] or securitization SPE purchased from an unaffiliated seller and did not directly or indirectly originate;

(2) Was generated on an arm's-length basis between the seller and the obligor (intercompany accounts receivable and receivables subject to contra-accounts between firms that buy and sell to each other do not satisfy this criterion);

(3) Provides the [bank] or securitization SPE with a claim on all proceeds from the exposure or a pro rata interest in the proceeds from the exposure;

(4) Has an M of less than one year; and

(5) When consolidated by obligor, does not represent a concentrated exposure relative to the portfolio of purchased wholesale exposures.

Eligible securitization guarantor means:

(1) A sovereign entity, 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, a depository institution, a bank holding company, a savings and loan holding company (as defined in 12 U.S.C. 1467a) provided all or substantially all of the holding company's activities are permissible for a financial holding company under 12 U.S.C. 1843(k), a foreign bank (as defined in section 211.2 of the Federal Reserve Board's Regulation K (12 CFR 211.2)), or a securities firm;

(2) Any other entity (other than a securitization SPE) that has issued and outstanding an unsecured long-term debt security without credit enhancement that has a long-term applicable external rating in one of the three highest investment-grade rating categories; or

(3) Any other entity (other than a securitization SPE) that has a PD assigned by the [bank] that is lower than or equal to the PD associated with a long-term external rating in the third highest investment-grade rating category.

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 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 appendix;

(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.

Excess spread for a period means:

(1) Gross finance charge collections and other income received by a securitization SPE (including market interchange fees) over a period minus interest paid to the holders of the securitization exposures, servicing fees, charge-offs, and other senior trust or similar expenses of the SPE over the period; divided by

(2) The principal balance of the underlying exposures at the end of the period.

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.

Excluded mortgage exposure means any one- to four-family residential pre-sold construction loan for a residence for which the purchase contract is cancelled that would receive a 100 percent risk weight under section 618(a)(2) of the Resolution Trust Corporation Refinancing, Restructuring, and Improvement Act and under 12 CFR part 3,

Appendix A, section 3(a)(3)(iii) (for national banks), 12 CFR part 208, Appendix A, section III.C.3. (for state member banks), 12 CFR part 225, Appendix A, section III.C.3. (for bank holding companies), 12 CFR part 325, Appendix A, section II.C.a. (for state nonmember banks), or 12 CFR 567.1 (definition of "qualifying residential construction loan") and 12 CFR 567.6(a)(1)(iv) (for savings associations).

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 PD times LGD times 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 section 34.

Expected exposure (EE) means the expected value of the probability distribution of non-negative credit risk exposures to a counterparty at any specified future date before the maturity date of the longest term transaction in the netting set. Any negative market values in the probability distribution of market values to a counterparty at a specified

future date are set to zero to convert the probability distribution of market values to the probability distribution of credit risk exposures.

Expected operational loss (EOL) means the expected value of the distribution of potential aggregate operational losses, as generated by the [bank]'s operational risk quantification system using a one-year horizon.

Expected positive exposure (EPE) means the weighted average over time of expected (non-negative) exposures to a counterparty where the weights are the proportion of the time interval that an individual expected exposure represents. When calculating risk-based capital requirements, the average is taken over a one-year horizon.

Exposure at default (EAD). (1) For the on-balance sheet component of a wholesale exposure or segment of retail exposures (other than an OTC derivative contract, or a repo-style transaction or eligible margin loan for which the [bank] determines EAD under section 32), EAD means:

(i) If the exposure or segment is a security classified as available-for-sale, the [bank]'s carrying value (including net accrued but unpaid interest and fees) for the exposure or segment less any allocated transfer risk reserve for the exposure or segment, less any unrealized gains on the exposure or segment, and plus any unrealized losses on the exposure or segment; or

(ii) If the exposure or segment is not a security classified as available-for-sale, the [bank]'s carrying value (including net accrued but unpaid interest and fees) for the exposure or segment less any allocated transfer risk reserve for the exposure or segment.

(2) For the off-balance sheet component of a wholesale exposure or segment of retail exposures (other than an OTC derivative contract, or a repo-style transaction or

eligible margin loan for which the [bank] determines EAD under section 32) in the form of a loan commitment, line of credit, trade-related letter of credit, or transaction-related contingency, EAD means the [bank]'s best estimate of net additions to the outstanding amount owed the [bank], including estimated future additional draws of principal and accrued but unpaid interest and fees, that are likely to occur over a one-year horizon assuming the wholesale exposure or the retail exposures in the segment were to go into default. This estimate of net additions must reflect what would be expected during economic downturn conditions. Trade-related letters of credit are short-term, self-liquidating instruments that are used to finance the movement of goods and are collateralized by the underlying goods. Transaction-related contingencies relate to a particular transaction and include, among other things, performance bonds and performance-based letters of credit.

(3) For the off-balance sheet component of a wholesale exposure or segment of retail exposures (other than an OTC derivative contract, or a repo-style transaction or eligible margin loan for which the [bank] determines EAD under section 32) in the form of anything other than a loan commitment, line of credit, trade-related letter of credit, or transaction-related contingency, EAD means the notional amount of the exposure or segment.

(4) EAD for OTC derivative contracts is calculated as described in section 32. A [bank] also may determine EAD for repo-style transactions and eligible margin loans as described in section 32.

(5) For wholesale or retail exposures in which only the drawn balance has been securitized, the [bank] must reflect its share of the exposures' undrawn balances in EAD.

Undrawn balances of revolving exposures for which the drawn balances have been securitized must be allocated between the seller's and investors' interests on a pro rata basis, based on the proportions of the seller's and investors' shares of the securitized drawn balances.

Exposure category means any of the wholesale, retail, securitization, or equity exposure categories.

External operational loss event data means, with respect to a [bank], gross operational loss amounts, dates, recoveries, and relevant causal information for operational loss events occurring at organizations other than the [bank].

External rating means a credit rating that is assigned by an NRSRO to an exposure, provided:

(1) The credit rating fully reflects the entire amount of credit risk with regard to all payments owed to the holder of the exposure. If a holder is owed principal and interest on an exposure, the credit rating must fully reflect the credit risk associated with timely repayment of principal and interest. If a holder is owed only principal on an exposure, the credit rating must fully reflect only the credit risk associated with timely repayment of principal; and

(2) The credit rating is published in an accessible form and is or will be included in the transition matrices made publicly available by the NRSRO that summarize the historical performance of positions rated by the NRSRO.

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 have an applicable external rating of one category below investment grade or higher;

(iv) Short-term debt instruments that have an applicable external rating of at least investment grade;

(v) Equity securities that are publicly traded;

(vi) Convertible bonds that are publicly traded;

(vii) Money market mutual fund shares and other mutual fund shares if a price for the shares is publicly quoted daily; or

(viii) Conforming residential mortgages; 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).

GAAP means generally accepted accounting principles as used in the United States.

Gain-on-sale means an increase in the equity capital (as reported on Schedule RC of the Call Report, Schedule HC of the FR Y-9C Report, or Schedule SC of the Thrift Financial Report) of a [bank] that results from a securitization (other than an increase in equity capital that results from the [bank]'s receipt of cash in connection with the securitization).

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). See also eligible guarantee.

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 (OCC); 12 CFR part 208, Appendix C (Board); 12 CFR part 365, Subpart D (FDIC); and 12 CFR 560.100-560.101 (OTS);

(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.

Inferred rating. A securitization exposure has an inferred rating equal to the external rating referenced in paragraph (2)(i) of this definition if:

(1) The securitization exposure does not have an external rating; and

(2) Another securitization exposure issued by the same issuer and secured by the same underlying exposures:

(i) Has an external rating;

(ii) Is subordinated in all respects to the unrated securitization exposure;

(iii) Does not benefit from any credit enhancement that is not available to the unrated securitization exposure; and

(iv) Has an effective remaining maturity that is equal to or longer than that of the unrated securitization exposure.

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.

Internal operational loss event data means, with respect to a [bank], gross operational loss amounts, dates, recoveries, and relevant causal information for operational loss events occurring at the [bank].

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) All or substantially all of the assets of which are financial assets; and

(2) That has no material liabilities.

Investors' interest EAD means, with respect to a securitization, the EAD of the underlying exposures multiplied by the ratio of:

(1) The total amount of securitization exposures issued by the securitization SPE to investors; divided by

(2) The outstanding principal amount of underlying exposures.

Loss given default (LGD) means:

(1) For a wholesale exposure, the greatest of:

(i) Zero;

(ii) The [bank]'s empirically based best estimate of the long-run default-weighted average economic loss, per dollar of EAD, the [bank] would expect to incur if the obligor (or a typical obligor in the loss severity grade assigned by the [bank] to the exposure) were to default within a one-year horizon over a mix of economic conditions, including economic downturn conditions; or

(iii) The [bank]'s empirically based best estimate of the economic loss, per dollar of EAD, the [bank] would expect to incur if the obligor (or a typical obligor in the loss severity grade assigned by the [bank] to the exposure) were to default within a one-year horizon during economic downturn conditions.

(2) For a segment of retail exposures, the greatest of:

(i) Zero;

(ii) The [bank]'s empirically based best estimate of the long-run default-weighted average economic loss, per dollar of EAD, the [bank] would expect to incur if the exposures in the segment were to default within a one-year horizon over a mix of economic conditions, including economic downturn conditions; or

(iii) The [bank]'s empirically based best estimate of the economic loss, per dollar of EAD, the [bank] would expect to incur if the exposures in the segment were to default within a one-year horizon during economic downturn conditions.

(3) The economic loss on an exposure in the event of default is all material credit-related losses on the exposure (including accrued but unpaid interest or fees, losses on the sale of collateral, direct workout costs, and an appropriate allocation of indirect workout costs). Where positive or negative cash flows on a wholesale exposure to a defaulted obligor or a defaulted retail exposure (including proceeds from the sale of collateral, workout costs, additional extensions of credit to facilitate repayment of the exposure, and draw-downs of unused credit lines) occur after the date of default, the economic loss must reflect the net present value of cash flows as of the default date using a discount rate appropriate to the risk of the defaulted 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.

Multilateral development bank means the International Bank for Reconstruction and Development, 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 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.

Nationally recognized statistical rating organization (NRSRO) means an entity registered with the SEC as a nationally recognized statistical rating organization under section 15E of the Securities Exchange Act of 1934 (15 U.S.C. 78o-7).

Netting set means a group of transactions with a single counterparty that are subject to a qualifying master netting agreement or qualifying cross-product master netting agreement. For purposes of the internal models methodology in paragraph (d) of section 32, each transaction that is not subject to such a master netting agreement is its own netting set.

N^{th}-to-default credit derivative means a credit derivative that provides credit protection only for the n^{th}-defaulting reference exposure in a group of reference exposures.

Obligor means the legal entity or natural person contractually obligated on a wholesale exposure, except that a [bank] may treat the following exposures as having separate obligors:

(1) Exposures to the same legal entity or natural person denominated in different currencies;

(2) (i) An income-producing real estate exposure for which all or substantially all of the repayment of the exposure is reliant on the cash flows of the real estate serving as collateral for the exposure; the [bank], in economic substance, does not have recourse to the borrower beyond the real estate collateral; and no cross-default or cross-acceleration clauses are in place other than clauses obtained solely out of an abundance of caution; and

(ii) Other credit exposures to the same legal entity or natural person; and

(3) (i) A wholesale exposure authorized under section 364 of the U.S. Bankruptcy Code (11 U.S.C. 364) to a legal entity or natural person who is a debtor-in-possession for purposes of Chapter 11 of the Bankruptcy Code; and

(ii) Other credit exposures to the same legal entity or natural person.

Operational loss means a loss (excluding insurance or tax effects) resulting from an operational loss event. Operational loss includes all expenses associated with an operational loss event except for opportunity costs, forgone revenue, and costs related to risk management and control enhancements implemented to prevent future operational losses.

Operational loss event means an event that results in loss and is associated with any of the following seven operational loss event type categories:

(1) Internal fraud, which means the operational loss event type category that comprises operational losses resulting from an act involving at least one internal party of

a type intended to defraud, misappropriate property, or circumvent regulations, the law, or company policy, excluding diversity- and discrimination-type events.

(2) External fraud, which means the operational loss event type category that comprises operational losses resulting from an act by a third party of a type intended to defraud, misappropriate property, or circumvent the law. Retail credit card losses arising from non-contractual, third-party initiated fraud (for example, identity theft) are external fraud operational losses. All other third-party initiated credit losses are to be treated as credit risk losses.

(3) Employment practices and workplace safety, which means the operational loss event type category that comprises operational losses resulting from an act inconsistent with employment, health, or safety laws or agreements, payment of personal injury claims, or payment arising from diversity- and discrimination-type events.

(4) Clients, products, and business practices, which means the operational loss event type category that comprises operational losses resulting from the nature or design of a product or from an unintentional or negligent failure to meet a professional obligation to specific clients (including fiduciary and suitability requirements).

(5) Damage to physical assets, which means the operational loss event type category that comprises operational losses resulting from the loss of or damage to physical assets from natural disaster or other events.

(6) Business disruption and system failures, which means the operational loss event type category that comprises operational losses resulting from disruption of business or system failures.

(7) Execution, delivery, and process management, which means the operational loss event type category that comprises operational losses resulting from failed transaction processing or process management or losses arising from relations with trade counterparties and vendors.

Operational risk means the risk of loss resulting from inadequate or failed internal processes, people, and systems or from external events (including legal risk but excluding strategic and reputational risk).

Operational risk exposure means the 99.9^{th} percentile of the distribution of potential aggregate operational losses, as generated by the [bank]'s operational risk quantification system over a one-year horizon (and not incorporating eligible operational risk offsets or qualifying operational risk mitigants).

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.

Other retail exposure means an exposure (other than a securitization exposure, an equity exposure, a residential mortgage exposure, an excluded mortgage exposure, a qualifying revolving exposure, or the residual value portion of a lease exposure) that is managed as part of a segment of exposures with homogeneous risk characteristics, not on an individual-exposure basis, and is either:

(1) An exposure to an individual for non-business purposes; or

(2) An exposure to an individual or company for business purposes if the [bank]'s consolidated business credit exposure to the individual or company is $1 million or less.

Over-the-counter (OTC) derivative contract means a derivative contract that is not traded on an exchange that requires the daily receipt and payment of cash-variation margin.

Probability of default (PD) means:

(1) For a wholesale exposure to a non-defaulted obligor, the [bank]'s empirically based best estimate of the long-run average one-year default rate for the rating grade assigned by the [bank] to the obligor, capturing the average default experience for obligors in the rating grade over a mix of economic conditions (including economic downturn conditions) sufficient to provide a reasonable estimate of the average one-year default rate over the economic cycle for the rating grade.

(2) For a segment of non-defaulted retail exposures, the [bank]'s empirically based best estimate of the long-run average one-year default rate for the exposures in the segment, capturing the average default experience for exposures in the segment over a mix of economic conditions (including economic downturn conditions) sufficient to provide a reasonable estimate of the average one-year default rate over the economic cycle for the segment and adjusted upward as appropriate for segments for which seasoning effects are material. For purposes of this definition, a segment for which seasoning effects are material is a segment where there is a material relationship between the time since origination of exposures within the segment and the [bank]'s best estimate of the long-run average one-year default rate for the exposures in the segment.

(3) For a wholesale exposure to a defaulted obligor or segment of defaulted retail exposures, 100 percent.

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 section 33).

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 of 1934 (15 U.S.C. 78f); 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, meaning that there are enough independent bona fide offers to buy and sell so that a sales price reasonably related to the last sales price or current bona fide competitive bid and offer quotations can be determined promptly and a trade can be settled at such a price within five business days.

Qualifying central counterparty means a counterparty (for example, a clearing house) that:

(1) Facilitates trades between counterparties in one or more financial markets by either guaranteeing trades or novating contracts;

(2) Requires all participants in its arrangements to be fully collateralized on a daily basis; and

(3) The [bank] demonstrates to the satisfaction of the [AGENCY] is in sound financial condition and is subject to effective oversight by a national supervisory authority.

Qualifying cross-product master netting agreement means a qualifying master netting agreement that provides for termination and close-out netting across multiple types of financial transactions or qualifying master netting agreements in the event of a counterparty's default, provided that:

(1) The underlying financial transactions are OTC derivative contracts, eligible margin loans, or repo-style transactions; and

(2) The [bank] obtains a written legal opinion verifying the validity and enforceability of the agreement under applicable law of the relevant jurisdictions if the counterparty fails to perform upon an event of default, including upon an event of bankruptcy, insolvency, or similar proceeding.

Qualifying master netting agreement means any written, legally enforceable bilateral 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 bankruptcy, insolvency, 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 bankruptcy, insolvency, 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;

(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 bankruptcy, insolvency, 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 would make otherwise 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).

Qualifying revolving exposure (QRE) means an exposure (other than a securitization exposure or equity exposure) to an individual that is managed as part of a segment of exposures with homogeneous risk characteristics, not on an individual-exposure basis, and:

(1) Is revolving (that is, the amount outstanding fluctuates, determined largely by the borrower's decision to borrow and repay, up to a pre-established maximum amount);

(2) Is unsecured and unconditionally cancelable by the [bank] to the fullest extent permitted by Federal law; and

(3) Has a maximum exposure amount (drawn plus undrawn) of up to $100,000.

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, gold, or conforming residential mortgages;

(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 (12 U.S.C. 1821(e)(8)), or a netting contract between or among financial institutions under sections 401-407 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (12 U.S.C. 4401-4407) 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

bankruptcy, insolvency, 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; 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.

Residential mortgage exposure means an exposure (other than a securitization exposure, equity exposure, or excluded mortgage exposure) that is managed as part of a segment of exposures with homogeneous risk characteristics, not on an individual-exposure basis, and is:

(1) An exposure that is primarily secured by a first or subsequent lien on one- to four-family residential property; or

(2) 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.

Retail exposure means a residential mortgage exposure, a qualifying revolving exposure, or an other retail exposure.

Retail exposure subcategory means the residential mortgage exposure, qualifying revolving exposure, or other retail exposure subcategory.

Risk parameter means a variable used in determining risk-based capital requirements for wholesale and retail exposures, specifically probability of default (PD), loss given default (LGD), exposure at default (EAD), or effective maturity (M).

Scenario analysis means a systematic process of obtaining expert opinions from business managers and risk management experts to derive reasoned assessments of the likelihood and loss impact of plausible high-severity operational losses. Scenario analysis may include the well-reasoned evaluation and use of external operational loss event data, adjusted as appropriate to ensure relevance to a [bank]'s operational risk profile and control structure.

SEC means the U.S. Securities and Exchange Commission.

Securitization means a traditional securitization or a synthetic securitization.

Securitization exposure means an on-balance sheet or off-balance sheet credit exposure that arises from a traditional or synthetic securitization (including credit-enhancing representations and warranties).

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.

Senior securitization exposure means a securitization exposure that has a first priority claim on the cash flows from the underlying exposures. When determining whether a securitization exposure has a first priority claim on the cash flows from the underlying exposures, a [bank] is not required to consider amounts due under interest rate or currency derivative contracts, fees due, or other similar payments. Both the most senior commercial paper issued by an ABCP program and a liquidity facility that supports the ABCP program may be senior securitization exposures if the liquidity facility provider's right to reimbursement of the drawn amounts is senior to all claims on the cash flows from the underlying exposures except amounts due under interest rate or currency derivative contracts, fees due, or other similar payments.

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. See also eligible servicer cash advance facility.

Sovereign entity means a central government (including the U.S. government) or an agency, department, ministry, or central bank of a central government.

Sovereign exposure means:

(1) A direct exposure to a sovereign entity; or

(2) An exposure directly and unconditionally backed by the full faith and credit of a sovereign entity.

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 is defined in [the general risk-based capital rules], as modified in part II of this appendix.

Tier 2 capital is defined in [the general risk-based capital rules], as modified in part II of this appendix.

Total qualifying capital means the sum of tier 1 capital and tier 2 capital, after all deductions required in this appendix.

Total risk-weighted assets means:

(1) The sum of:

(i) Credit risk-weighted assets; and

(ii) Risk-weighted assets for operational risk; minus

(2) Excess eligible credit reserves not included in tier 2 capital.

Total wholesale and retail risk-weighted assets means the sum of risk-weighted assets for wholesale exposures to non-defaulted obligors and segments of non-defaulted retail exposures; risk-weighted assets for wholesale exposures to defaulted obligors and segments of defaulted retail exposures; risk-weighted assets for assets not defined by an exposure category; and risk-weighted assets for non-material portfolios of exposures (all as determined in section 31) and risk-weighted assets for unsettled transactions (as determined in section 35) minus the amounts deducted from capital pursuant to [the general risk-based capital rules] (excluding those deductions reversed in section 12).

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 of 1958 (15 U.S.C. 682); and

(7) The underlying exposures are not owned by a firm an investment in which qualifies as a community development investment under 12 U.S.C. 24(Eleventh).

(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.

Tranche means all securitization exposures associated with a securitization that have the same seniority level.

Underlying exposures means one or more exposures that have been securitized in a securitization transaction.

Unexpected operational loss (UOL) means the difference between the [bank]'s operational risk exposure and the [bank]'s expected operational loss.

Unit of measure means the level (for example, organizational unit or operational loss event type) at which the [bank]'s operational risk quantification system generates a separate distribution of potential operational losses.

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.

Wholesale exposure means a credit exposure to a company, natural person, sovereign entity, or governmental entity (other than a securitization exposure, retail exposure, excluded mortgage exposure, or equity exposure). Examples of a wholesale exposure include:

(1) A non-tranched guarantee issued by a [bank] on behalf of a company;

(2) A repo-style transaction entered into by a [bank] with a company and any other transaction in which a [bank] posts collateral to a company and faces counterparty credit risk;

(3) An exposure that a [bank] treats as a covered position under [the market risk rule] for which there is a counterparty credit risk capital requirement;

(4) A sale of corporate loans by a [bank] to a third party in which the [bank] retains full recourse;

(5) An OTC derivative contract entered into by a [bank] with a company;

(6) An exposure to an individual that is not managed by a [bank] as part of a segment of exposures with homogeneous risk characteristics; and

(7) A commercial lease.

Wholesale exposure subcategory means the HVCRE or non-HVCRE wholesale exposure subcategory.

Section 3. Minimum Risk-Based Capital Requirements

(a) Except as modified by paragraph (c) of this section or by section 23, each [bank] must meet a minimum ratio of:

(1) Total qualifying capital to total risk-weighted assets of 8.0 percent; and

(2) Tier 1 capital to total risk-weighted assets of 4.0 percent.

(b) Each [bank] must hold capital commensurate with the level and nature of all risks to which the [bank] is exposed.

(c) When a [bank] subject to [the market risk rule] calculates its risk-based capital requirements under this appendix, the [bank] must also refer to [the market risk rule] for supplemental rules to calculate risk-based capital requirements adjusted for market risk.

Part II. Qualifying Capital

Section 11. Additional Deductions

(a) General. A [bank] that uses this appendix must make the same deductions from its tier 1 capital and tier 2 capital required in [the general risk-based capital rules], except that:

(1) A [bank] is not required to deduct certain equity investments and CEIOs (as provided in section 12 of this appendix); and

(2) A [bank] also must make the deductions from capital required by paragraphs (b) and (c) of this section.

(b) Deductions from tier 1 capital. A [bank] must deduct from tier 1 capital any gain-on-sale associated with a securitization exposure as provided in paragraph (a) of section 41 and paragraphs (a)(1), (c), (g)(1), and (h)(1) of section 42.

(c) Deductions from tier 1 and tier 2 capital. A [bank] must deduct the exposures specified in paragraphs (c)(1) through (c)(7) in this section 50 percent from tier 1 capital and 50 percent from tier 2 capital. If the amount deductible from tier 2 capital exceeds the [bank]'s actual tier 2 capital, however, the [bank] must deduct the excess from tier 1 capital.

(1) Credit-enhancing interest-only strips (CEIOs). In accordance with paragraphs (a)(1) and (c) of section 42, any CEIO that does not constitute gain-on-sale.

(2) Non-qualifying securitization exposures. In accordance with paragraphs (a)(4) and (c) of section 42, any securitization exposure that does not qualify for the Ratings-Based Approach, the Internal Assessment Approach, or the Supervisory Formula Approach under sections 43, 44, and 45, respectively.

(3) Securitizations of non-IRB exposures. In accordance with paragraphs (c) and (g)(4) of section 42, certain exposures to a securitization any underlying exposure of which is not a wholesale exposure, retail exposure, securitization exposure, or equity exposure.

(4) Low-rated securitization exposures. In accordance with section 43 and paragraph (c) of section 42, any securitization exposure that qualifies for and must be deducted under the Ratings-Based Approach.

(5) High-risk securitization exposures subject to the Supervisory Formula Approach. In accordance with paragraphs (b) and (c) of section 45 and paragraph (c) of section 42, certain high-risk securitization exposures (or portions thereof) that qualify for the Supervisory Formula Approach.

(6) Eligible credit reserves shortfall. In accordance with paragraph (a)(1) of section 13, any eligible credit reserves shortfall.

(7) Certain failed capital markets transactions. In accordance with paragraph (e)(3) of section 35, the [bank]'s exposure on certain failed capital markets transactions.

Section 12. Deductions and Limitations Not Required

(a) Deduction of CEIOs. A [bank] is not required to make the deductions from capital for CEIOs in 12 CFR part 3, Appendix A, § 2(c) (for national banks), 12 CFR part 208, Appendix A, § II.B.1.e. (for state member banks), 12 CFR part 225, Appendix A, § II.B.1.e. (for bank holding companies), 12 CFR part 325, Appendix A, § II.B.5. (for state nonmember banks), and 12 CFR 567.5(a)(2)(iii) and 567.12(e) (for savings associations).

(b) Deduction of certain equity investments. A [bank] is not required to make the deductions from capital for nonfinancial equity investments in 12 CFR part 3, Appendix A, § 2(c) (for national banks), 12 CFR part 208, Appendix A, § II.B.5. (for state member banks), 12 CFR part 225, Appendix A, § II.B.5. (for bank holding companies), and 12 CFR part 325, Appendix A, § II.B. (for state nonmember banks).

Section 13. Eligible Credit Reserves

(a) Comparison of eligible credit reserves to expected credit losses - (1) Shortfall of eligible credit reserves. If a [bank]'s eligible credit reserves are less than the [bank]'s total expected credit losses, the [bank] must deduct the shortfall amount 50 percent from tier 1 capital and 50 percent from tier 2 capital. If the amount deductible from tier 2 capital exceeds the [bank]'s actual tier 2 capital, the [bank] must deduct the excess amount from tier 1 capital.

(2) Excess eligible credit reserves. If a [bank]'s eligible credit reserves exceed the [bank]'s total expected credit losses, the [bank] may include the excess amount in tier 2 capital to the extent that the excess amount does not exceed 0.6 percent of the [bank]'s credit-risk-weighted assets.

(b) Treatment of allowance for loan and lease losses. Regardless of any provision in [the general risk-based capital rules], the ALLL is included in tier 2 capital only to the extent provided in paragraph (a)(2) of this section and in section 24.

Part III. Qualification

Section 21. Qualification Process

(a) Timing. (1) A [bank] that is described in paragraph (b)(1) of section 1 must adopt a written implementation plan no later than six months after the later of [INSERT EFFECTIVE DATE] or the date the [bank] meets a criterion in that section. The implementation plan must incorporate an explicit first floor period start date no later than 36 months after the later of [INSERT EFFECTIVE DATE] or the date the [bank] meets at least one criterion under paragraph (b)(1) of section 1. The [AGENCY] may extend the first floor period start date.

(2) A [bank] that elects to be subject to this appendix under paragraph (b)(2) of section 1 must adopt a written implementation plan.

(b) Implementation plan. (1) The [bank]'s implementation plan must address in detail how the [bank] complies, or plans to comply, with the qualification requirements in section 22. The [bank] also must maintain a comprehensive and sound planning and governance process to oversee the implementation efforts described in the plan. At a minimum, the plan must:

(i) Comprehensively address the qualification requirements in section 22 for the [bank] and each consolidated subsidiary (U.S. and foreign-based) of the [bank] with respect to all portfolios and exposures of the [bank] and each of its consolidated subsidiaries;

(ii) Justify and support any proposed temporary or permanent exclusion of business lines, portfolios, or exposures from application of the advanced approaches in this appendix (which business lines, portfolios, and exposures must be, in the aggregate, immaterial to the [bank]);

(iii) Include the [bank]'s self-assessment of:

(A) The [bank]'s current status in meeting the qualification requirements in section 22; and

(B) The consistency of the [bank]'s current practices with the [AGENCY]'s supervisory guidance on the qualification requirements;

(iv) Based on the [bank]'s self-assessment, identify and describe the areas in which the [bank] proposes to undertake additional work to comply with the qualification requirements in section 22 or to improve the consistency of the [bank]'s current practices with the [AGENCY]'s supervisory guidance on the qualification requirements (gap analysis);

(v) Describe what specific actions the [bank] will take to address the areas identified in the gap analysis required by paragraph (b)(1)(iv) of this section;

(vi) Identify objective, measurable milestones, including delivery dates and a date when the [bank]'s implementation of the methodologies described in this appendix will be fully operational;

(vii) Describe resources that have been budgeted and are available to implement the plan; and

(viii) Receive approval of the [bank]'s board of directors.

(2) The [bank] must submit the implementation plan, together with a copy of the minutes of the board of directors' approval, to the [AGENCY] at least 60 days before the [bank] proposes to begin its parallel run, unless the [AGENCY] waives prior notice.

(c) Parallel run. Before determining its risk-based capital requirements under this appendix and following adoption of the implementation plan, the [bank] must conduct a satisfactory parallel run. A satisfactory parallel run is a period of no less than four consecutive calendar quarters during which the [bank] complies with the qualification requirements in section 22 to the satisfaction of the [AGENCY]. During the parallel run, the [bank] must report to the [AGENCY] on a calendar quarterly basis its risk-based capital ratios using [the general risk-based capital rules] and the risk-based capital requirements described in this appendix. During this period, the [bank] is subject to [the general risk-based capital rules].

(d) Approval to calculate risk-based capital requirements under this appendix. The [AGENCY] will notify the [bank] of the date that the [bank] may begin its first floor period if the [AGENCY] determines that:

(1) The [bank] fully complies with all the qualification requirements in section 22;

(2) The [bank] has conducted a satisfactory parallel run under paragraph (c) of this section; and

(3) The [bank] has an adequate process to ensure ongoing compliance with the qualification requirements in section 22.

(e) Transitional floor periods. Following a satisfactory parallel run, a [bank] is subject to three transitional floor periods.

(1) Risk-based capital ratios during the transitional floor periods - (i) Tier 1 risk-based capital ratio. During a [bank]'s transitional floor periods, the [bank]'s tier 1 risk-based capital ratio is equal to the lower of:

(A) The [bank]'s floor-adjusted tier 1 risk-based capital ratio; or

(B) The [bank]'s advanced approaches tier 1 risk-based capital ratio.

(ii) Total risk-based capital ratio. During a [bank]'s transitional floor periods, the [bank]'s total risk-based capital ratio is equal to the lower of:

(A) The [bank]'s floor-adjusted total risk-based capital ratio; or

(B) The [bank]'s advanced approaches total risk-based capital ratio.

(2) Floor-adjusted risk-based capital ratios. (i) A [bank]'s floor-adjusted tier 1 risk-based capital ratio during a transitional floor period is equal to the [bank]'s tier 1 capital as calculated under [the general risk-based capital rules], divided by the product of:

(A) The [bank]'s total risk-weighted assets as calculated under [the general risk-based capital rules]; and

(B) The appropriate transitional floor percentage in Table 1.

(ii) A [bank]'s floor-adjusted total risk-based capital ratio during a transitional floor period is equal to the sum of the [bank]'s tier 1 and tier 2 capital as calculated under [the general risk-based capital rules], divided by the product of:

(A) The [bank]'s total risk-weighted assets as calculated under [the general risk-based capital rules]; and

(B) The appropriate transitional floor percentage in Table 1.

(iii) A [bank] that meets the criteria in paragraph (b)(1) or (b)(2) of section 1 as of [INSERT EFFECTIVE DATE] must use [the general risk-based capital rules] during the parallel run and as the basis for its transitional floors.

Table 1 – Transitional Floors

Transitional floor period	**Transitional floor percentage**
First floor period	95 percent
Second floor period	90 percent
Third floor period	85 percent

(3) Advanced approaches risk-based capital ratios. (i) A [bank]'s advanced approaches tier 1 risk-based capital ratio equals the [bank]'s tier 1 risk-based capital ratio as calculated under this appendix (other than this section on transitional floor periods).

(ii) A [bank]'s advanced approaches total risk-based capital ratio equals the [bank]'s total risk-based capital ratio as calculated under this appendix (other than this section on transitional floor periods).

(4) Reporting. During the transitional floor periods, a [bank] must report to the [AGENCY] on a calendar quarterly basis both floor-adjusted risk-based capital ratios and both advanced approaches risk-based capital ratios.

(5) Exiting a transitional floor period. A [bank] may not exit a transitional floor period until the [bank] has spent a minimum of four consecutive calendar quarters in the period and the [AGENCY] has determined that the [bank] may exit the floor period. The [AGENCY]'s determination will be based on an assessment of the [bank]'s ongoing compliance with the qualification requirements in section 22.

(6) Interagency study. After the end of the second transition year (2010), the Federal banking agencies will publish a study that evaluates the advanced approaches to determine if there are any material deficiencies. For any primary Federal supervisor to authorize any institution to exit the third transitional floor period, the study must determine that there are no such material deficiencies that cannot be addressed by then-existing tools, or, if such deficiencies are found, they are first remedied by changes to this appendix. Notwithstanding the preceding sentence, a primary Federal supervisor that disagrees with the finding of material deficiency may not authorize any institution under its jurisdiction to exit the third transitional floor period unless it provides a public report explaining its reasoning.

Section 22. Qualification Requirements

(a) Process and systems requirements. (1) A [bank] must have a 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.

(2) The systems and processes used by a [bank] for risk-based capital purposes under this appendix must be consistent with the [bank]'s internal risk management processes and management information reporting systems.

(3) Each [bank] must have an appropriate infrastructure with risk measurement and management processes that meet the qualification requirements of this section and are appropriate given the [bank]'s size and level of complexity. Regardless of whether the systems and models that generate the risk parameters necessary for calculating a [bank]'s risk-based capital requirements are located at any affiliate of the [bank], the [bank] itself must ensure that the risk parameters and reference data used to determine its

risk-based capital requirements are representative of its own credit risk and operational risk exposures.

(b) Risk rating and segmentation systems for wholesale and retail exposures. (1) A [bank] must have an internal risk rating and segmentation system that accurately and reliably differentiates among degrees of credit risk for the [bank]'s wholesale and retail exposures.

(2) For wholesale exposures:

(i) A [bank] must have an internal risk rating system that accurately and reliably assigns each obligor to a single rating grade (reflecting the obligor's likelihood of default). A [bank] may elect, however, not to assign to a rating grade an obligor to whom the [bank] extends credit based solely on the financial strength of a guarantor, provided that all of the [bank]'s exposures to the obligor are fully covered by eligible guarantees, the [bank] applies the PD substitution approach in paragraph (c)(1) of section 33 to all exposures to that obligor, and the [bank] immediately assigns the obligor to a rating grade if a guarantee can no longer be recognized under this appendix. The [bank]'s wholesale obligor rating system must have at least seven discrete rating grades for non-defaulted obligors and at least one rating grade for defaulted obligors.

(ii) Unless the [bank] has chosen to directly assign LGD estimates to each wholesale exposure, the [bank] must have an internal risk rating system that accurately and reliably assigns each wholesale exposure to a loss severity rating grade (reflecting the [bank]'s estimate of the LGD of the exposure). A [bank] employing loss severity rating grades must have a sufficiently granular loss severity grading system to avoid grouping together exposures with widely ranging LGDs.

(3) For retail exposures, a [bank] must have an internal system that groups retail exposures into the appropriate retail exposure subcategory, groups the retail exposures in each retail exposure subcategory into separate segments with homogeneous risk characteristics, and assigns accurate and reliable PD and LGD estimates for each segment on a consistent basis. The [bank]'s system must identify and group in separate segments by subcategories exposures identified in paragraphs (c)(2)(ii) and (iii) of section 31.

(4) The [bank]'s internal risk rating policy for wholesale exposures must describe the [bank]'s rating philosophy (that is, must describe how wholesale obligor rating assignments are affected by the [bank]'s choice of the range of economic, business, and industry conditions that are considered in the obligor rating process).

(5) The [bank]'s internal risk rating system for wholesale exposures must provide for the review and update (as appropriate) of each obligor rating and (if applicable) each loss severity rating whenever the [bank] receives new material information, but no less frequently than annually. The [bank]'s retail exposure segmentation system must provide for the review and update (as appropriate) of assignments of retail exposures to segments whenever the [bank] receives new material information, but generally no less frequently than quarterly.

(c) Quantification of risk parameters for wholesale and retail exposures. (1) The [bank] must have a comprehensive risk parameter quantification process that produces accurate, timely, and reliable estimates of the risk parameters for the [bank]'s wholesale and retail exposures.

(2) Data used to estimate the risk parameters must be relevant to the [bank]'s actual wholesale and retail exposures, and of sufficient quality to support the determination of risk-based capital requirements for the exposures.

(3) The [bank]'s risk parameter quantification process must produce appropriately conservative risk parameter estimates where the [bank] has limited relevant data, and any adjustments that are part of the quantification process must not result in a pattern of bias toward lower risk parameter estimates.

(4) The [bank]'s risk parameter estimation process should not rely on the possibility of U.S. government financial assistance, except for the financial assistance that the U.S. government has a legally binding commitment to provide.

(5) Where the [bank]'s quantifications of LGD directly or indirectly incorporate estimates of the effectiveness of its credit risk management practices in reducing its exposure to troubled obligors prior to default, the [bank] must support such estimates with empirical analysis showing that the estimates are consistent with its historical experience in dealing with such exposures during economic downturn conditions.

(6) PD estimates for wholesale obligors and retail segments must be based on at least five years of default data. LGD estimates for wholesale exposures must be based on at least seven years of loss severity data, and LGD estimates for retail segments must be based on at least five years of loss severity data. EAD estimates for wholesale exposures must be based on at least seven years of exposure amount data, and EAD estimates for retail segments must be based on at least five years of exposure amount data.

(7) Default, loss severity, and exposure amount data must include periods of economic downturn conditions, or the [bank] must adjust its estimates of risk parameters to compensate for the lack of data from periods of economic downturn conditions.

(8) The [bank]'s PD, LGD, and EAD estimates must be based on the definition of default in this appendix.

(9) The [bank] must review and update (as appropriate) its risk parameters and its risk parameter quantification process at least annually.

(10) The [bank] must at least annually conduct a comprehensive review and analysis of reference data to determine relevance of reference data to the [bank]'s exposures, quality of reference data to support PD, LGD, and EAD estimates, and consistency of reference data to the definition of default contained in this appendix.

(d) Counterparty credit risk model. A [bank] must obtain the prior written approval of the [AGENCY] under section 32 to use the internal models methodology for counterparty credit risk.

(e) Double default treatment. A [bank] must obtain the prior written approval of the [AGENCY] under section 34 to use the double default treatment.

(f) Securitization exposures. A [bank] must obtain the prior written approval of the [AGENCY] under section 44 to use the Internal Assessment Approach for securitization exposures to ABCP programs.

(g) Equity exposures model. A [bank] must obtain the prior written approval of the [AGENCY] under section 53 to use the Internal Models Approach for equity exposures.

(h) Operational risk - (1) Operational risk management processes. A [bank] must:

(i) Have an operational risk management function that:

(A) Is independent of business line management; and

(B) Is responsible for designing, implementing, and overseeing the [bank]'s operational risk data and assessment systems, operational risk quantification systems, and related processes;

(ii) Have and document a process (which must capture business environment and internal control factors affecting the [bank]'s operational risk profile) to identify, measure, monitor, and control operational risk in [bank] products, activities, processes, and systems; and

(iii) Report operational risk exposures, operational loss events, and other relevant operational risk information to business unit management, senior management, and the board of directors (or a designated committee of the board).

(2) Operational risk data and assessment systems. A [bank] must have operational risk data and assessment systems that capture operational risks to which the [bank] is exposed. The [bank]'s operational risk data and assessment systems must:

(i) Be structured in a manner consistent with the [bank]'s current business activities, risk profile, technological processes, and risk management processes; and

(ii) Include credible, transparent, systematic, and verifiable processes that incorporate the following elements on an ongoing basis:

(A) Internal operational loss event data. The [bank] must have a systematic process for capturing and using internal operational loss event data in its operational risk data and assessment systems.

(1) The [bank]'s operational risk data and assessment systems must include a historical observation period of at least five years for internal operational loss event data (or such shorter period approved by the [AGENCY] to address transitional situations, such as integrating a new business line).

(2) The [bank] must be able to map its internal operational loss event data into the seven operational loss event type categories.

(3) The [bank] may refrain from collecting internal operational loss event data for individual operational losses below established dollar threshold amounts if the [bank] can demonstrate to the satisfaction of the [AGENCY] that the thresholds are reasonable, do not exclude important internal operational loss event data, and permit the [bank] to capture substantially all the dollar value of the [bank]'s operational losses.

(B) External operational loss event data. The [bank] must have a systematic process for determining its methodologies for incorporating external operational loss event data into its operational risk data and assessment systems.

(C) Scenario analysis. The [bank] must have a systematic process for determining its methodologies for incorporating scenario analysis into its operational risk data and assessment systems.

(D) Business environment and internal control factors. The [bank] must incorporate business environment and internal control factors into its operational risk data and assessment systems. The [bank] must also periodically compare the results of its prior business environment and internal control factor assessments against its actual operational losses incurred in the intervening period.

(3) Operational risk quantification systems. (i) The [bank]'s operational risk quantification systems:

(A) Must generate estimates of the [bank]'s operational risk exposure using its operational risk data and assessment systems;

(B) Must employ a unit of measure that is appropriate for the [bank]'s range of business activities and the variety of operational loss events to which it is exposed, and that does not combine business activities or operational loss events with demonstrably different risk profiles within the same loss distribution;

(C) Must include a credible, transparent, systematic, and verifiable approach for weighting each of the four elements, described in paragraph (h)(2)(ii) of this section, that a [bank] is required to incorporate into its operational risk data and assessment systems;

(D) May use internal estimates of dependence among operational losses across and within units of measure if the [bank] can demonstrate to the satisfaction of the [AGENCY] that its process for estimating dependence is sound, robust to a variety of scenarios, and implemented with integrity, and allows for the uncertainty surrounding the estimates. If the [bank] has not made such a demonstration, it must sum operational risk exposure estimates across units of measure to calculate its total operational risk exposure; and

(E) Must be reviewed and updated (as appropriate) whenever the [bank] becomes aware of information that may have a material effect on the [bank]'s estimate of operational risk exposure, but the review and update must occur no less frequently than annually.

(ii) With the prior written approval of the [AGENCY], a [bank] may generate an estimate of its operational risk exposure using an alternative approach to that specified in paragraph (h)(3)(i) of this section. A [bank] proposing to use such an alternative operational risk quantification system must submit a proposal to the [AGENCY]. In determining whether to approve a [bank]'s proposal to use an alternative operational risk quantification system, the [AGENCY] will consider the following principles:

(A) Use of the alternative operational risk quantification system will be allowed only on an exception basis, considering the size, complexity, and risk profile of the [bank];

(B) The [bank] must demonstrate that its estimate of its operational risk exposure generated under the alternative operational risk quantification system is appropriate and can be supported empirically; and

(C) A [bank] must not use an allocation of operational risk capital requirements that includes entities other than depository institutions or the benefits of diversification across entities.

(i) Data management and maintenance. (1) A [bank] must have data management and maintenance systems that adequately support all aspects of its advanced systems and the timely and accurate reporting of risk-based capital requirements.

(2) A [bank] must retain data using an electronic format that allows timely retrieval of data for analysis, validation, reporting, and disclosure purposes.

(3) A [bank] must retain sufficient data elements related to key risk drivers to permit adequate monitoring, validation, and refinement of its advanced systems.

(j) Control, oversight, and validation mechanisms. (1) The [bank]'s senior management must ensure that all components of the [bank]'s advanced systems function effectively and comply with the qualification requirements in this section.

(2) The [bank]'s board of directors (or a designated committee of the board) must at least annually review the effectiveness of, and approve, the [bank]'s advanced systems.

(3) A [bank] must have an effective system of controls and oversight that:

(i) Ensures ongoing compliance with the qualification requirements in this section;

(ii) Maintains the integrity, reliability, and accuracy of the [bank]'s advanced systems; and

(iii) Includes adequate governance and project management processes.

(4) The [bank] must validate, on an ongoing basis, its advanced systems. The [bank]'s validation process must be independent of the advanced systems' development, implementation, and operation, or the validation process must be subjected to an independent review of its adequacy and effectiveness. Validation must include:

(i) An evaluation of the conceptual soundness of (including developmental evidence supporting) the advanced systems;

(ii) An ongoing monitoring process that includes verification of processes and benchmarking; and

(iii) An outcomes analysis process that includes back-testing.

(5) The [bank] must have an internal audit function independent of business-line management that at least annually assesses the effectiveness of the controls supporting

the [bank]'s advanced systems and reports its findings to the [bank]'s board of directors (or a committee thereof).

(6) The [bank] must periodically stress test its advanced systems. The stress testing must include a consideration of how economic cycles, especially downturns, affect risk-based capital requirements (including migration across rating grades and segments and the credit risk mitigation benefits of double default treatment).

(k) Documentation. The [bank] must adequately document all material aspects of its advanced systems.

Section 23. Ongoing Qualification

(a) Changes to advanced systems. A [bank] must meet all the qualification requirements in section 22 on an ongoing basis. A [bank] must notify the [AGENCY] when the [bank] makes any change to an advanced system that would result in a material change in the [bank]'s risk-weighted asset amount for an exposure type, or when the [bank] makes any significant change to its modeling assumptions.

(b) Failure to comply with qualification requirements. (1) If the [AGENCY] determines that a [bank] that uses this appendix and has conducted a satisfactory parallel run fails to comply with the qualification requirements in section 22, the [AGENCY] will notify the [bank] in writing of the [bank]'s failure to comply.

(2) The [bank] must establish and submit a plan satisfactory to the [AGENCY] to return to compliance with the qualification requirements.

(3) In addition, if the [AGENCY] determines that the [bank]'s risk-based capital requirements are not commensurate with the [bank]'s credit, market, operational, or other

risks, the [AGENCY] may require such a [bank] to calculate its risk-based capital requirements:

(i) Under [the general risk-based capital rules]; or

(ii) Under this appendix with any modifications provided by the [AGENCY].

Section 24. Merger and Acquisition Transitional Arrangements

(a) Mergers and acquisitions of companies without advanced systems. If a [bank] merges with or acquires a company that does not calculate its risk-based capital requirements using advanced systems, the [bank] may use [the general risk-based capital rules] to determine the risk-weighted asset amounts for, and deductions from capital associated with, the merged or acquired company's exposures for up to 24 months after the calendar quarter during which the merger or acquisition consummates. The [AGENCY] may extend this transition period for up to an additional 12 months. Within 90 days of consummating the merger or acquisition, the [bank] must submit to the [AGENCY] an implementation plan for using its advanced systems for the acquired company. During the period when [the general risk-based capital rules] apply to the merged or acquired company, any ALLL, net of allocated transfer risk reserves established pursuant to 12 U.S.C. 3904, associated with the merged or acquired company's exposures may be included in the acquiring [bank]'s tier 2 capital up to 1.25 percent of the acquired company's risk-weighted assets. All general allowances of the merged or acquired company must be excluded from the [bank]'s eligible credit reserves. In addition, the risk-weighted assets of the merged or acquired company are not included in the [bank]'s credit-risk-weighted assets but are included in total risk-weighted assets. If a [bank] relies on this paragraph, the [bank] must disclose publicly the amounts of risk-

weighted assets and qualifying capital calculated under this appendix for the acquiring [bank] and under [the general risk-based capital rules] for the acquired company.

(b) Mergers and acquisitions of companies with advanced systems - (1) If a [bank] merges with or acquires a company that calculates its risk-based capital requirements using advanced systems, the [bank] may use the acquired company's advanced systems to determine the risk-weighted asset amounts for, and deductions from capital associated with, the merged or acquired company's exposures for up to 24 months after the calendar quarter during which the acquisition or merger consummates. The [AGENCY] may extend this transition period for up to an additional 12 months. Within 90 days of consummating the merger or acquisition, the [bank] must submit to the [AGENCY] an implementation plan for using its advanced systems for the merged or acquired company.

(2) If the acquiring [bank] is not subject to the advanced approaches in this appendix at the time of acquisition or merger, during the period when [the general risk-based capital rules] apply to the acquiring [bank], the ALLL associated with the exposures of the merged or acquired company may not be directly included in tier 2 capital. Rather, any excess eligible credit reserves associated with the merged or acquired company's exposures may be included in the [bank]'s tier 2 capital up to 0.6 percent of the credit-risk-weighted assets associated with those exposures.

Part IV. Risk-Weighted Assets for General Credit Risk

Section 31. Mechanics for Calculating Total Wholesale and Retail Risk-Weighted Assets

(a) Overview. A [bank] must calculate its total wholesale and retail risk-weighted asset amount in four distinct phases:

(1) Phase 1 – categorization of exposures;

(2) Phase 2 – assignment of wholesale obligors and exposures to rating grades and segmentation of retail exposures;

(3) Phase 3 – assignment of risk parameters to wholesale exposures and segments of retail exposures; and

(4) Phase 4 – calculation of risk-weighted asset amounts.

(b) Phase 1 − Categorization. The [bank] must determine which of its exposures are wholesale exposures, retail exposures, securitization exposures, or equity exposures. The [bank] must categorize each retail exposure as a residential mortgage exposure, a QRE, or an other retail exposure. The [bank] must identify which wholesale exposures are HVCRE exposures, sovereign exposures, OTC derivative contracts, repo-style transactions, eligible margin loans, eligible purchased wholesale exposures, unsettled transactions to which section 35 applies, and eligible guarantees or eligible credit derivatives that are used as credit risk mitigants. The [bank] must identify any on-balance sheet asset that does not meet the definition of a wholesale, retail, equity, or securitization exposure, as well as any non-material portfolio of exposures described in paragraph (e)(4) of this section.

(c) Phase 2 – Assignment of wholesale obligors and exposures to rating grades and retail exposures to segments - (1) Assignment of wholesale obligors and exposures to rating grades.

(i) The [bank] must assign each obligor of a wholesale exposure to a single obligor rating grade and must assign each wholesale exposure to which it does not directly assign an LGD estimate to a loss severity rating grade.

(ii) The [bank] must identify which of its wholesale obligors are in default.

(2) Segmentation of retail exposures. (i) The [bank] must group the retail exposures in each retail subcategory into segments that have homogeneous risk characteristics.

(ii) The [bank] must identify which of its retail exposures are in default. The [bank] must segment defaulted retail exposures separately from non-defaulted retail exposures.

(iii) If the [bank] determines the EAD for eligible margin loans using the approach in paragraph (b) of section 32, the [bank] must identify which of its retail exposures are eligible margin loans for which the [bank] uses this EAD approach and must segment such eligible margin loans separately from other retail exposures.

(3) Eligible purchased wholesale exposures. A [bank] may group its eligible purchased wholesale exposures into segments that have homogeneous risk characteristics. A [bank] must use the wholesale exposure formula in Table 2 in this section to determine the risk-based capital requirement for each segment of eligible purchased wholesale exposures.

(d) Phase 3 − Assignment of risk parameters to wholesale exposures and segments of retail exposures - (1) Quantification process. Subject to the limitations in this paragraph (d), the [bank] must:

(i) Associate a PD with each wholesale obligor rating grade;

(ii) Associate an LGD with each wholesale loss severity rating grade or assign an LGD to each wholesale exposure;

(iii) Assign an EAD and M to each wholesale exposure; and

(iv) Assign a PD, LGD, and EAD to each segment of retail exposures.

(2) Floor on PD assignment. The PD for each wholesale obligor or retail segment may not be less than 0.03 percent, except for exposures to or directly and unconditionally guaranteed by a sovereign entity, the Bank for International Settlements, the International Monetary Fund, the European Commission, the European Central Bank, or a multilateral development bank, to which the [bank] assigns a rating grade associated with a PD of less than 0.03 percent.

(3) Floor on LGD estimation. The LGD for each segment of residential mortgage exposures (other than segments of residential mortgage exposures for which all or substantially all of the principal of each exposure is directly and unconditionally guaranteed by the full faith and credit of a sovereign entity) may not be less than 10 percent.

(4) Eligible purchased wholesale exposures. A [bank] must assign a PD, LGD, EAD, and M to each segment of eligible purchased wholesale exposures. If the [bank] can estimate ECL (but not PD or LGD) for a segment of eligible purchased wholesale exposures, the [bank] must assume that the LGD of the segment equals 100 percent and that the PD of the segment equals ECL divided by EAD. The estimated ECL must be calculated for the exposures without regard to any assumption of recourse or guarantees from the seller or other parties.

(5) Credit risk mitigation − credit derivatives, guarantees, and collateral. (i) A [bank] may take into account the risk reducing effects of eligible guarantees and eligible credit derivatives in support of a wholesale exposure by applying the PD substitution or LGD adjustment treatment to the exposure as provided in section 33 or, if applicable, applying double default treatment to the exposure as provided in section 34. A [bank] may decide separately for each wholesale exposure that qualifies for the double default treatment under section 34 whether to apply the double default treatment or to use the PD substitution or LGD adjustment treatment without recognizing double default effects.

(ii) A [bank] may take into account the risk reducing effects of guarantees and credit derivatives in support of retail exposures in a segment when quantifying the PD and LGD of the segment.

(iii) Except as provided in paragraph (d)(6) of this section, a [bank] may take into account the risk reducing effects of collateral in support of a wholesale exposure when quantifying the LGD of the exposure and may take into account the risk reducing effects of collateral in support of retail exposures when quantifying the PD and LGD of the segment.

(6) EAD for OTC derivative contracts, repo-style transactions, and eligible margin loans. (i) A [bank] must calculate its EAD for an OTC derivative contract as provided in paragraphs (c) and (d) of section 32. A [bank] may take into account the risk-reducing effects of financial collateral in support of a repo-style transaction or eligible margin loan and of any collateral in support of a repo-style transaction that is included in the [bank]'s VaR-based measure under [the market risk rule] through an adjustment to EAD as provided in paragraphs (b) and (d) of section 32. A [bank] that

takes collateral into account through such an adjustment to EAD under section 32 may not reflect such collateral in LGD.

(ii) A [bank] may attribute an EAD of zero to:

(A) Derivative contracts that are publicly traded on an exchange that requires the daily receipt and payment of cash-variation margin;

(B) Derivative contracts and repo-style transactions that are outstanding with a qualifying central counterparty (but not for those transactions that a qualifying central counterparty has rejected); and

(C) Credit risk exposures to a qualifying central counterparty in the form of clearing deposits and posted collateral that arise from transactions described in paragraph (d)(6)(ii)(B) of this section.

(7) Effective maturity. An exposure's M must be no greater than five years and no less than one year, except that an exposure's M must be no less than one day if the exposure has an original maturity of less than one year and is not part of a [bank]'s ongoing financing of the obligor. An exposure is not part of a [bank]'s ongoing financing of the obligor if the [bank]:

(i) Has a legal and practical ability not to renew or roll over the exposure in the event of credit deterioration of the obligor;

(ii) Makes an independent credit decision at the inception of the exposure and at every renewal or roll over; and

(iii) Has no substantial commercial incentive to continue its credit relationship with the obligor in the event of credit deterioration of the obligor.

(e) Phase 4 − Calculation of risk-weighted assets - (1) Non-defaulted exposures. (i) A [bank] must calculate the dollar risk-based capital requirement for each of its wholesale exposures to a non-defaulted obligor (except eligible guarantees and eligible credit derivatives that hedge another wholesale exposure and exposures to which the [bank] applies the double default treatment in section 34) and segments of non-defaulted retail exposures by inserting the assigned risk parameters for the wholesale obligor and exposure or retail segment into the appropriate risk-based capital formula specified in Table 2 and multiplying the output of the formula (K) by the EAD of the exposure or segment. Alternatively, a [bank] may apply a 300 percent risk weight to the EAD of an eligible margin loan if the [bank] is not able to meet the agencies' requirements for estimation of PD and LGD for the margin loan.

Table 2 – IRB Risk-Based Capital Formulas for Wholesale Exposures to Non-Defaulted Obligors and Segments of Non-Defaulted Retail Exposures[1]

Retail	**Capital Requirement (K) Non-Defaulted Exposures**	$K = \left[LGD \times N\left(\frac{N^{-1}(PD) + \sqrt{R} \times N^{-1}(0.999)}{\sqrt{1-R}} \right) - (LGD \times PD) \right]$
	Correlation Factor (R)	For residential mortgage exposures: $R = 0.15$
		For qualifying revolving exposures: $R = 0.04$
		For other retail exposures: $R = 0.03 + 0.13 \times e^{-35 \times PD}$
Wholesale	**Capital Requirement (K) Non-Defaulted Exposures**	$K = \left[LGD \times N\left(\frac{N^{-1}(PD) + \sqrt{R} \times N^{-1}(0.999)}{\sqrt{1-R}} \right) - (LGD \times PD) \right] \times \left(\frac{1 + (M - 2.5) \times b}{1 - 1.5 \times b} \right)$
	Correlation Factor (R)	For HVCRE exposures: $R = 0.12 + 0.18 \times e^{-50 \times PD}$
		For wholesale exposures other than HVCRE exposures: $R = 0.12 + 0.12 \times e^{-50 \times PD}$
	Maturity Adjustment (b)	$b = (0.11852 - 0.05478 \times \ln(PD))^2$

[1]N(.) means the cumulative distribution function for a standard normal random variable. N^{-1}(.) means the inverse cumulative distribution function for a standard normal random variable. The symbol e refers to the base of the natural logarithms, and the function ln(.) refers to the natural logarithm of the expression within parentheses. The formulas apply when PD is greater than zero. If PD equals zero, the capital requirement K is set equal to zero.

(ii) The sum of all the dollar risk-based capital requirements for each wholesale exposure to a non-defaulted obligor and segment of non-defaulted retail exposures

calculated in paragraph (e)(1)(i) of this section and in paragraph (e) of section 34 equals the total dollar risk-based capital requirement for those exposures and segments.

(iii) The aggregate risk-weighted asset amount for wholesale exposures to non-defaulted obligors and segments of non-defaulted retail exposures equals the total dollar risk-based capital requirement calculated in paragraph (e)(1)(ii) of this section multiplied by 12.5.

(2) Wholesale exposures to defaulted obligors and segments of defaulted retail exposures. (i) The dollar risk-based capital requirement for each wholesale exposure to a defaulted obligor equals 0.08 multiplied by the EAD of the exposure.

(ii) The dollar risk-based capital requirement for a segment of defaulted retail exposures equals 0.08 multiplied by the EAD of the segment.

(iii) The sum of all the dollar risk-based capital requirements for each wholesale exposure to a defaulted obligor calculated in paragraph (e)(2)(i) of this section plus the dollar risk-based capital requirements for each segment of defaulted retail exposures calculated in paragraph (e)(2)(ii) of this section equals the total dollar risk-based capital requirement for those exposures and segments.

(iv) The aggregate risk-weighted asset amount for wholesale exposures to defaulted obligors and segments of defaulted retail exposures equals the total dollar risk-based capital requirement calculated in paragraph (e)(2)(iii) of this section multiplied by 12.5.

(3) Assets not included in a defined exposure category. (i) A [bank] may assign a risk-weighted asset amount of zero to cash owned and held in all offices of the [bank] or in transit and for gold bullion held in the [bank]'s own vaults, or held in another [bank]'s

vaults on an allocated basis, to the extent the gold bullion assets are offset by gold bullion liabilities.

(ii) The risk-weighted asset amount for the residual value of a retail lease exposure equals such residual value.

(iii) The risk-weighted asset amount for any other on-balance-sheet asset that does not meet the definition of a wholesale, retail, securitization, or equity exposure equals the carrying value of the asset.

(4) Non-material portfolios of exposures. The risk-weighted asset amount of a portfolio of exposures for which the [bank] has demonstrated to the [AGENCY]'s satisfaction that the portfolio (when combined with all other portfolios of exposures that the [bank] seeks to treat under this paragraph) is not material to the [bank] is the sum of the carrying values of on-balance sheet exposures plus the notional amounts of off-balance sheet exposures in the portfolio. For purposes of this paragraph (e)(4), the notional amount of an OTC derivative contract that is not a credit derivative is the EAD of the derivative as calculated in section 32.

Section 32. Counterparty Credit Risk of Repo-Style Transactions, Eligible Margin Loans, and OTC Derivative Contracts

(a) In General. (1) This section describes two methodologies – a collateral haircut approach and an internal models methodology – that a [bank] may use instead of an LGD estimation methodology to recognize the benefits of financial collateral in mitigating the counterparty credit risk of repo-style transactions, eligible margin loans, collateralized OTC derivative contracts, and single product netting sets of such transactions and to recognize the benefits of any collateral in mitigating the counterparty credit risk of repo-

style transactions that are included in a [bank]'s VaR-based measure under [the market risk rule]. A third methodology, the simple VaR methodology, is available for single product netting sets of repo-style transactions and eligible margin loans.

(2) This section also describes the methodology for calculating EAD for an OTC derivative contract or a set of OTC derivative contracts subject to a qualifying master netting agreement. A [bank] also may use the internal models methodology to estimate EAD for qualifying cross-product master netting agreements.

(3) A [bank] may only use the standard supervisory haircut approach with a minimum 10-business-day holding period to recognize in EAD the benefits of conforming residential mortgage collateral that secures repo-style transactions (other than repo-style transactions included in the [bank]'s VaR-based measure under [the market risk rule]), eligible margin loans, and OTC derivative contracts.

(4) A [bank] may use any combination of the three methodologies for collateral recognition; however, it must use the same methodology for similar exposures.

(b) EAD for eligible margin loans and repo-style transactions - (1) General. A [bank] may recognize the credit risk mitigation benefits of financial collateral that secures an eligible margin loan, repo-style transaction, or single-product netting set of such transactions by factoring the collateral into its LGD estimates for the exposure. Alternatively, a [bank] may estimate an unsecured LGD for the exposure, as well as for any repo-style transaction that is included in the [bank]'s VaR-based measure under [the market risk rule], and determine the EAD of the exposure using:

(i) The collateral haircut approach described in paragraph (b)(2) of this section;

(ii) For netting sets only, the simple VaR methodology described in paragraph (b)(3) of this section; or

(iii) The internal models methodology described in paragraph (d) of this section.

(2) Collateral haircut approach - (i) EAD equation. A [bank] may determine EAD for an eligible margin loan, repo-style transaction, or netting set by setting EAD equal to max {0, [(∑E - ∑C) + ∑(Es x Hs) + ∑(Efx x Hfx)]}, where:

(A) ∑E equals the value of the exposure (the sum of the current market values of all instruments, gold, and cash the [bank] has lent, sold subject to repurchase, or posted as collateral to the counterparty under the transaction (or netting set));

(B) ∑C equals the value of the collateral (the sum of the current market values of all instruments, gold, and cash the [bank] has borrowed, purchased subject to resale, or taken as collateral from the counterparty under the transaction (or netting set));

(C) Es equals the absolute value of the net position in a given instrument or in gold (where the net position in a given instrument or in gold equals the sum of the current market values of the instrument or gold the [bank] has lent, sold subject to repurchase, or posted as collateral to the counterparty minus the sum of the current market values of that same instrument or gold the [bank] has borrowed, purchased subject to resale, or taken as collateral from the counterparty);

(D) Hs equals the market price volatility haircut appropriate to the instrument or gold referenced in Es;

(E) Efx equals the absolute value of the net position of instruments and cash in a currency that is different from the settlement currency (where the net position in a given currency equals the sum of the current market values of any instruments or cash in the

currency the [bank] has lent, sold subject to repurchase, or posted as collateral to the counterparty minus the sum of the current market values of any instruments or cash in the currency the [bank] has borrowed, purchased subject to resale, or taken as collateral from the counterparty); and

(F) Hfx equals the haircut appropriate to the mismatch between the currency referenced in Efx and the settlement currency.

(ii) Standard supervisory haircuts. (A) Under the standard supervisory haircuts approach:

(1) A [bank] must use the haircuts for market price volatility (Hs) in Table 3, as adjusted in certain circumstances as provided in paragraph (b)(2)(ii)(A)(3) and (4) of this section;

Table 3 – Standard Supervisory Market Price Volatility Haircuts[1]

Applicable external rating grade category for debt securities	Residual maturity for debt securities	Issuers exempt from the 3 basis point floor	Other issuers
Two highest investment-grade rating categories for long-term ratings/highest investment-grade rating category for short-term ratings	≤ 1 year	0.005	0.01
	>1 year, ≤ 5 years	0.02	0.04
	> 5 years	0.04	0.08
Two lowest investment-grade rating categories for both short- and long-term ratings	≤ 1 year	0.01	0.02
	>1 year, ≤ 5 years	0.03	0.06
	> 5 years	0.06	0.12
One rating category below investment grade	All	0.15	0.25
Main index equities (including convertible bonds) and gold		0.15	
Other publicly traded equities (including convertible bonds), conforming residential mortgages, and nonfinancial collateral		0.25	
Mutual funds		Highest haircut applicable to any security in which the fund can invest	
Cash on deposit with the [bank] (including a certificate of deposit issued by the [bank])		0	

[1]The market price volatility haircuts in Table 3 are based on a ten-business-day holding period.

(2) For currency mismatches, a [bank] must use a haircut for foreign exchange rate volatility (Hfx) of 8 percent, as adjusted in certain circumstances as provided in paragraph (b)(2)(ii)(A)(3) and (4) of this section.

(3) For repo-style transactions, a [bank] may multiply the supervisory haircuts provided in paragraphs (b)(2)(ii)(A)(1) and (2) of this section by the square root of ½ (which equals 0.707107).

(4) A [bank] must adjust the supervisory haircuts upward on the basis of a holding period longer than ten business days (for eligible margin loans) or five business days (for repo-style transactions) where and as appropriate to take into account the illiquidity of an instrument.

(iii) Own internal estimates for haircuts. With the prior written approval of the [AGENCY], a [bank] may calculate haircuts (Hs and Hfx) using its own internal estimates of the volatilities of market prices and foreign exchange rates.

(A) To receive [AGENCY] approval to use its own internal estimates, a [bank] must satisfy the following minimum quantitative standards:

(1) A [bank] must use a 99^{th} percentile one-tailed confidence interval.

(2) The minimum holding period for a repo-style transaction is five business days and for an eligible margin loan is ten business days. When a [bank] calculates an own-estimates haircut on a T_N-day holding period, which is different from the minimum holding period for the transaction type, the applicable haircut (H_M) is calculated using the following square root of time formula:

$$H_M = H_N \sqrt{\frac{T_M}{T_N}}, \text{ where}$$

(i) T_M equals 5 for repo-style transactions and 10 for eligible margin loans;

(ii) T_N equals the holding period used by the [bank] to derive H_N; and

(iii) H_N equals the haircut based on the holding period T_N.

(3) A [bank] must adjust holding periods upwards where and as appropriate to take into account the illiquidity of an instrument.

(4) The historical observation period must be at least one year.

(5) A [bank] must update its data sets and recompute haircuts no less frequently than quarterly and must also reassess data sets and haircuts whenever market prices change materially.

(B) With respect to debt securities that have an applicable external rating of investment grade, a [bank] may calculate haircuts for categories of securities. For a category of securities, the [bank] must calculate the haircut on the basis of internal volatility estimates for securities in that category that are representative of the securities in that category that the [bank] has lent, sold subject to repurchase, posted as collateral, borrowed, purchased subject to resale, or taken as collateral. In determining relevant categories, the [bank] must at a minimum take into account:

(1) The type of issuer of the security;

(2) The applicable external rating of the security;

(3) The maturity of the security; and

(4) The interest rate sensitivity of the security.

(C) With respect to debt securities that have an applicable external rating of below investment grade and equity securities, a [bank] must calculate a separate haircut for each individual security.

(D) Where an exposure or collateral (whether in the form of cash or securities) is denominated in a currency that differs from the settlement currency, the [bank] must calculate a separate currency mismatch haircut for its net position in each mismatched

currency based on estimated volatilities of foreign exchange rates between the mismatched currency and the settlement currency.

(E) A [bank]'s own estimates of market price and foreign exchange rate volatilities may not take into account the correlations among securities and foreign exchange rates on either the exposure or collateral side of a transaction (or netting set) or the correlations among securities and foreign exchange rates between the exposure and collateral sides of the transaction (or netting set).

(3) Simple VaR methodology. With the prior written approval of the [AGENCY], a [bank] may estimate EAD for a netting set using a VaR model that meets the requirements in paragraph (b)(3)(iii) of this section. In such event, the [bank] must set EAD equal to max $\{0, [(\sum E - \sum C) + PFE]\}$, where:

(i) $\sum E$ equals the value of the exposure (the sum of the current market values of all securities and cash the [bank] has lent, sold subject to repurchase, or posted as collateral to the counterparty under the netting set);

(ii) $\sum C$ equals the value of the collateral (the sum of the current market values of all securities and cash the [bank] has borrowed, purchased subject to resale, or taken as collateral from the counterparty under the netting set); and

(iii) PFE (potential future exposure) equals the [bank]'s empirically based best estimate of the 99^{th} percentile, one-tailed confidence interval for an increase in the value of $(\sum E - \sum C)$ over a five-business-day holding period for repo-style transactions or over a ten-business-day holding period for eligible margin loans using a minimum one-year historical observation period of price data representing the instruments that the [bank] has lent, sold subject to repurchase, posted as collateral, borrowed, purchased subject to

resale, or taken as collateral. The [bank] must validate its VaR model, including by establishing and maintaining a rigorous and regular back-testing regime.

(c) EAD for OTC derivative contracts. (1) A [bank] must determine the EAD for an OTC derivative contract that is not subject to a qualifying master netting agreement using the current exposure methodology in paragraph (c)(5) of this section or using the internal models methodology described in paragraph (d) of this section.

(2) A [bank] must determine the EAD for multiple OTC derivative contracts that are subject to a qualifying master netting agreement using the current exposure methodology in paragraph (c)(6) of this section or using the internal models methodology described in paragraph (d) of this section.

(3) Counterparty credit risk for credit derivatives. Notwithstanding the above,

(i) A [bank] that purchases a credit derivative that is recognized under section 33 or 34 as a credit risk mitigant for an exposure that is not a covered position under [the market risk rule] need not compute a separate counterparty credit risk capital requirement under this section so long as the [bank] does so consistently for all such credit derivatives and either includes all or excludes all such credit derivatives that are subject to a master netting agreement from any measure used to determine counterparty credit risk exposure to all relevant counterparties for risk-based capital purposes.

(ii) A [bank] that is the protection provider in a credit derivative must treat the credit derivative as a wholesale exposure to the reference obligor and need not compute a counterparty credit risk capital requirement for the credit derivative under this section, so long as it does so consistently for all such credit derivatives and either includes all or excludes all such credit derivatives that are subject to a master netting agreement from

any measure used to determine counterparty credit risk exposure to all relevant counterparties for risk-based capital purposes (unless the [bank] is treating the credit derivative as a covered position under [the market risk rule], in which case the [bank] must compute a supplemental counterparty credit risk capital requirement under this section).

(4) Counterparty credit risk for equity derivatives. A [bank] must treat an equity derivative contract as an equity exposure and compute a risk-weighted asset amount for the equity derivative contract under part VI (unless the [bank] is treating the contract as a covered position under [the market risk rule]). In addition, if the [bank] is treating the contract as a covered position under [the market risk rule] and in certain other cases described in section 55, the [bank] must also calculate a risk-based capital requirement for the counterparty credit risk of an equity derivative contract under this part.

(5) Single OTC derivative contract. Except as modified by paragraph (c)(7) of this section, the EAD for a single OTC derivative contract that is not subject to a qualifying master netting agreement is equal to the sum of the [bank]'s current credit exposure and potential future credit exposure (PFE) on the derivative contract.

(i) Current credit exposure. The current credit exposure for a single OTC derivative contract is the greater of the mark-to-market value of the derivative contract or zero.

(ii) PFE. The PFE for a single OTC derivative contract, including an OTC derivative contract with a negative mark-to-market value, is calculated by multiplying the notional principal amount of the derivative contract by the appropriate conversion factor in Table 4. For purposes of calculating either the PFE under this paragraph or the gross

PFE under paragraph (c)(6) of this section for exchange rate contracts and other similar contracts in which the notional principal amount is equivalent to the cash flows, notional principal amount is the net receipts to each party falling due on each value date in each currency. For any OTC derivative contract that does not fall within one of the specified categories in Table 4, the PFE must be calculated using the "other" conversion factors. A [bank] must use an OTC derivative contract's effective notional principal amount (that is, its apparent or stated notional principal amount multiplied by any multiplier in the OTC derivative contract) rather than its apparent or stated notional principal amount in calculating PFE. PFE of the protection provider of a credit derivative is capped at the net present value of the amount of unpaid premiums.

Table 4 – Conversion Factor Matrix for OTC Derivative Contracts[1]

Remaining maturity[2]	Interest rate	Foreign exchange rate and gold	Credit (investment-grade reference obligor)[3]	Credit (non-investment-grade reference obligor)	Equity	Precious metals (except gold)	Other
One year or less	0.00	0.01	0.05	0.10	0.06	0.07	0.10
Over one to five years	0.005	0.05	0.05	0.10	0.08	0.07	0.12
Over five years	0.015	0.075	0.05	0.10	0.10	0.08	0.15

[1]For an OTC derivative contract with multiple exchanges of principal, the conversion factor is multiplied by the number of remaining payments in the derivative contract.

[2]For an OTC derivative contract that is structured such that on specified dates any outstanding exposure is settled and the terms are reset so that the market value of the contract is zero, the remaining maturity equals the time until the next reset date. For an interest rate derivative contract with a remaining maturity of greater than one year that meets these criteria, the minimum conversion factor is 0.005.

[3]A [bank] must use the column labeled "Credit (investment-grade reference obligor)" for a credit derivative whose reference obligor has an outstanding unsecured long-term debt security without credit enhancement that has a long-term applicable external rating of at

least investment grade. A [bank] must use the column labeled "Credit (non-investment-grade reference obligor)" for all other credit derivatives.

(6) Multiple OTC derivative contracts subject to a qualifying master netting agreement. Except as modified by paragraph (c)(7) of this section, the EAD for multiple OTC derivative contracts subject to a qualifying master netting agreement is equal to the sum of the net current credit exposure and the adjusted sum of the PFE exposure for all OTC derivative contracts subject to the qualifying master netting agreement.

(i) Net current credit exposure. The net current credit exposure is the greater of:

(A) The net sum of all positive and negative mark-to-market values of the individual OTC derivative contracts subject to the qualifying master netting agreement; or

(B) zero.

(ii) Adjusted sum of the PFE. The adjusted sum of the PFE, Anet, is calculated as $A_{net} = (0.4 \times A_{gross}) + (0.6 \times NGR \times A_{gross})$, where:

(A) A_{gross} = the gross PFE (that is, the sum of the PFE amounts (as determined under paragraph (c)(5)(ii) of this section) for each individual OTC derivative contract subject to the qualifying master netting agreement); and

(B) NGR = the net to gross ratio (that is, the ratio of the net current credit exposure to the gross current credit exposure). In calculating the NGR, the gross current credit exposure equals the sum of the positive current credit exposures (as determined under paragraph (c)(5)(i) of this section) of all individual OTC derivative contracts subject to the qualifying master netting agreement.

(7) Collateralized OTC derivative contracts. A [bank] may recognize the credit risk mitigation benefits of financial collateral that secures an OTC derivative contract or single-product netting set of OTC derivatives by factoring the collateral into its LGD estimates for the contract or netting set. Alternatively, a [bank] may recognize the credit risk mitigation benefits of financial collateral that secures such a contract or netting set that is marked to market on a daily basis and subject to a daily margin maintenance requirement by estimating an unsecured LGD for the contract or netting set and adjusting the EAD calculated under paragraph (c)(5) or (c)(6) of this section using the collateral haircut approach in paragraph (b)(2) of this section. The [bank] must substitute the EAD calculated under paragraph (c)(5) or (c)(6) of this section for $\sum E$ in the equation in paragraph (b)(2)(i) of this section and must use a ten-business-day minimum holding period ($T_M = 10$).

(d) Internal models methodology. (1) With prior written approval from the [AGENCY], a [bank] may use the internal models methodology in this paragraph (d) to determine EAD for counterparty credit risk for OTC derivative contracts (collateralized or uncollateralized) and single-product netting sets thereof, for eligible margin loans and single-product netting sets thereof, and for repo-style transactions and single-product netting sets thereof. A [bank] that uses the internal models methodology for a particular transaction type (OTC derivative contracts, eligible margin loans, or repo-style transactions) must use the internal models methodology for all transactions of that transaction type. A [bank] may choose to use the internal models methodology for one or two of these three types of exposures and not the other types. A [bank] may also use the

internal models methodology for OTC derivative contracts, eligible margin loans, and repo-style transactions subject to a qualifying cross-product netting agreement if:

(i) The [bank] effectively integrates the risk mitigating effects of cross-product netting into its risk management and other information technology systems; and

(ii) The [bank] obtains the prior written approval of the [AGENCY].

A [bank] that uses the internal models methodology for a transaction type must receive approval from the [AGENCY] to cease using the methodology for that transaction type or to make a material change to its internal model.

(2) Under the internal models methodology, a [bank] uses an internal model to estimate the expected exposure (EE) for a netting set and then calculates EAD based on that EE.

(i) The [bank] must use its internal model's probability distribution for changes in the market value of a netting set that are attributable to changes in market variables to determine EE.

(ii) Under the internal models methodology, EAD = α x effective EPE, or, subject to [AGENCY] approval as provided in paragraph (d)(7), a more conservative measure of EAD.

(A) $EffectiveEPE_{t_k} = \sum_{k=1}^{n} EffectiveEE_{t_k} x \Delta t_k$ (that is, effective EPE is the time-weighted average of effective EE where the weights are the proportion that an individual effective EE represents in a one-year time interval) where:

(1) $EffectiveEE_{t_k} = \max\left(EffectiveEE_{t_{k-1}}, EE_{t_k}\right)$ (that is, for a specific date t_k, effective EE is the greater of EE at that date or the effective EE at the previous date); and

(2) t_k represents the k^{th} future time period in the model and there are n time periods represented in the model over the first year; and

(B) $\alpha = 1.4$ except as provided in paragraph (d)(6), or when the [AGENCY] has determined that the [bank] must set α higher based on the [bank]'s specific characteristics of counterparty credit risk.

(iii) A [bank] may include financial collateral currently posted by the counterparty as collateral (but may not include other forms of collateral) when calculating EE.

(iv) If a [bank] hedges some or all of the counterparty credit risk associated with a netting set using an eligible credit derivative, the [bank] may take the reduction in exposure to the counterparty into account when estimating EE. If the [bank] recognizes this reduction in exposure to the counterparty in its estimate of EE, it must also use its internal model to estimate a separate EAD for the [bank]'s exposure to the protection provider of the credit derivative.

(3) To obtain [AGENCY] approval to calculate the distributions of exposures upon which the EAD calculation is based, the [bank] must demonstrate to the satisfaction of the [AGENCY] that it has been using for at least one year an internal model that broadly meets the following minimum standards, with which the [bank] must maintain compliance:

(i) The model must have the systems capability to estimate the expected exposure to the counterparty on a daily basis (but is not expected to estimate or report expected exposure on a daily basis).

(ii) The model must estimate expected exposure at enough future dates to reflect accurately all the future cash flows of contracts in the netting set.

(iii) The model must account for the possible non-normality of the exposure distribution, where appropriate.

(iv) The [bank] must measure, monitor, and control current counterparty exposure and the exposure to the counterparty over the whole life of all contracts in the netting set.

(v) The [bank] must be able to measure and manage current exposures gross and net of collateral held, where appropriate. The [bank] must estimate expected exposures for OTC derivative contracts both with and without the effect of collateral agreements.

(vi) The [bank] must have procedures to identify, monitor, and control specific wrong-way risk throughout the life of an exposure. Wrong-way risk in this context is the risk that future exposure to a counterparty will be high when the counterparty's probability of default is also high.

(vii) The model must use current market data to compute current exposures. When estimating model parameters based on historical data, at least three years of historical data that cover a wide range of economic conditions must be used and must be updated quarterly or more frequently if market conditions warrant. The [bank] should consider using model parameters based on forward-looking measures, where appropriate.

(viii) A [bank] must subject its internal model to an initial validation and annual model review process. The model review should consider whether the inputs and risk factors, as well as the model outputs, are appropriate.

(4) Maturity. (i) If the remaining maturity of the exposure or the longest-dated contract in the netting set is greater than one year, the [bank] must set M for the exposure or netting set equal to the lower of five years or M(EPE),[4] where:

(A) $$M(EPE) = 1 + \frac{\sum_{t_k > 1\,year}^{maturity} EE_k \times \Delta t_k \times df_k}{\sum_{k=1}^{t_k \le 1\,year} effectiveEE_k \times \Delta t_k \times df_k}$$;

(B) df_k is the risk-free discount factor for future time period t_k; and

(C) $\Delta t_k = t_k - t_{k-1}$.

(ii) If the remaining maturity of the exposure or the longest-dated contract in the netting set is one year or less, the [bank] must set M for the exposure or netting set equal to one year, except as provided in paragraph (d)(7) of section 31.

(5) Collateral agreements. A [bank] may capture the effect on EAD of a collateral agreement that requires receipt of collateral when exposure to the counterparty increases but may not capture the effect on EAD of a collateral agreement that requires receipt of collateral when counterparty credit quality deteriorates. For this purpose, a collateral agreement means a legal contract that specifies the time when, and circumstances under which, the counterparty is required to pledge collateral to the [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

[4] Alternatively, a [bank] that uses an internal model to calculate a one-sided credit valuation adjustment may use the effective credit duration estimated by the model as M(EPE) in place of the formula in paragraph (d)(4).

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. Two methods are available to capture the effect of a collateral agreement:

(i) With prior written approval from the [AGENCY], a [bank] may include the effect of a collateral agreement within its internal model used to calculate EAD. The [bank] may set EAD equal to the expected exposure at the end of the margin period of risk. The margin period of risk means, with respect to a netting set subject to a collateral agreement, the time period from the most recent exchange of collateral with a counterparty until the next required exchange of collateral plus the period of time required to sell and realize the proceeds of the least liquid collateral that can be delivered under the terms of the collateral agreement and, where applicable, the period of time required to re-hedge the resulting market risk, upon the default of the counterparty. The minimum margin period of risk is five business days for repo-style transactions and ten business days for other transactions when liquid financial collateral is posted under a daily margin maintenance requirement. This period should be extended to cover any additional time between margin calls; any potential closeout difficulties; any delays in selling collateral, particularly if the collateral is illiquid; and any impediments to prompt re-hedging of any market risk.

(ii) A [bank] that can model EPE without collateral agreements but cannot achieve the higher level of modeling sophistication to model EPE with collateral agreements can set effective EPE for a collateralized netting set equal to the lesser of:

(A) The threshold, defined as the exposure amount at which the counterparty is required to post collateral under the collateral agreement, if the threshold is positive, plus an add-on that reflects the potential increase in exposure of the netting set over the margin period of risk. The add-on is computed as the expected increase in the netting set's exposure beginning from current exposure of zero over the margin period of risk. The margin period of risk must be at least five business days for netting sets consisting only of repo-style transactions subject to daily re-margining and daily marking-to-market, and ten business days for all other netting sets; or

(B) Effective EPE without a collateral agreement.

(6) Own estimate of alpha. With prior written approval of the [AGENCY], a [bank] may calculate alpha as the ratio of economic capital from a full simulation of counterparty exposure across counterparties that incorporates a joint simulation of market and credit risk factors (numerator) and economic capital based on EPE (denominator), subject to a floor of 1.2. For purposes of this calculation, economic capital is the unexpected losses for all counterparty credit risks measured at a 99.9 percent confidence level over a one-year horizon. To receive approval, the [bank] must meet the following minimum standards to the satisfaction of the [AGENCY]:

(i) The [bank]'s own estimate of alpha must capture in the numerator the effects of:

(A) The material sources of stochastic dependency of distributions of market values of transactions or portfolios of transactions across counterparties;

(B) Volatilities and correlations of market risk factors used in the joint simulation, which must be related to the credit risk factor used in the simulation to reflect potential increases in volatility or correlation in an economic downturn, where appropriate; and

(C) The granularity of exposures (that is, the effect of a concentration in the proportion of each counterparty's exposure that is driven by a particular risk factor).

(ii) The [bank] must assess the potential model uncertainty in its estimates of alpha.

(iii) The [bank] must calculate the numerator and denominator of alpha in a consistent fashion with respect to modeling methodology, parameter specifications, and portfolio composition.

(iv) The [bank] must review and adjust as appropriate its estimates of the numerator and denominator of alpha on at least a quarterly basis and more frequently when the composition of the portfolio varies over time.

(7) Other measures of counterparty exposure. With prior written approval of the [AGENCY], a [bank] may set EAD equal to a measure of counterparty credit risk exposure, such as peak EAD, that is more conservative than an alpha of 1.4 (or higher under the terms of paragraph (d)(2)(ii)(B)) times EPE for every counterparty whose EAD will be measured under the alternative measure of counterparty exposure. The [bank] must demonstrate the conservatism of the measure of counterparty credit risk exposure used for EAD. For material portfolios of new OTC derivative products, the [bank] may assume that the current exposure methodology in paragraphs (c)(5) and (c)(6) of this section meets the conservatism requirement of this paragraph for a period not to exceed 180 days. For immaterial portfolios of OTC derivative contracts, the [bank] generally

may assume that the current exposure methodology in paragraphs (c)(5) and (c)(6) of this section meets the conservatism requirement of this paragraph.

Section 33. Guarantees and Credit Derivatives: PD Substitution and LGD Adjustment Approaches

(a) Scope. (1) This section applies to wholesale exposures for which:

(i) Credit risk is fully covered by an eligible guarantee or eligible credit derivative; or

(ii) Credit risk is covered on a pro rata basis (that is, on a basis in which the [bank] and the protection provider share losses proportionately) by an eligible guarantee or eligible credit derivative.

(2) Wholesale exposures on which there is a tranching of credit risk (reflecting at least two different levels of seniority) are securitization exposures subject to the securitization framework in part V.

(3) A [bank] may elect to recognize the credit risk mitigation benefits of an eligible guarantee or eligible credit derivative covering an exposure described in paragraph (a)(1) of this section by using the PD substitution approach or the LGD adjustment approach in paragraph (c) of this section or, if the transaction qualifies, using the double default treatment in section 34. A [bank]'s PD and LGD for the hedged exposure may not be lower than the PD and LGD floors described in paragraphs (d)(2) and (d)(3) of section 31.

(4) If multiple eligible guarantees or eligible credit derivatives cover a single exposure described in paragraph (a)(1) of this section, a [bank] may treat the hedged exposure as multiple separate exposures each covered by a single eligible guarantee or

eligible credit derivative and may calculate a separate risk-based capital requirement for each separate exposure as described in paragraph (a)(3) of this section.

(5) If a single eligible guarantee or eligible credit derivative covers multiple hedged wholesale exposures described in paragraph (a)(1) of this section, a [bank] must treat each hedged exposure as covered by a separate eligible guarantee or eligible credit derivative and must calculate a separate risk-based capital requirement for each exposure as described in paragraph (a)(3) of this section.

(6) A [bank] must use the same risk parameters for calculating ECL as it uses for calculating the risk-based capital requirement for the exposure.

(b) Rules of recognition. (1) A [bank] may only recognize the credit risk mitigation benefits of eligible guarantees and eligible credit derivatives.

(2) A [bank] may only recognize the credit risk mitigation benefits of an eligible credit derivative to hedge an exposure that is different from the credit derivative's reference exposure used for determining the derivative's cash settlement value, deliverable obligation, or occurrence of a credit event if:

(i) The reference exposure ranks pari passu (that is, equally) with or is junior to the hedged exposure; and

(ii) The reference exposure and the hedged exposure are exposures to the same legal entity, and legally enforceable cross-default or cross-acceleration clauses are in place to assure payments under the credit derivative are triggered when the obligor fails to pay under the terms of the hedged exposure.

(c) Risk parameters for hedged exposures - (1) PD substitution approach - (i) Full coverage. If an eligible guarantee or eligible credit derivative meets the conditions in

paragraphs (a) and (b) of this section and the protection amount (P) of the guarantee or credit derivative is greater than or equal to the EAD of the hedged exposure, a [bank] may recognize the guarantee or credit derivative in determining the [bank]'s risk-based capital requirement for the hedged exposure by substituting the PD associated with the rating grade of the protection provider for the PD associated with the rating grade of the obligor in the risk-based capital formula applicable to the guarantee or credit derivative in Table 2 and using the appropriate LGD as described in paragraph (c)(1)(iii) of this section. If the [bank] determines that full substitution of the protection provider's PD leads to an inappropriate degree of risk mitigation, the [bank] may substitute a higher PD than that of the protection provider.

(ii) Partial coverage. If an eligible guarantee or eligible credit derivative meets the conditions in paragraphs (a) and (b) of this section and the protection amount (P) of the guarantee or credit derivative is less than the EAD of the hedged exposure, the [bank] must treat the hedged exposure as two separate exposures (protected and unprotected) in order to recognize the credit risk mitigation benefit of the guarantee or credit derivative.

(A) The [bank] must calculate its risk-based capital requirement for the protected exposure under section 31, where PD is the protection provider's PD, LGD is determined under paragraph (c)(1)(iii) of this section, and EAD is P. If the [bank] determines that full substitution leads to an inappropriate degree of risk mitigation, the [bank] may use a higher PD than that of the protection provider.

(B) The [bank] must calculate its risk-based capital requirement for the unprotected exposure under section 31, where PD is the obligor's PD, LGD is the hedged

exposure's LGD (not adjusted to reflect the guarantee or credit derivative), and EAD is the EAD of the original hedged exposure minus P.

(C) The treatment in this paragraph (c)(1)(ii) is applicable when the credit risk of a wholesale exposure is covered on a partial pro rata basis or when an adjustment is made to the effective notional amount of the guarantee or credit derivative under paragraph (d), (e), or (f) of this section.

(iii) LGD of hedged exposures. The LGD of a hedged exposure under the PD substitution approach is equal to:

(A) The lower of the LGD of the hedged exposure (not adjusted to reflect the guarantee or credit derivative) and the LGD of the guarantee or credit derivative, if the guarantee or credit derivative provides the [bank] with the option to receive immediate payout upon triggering the protection; or

(B) The LGD of the guarantee or credit derivative, if the guarantee or credit derivative does not provide the [bank] with the option to receive immediate payout upon triggering the protection.

(2) LGD adjustment approach - (i) Full coverage. If an eligible guarantee or eligible credit derivative meets the conditions in paragraphs (a) and (b) of this section and the protection amount (P) of the guarantee or credit derivative is greater than or equal to the EAD of the hedged exposure, the [bank]'s risk-based capital requirement for the hedged exposure is the greater of:

(A) The risk-based capital requirement for the exposure as calculated under section 31, with the LGD of the exposure adjusted to reflect the guarantee or credit derivative; or

(B) The risk-based capital requirement for a direct exposure to the protection provider as calculated under section 31, using the PD for the protection provider, the LGD for the guarantee or credit derivative, and an EAD equal to the EAD of the hedged exposure.

(ii) Partial coverage. If an eligible guarantee or eligible credit derivative meets the conditions in paragraphs (a) and (b) of this section and the protection amount (P) of the guarantee or credit derivative is less than the EAD of the hedged exposure, the [bank] must treat the hedged exposure as two separate exposures (protected and unprotected) in order to recognize the credit risk mitigation benefit of the guarantee or credit derivative.

(A) The [bank]'s risk-based capital requirement for the protected exposure would be the greater of:

(1) The risk-based capital requirement for the protected exposure as calculated under section 31, with the LGD of the exposure adjusted to reflect the guarantee or credit derivative and EAD set equal to P; or

(2) The risk-based capital requirement for a direct exposure to the guarantor as calculated under section 31, using the PD for the protection provider, the LGD for the guarantee or credit derivative, and an EAD set equal to P.

(B) The [bank] must calculate its risk-based capital requirement for the unprotected exposure under section 31, where PD is the obligor's PD, LGD is the hedged exposure's LGD (not adjusted to reflect the guarantee or credit derivative), and EAD is the EAD of the original hedged exposure minus P.

(3) M of hedged exposures. The M of the hedged exposure is the same as the M of the exposure if it were unhedged.

(d) Maturity mismatch. (1) A [bank] that recognizes an eligible guarantee or eligible credit derivative in determining its risk-based capital requirement for a hedged exposure must adjust the effective notional amount of the credit risk mitigant to reflect any maturity mismatch between the hedged exposure and the credit risk mitigant.

(2) A maturity mismatch occurs when the residual maturity of a credit risk mitigant is less than that of the hedged exposure(s).

(3) The residual maturity of a hedged exposure is the longest possible remaining time before the obligor is scheduled to fulfill its obligation on the exposure. If a credit risk mitigant has embedded options that may reduce its term, the [bank] (protection purchaser) must use the shortest possible residual maturity for the credit risk mitigant. If a call is at the discretion of the protection provider, the residual maturity of the credit risk mitigant is at the first call date. If the call is at the discretion of the [bank] (protection purchaser), but the terms of the arrangement at origination of the credit risk mitigant contain a positive incentive for the [bank] to call the transaction before contractual maturity, the remaining time to the first call date is the residual maturity of the credit risk mitigant. For example, where there is a step-up in cost in conjunction with a call feature or where the effective cost of protection increases over time even if credit quality remains the same or improves, the residual maturity of the credit risk mitigant will be the remaining time to the first call.

(4) A credit risk mitigant with a maturity mismatch may be recognized only if its original maturity is greater than or equal to one year and its residual maturity is greater than three months.

(5) When a maturity mismatch exists, the [bank] must apply the following adjustment to the effective notional amount of the credit risk mitigant: $Pm = E \times (t-0.25)/(T-0.25)$, where:

(i) Pm = effective notional amount of the credit risk mitigant, adjusted for maturity mismatch;

(ii) E = effective notional amount of the credit risk mitigant;

(iii) t = the lesser of T or the residual maturity of the credit risk mitigant, expressed in years; and

(iv) T = the lesser of five or the residual maturity of the hedged exposure, expressed in years.

(e) Credit derivatives without restructuring as a credit event. If a [bank] recognizes an eligible credit derivative that does not include as a credit event a restructuring of the hedged exposure involving forgiveness or postponement of principal, interest, or fees that results in a credit loss event (that is, a charge-off, specific provision, or other similar debit to the profit and loss account), the [bank] must apply the following adjustment to the effective notional amount of the credit derivative: $Pr = Pm \times 0.60$, where:

(1) Pr = effective notional amount of the credit risk mitigant, adjusted for lack of restructuring event (and maturity mismatch, if applicable); and

(2) Pm = effective notional amount of the credit risk mitigant adjusted for maturity mismatch (if applicable).

(f) Currency mismatch. (1) If a [bank] recognizes an eligible guarantee or eligible credit derivative that is denominated in a currency different from that in which the

hedged exposure is denominated, the [bank] must apply the following formula to the effective notional amount of the guarantee or credit derivative: $Pc = Pr \times (1-H_{FX})$, where:

(i) Pc = effective notional amount of the credit risk mitigant, adjusted for currency mismatch (and maturity mismatch and lack of restructuring event, if applicable);

(ii) Pr = effective notional amount of the credit risk mitigant (adjusted for maturity mismatch and lack of restructuring event, if applicable); and

(iii) H_{FX} = haircut appropriate for the currency mismatch between the credit risk mitigant and the hedged exposure.

(2) A [bank] must set H_{FX} equal to 8 percent unless it qualifies for the use of and uses its own internal estimates of foreign exchange volatility based on a ten-business-day holding period and daily marking-to-market and remargining. A [bank] qualifies for the use of its own internal estimates of foreign exchange volatility if it qualifies for:

(i) The own-estimates haircuts in paragraph (b)(2)(iii) of section 32;

(ii) The simple VaR methodology in paragraph (b)(3) of section 32; or

(iii) The internal models methodology in paragraph (d) of section 32.

(3) A [bank] must adjust H_{FX} calculated in paragraph (f)(2) of this section upward if the [bank] revalues the guarantee or credit derivative less frequently than once every ten business days using the square root of time formula provided in paragraph (b)(2)(iii)(A)(2) of section 32.

Section 34. Guarantees and Credit Derivatives: Double Default Treatment

(a) Eligibility and operational criteria for double default treatment. A [bank] may recognize the credit risk mitigation benefits of a guarantee or credit derivative covering

an exposure described in paragraph (a)(1) of section 33 by applying the double default treatment in this section if all the following criteria are satisfied.

(1) The hedged exposure is fully covered or covered on a pro rata basis by:

(i) An eligible guarantee issued by an eligible double default guarantor; or

(ii) An eligible credit derivative that meets the requirements of paragraph (b)(2) of section 33 and is issued by an eligible double default guarantor.

(2) The guarantee or credit derivative is:

(i) An uncollateralized guarantee or uncollateralized credit derivative (for example, a credit default swap) that provides protection with respect to a single reference obligor; or

(ii) An n^{th}-to-default credit derivative (subject to the requirements of paragraph (m) of section 42).

(3) The hedged exposure is a wholesale exposure (other than a sovereign exposure).

(4) The obligor of the hedged exposure is not:

(i) An eligible double default guarantor or an affiliate of an eligible double default guarantor; or

(ii) An affiliate of the guarantor.

(5) The [bank] does not recognize any credit risk mitigation benefits of the guarantee or credit derivative for the hedged exposure other than through application of the double default treatment as provided in this section.

(6) The [bank] has implemented a process (which has received the prior, written approval of the [AGENCY]) to detect excessive correlation between the creditworthiness

of the obligor of the hedged exposure and the protection provider. If excessive correlation is present, the [bank] may not use the double default treatment for the hedged exposure.

(b) Full coverage. If the transaction meets the criteria in paragraph (a) of this section and the protection amount (P) of the guarantee or credit derivative is at least equal to the EAD of the hedged exposure, the [bank] may determine its risk-weighted asset amount for the hedged exposure under paragraph (e) of this section.

(c) Partial coverage. If the transaction meets the criteria in paragraph (a) of this section and the protection amount (P) of the guarantee or credit derivative is less than the EAD of the hedged exposure, the [bank] must treat the hedged exposure as two separate exposures (protected and unprotected) in order to recognize double default treatment on the protected portion of the exposure.

(1) For the protected exposure, the [bank] must set EAD equal to P and calculate its risk-weighted asset amount as provided in paragraph (e) of this section.

(2) For the unprotected exposure, the [bank] must set EAD equal to the EAD of the original exposure minus P and then calculate its risk-weighted asset amount as provided in section 31.

(d) Mismatches. For any hedged exposure to which a [bank] applies double default treatment, the [bank] must make applicable adjustments to the protection amount as required in paragraphs (d), (e), and (f) of section 33.

(e) The double default dollar risk-based capital requirement. The dollar risk-based capital requirement for a hedged exposure to which a [bank] has applied double

default treatment is K_{DD} multiplied by the EAD of the exposure. K_{DD} is calculated according to the following formula: $K_{DD} = K_o \times (0.15 + 160 \times PD_g)$,

where:

(1)

$$K_O = LGD_g \times \left[N\left(\frac{N^{-1}(PD_o) + N^{-1}(0.999)\sqrt{\rho_{os}}}{\sqrt{1-\rho_{os}}} \right) - PD_o \right] \times \left[\frac{1+(M-2.5)\times b}{1-1.5\times b} \right]$$

(2) PD_g = PD of the protection provider.

(3) PD_o = PD of the obligor of the hedged exposure.

(4) LGD_g = (i) The lower of the LGD of the hedged exposure (not adjusted to reflect the guarantee or credit derivative) and the LGD of the guarantee or credit derivative, if the guarantee or credit derivative provides the [bank] with the option to receive immediate payout on triggering the protection; or

(ii) The LGD of the guarantee or credit derivative, if the guarantee or credit derivative does not provide the [bank] with the option to receive immediate payout on triggering the protection.

(5) ρ_{os} (asset value correlation of the obligor) is calculated according to the appropriate formula for (R) provided in Table 2 in section 31, with PD equal to PD_o.

(6) b (maturity adjustment coefficient) is calculated according to the formula for b provided in Table 2 in section 31, with PD equal to the lesser of PD_o and PD_g.

(7) M (maturity) is the effective maturity of the guarantee or credit derivative, which may not be less than one year or greater than five years.

Section 35. Risk-Based Capital Requirement for Unsettled Transactions

(a) Definitions. For purposes of this section:

(1) Delivery-versus-payment (DvP) transaction means a securities or commodities transaction in which the buyer is obligated to make payment only if the seller has made delivery of the securities or commodities and the seller is obligated to deliver the securities or commodities only if the buyer has made payment.

(2) Payment-versus-payment (PvP) transaction means a foreign exchange transaction in which each counterparty is obligated to make a final transfer of one or more currencies only if the other counterparty has made a final transfer of one or more currencies.

(3) Normal settlement period. A transaction has a normal settlement period if the contractual settlement period for the transaction is equal to or less than the market standard for the instrument underlying the transaction and equal to or less than five business days.

(4) Positive current exposure. The positive current exposure of a [bank] for a transaction is the difference between the transaction value at the agreed settlement price and the current market price of the transaction, if the difference results in a credit exposure of the [bank] to the counterparty.

(b) Scope. This section applies to all transactions involving securities, foreign exchange instruments, and commodities that have a risk of delayed settlement or delivery. This section does not apply to:

(1) Transactions accepted by a qualifying central counterparty that are subject to daily marking-to-market and daily receipt and payment of variation margin;

(2) Repo-style transactions, including unsettled repo-style transactions (which are addressed in sections 31 and 32);

(3) One-way cash payments on OTC derivative contracts (which are addressed in sections 31 and 32); or

(4) Transactions with a contractual settlement period that is longer than the normal settlement period (which are treated as OTC derivative contracts and addressed in sections 31 and 32).

(c) System-wide failures. In the case of a system-wide failure of a settlement or clearing system, the [AGENCY] may waive risk-based capital requirements for unsettled and failed transactions until the situation is rectified.

(d) Delivery-versus-payment (DvP) and payment-versus-payment (PvP) transactions. A [bank] must hold risk-based capital against any DvP or PvP transaction with a normal settlement period if the [bank]'s counterparty has not made delivery or payment within five business days after the settlement date. The [bank] must determine its risk-weighted asset amount for such a transaction by multiplying the positive current exposure of the transaction for the [bank] by the appropriate risk weight in Table 5.

Table 5 – Risk Weights for Unsettled DvP and PvP Transactions

Number of business days after contractual settlement date	**Risk weight to be applied to positive current exposure**
From 5 to 15	100%
From 16 to 30	625%
From 31 to 45	937.5%
46 or more	1,250%

(e) Non-DvP/non-PvP (non-delivery-versus-payment/non-payment-versus-payment) transactions. (1) A [bank] must hold risk-based capital against any non-

DvP/non-PvP transaction with a normal settlement period if the [bank] has delivered cash, securities, commodities, or currencies to its counterparty but has not received its corresponding deliverables by the end of the same business day. The [bank] must continue to hold risk-based capital against the transaction until the [bank] has received its corresponding deliverables.

(2) From the business day after the [bank] has made its delivery until five business days after the counterparty delivery is due, the [bank] must calculate its risk-based capital requirement for the transaction by treating the current market value of the deliverables owed to the [bank] as a wholesale exposure.

(i) A [bank] may assign an obligor rating to a counterparty for which it is not otherwise required under this appendix to assign an obligor rating on the basis of the applicable external rating of any outstanding unsecured long-term debt security without credit enhancement issued by the counterparty.

(ii) A [bank] may use a 45 percent LGD for the transaction rather than estimating LGD for the transaction provided the [bank] uses the 45 percent LGD for all transactions described in paragraphs (e)(1) and (e)(2) of this section.

(iii) A [bank] may use a 100 percent risk weight for the transaction provided the [bank] uses this risk weight for all transactions described in paragraphs (e)(1) and (e)(2) of this section.

(3) If the [bank] has not received its deliverables by the fifth business day after the counterparty delivery was due, the [bank] must deduct the current market value of the deliverables owed to the [bank] 50 percent from tier 1 capital and 50 percent from tier 2 capital.

(f) Total risk-weighted assets for unsettled transactions. Total risk-weighted assets for unsettled transactions is the sum of the risk-weighted asset amounts of all DvP, PvP, and non-DvP/non-PvP transactions.

Part V. Risk-Weighted Assets for Securitization Exposures

Section 41. Operational Criteria for Recognizing the Transfer of Risk

(a) Operational criteria for traditional securitizations. A [bank] that transfers exposures it has originated or purchased to a securitization SPE or other third party in connection with a traditional securitization may exclude the exposures from the calculation of its risk-weighted assets only if each of the conditions in this paragraph (a) is satisfied. A [bank] that meets these conditions must hold risk-based capital against any securitization exposures it retains in connection with the securitization. A [bank] that fails to meet these conditions must hold risk-based capital against the transferred exposures as if they had not been securitized and must deduct from tier 1 capital any after-tax gain-on-sale resulting from the transaction. The conditions are:

(1) The transfer is considered a sale under GAAP;

(2) The [bank] has transferred to third parties credit risk associated with the underlying exposures; and

(3) Any clean-up calls relating to the securitization are eligible clean-up calls.

(b) Operational criteria for synthetic securitizations. For synthetic securitizations, a [bank] may recognize for risk-based capital purposes the use of a credit risk mitigant to hedge underlying exposures only if each of the conditions in this paragraph (b) is satisfied. A [bank] that fails to meet these conditions must hold risk-based capital against

the underlying exposures as if they had not been synthetically securitized. The conditions are:

(1) The credit risk mitigant is an eligible credit derivative from an eligible securitization guarantor or an eligible guarantee from an eligible securitization guarantor;

(2) The [bank] transfers credit risk associated with the underlying exposures to third parties, and the terms and conditions in the credit risk mitigants employed do not include provisions that:

(i) Allow for the termination of the credit protection due to deterioration in the credit quality of the underlying exposures;

(ii) Require the [bank] to alter or replace the underlying exposures to improve the credit quality of the pool of underlying exposures;

(iii) Increase the [bank]'s cost of credit protection in response to deterioration in the credit quality of the underlying exposures;

(iv) Increase the yield payable to parties other than the [bank] in response to a deterioration in the credit quality of the underlying exposures; or

(v) Provide for increases in a retained first loss position or credit enhancement provided by the [bank] after the inception of the securitization;

(3) The [bank] obtains a well-reasoned opinion from legal counsel that confirms the enforceability of the credit risk mitigant in all relevant jurisdictions; and

(4) Any clean-up calls relating to the securitization are eligible clean-up calls.

Section 42. Risk-Based Capital Requirement for Securitization Exposures

(a) Hierarchy of approaches. Except as provided elsewhere in this section:

(1) A [bank] must deduct from tier 1 capital any after-tax gain-on-sale resulting from a securitization and must deduct from total capital in accordance with paragraph (c) of this section the portion of any CEIO that does not constitute gain-on-sale.

(2) If a securitization exposure does not require deduction under paragraph (a)(1) of this section and qualifies for the Ratings-Based Approach in section 43, a [bank] must apply the Ratings-Based Approach to the exposure.

(3) If a securitization exposure does not require deduction under paragraph (a)(1) of this section and does not qualify for the Ratings-Based Approach, the [bank] may either apply the Internal Assessment Approach in section 44 to the exposure (if the [bank], the exposure, and the relevant ABCP program qualify for the Internal Assessment Approach) or the Supervisory Formula Approach in section 45 to the exposure (if the [bank] and the exposure qualify for the Supervisory Formula Approach).

(4) If a securitization exposure does not require deduction under paragraph (a)(1) of this section and does not qualify for the Ratings-Based Approach, the Internal Assessment Approach, or the Supervisory Formula Approach, the [bank] must deduct the exposure from total capital in accordance with paragraph (c) of this section.

(5) If a securitization exposure is an OTC derivative contract (other than a credit derivative) that has a first priority claim on the cash flows from the underlying exposures (notwithstanding amounts due under interest rate or currency derivative contracts, fees due, or other similar payments), with approval of the [AGENCY], a [bank] may choose to set the risk-weighted asset amount of the exposure equal to the amount of the exposure as determined in paragraph (e) of this section rather than apply the hierarchy of approaches described in paragraphs (a)(1) through (4) of this section.

(b) Total risk-weighted assets for securitization exposures. A [bank]'s total risk-weighted assets for securitization exposures is equal to the sum of its risk-weighted assets calculated using the Ratings-Based Approach in section 43, the Internal Assessment Approach in section 44, and the Supervisory Formula Approach in section 45, and its risk-weighted assets amount for early amortization provisions calculated in section 47.

(c) Deductions. (1) If a [bank] must deduct a securitization exposure from total capital, the [bank] 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 [bank]'s tier 2 capital, the [bank] must deduct the excess from tier 1 capital.

(2) A [bank] may calculate any deduction from tier 1 capital and tier 2 capital for a securitization exposure net of any deferred tax liabilities associated with the securitization exposure.

(d) Maximum risk-based capital requirement. Regardless of any other provisions of this part, unless one or more underlying exposures does not meet the definition of a wholesale, retail, securitization, or equity exposure, the total risk-based capital requirement for all securitization exposures held by a single [bank] associated with a single securitization (including any risk-based capital requirements that relate to an early amortization provision of the securitization but excluding any risk-based capital requirements that relate to the [bank]'s gain-on-sale or CEIOs associated with the securitization) may not exceed the sum of:

(1) The [bank]'s total risk-based capital requirement for the underlying exposures as if the [bank] directly held the underlying exposures; and

(2) The total ECL of the underlying exposures.

(e) Amount of a securitization exposure. (1) The amount of an on-balance sheet securitization exposure that is not a repo-style transaction, eligible margin loan, or OTC derivative contract (other than a credit derivative) is:

(i) The [bank]'s carrying value minus any unrealized gains and plus any unrealized losses on the exposure, if the exposure is a security classified as available-for-sale; or

(ii) The [bank]'s carrying value, if the exposure is not a security classified as available-for-sale.

(2) The amount of an off-balance sheet securitization exposure that is not an OTC derivative contract (other than a credit derivative) is the notional amount of the exposure. For an off-balance-sheet securitization exposure to an ABCP program, such as a liquidity facility, the notional amount may be reduced to the maximum potential amount that the [bank] could be required to fund given the ABCP program's current underlying assets (calculated without regard to the current credit quality of those assets).

(3) The amount of a securitization exposure that is a repo-style transaction, eligible margin loan, or OTC derivative contract (other than a credit derivative) is the EAD of the exposure as calculated in section 32.

(f) Overlapping exposures. If a [bank] has multiple securitization exposures that provide duplicative coverage of the underlying exposures of a securitization (such as when a [bank] provides a program-wide credit enhancement and multiple pool-specific liquidity facilities to an ABCP program), the [bank] is not required to hold duplicative risk-based capital against the overlapping position. Instead, the [bank] may apply to the

overlapping position the applicable risk-based capital treatment that results in the highest risk-based capital requirement.

(g) Securitizations of non-IRB exposures. If a [bank] has a securitization exposure where any underlying exposure is not a wholesale exposure, retail exposure, securitization exposure, or equity exposure, the [bank] must:

(1) If the [bank] is an originating [bank], deduct from tier 1 capital any after-tax gain-on-sale resulting from the securitization and deduct from total capital in accordance with paragraph (c) of this section the portion of any CEIO that does not constitute gain-on-sale;

(2) If the securitization exposure does not require deduction under paragraph (g)(1), apply the RBA in section 43 to the securitization exposure if the exposure qualifies for the RBA;

(3) If the securitization exposure does not require deduction under paragraph (g)(1) and does not qualify for the RBA, apply the IAA in section 44 to the exposure (if the [bank], the exposure, and the relevant ABCP program qualify for the IAA); and

(4) If the securitization exposure does not require deduction under paragraph (g)(1) and does not qualify for the RBA or the IAA, deduct the exposure from total capital in accordance with paragraph (c) of this section.

(h) Implicit support. If a [bank] provides support to a securitization in excess of the [bank]'s contractual obligation to provide credit support to the securitization (implicit support):

(1) The [bank] must hold regulatory capital against all of the underlying exposures associated with the securitization as if the exposures had not been securitized and must deduct from tier 1 capital any after-tax gain-on-sale resulting from the securitization; and

(2) The [bank] must disclose publicly:

(i) That it has provided implicit support to the securitization; and

(ii) The regulatory capital impact to the [bank] of providing such implicit support.

(i) Eligible servicer cash advance facilities. Regardless of any other provisions of this part, a [bank] is not required to hold risk-based capital against the undrawn portion of an eligible servicer cash advance facility.

(j) Interest-only mortgage-backed securities. Regardless of any other provisions of this part, the risk weight for a non-credit-enhancing interest-only mortgage-backed security may not be less than 100 percent.

(k) Small-business loans and leases on personal property transferred with recourse. (1) Regardless of any other provisions of this appendix, a [bank] that has transferred small-business loans and leases on personal property (small-business obligations) with recourse must include in risk-weighted assets only the contractual amount of retained recourse if all the following conditions are met:

(i) The transaction is a sale under GAAP.

(ii) The [bank] establishes and maintains, pursuant to GAAP, a non-capital reserve sufficient to meet the [bank]'s reasonably estimated liability under the recourse arrangement.

(iii) The loans and leases are to businesses that meet the criteria for a small-business concern established by the Small Business Administration under section 3(a) of the Small Business Act (15 USC 632).

(iv) The [bank] is well capitalized, as defined in the [AGENCY]'s prompt corrective action regulation -- 12 CFR part 6 (for national banks), 12 CFR part 208, subpart D (for state member banks or bank holding companies), 12 CFR part 325, subpart B (for state nonmember banks), and 12 CFR part 565 (for savings associations). For purposes of determining whether a [bank] is well capitalized for purposes of this paragraph, the [bank]'s capital ratios must be calculated without regard to the capital treatment for transfers of small-business obligations with recourse specified in paragraph (k)(1) of this section.

(2) The total outstanding amount of recourse retained by a [bank] on transfers of small-business obligations receiving the capital treatment specified in paragraph (k)(1) of this section cannot exceed 15 percent of the [bank]'s total qualifying capital.

(3) If a [bank] ceases to be well capitalized or exceeds the 15 percent capital limitation, the preferential capital treatment specified in paragraph (k)(1) of this section will continue to apply to any transfers of small-business obligations with recourse that occurred during the time that the [bank] was well capitalized and did not exceed the capital limit.

(4) The risk-based capital ratios of the [bank] must be calculated without regard to the capital treatment for transfers of small-business obligations with recourse specified in paragraph (k)(1) of this section as provided in 12 CFR part 3, Appendix A (for national banks), 12 CFR part 208, Appendix A (for state member banks), 12 CFR part 225,

Appendix A (for bank holding companies), 12 CFR part 325, Appendix A (for state nonmember banks), and 12 CFR 567.6(b)(5)(v) (for savings associations).

(l) Consolidated ABCP programs. (1) A [bank] that qualifies as a primary beneficiary and must consolidate an ABCP program as a variable interest entity under GAAP may exclude the consolidated ABCP program assets from risk-weighted assets if the [bank] is the sponsor of the ABCP program. If a [bank] excludes such consolidated ABCP program assets from risk-weighted assets, the [bank] must hold risk-based capital against any securitization exposures of the [bank] to the ABCP program in accordance with this part.

(2) If a [bank] either is not permitted, or elects not, to exclude consolidated ABCP program assets from its risk-weighted assets, the [bank] must hold risk-based capital against the consolidated ABCP program assets in accordance with this appendix but is not required to hold risk-based capital against any securitization exposures of the [bank] to the ABCP program.

(m) N^{th}-to-default credit derivatives - (1) First-to-default credit derivatives - (i) Protection purchaser. A [bank] that obtains credit protection on a group of underlying exposures through a first-to-default credit derivative must determine its risk-based capital requirement for the underlying exposures as if the [bank] synthetically securitized the underlying exposure with the lowest risk-based capital requirement and had obtained no credit risk mitigant on the other underlying exposures.

(ii) Protection provider. A [bank] that provides credit protection on a group of underlying exposures through a first-to-default credit derivative must determine its risk-weighted asset amount for the derivative by applying the RBA in section 43 (if the

derivative qualifies for the RBA) or, if the derivative does not qualify for the RBA, by setting its risk-weighted asset amount for the derivative equal to the product of:

(A) The protection amount of the derivative;

(B) 12.5; and

(C) The sum of the risk-based capital requirements of the individual underlying exposures, up to a maximum of 100 percent.

(2) Second-or-subsequent-to-default credit derivatives - (i) Protection purchaser. (A) A [bank] that obtains credit protection on a group of underlying exposures through a n^{th}-to-default credit derivative (other than a first-to-default credit derivative) may recognize the credit risk mitigation benefits of the derivative only if:

(1) The [bank] also has obtained credit protection on the same underlying exposures in the form of first-through-(n-1)-to-default credit derivatives; or

(2) If n-1 of the underlying exposures have already defaulted.

(B) If a [bank] satisfies the requirements of paragraph (m)(2)(i)(A) of this section, the [bank] must determine its risk-based capital requirement for the underlying exposures as if the [bank] had only synthetically securitized the underlying exposure with the n^{th} lowest risk-based capital requirement and had obtained no credit risk mitigant on the other underlying exposures.

(ii) Protection provider. A [bank] that provides credit protection on a group of underlying exposures through a n^{th}-to-default credit derivative (other than a first-to-default credit derivative) must determine its risk-weighted asset amount for the derivative by applying the RBA in section 43 (if the derivative qualifies for the RBA) or, if the

derivative does not qualify for the RBA, by setting its risk-weighted asset amount for the derivative equal to the product of:

(A) The protection amount of the derivative;

(B) 12.5; and

(C) The sum of the risk-based capital requirements of the individual underlying exposures (excluding the n-1 underlying exposures with the lowest risk-based capital requirements), up to a maximum of 100 percent.

Section 43. Ratings-Based Approach (RBA)

(a) Eligibility requirements for use of the RBA - (1) Originating [bank]. An originating [bank] must use the RBA to calculate its risk-based capital requirement for a securitization exposure if the exposure has two or more external ratings or inferred ratings (and may not use the RBA if the exposure has fewer than two external ratings or inferred ratings).

(2) Investing [bank]. An investing [bank] must use the RBA to calculate its risk-based capital requirement for a securitization exposure if the exposure has one or more external or inferred ratings (and may not use the RBA if the exposure has no external or inferred rating).

(b) Ratings-based approach. (1) A [bank] must determine the risk-weighted asset amount for a securitization exposure by multiplying the amount of the exposure (as defined in paragraph (e) of section 42) by the appropriate risk weight provided in Table 6 and Table 7.

(2) A [bank] must apply the risk weights in Table 6 when the securitization exposure's applicable external or applicable inferred rating represents a long-term credit

rating, and must apply the risk weights in Table 7 when the securitization exposure's applicable external or applicable inferred rating represents a short-term credit rating.

(i) A [bank] must apply the risk weights in column 1 of Table 6 or Table 7 to the securitization exposure if:

(A) N (as calculated under paragraph (e)(6) of section 45) is six or more (for purposes of this section only, if the notional number of underlying exposures is 25 or more or if all of the underlying exposures are retail exposures, a [bank] may assume that N is six or more unless the [bank] knows or has reason to know that N is less than six); and

(B) The securitization exposure is a senior securitization exposure.

(ii) A [bank] must apply the risk weights in column 3 of Table 6 or Table 7 to the securitization exposure if N is less than six, regardless of the seniority of the securitization exposure.

(iii) Otherwise, a [bank] must apply the risk weights in column 2 of Table 6 or Table 7.

Table 6 – Long-Term Credit Rating Risk Weights under RBA and IAA

	Column 1	**Column 2**	**Column 3**
Applicable external or inferred rating (Illustrative rating example)	**Risk weights for senior securitization exposures backed by granular pools**	**Risk weights for non-senior securitization exposures backed by granular pools**	**Risk weights for securitization exposures backed by non-granular pools**
Highest investment grade (for example, AAA)	7%	12%	20%
Second highest investment grade (for example, AA)	8%	15%	25%

Third-highest investment grade – positive designation (for example, A+)	10%	18%	35%
Third-highest investment grade (for example, A)	12%	20%	
Third-highest investment grade – negative designation (for example, A-)	20%	35%	
Lowest investment grade—positive designation (for example, BBB+)	35%	50%	
Lowest investment grade (for example, BBB)	60%	75%	
Lowest investment grade—negative designation (for example, BBB-)	100%		
One category below investment grade—positive designation (for example, BB+)	250%		
One category below investment grade (for example, BB)	425%		
One category below investment grade—negative designation (for example, BB-)	650%		
More than one category below investment grade	Deduction from tier 1 and tier 2 capital		

Table 7 – Short-Term Credit Rating Risk Weights under RBA and IAA

	Column 1	**Column 2**	**Column 3**
Applicable external or inferred rating (Illustrative rating example)	**Risk weights for senior securitization exposures backed**	**Risk weights for non-senior securitization exposures backed**	**Risk weights for securitization exposures backed by non-granular pools**

	by granular pools	by granular pools	
Highest investment grade (for example, A1)	7%	12%	20%
Second highest investment grade (for example, A2)	12%	20%	35%
Third highest investment grade (for example, A3)	60%	75%	75%
All other ratings	Deduction from tier 1 and tier 2 capital		

Section 44. Internal Assessment Approach (IAA)

(a) Eligibility requirements. A [bank] may apply the IAA to calculate the risk-weighted asset amount for a securitization exposure that the [bank] has to an ABCP program (such as a liquidity facility or credit enhancement) if the [bank], the ABCP program, and the exposure qualify for use of the IAA.

(1) [Bank] qualification criteria. A [bank] qualifies for use of the IAA if the [bank] has received the prior written approval of the [AGENCY]. To receive such approval, the [bank] must demonstrate to the [AGENCY]'s satisfaction that the [bank]'s internal assessment process meets the following criteria:

(i) The [bank]'s internal credit assessments of securitization exposures must be based on publicly available rating criteria used by an NRSRO.

(ii) The [bank]'s internal credit assessments of securitization exposures used for risk-based capital purposes must be consistent with those used in the [bank]'s internal risk management process, management information reporting systems, and capital adequacy assessment process.

(iii) The [bank]'s internal credit assessment process must have sufficient granularity to identify gradations of risk. Each of the [bank]'s internal credit assessment categories must correspond to an external rating of an NRSRO.

(iv) The [bank]'s internal credit assessment process, particularly the stress test factors for determining credit enhancement requirements, must be at least as conservative as the most conservative of the publicly available rating criteria of the NRSROs that have provided external ratings to the commercial paper issued by the ABCP program.

(A) Where the commercial paper issued by an ABCP program has an external rating from two or more NRSROs and the different NRSROs' benchmark stress factors require different levels of credit enhancement to achieve the same external rating equivalent, the [bank] must apply the NRSRO stress factor that requires the highest level of credit enhancement.

(B) If any NRSRO that provides an external rating to the ABCP program's commercial paper changes its methodology (including stress factors), the [bank] must evaluate whether to revise its internal assessment process.

(v) The [bank] must have an effective system of controls and oversight that ensures compliance with these operational requirements and maintains the integrity and accuracy of the internal credit assessments. The [bank] must have an internal audit function independent from the ABCP program business line and internal credit assessment process that assesses at least annually whether the controls over the internal credit assessment process function as intended.

(vi) The [bank] must review and update each internal credit assessment whenever new material information is available, but no less frequently than annually.

(vii) The [bank] must validate its internal credit assessment process on an ongoing basis and at least annually.

(2) ABCP-program qualification criteria. An ABCP program qualifies for use of the IAA if all commercial paper issued by the ABCP program has an external rating.

(3) Exposure qualification criteria. A securitization exposure qualifies for use of the IAA if the exposure meets the following criteria:

(i) The [bank] initially rated the exposure at least the equivalent of investment grade.

(ii) The ABCP program has robust credit and investment guidelines (that is, underwriting standards) for the exposures underlying the securitization exposure.

(iii) The ABCP program performs a detailed credit analysis of the sellers of the exposures underlying the securitization exposure.

(iv) The ABCP program's underwriting policy for the exposures underlying the securitization exposure establishes minimum asset eligibility criteria that include the prohibition of the purchase of assets that are significantly past due or of assets that are defaulted (that is, assets that have been charged off or written down by the seller prior to being placed into the ABCP program or assets that would be charged off or written down under the program's governing contracts), as well as limitations on concentration to individual obligors or geographic areas and the tenor of the assets to be purchased.

(v) The aggregate estimate of loss on the exposures underlying the securitization exposure considers all sources of potential risk, such as credit and dilution risk.

(vi) Where relevant, the ABCP program incorporates structural features into each purchase of exposures underlying the securitization exposure to mitigate potential credit

deterioration of the underlying exposures. Such features may include wind-down triggers specific to a pool of underlying exposures.

(b) Mechanics. A [bank] that elects to use the IAA to calculate the risk-based capital requirement for any securitization exposure must use the IAA to calculate the risk-based capital requirements for all securitization exposures that qualify for the IAA approach. Under the IAA, a [bank] must map its internal assessment of such a securitization exposure to an equivalent external rating from an NRSRO. Under the IAA, a [bank] must determine the risk-weighted asset amount for such a securitization exposure by multiplying the amount of the exposure (as defined in paragraph (e) of section 42) by the appropriate risk weight in Table 6 and Table 7 in paragraph (b) of section 43.

Section 45. Supervisory Formula Approach (SFA)

(a) Eligibility requirements. A [bank] may use the SFA to determine its risk-based capital requirement for a securitization exposure only if the [bank] can calculate on an ongoing basis each of the SFA parameters in paragraph (e) of this section.

(b) Mechanics. Under the SFA, a securitization exposure incurs a deduction from total capital (as described in paragraph (c) of section 42) and/or an SFA risk-based capital requirement, as determined in paragraph (c) of this section. The risk-weighted asset amount for the securitization exposure equals the SFA risk-based capital requirement for the exposure multiplied by 12.5.

(c) The SFA risk-based capital requirement. (1) If K_{IRB} is greater than or equal to L+T, the entire exposure must be deducted from total capital.

(2) If K_{IRB} is less than or equal to L, the exposure's SFA risk-based capital requirement is UE multiplied by TP multiplied by the greater of:

(i) 0.0056 * T; or

(ii) S[L+T] – S[L].

(3) If K_{IRB} is greater than L and less than L+T, the [bank] must deduct from total capital an amount equal to UE*TP*(K_{IRB} –L), and the exposure's SFA risk-based capital requirement is UE multiplied by TP multiplied by the greater of:

(i) 0.0056 * (T – (K_{IRB} – L)); or

(ii) S[L+T] – S[K_{IRB}].

(d) The supervisory formula:

(1) $$S[Y] = \begin{cases} Y & when\ Y \le K_{IRB} \\ K_{IRB} + K[Y] - K[K_{IRB}] + \frac{d \cdot K_{IRB}}{20}\left(1 - e^{\frac{20 \cdot (K_{IRB} - Y)}{K_{IRB}}}\right) & when\ Y > K_{IRB} \end{cases}$$

(2) $$K[Y] = (1-h) \cdot \left[\left(1 - \beta[Y; a, b]\right) \cdot Y + \beta[Y; a+1, b] \cdot c\right]$$

(3) $$h = \left(1 - \frac{K_{IRB}}{EWALGD}\right)^{N}$$

(4) $$a = g \cdot c$$

(5) $$b = g \cdot (1-c)$$

(6) $$c = \frac{K_{IRB}}{1-h}$$

(7) $$g = \frac{(1-c) \cdot c}{f} - 1$$

(8) $$f = \frac{v + K_{IRB}^{\ 2}}{1-h} - c^2 + \frac{(1 - K_{IRB}) \cdot K_{IRB} - v}{(1-h) \cdot 1000}$$

(9) $v = K_{IRB} \cdot \frac{(EWALGD - K_{IRB}) + .25 \cdot (1 - EWALGD)}{N}$

(10) $d = 1 - (1 - h) \cdot (1 - \beta[K_{IRB}; a, b])$.

(11) In these expressions, β [Y; a, b] refers to the cumulative beta distribution with parameters a and b evaluated at Y. In the case where N = 1 and EWALGD = 100 percent, S[Y] in formula (1) must be calculated with K[Y] set equal to the product of K_{IRB} and Y, and d set equal to 1- K_{IRB}.

(e) SFA parameters - (1) Amount of the underlying exposures (UE). UE is the EAD of any underlying exposures that are wholesale and retail exposures (including the amount of any funded spread accounts, cash collateral accounts, and other similar funded credit enhancements) plus the amount of any underlying exposures that are securitization exposures (as defined in paragraph (e) of section 42) plus the adjusted carrying value of any underlying exposures that are equity exposures (as defined in paragraph (b) of section 51).

(2) Tranche percentage (TP). TP is the ratio of the amount of the [bank]'s securitization exposure to the amount of the tranche that contains the securitization exposure.

(3) Capital requirement on underlying exposures (K_{IRB}). (i) K_{IRB} is the ratio of:

(A) The sum of the risk-based capital requirements for the underlying exposures plus the expected credit losses of the underlying exposures (as determined under this appendix as if the underlying exposures were directly held by the [bank]); to

(B) UE.

(ii) The calculation of K_{IRB} must reflect the effects of any credit risk mitigant applied to the underlying exposures (either to an individual underlying exposure, to a group of underlying exposures, or to the entire pool of underlying exposures).

(iii) All assets related to the securitization are treated as underlying exposures, including assets in a reserve account (such as a cash collateral account).

(4) Credit enhancement level (L). (i) L is the ratio of:

(A) The amount of all securitization exposures subordinated to the tranche that contains the [bank]'s securitization exposure; to

(B) UE.

(ii) A [bank] must determine L before considering the effects of any tranche-specific credit enhancements.

(iii) Any gain-on-sale or CEIO associated with the securitization may not be included in L.

(iv) Any reserve account funded by accumulated cash flows from the underlying exposures that is subordinated to the tranche that contains the [bank]'s securitization exposure may be included in the numerator and denominator of L to the extent cash has accumulated in the account. Unfunded reserve accounts (that is, reserve accounts that are to be funded from future cash flows from the underlying exposures) may not be included in the calculation of L.

(v) In some cases, the purchase price of receivables will reflect a discount that provides credit enhancement (for example, first loss protection) for all or certain tranches of the securitization. When this arises, L should be calculated inclusive of this discount if the discount provides credit enhancement for the securitization exposure.

(5) Thickness of tranche (T). T is the ratio of:

(i) The amount of the tranche that contains the [bank]'s securitization exposure; to

(ii) UE.

(6) Effective number of exposures (N). (i) Unless the [bank] elects to use the formula provided in paragraph (f),

$$N = \frac{(\sum_i EAD_i)^2}{\sum_i EAD_i^2}$$

where EAD_i represents the EAD associated with the i^{th} instrument in the pool of underlying exposures.

(ii) Multiple exposures to one obligor must be treated as a single underlying exposure.

(iii) In the case of a re-securitization (that is, a securitization in which some or all of the underlying exposures are themselves securitization exposures), the [bank] must treat each underlying exposure as a single underlying exposure and must not look through to the originally securitized underlying exposures.

(7) Exposure-weighted average loss given default (EWALGD). EWALGD is calculated as:

$$EWALGD = \frac{\sum_i LGD_i \cdot EAD_i}{\sum_i EAD_i}$$

where LGD_i represents the average LGD associated with all exposures to the i^{th} obligor. In the case of a re-securitization, an LGD of 100 percent must be assumed for the underlying exposures that are themselves securitization exposures.

(f) Simplified method for computing N and EWALGD. (1) If all underlying exposures of a securitization are retail exposures, a [bank] may apply the SFA using the following simplifications:

(i) h = 0; and

(ii) v = 0.

(2) Under the conditions in paragraphs (f)(3) and (f)(4), a [bank] may employ a simplified method for calculating N and EWALGD.

(3) If C_1 is no more than 0.03, a [bank] may set EWALGD = 0.50 if none of the underlying exposures is a securitization exposure or EWALGD = 1 if one or more of the underlying exposures is a securitization exposure, and may set N equal to the following amount:

$$N = \frac{1}{C_1 C_m + \left(\frac{C_m - C_1}{m-1}\right)\max(1 - mC_1, 0)}$$

where:

(i) C_m is the ratio of the sum of the amounts of the 'm' largest underlying exposures to UE; and

(ii) The level of m is to be selected by the [bank].

(4) Alternatively, if only C_1 is available and C_1 is no more than 0.03, the [bank] may set EWALGD = 0.50 if none of the underlying exposures is a securitization exposure or EWALGD = 1 if one or more of the underlying exposures is a securitization exposure and may set $N = 1/C_1$.

Section 46. Recognition of Credit Risk Mitigants for Securitization Exposures

(a) General. An originating [bank] that has obtained a credit risk mitigant to hedge its securitization exposure to a synthetic or traditional securitization that satisfies the operational criteria in section 41 may recognize the credit risk mitigant, but only as provided in this section. An investing [bank] that has obtained a credit risk mitigant to hedge a securitization exposure may recognize the credit risk mitigant, but only as provided in this section. A [bank] that has used the RBA in section 43 or the IAA in section 44 to calculate its risk-based capital requirement for a securitization exposure whose external or inferred rating (or equivalent internal rating under the IAA) reflects the benefits of a credit risk mitigant provided to the associated securitization or that supports some or all of the underlying exposures may not use the credit risk mitigation rules in this section to further reduce its risk-based capital requirement for the exposure to reflect that credit risk mitigant.

(b) Collateral - (1) Rules of recognition. A [bank] may recognize financial collateral in determining the [bank]'s risk-based capital requirement for a securitization exposure (other than a repo-style transaction, an eligible margin loan, or an OTC derivative contract for which the [bank] has reflected collateral in its determination of exposure amount under section 32) as follows. The [bank]'s risk-based capital requirement for the collateralized securitization exposure is equal to the risk-based capital requirement for the securitization exposure as calculated under the RBA in section 43 or under the SFA in section 45 multiplied by the ratio of adjusted exposure amount (SE*) to original exposure amount (SE), where:

(i) $SE^* = \max \{0, [SE - C \times (1 - Hs - Hfx)]\}$;

(ii) SE = the amount of the securitization exposure calculated under paragraph (e) of section 42;

(iii) C = the current market value of the collateral;

(iv) Hs = the haircut appropriate to the collateral type; and

(v) Hfx = the haircut appropriate for any currency mismatch between the collateral and the exposure.

(2) Mixed collateral. Where the collateral is a basket of different asset types or a basket of assets denominated in different currencies, the haircut on the basket will be $H = \sum_i a_i H_i$, where a_i is the current market value of the asset in the basket divided by the current market value of all assets in the basket and H_i is the haircut applicable to that asset.

(3) Standard supervisory haircuts. Unless a [bank] qualifies for use of and uses own-estimates haircuts in paragraph (b)(4) of this section:

(i) A [bank] must use the collateral type haircuts (Hs) in Table 3;

(ii) A [bank] must use a currency mismatch haircut (Hfx) of 8 percent if the exposure and the collateral are denominated in different currencies;

(iii) A [bank] must multiply the supervisory haircuts obtained in paragraphs (b)(3)(i) and (ii) by the square root of 6.5 (which equals 2.549510); and

(iv) A [bank] must adjust the supervisory haircuts upward on the basis of a holding period longer than 65 business days where and as appropriate to take into account the illiquidity of the collateral.

(4) Own estimates for haircuts. With the prior written approval of the [AGENCY], a [bank] may calculate haircuts using its own internal estimates of market

price volatility and foreign exchange volatility, subject to paragraph (b)(2)(iii) of section 32. The minimum holding period (T_M) for securitization exposures is 65 business days.

(c) Guarantees and credit derivatives - (1) Limitations on recognition. A [bank] may only recognize an eligible guarantee or eligible credit derivative provided by an eligible securitization guarantor in determining the [bank]'s risk-based capital requirement for a securitization exposure.

(2) ECL for securitization exposures. When a [bank] recognizes an eligible guarantee or eligible credit derivative provided by an eligible securitization guarantor in determining the [bank]'s risk-based capital requirement for a securitization exposure, the [bank] must also:

(i) Calculate ECL for the protected portion of the exposure using the same risk parameters that it uses for calculating the risk-weighted asset amount of the exposure as described in paragraph (c)(3) of this section; and

(ii) Add the exposure's ECL to the [bank]'s total ECL.

(3) Rules of recognition. A [bank] may recognize an eligible guarantee or eligible credit derivative provided by an eligible securitization guarantor in determining the [bank]'s risk-based capital requirement for the securitization exposure as follows:

(i) Full coverage. If the protection amount of the eligible guarantee or eligible credit derivative equals or exceeds the amount of the securitization exposure, the [bank] may set the risk-weighted asset amount for the securitization exposure equal to the risk-weighted asset amount for a direct exposure to the eligible securitization guarantor (as determined in the wholesale risk weight function described in section 31), using the

[bank]'s PD for the guarantor, the [bank]'s LGD for the guarantee or credit derivative, and an EAD equal to the amount of the securitization exposure (as determined in paragraph (e) of section 42).

(ii) Partial coverage. If the protection amount of the eligible guarantee or eligible credit derivative is less than the amount of the securitization exposure, the [bank] may set the risk-weighted asset amount for the securitization exposure equal to the sum of:

(A) Covered portion. The risk-weighted asset amount for a direct exposure to the eligible securitization guarantor (as determined in the wholesale risk weight function described in section 31), using the [bank]'s PD for the guarantor, the [bank]'s LGD for the guarantee or credit derivative, and an EAD equal to the protection amount of the credit risk mitigant; and

(B) Uncovered portion. (1) 1.0 minus the ratio of the protection amount of the eligible guarantee or eligible credit derivative to the amount of the securitization exposure); multiplied by

(2) The risk-weighted asset amount for the securitization exposure without the credit risk mitigant (as determined in sections 42-45).

(4) Mismatches. The [bank] must make applicable adjustments to the protection amount as required in paragraphs (d), (e), and (f) of section 33 for any hedged securitization exposure and any more senior securitization exposure that benefits from the hedge. In the context of a synthetic securitization, when an eligible guarantee or eligible credit derivative covers multiple hedged exposures that have different residual maturities, the [bank] must use the longest residual maturity of any of the hedged exposures as the residual maturity of all the hedged exposures.

Section 47. Risk-Based Capital Requirement for Early Amortization Provisions

(a) General. (1) An originating [bank] must hold risk-based capital against the sum of the originating [bank]'s interest and the investors' interest in a securitization that:

(i) Includes one or more underlying exposures in which the borrower is permitted to vary the drawn amount within an agreed limit under a line of credit; and

(ii) Contains an early amortization provision.

(2) For securitizations described in paragraph (a)(1) of this section, an originating [bank] must calculate the risk-based capital requirement for the originating [bank]'s interest under sections 42-45, and the risk-based capital requirement for the investors' interest under paragraph (b) of this section.

(b) Risk-weighted asset amount for investors' interest. The originating [bank]'s risk-weighted asset amount for the investors' interest in the securitization is equal to the product of the following 5 quantities:

(1) The investors' interest EAD;

(2) The appropriate conversion factor in paragraph (c) of this section;

(3) K_{IRB} (as defined in paragraph (e)(3) of section 45);

(4) 12.5; and

(5) The proportion of the underlying exposures in which the borrower is permitted to vary the drawn amount within an agreed limit under a line of credit.

(c) Conversion factor. (1) (i) Except as provided in paragraph (c)(2) of this section, to calculate the appropriate conversion factor, a [bank] must use Table 8 for a securitization that contains a controlled early amortization provision and must use Table 9 for a securitization that contains a non-controlled early amortization provision. In

circumstances where a securitization contains a mix of retail and nonretail exposures or a mix of committed and uncommitted exposures, a [bank] may take a pro rata approach to determining the conversion factor for the securitization's early amortization provision. If a pro rata approach is not feasible, a [bank] must treat the mixed securitization as a securitization of nonretail exposures if a single underlying exposure is a nonretail exposure and must treat the mixed securitization as a securitization of committed exposures if a single underlying exposure is a committed exposure.

(ii) To find the appropriate conversion factor in the tables, a [bank] must divide the three-month average annualized excess spread of the securitization by the excess spread trapping point in the securitization structure. In securitizations that do not require excess spread to be trapped, or that specify trapping points based primarily on performance measures other than the three-month average annualized excess spread, the excess spread trapping point is 4.5 percent.

Table 8 – Controlled Early Amortization Provisions

	Uncommitted	**Committed**
Retail Credit Lines	**Three-month average annualized excess spread Conversion Factor (CF)**	90% CF
	133.33% of trapping point or more 0% CF	
	less than 133.33% to 100% of trapping point 1% CF	
	less than 100% to 75% of trapping point 2% CF	
	less than 75% to 50% of trapping point 10% CF	
	less than 50% to 25% of trapping	

	point 20% CF	
	less than 25% of trapping point 40% CF	
Non-retail Credit Lines	90% CF	90% CF

Table 9 – Non-Controlled Early Amortization Provisions

	Uncommitted	**Committed**
Retail Credit Lines	**Three-month average annualized excess spread Conversion Factor (CF)**	100% CF
	133.33% of trapping point or more 0% CF	
	less than 133.33% to 100% of trapping point 5% CF	
	less than 100% to 75% of trapping point 15% CF	
	less than 75% to 50% of trapping point 50% CF	
	less than 50% of trapping point 100% CF	
Non-retail Credit Lines	100% CF	100% CF

(2) For a securitization for which all or substantially all of the underlying exposures are residential mortgage exposures, a [bank] may calculate the appropriate conversion factor using paragraph (c)(1) of this section or may use a conversion factor of 10 percent. If the [bank] chooses to use a conversion factor of 10 percent, it must use that conversion factor for all securitizations for which all or substantially all of the underlying exposures are residential mortgage exposures.

Part VI. Risk-Weighted Assets for Equity Exposures

Section 51. Introduction and Exposure Measurement

(a) General. To calculate its risk-weighted asset amounts for equity exposures that are not equity exposures to investment funds, a [bank] may apply either the Simple Risk Weight Approach (SRWA) in section 52 or, if it qualifies to do so, the Internal Models Approach (IMA) in section 53. A [bank] must use the look-through approaches in section 54 to calculate its risk-weighted asset amounts for equity exposures to investment funds.

(b) Adjusted carrying value. For purposes of this part, the adjusted carrying value of an equity exposure is:

(1) For the on-balance sheet component of an equity exposure, the [bank]'s carrying value of the exposure reduced by any unrealized gains on the exposure that are reflected in such carrying value but excluded from the [bank]'s tier 1 and tier 2 capital; and

(2) For the off-balance sheet component of an equity exposure, the effective notional principal amount of the exposure, the size of which is equivalent to a hypothetical on-balance sheet position in the underlying equity instrument that would evidence the same change in fair value (measured in dollars) for a given small change in the price of the underlying equity instrument, minus the adjusted carrying value of the on-balance sheet component of the exposure as calculated in paragraph (b)(1) of this section. For unfunded equity commitments that are unconditional, the effective notional principal amount is the notional amount of the commitment. For unfunded equity commitments that are conditional, the effective notional principal amount is the [bank]'s best estimate of the amount that would be funded under economic downturn conditions.

Section 52. Simple Risk Weight Approach (SRWA)

(a) General. Under the SRWA, a [bank]'s aggregate risk-weighted asset amount for its equity exposures is equal to the sum of the risk-weighted asset amounts for each of the [bank]'s individual equity exposures (other than equity exposures to an investment fund) as determined in this section and the risk-weighted asset amounts for each of the [bank]'s individual equity exposures to an investment fund as determined in section 54.

(b) SRWA computation for individual equity exposures. A [bank] must determine the risk-weighted asset amount for an individual equity exposure (other than an equity exposure to an investment fund) by multiplying the adjusted carrying value of the equity exposure or the effective portion and ineffective portion of a hedge pair (as defined in paragraph (c) of this section) by the lowest applicable risk weight in this paragraph (b).

(1) 0 percent risk weight equity exposures. An equity exposure to an entity whose credit exposures are exempt from the 0.03 percent PD floor in paragraph (d)(2) of section 31 is assigned a 0 percent risk weight.

(2) 20 percent risk weight equity exposures. An equity exposure to a Federal Home Loan Bank or Farmer Mac is assigned a 20 percent risk weight.

(3) 100 percent risk weight equity exposures. The following equity exposures are assigned a 100 percent risk weight:

(i) Community development equity exposures. An equity exposure that qualifies as a community development investment under 12 U.S.C. 24(Eleventh), excluding equity exposures to an unconsolidated small business investment company and equity exposures

held through a consolidated small business investment company described in section 302 of the Small Business Investment Act of 1958 (15 U.S.C. 682).

(ii) Effective portion of hedge pairs. The effective portion of a hedge pair.

(iii) Non-significant equity exposures. Equity exposures, excluding exposures to an investment firm that (1) would meet the definition of a traditional securitization were it not for the [AGENCY]'s application of paragraph (8) of that definition and (2) has greater than immaterial leverage, to the extent that the aggregate adjusted carrying value of the exposures does not exceed 10 percent of the [bank]'s tier 1 capital plus tier 2 capital.

(A) To compute the aggregate adjusted carrying value of a [bank]'s equity exposures for purposes of this paragraph (b)(3)(iii), the [bank] may exclude equity exposures described in paragraphs (b)(1), (b)(2), (b)(3)(i), and (b)(3)(ii) of this section, the equity exposure in a hedge pair with the smaller adjusted carrying value, and a proportion of each equity exposure to an investment fund equal to the proportion of the assets of the investment fund that are not equity exposures or that meet the criterion of paragraph (b)(3)(i) of this section. If a [bank] does not know the actual holdings of the investment fund, the [bank] may calculate the proportion of the assets of the fund that are not equity exposures based on the terms of the prospectus, partnership agreement, or similar contract that defines the fund's permissible investments. If the sum of the investment limits for all exposure classes within the fund exceeds 100 percent, the [bank] must assume for purposes of this paragraph (b)(3)(iii) that the investment fund invests to the maximum extent possible in equity exposures.

(B) When determining which of a [bank]'s equity exposures qualify for a 100 percent risk weight under this paragraph, a [bank] first must include equity exposures to unconsolidated small business investment companies or held through consolidated small business investment companies described in section 302 of the Small Business Investment Act of 1958 (15 U.S.C. 682), then must include publicly traded equity exposures (including those held indirectly through investment funds), and then must include non-publicly traded equity exposures (including those held indirectly through investment funds).

(4) 300 percent risk weight equity exposures. A publicly traded equity exposure (other than an equity exposure described in paragraph (b)(6) of this section and including the ineffective portion of a hedge pair) is assigned a 300 percent risk weight.

(5) 400 percent risk weight equity exposures. An equity exposure (other than an equity exposure described in paragraph (b)(6) of this section) that is not publicly traded is assigned a 400 percent risk weight.

(6) 600 percent risk weight equity exposures. An equity exposure to an investment firm that (i) would meet the definition of a traditional securitization were it not for the [AGENCY]'s application of paragraph (8) of that definition and (ii) has greater than immaterial leverage is assigned a 600 percent risk weight.

(c) Hedge transactions - (1) Hedge pair. A hedge pair is two equity exposures that form an effective hedge so long as each equity exposure is publicly traded or has a return that is primarily based on a publicly traded equity exposure.

(2) Effective hedge. Two equity exposures form an effective hedge if the exposures either have the same remaining maturity or each has a remaining maturity of at

least three months; the hedge relationship is formally documented in a prospective manner (that is, before the [bank] acquires at least one of the equity exposures); the documentation specifies the measure of effectiveness (E) the [bank] will use for the hedge relationship throughout the life of the transaction; and the hedge relationship has an E greater than or equal to 0.8. A [bank] must measure E at least quarterly and must use one of three alternative measures of E:

(i) Under the dollar-offset method of measuring effectiveness, the [bank] must determine the ratio of value change (RVC). The RVC is the ratio of the cumulative sum of the periodic changes in value of one equity exposure to the cumulative sum of the periodic changes in the value of the other equity exposure. If RVC is positive, the hedge is not effective and E equals 0. If RVC is negative and greater than or equal to -1 (that is, between zero and -1), then E equals the absolute value of RVC. If RVC is negative and less than -1, then E equals 2 plus RVC.

(ii) Under the variability-reduction method of measuring effectiveness:

$$E = 1 - \frac{\sum_{t=1}^{T} \left(X_t - X_{t-1} \right)^2}{\sum_{t=1}^{T} \left(A_t - A_{t-1} \right)^2}, \text{ where}$$

(A) $X_t = A_t - B_t$;

(B) $A_t =$ the value at time t of one exposure in a hedge pair; and

(C) $B_t =$ the value at time t of the other exposure in a hedge pair.

(iii) Under the regression method of measuring effectiveness, E equals the coefficient of determination of a regression in which the change in value of one exposure in a hedge pair is the dependent variable and the change in value of the other exposure in a hedge pair is the independent variable. However, if the estimated regression coefficient is positive, then the value of E is zero.

(3) The effective portion of a hedge pair is E multiplied by the greater of the adjusted carrying values of the equity exposures forming a hedge pair.

(4) The ineffective portion of a hedge pair is (1-E) multiplied by the greater of the adjusted carrying values of the equity exposures forming a hedge pair.

Section 53. Internal Models Approach (IMA)

(a) General. A [bank] may calculate its risk-weighted asset amount for equity exposures using the IMA by modeling publicly traded and non-publicly traded equity exposures (in accordance with paragraph (c) of this section) or by modeling only publicly traded equity exposures (in accordance with paragraph (d) of this section).

(b) Qualifying criteria. To qualify to use the IMA to calculate risk-based capital requirements for equity exposures, a [bank] must receive prior written approval from the [AGENCY]. To receive such approval, the [bank] must demonstrate to the [AGENCY]'s satisfaction that the [bank] meets the following criteria:

(1) The [bank] must have one or more models that:

(i) Assess the potential decline in value of its modeled equity exposures;

(ii) Are commensurate with the size, complexity, and composition of the [bank]'s modeled equity exposures; and

(iii) Adequately capture both general market risk and idiosyncratic risk.

(2) The [bank]'s model must produce an estimate of potential losses for its modeled equity exposures that is no less than the estimate of potential losses produced by a VaR methodology employing a 99.0 percent, one-tailed confidence interval of the distribution of quarterly returns for a benchmark portfolio of equity exposures comparable to the [bank]'s modeled equity exposures using a long-term sample period.

(3) The number of risk factors and exposures in the sample and the data period used for quantification in the [bank]'s model and benchmarking exercise must be sufficient to provide confidence in the accuracy and robustness of the [bank]'s estimates.

(4) The [bank]'s model and benchmarking process must incorporate data that are relevant in representing the risk profile of the [bank]'s modeled equity exposures, and must include data from at least one equity market cycle containing adverse market movements relevant to the risk profile of the [bank]'s modeled equity exposures. In addition, the [bank]'s benchmarking exercise must be based on daily market prices for the benchmark portfolio. If the [bank]'s model uses a scenario methodology, the [bank] must demonstrate that the model produces a conservative estimate of potential losses on the [bank]'s modeled equity exposures over a relevant long-term market cycle. If the [bank] employs risk factor models, the [bank] must demonstrate through empirical analysis the appropriateness of the risk factors used.

(5) The [bank] must be able to demonstrate, using theoretical arguments and empirical evidence, that any proxies used in the modeling process are comparable to the [bank]'s modeled equity exposures and that the [bank] has made appropriate adjustments for differences. The [bank] must derive any proxies for its modeled equity exposures and benchmark portfolio using historical market data that are relevant to the [bank]'s modeled

equity exposures and benchmark portfolio (or, where not, must use appropriately adjusted data), and such proxies must be robust estimates of the risk of the [bank]'s modeled equity exposures.

(c) Risk-weighted assets calculation for a [bank] modeling publicly traded and non-publicly traded equity exposures. If a [bank] models publicly traded and non-publicly traded equity exposures, the [bank]'s aggregate risk-weighted asset amount for its equity exposures is equal to the sum of:

(1) The risk-weighted asset amount of each equity exposure that qualifies for a 0 percent, 20 percent, or 100 percent risk weight under paragraphs (b)(1) through (b)(3)(i) of section 52 (as determined under section 52) and each equity exposure to an investment fund (as determined under section 54); and

(2) The greater of:

(i) The estimate of potential losses on the [bank]'s equity exposures (other than equity exposures referenced in paragraph (c)(1) of this section) generated by the [bank]'s internal equity exposure model multiplied by 12.5; or

(ii) The sum of:

(A) 200 percent multiplied by the aggregate adjusted carrying value of the [bank]'s publicly traded equity exposures that do not belong to a hedge pair, do not qualify for a 0 percent, 20 percent, or 100 percent risk weight under paragraphs (b)(1) through (b)(3)(i) of section 52, and are not equity exposures to an investment fund;

(B) 200 percent multiplied by the aggregate ineffective portion of all hedge pairs; and

(C) 300 percent multiplied by the aggregate adjusted carrying value of the [bank]'s equity exposures that are not publicly traded, do not qualify for a 0 percent, 20 percent, or 100 percent risk weight under paragraphs (b)(1) through (b)(3)(i) of section 52, and are not equity exposures to an investment fund.

(d) Risk-weighted assets calculation for a [bank] using the IMA only for publicly traded equity exposures. If a [bank] models only publicly traded equity exposures, the [bank]'s aggregate risk-weighted asset amount for its equity exposures is equal to the sum of:

(1) The risk-weighted asset amount of each equity exposure that qualifies for a 0 percent, 20 percent, or 100 percent risk weight under paragraphs (b)(1) through (b)(3)(i) of section 52 (as determined under section 52), each equity exposure that qualifies for a 400 percent risk weight under paragraph (b)(5) of section 52 or a 600 percent risk weight under paragraph (b)(6) of section 52 (as determined under section 52), and each equity exposure to an investment fund (as determined under section 54); and

(2) The greater of:

(i) The estimate of potential losses on the [bank]'s equity exposures (other than equity exposures referenced in paragraph (d)(1) of this section) generated by the [bank]'s internal equity exposure model multiplied by 12.5; or

(ii) The sum of:

(A) 200 percent multiplied by the aggregate adjusted carrying value of the [bank]'s publicly traded equity exposures that do not belong to a hedge pair, do not qualify for a 0 percent, 20 percent, or 100 percent risk weight under paragraphs (b)(1) through (b)(3)(i) of section 52, and are not equity exposures to an investment fund; and

(B) 200 percent multiplied by the aggregate ineffective portion of all hedge pairs.

Section 54. Equity Exposures to Investment Funds

(a) Available approaches. (1) Unless the exposure meets the requirements for a community development equity exposure in paragraph (b)(3)(i) of section 52, a [bank] must determine the risk-weighted asset amount of an equity exposure to an investment fund under the Full Look-Through Approach in paragraph (b) of this section, the Simple Modified Look-Through Approach in paragraph (c) of this section, the Alternative Modified Look-Through Approach in paragraph (d) of this section, or, if the investment fund qualifies for the Money Market Fund Approach, the Money Market Fund Approach in paragraph (e) of this section.

(2) The risk-weighted asset amount of an equity exposure to an investment fund that meets the requirements for a community development equity exposure in paragraph (b)(3)(i) of section 52 is its adjusted carrying value.

(3) If an equity exposure to an investment fund is part of a hedge pair and the [bank] does not use the Full Look-Through Approach, the [bank] may use the ineffective portion of the hedge pair as determined under paragraph (c) of section 52 as the adjusted carrying value for the equity exposure to the investment fund. The risk-weighted asset amount of the effective portion of the hedge pair is equal to its adjusted carrying value.

(b) Full Look-Through Approach. A [bank] that is able to calculate a risk-weighted asset amount for its proportional ownership share of each exposure held by the investment fund (as calculated under this appendix as if the proportional ownership share of each exposure were held directly by the [bank]) may either:

(1) Set the risk-weighted asset amount of the [bank]'s exposure to the fund equal to the product of:

(i) The aggregate risk-weighted asset amounts of the exposures held by the fund as if they were held directly by the [bank]; and

(ii) The [bank]'s proportional ownership share of the fund; or

(2) Include the [bank]'s proportional ownership share of each exposure held by the fund in the [bank]'s IMA.

(c) Simple Modified Look-Through Approach. Under this approach, the risk-weighted asset amount for a [bank]'s equity exposure to an investment fund equals the adjusted carrying value of the equity exposure multiplied by the highest risk weight in Table 10 that applies to any exposure the fund is permitted to hold under its prospectus, partnership agreement, or similar contract that defines the fund's permissible investments (excluding derivative contracts that are used for hedging rather than speculative purposes and that do not constitute a material portion of the fund's exposures).

Table 10 – Modified Look-Through Approaches for Equity Exposures to Investment Funds

Risk Weight	Exposure Class
0 percent	Sovereign exposures with a long-term applicable external rating in the highest investment-grade rating category and sovereign exposures of the United States
20 percent	Non-sovereign exposures with a long-term applicable external rating in the highest or second-highest investment-grade rating category; exposures with a short-term applicable external rating in the highest investment-grade rating category; and exposures to, or guaranteed by, depository institutions, foreign banks (as defined in 12 CFR 211.2), or securities firms subject to consolidated supervision and regulation comparable to that imposed on U.S. securities broker-dealers that are repo-style transactions or bankers' acceptances

50 percent	Exposures with a long-term applicable external rating in the third-highest investment-grade rating category or a short-term applicable external rating in the second-highest investment-grade rating category
100 percent	Exposures with a long-term or short-term applicable external rating in the lowest investment-grade rating category
200 percent	Exposures with a long-term applicable external rating one rating category below investment grade
300 percent	Publicly traded equity exposures
400 percent	Non-publicly traded equity exposures; exposures with a long-term applicable external rating two rating categories or more below investment grade; and exposures without an external rating (excluding publicly traded equity exposures)
1,250 percent	OTC derivative contracts and exposures that must be deducted from regulatory capital or receive a risk weight greater than 400 percent under this appendix

(d) Alternative Modified Look-Through Approach. Under this approach, a [bank] may assign the adjusted carrying value of an equity exposure to an investment fund on a pro rata basis to different risk weight categories in Table 10 based on the investment limits in the fund's prospectus, partnership agreement, or similar contract that defines the fund's permissible investments. The risk-weighted asset amount for the [bank]'s equity exposure to the investment fund equals the sum of each portion of the adjusted carrying value assigned to an exposure class multiplied by the applicable risk weight. If the sum of the investment limits for exposure classes within the fund exceeds 100 percent, the [bank] must assume that the fund invests to the maximum extent permitted under its investment limits in the exposure class with the highest risk weight under Table 10, and continues to make investments in order of the exposure class with the next highest risk weight under Table 10 until the maximum total investment level is reached. If more than one exposure class applies to an exposure, the [bank] must use the highest applicable risk

weight. A [bank] may exclude derivative contracts held by the fund that are used for hedging rather than for speculative purposes and do not constitute a material portion of the fund's exposures.

(e) Money Market Fund Approach. The risk-weighted asset amount for a [bank]'s equity exposure to an investment fund that is a money market fund subject to 17 CFR 270.2a-7 and that has an applicable external rating in the highest investment-grade rating category equals the adjusted carrying value of the equity exposure multiplied by 7 percent.

Section 55. Equity Derivative Contracts

Under the IMA, in addition to holding risk-based capital against an equity derivative contract under this part, a [bank] must hold risk-based capital against the counterparty credit risk in the equity derivative contract by also treating the equity derivative contract as a wholesale exposure and computing a supplemental risk-weighted asset amount for the contract under part IV. Under the SRWA, a [bank] may choose not to hold risk-based capital against the counterparty credit risk of equity derivative contracts, as long as it does so for all such contracts. Where the equity derivative contracts are subject to a qualified master netting agreement, a [bank] using the SRWA must either include all or exclude all of the contracts from any measure used to determine counterparty credit risk exposure.

Part VII. Risk-Weighted Assets for Operational Risk

Section 61. Qualification Requirements for Incorporation of Operational Risk Mitigants

(a) Qualification to use operational risk mitigants. A [bank] may adjust its estimate of operational risk exposure to reflect qualifying operational risk mitigants if:

(1) The [bank]'s operational risk quantification system is able to generate an estimate of the [bank]'s operational risk exposure (which does not incorporate qualifying operational risk mitigants) and an estimate of the [bank]'s operational risk exposure adjusted to incorporate qualifying operational risk mitigants; and

(2) The [bank]'s methodology for incorporating the effects of insurance, if the [bank] uses insurance as an operational risk mitigant, captures through appropriate discounts to the amount of risk mitigation:

(i) The residual term of the policy, where less than one year;

(ii) The cancellation terms of the policy, where less than one year;

(iii) The policy's timeliness of payment;

(iv) The uncertainty of payment by the provider of the policy; and

(v) Mismatches in coverage between the policy and the hedged operational loss event.

(b) Qualifying operational risk mitigants. Qualifying operational risk mitigants are:

(1) Insurance that:

(i) Is provided by an unaffiliated company that has a claims payment ability that is rated in one of the three highest rating categories by a NRSRO;

(ii) Has an initial term of at least one year and a residual term of more than 90 days;

(iii) Has a minimum notice period for cancellation by the provider of 90 days;

(iv) Has no exclusions or limitations based upon regulatory action or for the receiver or liquidator of a failed depository institution; and

(v) Is explicitly mapped to a potential operational loss event; and

(2) Operational risk mitigants other than insurance for which the [AGENCY] has given prior written approval. In evaluating an operational risk mitigant other than insurance, the [AGENCY] will consider whether the operational risk mitigant covers potential operational losses in a manner equivalent to holding regulatory capital.

Section 62. Mechanics of Risk-Weighted Asset Calculation

(a) If a [bank] does not qualify to use or does not have qualifying operational risk mitigants, the [bank]'s dollar risk-based capital requirement for operational risk is its operational risk exposure minus eligible operational risk offsets (if any).

(b) If a [bank] qualifies to use operational risk mitigants and has qualifying operational risk mitigants, the [bank]'s dollar risk-based capital requirement for operational risk is the greater of:

(1) The [bank]'s operational risk exposure adjusted for qualifying operational risk mitigants minus eligible operational risk offsets (if any); or

(2) 0.8 multiplied by the difference between:

(i) The [bank]'s operational risk exposure; and

(ii) Eligible operational risk offsets (if any).

(c) The [bank]'s risk-weighted asset amount for operational risk equals the [bank]'s dollar risk-based capital requirement for operational risk determined under paragraph (a) or (b) of this section multiplied by 12.5.

Part VIII. Disclosure

Section 71. Disclosure Requirements

(a) Each [bank] must publicly disclose each quarter its total and tier 1 risk-based capital ratios and their components (that is, tier 1 capital, tier 2 capital, total qualifying capital, and total risk-weighted assets).[5]

[Disclosure paragraph (b)]

[Disclosure paragraph (c)]

END OF COMMON RULE.
[END OF COMMON TEXT]

List of Subjects

12 CFR Part 3

Administrative practices and procedure, Capital, National banks, Reporting and recordkeeping requirements, Risk.

12 CFR Part 208

Confidential business information, Crime, Currency, Federal Reserve System, Mortgages, reporting and recordkeeping requirements, 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 nonmember banks.

12 CFR Part 559

[5] Other public disclosure requirements continue to apply - for example, Federal securities law and regulatory reporting requirements.

Reporting and recordkeeping requirements, Savings associations, Subsidiaries.

12 CFR Part 560

Consumer protection, Investments, Manufactured homes, Mortgages, Reporting and recordkeeping requirements, Savings associations, Securities.

12 CFR Part 563

Accounting, Administrative practice and procedure, Advertising, Conflict of interest, Crime, Currency, Holding companies, Investments, Mortgages, Reporting and recordkeeping requirements, Savings associations, Securities, Surety bond.

12 CFR Part 567

Capital, Reporting and recordkeeping requirements, Savings associations.

Adoption of Common Appendix

The adoption of the final common rules by the agencies, as modified by 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 stated in the common preamble, the Office of the Comptroller of the Currency amends Part 3 of chapter I of Title 12, Code of Federal Regulations as follows:

PART 3—MINIMUM CAPITAL RATIOS; ISSUANCE OF DIRECTIVES

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

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

2. New Appendix C to part 3 is added as set forth at the end of the common preamble.

3. Appendix C to part 3 is amended as set forth below:

a. Remove "[AGENCY]" and add "OCC" in its place wherever it appears.

b. Remove "[bank]" and add "bank" in its place wherever it appears, remove "[banks]" and add "banks" in its place wherever it appears, remove "[Banks]" and add "Banks" in its place wherever it appears, and remove "[Bank]" and add "Bank" in its place wherever it appears.

c. Remove "[Appendix __ to Part __]" and add "Appendix C to Part 3" in its place wherever it appears.

d. Remove "[the general risk-based capital rules]" and add "12 CFR part 3, Appendix A" in its place wherever it appears.

e. Remove “[the market risk rule]” and add “12 CFR part 3, Appendix B” in its place wherever it appears.

f. Remove “[Disclosure paragraph (b)]” and add in its place “(b) A bank must comply with paragraph (c) of section 71 of appendix G to the Federal Reserve Board’s Regulation Y (12 CFR part 225, appendix G) unless it is a consolidated subsidiary of a bank holding company or depository institution that is subject to these requirements.”

g. Remove “[Disclosure paragraph (c)].”

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

12 CFR Chapter II

Authority and Issuance

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

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

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

Authority: 12 U.S.C. 24, 36, 92a, 93a, 248(a), 248(c), 321-338a, 371d, 461, 481-486, 601, 611, 1814, 1816, 1818, 1820(d)(9), 1823(j), 1828(o), 1831, 1831o, 1831p-1, 1831r-1, 1835a, 1882, 2901-2907, 3105, 3310, 3331-3351, and 3906-3909; 15 U.S.C. 78b, 78l(b), 78l(g), 78l(i), 78o-4(c)(5), 78q, 78q-1, and 78w, 6801, and 6805; 31 U.S.C. 5318; 42 U.S.C. 4012a, 4104a, 4104b, 4106, and 4128.

2. New Appendix F to part 208 is added as set forth at the end of the common preamble.

3. Appendix F to part 208 is amended as set forth below:

a. Remove "[AGENCY]" and add "Federal Reserve" in its place wherever it appears.

b. Remove "[bank]" and add "bank" in its place wherever it appears, remove "[banks]" and add "banks" in its place wherever it appears, remove "[Banks]" and add "Banks" in its place wherever it appears, and remove "[Bank]" and add "Bank" in its place wherever it appears.

c. Remove "[Appendix __ to Part __]" and add "Appendix F to Part 208" in its place wherever it appears.

d. Remove "[the general risk-based capital rules]" and add "12 CFR part 208, Appendix A" in its place wherever it appears.

e. Remove "[the market risk rule]" and add "12 CFR part 208, Appendix E" in its place wherever it appears.

f. Remove "[Disclosure paragraph (b)]" and add in its place "(b) A bank must comply with paragraph (c) of section 71 of appendix G to the Federal Reserve Board's Regulation Y (12 CFR part 225, appendix G) unless it is a consolidated subsidiary of a bank holding company or depository institution that is subject to these requirements."

g. Remove "[Disclosure paragraph (c)]."

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

1. 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. 6801 and 6805.

2. New Appendix G to part 225 is added as set forth at the end of the common preamble.

3. Appendix G to part 225 is amended as set forth below:

a. Remove "[AGENCY]" and add "Federal Reserve" in its place wherever it appears.

b. Remove "[bank]" and add in its place "bank holding company" wherever it appears, remove "[banks]" and add "bank holding companies" in its place wherever it appears, remove "[Banks]" and add "Bank holding companies" in its place wherever it appears, and remove "[Bank]" and add "Bank holding company" in its place wherever it appears.

c. Remove "[Appendix __ to Part __]" and add "Appendix G to Part 225" in its place wherever it appears.

d. Remove "[the general risk-based capital rules]" and add "12 CFR part 225, Appendix A" in its place wherever it appears.

e. Remove "[the market risk rule]" and add "12 CFR part 225, Appendix E" in its place wherever it appears.

f. Remove the text of section 1(b)(1) and add in its place: "This appendix applies to a bank holding company that:

(i) Is not a consolidated subsidiary of another bank holding company that uses this appendix to calculate its risk-based capital requirements; and

(ii) That:

(A) Is a U.S.-based bank holding company that has total consolidated assets (excluding assets held by an insurance underwriting subsidiary), as reported on the most recent year-end FR Y-9C, equal to $250 billion or more;

(B) Has consolidated total on-balance sheet foreign exposure at the most recent year-end equal to $10 billion or more (where total on-balance sheet foreign exposure equals total cross-border claims less claims with head office or guarantor located in another country plus redistributed guaranteed amounts to the country of head office or guarantor plus local country claims on local residents plus revaluation gains on foreign exchange and derivative products, calculated in accordance with the Federal Financial Institutions Examination Council (FFIEC) 009 Country Exposure Report); or

(C) Has a subsidiary depository institution (as defined in 12 U.S.C. 1813) that is required, or has elected, to use 12 CFR part 3, Appendix C, 12 CFR part 208, Appendix F, 12 CFR part 325, Appendix F, or 12 CFR part 567, Appendix C to calculate its risk-based capital requirements."

g. Add a new paragraph (8) to section 11(c): "A bank holding company must also 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 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."

h. Remove section 22(h)(3)(ii).

i. In section 31(e)(3), remove "A bank may assign a risk-weighted asset amount of zero to cash owned and held in all offices of the bank or in transit and to gold bullion held in the bank's own vaults, or held in another bank's vaults on an allocated basis, to the extent it is offset by gold bullion liabilities" and add in its place "A bank holding company may assign a risk-weighted asset amount of zero to cash owned and held in all offices of subsidiary depository institutions or in transit and for gold bullion held in either a subsidiary depository institution's own vaults, or held in another depository institution's vaults on an allocated basis, to the extent it is offset by gold bullion liabilities."

j. In section 71, remove "[Disclosure paragraph (b)]."

k. In section 71, remove "[Disclosure paragraph (c)]."

l. In section 71, add new paragraph (b) to read as follows:

Section 71. * * *

* * * * *

(b) (1) Each consolidated bank holding company that is not a subsidiary of a non-U.S. banking organization that is subject to comparable public disclosure requirements in its home jurisdiction and has successfully completed its parallel run must provide timely public disclosures each calendar quarter of the information in tables 11.1 – 11.11 below. If a significant change occurs, such that the most recent reported amounts are no longer reflective of the bank holding company's capital adequacy and risk profile, then a brief discussion of this change and its likely impact must be provided as soon as practicable

thereafter. Qualitative disclosures that typically do not change each quarter (for example, a general summary of the bank holding company's risk management objectives and policies, reporting system, and definitions) may be disclosed annually, provided any significant changes to these are disclosed in the interim. Management is encouraged to provide all of the disclosures required by this appendix in one place on the bank holding company's public website.[6] The bank holding company must make these disclosures publicly available for each of the last three years (that is, twelve quarters) or such shorter period since it began its first floor period.

(2) Each bank holding company is required to have a formal disclosure policy approved by the board of directors that addresses its approach for determining the disclosures it makes. The policy must address the associated internal controls and disclosure controls and procedures. The board of directors and senior management are responsible for establishing and maintaining an effective internal control structure over financial reporting, including the disclosures required by this appendix, and must ensure that appropriate review of the disclosures takes place. One or more senior officers of the bank holding company must attest that the disclosures meet the requirements of this appendix.

(3) If a bank holding company believes that disclosure of specific commercial or financial information would prejudice seriously its position by making public information that is either proprietary or confidential in nature, the bank holding company need not disclose those specific items, but must disclose more general information about the

[6] Alternatively, a bank holding company may provide the disclosures in more than one place, as some of them may be included in public financial reports (for example, in Management's Discussion and Analysis included in SEC filings) or other regulatory reports. The bank holding company must provide a summary table on its public website that specifically indicates where all the disclosures may be found (for example, regulatory report schedules, page numbers in annual reports).

subject matter of the requirement, together with the fact that, and the reason why, the specific items of information have not been disclosed.

Table 11.1 – Scope of Application

Qualitative Disclosures	(a)	The name of the top corporate entity in the group to which the appendix applies.
	(b)	An outline of differences in the basis of consolidation for accounting and regulatory purposes, with a brief description of the entities[7] within the group (a) that are fully consolidated; (b) that are deconsolidated and deducted; (c) for which the regulatory capital requirement is deducted; and (d) that are neither consolidated nor deducted (for example, where the investment is risk-weighted).
	(c)	Any restrictions, or other major impediments, on transfer of funds or regulatory capital within the group.
Quantitative Disclosures	(d)	The aggregate amount of surplus capital of insurance subsidiaries (whether deducted or subjected to an alternative method) included in the regulatory capital of the consolidated group.
	(e)	The aggregate amount by which actual regulatory capital is less than the minimum regulatory capital requirement in all subsidiaries with regulatory capital requirements and the name(s) of the subsidiaries with such deficiencies.

[7] Entities include securities, insurance and other financial subsidiaries, commercial subsidiaries (where permitted), and significant minority equity investments in insurance, financial and commercial entities.

Table 11.2 – Capital Structure

Qualitative Disclosures	(a)	Summary information on the terms and conditions of the main features of all capital instruments, especially in the case of innovative, complex or hybrid capital instruments.
Quantitative Disclosures	(b)	The amount of tier 1 capital, with separate disclosure of: • common stock/surplus; • retained earnings; • minority interests in the equity of subsidiaries; • restricted core capital elements as defined in 12 CFR part 225, Appendix A; • regulatory calculation differences deducted from tier 1 capital;[8] and • other amounts deducted from tier 1 capital, including goodwill and certain intangibles.
	(c)	The total amount of tier 2 capital.
	(d)	Other deductions from capital.[9]
	(e)	Total eligible capital.

[8] Representing 50 percent of the amount, if any, by which total expected credit losses as calculated within the IRB approach exceed eligible credit reserves, which must be deducted from tier 1 capital.
[9] Including 50 percent of the amount, if any, by which total expected credit losses as calculated within the IRB approach exceed eligible credit reserves, which must be deducted from tier 2 capital.

Table 11.3 – Capital Adequacy

Qualitative disclosures	(a)	A summary discussion of the bank holding company's approach to assessing the adequacy of its capital to support current and future activities.

Quantitative disclosures	(b)	Risk-weighted assets for credit risk from:
		• Wholesale exposures;
		• Residential mortgage exposures;
		• Qualifying revolving exposures;
		• Other retail exposures;
		• Securitization exposures;
		• Equity exposures
		  • Equity exposures subject to the simple risk weight approach; and
		  • Equity exposures subject to the internal models approach.

	(c)	Risk-weighted assets for market risk as calculated under [the market risk rule]:[10] • Standardized approach for specific risk; and • Internal models approach for specific risk.
	(d)	Risk-weighted assets for operational risk.
	(e)	Total and tier 1 risk-based capital ratios:[11] • For the top consolidated group; and • For each DI subsidiary.

General qualitative disclosure requirement

For each separate risk area described in tables 11.4 through 11.11, the bank holding company must describe its risk management objectives and policies, including:

- strategies and processes;
- the structure and organization of the relevant risk management function;
- the scope and nature of risk reporting and/or measurement systems;
- policies for hedging and/or mitigating risk and strategies and processes for monitoring the continuing effectiveness of hedges/mitigants.

[10] Risk-weighted assets determined under [the market risk rule] are to be disclosed only for the approaches used.
[11] Total risk-weighted assets should also be disclosed.

Table 11.4[12] – Credit Risk: General Disclosures

Qualitative Disclosures	(a)	The general qualitative disclosure requirement with respect to credit risk (excluding counterparty credit risk disclosed in accordance with Table 11.6), including: • Definitions of past due and impaired (for accounting purposes); • Description of approaches followed for allowances, including statistical methods used where applicable; and • Discussion of the bank holding company's credit risk management policy.
Quantitative Disclosures	(b)	Total credit risk exposures and average credit risk exposures, after accounting offsets in accordance with GAAP,[13] and without taking into account the effects of credit risk mitigation techniques (for example, collateral and netting), over the period broken down by major types of credit exposure.[14]
	(c)	Geographic[15] distribution of exposures, broken down in significant areas by major types of credit exposure.
	(d)	Industry or counterparty type distribution of exposures, broken down by major types of credit exposure.
	(e)	Remaining contractual maturity breakdown (for example, one year or less) of the whole portfolio, broken down by major types of credit exposure.
	(f)	By major industry or counterparty type: • Amount of impaired loans; • Amount of past due loans;[16] • Allowances; and • Charge-offs during the period.
	(g)	Amount of impaired loans and, if available, the amount of past due loans broken down by significant geographic areas including, if practical, the amounts of allowances related to each geographical area.[17]

[12] Table 4 does not include equity exposures.
[13] For example, FASB Interpretations 39 and 41.
[14] For example, bank holding companies could apply a breakdown similar to that used for accounting purposes. Such a breakdown might, for instance, be (a) loans, off-balance sheet commitments, and other non-derivative off-balance sheet exposures, (b) debt securities, and (c) OTC derivatives.
[15] Geographical areas may comprise individual countries, groups of countries, or regions within countries. A bank holding company might choose to define the geographical areas based on the way the company's portfolio is geographically managed. The criteria used to allocate the loans to geographical areas must be specified.
[16] A bank holding company is encouraged also to provide an analysis of the aging of past-due loans.
[17] The portion of general allowance that is not allocated to a geographical area should be disclosed separately.

	(h)	Reconciliation of changes in the allowance for loan and lease losses.[18]

Table 11.5 – Credit Risk: Disclosures for Portfolios Subject to IRB Risk-Based Capital Formulas

Qualitative disclosures	(a)	Explanation and review of the: • Structure of internal rating systems and relation between internal and external ratings; • Use of risk parameter estimates other than for regulatory capital purposes; • Process for managing and recognizing credit risk mitigation (see table 11.7); and • Control mechanisms for the rating system, including discussion of independence, accountability, and rating systems review.

	(b)	Description of the internal ratings process, provided separately for the following:
		• Wholesale category;
		• Retail subcategories;
		  • Residential mortgage exposures;
		  • Qualifying revolving exposures; and
		  • Other retail exposures.
		For each category and subcategory the description should include:
		• The types of exposure included in the category/subcategories; and
		• The definitions, methods and data for estimation and validation of PD, LGD, and EAD, including assumptions employed in the derivation of these variables.[19]

[18] The reconciliation should include the following: a description of the allowance; the opening balance of the allowance; charge-offs taken against the allowance during the period; amounts provided (or reversed) for estimated probable loan losses during the period; any other adjustments (for example, exchange rate differences, business combinations, acquisitions and disposals of subsidiaries), including transfers between allowances; and the closing balance of the allowance. Charge-offs and recoveries that have been recorded directly to the income statement should be disclosed separately.

[19] This disclosure does not require a detailed description of the model in full – it should provide the reader with a broad overview of the model approach, describing definitions of the variables and methods for estimating and validating those variables set out in the quantitative risk disclosures below. This should be done for each of the four category/subcategories. The bank holding company should disclose any significant differences in approach to estimating these variables within each category/subcategories.

Quantitative disclosures: risk assessment	(c)	For wholesale exposures, present the following information across a sufficient number of PD grades (including default) to allow for a meaningful differentiation of credit risk:[20] • Total EAD;[21] • Exposure-weighted average LGD (percentage**)**; • Exposure-weighted average risk weight; and • Amount of undrawn commitments and exposure-weighted average EAD for wholesale exposures. For each retail subcategory, present the disclosures outlined above across a sufficient number of segments to allow for a meaningful differentiation of credit risk.

[20] The PD, LGD and EAD disclosures in Table 11.5(c) should reflect the effects of collateral, qualifying master netting agreements, eligible guarantees and eligible credit derivatives as defined in part I. Disclosure of each PD grade should include the exposure-weighted average PD for each grade. Where a bank holding company aggregates PD grades for the purposes of disclosure, this should be a representative breakdown of the distribution of PD grades used for regulatory capital purposes.

[21] Outstanding loans and EAD on undrawn commitments can be presented on a combined basis for these disclosures.

Quantitative disclosures: historical results	(d)	Actual losses in the preceding period for each category and subcategory and how this differs from past experience. A discussion of the factors that impacted the loss experience in the preceding period – for example, has the bank holding company experienced higher than average default rates, loss rates or EADs.
	(e)	Bank holding company's estimates compared against actual outcomes over a longer period.[22] At a minimum, this should include information on estimates of losses against actual losses in the wholesale category and each retail subcategory over a period sufficient to allow for a meaningful assessment of the performance of the internal rating processes for each category/subcategory.[23] Where appropriate, the bank holding company should further decompose this to provide analysis of PD, LGD, and EAD outcomes against estimates provided in the quantitative risk assessment disclosures above.[24]

[22] These disclosures are a way of further informing the reader about the reliability of the information provided in the "quantitative disclosures: risk assessment" over the long run. The disclosures are requirements from year-end 2010; in the meantime, early adoption is encouraged. The phased implementation is to allow a bank holding company sufficient time to build up a longer run of data that will make these disclosures meaningful.

[23] This regulation is not prescriptive about the period used for this assessment. Upon implementation, it might be expected that a bank holding company would provide these disclosures for as long run of data as possible – for example, if a bank holding company has 10 years of data, it might choose to disclose the average default rates for each PD grade over that 10-year period. Annual amounts need not be disclosed.

[24] A bank holding company should provide this further decomposition where it will allow users greater insight into the reliability of the estimates provided in the "quantitative disclosures: risk assessment." In particular, it should provide this information where there are material differences between its estimates of PD, LGD or EAD compared to actual outcomes over the long run. The bank holding company should also provide explanations for such differences.

Table 11.6 – General Disclosure for Counterparty Credit Risk of OTC Derivative Contracts, Repo-Style Transactions, and Eligible Margin Loans

Qualitative Disclosures	(a)	The general qualitative disclosure requirement with respect to OTC derivatives, eligible margin loans, and repo-style transactions, including: • Discussion of methodology used to assign economic capital and credit limits for counterparty credit exposures; • Discussion of policies for securing collateral, valuing and managing collateral, and establishing credit reserves; • Discussion of the primary types of collateral taken; • Discussion of policies with respect to wrong-way risk exposures; and • Discussion of the impact of the amount of collateral the bank holding company would have to provide if the bank holding company were to receive a credit rating downgrade.
Quantitative Disclosures	(b)	Gross positive fair value of contracts, netting benefits, netted current credit exposure, collateral held (including type, for example, cash, government securities), and net unsecured credit exposure.[25] Also report measures for EAD used for regulatory capital for these transactions, the notional value of credit derivative hedges purchased for counterparty credit risk protection, and, for bank holding companies not using the internal models methodology in section 32(d), the distribution of current credit exposure by types of credit exposure.[26]
	(c)	Notional amount of purchased and sold credit derivatives, segregated between use for the bank holding company's own credit portfolio and for its intermediation activities, including the distribution of the credit derivative products used, broken down further by protection bought and sold within each product group.
	(d)	The estimate of alpha if the bank holding company has received supervisory approval to estimate alpha.

Table 11.7 – Credit Risk Mitigation [27,28, 29]

[25] Net unsecured credit exposure is the credit exposure after considering the benefits from legally enforceable netting agreements and collateral arrangements, without taking into account haircuts for price volatility, liquidity, etc.

[26] This may include interest rate derivative contracts, foreign exchange derivative contracts, equity derivative contracts, credit derivatives, commodity or other derivative contracts, repo-style transactions, and eligible margin loans.

[27] At a minimum, a bank holding company must provide the disclosures in Table 11.7 in relation to credit risk mitigation that has been recognized for the purposes of reducing capital requirements under this appendix. Where relevant, bank holding companies are encouraged to give further information about mitigants that have not been recognized for that purpose.

Qualitative Disclosures	(a)	The general qualitative disclosure requirement with respect to credit risk mitigation including: • policies and processes for, and an indication of the extent to which the bank holding company uses, on- and off-balance sheet netting; • policies and processes for collateral valuation and management; • a description of the main types of collateral taken by the bank holding company; • the main types of guarantors/credit derivative counterparties and their creditworthiness; and • information about (market or credit) risk concentrations within the mitigation taken.
Quantitative Disclosures	(b)	For each separately disclosed portfolio, the total exposure (after, where applicable, on- or off-balance sheet netting) that is covered by guarantees/credit derivatives.

[28] Credit derivatives that are treated, for the purposes of this appendix, as synthetic securitization exposures should be excluded from the credit risk mitigation disclosures and included within those relating to securitization.

[29] Counterparty credit risk-related exposures disclosed pursuant to Table 11.6 should be excluded from the credit risk mitigation disclosures in Table 11.7.

Table 11.8 – Securitization

Qualitative disclosures	(a)	The general qualitative disclosure requirement with respect to securitization (including synthetics), including a discussion of: • the bank holding company's objectives relating to securitization activity, including the extent to which these activities transfer credit risk of the underlying exposures away from the bank holding company to other entities; • the roles played by the bank holding company in the securitization process[30] and an indication of the extent of the bank holding company's involvement in each of them; and • the regulatory capital approaches (for example, RBA, IAA and SFA) that the bank holding company follows for its securitization activities.
	(b)	Summary of the bank holding company's accounting policies for securitization activities, including: • whether the transactions are treated as sales or financings; • recognition of gain-on-sale; • key assumptions for valuing retained interests, including any significant changes since the last reporting period and the impact of such changes; and • treatment of synthetic securitizations.
	(c)	Names of NRSROs used for securitizations and the types of securitization exposure for which each agency is used.
Quantitative disclosures	(d)	The total outstanding exposures securitized by the bank holding company in securitizations that meet the operational criteria in section 41 (broken down into traditional/synthetic), by underlying exposure type.[31,32,33]

[30] For example: originator, investor, servicer, provider of credit enhancement, sponsor of asset backed commercial paper facility, liquidity provider, or swap provider.
[31] Underlying exposure types may include, for example, one- to four-family residential loans, home equity lines, credit card receivables, and auto loans.
[32] Securitization transactions in which the originating bank holding company does not retain any securitization exposure should be shown separately but need only be reported for the year of inception.
[33] Where relevant, a bank holding company is encouraged to differentiate between exposures resulting from activities in which they act only as sponsors, and exposures that result from all other bank holding company securitization activities.

	(e)	For exposures securitized by the bank holding company in securitizations that meet the operational criteria in Section 41: • amount of securitized assets that are impaired/past due; and • losses recognized by the bank holding company during the current period[34] broken down by exposure type.
	(f)	Aggregate amount of securitization exposures broken down by underlying exposure type.
	(g)	Aggregate amount of securitization exposures and the associated IRB capital requirements for these exposures broken down into a meaningful number of risk weight bands. Exposures that have been deducted from capital should be disclosed separately by type of underlying asset.
	(h)	For securitizations subject to the early amortization treatment, the following items by underlying asset type for securitized facilities: • the aggregate drawn exposures attributed to the seller's and investors' interests; and • the aggregate IRB capital charges incurred by the bank holding company against the investors' shares of drawn balances and undrawn lines.
	(i)	Summary of current year's securitization activity, including the amount of exposures securitized (by exposure type), and recognized gain or loss on sale by asset type.

Table 11.9 – Operational Risk

Qualitative disclosures	(a)	The general qualitative disclosure requirement for operational risk.
	(b)	Description of the AMA, including a discussion of relevant internal and external factors considered in the bank holding company's measurement approach.
	(c)	A description of the use of insurance for the purpose of mitigating operational risk.

[34] For example, charge-offs/allowances (if the assets remain on the bank holding company's balance sheet) or write-downs of I/O strips and other residual interests.

Table 11.10 – Equities Not Subject to Market Risk Rule

Qualitative Disclosures	(a)	The general qualitative disclosure requirement with respect to equity risk, including: • differentiation between holdings on which capital gains are expected and those held for other objectives, including for relationship and strategic reasons; and • discussion of important policies covering the valuation of and accounting for equity holdings in the banking book. This includes the accounting techniques and valuation methodologies used, including key assumptions and practices affecting valuation as well as significant changes in these practices.
Quantitative Disclosures	(b)	Value disclosed in the balance sheet of investments, as well as the fair value of those investments; for quoted securities, a comparison to publicly-quoted share values where the share price is materially different from fair value.
	(c)	The types and nature of investments, including the amount that is: • Publicly traded; and • Non-publicly traded.
	(d)	The cumulative realized gains (losses) arising from sales and liquidations in the reporting period.
	(e)	• Total unrealized gains (losses)[35] • Total latent revaluation gains (losses)[36] • Any amounts of the above included in tier 1 and/or tier 2 capital.
	(f)	Capital requirements broken down by appropriate equity groupings, consistent with the bank holding company's methodology, as well as the aggregate amounts and the type of equity investments subject to any supervisory transition regarding regulatory capital requirements.[37]

[35] Unrealized gains (losses) recognized in the balance sheet but not through earnings.
[36] Unrealized gains (losses) not recognized either in the balance sheet or through earnings.
[37] This disclosure should include a breakdown of equities that are subject to the 0 percent, 20 percent, 100 percent, 300 percent, 400 percent, and 600 percent risk weights, as applicable.

Table 11.11 – Interest Rate Risk for Non-trading Activities

Qualitative disclosures	(a)	The general qualitative disclosure requirement, including the nature of interest rate risk for non-trading activities and key assumptions, including assumptions regarding loan prepayments and behavior of non-maturity deposits, and frequency of measurement of interest rate risk for non-trading activities.
Quantitative disclosures	(b)	The increase (decline) in earnings or economic value (or relevant measure used by management) for upward and downward rate shocks according to management's method for measuring interest rate risk for non-trading activities, broken down by currency (as appropriate).

* * * * *

FEDERAL DEPOSIT INSURANCE CORPORATION
12 CFR Chapter III

Authority and Issuance

For the reasons stated in the common preamble, the Federal Deposit Insurance Corporation amends part 325 of chapter III of title 12 of the Code of Federal Regulations as follows:

PART 325—CAPITAL MAINTENANCE

1. The authority citation for part 325 continues to read as follows:

Authority: 12 U.S.C. 1815(a), 1815(b), 1816, 1818(a), 1818(b), 1818(c), 1818(t), 1819(Tenth), 1828(c), 1828(d), 1828(i), 1828(n), 1828(o), 1831o, 1835, 3907, 3909, 4808; Pub. L. 102-233, 105 Stat. 1761, 1789, 1790 (12 U.S.C. 1831n note); Pub. L. 102-242, 105 Stat. 2236, 2355, 2386 (12 U.S.C. 1828 note).

2. New Appendix D to part 325 is added as set forth at the end of the common preamble.

3. Appendix D to part 325 is amended as set forth below:

a. Remove "[AGENCY]" and add "FDIC" in its place wherever it appears.

b. Remove "[bank]" and add "bank" in its place wherever it appears, remove "[banks]" and add "banks" in its place wherever it appears, remove "[Banks]" and add "Banks" in its place wherever it appears, and remove "[Bank]" and add "Bank" in its place wherever it appears.

c. Remove "[Appendix __ to Part __]" and add "Appendix D to Part 325" in its place wherever it appears.

d. Remove "[the general risk-based capital rules]" and add "12 CFR part 325, Appendix A" in its place wherever it appears.

e. Remove “[the market risk rule]” and add “12 CFR part 325, Appendix C” in its place wherever it appears.

f. Remove “[Disclosure paragraph (b)]” and add in its place “(b) A bank must comply with paragraph (c) of section 71 of appendix G to the Federal Reserve Board’s Regulation Y (12 CFR part 225, appendix G) unless it is a consolidated subsidiary of a bank holding company or depository institution that is subject to these requirements.”

g. Remove “[Disclosure paragraph (c)].”

DEPARTMENT OF THE TREASURY

OFFICE OF THRIFT SUPERVISION

12 CFR Chapter V

Authority and issuance

For the reasons set out in the preamble, the Office of Thrift Supervision amends Chapter 12 of title 12 of the Code of Federal Regulations to read as follows:

PART 559 –SUBORDINATE ORGANIZATIONS

1. The authority citation for part 559 continues to read as follows:

Authority: 12 U.S.C. 1462, 1462a, 1463, 1464, 1467a, 1828.

2. Revise § 559.5(b)(1) to read as follows:

§ 559.5 How much may a savings association invest in service corporations or lower tier entities?

*** * * * ***

(b) * * *

(1) You and your GAAP-consolidated subsidiaries may, in the aggregate, make loans of up to 15% of your total capital, as described in part 567 of this chapter to each subordinate organization that does not qualify as a GAAP-consolidated subsidiary. All loans made under this paragraph (b)(1) may not, in the aggregate, exceed 50% of your total capital, as described in part 567 of this chapter.

* * * * *

PART 560 – LENDING AND INVESTMENT

3. The authority citation for part 560 continues to read as follows:

Authority: 12 U.S.C. 1462, 1462a, 1463, 1464, 1467a, 1701j-3, 1828, 3803, 3806, 42 U.S.C. 4106.

§ 560.101 [amended]

4. In footnote 2 to the appendix to §560.101, remove the phrase "as defined at 12 CFR 567.5(c)" and add the phrase "as described in part 567 of this chapter" in its place.

PART 563 –SAVINGS ASSOCIATIONS – OPERATIONS

5. The authority citation for part 563 continues to read as follows:

Authority: 12 U.S.C. 375b, 1462, 1462a, 1463, 1464, 1467a, 1468, 1817, 1820, 1828, 1831o, 3806; 31 U.S.C. 5318; 42 U.S.C. 4106.

§ 563.74 [amended]

6. Amend § 563.74 as follows:

a. In paragraph (i)(2)(iv), remove the phrase "regulatory capital requirement under § 567.2 of this chapter" and add the phrase "regulatory capital requirements under part 567 of this chapter" in its place.

b. In paragraph (i)(v) remove the phrase "regulatory capital requirement under § 567.2 of this chapter" and add the phrase "regulatory capital requirements under part 567 of this chapter" in its place.

§ 563.81 [amended]

7. Amend § 563.83 as follows:

a. In paragraph (a), remove the phrase "in supplementary capital under 12 CFR 567.5(b)" and add the phrase "in supplementary capital (tier 2 capital) under part 567 of this chapter" in its place.

b. In paragraph (d)(2)(ii), remove the phrase "regulatory capital requirements at § 567.2 of this chapter" and add the phrase "regulatory capital requirements at part 567 of this chapter" in its place.

§ 563.141 [amended]

8. In § 563.141(b), delete the phrase "in your total capital under 12 CFR 567.5 of this chapter" and add the phrase "in your total capital under part 567 of this chapter" in its place.

§ 563.142 [amended]

9. In § 563.142, amend the definition of "capital" by deleting the phrase "total capital, as described under 12 CFR 567.5(c) of this chapter" and adding the phrase "total capital, as computed under part 567 of this chapter" in its place.

PART 567 – CAPITAL

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

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

11. Add a new subpart A to read as follows

Subpart A – Scope

§ 567.0 Scope.

(a) This part prescribes the minimum regulatory capital requirements for savings associations. Subpart B of this part applies to all savings associations, except as described in paragraph (b) of this section.

(b)(1) A savings association that uses Appendix C of this part must comply with the minimum qualifying criteria for internal risk measurement and management processes for calculating risk-based capital requirements, utilize the methodologies for calculating

risk-based capital requirements, and make the required disclosures described in that appendix.

(2) Subpart B of this part does not apply to the computation of risk-based capital requirements by a savings association that uses Appendix C of this part. However, these savings associations must:

(i) Must compute the components of capital under § 567.5, subject to the modifications in sections 11 and 12 of Appendix C of this part.

(ii) Must meet the leverage ratio requirement at §§ 567.2(a)(2) and 567.8 with tier 1 capital, as computed under sections 11 and 12 of Appendix C of this part.

(iii) Must meet the tangible capital requirement described at §§ 567.2(a)(3) and 567.9.

(iv) Are subject to §§ 567.3 (individual minimum capital requirement), 567.4 (capital directives); and 567.10 (consequences of failure to meet capital requirements).

(v) Are subject to the reservations of authority at § 567.11, which supplement the reservations of authority at section 1 of Appendix C of this part.

12. Designate §§ 567.1 through 567.6 and §§ 567.8 through 567.12 as subpart B and add a heading for subpart B to read as follows:

Subpart B – Regulatory Capital Requirements

13. Revise the introductory sentence to § 567.1 to read as follows:

§ 567.1 Definitions.

For the purposes of this subpart:

* * * * *

13. In § 567.3, revise paragraphs (a), (b), and (d) to read as follows:

§ 567.3 Individual minimum capital requirements.

(a) Purpose and scope. The rules and procedures specified in this section apply to the establishment of an individual minimum capital requirement for a savings association that varies from the risk-based capital requirement, the leverage ratio requirement or the tangible capital requirement that would otherwise apply to the savings association under this part.

(b) Appropriate considerations for establishing individual minimum capital requirements. Minimum capital levels higher than the risk-based capital requirement, the leverage ratio requirement or the tangible capital requirement required under this part may be appropriate for individual savings associations. Increased individual minimum capital requirements may be established upon a determination that the savings association's capital is or may become inadequate in view of its circumstances. For example, higher capital levels may be appropriate for: * * *

* * * * *

(d) Procedures -- (1) Notification. When the OTS determines that a minimum capital requirement is necessary or appropriate for a particular savings association, it shall notify the savings association in writing of its proposed individual minimum capital requirement; the schedule for compliance with the new requirement; and the specific causes for determining that the higher individual minimum capital requirement is necessary or appropriate for the savings association. The OTS shall forward the notifying letter to the appropriate state supervisor if a state-chartered savings association would be subject to an individual minimum capital requirement.

* * * * *

14. Revise (a)(1) of § 567.4 to read as follows:

§ 567.4 Capital directives.

(a) Issuance of a Capital Directive -- (1) Purpose. In addition to any other action authorized by law, the Office, may issue a capital directive to a savings association that does not have an amount of capital satisfying its minimum capital requirement. Issuance of such a capital directive may be based on a savings association's noncompliance with the risk-based capital requirement, the leverage ratio requirement, the tangible capital requirement, or individual minimum capital requirement established under this part, by a written agreement under 12 U.S.C. 1464(s), or as a condition for approval of an application. A capital directive may order a savings association to: * * *

* * ** *

15. Revise paragraph (e) of § 567.10 to read as follows

§ 567.10 Consequences of failure to meet capital requirements.

* * * * *

(e) If a savings association fails to meet the risk-based capital requirement, the leverage ratio requirement, or the tangible capital requirement established under this part, the Director may, through enforcement proceedings or otherwise, require such savings association to take one or more of the following corrective actions:

* * * * *

16. Appendices A and B are added to part 567, and are reserved.

17. Appendix C is added to part 567 as set forth at the end of the common preamble.

8. Revise Appendix C of part 567 as follows:

a. Retitle Appendix C as follows: Risk-Based Capital Requirements - Internal-Ratings-Based and Advanced Measurement Approaches".

b. Remove [AGENCY] and add "OTS" in its place wherever it appears.

c. Remove "[bank]" and add "savings association" in its place wherever it appears, remove "[banks]" and add "savings associations" in its place wherever it appears, remove "[Banks]" and add "Savings associations" in its place wherever it appears, and remove "[Bank]" and add "Savings association" in its place wherever it appears.

d. Remove "[Appendix __ to Part __]" and add "Appendix C to Part 567" in its place wherever it appears.

e. Remove "[the general risk-based capital rules]" and add "subpart B of part 567" in its place wherever it appears.

f. Remove "[the market risk rule]" and add "any applicable market risk rule" in its place wherever it appears.

g. In section 1, revise paragraph (b)(1)(i), the last sentence in paragraph (b)(3), and the last sentence in paragraph (c)(1) to read as follows:

Section 1 Purpose, Applicability, Reservation of Authority, and Principle of Conservatism.

* * * * *

(b) Applicability. (1) * * *

(i) Has consolidated assets, as reported on the most recent year-end Thrift Financial Report (TFR) equal to $250 billion or more; * * *

(3) * * * In making a determination under this paragraph, the OTS will apply notice and response procedures in the same manner and to the same extent as the notice and response procedures in §567.3(d).

(c) Reservation of authority – (1) * * * In making a determination under this paragraph, the OTS will apply notice and response procedures in the same manner and to the same extent as the notice and response procedures in §567.3(d).

* * * * *

h. In section 2, revise the definition of eligible credit reserves, the definition of excluded mortgage exposure, paragraph (1) of the definition of exposure at default (EAD), the definition of gain-on-sale, paragraph (2)(i) of the definition of high volatility commercial real estate (HVCRE) exposure, and paragraph (7) of the definition of traditional securitization, to read as follows:

Section 2 Definitions.

******

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 specific reserves created against recognized losses.

* * * * *

Excluded mortgage exposure means any one- to four-family residential pre-sold construction loan for a residence for which the purchase contract is cancelled that would receive a 100 percent risk weight under section 618(a)(2) of the Resolution Trust Corporation Refinancing, Restructuring, and Improvement Act and under 12 CFR 567.1 (definition of "qualifying residential construction loan") and 12 CFR 567.6(a)(1)(iv).

* * * * *

Exposure at default (EAD).

(1) For the on-balance sheet component of a wholesale exposure or segment of retail exposures (other than an OTC derivative contract, or a repo-style transaction, or eligible margin loan for which the savings association determines EAD under section 32), EAD means:

(i) If the exposure or segment is a security classified as available-for-sale, the savings associations carrying value (including net accrued but unpaid interest and fees) for the exposure or segment less any unrealized gains on the exposure or segment and plus any unrealized losses on the exposure or segment; or

(ii) If the exposure or segment is not a security classified as available-for-sale, the savings association's carrying value (including net accrued but unpaid interest and fees) for the exposure or segment.

* * * * * *

Gain-on-sale means an increase in the equity capital (as reported on Schedule SC of the Thrift Financial Report) of a savings association that results from a securitization (other than an increase in equity capital that results from the savings association's receipt of cash in connection with the securitization).

* * * * *

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: *** * ***

(2) * * *

(i) The loan-to-value ratio is less than or equal to the applicable maximum supervisory loan-to-value ratio in the OTS's real estate lending standards at 12 CFR 560.100-560.101;

* * * * *

Traditional securitization means a transaction in which:* * *

(7) The underlying exposures are not owned by a firm an investment in which is designed primarily to promote community welfare, including the welfare of low- and moderate-income communities or families, such as by providing services or jobs.

* * * * *

i. Revise section 12 to read as follows:

Section 12 Deductions and limitations not required.

(a) Deduction of CEIOs. A savings association is not required to make the deduction from capital for CEIOs in 12 CFR 567.5(a)(2)(iii) and 567.12(e).

(b) Deduction for certain equity investments. A savings association is not required to deduct equity securities from capital under 12 CFR 567.5(c)(2)(ii). However, it must continue to deduct equity investments in real estate under that section. See 12 CFR 567.1, which defines equity investments, including equity securities and equity investments in real estate.

j. Revise the fourth sentence of section 24(a) to read as follows:

Section 24 Merger and Acquisition Transition Arrangements

(a) Mergers and acquisitions of companies without advanced systems. * * * During the period when subpart A of this part applies to the merged or acquired company, any ALLL associated with the merged or acquired company's exposures may be included in the savings association's tier 2 capital up to 1.25 percent of the acquired company's risk-weighted assets. * * *

* * * ** *

k. Revise the first sentence of paragraph (k)(1)(iv) and paragraph (k)(4) of section 42 to read as follows:

Section 42 Risk-Based Capital Requirement for Securitization Exposures.

* * * * *

(k) * * *

(1) * * *

(iv) The savings association is well capitalized, as defined in the OTS 's prompt corrective action regulation at 12 CFR part 565. * * *

(4) The risk-based capital ratios of the savings association must be calculated without regard to the capital treatment for transfers of small-business obligations with recourse specified in paragraph (k)(1) of this section as provided in 12 CFR 567.6(b)(5)(v).

l. Revise paragraph (b)(3)(i) of section 52 to read as follows:

Section 52 Simple Risk Weight Approach

* * * * *

(b) * * *

(3) * * *

(i) An equity exposure that is designed primarily to promote community welfare, including the welfare of low- and moderate-income communities or families, such as by providing services or jobs, excluding equity exposures to an unconsolidated small business investment company and equity exposures held through a consolidated small business investment company described in section 302 of the Small Business Investment Act of 1958 (15 U.S.C. 682).

* * * * *

m. Remove "[Disclosure paragraph (b)]" and add in its place "(b) A savings association must comply with paragraph (c) of section 71 unless it is a consolidated subsidiary of a depository institution or bank holding company that is subject to these requirements."

n. Remove "[Disclosure paragraph (c)]."

o. In section 71, add new paragraph (c) to read as follows:

Section 71 * * *

* * * * *

(c)(1) Each consolidated savings association described in paragraph (b) of this section that is not a subsidiary of a non-U.S. banking organization that is subject to comparable public disclosure requirements in its home jurisdiction and has successfully completed its parallel run must provide timely public disclosures each calendar quarter of the information in tables 11.1 – 11.11 below. If a significant change occurs, such that the most recent reported amounts are no longer reflective of the savings association's capital

adequacy and risk profile, then a brief discussion of this change and its likely impact must be provided as soon as practicable thereafter. Qualitative disclosures that typically do not change each quarter (for example, a general summary of the savings association's risk management objectives and policies, reporting system, and definitions) may be disclosed annually, provided any significant changes to these are disclosed in the interim. Management is encouraged to provide all of the disclosures required by this appendix in one place on the savings association's public website.[38] The savings association must make these disclosures publicly available for each of the last three years (twelve quarters) or such shorter period since it began its first floor period.

(2) Each savings association is required to have a formal disclosure policy approved by the board of directors that addresses its approach for determining the disclosures it makes. The policy must address the associated internal controls and disclosure controls and procedures. The board of directors and senior management are responsible for establishing and maintaining an effective internal control structure over financial reporting, including the disclosures required by this appendix, and must ensure that appropriate review of the disclosures takes place. One or more senior officers of the savings association must attest that the disclosures required by this appendix meet the requirements of this appendix.

(3) If a savings association believes that disclosure of specific commercial or financial information would prejudice seriously its position by making public information

[38] Alternatively, a savings association may provide the disclosures in more than one place, as some of them may be included in public financial reports (for example, in Management's Discussion and Analysis included in SEC filings) or other regulatory reports. The savings association must provide a summary table on its public website that specifically indicates where all the disclosures may be found (for example, regulatory report schedules, page numbers in annual reports).

that is either proprietary or confidential in nature, the savings association need not disclose those specific items, but must disclose more general information about the subject matter of the requirement, together with the fact that, and the reason why, the specific items of information have not been disclosed.

Table 11.1 – Scope of Application

Qualitative Disclosures	(a)	The name of the top corporate entity in the group to which the appendix applies.
	(b)	An outline of differences in the basis of consolidation for accounting and regulatory purposes, with a brief description of the entities[39] within the group (a) that are fully consolidated; (b) that are deconsolidated and deducted; (c) for which the regulatory capital requirement is deducted; and (d) that are neither consolidated nor deducted (for example, where the investment is risk-weighted).
	(c)	Any restrictions, or other major impediments, on transfer of funds or regulatory capital within the group.
Quantitative Disclosures	(d)	The aggregate amount of surplus capital of insurance subsidiaries (whether deducted or subjected to an alternative method) included in the regulatory capital of the consolidated group.
	(e)	The aggregate amount by which actual regulatory capital is less than the minimum regulatory capital requirement in all subsidiaries with regulatory capital requirements and the name(s) of the subsidiaries with such deficiencies.

[39] Entities include securities, insurance and other financial subsidiaries, commercial subsidiaries (where permitted), and significant minority equity investments in insurance, financial and commercial entities.

Table 11.2 – Capital Structure

Qualitative Disclosures	(a)	Summary information on the terms and conditions of the main features of all capital instruments, especially in the case of innovative, complex or hybrid capital instruments.
Quantitative Disclosures	(b)	The amount of tier 1 capital, with separate disclosure of: • common stock/surplus; • retained earnings; • minority interests in the equity of subsidiaries; • regulatory calculation differences deducted from tier 1 capital;[40] and • other amounts deducted from tier 1 capital, including goodwill and certain intangibles.
	(c)	The total amount of tier 2 capital.
	(d)	Other deductions from capital. [41]
	(e)	Total eligible capital.

[40] Representing 50 percent of the amount, if any, by which total expected credit losses as calculated within the IRB approach exceed eligible credit reserves, which must be deducted from tier 1 capital.
[41] Including 50 percent of the amount, if any, by which total expected credit losses as calculated within the IRB approach exceed eligible credit reserves, which must be deducted from tier 2 capital.

Table 11.3 – Capital Adequacy

Qualitative disclosures	(a)	A summary discussion of the savings association's approach to assessing the adequacy of its capital to support current and future activities.

Quantitative disclosures	(b)	Risk-weighted assets for credit risk from:
		• Wholesale exposures;
		• Residential mortgage exposures;
		• Qualifying revolving exposures;
		• Other retail exposures;
		• Securitization exposures;
		• Equity exposures
		  • Equity exposures subject to the simple risk weight approach; and
		  • Equity exposures subject to the internal models approach.

	(c)	Risk-weighted assets for market risk as calculated under [the market risk rule]:[42] • Standardized approach for specific risk; and • Internal models approach for specific risk.
	(d)	Risk-weighted assets for operational risk.
	(e)	Total and tier 1 risk-based capital ratios:[43] • For the top consolidated group; and • For each DI subsidiary.

General qualitative disclosure requirement

For each separate risk area described in tables 11.4 through 11.11, the savings association must describe its risk management objectives and policies, including:

- strategies and processes;
- the structure and organization of the relevant risk management function;
- the scope and nature of risk reporting and/or measurement systems;
- policies for hedging and/or mitigating risk and strategies and processes for monitoring the continuing effectiveness of hedges/mitigants.

[42] Risk-weighted assets determined under [the market risk rule] are to be disclosed only for the approaches used.
[43] Total risk-weighted assets should also be disclosed.

Table 11.4[44] – Credit Risk: General Disclosures

Qualitative Disclosures	(a)	The general qualitative disclosure requirement with respect to credit risk (excluding counterparty credit risk disclosed in accordance with Table 11.6), including: • Definitions of past due and impaired (for accounting purposes); • Description of approaches followed for allowances, including statistical methods used where applicable; and • Discussion of the savings association's credit risk management policy.
Quantitative Disclosures	(b)	Total credit risk exposures and average credit risk exposures, after accounting offsets in accordance with GAAP,[45] and without taking into account the effects of credit risk mitigation techniques (for example, collateral and netting), over the period broken down by major types of credit exposure.[46]
	(c)	Geographic[47] distribution of exposures, broken down in significant areas by major types of credit exposure.
	(d)	Industry or counterparty type distribution of exposures, broken down by major types of credit exposure.
	(e)	Remaining contractual maturity breakdown (for example, one year or less) of the whole portfolio, broken down by major types of credit exposure.
	(f)	By major industry or counterparty type: • Amount of impaired loans; • Amount of past due loans;[48] • Allowances; and • Charge-offs during the period.
	(g)	Amount of impaired loans and, if available, the amount of past due loans broken down by significant geographic areas including, if practical, the amounts of allowances related to each geographical area.[49]

[44] Table 4 does not include equity exposures.
[45] For example, FASB Interpretations 39 and 41.
[46] For example, savings associations could apply a breakdown similar to that used for accounting purposes. Such a breakdown might, for instance, be (a) loans, off-balance sheet commitments, and other non-derivative off-balance sheet exposures, (b) debt securities, and (c) OTC derivatives.
[47] Geographical areas may comprise individual countries, groups of countries, or regions within countries. A savings association might choose to define the geographical areas based on the way the company's portfolio is geographically managed. The criteria used to allocate the loans to geographical areas must be specified.
[48] A savings association is encouraged also to provide an analysis of the aging of past-due loans.
[49] The portion of general allowance that is not allocated to a geographical area should be disclosed separately.

	(h)	Reconciliation of changes in the allowance for loan and lease losses.[50]

Table 11.5 – Credit Risk: Disclosures for Portfolios Subject to IRB Risk-Based Capital Formulas

Qualitative disclosures	(a)	Explanation and review of the: • Structure of internal rating systems and relation between internal and external ratings; • Use of risk parameter estimates other than for regulatory capital purposes; • Process for managing and recognizing credit risk mitigation (see table 11.7); and • Control mechanisms for the rating system, including discussion of independence, accountability, and rating systems review.

	(b)	Description of the internal ratings process, provided separately for the following:
		• Wholesale category;
		• Retail subcategories;
		  • Residential mortgage exposures;
		  • Qualifying revolving exposures; and
		  • Other retail exposures.
		For each category and subcategory the description should include:
		• The types of exposure included in the category/subcategories; and
		• The definitions, methods and data for estimation and validation of PD, LGD, and EAD, including assumptions employed in the derivation of these variables.[51]

[50] The reconciliation should include the following: a description of the allowance; the opening balance of the allowance; charge-offs taken against the allowance during the period; amounts provided (or reversed) for estimated probable loan losses during the period; any other adjustments (for example, exchange rate differences, business combinations, acquisitions and disposals of subsidiaries), including transfers between allowances; and the closing balance of the allowance. Charge-offs and recoveries that have been recorded directly to the income statement should be disclosed separately.

[51] This disclosure does not require a detailed description of the model in full – it should provide the reader with a broad overview of the model approach, describing definitions of the variables and methods for estimating and validating those variables set out in the quantitative risk disclosures below. This should be done for each of the four category/subcategories. The savings association should disclose any significant differences in approach to estimating these variables within each category/subcategories.

Quantitative disclosures: risk assessment	(c)	For wholesale exposures, present the following information across a sufficient number of PD grades (including default) to allow for a meaningful differentiation of credit risk:[52] • Total EAD;[53] • Exposure-weighted average LGD (percentage**)**; • Exposure-weighted average risk weight; and • Amount of undrawn commitments and exposure-weighted average EAD for wholesale exposures. For each retail subcategory, present the disclosures outlined above across a sufficient number of segments to allow for a meaningful differentiation of credit risk.

[52] The PD, LGD and EAD disclosures in Table 11.5(c) should reflect the effects of collateral, qualifying master netting agreements, eligible guarantees and eligible credit derivatives as defined in part I. Disclosure of each PD grade should include the exposure-weighted average PD for each grade. Where a savings association aggregates PD grades for the purposes of disclosure, this should be a representative breakdown of the distribution of PD grades used for regulatory capital purposes.

[53] Outstanding loans and EAD on undrawn commitments can be presented on a combined basis for these disclosures.

Quantitative disclosures: historical results	(d)	Actual losses in the preceding period for each category and subcategory and how this differs from past experience. A discussion of the factors that impacted the loss experience in the preceding period – for example, has the savings association experienced higher than average default rates, loss rates or EADs.
	(e)	Savings association's estimates compared against actual outcomes over a longer period.[54] At a minimum, this should include information on estimates of losses against actual losses in the wholesale category and each retail subcategory over a period sufficient to allow for a meaningful assessment of the performance of the internal rating processes for each category/subcategory.[55] Where appropriate, the savings association should further decompose this to provide analysis of PD, LGD, and EAD outcomes against estimates provided in the quantitative risk assessment disclosures above.[56]

[54] These disclosures are a way of further informing the reader about the reliability of the information provided in the "quantitative disclosures: risk assessment" over the long run. The disclosures are requirements from year-end 2010; in the meantime, early adoption is encouraged. The phased implementation is to allow a savings association sufficient time to build up a longer run of data that will make these disclosures meaningful.

[55] This regulation is not prescriptive about the period used for this assessment. Upon implementation, it might be expected that a savings association would provide these disclosures for as long run of data as possible – for example, if a savings association has 10 years of data, it might choose to disclose the average default rates for each PD grade over that 10-year period. Annual amounts need not be disclosed.

[56] A savings association should provide this further decomposition where it will allow users greater insight into the reliability of the estimates provided in the "quantitative disclosures: risk assessment." In particular, it should provide this information where there are material differences between its estimates of PD, LGD or EAD compared to actual outcomes over the long run. The savings association should also provide explanations for such differences.

Table 11.6 – General Disclosure for Counterparty Credit Risk of OTC Derivative Contracts, Repo-Style Transactions, and Eligible Margin Loans

Qualitative Disclosures	(a)	The general qualitative disclosure requirement with respect to OTC derivatives, eligible margin loans, and repo-style transactions, including: • Discussion of methodology used to assign economic capital and credit limits for counterparty credit exposures; • Discussion of policies for securing collateral, valuing and managing collateral, and establishing credit reserves; • Discussion of the primary types of collateral taken; • Discussion of policies with respect to wrong-way risk exposures; and • Discussion of the impact of the amount of collateral the savings association would have to provide if the savings association were to receive a credit rating downgrade.
Quantitative Disclosures	(b)	Gross positive fair value of contracts, netting benefits, netted current credit exposure, collateral held (including type, for example, cash, government securities), and net unsecured credit exposure.[57] Also report measures for EAD used for regulatory capital for these transactions, the notional value of credit derivative hedges purchased for counterparty credit risk protection, and, for savings associations not using the internal models methodology in section 32(d), the distribution of current credit exposure by types of credit exposure.[58]
	(c)	Notional amount of purchased and sold credit derivatives, segregated between use for the savings association's own credit portfolio and for its intermediation activities, including the distribution of the credit derivative products used, broken down further by protection bought and sold within each product group.
	(d)	The estimate of alpha if the savings association has received supervisory approval to estimate alpha.

Table 11.7 – Credit Risk Mitigation [59,60, 61]

[57] Net unsecured credit exposure is the credit exposure after considering the benefits from legally enforceable netting agreements and collateral arrangements, without taking into account haircuts for price volatility, liquidity, etc.

[58] This may include interest rate derivative contracts, foreign exchange derivative contracts, equity derivative contracts, credit derivatives, commodity or other derivative contracts, repo-style transactions, and eligible margin loans.

[59] At a minimum, a savings association must provide the disclosures in Table 11.7 in relation to credit risk mitigation that has been recognized for the purposes of reducing capital requirements under this appendix. Where relevant, savings associations are encouraged to give further information about mitigants that have not been recognized for that purpose.

Qualitative Disclosures	(a)	The general qualitative disclosure requirement with respect to credit risk mitigation including: • policies and processes for, and an indication of the extent to which the savings association uses, on- and off-balance sheet netting; • policies and processes for collateral valuation and management; • a description of the main types of collateral taken by the savings association; • the main types of guarantors/credit derivative counterparties and their creditworthiness; and • information about (market or credit) risk concentrations within the mitigation taken.
Quantitative Disclosures	(b)	For each separately disclosed portfolio, the total exposure (after, where applicable, on- or off-balance sheet netting) that is covered by guarantees/credit derivatives.

[60] Credit derivatives that are treated, for the purposes of this appendix, as synthetic securitization exposures should be excluded from the credit risk mitigation disclosures and included within those relating to securitization.

[61] Counterparty credit risk-related exposures disclosed pursuant to Table 11.6 should be excluded from the credit risk mitigation disclosures in Table 11.7.

Table 11.8 – Securitization

Qualitative disclosures	(a)	The general qualitative disclosure requirement with respect to securitization (including synthetics), including a discussion of: • the savings association's objectives relating to securitization activity, including the extent to which these activities transfer credit risk of the underlying exposures away from the savings association to other entities; • the roles played by the savings association in the securitization process[62] and an indication of the extent of the savings association's involvement in each of them; and • the regulatory capital approaches (for example, RBA, IAA and SFA) that the savings association follows for its securitization activities.
	(b)	Summary of the savings association's accounting policies for securitization activities, including: • whether the transactions are treated as sales or financings; • recognition of gain-on-sale; • key assumptions for valuing retained interests, including any significant changes since the last reporting period and the impact of such changes; and • treatment of synthetic securitizations.
	(c)	Names of NRSROs used for securitizations and the types of securitization exposure for which each agency is used.
Quantitative disclosures	(d)	The total outstanding exposures securitized by the savings association in securitizations that meet the operational criteria in section 41 (broken down into traditional/synthetic), by underlying exposure type.[63,64,65]

[62] For example: originator, investor, servicer, provider of credit enhancement, sponsor of asset backed commercial paper facility, liquidity provider, or swap provider.
[63] Underlying exposure types may include, for example, one- to four-family residential loans, home equity lines, credit card receivables, and auto loans.
[64] Securitization transactions in which the originating savings association does not retain any securitization exposure should be shown separately but need only be reported for the year of inception.
[65] Where relevant, a savings association is encouraged to differentiate between exposures resulting from activities in which they act only as sponsors, and exposures that result from all other savings association securitization activities.

	(e)	For exposures securitized by the savings association in securitizations that meet the operational criteria in Section 41: • amount of securitized assets that are impaired/past due; and • losses recognized by the savings association during the current period[66] broken down by exposure type.
	(f)	Aggregate amount of securitization exposures broken down by underlying exposure type.
	(g)	Aggregate amount of securitization exposures and the associated IRB capital requirements for these exposures broken down into a meaningful number of risk weight bands. Exposures that have been deducted from capital should be disclosed separately by type of underlying asset.
	(h)	For securitizations subject to the early amortization treatment, the following items by underlying asset type for securitized facilities: • the aggregate drawn exposures attributed to the seller's and investors' interests; and • the aggregate IRB capital charges incurred by the savings association against the investors' shares of drawn balances and undrawn lines.
	(i)	Summary of current year's securitization activity, including the amount of exposures securitized (by exposure type), and recognized gain or loss on sale by asset type.

Table 11.9 – Operational Risk

Qualitative disclosures	(a)	The general qualitative disclosure requirement for operational risk.
	(b)	Description of the AMA, including a discussion of relevant internal and external factors considered in the savings association's measurement approach.
	(c)	A description of the use of insurance for the purpose of mitigating operational risk.

[66] For example, charge-offs/allowances (if the assets remain on the savings association's balance sheet) or write-downs of I/O strips and other residual interests.

Table 11.10 – Equities Not Subject to Market Risk Rule

Qualitative Disclosures	(a)	The general qualitative disclosure requirement with respect to equity risk, including: • differentiation between holdings on which capital gains are expected and those held for other objectives, including for relationship and strategic reasons; and • discussion of important policies covering the valuation of and accounting for equity holdings in the banking book. This includes the accounting techniques and valuation methodologies used, including key assumptions and practices affecting valuation as well as significant changes in these practices.
Quantitative Disclosures	(b)	Value disclosed in the balance sheet of investments, as well as the fair value of those investments; for quoted securities, a comparison to publicly-quoted share values where the share price is materially different from fair value.
	(c)	The types and nature of investments, including the amount that is: • Publicly traded; and • Non-publicly traded.
	(d)	The cumulative realized gains (losses) arising from sales and liquidations in the reporting period.
	(e)	• Total unrealized gains (losses)[67] • Total latent revaluation gains (losses)[68] • Any amounts of the above included in tier 1 and/or tier 2 capital.
	(f)	Capital requirements broken down by appropriate equity groupings, consistent with the savings association's methodology, as well as the aggregate amounts and the type of equity investments subject to any supervisory transition regarding regulatory capital requirements.[69]

[67] Unrealized gains (losses) recognized in the balance sheet but not through earnings.
[68] Unrealized gains (losses) not recognized either in the balance sheet or through earnings.
[69] This disclosure should include a breakdown of equities that are subject to the 0 percent, 20 percent, 100 percent, 300 percent, 400 percent, and 600 percent risk weights, as applicable.

Table 11.11 – Interest Rate Risk for Non-trading Activities

Qualitative disclosures	(a)	The general qualitative disclosure requirement, including the nature of interest rate risk for non-trading activities and key assumptions, including assumptions regarding loan prepayments and behavior of non-maturity deposits, and frequency of measurement of interest rate risk for non-trading activities.
Quantitative disclosures	(b)	The increase (decline) in earnings or economic value (or relevant measure used by management) for upward and downward rate shocks according to management's method for measuring interest rate risk for non-trading activities, broken down by currency (as appropriate).

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Dated: November XX, 2007

John C. Dugan,
Comptroller of the Currency.

By order of the Board of Governors of the Federal Reserve System, November XX, 2007

Jennifer J. Johnson
Secretary of the Board

Dated at Washington, D.C., this Xth day of November, 2007.
By order of the Board of Directors.
Federal Deposit Insurance Corporation.

Robert E. Feldman,
Executive Secretary.

Dated: November XX, 2007

BY THE OFFICE OF THRIFT SUPERVISION

John M. Reich
Director

[FR Doc. 06-_____ Filed _____]
Billing Codes 4810-33-P (25%), 6210-01-P (25%), 6714-01-P (25%), 6720-01-P (25%)