

**DEPARTMENT OF TREASURY**

**Office of the Comptroller of the Currency**

**12 CFR Part 3**

**[Docket ID OCC-XYZ]**

**RIN XYZ**

**FEDERAL RESERVE SYSTEM**

**12 CFR Parts 217, 238, 252**

**[Docket No. XYZ]**

**RIN XYZ**

**FEDERAL DEPOSIT INSURANCE CORPORATION**

**12 CFR Part 324**

**RIN 3064-AG23**

**Regulatory Capital Rules: Regulatory Capital and Standardized Approach for Risk-weighted Assets**

**AGENCY:** Office of the Comptroller of the Currency (OCC), Treasury; the Board of Governors of the Federal Reserve System (Board); and the Federal Deposit Insurance Corporation (FDIC).

**ACTION:** Notice of proposed rulemaking.

**SUMMARY:** The Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, and the Federal Deposit Insurance Corporation are proposing to modify certain aspects of the regulatory capital rule (the proposal). The proposal would revise the risk-based capital treatment of certain exposure categories under the standardized approach, focusing on improving the calibration and risk sensitivity of risk weights that are particularly material to covered banking organizations' lending activities. The proposal would also modify the definition of regulatory capital by removing the threshold-based deduction for mortgage servicing assets for all banking organizations subject to the regulatory capital rule, including

banking organizations subject to the community bank leverage ratio framework. In addition, the proposal would require Category III and IV banking organizations to recognize most elements of accumulated other comprehensive income in their regulatory capital. The agencies are concurrently publishing a separate proposal, which would require Category I and II banking organizations to use a new framework to calculate risk-weighted assets, called the expanded risk-based approach and would allow other banking organizations to elect to use the expanded risk-based approach.

**DATES:** Comments must be received by June 18, 2026

**ADDRESSES:** Comments should be directed to:

**OCC:** Commenters are encouraged to submit comments through the Federal eRulemaking Portal, if possible. Please use the title “Regulatory Capital Rules: Regulatory Capital and Standardized Approach for Risk-weighted Assets” to facilitate the organization and distribution of the comments and identify the number of the specific question(s) to which you are responding. You may submit comments by any of the following methods:

- *Federal eRulemaking Portal – Regulations.gov:*

Go to <https://regulations.gov/>. Enter “Docket ID OCC-2026-\_\_\_\_” in the Search Box and click “Search.” Public comments can be submitted via the “Comment” box below the displayed document information or by clicking on the document title and then clicking the “Comment” box on the top-left side of the screen. For help with submitting effective comments, please click on “Commenter’s Checklist.” For assistance with the *Regulations.gov* site, please call 1-866-498-2945 (toll free) Monday-Friday, 9 a.m.-5 p.m. ET, or e-mail [regulationshelpdesk@gsa.gov](mailto:regulationshelpdesk@gsa.gov).

- a. *Mail:* Chief Counsel’s Office, Attention: Comment Processing, Office of the Comptroller of the Currency, 400 7th Street, SW, suite 3E-218, Washington, DC 20219.
- b. *Hand Delivery/Courier:* 400 7<sup>th</sup> Street, SW, suite 3E-218, Washington, DC 20219.

*Instructions:* You must include “OCC” as the agency name and “Docket ID OCC-2026-\_\_\_\_” in your comment. In general, the OCC will enter all comments received into the docket and publish the comments on the *Regulations.gov* website without change, including any business or personal information provided such as name and address information, e-mail addresses, or phone numbers. Comments received, including attachments and other supporting materials, are part of the public record and subject to public disclosure. Do not include any information in your comment or supporting materials that you consider confidential or inappropriate for public disclosure.

You may review comments and other related materials that pertain to this action by the following method:

- c. *Viewing Comments Electronically – Regulations.gov:*

Go to <https://regulations.gov/>. Enter “Docket ID OCC-2026-\_\_\_\_” in the Search Box and click “Search.” Click on the “Dockets” tab and then the document’s title. After clicking the document’s title, click the “Browse All Comments” tab. Comments can be viewed and filtered by clicking on the “Sort By” drop-down on the right side of the screen or the “Refine Comments Results” options on the left side of the screen. Supporting materials can be viewed by clicking on the “Browse Documents” tab. Click on the “Sort By” drop-down on the right side of the screen or the “Refine Results” options on the left side of the screen checking the

“Supporting & Related Material” checkbox. For assistance with the *Regulations.gov* site, please call 1-866-498-2945 (toll free) Monday-Friday, 9 a.m.-5 p.m. ET, or e-mail [regulationshelpdesk@gsa.gov](mailto:regulationshelpdesk@gsa.gov).

The docket may be viewed after the close of the comment period in the same manner as during the comment period.

**Board:** You may submit comments, identified by Docket No. R-1813, RIN 7100-AG64 by any of the following methods:

- *Agency Website:* <https://www.federalreserve.gov/apps/proposals/>. Follow the instructions for submitting comments, including attachments. ***Preferred Method.***
- *Mail:* Benjamin W. McDonough, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue NW, Washington, DC 20551.
- *Hand Delivery/Courier:* Same as mailing address.
- *Other Means:* [publiccomments@frb.gov](mailto:publiccomments@frb.gov). You must include the docket number in the subject line of the message.

Comments received are subject to public disclosure. In general, comments received will be made available on the Board’s website at <https://www.federalreserve.gov/apps/proposals/> without change and will not be modified to remove personal or business information including confidential, contact, or other identifying information. Comments should not include any information such as confidential information that would not be appropriate for public disclosure. Comments should identify the number for the specific question(s) to which they respond. Public comments may also be viewed electronically or in person in Room M-4365A, 2001 C St. NW, Washington, DC 20551, between 9 a.m. and 5 p.m. during Federal business weekdays.

**FDIC:** You may submit comments to the FDIC, identified by RIN 3064-AG23 and identify the number for the specific question(s) to which you are responding, by any of the following methods:

**Agency Website:** <https://www.fdic.gov/resources/regulations/federal-register-publications>.

Follow instructions for submitting comments on the FDIC's website.

**Email:** [comments@FDIC.gov](mailto:comments@FDIC.gov). Include RIN 3064-AG23 in the subject line of the message.

**Mail:** Jennifer M. Jones, Deputy Executive Secretary, Attention: Comments - RIN 3064-AG23, Federal Deposit Insurance Corporation, 550 17th Street NW, Washington, DC 20429.

**Hand Delivered/Courier:** Comments may be hand-delivered to the guard station at the rear of the 550 17th Street NW building (located on F Street NW) on business days between 7 a.m. and 5 p.m.

**Public Inspection:** Comments received, including any personal information provided, may be posted without change to <https://www.fdic.gov/resources/regulations/federal-register-publications>. Commenters should submit only information that the commenter wishes to make available publicly. The FDIC may review, redact, or refrain from posting all or any portion of any comment that it may deem to be inappropriate for publication, such as irrelevant or obscene material. The FDIC may post only a single representative example of identical or substantially identical comments, and in such cases will generally identify the number of identical or substantially identical comments represented by the posted example. All comments that have been redacted, as well as those that have not been posted, that contain comments on the merits of this document will be retained in the public comment file and will be considered as required under all applicable laws. All comments may be accessible under the Freedom of Information Act.

**FOR FURTHER INFORMATION CONTACT:**

**OCC:** Venus Fan, Risk Expert, Benjamin Pegg, Technical Expert, or Diana Wei, Risk Expert, Capital Policy, (202) 649-6370; Carl Kaminski, Assistant Director, Ron Shimabukuro, Senior Counsel, Kevin Korzeniewski, Counsel, Daniel Perez, Counsel, Chris Rafferty, Counsel, Chief Counsel's Office, (202) 649-5490, Office of the Comptroller of the Currency, 400 7th Street SW., Washington, DC 20219. If you are deaf, hard of hearing, or have a speech disability, please dial 7-1-1 to access telecommunications relay services.

**Board:** Anna Lee Hewko, Associate Director, (202) 530-6260; Andrew Willis, Manager, (202) 430-1667; Missaka Nuwan Warusawitharana, Manager, (202) 452-3461; Marco Migueis, Principal Economist, (202) 452-6447; Ke Wang, Principal Economist, (202) 680-8527; Emily Davine, Senior Financial Institution Policy Analyst, (771) 216-7655; Division of Supervision and Regulation; or Jay Schwarz, Deputy Associate General Counsel, (202) 452-2970; Mark Buresh, Senior Special Counsel, (202) 452-5270; Gillian Burgess, Senior Counsel, (202) 736-5564; Jonah Kind, Senior Counsel, (202) 452-2045, Legal Division, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue NW, Washington, DC 20551. For users of TTY-TRS, please call 711 from any telephone, anywhere in the United States.

**FDIC:** Benedetto Bosco, Chief Capital Policy Section; Bob Charurat, Corporate Expert; Irina Leonova, Corporate Expert; Andrew Carayiannis, Chief, Policy and Risk Analytics Section; Michael Maloney, Senior Policy Analyst; Iris Li, Senior Policy Analyst; Olga Lionakis, Senior Policy Analyst; Richard Smith, Capital Markets Policy Analyst; Ernest Barkett, Financial Analyst; Kyle McCormick, Senior Policy Analyst; Keith Bergstresser, Senior Policy Analyst; Lauren Brown, Senior Risk and Policy Analyst; Rachel Romm-Nisson, Risk Analytics Specialist; Jim Yu, Senior Policy Analyst, Peter Yen, Senior Policy Analyst; Huiyang Zhou,

Senior Quantitative Risk Specialist; Soo Jeong Kim, Capital Markets Policy Analyst; Capital Markets and Accounting Policy Branch, Division of Risk Management Supervision; Catherine Wood, Counsel; Merritt Pardini, Counsel; Kevin Zhao, Senior Attorney; Nicholas Soyer, Attorney, Michael Overmyer, Special Counsel, Legal Division; [regulatorycapital@fdic.gov](mailto:regulatorycapital@fdic.gov), (202) 898-6888; Federal Deposit Insurance Corporation, 550 17th Street NW, Washington, DC 20429.

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## **I. Introduction and overview**

The Office of the Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve System (Board), and the Federal Deposit Insurance Corporation (FDIC) (collectively, the agencies) are proposing to modify aspects of the capital rule. Specifically, the proposal would revise certain elements of the calculation of the denominator of the risk-based capital ratios (risk-weighted assets) under the standardized approach and make certain adjustments to the definition of regulatory capital.<sup>1</sup> The proposed changes aim to improve risk sensitivity while generally retaining the simplicity of the current framework. Elements of the proposal would also address comments received from the Economic Growth and Regulatory

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<sup>1</sup> The standardized approach does not apply to banking organizations that have elected to use the community bank leverage ratio framework. Under the terms of a concurrent proposal, the standardized approach would not apply to Category I or II banking organizations or to banking organizations that elect to use the expanded risk-based approach. In 2019, the agencies adopted rules establishing four categories of capital standards for U.S. banking organizations with \$100 billion or more in total consolidated assets and foreign banking organizations with \$100 billion or more in combined U.S. assets. Under this framework, Category I standards apply to U.S.-domiciled bank holding companies identified as GSIBs and their depository institution subsidiaries. Category II standards apply to banking organizations with at least \$700 billion in total consolidated assets or at least \$75 billion in cross-jurisdictional activity and their depository institution subsidiaries. Category III standards apply to banking organizations with total consolidated assets of at least \$250 billion or at least \$75 billion in weighted short-term wholesale funding, nonbank assets, or off-balance sheet exposure and their depository institution subsidiaries. Category IV standards apply to banking organizations with total consolidated assets of at least \$100 billion that do not meet the thresholds for a higher category and their depository institution subsidiaries. See 12 CFR 3.2 (OCC); 12 CFR 217.400, 238.10, 252.5, (Board); 12 CFR 324.2 (FDIC); “Prudential Standards for Large Bank Holding Companies, Savings and Loan Holding Companies, and Foreign Banking Organizations,” 84 FR 59032 (Nov. 1, 2019); “Changes to Applicability Thresholds for Regulatory Capital and Liquidity Requirements,” 84 FR 59230 (Nov. 1, 2019).

Paperwork Reduction Act (EGRPRA) public notices.<sup>2</sup> The banking organizations that would be subject to the changes to risk-weighted assets under this proposal are referred to as “covered banking organizations” herein.

The prompt corrective action framework in section 38 of the Federal Deposit Insurance Act (FDI Act) requires the agencies to set capital standards for insured depository institutions that include a risk-based capital requirement and provides that the agencies may establish any additional relevant capital measures to carry out the purpose of that section.<sup>3</sup> Various other statutory authorities provide the agencies with broad discretionary authority to set capital requirements and standards for banking organizations supervised by the agencies, including national banking associations, state-chartered banks, savings associations, and depository institution holding companies.<sup>4</sup> Further, Congress has authorized the agencies to establish enhanced risk-based capital requirements and standards for larger banking organizations subject to the capital rule.<sup>5</sup>

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<sup>2</sup> The agencies, together with the Federal Financial Institutions Examination Council, commenced a review under the Economic Growth and Regulatory Paperwork Reduction Act of 1996 in 2024 to identify outdated or otherwise unnecessary regulatory requirements. The agencies will continue reviewing and considering these comments as part of any final rulemaking. Public Law 104-208, Div. A, Title II, section 2222, 110 Stat. 3009-414, (1996) (codified at 12 U.S.C. 3311). See also Regulatory Publication and Review Under the Economic Growth and Regulatory Paperwork Reduction Act of 1996, 90 FR. 35241 (Jul. 25, 2025).

<sup>3</sup> See 12 U.S.C. 1831o(c)(1)(A), (c)(1)(B)(i).

<sup>4</sup> See 12 U.S.C. 93a (national banking associations); 12 U.S.C. 248(i), 324, 327, 329 (state member banks); 12 U.S.C. 1463 (savings associations); 12 U.S.C. 1467a(g)(1) (savings and loan holding companies); 12 U.S.C. 1844(b) (bank holding companies); 12 U.S.C. 3106 (certain U.S. operations of foreign banking organizations); 12 U.S.C. 3902(1)-(2), 3907(a), 3909(a), (c)(1)-(2) (depository institutions; affiliates of depository institutions, including holding companies; and certain U.S. operations of foreign banking organizations); 12 U.S.C. 5371 (insured depository institutions, depository institution holding companies, and nonbank financial companies supervised by the Board).

<sup>5</sup> See, e.g., section 165 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), as amended by section 401 of the Economic Growth, Regulatory Relief, and Consumer Protection Act, which requires the Board to establish enhanced prudential standards that include risk-based capital requirements for bank holding companies with \$250 billion or more in total consolidated assets.

In a concurrent notice of proposed rulemaking, the agencies are seeking comment on changes to the risk-based capital framework that would apply to Category I and II banking organizations as well as banking organizations with significant trading activity (expanded risk-based proposal).<sup>6</sup> That proposal would introduce a new “expanded risk-based approach” – which would include requirements for credit risk, equity risk, and operational risk – and a revised market risk framework. Notably, the expanded risk-based proposal would allow banking organizations of any size to elect to use the expanded risk-based approach to determine requirements for credit risk, equity risk, and operational risk in place of the standardized approach.<sup>7</sup>

Analysis undertaken by the agencies in connection with the expanded risk-based proposal included evaluating the appropriateness of the risk weights applicable to exposures at the business-line level. That analysis informs the changes in this proposal, including revisions to risk weights that are particularly material to lending activities. Specifically, the analysis suggests revisions would be appropriate to the risk weights applicable to residential mortgage exposures, corporate exposures, and certain exposures in the current standardized approach’s “other assets” category. The proposal would reduce the risk weight applicable to corporate exposures from 100 percent to 95 percent and the risk weight applicable to all assets not specifically assigned a different risk weight under the rule from 100 percent to 90 percent. The proposal would also

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<sup>6</sup> Banking organizations with significant trading activities that are not Category I or II banking organizations would apply (1) the market risk framework under the expanded risk-based proposal and (2) the standardized approach in this proposal (unless they elect to use expanded risk-based approach under the expanded risk-based proposal) to determine their risk-weighted assets.

<sup>7</sup> The agencies consider the proposed requirements under the expanded risk-based approach to be appropriate for Category I and II banking organizations given their risk profiles, complexity, risk management resources, and international activities. Although the expanded risk-based proposal poses more operational complexity relative to this proposal, the expanded risk-based proposal would allow other banking organizations to elect to use it. A banking organization that elects to do so would be subject to the same definition of capital as Category I and II banking organizations.

introduce a broader range of risk weights for residential mortgage exposures, based on more granular risk factors. In addition, the proposal would adopt the same definition of commitment as the expanded risk-based proposal and would align the credit conversion factors for certain off-balance sheet exposures, including equity commitments, with that proposal.

These changes focus on exposure categories that comprise a substantial amount of total risk-weighted assets for covered banking organizations and aim to balance a more risk-sensitive calibration of the requirements with retaining the simplicity of the standardized approach.<sup>8,9</sup>

To improve risk sensitivity, this proposal would also make targeted adjustments to the existing methodologies for determining exposure amounts for counterparty credit risk and risk-weighted asset amounts for securitizations, as well as for recognizing the benefits of credit risk mitigants. These targeted adjustments would align with adjustments included in the expanded risk-based proposal. Improving the risk sensitivity of the regulatory capital framework would mean that a banking organization's capital requirements more readily increase or decrease due to changes in the risk of its business activities.

In addition to changes to the calculation of risk-weighted assets, the proposal would modify the definition of regulatory capital by removing the threshold-based deduction of mortgage servicing assets (MSAs). All MSAs would receive a 250 percent risk weight under the proposal, consistent with the risk weight in the current capital rule for MSAs that do not exceed

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<sup>8</sup> See Table V.G.1 in the Data Appendix (Section V.G.) for a breakdown of the size of the exposure categories whose treatment would be revised under this proposal.

<sup>9</sup> The calculation of the risk-weighted assets under the expanded risk-based approach is more complex than under the standardized approach as it is more granular and includes several additional risk factors. The expanded risk-based approach would also include an operational risk capital requirement and the requirement to use the standardized approach for counterparty credit risk to determine the exposure amount for derivative contracts. Banking organizations subject to the expanded risk-based approach would also be subject to a more risk-sensitive but complex definition of capital, including the requirement to include most elements of accumulated other comprehensive income in regulatory capital.

the deduction threshold. This proposed revision would promote mortgage origination and servicing by banking organizations in a risk-appropriate manner and would apply to all banking organizations subject to the regulatory capital rule, including banking organizations subject to the community bank leverage ratio framework.<sup>10</sup>

The proposal would require Category III and IV banking organizations to include most elements of accumulated other comprehensive income (AOCI) in common equity tier 1 capital, consistent with the current treatment applicable to Category I and II banking organizations.<sup>11</sup> This change would better reflect the capital adequacy and loss-absorbing capacity of Category III and IV banking organizations in their regulatory capital ratios. The proposal would include a transition period five years from the effective date of any final rule for Category III and IV banking organizations to phase-in the effect of recognizing AOCI in regulatory capital; this transition period would provide sufficient time to adapt to the changes while minimizing any potential adverse impact.<sup>12</sup>

The proposal would also amend certain dollar-based regulatory thresholds in the standardized approach to reflect inflation and ensure that such thresholds preserve their intended application in real terms over time. Finally, the proposal would not make any modifications to

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<sup>10</sup> The expanded risk-based approach proposal contains a corresponding change that would apply to Category I and II banking organizations.

<sup>11</sup> AOCI generally includes accumulated unrealized gains and losses on certain assets and liabilities that have not been included in net income but are included in equity under U.S. generally accepted accounting principles (for example, unrealized gains and losses on securities designated as available-for-sale).

<sup>12</sup> This transition period would mirror the transition period under the expanded risk-based proposal provided to banking organizations that elect to use the expanded risk-based approach and that do not currently recognize AOCI in their regulatory capital.

the enhanced disclosure requirements under section \_\_.63 of the capital rule but seeks comment on whether certain modifications would be appropriate.<sup>13</sup>

Taken together, the proposed changes aim to improve the risk sensitivity of the framework while retaining its simplicity. The agencies expect the proposal to reduce the common equity tier 1 capital requirements applicable to Category III and IV holding companies by 3.0 percent and the capital requirements applicable to smaller holding companies<sup>14</sup> by 7.8 percent. The reduction in requirements for Category III and IV holding companies reflects a 6.1 percent reduction due to the revised risk-weighted assets combined with an estimated 3.1 percent increase in capital requirements due to an estimated long-run average impact of including AOCI in regulatory capital. Similarly, the agencies expect the proposal to reduce the common equity tier 1 capital requirements applicable to depository institution subsidiaries of Category III and IV banking organizations by 4.7 percent, and those applicable to smaller depository institutions by 8.0 percent. The agencies performed economic analysis to assess the potential effects of the proposal (see Section VI). The improvements in risk sensitivity of capital requirements and associated benefits expected to result from the proposal justify the proposal's expected costs.

The agencies seek comment on all aspects of the proposal.

## **II. Definition of capital**

The proposal would broadly maintain the definition of capital applicable to covered banking organizations in the current capital rule with two modifications. The proposal would (1) eliminate the requirement to deduct MSAs above a threshold from common equity tier 1 capital

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<sup>13</sup> The agencies anticipate proposing revisions to several reporting forms of the agencies filed by covered banking organizations that would align with the proposed revisions to the capital rule.

<sup>14</sup> Refers to holding companies with total assets under \$100 billion that are required to report risk-based capital information on the FR Y9-C.

for all covered banking organizations<sup>15</sup> and (2) require Category III and IV banking organizations to recognize certain elements of AOCI in common equity tier 1 capital.

***A. Removal of the mortgage servicing asset deduction***

Under the current capital rule, covered banking organizations must deduct from common equity tier 1 capital amounts of MSAs that exceed 25 percent of the banking organization's common equity tier 1 capital. Under the proposal, covered banking organizations would no longer be required to deduct any amount of MSAs from common equity tier 1 capital. Instead, MSAs would be subject to a 250 percent risk weight, consistent with the treatment in the current capital rule for MSAs that do not exceed the deduction threshold.<sup>16</sup>

An MSA arises when a banking organization sells a loan to a third party but retains the obligation to service the loan in exchange for a fee. Banking organizations may also purchase, sell, or transfer MSAs separately from the underlying mortgage loans.

MSAs can be a useful tool for banking organizations to manage interest rate risk. The value of MSAs generally increases when interest rates rise, which extends the expected duration of related servicing fees. As a result, they may provide a hedge against losses on other assets that decline in value in the same interest rate environment.<sup>17</sup>

Moreover, MSAs are important for banking organizations to maintain their relationship with borrowers by retaining customer-facing relationships even after transferring the underlying

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<sup>15</sup> In addition, the proposal would require a covered banking organization to deduct from common equity tier 1 capital any portion of a credit-enhancing interest only strip that does not constitute an after-tax-gain-on sale, as discussed in section III.E.5.f.

<sup>16</sup> This revision would also be consistent with comments received under EGRPRA as commenters requested removal of the MSA threshold. The expanded risk-based approach proposal would make the same modification to the definition of regulatory capital for Category I and II banking organizations and banking organizations that elect to use the expanded risk-based approach.

<sup>17</sup> In a rising rate environment, the expected life of a mortgage will increase due to reduced prepayments. As a result, MSAs will increase in value, as the banking organization will collect servicing fees over a longer period of time. The increased value of MSAs act as a natural hedge against existing mortgage-backed securities which would be expected to trade at a discount in such an environment.

loans, allowing cross-selling of products. Banking organizations can also improve efficiency by increasing scale. A deduction approach for MSAs can discourage banking organizations from creating economies of scale, which can hinder their ability to compete in mortgage underwriting or servicing businesses and to manage risks.

At the same time, MSAs have long been subject to elevated capital requirements because of the high level of uncertainty regarding the ability of banking organizations to realize value from these assets, especially under adverse financial conditions. MSAs may face significant valuation risk, which mainly stems from prepayment risk, default risk, and liquidity risk. For example, increased refinancing of mortgage loans due to lower interest rates can quickly erode the value of MSA portfolios, as can increased incidents of mortgage defaults. MSAs can also be difficult to value, as bank portfolios of MSAs can be heterogeneous and MSA valuations rely on assessments of future economic variables. Maintaining the 250 percent risk weight for MSAs would promote regulatory capital requirements that are commensurate with the risk of these assets.

*Question 1: What are the advantages and disadvantages of the proposed treatment of MSAs? What are the implications of the proposed treatment of MSAs for banking organizations' mortgage origination business? To what extent does the 250 percent risk weight appropriately reflect the risk of these assets throughout the economic cycle? Given the potential volatility of MSAs under certain circumstances, what are the advantages and disadvantages of the agencies imposing a higher limit on MSA as a percentage of common equity tier 1 capital (for example, 100 percent) and why? What are the advantages and disadvantages of differentiating the treatment of MSAs based on the size of the banking organization (for example, banking organizations with assets under \$10 billion or over \$100 billion) or applicable capital*

*framework (for example, banking organizations that elect the community bank leverage ratio framework)?*

***B. Recognition of accumulated other comprehensive income for Category III and IV banking organizations***

Under the current capital rule, Category I and II banking organizations are required to include most elements of AOCI in regulatory capital. All other banking organizations, including all covered banking organizations, had the option to make a one-time election to opt-out of recognizing most elements of AOCI and related deferred tax assets and liabilities within regulatory capital.<sup>18</sup> Under the proposal, Category III and IV banking organizations would be required to include all AOCI components in common equity tier 1 capital, except gains and losses on cash-flow hedges where the hedged item is not recognized on a covered banking organization's balance sheet at fair value. This would require all net unrealized gains and losses on holdings of available-for-sale debt securities from changes in fair value to flow through to common equity tier 1 capital, including those that result primarily from fluctuations in benchmark interest rates.<sup>19</sup> This treatment would align with the treatment of AOCI for banking organizations subject to the expanded risk-based proposal.

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<sup>18</sup> See 12 CFR 3.22(b) (OCC); 12 CFR 217.22(b) (Board); 12 CFR 324.22(b) (FDIC). A banking organization that made an opt-out election is currently required to adjust common equity tier 1 capital as follows: subtract any net unrealized holding gains and add any net unrealized holding losses on available-for-sale securities; subtract any accumulated net gains and add any accumulated net losses on cash flow hedges; subtract any amounts recorded in AOCI attributed to defined benefit postretirement plans resulting from the initial and subsequent application of the relevant GAAP standards that pertain to such plans (excluding, at the banking organization's option, the portion relating to pension assets deducted under § \_\_.22(a)(5) of the current capital rule); and, subtract any net unrealized holding gains and add any net unrealized holding losses on held-to-maturity securities that are included in AOCI.

<sup>19</sup> Available-for-sale securities refers to debt securities. Accounting Standards Update 2016-01 eliminated the classification of available-for-sale equity securities under Accounting Standards Codification Subtopic 321-10 and generally requires investments in equity securities to be measured at fair value with changes in fair value recognized in net income. Changes in the fair value of (i.e., the unrealized gains and losses on) a banking organization's equity securities are recognized through net income rather than other comprehensive income.

AOCI is an important indicator that regulators and market observers use to evaluate the capital strength of a banking organization. The requirement to recognize elements of AOCI in regulatory capital has helped improve the transparency of regulatory capital ratios for Category I and II banking organizations, as it better reflects a banking organization's actual loss-absorbing capacity at a specific point in time, notwithstanding the potential volatility that such recognition may pose for its regulatory capital ratios. Category III and IV banking organizations have the tools and access to capital markets to manage the volatility of regulatory capital that recognition of AOCI in capital may cause. In addition, as noted in the expanded risk-based proposal, any banking organization that elects to apply the expanded risk-based approach would be required to include AOCI in regulatory capital. Given the more complex nature of the expanded risk-based proposal, these electing banking organizations are expected to have the ability to manage the volatility which may arise from the recognition of AOCI in capital, even if they are smaller banking organizations.

AOCI contributes to a banking organization's balance sheet equity and may be used by market participants in evaluating a banking organization's capital position.<sup>20</sup> Adverse trends in a banking organization's balance sheet equity can result in negative market perception and have liquidity implications.<sup>21</sup> Banking organizations that do not include AOCI in regulatory capital are often reluctant to sell available-for-sale securities that have unrealized losses, as the losses would have to be recognized upon sale, thereby reducing regulatory capital. However, banking organizations may need to take such steps to meet liquidity needs. Recognizing elements of

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<sup>20</sup> See 84 FR 59230, 59249 (Nov. 1, 2019)

<sup>21</sup> See Interagency Advisory on Interest Rate Risk Management (OCC Bulletin 2010-1, SR 10-1, FIL 2-2012, Jan. 11, 2010).

AOCI in regulatory capital achieves a better alignment of regulatory capital with a banking organization's point-in-time loss-absorbing capacity.

*Question 2: What are the advantages and disadvantages of requiring Category III and IV banking organizations to recognize AOCI in their regulatory capital? What other scope of application for the proposed AOCI treatment should the agencies consider and why? Please provide any supporting data and analysis.*

The proposal includes transition provisions that would provide Category III and IV banking organizations that do not currently recognize AOCI in their regulatory capital with a phase-in for reflecting AOCI in their regulatory capital over a five-year period from the effective date of any final rule.<sup>22</sup> Such a banking organization would determine its AOCI adjustment amount as the sum of: (1) net unrealized gains or losses on available-for-sale securities, plus (2) accumulated net gains or losses on cash flow hedges, plus (3) any amounts recorded in AOCI attributed to defined benefit postretirement plans resulting from the initial and subsequent application of the relevant GAAP standards that pertain to such plans, plus (4) net unrealized holding gains or losses on held-to-maturity securities that are included in AOCI. This AOCI adjustment amount would be transitioned as set forth in Table 1 below for Category III and IV banking organizations that have previously made the AOCI opt-out election.<sup>23</sup> If the banking organization's AOCI adjustment amount is positive, it would multiply this amount by the percentage of the appropriate transition period provided in Table 1 below and subtract the resulting amount from its common equity tier 1 capital. If the AOCI adjustment amount is

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<sup>22</sup> This transition period would mirror the transition period under the expanded risk-based proposal provided to banking organizations that elect to use the expanded risk-based approach and that do not currently recognize AOCI in their regulatory capital.

<sup>23</sup> For simplicity and illustrative purposes, the transition table assumes an effective date of January 1, 2027.

negative, the banking organization would perform the same calculation and add back the resulting amount to its common equity tier 1 capital.

**Table 1 to § 300 Transition AOCI Adjustment Amount**

<b>Transition period</b>	<b>Percentage applicable to AOCI adjustment amount</b>
January 1, 2027 to December 31, 2027	100
January 1, 2028 to December 31, 2028	80
January 1, 2029 to December 31, 2029	60
January 1, 2030 to December 31, 2030	40
January 1, 2031 to December 31, 2031	20
January 1, 2032 to thereafter	0

*Question 3: What are the advantages and disadvantages of the proposed transition provisions for AOCI adjustments? What alternatives to the proposed transition provisions should the agencies consider, and why? For example, what are the costs and benefits of different transition-period durations or different recognition percentages in each period of the transition?*

*Question 4: Under the proposal, Category III or IV banking organizations would recognize AOCI in common equity tier 1 capital through a transition period, with only a portion of AOCI recognized during the transition. Category III and IV banking organizations with positive AOCI (for example, from unrealized gains on available-for-sale securities) would recognize less AOCI in its regulatory capital ratios during the transition period than they would if the full AOCI amount were recognized immediately. What are the costs and benefits of making the transition period optional, allowing Category III and IV banking organizations to elect to recognize the full AOCI amount on the effective date of the rule? Please provide relevant data to support your views, including information on the magnitude of AOCI at Category III and IV banking organizations and how it has varied over time and in different interest rate environments.*

*Question 5: The expanded risk-based proposal would provide covered banking organizations under this proposal the choice to adopt the expanded risk-based approach. The expanded risk-based proposal includes the same AOCI transition period for banking organizations that do not currently recognize AOCI in their regulatory capital and that elect to use the expanded risk-based approach. What are the costs and benefits of applying the same AOCI transition provisions to banking organizations that elect to adopt the expanded risk-based approach as would apply to Category III and IV banking organizations under the standardized approach? Should banking organizations that elect to adopt the expanded risk-based approach be subject to different AOCI transition provisions? If so, what alternative transition provisions would be appropriate, and why?*

### **III. Calculation of risk-weighted assets under the standardized approach**

Under the proposal, a covered banking organization would continue to follow the mechanics of the current capital rule for determining its standardized total risk-weighted assets.<sup>24</sup> Accordingly, such a banking organization would calculate its risk-weighted asset amounts for its on- and off-balance sheet exposures and, if applicable, risk-weighted assets for market risk covered positions. Risk-weighted asset amounts generally are determined by assigning on-balance sheet assets to broad risk-weight categories according to the counterparty, or, if relevant, the guarantor or collateral. Similarly, risk-weighted asset amounts for off-balance sheet items are calculated using a two-step process: (1) multiplying the amount of the off-balance sheet exposure by a conversion factor to determine a credit equivalent amount or adjusted carrying

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<sup>24</sup> See generally, 12 CFR part 3, subpart D (OCC); 12 CFR part 217, subpart D (Board); 12 CFR part 324, subpart D (FDIC).

value, and (2) assigning the credit equivalent amount or adjusted carrying value to a relevant risk-weight category.

### **A. General risk weight treatment**

To improve the risk sensitivity of the standardized approach, the proposal would make targeted revisions to the general risk weight treatment of certain exposure categories that are particularly material to bank lending activities. As more specifically discussed below, the proposal would (1) introduce a more risk-sensitive treatment for residential mortgage exposures and (2) amend the risk weights applicable to corporate exposures and to all assets not specifically assigned a different risk weight under the current standardized approach. The risk weights applicable to all other exposure categories would remain unchanged under the proposal.

#### *1. Residential mortgage exposures*

Under the proposal, a residential mortgage exposure would continue to be defined as an exposure that is primarily secured by a first or subsequent lien on one-to-four family residential property or an exposure with an original and outstanding amount of \$1 million or less that is primarily secured by a first or subsequent lien on a residential property that is not one-to-four family.<sup>25</sup> A residential mortgage exposure would not include an ADC exposure, a pre-sold construction loan, a statutory multifamily mortgage, or an HVCRE exposure.

To improve risk sensitivity, the proposal would introduce a loan-to-value (LTV)-based approach for assigning risk weights to certain residential mortgage exposures as discussed in section III.A.1.b. of this **SUPPLEMENTARY INFORMATION**. LTV ratios are a useful credit risk indicator as higher levels of homeowner equity generally reduce the likelihood of borrower default and provide lenders with a degree of protection against credit losses.

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<sup>25</sup> See 12 CFR §\_\_.2

The proposed LTV-based approach would further differentiate risk weights based on whether a residential mortgage is dependent on cash flows generated by the real estate securing the extension of credit. Residential mortgage exposures in which the primary source of repayment is dependent on cash flows generated by the real estate can expose a banking organization to elevated credit risk relative to residential mortgage exposures where the source of repayment does not face such dependency, as the obligor may be unable to meet its financial commitments when cash flows from the property decrease, such as when tenants default or properties are unexpectedly vacant.<sup>26</sup> Residential mortgage exposures that are dependent on such cash flows to repay the loan can also be more affected by local market conditions and, thus, present elevated credit risk relative to exposures that are serviceable by the income, cash, or other assets of the obligor. For example, an increase in the supply of competitive rental property could lower rental prices and suppress cash flows needed to support repayment of the loan.

If the underwriting process at origination of the residential mortgage exposure considers any cash flows generated by the real estate securing the loan, such as from rental payments, then the exposure would meet the proposal's definition of dependent on the cash flows generated by the real estate. Evaluating the dependence on cash flows generated from the real estate is a conservative and straightforward measure of credit risk. Reliance on cash flows from the property for repayment of a loan indicates increased risk of nonpayment relative to when the borrower has sufficient funds from other sources for full repayment of the loan. Given their increased credit risk, the proposal would assign higher risk weights to residential mortgage

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<sup>26</sup> See Board of Governors of the Federal Reserve System, Financial Stability Report (November 2020), <https://www.federalreserve.gov/publications/files/financial-stability-report-20201109.pdf>.

exposures that are dependent on proceeds or cash flows generated from the real estate itself to service the loan.

Under the proposal, additional loan characteristics can affect whether an exposure would be considered dependent on cash flows from the real estate. The proposal's definition of dependent on the cash flows generated by the real estate would exclude any residential mortgage exposure that is secured by the obligor's principal residence, as such mortgage exposures present reduced credit risk relative to real estate exposures that are secured by the obligor's non-principal residence.<sup>27</sup> For residential properties that are not the obligor's principal residence, including vacation homes and other second homes, such properties would be considered dependent on the cash flows generated by the real estate unless the covered banking organization has relied solely on the obligor's personal income and resources, rather than rental income (or resale or refinance of the property), to ascertain the obligor's capacity to repay the loan.<sup>28</sup>

To be eligible to use the proposed LTV-based approach, a residential mortgage exposure would be required to: (1) be secured by a property that is either owner-occupied or rented; (2) be made in accordance with prudent underwriting standards, including relating to the loan amount as a percent of the value of the property;<sup>29</sup> (3) not be 90 days or more past due or carried in

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<sup>27</sup> See Breck Robinson, Federal Reserve Bank of Richmond, and Richard M. Todd, Federal Reserve Bank of Minneapolis, "The Role of Non-Owner-Occupied Homes in the Current Housing and Foreclosure Cycle," which cites multiple studies that loans on non-owner occupied properties have higher loss rates on mortgages to non-occupant owners than on mortgages to owner-occupants, at least after controlling for credit scores and other standard underwriting criteria. Pg. 6.

[https://www.richmondfed.org/~media/richmondfedorg/publications/research/working\\_papers/2010/pdf/wp10-11.pdf](https://www.richmondfed.org/~media/richmondfedorg/publications/research/working_papers/2010/pdf/wp10-11.pdf).

<sup>28</sup> For example, if (1) a borrower purchases a two-unit property with the intention of making one unit their principal residence, (2) the borrower intends to rent out the second unit to a third party, and (3) the covered banking organization considered the cash flows from the rental unit as a source of repayment, the exposure would not meet the proposal's definition of dependent on the cash flows generated by the real estate because the property securing the exposure is the borrower's principal residence.

<sup>29</sup> The agencies expect these underwriting standards to align with the agencies' safety and soundness and real estate lending guidelines. See 12 CFR part 30, appendix C and 12 CFR Part 34, appendix A to subpart D (OCC); 12 CFR part 208, appendix C (Board); 12 CFR parts 364 and 365 (FDIC).

nonaccrual status; and (4) not be restructured or modified.<sup>30,31</sup> Additionally, the property would need to be valued in accordance with the proposed requirements included in the proposed LTV ratio calculation, as discussed below. Consistent with the current capital rule, residential mortgage exposures that do not meet the above criteria or are a junior lien residential mortgage exposure would continue to receive a 100 percent risk weight.

*Question 6: The agencies seek comment on the set of residential mortgage exposures that are eligible to use the LTV-based approach. What are the advantages and disadvantages of aligning the scope of mortgages eligible to use the LTV-based approach with the current capital rule's 50 percent risk-weight category for residential mortgage exposures? What other alternatives should the agencies consider? Should covered banking organizations have the option to adopt the LTV-based approach or the option to retain the current treatment which applies less risk-sensitive risk weights of 50 and 100 percent?*

*Question 7: The agencies seek comment on the appropriateness of using an LTV-based approach to determine risk-weights for residential mortgages as a standardized approach and the operational or administrative burden associated with its implementation. What are the advantages or disadvantages of using an LTV-based approach for the standardized approach? What alternative approaches should the agencies consider, and why? Please provide examples of potential operational or administrative challenges associated with implementing the LTV-based approach.*

*a. Calculating the loan-to-value ratio*

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<sup>30</sup> Consistent with the current capital rule and under the proposal, when a covered banking organization holds the first-lien and junior-lien(s) residential mortgage exposures and no other party holds an intervening lien, the covered banking organization would be required to combine the exposures and treat them as a single first-lien residential mortgage exposure.

<sup>31</sup> These requirements generally align with the current capital rule's requirements for first-lien residential mortgages that are eligible for a 50 percent risk weight.

Under the proposal and in line with the expanded risk-based approach proposal, covered banking organizations would use an LTV ratio to assign a risk weight applicable to certain residential mortgage exposures. The proposed calculation of the LTV ratio would generally align with the real estate lending guidelines, except with respect to the recognition of private mortgage insurance.

A covered banking organization would calculate the LTV ratio for purposes of Table III.1 and Table III.2 below by dividing the extension of credit by the value of the property. The extension of credit means the total outstanding amount of the loan, including any undrawn committed amount. The total outstanding amount reflects the current amortized balance as the loan pays down, which would allow a covered banking organization to assign a lower risk weight to a loan over time as the principal is repaid. Similarly, if an extension of credit increases, a covered banking organization would reflect that increase in the LTV ratio.

For the LTV ratio calculation, a covered banking organization would calculate the loan amount without making any adjustments for credit loss provisions or private mortgage insurance. Not recognizing private mortgage insurance for these purposes would be consistent with the current capital rule's definition of eligible guarantor, which does not recognize an insurance company predominately engaged in the business of providing credit protection (such as a monoline bond insurer or re-insurer).<sup>32</sup> During the 2007-2009 housing market stress, the performance of private mortgage insurance deteriorated at the same time as the underlying

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<sup>32</sup> A guarantor is not an eligible guarantor under the current capital rule if the guarantor's creditworthiness is positively correlated with the credit risk of the exposures for which it has provided guarantees. 78 FR 62141 (Oct. 11, 2013). See definition of eligible guarantor in § \_\_.2 of the capital rule. 12 CFR 3.2 (OCC); 12 CFR 217.2 (Board); 12 CFR 324.2 (FDIC).

exposures.<sup>33</sup> Under the proposal and consistent with the current capital rule, private mortgage insurance is considered when a covered banking organization identifies which of its residential mortgage exposures are made in accordance with prudent underwriting standards and eligible to use the proposed risk weights discussed in section III.A.1.b. of this **SUPPLEMENTARY INFORMATION**.<sup>34</sup>

The value of the property would mean the value at the time of origination of all real estate properties securing the extension of credit, including the increased estimated value of the property if the property is being improved by an extension of credit. The value of the property would also include the fair value of any readily marketable collateral and other acceptable collateral, as defined in the real estate lending guidelines, that secures the extension of credit.

For exposures subject to the Real Estate Lending, Appraisal Standards, and Minimum Requirements for Appraisal Management Companies or Appraisal Standards for Federally Related Transactions (collectively, the appraisal rule),<sup>35</sup> the market value of real estate would be a valuation that meets all requirements of that rule. For exposures not subject to the appraisal rule, the proposal would require that (1) the market value of real estate be obtained from an independent valuation of the property using prudently conservative valuation criteria and (2) the valuation be done independently from the covered banking organization's origination and underwriting process. Most residential mortgage exposures held by insured depository institutions are subject to the agencies' appraisal rule, which also provides for evaluations in

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<sup>33</sup> See Laurie Goodman and Karan Kuhl, "Sixty Years of Private Mortgage Insurance in the United States", The Urban Institute Housing Finance Policy Center, August 2017.Pg. 7, [https://www.urban.org/sites/default/files/publication/92676/2017\\_08\\_18\\_sixty\\_years\\_of\\_pmi\\_finalizedv3\\_3.pdf](https://www.urban.org/sites/default/files/publication/92676/2017_08_18_sixty_years_of_pmi_finalizedv3_3.pdf).

<sup>34</sup> See 12 CFR § \_\_.32(g)(1)(ii).

<sup>35</sup> See 12 CFR part 34, subpart C or subpart G (OCC); 12 CFR part 208, subpart E or 12 CFR part 225, subpart G (Board); 12 CFR part 323 (FDIC).

some cases, and provides for certain exceptions, such as where a lien on real estate is taken as an abundance of caution. To help ensure that the value of the real estate is determined in a prudently conservative manner, the proposal would also provide that, for exposures not subject to the appraisal rule, the valuations of the real estate properties would need to exclude expectations of price increases and be adjusted downward to take into account the potential for the current market prices to be significantly above the values that would be sustainable over the life of the loan.

In addition, when the residential mortgage exposure finances the purchase of a property, the value would be the lower of (1) the actual acquisition cost of the property and (2) the market value obtained from either (i) the valuation requirements under the appraisal rule (if applicable) or (ii) as described above, an independent valuation using prudently conservative valuation criteria that is separate from the covered banking organization's origination and underwriting process.

Using the value of a property at origination when calculating the LTV ratio protects against volatility risk or short-term market price inflation. For purposes of the LTV ratio calculation, the proposal would require covered banking organizations to use the value of the property at the time of origination, except under the following circumstances: (1) the covered banking organization's primary Federal supervisor requires the covered banking organization to revise the property value downward; (2) an extraordinary event occurs resulting in a permanent reduction of the property value (for example, a natural disaster); or (3) modifications are made to the property that increase its market value and are supported by an appraisal or independent evaluation using prudently conservative criteria. These proposed exceptions are intended to

constrain the use of values other than the value of the property at loan origination only to exceptional circumstances that are sufficiently material to warrant use of a revised valuation.

For purposes of determining the value of the property, the proposal would use the definition of readily marketable collateral and other acceptable collateral consistent with the real estate lending guidelines. Therefore, readily marketable collateral would mean insured deposits, financial instruments, and bullion in which the covered banking organization has a perfected security interest. Financial instruments and bullion would need to be salable under ordinary circumstances with reasonable promptness at a fair market value determined by quotations based on actual transactions, in an auction or on similarly available daily bid and ask price market. Other acceptable collateral would mean any collateral in which the covered banking organization has a perfected security interest that has a quantifiable value and is accepted by the covered banking organization in accordance with safe and sound lending practices. Under the proposal, other acceptable collateral would include, among other items, unconditional irrevocable standby letters of credit for the benefit of the covered banking organization. Readily marketable collateral and other acceptable collateral must be appropriately discounted by the covered banking organization consistent with the banking organization's usual practices for making loans secured by such collateral. The reasonableness of a covered banking organization's underwriting criteria would continue to be reviewed through the supervisory process to help ensure its real estate lending policies are consistent with safe and sound banking practices.

*Question 8: The agencies have considered various alternatives relating to how private mortgage insurance should be recognized for residential mortgages exposures beyond the proposed treatment of considering private mortgage insurance when identifying which residential mortgage exposures meet the requirements to be considered prudently underwritten*

*and eligible to use the proposed LTV-based approach. What would be the pros and cons of providing explicit recognition of private mortgage insurance in the calculation of LTV ratios for purposes of determining the risk weights for residential exposures? What, if any, increases in procyclicality and incentives for increased risk-taking by covered banking organizations might such recognition create? What conditions could the agencies impose on such recognition to mitigate concerns about the wrong-way risk of monoline credit insurance? In recognition that private mortgage insurance may not provide protection under all relevant stress events, what are the advantages and disadvantages of recognizing a portion (such as 50 percent) of the value of the private mortgage insurance in determining the total outstanding amount of the loan in the calculation of the LTV ratio? Please provide any data and analysis supporting alternative approaches.*

*b. Risk weights for residential mortgage exposures*

Under the proposal, a covered banking organization would assign a risk weight to an eligible residential mortgage exposure based on the exposure's LTV ratio without private mortgage insurance and based on whether repayment is dependent on the cash flows generated by the real estate, in accordance with Tables III.1 and III.2 below.<sup>36</sup> LTV ratios and source of repayment would factor into the risk-weight treatment for residential mortgage exposures because they are key determinants of risk for real estate exposures.

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<sup>36</sup> The risk weight assigned to loans does not impact the appropriate treatment of loans under the agencies' other regulations and guidance, such as the supervisory LTV limits under the real estate lending guidelines. See Appendix C to Part 208, Title 12.

The proposed risk weights would recognize the reduction in risk due to amortization, as the borrower pays down principal and builds equity.<sup>37</sup> Given the increased risk sensitivity of the LTV-based approach relative to the current standardized approach, the risk weights for eligible residential mortgage exposures would decrease throughout the life of the loan as the obligor makes payments. Lower LTVs are strongly associated with lower realized loss given default.<sup>38</sup>

**Table III.1:** Proposed Risk Weights for Residential Mortgage Exposures that are Not Dependent on the Cash Flows of the Real Estate

	LTV Ratio ≤ 50%	50% < LTV Ratio ≤ 60%	60% < LTV Ratio ≤ 80%	80% < LTV Ratio ≤ 90%	90% < LTV Ratio ≤ 100%	LTV Ratio > 100%
<b>Risk Weight</b>	25%	30%	35%	45%	55%	75%

**Table III.2:** Proposed Risk Weights for Residential Mortgage Exposures Dependent on the Cash Flows of the Real Estate

	LTV Ratio ≤ 50%	50% < LTV Ratio ≤ 60%	60% < LTV Ratio ≤ 80%	80% < LTV Ratio ≤ 90%	90% < LTV Ratio ≤ 100%	LTV Ratio > 100%
<b>Risk Weight</b>	35%	40%	50%	65%	80%	110%

The proposed risk weights in Tables III.1 and III.2 would appropriately balance the benefits of risk sensitivity, transparency, and consistency in requirements across covered banking organizations.

Relative to the current standardized approach, the proposed risk weights in Tables III.1 and

<sup>37</sup> For purposes of the LTV ratio calculation, the proposal would require covered banking organizations to use the value of the property at the time of origination, except under limited circumstances. *See also* Luis Otero González, Pablo Durán Santomil, Milagros Vivel Búa and Rubén Lado Sestayo, “The Impact of Loan-to-Value on The Default Rate of Residential MBS” *Journal of Credit Risk* (July 2016), <https://www.risk.net/journal-of-credit-risk/2465626/the-impact-of-loan-to-value-on-the-default-rate-of-residential-mortgage-backed-securities>.

<sup>38</sup> Kenç, Turalay. "Macropprudential regulation: history, theory and policy." *BIS Paper* 86c (2016).

III.2 would also align more closely with the treatment of regulatory residential real estate exposures under the expanded risk-based proposal. Consistent with the general risk weights in the current standardized approach and in contrast with the proposed expanded risk-based approach, there is not a separate operational risk-based capital requirement. Therefore, the proposed risk weights for residential mortgage exposures under this proposal would not account exclusively for credit risk. The difference in risk weights between the two proposals is, therefore, explained by the differing approaches for how risk categories, such as specific credit and operational risk-based requirements, factor into each proposal's methodology for assigning risk weights.<sup>39</sup>

*Question 9: The agencies seek comment on the proposed risk-weights for residential mortgage exposures in Tables III.1 and III.2. What alternative approaches, if any, should the agencies consider to account for risks other than credit risk posed by covered banking organizations' residential mortgage lending activities? What alternative risk weights, if any, should the agencies consider, and why? Please provide any supporting data.*

*Question 10: What are the advantages and disadvantages of the proposed LTV-based approach for residential mortgage exposures that are dependent on the cash flows of the property? What, if any, implementation challenges would the requirement to determine whether an exposure is dependent on the cash flows of the property present? What would be the advantages and disadvantages of an alternative LTV-based approach that differentiates risk weights on whether the property securing the residential mortgage exposure is owner occupied?*

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<sup>39</sup> The calibration of the operational risk add-on followed a similar logic to the one used for corporate exposures and other assets (discussed below). Given that operational risk represents approximately 12 percent of risk-weighted assets for traditional lending under the expanded risk-based approach and assuming an average 35 percent risk weight for eligible residential real estate exposures, an operational risk add-on of approximately 5 percentage points to residential real estate risk weights would be appropriate.

*If the agencies were to implement such an approach for purposes of the final rule, what would be the appropriate risk-weight calibration? The agencies encourage commenters to provide data and supporting analysis.*

## *2. Corporate exposures and certain other assets*

The proposal would update the risk weights applicable to (1) corporate exposures and (2) all assets not specifically assigned a different risk weight under the capital rule and that are not deducted from regulatory capital (other assets).

Under the proposal, the risk weight applicable to corporate exposures would be reduced from 100 percent to 95 percent and the risk weight applicable to other assets would be reduced from 100 percent to 90 percent.<sup>40</sup> These changes aim to balance a more risk-sensitive calibration with maintaining the simplicity of the standardized approach. The proposal would maintain the existing definition of corporate exposure and other assets.

When analyzing the risk-based capital requirements for specific business lines under the expanded risk-based proposal, the agencies determined that the current risk weights for certain exposure categories may not appropriately reflect risks. The expanded risk-based proposal includes reduced risk weights relative to the current standardized approach for corporate exposures that are deemed investment grade and retail exposures that exhibit reduced credit risk. These changes in the expanded risk-based proposal are intended to increase sensitivity to risk of the capital requirements for the banking organizations covered by that proposal. However, the increased complexity and operational burden for achieving these enhancements in risk sensitivity would not be appropriate for a standardized approach that applies to smaller and less complex

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<sup>40</sup> The other assets category is composed of exposures to individuals, other real estate owned, and other exposures not specifically assigned a different risk weight.

banking organizations. To better calibrate the standardized approach's general risk weights for similar exposures while retaining their simplicity, the agencies conducted additional data analysis.

The risk weights assigned to corporate exposures and other assets under this proposal are informed by the risk weights for credit risk and operational risk that would apply to domestic Category III and IV banking organizations under the expanded risk-based approach. Specifically, the exposure categories that would be risk-weighted as corporate exposures and other assets were approximated using exposures reported in the special data collection, risk-weighted as under the expanded risk-based proposal.<sup>41</sup> This analysis resulted in a weighted-average credit risk weight of 85 percent for corporate exposures and 77 percent for other assets.

In addition to credit risk, the expanded risk-based proposal would assign risk-weighted asset requirements for the operational risk of these exposures. Consistent with the simple risk weighting of the standardized approach, this proposal would reflect a nominal add-on to account for operational risk. Analysis in the expanded risk-based proposal suggests that risk-weighted assets for operational risk would represent approximately 12 percent of credit risk-weighted assets for traditional lending activities.<sup>42</sup> Assuming approximately an 80 percent credit risk weight for these activities, this would result in approximately a 10 percentage points risk-weight

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<sup>41</sup> In late 2023, the Board collected data on risk-weighted assets from 32 large bank holding companies based on the specific requirements contained in a July 27, 2023, capital proposal. See <https://www.federalreserve.gov/newsevents/pressreleases/bcreg20231020b.htm>. Corporate exposures were proxied using data reported in line items containing corporate exposures (item 8), certain real estate exposures (items 6.d, 6.g, 6.h, and 6.i), and certain off-balance sheet items (items 13 to 25 and 27), where those items were assigned one of the possible risk-weights corresponding to corporate exposure under the expanded risk-based approach proposal. Other asset exposures were proxied using data reported in line items containing retail exposures (item 7), other assets (item 9), and certain off-balance sheet items (items 13) where such exposures were assigned a risk weight corresponding to either retail exposures or a risk weight of 100 percent.

<sup>42</sup> See Table VII.6 in the expanded risk-based proposal. This calculation is based on the risk-weighted assets estimated to apply to the traditional lending activities of Category I and II bank holding companies.

add-on for operational risk. Moreover, the methodology used to determine the weighted-average risk weight for other assets under the expanded risk-based approach is likely slightly underestimated because the portfolios of non-Category III or IV banking organizations subject to the standardized approach likely include fewer transactor retail exposures (with relatively low risk weights) as smaller banking organizations have more limited credit card portfolios. Therefore, this proposal would assign risk weights of 95 percent for corporate exposures and 90 percent for other assets.

*Question 11: The agencies seek comment on the proposed risk weight for corporate exposures. What alternative risk-weight should the agencies consider, and why? Please provide any supporting data.*

*Question 12: The agencies seek comment on the proposed risk weight for exposures to assets not otherwise assigned to a specific risk weight under the current standardized approach and that are not deducted from tier 1 or tier 2 capital pursuant to § .22. What are the advantages and disadvantages of the proposed risk weight of 90 percent for this set of exposures? What alternative risk-weight should the agencies consider, and why? Please provide any supporting data.*

*Question 13: The agencies seek comment on whether to create a separate category, or separate categories, for retail exposures in the proposed standardized approach. What would be the advantages and disadvantages of creating a separate category for retail exposures? What are the appropriate criteria for defining retail exposures (for example, the criteria used to define retail exposures under the expanded risk-based proposal)? What risk weight would be appropriate for retail exposures for covered banking organizations? In a revised treatment where retail exposures are segregated into their own risk-weight category, would it be*

*appropriate to set a 100 percent risk weight for other assets (not including retail exposures) and why? Please provide relevant data to support your views, including information on the historical loss rates and risk characteristics of retail exposures.*

***B. Off-balance sheet exposures***

The proposal would better capture the risk of certain off-balance sheet exposures relative to the current standardized approach by revising the definition of commitment to clarify the off-balance sheet exposures that would be subject to risk-based capital requirements and modifying the conversion factors applicable to certain credit and equity commitments.

*1. Definition of commitment*

The current capital rule defines a commitment as any legally binding arrangement that obligates a banking organization to extend credit or to purchase assets.<sup>43</sup> Such an arrangement is treated as a commitment even when the banking organization has the unilateral right to cancel the arrangement at any time. The agencies have received questions from banking organizations regarding whether certain types of arrangements, such as advised credit lines and uncommitted lines, would be commitments even if they are unconditionally cancelable. In addition, the agencies have observed an inconsistent application of the current definition of commitment.

Consistent with the expanded risk-based proposal, the proposal would revise the definition of commitment to clarify that any contractual arrangement under which a banking organization and an obligor agree to the terms applicable to one or more future extensions of credit, purchases of assets, or issuances of credit substitutes by the banking organization is a commitment, whether or not the arrangement is unconditionally cancelable. Consistent with the current capital rule, an unconditionally cancelable commitment would include a commitment that permits a banking

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<sup>43</sup> See 12 CFR 3.2 (OCC); 12 CFR 217.2 (Board); 12 CFR 324.2 (FDIC).

organization to, at any time, with or without cause, refuse to extend credit, purchase assets, or issue credit substitutes under the arrangement (to the extent permitted under applicable law). Similarly, the proposal clarifies that a contractual arrangement to extend credit, purchase assets, or issue credit substitutes, but which does not obligate the banking organization to do so, is also considered a commitment that is unconditionally cancelable.<sup>44</sup> This approach would promote comparable treatment across banking organizations subject to the capital rule.

Commitments represent an arrangement where the banking organization could expect to purchase assets or to extend credit to an obligor, in which case the credit becomes an on-balance sheet asset. The scope of the definition is, therefore, not intended to be limited to those situations in which the banking organization is obligated to provide some amount of credit to an obligor. The agencies do not, however, intend for the definition of commitment to include arrangements where a banking organization has merely offered potential terms to a potential obligor or that continue to be subject to negotiation between the parties. For the purpose of the regulatory capital rule, a commitment does not and would not include pre-approval letters for residential mortgage loans, credit card offers, or other offers that have not yet been agreed upon by both parties to the transaction.

Examples of arrangements that would generally be considered commitments under the proposal include fronting commitments, where a banking organization agrees to fund the obligations of other members of a syndicate of lenders, and commitment letters, where a banking organization agrees to provide financing in connection with an acquisition or other transaction to be entered into by the obligor. The proposal would also include other off-balance sheet activities

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<sup>44</sup> The proposal would remove the definition of “unconditionally cancelable” and revise the definition of “commitment” to indicate which commitments are considered unconditionally cancelable.

such as advised lines or “uncommitted” facilities as commitments (even if they are unconditionally cancelable or provide that the banking organization is not obligated to perform). For example, an arrangement under which a banking organization retains full discretion as to whether to extend credit to a potential borrower, but under which the banking organization and the potential borrower have agreed to the material terms on which such lending would take place if the banking organization chose to extend credit, is an unconditionally cancelable commitment under the proposal. An unconditionally cancelable commitment also includes an arrangement where a banking organization provides an initial line of credit with an additional amount that the banking organization may extend in the future subject to prior approval by the banking organization, with the agreed upon terms of the future unconditionally cancelable line.

Exposures without pre-set limits on the amount of credit that can be extended also can be unconditionally cancelable commitments. With some retail products, such as with charge cards, the banking organization does not disclose a pre-set credit limit to its obligors. For charge cards, or similar types of off-balance sheet exposures, each attempt to borrow by an obligor is individually underwritten and requires the approval of the banking organization. Nevertheless, because the banking organization and the borrower have agreed to the material terms on which such lending would take place, such arrangements meet the definition of commitment and, therefore, should be treated as unconditionally cancelable commitments for regulatory capital purposes.<sup>45</sup>

*Question 14: The agencies seek comment on the clarification to the definition of commitment. Does the proposal appropriately capture as off-balance sheet exposures*

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<sup>45</sup> See section V.F. for the proposed methodology to determine the exposure amount for retail exposures with no pre-set limit.

*arrangements where the covered banking organization is not legally obligated to extend credit, purchase assets, or issue credit substitutes but which nonetheless arise out of a contractual arrangement to extend credit or purchase assets? To what extent would the proposed definition affect a covered banking organization's business practices regarding commitments and similar arrangements, including how covered banking organizations treat such arrangements for regulatory capital and reporting purposes? Please provide any rationale or data that may be helpful for the agencies to consider.*

## *2. Conversion factors*

Consistent with the current rule, under the proposed rule a covered banking organization would calculate the exposure amount of an off-balance sheet exposure by multiplying the off-balance sheet component, which is usually the contractual amount or adjusted carrying value, by the applicable conversion factor. The resulting exposure amount would then be assigned to the relevant risk-weight category for the exposure. The proposal would retain the same conversion factors from the current capital rule, except with respect to commitments.<sup>46</sup>

Under the current standardized approach, commitments that are not unconditionally cancelable with an original maturity of one year or less receive a 20 percent credit conversion factor and those with an original maturity of more than one year receive a 50 percent credit conversion factor.<sup>47</sup> The proposal would simplify the conversion factors applicable to the unused

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<sup>46</sup> Note issuance facilities and revolving underwriting facilities are forms of revolving credit. Notes issued under note issuance facilities and revolving underwriting facilities are short-term instruments issued under a legally binding medium-term contractual arrangement. Under a revolving underwriting facility, the underwriting banking organization agrees to provide loans should the issue fail, but under a note issuance facility the banking organization could either lend to the issuer or purchase the outstanding notes. Consistent with the current rule and with the Basel standards, the proposal would require banking organizations to apply a 50 percent credit conversion factor to the off-balance sheet amount of note issuance facilities and revolving underwriting facilities, regardless of whether a lower credit conversion factor would otherwise apply.

<sup>47</sup> 12 CFR 3.33(b)(2) (OCC); 12 CFR 217.33(b)(2) (Board); 12 CFR 324.33(b)(2) (FDIC).

portion of a credit or equity commitment that is not unconditionally cancelable. For these commitments, the proposal would no longer differentiate conversion factors by original maturity of one year or less and greater than one year.

Under the proposal, a credit commitment that is not unconditionally cancelable would be subject to a credit conversion factor of 40 percent regardless of the maturity of the facility.<sup>48</sup> Removing the one-year mark as a dividing line between substantially different treatments would remove any regulatory incentive to structure transactions around that line. The 40 percent credit conversion factor would align with the expanded risk-based proposal and reflect that most outstanding commitments that are not unconditionally cancelable have a maturity greater than one year.<sup>49</sup>

The proposal would also simplify the treatment of conditional commitments to acquire an equity exposure by removing the differentiation of conversion factors by maturity. Under the proposal a covered banking organization would be required to multiply the effective notional principal amount of a conditional commitment by a 40 percent conversion factor to calculate its adjusted carrying value.<sup>50</sup>

*Question 15: What additional factors, if any, should the agencies consider for determining the applicable credit conversion factors for commitments?*

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<sup>48</sup> Under the proposal, a 40 percent conversion factor would also apply to commitments that are not unconditionally cancelable commitments for purposes of calculating the total leverage exposure for the supplementary leverage ratio framework and for the calculation of the Size Category of the FR Y-15 Systemic Risk Report form.

<sup>49</sup> In Q2 2025, prior to application of conversion factors, commitments with maturity less than one year accounted for under 20 percent of aggregate risk-weighted assets associated with commitments of Category III and smaller bank holding companies (See FR Y-9C Schedule HC-R Part II, items 18.a and b).

<sup>50</sup> Aside from this change, the equity framework would retain the current capital rule's methods for calculating the adjusted carrying value for equity exposures. Under the proposal, the risk-weighted asset amount calculation for equity exposures would also be consistent with the current rule.

*Question 16: What are the advantages and disadvantages relative to the proposal of using the current treatment for commitments, that are not unconditionally cancelable which differentiates credit conversion factors based on maturity, and would apply a 20 percent credit conversion factor to those commitments with an original maturity of one year or less, and a 50 percent credit conversion factor to those with an original maturity of more than one year?*

*Question 17: What are the advantages and disadvantages of applying the proposed 40 percent credit conversion factor for commitments regardless of maturity that are not unconditionally cancelable to the supplementary leverage ratio framework and to the Size Category of the FR Y-15?*

### *3. Commitments with no pre-set limit*

Most off-balance sheet exposures, such as credit card lines, allow obligors to borrow up to a specified amount. However, some off-balance sheet exposures such as charge cards do not have an explicit contractual pre-set credit limit. For commitments that do not have an express contractual maximum amount or pre-set limit, the proposal would include an approach to calculate a proxy for the committed but undrawn amount of the commitment (undrawn exposure amount). This approach would generally align with that under the expanded risk-based proposal, except for a broader scope of application under this proposal given the objective to retain a simpler and less granular framework.

The proxy for the undrawn exposure amount is particularly important for covered banking organizations subject to the supplementary leverage ratio framework. Consistent with the current rule, under the proposal, covered banking organizations would apply a zero percent credit conversion factor to the unused portion of a commitment that is unconditionally cancelable for risk-based capital purposes. However, for purposes of the supplementary leverage ratio the

minimum credit conversion factor that may be assigned to an off-balance sheet exposure is 10 percent.<sup>51</sup>

The undrawn exposure amount would be calculated by using the exposure's highest drawn amount over the previous 24 months as an indicator of the amount of credit a covered banking organization is likely to extend to an obligor in the future. Specifically, under the proposal, a covered banking organization would first identify the largest drawn amount by an obligor over the prior 24 months or, if the covered banking organization has offered the product to the obligor for fewer than 24 months, the largest drawn amount since the commitment was first issued. The off-balance sheet exposure amount would be calculated by first subtracting the current drawn amount from the largest drawn amount and then multiplying this difference by the applicable credit conversion factor. The risk-weighted asset amount would be the off-balance sheet exposure amount multiplied by the applicable risk weight for the obligor.

A substantial share of uncapped commitments is in the form of charge cards to individuals, and these exposures have characteristics that suggest the highest drawn balance method described above is a reasonable proxy to estimate the undrawn exposure amount. A charge card does not have a pre-set credit limit, its balance is generally required to be paid in full at the end of each statement period, and charge card transactions are generally underwritten separately and reviewed by the issuing banking organization for approval or denial. Therefore, a charge card obligor's spending pattern, which reflects a covered banking organization's approval of the charge card obligor's usage, is indicative of the off-balance sheet exposure amount for a charge card.

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<sup>51</sup> See 12 CFR 3.10(c)(2)(viii) (OCC); 12 CFR 217.10(c)(2)(viii)(Board); 12 CFR 324.10(c)(2)(viii)(FDIC)

As an example of the proposed treatment, assume an obligor's charge card had a maximum drawn amount of \$4,000 during the period of the prior 24 months and a current drawn amount of \$3,000.<sup>52</sup> To determine the off-balance sheet exposure amount of the charge card, the covered banking organization would (1) identify the maximum drawn amount over the prior 24 months (\$4,000), (2) subtract the applicable drawn amount of \$3,000 from \$4,000 (\$1,000), and (3) multiply \$1,000 by the applicable credit conversion factor.<sup>53</sup>

*Question 18: What are the advantages and disadvantages of the proposed treatment for commitments with no express contractual maximum amount or pre-set limit? What other time period or approach should the agencies consider for calculating the highest drawn amount (for example, using month-end balance or statement balances), and why?*

*Question 19: What would be the advantages and disadvantages of applying a multiplier to the highest drawn amount to calculate the off-balance sheet exposure amount (for example, multiplying the highest drawn balance by a figure between 1.5 and 3) to calculate the off-balance sheet exposure amount?<sup>54</sup> If applied, how should such multiplier be calibrated? What data should the agencies use to calibrate such a multiplier?*

*Question 20: The agencies seek feedback on commitments that contain no express contractual maximum amount but also contain features such as a "pay over time" limit, which allows a borrower to carry a balance with interest on certain charges. What would be the*

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<sup>52</sup> The maximum balance would reflect the highest daily drawn amount for the account with no pre-set limit over the period.

<sup>53</sup> The applicable credit conversion factor for these types of exposures, assuming they are unconditionally cancelable commitments, would continue to be zero percent under the standardized approach and 10 percent under the supplementary leverage ratio.

<sup>54</sup> If a multiplier of two were applied to the maximum drawn amount over the prior 24 months, under the example presented above, the off-balance sheet exposure amount would equal \$5,000, which corresponds to \$4,000 times two minus \$3,000. The other steps of the process would remain unchanged and would result in a risk-weighted asset amount of \$225 for the off-balance sheet exposure.

*advantages and disadvantages of incorporating the “pay over time” limit as a floor when calculating the highest drawn amount under the proposal? For example, assume the maximum drawn amount over the prior 24 months is \$4,000 and the “pay over time” limit is \$5,000. Under this alternative, the applicable drawn amount would be subtracted from \$5,000 instead of \$4,000.*

*Question 21: The agencies seek comment on whether the specific treatment described above is appropriate for all commitments with no contractual maximum or pre-set limit. What are the advantages and disadvantages of instead limiting the proposed treatment for such commitments to a narrower set of exposure categories (such as the scope under the expanded risk-based proposal) and why? What alternative treatments, if any, should the agencies consider for determining the exposure amount when no contractual maximum or pre-set limit exists? Describe in detail the types of alternative treatments that the agencies should consider, and provide supporting rationale or data that may be helpful for the agencies.*

### ***C. Derivative contracts***

Under the proposal and consistent with the current capital rule, a covered banking organization would use the current exposure methodology to calculate the exposure amount for derivative contracts unless it elects to use the standardized approach for counterparty credit risk (SA-CCR).<sup>55,56</sup> To promote consistency, a covered banking organization that elects to use SA-CCR would apply the same revised SA-CCR framework that is proposed in the expanded risk-based proposal regardless of whether the banking organization is subject to the standardized

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<sup>55</sup> See 12 CFR 3.34 (OCC); 12 CFR 217.34 (Board); 12 CFR 324.34 (FDIC).

<sup>56</sup> 85 FR 4362 (Jan. 24, 2020).

approach or the expanded risk-based approach.<sup>57</sup> The revised SA-CCR framework would better reflect the risk-reducing effects of netting arrangements and collateral.

Specifically, the revised SA-CCR framework would recognize qualifying cross-product master netting agreements for non-cleared transactions and incorporate certain non-cleared repo-style transactions, including client-facing transactions. The revised framework would also permit the netting of collateralized-to-market and settled-to-market client-facing derivative transactions. In addition, the proposal would make technical revisions to promote consistent implementation of SA-CCR and better reflect counterparty credit risk. The accompanying expanded risk-based approach proposal provides further details on the changes to the SA-CCR framework.

#### ***D. Credit risk mitigation***

The current capital rule permits covered banking organizations to recognize certain types of credit risk mitigants, such as guarantees, credit derivatives, and collateral, for risk-based capital purposes provided the credit risk mitigants satisfy the qualification standards under the rule.<sup>58</sup> Credit derivatives and guarantees can reduce the credit risk of an exposure by placing a legal obligation on a third-party protection provider to compensate the banking organization for losses associated with a credit event of the original obligor.<sup>59</sup> Similarly, the use of collateral often can reduce the credit risk of an exposure by creating the right of a banking organization to take ownership of and liquidate the collateral in the event of a default by the counterparty.

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<sup>57</sup> See expanded risk-based proposal section IV.A.4.

<sup>58</sup> Consistent with the current capital rule, the proposal would not require covered banking organizations to recognize a credit risk mitigant that it has obtained. Credit derivatives that a covered banking organization cannot or chooses not to recognize as a credit risk mitigant would be subject to a separate counterparty credit risk capital requirement.

<sup>59</sup> Credit events are defined in the documents governing the credit risk mitigant and often include events such as failure to pay principal and interest and entry into insolvency or similar proceedings.

Prudent use of such mitigants can help a banking organization reduce the credit risk of an exposure and in some circumstances reduce the risk-based capital requirement associated with that exposure.

Credit risk mitigants recognized for risk-based capital purposes must be of sufficiently high quality to effectively reduce credit risk. For guarantees and credit derivatives, the current capital rule primarily looks to the creditworthiness of the guarantor and the features of the underlying contract to determine whether these forms of credit risk mitigation may be recognized for risk-based capital purposes (eligible guarantee or eligible credit derivative). With respect to collateralized transactions, the current capital rule primarily looks to the liquidity profile and quality of the collateral received (such as the creditworthiness of the issuer of the collateral) and the nature of the banking organization's security interest to determine whether the collateral qualifies as financial collateral that may be recognized for purposes of risk-based capital.<sup>60</sup>

The proposal would largely incorporate the treatments for collateralized transactions, guarantees, and credit derivatives from the current capital rule with enhancements to increase risk sensitivity. For eligible guarantees and eligible credit derivatives, the proposal would generally retain the substitution approach from the current capital rule with two modifications. Specifically, the proposal would modify the treatment for eligible credit derivatives that do not include restructuring as a credit event and no longer permit the recognition of credit protection from nth-to-default credit derivatives.<sup>61</sup>

For collateralized transactions where financial collateral secures exposures that are not derivative contracts or netting sets of derivative contracts, the proposal would generally retain

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<sup>60</sup> See definition of financial collateral in § \_\_.2 of the capital rule. 12 CFR 3.2 (OCC); 12 CFR 217.2 (Board); 12 CFR 324.2 (FDIC).

<sup>61</sup> See section III.E.5.b. of this **SUPPLEMENTARY INFORMATION**.

the simple approach from the current capital rule with the following two modifications.<sup>62</sup> First, the proposal would replace the requirement that financial collateral be subject to a collateral agreement with conditions including the requirement that the covered banking organization have the right to liquidate or take legal possession of the collateral upon an event of default. Second, the proposal would permit covered banking organizations to recognize, under the simple approach, the credit risk mitigation benefits of financial collateral with a maturity or currency mismatch, after applying certain adjustments. The proposal would also update the collateral haircut approach to partially recognize the netting and diversification benefits that may be present in repo-style transactions, eligible margin loans, collateralized derivative contracts and single product netting sets of such transactions.<sup>63</sup>

The proposal would also introduce eligible prepaid credit protection arrangements as a credit risk mitigant available to all exposure types, including securitizations, and permit covered banking organizations to recognize the credit risk mitigation benefits of the protection amount of the prepaid credit protection arrangement, discounted to reflect any applicable maturity and currency mismatch adjustments.

*1. Guarantees and credit derivatives*

*a. Substitution approach*

Consistent with the current capital rule, the proposal would permit a covered banking organization to recognize the credit risk-mitigation benefits of eligible guarantees and eligible credit derivatives by substituting the risk weight applicable to the eligible guarantor or

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<sup>62</sup> The collateral haircut approach also would be available to covered banking organizations to recognize the benefits of collateral for eligible margin loans and repo-style transactions.

<sup>63</sup> Consistent with the expanded risk-based approach, the proposal would increase simplicity, consistency and comparability of capital requirements eliminating the option for banking organizations to use of their own estimates of haircuts for purposes of the collateral haircut approach.

counterparty to the eligible credit derivative (protection provider) for the risk weight applicable to the hedged exposure. To recognize the risk mitigating benefits of a guarantee or credit derivative for risk-based capital purposes, the proposal would continue to require the issuer of or counterparty to the eligible guarantee or eligible credit derivative, respectively, to be an eligible guarantor.<sup>64</sup> The proposal would rely on the definition of eligible guarantor in §\_\_.2 of the capital rule, which, among other criteria, requires an entity to have issued and outstanding an unsecured debt security without credit enhancement that is investment grade at the time the guarantee is issued or anytime thereafter.

*Question 22: The agencies seek comment on the requirement that the entity has issued and outstanding an unsecured debt security without credit enhancement that is investment grade to meet the definition of an eligible guarantor. What, if any, alternatives to this requirement should the agencies consider to help ensure that eligible guarantors can be expected to perform on guarantees, and what would the pros and cons of those alternatives be?*

*b. Adjustment for credit derivatives without restructuring*

Credit derivative contracts in certain jurisdictions include debt restructuring as a credit event that triggers a payment obligation by the protection provider to the protection purchaser. Such restructurings of the hedged exposure may involve forgiveness or postponement of principal, interest, or fees that result in a loss to investors. Consistent with the current capital rule, the proposal would generally require a banking organization that seeks to recognize the credit risk-mitigation benefits of an eligible credit derivative that does not include a restructuring

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<sup>64</sup> Under the advanced approaches framework in the current capital rule, an eligible guarantee need not be issued by an eligible guarantor unless the exposure is a securitization exposure. Under the proposal, an eligible guarantee would need to be issued by an eligible guarantor.

of the reference exposure as a credit event to reduce the effective notional amount of the credit derivative by 40 percent to account for any unmitigated losses that could occur as a result of a restructuring of the hedged exposure.

Under the proposal, however, the 40 percent adjustment would not apply to eligible credit derivatives without restructuring as a credit event if both of the following requirements are satisfied: (1) the terms of the hedged exposure (and the reference exposure, if different from the hedged exposure) allow the maturity, principal, coupon, currency, or seniority status to be amended outside of receivership, insolvency, liquidation, or similar proceeding only by unanimous consent of all parties; and (2) the covered banking organization has conducted sufficient legal review to conclude with a well-founded basis (and maintains sufficient written documentation of that legal review) that the hedged exposure is subject to the U.S. Bankruptcy Code or a domestic or foreign insolvency regime with similar features that allows for a company to reorganize or restructure and provides for an orderly settlement of creditor claims.

The unanimous consent requirement would mean that, for restructurings occurring outside of an insolvency proceeding, all holders of the hedged exposure (and the reference exposure, if different from the hedged exposure) must agree to any restructuring for the restructuring to occur, and no holder can vote against the restructuring or abstain. This unanimous consent requirement would reduce the risk that a covered banking organization would suffer a credit loss on the hedged exposure that would not be offset by a payment under the eligible credit derivative. Banking organizations generally would only be incentivized to vote for a restructuring if the terms of the restructuring provide a more beneficial outcome to the banking organization relative to insolvency proceedings that would trigger payment under the eligible credit derivative. Additionally, the unanimous consent requirement for the reference exposure, if

different from the hedged exposure, would provide an additional layer of security by significantly reducing the probability of reaching a restructuring agreement that results in a loss of principal or interest for creditors without triggering payment under the eligible credit derivative. The unanimous consent requirement would need to be satisfied through the terms of the hedged exposure (and the reference exposure, if different from the hedged exposure), which could be accomplished through a contractual provision of the exposure or the operation of the applicable law.

The requirement that the hedged exposure be subject to the U.S. Bankruptcy Code or a similar domestic or foreign insolvency regime would help to ensure that any restructuring is done in an orderly, predictable, and regulated process. In the event that the obligor of the hedged exposure defaults and the default is not cured, the obligor would either be required to enter insolvency proceedings, which would trigger payment under the credit derivative, or the obligor would be required to pursue restructuring outside of insolvency, which could not occur without the banking organization's consent. Together, the proposed conditions are intended to ensure that credit derivatives that do not include restructuring as a credit event but provide similarly effective protection as those that do contain such provisions would be afforded similar recognition under the capital framework.

*Question 23: The agencies seek comment on allowing covered banking organizations to recognize in full the effective notional amount of credit derivatives that do not include restructuring as a credit event, if certain conditions are met. What are the cost and benefits of this approach? What, if any, less restrictive conditions for receiving full recognition should the agencies consider that would more appropriately capture credit derivatives that provide similar protection as those that include restructuring as a credit event receive and why? For example,*

*what would be the advantages and disadvantages of requiring the consent of all parties directly and adversely affected by a restructuring, rather than the unanimous consent of all parties?*

*What would be the advantages and disadvantages of requiring the consent of all parties affected by any change in lien position or priority in the hedged or referenced exposure?*

*Question 24: To what extent is the proposed treatment of eligible credit derivatives that do not include restructuring of the reference exposure as a credit event relevant outside of the United States and how should this be considered for purposes of the proposal?*

*Question 25: In order for a covered banking organization to recognize the credit risk mitigation benefits of an eligible credit derivative, the current capital rule requires that legally-enforceable cross-default or cross-acceleration clauses be in place and that the reference exposure and the hedged exposure be to the same legal entity. What would be the advantages and disadvantages of allowing recognition of credit derivatives where (1) the reference exposure is to a different legal entity than the hedged exposure, (2) the reference exposure's legal entity is guaranteed by its parent company, and (3) the parent company is subject to a binding cross-default or cross-acceleration provision related to the hedged exposure's debt?*

## *2. Collateralized transactions*

### *a. Simple approach*

Consistent with the current capital rule, a covered banking organization would be permitted to recognize the risk-mitigating benefits of financial collateral using the simple approach by substituting the risk weight applicable to an exposure with the risk weight applicable to the financial collateral securing the exposure, generally subject to a 20 percent floor.

Under the current capital rule, a requirement for recognizing the credit risk mitigation benefit of financial collateral under the simple approach is that the collateral must be subject to a

collateral agreement for at least the life of the exposure. The proposal would not include this requirement under the simple approach because the requirement is overly broad and not relevant for certain transaction types. For example, while the right to close out a transaction would be relevant with respect to a repurchase agreement, it may not be relevant with respect to a loan. Instead, the proposal would require that the legal mechanism by which the financial collateral is pledged or transferred be enforceable and provide the covered banking organization with an ability to exercise its applicable legal rights with respect to the collateral in a timely manner upon an event of default. Depending on the characteristics of the type of exposure and the financial collateral in question, those rights may include the right to liquidate or take legal possession of the financial collateral, to set off amounts owed by the covered banking organization against amounts owed by the obligor, and to close out the underlying transaction. However, not all of these rights may be applicable with respect to all types of exposures and financial collateral, and a covered banking organization would only be required to have those rights that are applicable for the type of exposure and financial collateral in question. This requirement, in combination with the definition of financial collateral—which, in part, requires a covered banking organization to have a perfected, first-priority security interest (or the legal equivalent thereof) in the collateral—and the other requirements of §\_\_.37(b)(1) would provide a sufficient basis for recognizing the collateral under the simple approach.

The requirement under the current capital rule that financial collateral be subject to a collateral agreement often prevents a covered banking organization from recognizing financial collateral as a credit risk mitigant under the simple approach if the covered banking organization's exercise of its rights may be stayed in a bankruptcy of the obligor. This has generally meant that a covered banking organization could not use the simple approach to

recognize financial collateral in respect of collateralized loans because the exercise of a covered banking organization's collateral rights with respect to a loan would often be subject to a stay in the bankruptcy or insolvency of a borrower under the applicable law. Under the proposal, the fact that a covered banking organization's rights may be subject to a stay in the event of an obligor's bankruptcy would not preclude the banking organization from recognizing the credit risk mitigation benefits of financial collateral, provided the banking organization has a well-founded basis for concluding that it will be able to exercise its rights in a timely manner. The proposed change would permit covered banking organizations to recognize the credit risk mitigation benefits of financial collateral that protects exposures arising from many types of loans and traditional credit products. Other elements of the simple approach, such as the 20 percent risk-weight floor, help to address the risk of declines in the value of collateral.

Typically, financial collateral in respect of a collateralized transaction is pledged by the obligor of that exposure. In some cases, collateral may be pledged or transferred by a party other than the obligor. A third-party pledgor may be the parent or an affiliate of an obligor or an unrelated party that is providing credit risk protection to the banking organization. While collateral provided by a third party may be an effective credit risk mitigant, it may also pose unique risks. In particular, depending on the laws of the applicable jurisdictions and the terms of the relevant legal agreements, the bankruptcy or insolvency of a pledgor prior to an event of default of the obligor may terminate or impair the banking organization's rights to the collateral. In these circumstances, financial collateral does not provide an effective credit risk mitigant. Consequently, the proposal would require that the bankruptcy or insolvency of a third-party pledgor not result in the termination or impairment of the covered banking organization's rights in respect of the financial collateral.

There may be situations where obligors have the ability to remove collateral that they are contractually obligated to maintain when a banking organization is experiencing stress. This risk is most apparent when financial collateral takes the form of cash on deposit at a banking organization, where a banking organization's deposit systems may not reflect the obligor's contractual obligation to maintain the deposit at the banking organization. It may also arise, in respect of other types of financial collateral, depending on the custody arrangement and associated controls in respect of the collateral. Financial collateral is not an effective credit risk mitigant if a banking organization cannot appropriately safeguard its rights in respect of such financial collateral. Consequently, the proposal would also require a covered banking organization to be able to reasonably demonstrate the ability to protect and enforce its rights in respect of any financial collateral.

Other safeguards relating to the simple approach are intended to sufficiently calibrate the benefits of the proposal's recognition of financial collateral for a broader scope of products. For example, the maturity mismatch adjustment, which is described in greater detail below, reduces the benefit of financial collateral based on the difference between the residual maturity of the legal mechanism by which financial collateral is pledged and that of the secured exposure. Additionally, for a situation with a maturity mismatch, the proposal would only allow for recognition of the credit risk mitigant where the original maturity of the legal mechanism is greater than or equal to one year and the residual maturity of the legal mechanism is greater than three months. These requirements, taken together with the other requirements in section .121 of the proposal, would incentivize covered banking organizations to utilize credit risk mitigants that provide effective credit risk transfer.

*Question 26: Under the simple approach, the current capital rule requires that collateral be revalued at least every six months. The agencies recognize that, in practice, most collateral agreements for liquid collateral provide for more frequent valuation. The proposal would remove the requirement for collateral agreements. Given that financial collateral is generally liquid, what would be the advantages and disadvantages of requiring a more frequent minimum revaluation interval—such as quarterly—under the simple approach? Please provide rationale supporting or opposing a more frequent revaluation requirement.*

*Question 27: The proposal would maintain the current capital rule’s definition of financial collateral and allow covered banking organizations to recognize the risk-mitigating benefits of cash on deposit, including cash held by a third-party custodian or trustee. The agencies invite comment on whether the definition of financial collateral is sufficiently clear with respect to cash collateral held for a covered banking organization by a third-party custodian or trustee. What would be the advantages or disadvantages of revising the “cash on deposit” prong of the definition of financial collateral to explicitly recognize cash on deposit at any third-party depository institution, regardless of whether it is a custodian or trustee? In addition, what would be the appropriate risk weight for the collateralized exposure where the financial collateral is, directly or indirectly, in the form of a deposit claim on a third-party depository institution and why? What would be the advantages and disadvantages of subjecting the collateralized exposure to the 20 percent risk weight floor? What, if any, other alternative approaches should the agencies consider and why?*

*b. Collateral haircut approach*

Under the proposal, as under the current capital rule, a covered banking organization would be permitted to recognize the credit risk-mitigation benefits of collateral supporting repo-

style transactions, eligible margin loans, collateralized derivative contracts, and single product<sup>65</sup> netting sets of such transactions by adjusting its exposure amount to its counterparty to recognize financial collateral received and any collateral posted to the counterparty. The collateral haircut approach would continue to require a covered banking organization to adjust the fair value of the collateral received and posted to account for any potential market price volatility in the value of the collateral during the margin period of risk, as well as to address any currency mismatch. To increase the risk-sensitivity of the collateral haircut approach, the proposal would modify certain of the standard market price volatility haircuts. At the same time, to reduce unwarranted divergence in risk-weighted assets, the proposal would no longer allow a covered banking organization to use its own internal estimates for calculating haircuts.

*i. Formula for determining exposure amount*

The proposal would introduce a new formula for calculating the exposure amount of eligible margin loans, repo-style transactions, or netting sets thereof. The proposed exposure amount equation is revised from the current formula to improve the recognition of the risk-mitigating benefits of netting and portfolio diversification. The proposed formula would revert to the current collateral haircut approach formula in cases where there are no variables to populate the second and the third components as described below. The modification would increase the risk sensitivity of the capital requirement for such transactions relative to the current collateral haircut approach. Under the proposal, the exposure amount ( $E^*$ ) of a netting set of eligible margin loans or repo-style transactions or an individual transaction that is not part of a netting set would be determined according to the following formula:

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<sup>65</sup> SA-CCR is proposed for use under Subpart D § 217.34(a)(3) and § 217.37(f) for repo-style transactions that are subject to a qualifying cross-product master netting agreement with derivative contracts

$$E^* = \max \left\{ 0; \left( \sum_i E_i - \sum_i C_i \right) + (0.4 \times net_{exposure}) + \left( 0.6 \times \frac{gross_{exposure}}{\sqrt{N}} \right) + \left( \sum_{fx} (E_{fx} \times H_{fx}) \right) \right\}$$

Where:

- $E^*$  is the exposure amount of the eligible margin loan, repo-style transaction, or netting set after credit risk mitigation.
- $E_i$  is the current fair value of the instrument, cash, or gold the banking organization has lent, sold subject to repurchase, or posted as collateral to the counterparty.
- $C_i$  is the current fair value of the instrument, cash, or gold the banking organization has borrowed, purchased subject to resale, or taken as collateral from the counterparty.
- $net_{exposure} = |\sum_s E_s H_s|$
- $gross_{exposure} = \sum_s E_s |H_s|$
- $E_s$  is the absolute value of the net position in a given instrument or in gold (where the net position in a given instrument or gold equals the sum of the current fair values of the instrument or gold the banking organization has lent, sold subject to repurchase, or posted as collateral to the counterparty, minus the sum of the current fair values of that same instrument or gold the banking organization has borrowed, purchased subject to resale, or taken as collateral from the counterparty).

- $H_s$  is the haircut appropriate to  $E_s$  as described in Table 1 to § \_\_.37, as applicable.  $H_s$  has a positive sign if the instrument or gold is net lent, sold subject to repurchase, or posted as collateral to the counterparty;  $H_s$  has a negative sign if the instrument or gold is net borrowed, purchased subject to resale, or taken as collateral from the counterparty.
- $N$  is the number of instruments with a unique Committee on Uniform Securities Identification Procedures (CUSIP) designation or foreign equivalent, with certain exceptions.  $N$  includes any instrument with a unique CUSIP that the banking organization lends, sells subject to repurchase, or posts as collateral, as well as any instrument with a unique CUSIP that the banking organization borrows, purchases subject to resale, or takes as collateral. However,  $N$  would not include collateral instruments that the banking organization is not permitted to include within the credit risk mitigation framework (such as nonfinancial collateral that is not part of a repo-style transaction included in the banking organization's market risk weighted assets) or elects not to include within the credit risk mitigation framework. The number of instruments for  $N$  would also not include any instrument (or gold) for which the value  $E_s$  is less than one-tenth of the value of the largest  $E_s$  in the netting set. Any amount of gold would be given a value of one.
- $E_{fx}$  is the absolute value of the net position in each currency  $fx$  different from the settlement currency.
- $H_{fx}$  is the haircut appropriate for currency mismatch of currency  $fx$ .

The first component in the above formula ( $\sum_i E_i - \sum_i C_i$ ) would capture the baseline exposure of eligible margin loans, repo-style transactions, or netting sets thereof, after accounting for the value of any collateral received. The second ( $0.4 \times net_{exposure}$ ) and third ( $0.6 \times (gross_{exposure}/\sqrt{N})$ ) components in the above formula would allow for the partial recognition of the netting and diversification benefit of instruments exchanged between a covered banking organization and a given counterparty within a netting set. The net exposure component partially recognizes the offsetting of gross exposures between a given instrument that is both lent and received as collateral within a netting set. Additionally, because the contribution from the gross exposure component to the exposure amount would decrease proportionally with an increase in the number of unique instruments by CUSIP designations or foreign equivalent, the gross exposure component would capture the impact of diversification in the types of instruments lent or received. The fourth component ( $\sum_{fx} (E_{fx} \times H_{fx})$ ) would capture any adjustment to reflect currency mismatch, if applicable.

When determining the market price volatility and currency mismatch haircuts, the covered banking organization would use the market price volatility haircuts described in the following section and a standard 8 percent currency mismatch haircut, subject to certain adjustments.

*Question 28: What are the pros and cons of basing N for purposes of the collateral haircut approach on the number of unique CUSIPs in a netting set? What alternatives should the agencies consider and how would such alternatives align with the goal of identifying the number of instruments for purposes of measuring diversification in the pool?*

*Question 29: The agencies seek comment on the appropriateness of the proposed collateral haircut approach formula, in particular for banking organizations that use the current*

*exposure methodology for derivatives. What are the advantages and disadvantages of revising the collateral haircut approach to align with the formula in the expanded risk-based approach proposal? What, if any, risks may not be appropriately captured by the proposed change for banking organizations that use the current exposure methodology for derivative transactions and why?*

*ii. Market price volatility haircuts*

Under the proposal, a covered banking organization would apply the market price volatility haircut appropriate for the type of collateral, as provided in Table 1 to § \_\_.37 below, when calculating the exposure amount for repo-style transactions, eligible margin loans, collateralized derivative contracts, and single-product netting sets thereof using the collateral haircut approach and in the calculation of the net independent collateral amount and the variation margin amount for collateralized derivative transactions using SA-CCR, if applicable.<sup>66</sup> Consistent with the current capital rule, the proposal would require covered banking organizations to apply an 8 percent supervisory haircut, subject to adjustments, to the absolute value of the net position in each currency that is different from the settlement currency.

*Proposed Table 1 to § \_\_.37*

<b>Market Price Volatility Haircuts</b> (Haircuts in percent)						
Residual Maturity	Securities issued by a sovereign or an issuer described in § __.32(b) <sup>67</sup> (percent)			Other investment-grade securities (percent)		
	Issuer risk weight of zero	Issuer risk	Issuer risk weight of 100	GSE exposures	Exposures other than GSE or	Senior securitization

<sup>66</sup> As described in section III.C. of this Supplementary Information, under the proposal and consistent with the current capital rule, a covered banking organization would use the current exposure methodology to calculate the exposure amount for derivative contracts unless it elects to use SA-CCR.

<sup>67</sup> Includes a foreign PSE that receives a zero percent risk weight.

			weight of 20 or 50			securitization exposures	exposures with risk weight <100
Debt Securities	Less than or equal to 1 year	0.5	1.0	15.0	1.0	2.0	4.0
	Greater than 1 year and less than or equal to 3 years	2.0	3.0	15.0	4.0	4.0	12.0
	Greater than 3 years and less than or equal to 5 years					6.0	
	Greater than 5 years and less than or equal to 10 years	4.0	6.0	15.0	8.0	12.0	24.0
	Greater than 10 years					20.0	
Main index equities (including convertible bonds) and gold					20.0		
Other publicly traded equities and convertible bonds					30.0		
Mutual funds and exchange traded funds					Highest haircut applicable to any security in which the fund can invest, unless the banking organization can apply the full look-through approach for equity exposures to investment funds in § __.53(b), in which case the banking organization may use a weighted average of haircuts applicable to the securities held by the fund.		
Cash on deposit					0.0		
Other exposure types <sup>68</sup>					30.0		

The proposed haircuts would strike a balance between simplicity and risk sensitivity relative to the supervisory haircuts in the current capital rule by introducing additional granularity with respect to residual maturity, which is a meaningful driver for distinguishing between the market price volatility of different instruments, and by streamlining other aspects of

<sup>68</sup> Includes senior securitization exposures with a risk weight greater than or equal to 100 percent and sovereign exposures with a risk weight greater than 100 percent.

the collateral haircut approach where the exposure's risk weight figures less prominently in the instrument's market price volatility, as described below.

The proposal would apply haircuts primarily based on residual maturity, rather than a combination of residual maturity and underlying risk weight as under the current capital rule, for non-sovereign investment grade debt securities. These haircuts are derived from observed stress volatilities during 10-business day periods during the 2008 financial crisis. Debt securities with longer maturities are subject to higher price volatility from changes in both interest rates and the creditworthiness of the issuer.

Because securitization exposures tend to be more volatile than corporate debt, the proposal would provide a distinct category of market price volatility haircuts for certain securitization exposures consistent with the current capital rule. The proposal would distinguish between non-senior and senior securitization exposures to enhance risk sensitivity.<sup>69</sup> Because senior securitization exposures absorb losses only after more junior securitization exposures, these exposures have an added layer of security and distinct market price volatility. Therefore, the proposal would only specify term-based haircuts for investment grade senior securitization exposures that receive a risk weight of less than 100 percent under the securitization framework. Other securitization exposures would receive the 30 percent market price volatility haircut applicable to "other" exposure types.

The proposal would require a banking organization to apply market price volatility haircuts of 20 percent for main index equities (including convertible bonds) and gold, 30 percent for other publicly traded equities and convertible bonds, and 30 percent for other exposure types. Equities

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<sup>69</sup> As described in section III.E.5.e. of this **SUPPLEMENTARY INFORMATION**, the proposal would define a senior securitization exposure as an exposure that has a first priority claim on the cash flows from the underlying exposures.

in a main index typically are more liquid than those that are not included in a main index, in part because investors may seek to replicate the index by purchasing the referenced equities or engaging in derivative transactions involving the index or equities within the index. The lower haircuts for equities included in a main index under the proposal would reflect the higher liquidity of those securities compared to other publicly traded equities or exposure types, which would generally help to reduce losses to banking organizations when liquidating those securities during stress conditions.

For collateral in the form of mutual fund shares, the proposal would be consistent with the current collateral haircut approach in which a covered banking organization would apply the highest haircut applicable to any security in which the fund can invest. Under the proposal, a covered banking organization could treat exchange traded fund (ETF) shares in the same manner as mutual fund shares and apply haircuts based on the underlying instruments in the fund. Given that ETFs (like mutual funds) may benefit from diversification and tend to have lower levels of price volatility compared to non-pooled investment vehicles, a look-through approach is more risk sensitive than applying the publicly traded equities haircut for ETF shares. The proposal also would include an alternative method available to a covered banking organization if the mutual fund or ETF qualifies for the full look-through approach for purposes of the equity framework under the current rule.<sup>70</sup> This alternative method would provide a more risk-sensitive calculation of the haircut on fund shares collateral by using the weighted average of haircuts applicable to the instruments held by the fund.<sup>71</sup>

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<sup>70</sup> See 12 CFR 3.53(b) (OCC); 12 CFR 217.53(b) (Board); 12 CFR 324.53(b) (FDIC).

<sup>71</sup> If the mutual fund qualifies for the full look-through approach in §\_\_\_.53(b) of the capital rule but would be treated as a market risk covered position if the covered banking organization held the mutual fund directly, the proposal would allow a covered banking organization that is subject to market risk capital requirements to apply the alternative method to calculate the haircut.

In addition, consistent with the expanded risk-based approach proposal, the proposal would require a covered banking organization to apply a market price volatility haircut of 30 percent to address the potential market price volatility for any instruments that the covered banking organization has lent, sold subject to repurchase, or posted as collateral that is not of a type otherwise specified in Table 1 to § \_\_.37.

*Question 30: The agencies seek comment on the appropriateness of the calibration of the market price volatility haircuts. Commenters are encouraged to submit data with their response.*

### *3. Prepaid credit protection*

The proposal would introduce eligible prepaid credit protection arrangements as an additional type of credit risk mitigant. The proposal would define a prepaid credit protection arrangement as a contractual agreement in which a protection purchaser receives an initial amount in cash from a protection provider that the protection purchaser is required to repay, less any losses that the protection purchaser incurs due to a credit event on the protected exposures, such as borrower default on the protected exposures. In this type of arrangement, the amount paid by the protection provider is not collateral that secures a future obligation of the protection provider; rather, it is consideration for a right to future payments, contingent on the performance of the protected exposure(s), from the protection purchaser. This form of credit risk mitigant effectively transfers credit risk to the protection provider, as the banking organization's liability created by the prepaid credit protection arrangement generally would be reduced at the same time the banking organization incurs a loss on the protected exposure(s). A common example of a prepaid credit protection arrangement are fully funded credit-linked notes issued by a banking

organization that transfer the credit risk of a reference exposure or portfolio of reference exposures to third party investors.<sup>72</sup>

Under the proposal, a prepaid credit protection arrangement would be required to meet specific requirements to be recognized for risk-based capital purposes as an eligible prepaid credit protection arrangement. Specifically, the proposal would define an eligible prepaid credit protection arrangement as a prepaid credit protection arrangement that:

- (1) Is written;
- (2) Is unconditional;
- (3) Covers all or a pro rata portion of all contractual payments due to be paid on the reference exposure or reference exposures;
- (4) Provides that the amount and timing of payments due from the protection purchaser to the protection provider are incorporated into the arrangement and the arrangement only allows these terms to change in the event of a breach of the arrangement by the protection purchaser;
- (5) Provides that entry of the protection provider into receivership, insolvency, liquidation, conservatorship, or similar proceeding does not change the amounts or timing of payments due by the protection purchaser under the arrangement;
- (6) Is legally valid and enforceable under applicable law of the relevant jurisdictions;
- (7) Upon a failure by the obligor on the one or more reference exposures to make a contractually required payment, or the occurrence of other credit events as described in the arrangement, allows the protection purchaser promptly to reduce the outstanding balance of the

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<sup>72</sup> See e.g., Frequently Asked Questions, 12 CFR Part 217, Q2 and Q3, <https://www.federalreserve.gov/supervisionreg/legalinterpretations/reg-q-frequently-asked-questions.htm>. This revision would also be consistent with comments received under EGRPRA as commenters requested recognition of the risk-mitigation benefits of credit-linked notes.

initial principal amount due to the protection provider by the loss of the protection purchaser on the reference exposures without input from the protection provider; and

(8) Does not increase the protection purchaser's cost of credit protection in response to deterioration in the credit quality of any of the reference exposures.

The protection amount of an eligible prepaid credit protection arrangement would be the effective notional amount of the prepaid credit protection, reduced to reflect any currency mismatch or maturity mismatch. The effective notional amount for an eligible prepaid credit protection arrangement would be the lesser of the contractual notional amount of the credit risk mitigant and the exposure amount of the reference exposure(s), multiplied by the percentage coverage of the credit risk mitigant.

Under the proposal, if the protection amount of the eligible prepaid credit protection arrangement is greater than or equal to the exposure amount of the reference exposure, a covered banking organization would be allowed to assign a zero percent risk weight to the exposure.

If the protection amount of the eligible prepaid credit protection arrangement is less than the exposure amount of the reference exposure(s) and any losses are shared on a pro rata basis between the covered banking organization and the protection provider,<sup>73</sup> the proposal would require the covered banking organization to treat the reference exposure(s) as two separate exposures, protected and unprotected, in order to recognize the credit risk mitigation benefit of the eligible prepaid credit protection arrangement. In such cases, a covered banking organization would apply a zero percent risk weight to the protected exposure. The covered banking organization would calculate its risk-weighted asset amount for the unprotected exposure under

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<sup>73</sup> Exposures on which there is a tranching of credit risk (reflecting at least two different levels of seniority) generally are securitization exposures, as described in section III.E. of this **SUPPLEMENTARY INFORMATION**.

the standardized approach using the risk weight assigned to the exposure and an exposure amount equal to the exposure amount of the original reference exposure minus the protection amount.

*Question 31: Under the definition of eligible prepaid credit protection arrangement, the proposal would require that a protection purchaser be able to reduce the outstanding balance due to the protection provider promptly upon realizing or otherwise recognizing a loss on the reference exposure, in the event that the obligor on one or more reference exposures fails to make a contractually required payment, or the occurrence of other credit events as described in the arrangement. What, if any, are the exposure types in respect of which, or circumstances when, a protection purchaser may be exposed to losses before such losses are manifested in a way that would permit a reduction in the protection purchaser's repayment obligation? For example, what would be the instances where nonpayment or other loss on the reference exposure may not always result in an accounting write-down of the eligible prepaid credit protection arrangement at the same time? What, if any, changes to the proposed definitions of prepaid credit protection arrangement and eligible prepaid credit protection arrangement should the agencies consider to further ensure that a protection purchaser would be able to reduce its repayment obligation on a prepaid credit protection arrangement as contemporaneously as possible with the manifestation of losses in respect of a reference exposure?*

*Question 32: The proposal would define the protection amount of an eligible prepaid credit protection arrangement to mean the effective notional amount of the prepaid credit protection. Certain credit-linked notes that may qualify as eligible prepaid credit protection under the proposal, are sometimes accounted for on a fair value basis. The fair value of such credit-linked notes may be affected by factors other than losses or credit events (for example, a*

*change in interest rates) in respect of the reference exposure. As a result, at the time that credit losses in respect of the reference exposure are realized, the fair value of the credit-linked note, and the amount by which the covered banking organization may set off its losses in respect of the reference exposure, may be less than the notional amount of the note. What, if any, modifications to the proposal should the agencies consider to address the risk that a covered banking organization may not be able to set off losses on a reference exposure against the full notional amount of a prepaid credit protection instrument? What would be the advantages and disadvantages of defining the protection amount of an eligible prepaid credit protection instrument to be the instrument's carrying value (for example, the fair value if the covered banking organizations elects this accounting treatment)?*

*Question 33: The definition of prepaid credit protection requires that the protection purchaser is obligated to repay the initial principal amount to the protection provider on or before the maturity date of the transaction, less any losses that the protection purchaser realizes or otherwise recognizes due to nonpayment of all contractual payments due to be paid on the reference exposure by the obligors. The agencies seek comment as to whether the definition is sufficiently broad to capture the types of prepaid credit protection arrangements that covered banking organizations may enter into to transfer credit risk. For example, may prepaid credit protection arrangements be structured to allow for a reduction in the initial principal amount of the arrangement upon the recognition of losses on one or more reference exposures due to credit quality deterioration of the exposures, even in the absence of any nonpayment. If so, what if any changes to the definition of prepaid credit protection should the agencies consider?*

#### *4. Maturity and currency mismatch adjustment*

The simple approach in the current capital rule does not permit a covered banking organization to recognize credit risk mitigation benefits where the transaction is subject to a

collateral agreement that has a shorter tenor than that of the secured exposure.<sup>74</sup> To improve the risk sensitivity of the simple approach, the proposal would permit covered banking organizations to recognize financial collateral and prepaid credit protection with a maturity mismatch after adjusting the fair value of the financial collateral or the effective notional amount of the eligible prepaid credit protection arrangement to reflect any maturity mismatch.<sup>75</sup>

Under the proposal, the residual maturity of an eligible prepaid credit protection arrangement would be determined in the same manner as applies to eligible credit derivatives and eligible guarantees under the current capital rule. For financial collateral that is not cash on deposit at the covered banking organization, but including cash held for the covered banking organization by a third-party custodian or trustee, the residual maturity of any amount of such financial collateral would be the earliest date on which the covered banking organization's rights in respect of such amount of financial collateral may be terminated without the pledgor being subject to a contemporaneous requirement to pledge additional financial collateral. For financial collateral that is cash on deposit at the covered banking organization, the residual maturity of any amount of such collateral would be the earliest date on which a depositor may withdraw such amount, notwithstanding any notice requirements or early withdrawal fees or penalties. For example, if an obligor is subject to a loan covenant requiring the obligor to maintain a certain

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<sup>74</sup> For determining maturity mismatch, the comparison is between the remaining maturity of the protected exposure against the remaining maturity of the legal mechanism by which financial collateral is pledged. For example, if the legal mechanism by which financial collateral is pledged to a 5-year loan has a 5-year term, even if the remaining maturity of the collateral is 2 years, there would be no maturity mismatch under the proposal as long as the security interest transfers without any breaks to the proceeds of the matured collateral or replacement collateral.

<sup>75</sup> The proposal would define residual maturity as the longest possible remaining time before the obligated party of the secured exposure is scheduled to fulfill its obligation on the reference exposure. If a contract has embedded options that may reduce its term, the proposal would require the covered banking organization to adjust the residual maturity of the contract. If a call is at the discretion of the protection provider, the residual maturity of the contract would be at the first call date. If the call is at the discretion of the covered banking organization, but the terms of the arrangement at origination of the contract contain a positive incentive for the covered banking organization to cancel the contract before contractual maturity, the remaining time to the first call date would be the residual maturity of the contract.

deposit balance at the covered banking organization until the maturity of the loan, the residual maturity of the cash on deposit would be the remaining maturity of the loan. Any amount of a deposit balance that an obligor is contractually permitted to withdraw, however, would have a residual maturity of the earliest date on which the deposit may be withdrawn. If an obligor may withdraw a deposit at any time, including where an obligor may be subject to a notice period or an early withdrawal fee or penalty, the residual maturity would be zero, notwithstanding any stated maturity date of the deposit instrument.

Under the proposal, a covered banking organization would be required to apply the same adjustment to reduce the fair value of the financial collateral or the effective notional amount of the prepaid credit protection arrangement as currently applies to eligible credit derivatives and eligible guarantees under the substitution approach:

$$P_m = E \times [(t-0.25)/(T-0.25)]$$

Where:

$P_m$  = fair value of the financial collateral or effective notional amount of the eligible prepaid credit protection arrangement, adjusted for maturity mismatch;

$E$  = fair value of the financial collateral or effective notional amount of the eligible prepaid credit protection arrangement;

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

$T$  = the lesser of five or the residual maturity of the secured exposure or reference exposure, as applicable, expressed in years.

Similarly, the proposal would eliminate the current capital rule's requirement that financial collateral be denominated in the same currency as the secured exposure for a covered banking

organization to use the simple approach. The proposal would permit covered banking organizations to recognize the credit risk mitigation benefits of financial collateral and eligible prepaid credit protection arrangements when denominated in a different currency than the currency of the secured exposure, after adjusting the fair value or the effective notional amount, as applicable, to reflect any currency mismatch. Under the proposal, a covered banking organization would use the following formula to adjust the fair value of the financial collateral or the effective notional amount of the eligible prepaid credit protection arrangement:

$$P_c = P_r \times (1 - H_{FX})$$

Where:

$P_c$  = fair value of the financial collateral or effective notional amount of the eligible prepaid credit protection arrangement, adjusted for currency mismatch (and maturity mismatch, if applicable).

$P_r$  = fair value of the financial collateral or effective notional amount of the eligible prepaid credit protection arrangement (adjusted for maturity mismatch, if applicable).

$H_{FX}$  = haircut appropriate for the currency mismatch between the financial collateral and the secured exposure or the eligible prepaid credit protection arrangement and the reference exposure.

Consistent with substitution approach for guarantees and credit derivatives in the current capital rule, the proposal would require covered banking organizations to use a standard supervisory haircut of 8 percent for  $H_{FX}$  (based on a ten business-day holding period and daily marking-to-market and re-margining). If a covered banking organization revalues the financial collateral or eligible prepaid credit protection arrangement less frequently than once every 10

business days, the proposal would require the covered banking organization to scale up the haircut using the following square root of time formula:

$$H_{FX} = 8\% \times \sqrt{\frac{T_M}{10}}$$

Where:

$T_M$  = the greater of 10 or the number of business days between revaluations.

*Question 34: The agencies seek comment on the effectiveness of the credit risk mitigation of collateral and eligible prepaid credit protection arrangement when there is a maturity mismatch between the credit risk mitigant and the hedged reference portfolio, for example, longer-dated assets that are protected by a shorter-dated prepaid credit protection arrangement. The agencies seek comment on whether the covered banking organization has effectively mitigated credit risk if the losses on the assets are estimated to occur after the expiration of the prepaid credit protection arrangement. Does the proposed maturity mismatch adjustment sufficiently capitalize for the residual risks of hedging longer-dated assets with shorter-term prepaid credit protection arrangement? Please provide supporting data and analysis.*

### ***E. Securitization framework***

The securitization framework is designed to produce capital requirements for exposures that involve tranching of the credit risk of one or more underlying financial exposures.<sup>76</sup> The risk and complexity posed by securitizations differ relative to direct exposures to the underlying

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<sup>76</sup> To segment the credit risk of the underlying financial exposures (“reference portfolio”), securitization exposures divide the reference portfolio into different slices (known as “tranches”) such that any cash flows or losses are allocated to the various tranches based on a predetermined order of priority. This payment structure is sometimes referred to as the cash flow waterfall (or simply the “waterfall”) and dictates the manner in which interest or principal payments from the reference portfolio must be allocated, creating different risk-return profiles for each tranche.

financial exposures because the credit risk of those exposures is divided into different levels of risk using a wide range of structural mechanisms.<sup>77</sup> The performance of a securitization exposure depends not only on the structure of the securitization, but also on the performance of the underlying exposures<sup>78</sup> and certain parties to the securitization structure, including the asset servicer and any liquidity facility provider. Such structural features and the involvement of these parties make securitization exposures susceptible to additional risks as compared to direct exposures to the underlying financial exposures.

The proposed securitization framework would incorporate the securitization framework in the current standardized approach with the following modifications: (1) a revised definition of and additional operational requirements for synthetic securitizations; (2) a modified treatment for resecuritizations that meet the operational requirements; (3) a modified definition of an eligible clean-up call; (4) a new securitization standardized approach (SEC-SA), as a replacement to the standardized supervisory formula approach (SSFA), which includes, relative to the SSFA, modified definitions of attachment point and detachment point, a modified definition of the W parameter, modifications to the definition of  $K_G$ , a lower risk-weight floor for securitization

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<sup>77</sup> For example, assume a covered banking organization extends a loan to a bankruptcy remote special purpose entity which holds financial exposures (including equity securities) and the fair value of the underlying financial assets exceeds that of the loan. Under this transaction, the underlying financial exposures are pledged as collateral to the lender. As the excess collateral would initially absorb any losses arising from non-payment on the loan (after which the covered banking organization would be exposed to any subsequent losses), the loan would generally be viewed as tranching and could qualify as a securitization exposure under the proposal, if the transaction satisfies all of the other applicable requirements. Consistent with the current capital rule, to the extent the fair value of the collateral declines such that it no longer exceeds the outstanding principal balance of the, the covered banking organization's exposure to the borrower, the transaction would no longer involve tranching of credit or equity risk – and thus would not qualify as a securitization exposure under the proposal. Rather, the covered banking organization would be required to calculate risk-based capital requirements for the exposure using the general risk-weight framework as described in section III.A. of this **SUPPLEMENTARY INFORMATION**.

<sup>78</sup> Consistent with the current capital rule, the proposal would define equity exposure to include exposures to equity instruments that do not have mandatory contractual payments, among other requirements. Accordingly, under the proposal, the performance of underlying equity exposures would refer to both changes in the fair value of the equity exposures and whether the issuer(s) of the equity exposures is subject to a bankruptcy or insolvency proceeding.

exposures that are not resecuritization exposures, and a higher risk-weight floor for resecuritization exposures; (5) a revised treatment for purchased and sold nth-to-default credit derivatives that would prohibit covered banking organizations from recognizing any risk-mitigating benefit for such exposures; (6) a revised treatment for certain derivative contracts that are not credit derivatives and a new treatment for derivative contracts that do not provide credit enhancement; (7) new provisions to expand the scope of securitization exposures for which a covered banking organization may apply the overlapping exposure treatment; (8) a new treatment and eligibility criteria for certain senior securitization exposures (the “look-through approach”); (9) a modification to the treatment for credit-enhancing interest only strips; (10) a new framework for non-performing loan securitizations; and (11) elimination of the gross-up approach . The proposal would also introduce certain minor technical edits to the definitions of traditional securitization and synthetic securitization to clarify the existing scope of exposures subject to the securitization framework under the current capital rule.

*Question 35: This proposal retains the current securitization framework, except as noted above and below, to align with the proposed expanded risk-based approach. As such, this proposal would not retain the gross-up approach under the current capital rule, which generally only is applicable to banking organizations not subject to the market risk rule. What are the advantages and disadvantages of retaining the gross-up approach for certain banking organizations, consistent with the current capital rule?*

#### *1. Definitions*

The proposal would generally retain the existing definitions of traditional securitization and synthetic securitization under the current capital rule, except for (1) revising the definition of synthetic securitization to include prepaid credit protection arrangements, and (2) introducing

technical modifications to the definitions of traditional securitization and synthetic securitization that are intended to clarify the existing scope of exposures subject to the securitization framework under the current capital rule.

*a. Synthetic securitization*

As discussed in section III.D.3. of this **SUPPLEMENTARY INFORMATION**, the proposal would permit covered banking organizations to recognize risk mitigating benefits of eligible prepaid credit protection arrangements. Consistent with these provisions, the proposal would revise the definitional and operational criteria for synthetic securitizations to include prepaid credit protection arrangements as structures that can qualify as synthetic securitizations and to include eligible prepaid credit protection arrangements as an eligible credit risk mitigant within the securitization framework. Under the proposal, a transaction would meet the definitional and operational criteria of synthetic securitization if all or a portion of the credit risk of one or more underlying exposures is transferred to one or more third parties through prepaid credit protection arrangements, and the transaction satisfies all other requirements of the securitization framework under the proposal.

*b. Technical modifications*

The proposal would modify paragraph (3) within the definitions of traditional securitization and synthetic securitization to clarify that the performance of the securitization exposure is expected to depend solely upon the performance of the underlying exposures, aside from the performance of common supporting transaction participants such as servicers and trustees. For example, a transaction would not satisfy this criterion if there is an expectation that any sources outside of the underlying exposures would fund the interest or principal payments due on the securitization exposures.

Consistent with the current capital rule, the proposed modification would continue to permit certain transactions where a party provides a specified amount of credit protection to qualify as a securitization exposure. As an example, consider a multi-seller ABCP conduit that funds itself entirely with a single class of commercial paper and purchases assets such as wholesale loan exposures from multiple sellers. As is typical in such multi-seller ABCP conduits, each seller provides first-loss protection by over-collateralizing its loans sold to the conduit. To ensure a high credit rating on the commercial paper issued by the ABCP conduit, a banking organization sponsor may provide either a pool-specific liquidity facility or a program-wide credit enhancement such as a guarantee on a portion of the losses not protected by the seller over-collateralization. Consistent with the current capital rule, under the proposal, commercial paper issued by the ABCP conduit with a pool-specific liquidity facility generally would be a securitization exposure because the pool-specific liquidity facility represents a tranche of the credit risk of the underlying exposures (that is the repayment of the liquidity facility depends upon the underlying exposures) and losses are allocated through subordination. Conversely, if the sponsor provides a program-wide credit enhancement that covers all credit losses across multiple asset pools without reference to asset-level performance (not just those above the seller-provided credit enhancement) or seller-specific subordination, the commercial paper generally would not be a securitization exposure, as the commercial paper holders are primarily exposed to the default risk of the sponsor instead of the underlying exposures and the commercial paper does not represent a tranching risk position. The proposed modification is intended to clarify that a securitization exposure to such program-wide guarantees, including guarantees provided by an operating company to a special purpose entity it establishes, generally would not satisfy the definition of traditional or synthetic securitization.

Additionally, the proposal would modify paragraph (1) of the definition of traditional securitization to clarify that a transaction transferring equity risk could be subject to the securitization framework if all of the other definitional criteria are satisfied. The securitization framework generally applies to exposures to companies with material liabilities that are not operating companies,<sup>79</sup> and whose underlying exposures are primarily financial exposures (including when all or substantially all of the underlying assets are equity exposures). For exposures to companies with material liabilities that are not operating companies and whose underlying exposures are all or substantially all financial exposures, the risk-based capital treatment under the current capital rule reflects how the risk of exposures to such entities depends primarily on the degree of leverage employed by the company. Accordingly, the current capital rule generally requires covered banking organizations to apply the securitization framework to determine the risk-weighted asset amount for exposures to non-operating companies with material liabilities, unless the primary Federal supervisor determines that the exposure is not a traditional securitization based on the transaction's leverage, risk profile or economic substance. The proposal would modify paragraph (1) of definition of traditional securitization to clarify that this treatment would also apply to exposures to such companies with material liabilities, where all or a portion of the credit or equity 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 or prepaid credit protection arrangements).<sup>80</sup> As a result, the proposed definition of traditional securitization would continue to include exposures to companies with

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<sup>79</sup> See 78 FR 62112 (Oct. 11, 2013).

<sup>80</sup> Consistent with the current capital rule, under the proposal, a covered banking organization would use the equity framework to calculate risk-based capital requirements for equity exposures to companies where all or substantially all of the underlying assets are financial assets and that have no material liabilities. See definition of investment fund in § \_\_.2 of the current capital rule and the treatment of equity exposures to investment funds in § \_\_.53 of the proposed rule.

material liabilities that are not operating companies, where all or substantially all of the underlying assets are financial exposures, and whose funding structure results in the risk associated with the underlying exposures being separated into at least two tranches with different levels of seniority.

*Question 36: What additional clarifications, if any, should the agencies consider for the proposed modification to paragraph (3) of the definition of traditional and synthetic securitization and why?*

*Question 37: What additional clarifications, if any, should the agencies consider for the proposed modification to paragraph (1) of the definition of traditional securitization and why? What would be the advantages and disadvantages of making similar changes to paragraph (1) of the definition of synthetic securitization?*

*Question 38: The agencies seek comment on the appropriateness of requiring covered banking organizations to use the general risk-weight framework for certain overcollateralized exposures if the fair value of underlying equity exposures declines such that there is no longer overcollateralization? What would be the advantages and disadvantages of requiring covered banking organizations to use the general risk-weight framework (rather than the securitization framework) to determine the applicable risk weight for securitization exposures where the underlying exposures are primarily equity exposures and the fair value of the underlying equity exposures has significantly declined? What criteria should the agencies consider to capture only those securitization exposures for which such an approach would more appropriately capture the risk and why?*

## *2. Operational requirements*

The proposed operational requirements would be consistent with the operational requirements in the current capital rule, with five exceptions as described below and directly above in section III.E.1.a. of this **SUPPLEMENTARY INFORMATION**. In addition, for resecuritization exposures that meet the operational requirements, the proposal would eliminate the option for covered banking organizations to treat the exposures as if they had not been securitized.<sup>81</sup>

*a. Early amortization provisions*

Early amortization provisions cause investors in securitization exposures to be repaid before the original stated maturity when certain conditions are triggered. For example, many securitizations of revolving credit facilities, most commonly credit-card receivable securitizations, contain provisions that require the securitization to be wound down and investors repaid on an accelerated basis if excess spread falls below a certain threshold. This decrease in excess spread would typically be caused by credit deterioration in the underlying exposures. Such provisions can expose the originating banking organization to increased credit and liquidity risk and potentially increased capital requirements after the early amortization is triggered as the banking organization could be obligated to fund the borrowers' future draws on the revolving lines of credit.<sup>82</sup> In such an instance, the originating banking organization may have to either find a new funding source, whether internal or external, to cover the new draws or reduce the borrowers' credit line availability.

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<sup>81</sup> In the case of non-performing loan securitizations, as described in section III.E.5.g. of this **SUPPLEMENTARY INFORMATION**, the proposal would allow a covered banking organization that meets the operational requirements to choose to hold risk-based capital against the transferred exposures as if they had not been securitized and deduct from common equity tier 1 capital any after-tax gain-on-sale resulting from the transaction.

<sup>82</sup> Under the capital rule, an originating banking organization, with respect to a securitization, means a banking organization 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. *See* 12 CFR 3.2 (OCC); 12 CFR 217.2 (Board); 12 CFR 324.2 (FDIC).

The proposal would expand the applicability of the operational requirements regarding early amortization provisions to synthetic securitizations, similar to their application to traditional securitizations under the current capital rule. The current capital rule defines an early amortization provision as 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, with certain exceptions.<sup>83</sup> Under the proposal, if a synthetic securitization includes an early amortization provision and references 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, the covered banking organization would be required to hold risk-based capital against the underlying exposures as if they had not been synthetically securitized. Aligning this treatment for both traditional and synthetic securitizations would provide greater consistency within the securitization framework and reduce the likelihood that a covered banking organization would provide implicit support for synthetic securitization exposures.

*Question 39: What, if any, additional exceptions to the early amortization provision definition should the agencies consider and why, provided such exceptions would not incentivize a covered banking organization to provide implicit support to a securitization exposure? In particular, is the current rule's exception where early amortization "is triggered solely by events not directly related to the performance of the underlying exposures or the originating institution (such as material changes in tax laws or regulations)" sufficiently clear? What types of early*

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<sup>83</sup> Under the capital rule, the exceptions to the definition of early amortization provision are a provision that: (1) is triggered solely by events not directly related to the performance of the underlying exposures or the originating banking organization (such as material changes in tax laws or regulations); or (2) leaves investors fully exposed to future draws by borrowers on the underlying exposures even after the provision is triggered. See definition of early amortization provision in § \_\_.2 of the capital rule. 12 CFR 3.2 (OCC); 12 CFR 217.2 (Board); 12 CFR 324.2 (FDIC).

*termination events should qualify as events not directly related to either the performance of the underlying exposures or the originating banking organization? Should events not directly related to the performance of the underlying exposures or the originating banking organization include customary provisions designed to protect against non-performance of various contractual obligations by one of the parties facilitating the securitization (including the originating banking organization, if it has such a transaction facilitating role, for example by acting as a servicer)? Commenters are also asked to describe under what circumstances could a provision in a revolving loan securitization that, when triggered, causes investors in the securitization exposures to be repaid before the original stated maturity of the securitization exposures, leaves investors “fully exposed to future draws by borrowers on the underlying exposures even after the provision is triggered”, or otherwise should be deemed not to be an early amortization provision. What are the advantages and disadvantages of “fully exposed” encompassing only cash-funded exposures versus also including exposures in the form of contractual commitments to provide funding?*

*b. Synthetic excess spread*

The proposal would prohibit a covered banking organization that is an originating banking organization from recognizing the risk-mitigating benefits of a synthetic securitization that includes synthetic excess spread. Synthetic excess spread would be defined as any contractual provision in a synthetic securitization that is designed to absorb losses prior to any of the tranches of the securitization structure. Synthetic excess spread is a form of credit enhancement provided by the originating banking organization to the investors in the synthetic securitization; therefore, the originating banking organization should maintain capital against the credit exposure represented by the synthetic excess spread. However, a risk-based capital

requirement for synthetic excess spread may not be determinable with sufficient precision to promote comparability across banking organizations because the amount of synthetic excess spread made available to investors in the synthetic securitization would depend upon the maturity of the underlying exposures, which itself depends on whether any of the underlying exposures have defaulted or prepaid. In particular, the total amount of synthetic excess spread made available at inception to investors over the life of the transaction may not be known *ex ante*, as the outstanding balance of the securitization in future years is unknown. Therefore, if a synthetic securitization structure includes synthetic excess spread, the proposal would require the covered banking organization to maintain capital against all the underlying exposures as if they had not been synthetically securitized.

*Question 40: What clarifications or modifications should the agencies consider for the above proposed definition of synthetic excess spread and why?*

*Question 41: What are the advantages and disadvantages of the proposed treatment of synthetic securitizations with synthetic excess spread? If the agencies were to permit a covered banking organization that is an originating banking organization to recognize the credit risk-mitigation benefits of securitizations with synthetic excess spread, how should the exposure amount of the synthetic excess spread be calculated, and what would be the appropriate capital requirement for synthetic excess spread?*

*c. Minimum payment threshold*

Under the proposal, the operational requirements for synthetic securitizations would include a new requirement that any applicable minimum payment threshold for the credit risk

mitigant be consistent with standard market practice.<sup>84</sup> A contractual minimum payment threshold refers to the delinquency condition that must exist before a credit event is deemed to have occurred under the terms of the credit protection. The proposed minimum payment threshold criterion is intended to prohibit a covered banking organization that is an originating banking organization from recognizing any risk mitigating benefit for a synthetic securitization whose minimum payment threshold is so large that it allows for material losses to occur without triggering the credit protection acquired by the protection purchaser, as such provisions would interfere with an effective transfer of credit risk.

*Question 42: What are the benefits and drawbacks of the proposed minimum payment threshold criterion? What, if any, additional criteria or clarifications should the agencies consider and why?*

*d. Resecuritization exposures*

For a resecuritization exposure arising from a traditional securitization, if the operational requirements have been met, a covered banking organization that is an originating banking organization would be required to exclude the transferred exposures from the calculation of its risk-weighted assets and maintain risk-based capital against any credit risk it retains in connection with the resecuritization. Unlike in the case of a securitization exposure that is not a resecuritization exposure, the proposal would not provide the option for a covered banking organization to elect to treat a resecuritization exposure as if the underlying exposures had not been resecuritized. While a securitization of non-securitized assets can be used to diversify or transfer credit risk of those exposures, a resecuritization might not offer similar risk reduction or

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<sup>84</sup> For example, for derivative contracts written under ISDA Master Agreement documentation, standard market practice for contractual minimum payment thresholds would generally be \$1 million (or the equivalent in other currencies), such as established in ISDA Credit Derivatives Definitions. *See* ISDA Credit Derivatives Definitions Section 4.5 “Failure to Pay” and Section 4.9(d) “Payment Requirement.”

diversification benefits, particularly if the underlying exposures reflect similar high-risk tranches of other securitizations. Therefore, these resecuritization exposures warrant a higher regulatory capital requirement than that applicable to the underlying exposures.

Similarly, for a resecuritization that is a synthetic securitization, if the operational requirements have been met, a covered banking organization that is an originating banking organization would be required to recognize for risk-based capital purposes the use of a credit risk mitigant to hedge the underlying exposures and must hold capital against any credit risk of the resecuritization exposures it retains in connection with the synthetic securitization.

*e. Clean-up Calls*

The proposal would use the definition of a clean-up call in the current capital rule without change. The capital rule defines a clean-up call as a contractual provision that permits an originating banking organization or servicer to call securitization exposures before their stated maturity date or call date. For an originating banking organization to exclude the underlying exposures from its risk-based capital calculation, any clean-up call associated with a securitization must be an eligible clean-up call.

The proposal would expand the definition of an eligible clean-up call. Under the current capital rule, an eligible clean-up call is defined as a clean-up call that is exercisable solely at the discretion of the originator or servicer, is not structured to avoid allocating losses to securitization exposures held by investors or otherwise structured to provide credit enhancement to the securitization, and is only exercisable when 10 percent or less of the principal amount of the initial pool of underlying or reference exposures is outstanding. The proposal would expand the definition of an eligible clean-up call to also include clean-up calls exercisable when certain regulatory and tax events occur, in addition to the existing criteria under the current capital rule.

Specifically, the modification would permit the exercise of a clean-up call upon the occurrence of (1) a regulatory event that significantly changes the risk-weighted asset amount for the securitization exposure under applicable risk-weighted asset standards of the agencies, or (2) a tax event that significantly changes the tax treatment of the securitization exposure under applicable tax laws. The events must represent final actions, such as a final rule adopted by the agencies or taxing authority, or a law enacted by Congress. Proposed rules or legislative bills would not satisfy this requirement.

*Question 43: What, if any, other modifications should the agencies consider for the definition of an eligible clean-up call and why?*

### *3. Exposure amount of a securitization exposure*

The proposal would maintain the exposure calculation methodology in the current capital rule for both on-balance-sheet and off-balance-sheet securitization exposures. The exposure amount for an on-balance-sheet securitization exposure that is not a repo-style transaction, an eligible margin loan, or a derivative contract (other than a credit derivative) would equal the carrying value of the exposure.<sup>85</sup> For off-balance-sheet securitization exposures that are not a repo-style transaction, eligible margin loan, or derivative contract (other than a credit derivative), the exposure amount would equal the notional amount of the exposure.<sup>86</sup> For a securitization exposure that is a repo-style transaction, eligible margin loan, or derivative contract (other than a

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<sup>85</sup> Consistent with the current rule, under the proposal, the exposure amount of an on-balance sheet securitization exposure that is an available-for-sale or held-to-maturity security held by a banking organization that has made an AOCI opt-out election would be the banking organization's carrying value (including net accrued but unpaid interest and fees), less any net unrealized gains on the exposure and plus any net unrealized losses on the exposure.

<sup>86</sup> The proposal would generally maintain the current capital rule's treatment for off-balance sheet securitization exposures to ABCP programs, with certain exceptions. The proposal would not include the specific treatments provided for such exposures in \_\_.42(c)(3)(ii)-(iii) and \_\_.44 in the current capital rule. The other elements of the proposed securitization framework (for example, the look through approach for senior securitization exposures) are intended to better reflect the risk of such exposures.

credit derivative), the exposure amount would be calculated based on the proposed counterparty credit risk framework, described in sections III.C. and III.D.2.b. of this **SUPPLEMENTARY INFORMATION**.

*Question 44: What, if any, clarifications should the agencies consider regarding the determination of the exposure amount for securitization exposures where one or more of the underlying exposures are off-balance sheet exposures (such as unfunded commitments)? Specifically, what are the advantages and disadvantages of a modification that would clarify that covered banking organizations could apply the same credit conversion factors described in section III.B.2. of this **SUPPLEMENTARY INFORMATION** when calculating the components of the SEC-SA ( $K_G$ ,  $W$  parameter, attachment point A and detachment point D) for a securitization exposure where one or more of the underlying exposures are off-balance sheet exposures? What would be the effect of such a clarification on the volatility of the capital requirements?*

#### *4. Securitization standardized approach (SEC-SA)*

Under the proposal, a covered banking organization would determine the capital requirements for most securitization exposures under the SEC-SA. The SEC-SA would be substantively similar to the SSFA in the current capital rule except for certain changes as discussed below. Under the SEC-SA, a covered banking organization would determine the risk weight for a securitization exposure based on the risk weight of the underlying exposures that are adjusted to reflect (1) delinquencies in such exposures, (2) the securitization exposure's subordination level in the allocation of losses, and (3) the heightened correlation and additional risks inherent in securitizations relative to direct exposures to the underlying financial exposures.

To calculate the risk weight for a securitization exposure using the SEC-SA, a covered banking organization would be required to have accurate information on the parameters used in the SEC-SA calculation. If the covered banking organization cannot, or chooses not to, apply the SEC-SA, the covered banking organization would be required to apply a 1,250 percent risk weight to the securitization exposure. For synthetic securitizations, the proposal would permit covered banking organizations to choose not to recognize the credit risk mitigant and hold risk-based capital against the underlying exposures as if they had not been synthetically securitized.

Under the proposed SEC-SA, the risk weight assigned to a securitization exposure, or portion of a securitization exposure, would be determined according to the formula under §\_\_.44(a) of the proposed rule, expressed as:

$$RW_{SEC-SA} = \begin{cases} \max(RW_{FLOOR}, 1,250\% \cdot K_{SEC-SA}), & K_A \leq A \\ \max\left(RW_{FLOOR}, \left(\frac{K_A - A}{D - A}\right) \cdot 1,250\% + \left(\frac{D - K_A}{D - A}\right) \cdot 1,250\% \cdot K_{SEC-SA}\right), & A < K_A < D \\ 1,250\%, & D \leq K_A \end{cases}$$

Where:

- $RW_{FLOOR}$  is equal to 100 percent for resecuritization exposures and 15 percent for all other securitization exposures.
- $K_A$  represents the delinquency-adjusted, weighted-average capital requirement of the underlying exposures, as described in section III.E.4.c. of this **SUPPLEMENTARY INFORMATION**.
- $A$  represents the attachment point of the securitization exposure, as described in section III.E.4.a. of this **SUPPLEMENTARY INFORMATION**.

- $D$  represents the detachment point of the securitization exposure, as described in section III.E.4.a. of this **SUPPLEMENTARY INFORMATION**.
- $K_{SEC-SA} = \frac{e^{a \cdot u} - e^{a \cdot l}}{a \cdot (u - l)}$
- $a = -\frac{1}{p \cdot K_A}$ , where  $p$  equals 1.5 for a resecuritization exposure and 0.5 for all other securitization exposures.
- $u = D - K_A$
- $l = \max(A - K_A, 0)$
- $e$  equals the base of the natural logarithm.

*a. Definition of attachment point and detachment point*

Under the current capital rule, the attachment point (parameter A) of a securitization exposure equals the ratio of (1) the current dollar amount of underlying exposures that are subordinated to the exposure of the banking organization to (2) the current dollar amount of underlying exposures. Any reserve account funded by the accumulated cash flows from the underlying exposures that is subordinated to the covered banking organization's securitization exposure may be included in the calculation of parameter A to the extent that cash is present in the account. The current capital rule generally requires a covered banking organization to recognize cash or securities that are included in a reserve account in the calculation of parameter A.<sup>87</sup>

The proposal would generally retain the existing definitions of attachment point and detachment point under the current capital rule, with one modification. Specifically, the proposal

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<sup>87</sup> Consistent with the current capital rule, the proposal would require covered banking organizations to treat any assets that are included in a reserve account as underlying exposures of the securitization exposure, which must be reflected in parameters A and D as well as  $K_G$  and the W parameter.

would not allow a covered banking organization to include interest rate derivative contracts and exchange rate derivative contracts, or the cash collateral accounts related to these instruments, in the calculation of parameters A and D. The agencies are proposing this treatment because assets held in a funded reserve account, whether cash or securities, can provide credit enhancement to a securitization exposure, whereas interest rate and foreign exchange derivatives (and any cash collateral held against these derivatives) do not.<sup>88</sup>

*b. Definition of W parameter*

Under the current capital rule, parameter W, which is expressed as a decimal value between zero and one, reflects the proportion of underlying exposures that are not performing or are delinquent, according to criteria outlined in the rule.<sup>89</sup> The proposal would retain the current capital rule's definition of parameter W, with two modifications. Specifically, the proposal would revise the definition of parameter W to (1) exclude any exposure that is directly and unconditionally guaranteed by the U.S. government, its central bank, or a U.S. government agency from the calculation of W, up to the amount of the guarantee; and (2) clarify that for resecuritization exposures, any underlying exposure that is a securitization exposure would only be included in the denominator of the ratio and would be excluded from the numerator of the ratio.

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<sup>88</sup> For example, assume a securitization has assets denominated in U.S. dollars and liabilities denominated in euros, and that the securitization executes a USD-EUR foreign exchange swap with a covered banking organization. The transaction would serve to hedge the foreign exchange risk of the securitization's assets and liabilities but would not provide credit enhancement to any of the tranches of the securitization.

<sup>89</sup> Consistent with the current capital rule, the proposal would define equity exposure to include exposures to equity instruments that do not have mandatory contractual payments, among other requirements. Accordingly, under the proposal, for purposes of determining the W parameter for a securitization exposure, a covered banking organization would not treat an underlying equity exposure as being past due or in default on payments, but could treat an underlying equity exposure as subject to a bankruptcy or insolvency proceeding if the issuer of the equity exposure were subject to such a proceeding. *See* definition of equity exposure in § \_\_.2 of the capital rule. 12 CFR 3.2 (OCC); 12 CFR 217.2 (Board); 12 CFR 324.2 (FDIC).

Under the proposal, a covered banking organization would exclude from the calculation of parameter  $W$  any exposure that is directly and unconditionally guaranteed by the U.S. government, its central bank, or a U.S. government agency, up to the amount of the guarantee. By allowing covered banking organizations to reflect the risk mitigation effects of the U.S. government's guarantee, the proposed modification is intended to more appropriately align the capital requirement with the risk of such securitization exposures. For example, when a covered banking organization invests in a securitization exposure where all of the underlying exposures are unconditionally guaranteed by the U.S. government, the covered banking organization may set parameter  $W$  equal to zero.

For resecuritization exposures, parameter  $W$  would be the ratio of the sum of the current dollar amount of any underlying exposures of the resecuritization that meet any of the criteria in paragraphs \_\_.42(b)(1)(i) through (vi) of the proposal that are not securitization exposures to the current dollar amount of all underlying exposures. Underlying securitization exposures do not need to be included in the numerator of parameter  $W$  because the risk weight of the underlying securitization exposure as calculated by the SEC-SA would already reflect the impact of any delinquent or otherwise nonperforming loans within the underlying securitization exposure. For example, if a resecuritization with a notional amount of \$10 million includes underlying securitization exposures with a notional amount of \$5 million and underlying non-securitization exposures with a notional amount of \$5 million, and if \$500,000 of the non-securitization exposures are delinquent, the numerator for the  $W$  parameter would be \$500,000 while the denominator for the  $W$  parameter would be \$10 million. This reflects the fact that the risk associated with securitization exposures generally arises from the underlying assets failing to perform as expected, resulting in investors receiving less cashflow than expected from the

securitization exposure, rather than from securitization exposure itself failing to make payments due to investors.

*Question 45: The agencies seek comment on the appropriateness of requiring covered banking organizations to only include equity exposures when the issuer is subject to a bankruptcy or insolvency proceeding in the  $W$  parameter calculation. What, if any, alternative approaches (such as requiring covered banking organizations to include equity exposures when the issuer has an obligation to the banking organization that is 90-days or more past due) should the agencies consider that would more appropriately capture the proportion of underlying exposures that are not performing or are delinquent and why? What, if any, operational concerns could such alternatives pose?*

*c. Delinquency-adjusted ( $K_A$ ) and non-adjusted ( $K_G$ ) weighted-average capital requirement of the underlying exposures*

Under the proposal,  $K_A$  would reflect the delinquency-adjusted, weighted-average capital requirement of the underlying exposures and would be a function of  $K_G$  and parameter  $W$ . Under this approach, in order to calculate parameter  $W$ , and thus  $K_A$ , the covered banking organization must know the delinquency status of all underlying exposures in the securitization.  $K_G$  would equal the weighted average total capital requirement of the underlying exposures (with the unpaid principal used as the weight for each exposure), calculated using the proposed risk weights in the standardized approach, as described in section III.A. of this **SUPPLEMENTARY INFORMATION**.

The proposal would retain the current capital rule's definition of  $K_G$ , with two modifications. First, for interest rate derivative contracts and exchange rate derivative contracts, the proposal would require covered banking organizations to include in the numerator of  $K_G$  (and

exclude from the denominator of  $K_G$ ) the product of (1) the positive current exposure, (2) the risk weight of the counterparty, and (3) 0.08. This accounts for the issue where, if amounts related to interest rate and exchange rate derivative contracts were included in both the numerator and denominator of  $K_G$ , these contracts could reduce the capital requirement of securitization exposures even though interest rate and exchange rate derivative contracts do not provide any credit enhancement to a securitization.

Second, the proposal would clarify the existing requirement that covered banking organizations must determine the risk weight applicable to an underlying equity exposure under the simple risk-weight approach in §\_\_.52 of the current capital rule based on the characteristics of the underlying equity exposure. Consistent with the treatment under the current capital rule, covered banking organizations would not be able to consider the underlying equity exposures as a non-significant equity exposure that receive a 100 percent risk weight when determining  $K_G$ . Unlike equity exposures to investment funds (as defined), traditional securitizations can include transactions with companies that have material liabilities and structures that allocate losses based on a predetermined order of priority (rather than on a pro-rata basis). Accordingly, unlike the look-through approaches applicable to underlying equity securities held by investment funds, the proposal would clarify that covered banking organizations may not calculate risk-based capital requirements for securitization exposures with underlying equity exposures as though the underlying equity exposures were on the covered banking organization's balance sheet. This clarification to the current capital rule promotes the risk sensitivity of the securitization framework by requiring covered banking organizations to reflect a risk weight based on the underlying exposure's risk characteristics and appropriately differentiates between the risk-based capital treatment applicable to investment funds and to securitization exposures.

*Question 46: Recognizing that banking organizations may not always know the delinquency status of each underlying exposure, what would be the benefits and drawbacks of allowing a covered banking organization to use the SEC-SA if the covered banking organization knows the delinquency status for most, but not all, of the underlying exposures? For example, if the covered banking organization knew the delinquency status of 95 percent of the exposures, what would be the benefits and drawbacks of allowing the covered banking organization to (1) split the underlying exposures into two subpools, (2) calculate a weighted average of the  $K_A$  of the subpool comprising the underlying exposures for which the delinquency status is known, (3) assign a value of 1 for  $K_A$  of the other subpool comprising exposures for which the delinquency status is unknown, and (4) assign a  $K_A$  for the entire pool equal to the weighted average of the  $K_A$  for each subpool? What other approaches, if any, should the agencies consider and why?*

*Question 47: The agencies seek comment on the appropriateness of requiring covered banking organizations to reflect underlying past due exposures in both the  $K_G$  and the  $W$  parameter components when calculating  $K_A$ . To what extent could including past due exposures in both components result in overly punitive capital requirements for such exposures under SEC-SA? What, if any, alternatives (such as not applying the heightened 150 risk weight for past due exposures for purposes of calculating  $K_G$ ) should the agencies consider and why? Commenters are encouraged to provide specific examples, including calculations and supporting data.*

*d. Supervisory risk-weight floors*

Consistent with the SSFA in the current capital rule, the SEC-SA would require covered banking organizations to apply a risk-weight floor to all securitization exposures. The proposed risk-weight floor is intended to ensure that covered banking organizations maintain a minimum level of capital to account for risks that may not otherwise be captured by SEC-SA, such as

modeling risks and correlation. The proposal would apply a risk-weight floor of 15 percent for securitization exposures that are not resecuritization exposures. The 15 percent risk-weight floor is most relevant for more senior securitization exposures. While junior tranches can absorb a significant amount of credit or equity risk, senior tranches are still exposed to some amount of credit or equity risk on the underlying exposures. Therefore, a minimum capital requirement continues to be appropriate for all securitization exposures.

For resecuritization exposures, the proposed SEC-SA approach would require covered banking organizations to apply a risk-weight floor of 100 percent. The proposed 100 percent supervisory risk-weight floor for resecuritization exposures is intended to capture the greater complexity of such exposures and heightened correlation risks inherent in the underlying securitization exposures.<sup>90</sup>

*Question 48: The agencies seek comment on the proposed 100 percent risk-weight floor for resecuritization exposures. What modifications, if any, should the agencies consider to the 100 percent risk-weight floor for resecuritization exposures and why? For example, what would be the pros and cons of excluding certain types of resecuritization exposures—such as resecuritizations of servicer cash advance receivables—from the 100 percent risk-weight floor and why? Commenters are encouraged to provide data (such as loss history) to support their recommendations.*

##### *5. Exceptions to the SEC-SA risk-based capital treatment for securitization exposures*

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<sup>90</sup> In a typical securitization exposure that is not a resecuritization, each underlying exposure is subject to idiosyncratic default risks (for example, the employment status of each obligor) which may exhibit lower relative default correlation. In a resecuritization exposure, the underlying exposures, which are typically tranches of securitizations, usually have credit enhancement from more junior tranches that protects against many idiosyncratic risks. Systematic risks are more likely to generate defaults in the underlying exposures of resecuritizations than idiosyncratic risks, but systematic risks are also much more likely to be correlated due to their system-wide nature; therefore, resecuritizations can be expected to have higher default correlations than other types of securitizations.

Securitization exposures sometimes contain features that, if not accounted for, could produce inconsistent outcomes under the SEC-SA, or in some cases make the calculation of the risk weight inoperable. Therefore, the proposal would include additional approaches for certain types of securitization exposures to more appropriately align the capital requirement with the risk of such securitization exposures.

*a. Purchased credit derivatives*

As discussed previously in section III.E.1.b. of this **SUPPLEMENTARY INFORMATION**, the proposal would modify paragraph (1) of the definition of traditional securitization to clarify that the securitization framework generally applies to exposures to companies with material liabilities that are not operating companies, and whose underlying exposures are primarily financial exposures. To further clarify the scope of exposures subject to the securitization framework under the current capital rule, the proposal would also remove the definition of securitization special purpose entity (SPE).

Under the current capital rule, if a covered banking organization purchases a credit derivative (other than an nth-to-default credit derivative) that is recognized as a credit risk mitigant (including via recognized collateral) under the securitization framework, the covered banking organization is not required to compute a separate counterparty credit risk capital requirement. For purchased credit derivatives that a covered banking organization cannot or chooses not to recognize as a credit risk mitigant under the securitization framework, the current capital rule requires the covered banking organization to calculate an exposure amount using SA-CCR and to determine the applicable risk weight based on whether or not the counterparty is a

securitization SPE.<sup>91</sup> Specifically, if the counterparty is a securitization SPE, the covered banking organization must determine the risk weight based on the securitization framework; if the counterparty is not a securitization SPE, the covered banking organization must apply the risk weight applicable to the counterparty under the general risk-weight framework.

Consistent with the proposed technical modification to the definition of traditional securitization,<sup>92</sup> the proposal would (1) remove the definition of securitization SPE, and (2) clarify that the risk weight applicable to purchased credit derivatives that a covered banking organization cannot or chooses not to recognize as a credit risk mitigant would be based on whether the counterparty is a securitization (i.e., a non-operating company that holds the underlying exposures of a securitization transaction).

*b. Nth-to-default credit derivatives*

Nth-to-default credit derivatives provide credit protection on a group of reference exposures only after a specific number (n) of the reference exposures default.<sup>93</sup> As nth-to-default credit derivatives tranche the credit risk of the reference exposures based on the order in which defaults occur within the group of reference exposures, such credit derivatives would generally qualify as securitization exposures under the proposal, consistent with the current capital rule.

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<sup>91</sup> Securitization SPE under § \_\_. 2 of the current capital rule 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. *See* 12 CFR 3.2 (OCC); 12 CFR 217.2 (Board); 12 CFR 324.2 (FDIC).

<sup>92</sup> The proposal would retain the existing definition of securitization exposure under the current capital rule. Under § \_\_. 2 of the current capital rule, securitization exposure means (1) an on-balance sheet or off-balance sheet credit exposure (including credit-enhancing representations and warranties) that arises from a traditional securitization or synthetic securitization (including a resecuritization), or (2) an exposure that directly or indirectly references a securitization exposure described in paragraph (1) of this definition. *See* 12 CFR 3.2 (OCC); 12 CFR 217.2 (Board); 12 CFR 324.2 (FDIC).

<sup>93</sup> Consistent with the current capital rule, the proposal would define an nth-to-default credit derivative as a credit derivative that provides credit protection only for the nth-defaulting reference exposure in a group of reference exposures. *See* 12 CFR 3.2 (OCC); 12 CFR 217.2 (Board); 12 CFR 324.2 (FDIC).

Under the current capital rule, covered banking organizations that have purchased credit protection in the form of an nth-to-default credit derivative may recognize the risk-mitigating benefit of that derivative under the credit risk mitigation framework applicable to securitization exposures if certain conditions are met. If a covered banking organization sells protection in the form of an nth-to-default credit derivative, the current capital rule requires the covered banking organization to calculate risk-weighted assets as the product of (1) the exposure amount produced by SA-CCR, and (2) either the risk weight produced by the SSFA or a 1,250 percent risk weight.

Nth-to-default credit derivatives provide protection only for a limited number of default event(s) and, therefore, do not provide continuous or comprehensive coverage of credit risk for the entire basket of reference exposures. Furthermore, the current capital treatment of nth-to-default credit derivatives may not appropriately capture the default correlation among the reference exposures. For example, assume a covered banking organization with exposure to five corporate entities purchases an nth-to-default credit derivative that pays out upon the default of the second of the five corporate entities. In such a case, the covered banking organization would remain exposed to any losses incurred upon the first corporate entity default, as well as losses from any defaults beyond the second corporate entity default, if applicable. Conversely, a covered banking organization that sells an nth-to-default credit derivative that provides protection against the default of the second corporate entity could incur losses exceeding the premiums collected from the protection purchaser if the defaults of the underlying corporates are highly correlated. Furthermore, the risk weight produced by the SEC-SA may not appropriately

capture the risk of sold nth-to-default credit derivatives, which are priced based on the expected default correlation among the reference exposures.<sup>94</sup>

Accordingly, while nth-to-default credit derivatives would continue to be securitization exposures, the proposal would not permit covered banking organizations to recognize any risk-mitigating benefit for nth-to-default credit derivatives for which the covered banking organization is the protection purchaser under the proposed securitization framework. Rather, the proposal would require covered banking organizations to calculate risk-weighted assets for counterparty credit risk using the exposure amount produced by current exposure methodology or SA-CCR, as described in section III.C. of this **SUPPLEMENTARY INFORMATION** and the risk weight applicable to the protection provider under the general risk-weight framework.

Similarly, while nth-to-default credit derivatives in which the covered banking organization is the seller of protection would continue to be securitization exposures, the proposal would prohibit the covered banking organization from using the SEC-SA to determine the applicable risk weight. Rather, the proposal would generally require covered banking organizations to calculate the risk-weighted asset amount by multiplying the notional amount of the protection provided by the nth-to-default credit derivative by the sum of the risk weights applicable to each of the underlying reference exposures, up to a maximum of 1,250 percent. In aggregating the risk weights for second- or-later-to-default credit derivatives, the proposal would permit covered banking organizations to exclude the (n-1) assets with the lowest risk weights

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<sup>94</sup> As a standardized approach, the SEC-SA calculation does not explicitly capture default correlation among the underlying exposures (such as the possibility that multiple underlying exposures will default simultaneously or that the default of one underlying exposure may affect the likelihood of another underlying exposure defaulting). Instead, default correlation effects are implicitly incorporated through the supervisory parameter (p) in the SEC-SA calculation, which serves as a proxy for the concentration and correlation of the underlying exposures.

from the calculation.<sup>95</sup> This approach would require a covered banking organization to maintain capital based on the risk characteristics of all the underlying reference exposures in the basket on which it is providing protection, while recognizing that the covered banking organization is not required to make a payment unless “n” names in the basket default.

*c. Derivative contracts that do not provide credit enhancements*

The proposal would revise the risk weight for securitization exposures that are derivative contracts (other than protection provided by a covered banking organization in the form of a credit derivative) that have a first priority claim on the cash flows from the underlying exposures, notwithstanding amounts due under interest rate or currency derivative contracts, fees, or other similar payments. The current capital rule permits covered banking organizations to assign a risk-weighted asset amount for such securitization exposures equal to the exposure amount calculated under current exposure methodology or SA-CCR, as applicable, (corresponding to a 100 percent risk weight). The proposal would eliminate this option. Instead, a covered banking organization would determine the risk-weighted asset amount by multiplying (1) the exposure amount produced by the counterparty credit risk framework, as described in section III.C. of this **SUPPLEMENTARY INFORMATION**, and (2) either the risk weight applicable to the exposure under the securitization framework or a 1,250 percent risk weight. The proposed treatment would be more risk sensitive and more accurately reflect the risks of such exposures than a flat 100 percent risk weight.

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<sup>95</sup> For example, assume a covered banking organization sells a first-to-default credit derivative that provides protection on three underlying entities, two of which would be subject to the 95 percent risk weight for corporate exposures under the proposal and one to the 20 percent risk weight for GSEs. The proposal would require the covered banking organization to multiply the sum of the three risk-weights (210 percent) by the notional amount of protection provided by the first-to-default credit derivative. If the covered banking organization sold a second-to-default credit derivative that provided protection on the same three entities, the proposal would require the covered banking organization to multiply the sum of the two highest applicable risk-weights (190 percent) by the notional amount of protection provided by the second-to-default credit derivative.

Additionally, the proposal would provide a new treatment for certain interest rate or foreign exchange derivative contracts that qualify as securitization exposures. Some securitizations either make payments to investors in a different currency from the underlying exposures or make fixed payments to investors when the cash flows received on the underlying exposures are linked to a floating interest rate. To neutralize these foreign exchange or interest rate risks, a securitization may enter into a derivative contract that mirrors the currency or interest rate mismatch between the exposures and the tranches. Cash flows required to be paid to the derivative counterparty tend to have a claim senior to the investors in the cash flow waterfall, and therefore tend not to provide credit enhancement.

The proposal would require a covered banking organization that acts as a counterparty to these types of interest rate and foreign exchange derivatives to set the risk weight on such derivatives equal to the risk weight calculated under the SEC-SA for a securitization exposure that is pari passu to the derivative contract or, if such an exposure does not exist, the risk weight of the next subordinated tranche of the securitization exposure. A covered banking organization may otherwise not be able to calculate a risk weight for these derivative contracts using the SEC-SA because the attachment and detachment points under the proposed formula could equal one another, rendering the formula inoperable. The proposed treatment is intended to appropriately reflect how the credit risk associated with these derivative contracts would be commensurate with or less than the credit risk associated with a pari passu tranche or the next subordinated tranche of a securitization exposure.

*Question 49: The current capital rule provides covered banking organizations the option to assign a 100 percent risk weight to securitization exposures that are derivative contracts (other than protection provided by a covered banking organization in the form of a credit*

*derivative) that have a first priority claim on the cash flows from the underlying exposures (notwithstanding amounts due under interest rate or currency derivative contracts, fees, or other similar payments). The agencies seek comment on the advantages and disadvantages of retaining this option. What, if any, operational burden would covered banking organizations face if this option were retained or eliminated? What, if any, clarifications should the agencies consider regarding the determination of the attachment point and detachment point for such securitization exposures, and why?*

*d. Overlapping exposures*

To enhance the risk sensitivity of the securitization framework, the proposal would introduce new provisions to address instances where one of the covered banking organization's securitization exposures would preclude the covered banking organization from incurring losses under all circumstances on one or more separate securitization exposures also held by the covered banking organization (overlapping exposures). The standardized approach of the current capital rule includes provisions to limit the double counting of risks in situations involving overlapping securitization exposures. If a covered banking organization has multiple securitization exposures that provide duplicative coverage to the underlying exposures of a securitization (such as when a covered banking organization provides a program-wide credit enhancement and multiple pool-specific liquidity facilities to an ABCP program), the covered banking organization is not required to hold duplicative risk-based capital against the overlapping position. Instead, the covered banking organization may apply to the overlapping position the applicable risk-based capital treatment under the securitization framework that results in the highest risk-based capital requirement.

The proposal would expand the treatment of overlapping exposures to allow covered banking organizations to also apply this treatment (1) where one or more of the overlapping securitization exposures would be subject to the securitization framework in §\_\_.43 of the proposal and other(s) to the proposed market risk framework, and (2) to securitization exposures that partially overlap for purposes of the securitization framework in §\_\_.43 of the proposal.

First, to the extent that (1) a covered banking organization is subject to market risk capital requirements, and (2) one or more of the such securitization exposures would be subject to securitization framework and others to the revised market risk framework, the proposal would allow the covered banking organization to reflect only the greater of the risk-based capital requirement produced by the securitization framework or the market risk capital framework, provided the covered banking organization is able to calculate and compare the capital requirements for the relevant exposures.

Second, if a covered banking organization has two or more securitization exposures that partially overlap, the proposal would permit the covered banking organization to treat the exposures as overlapping exposures, provided the covered banking organization can demonstrate that one of its securitization exposures can fully absorb losses arising from its other securitization exposures. For example, if a covered banking organization provides a program-wide credit enhancement to an ABCP conduit that covers only the portion of the losses above the seller-provided protection<sup>96</sup> and the covered banking organization<sup>96</sup> also holds commercial paper issued by the ABCP conduit, the covered banking organization would be permitted to reflect the risk-weighted asset amount only for the program-wide credit enhancement, provided the covered

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<sup>96</sup> For example, typically in the case of multi-seller ABCP conduits, each seller provides first-loss protection by over-collateralizing the conduit to which it sells loans.

banking organization demonstrates, for purposes of calculating risk-based capital requirements, that the program-wide credit enhancement would require the covered banking organization to fully absorb any losses arising from the ABCP conduit. As the risk-based capital requirement for the program-wide credit enhancement would be treated as covering any losses on the commercial paper, the proposal would not require the covered banking organization to also maintain additional risk-based capital against the securitization exposure(s) arising from the commercial paper.

In this regard, the proposal aims to increase risk sensitivity by allowing covered banking organizations to appropriately reflect the risk of such overlapping exposures within the calculation of risk-weighted assets while also providing sufficient flexibility if doing so would impose significant burden.<sup>97</sup>

*Question 50: What challenges, if any, would the option to recognize an overlap between market risk covered and noncovered positions introduce? To what degree do covered banking organizations anticipate recognizing overlaps between market risk covered and noncovered positions?*

*e. Look-through approach for senior securitization exposures*

The proposal would introduce a provision that would allow a covered banking organization to assign to a senior securitization exposure that is not a resecuritization exposure a risk weight equal to the weighted average risk weight of the underlying exposures, provided that the covered banking organization has knowledge of the composition of all of the underlying

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<sup>97</sup> For example, the proposed market risk capital framework would require banking organizations to calculate risk-based capital requirements at the trading desk level. Thus, the cost associated with requiring covered banking organizations to calculate market risk capital requirements for an individual securitization exposure may outweigh any improvement in risk sensitivity associated with the proposed treatment for overlapping exposures described above. See section V.A. of the expanded risk-based proposal.

exposures (also referred to as the “look-through approach”). For purposes of calculating the weighted-average risk weight, the proposal would require a covered banking organization to use (1) the unpaid principal amount of underlying exposures as the weight for each exposure, and (2) determine the risk weight applicable to an underlying equity exposure based on the characteristics of the underlying equity exposure.<sup>98</sup>

The proposal would define a senior securitization exposure as an 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 covered banking organization would not be required to consider amounts due under interest rate derivative contracts, currency derivative contracts, and servicer cash advance facility contracts,<sup>99</sup> or any fees and other similar payments to be made by the securitization to other parties. 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 derivative contracts, currency derivative contracts, and servicer cash advance facility contracts, fees due, and other similar payments. Accordingly, under the proposed look-through approach, if a senior securitization exposure’s underlying exposures consists solely of past due loans with a weighted-

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<sup>98</sup> As discussed in section III.E.4.c. of this **SUPPLEMENTARY INFORMATION**, the non-significant equity exposure treatment does not apply to equity securities underlying a securitization.

<sup>99</sup> Consistent with the current capital rule, the proposal would define a servicer cash advance facility as 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* 12 CFR 3.2 (OCC); 12 CFR 217.2 (Board); 12 CFR 324.2 (FDIC).

average risk weight of 150 percent, the risk weight for the senior securitization exposure would be no more than 150 percent.

Consistent with the proposed 15 percent floor under the SEC-SA, the proposal would require covered banking organizations to floor the total risk-based capital requirement under the look-through approach at 15 percent. The proposed 15 percent floor is intended to appropriately reflect the minimum amount of risk-based capital that a covered banking organization should maintain for senior securitization exposures given that the process of securitization can introduce risks that are not present in directly holding the underlying exposures. For example, the transformation of risk profiles through the securitization process and the introduction of payment waterfalls, among other structural features, can add complexity to modeling and correlation assumptions.

*Question 51: What are the advantages and disadvantages of the proposed 15 percent risk weight floor in the look-through approach and why?*

*f. Credit-enhancing interest only strips*

The proposal would require a covered banking organization to deduct from common equity tier 1 capital any portion of a credit-enhancing interest-only strip<sup>100</sup> that does not constitute an after-tax-gain-on sale, regardless of whether the securitization exposure meets the proposed operational requirements. The proposed treatment for credit-enhancing interest-only strips would be different than under standardized approach in the current capital rule, which requires a risk weight of 1,250 percent for these items. The proposal would require covered

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<sup>100</sup> Consistent with the current capital rule, the proposal would define a credit-enhancing interest-only strip as an on-balance sheet asset that, in form or in substance (1) represents a contractual right to receive some or all of the interest and no more than a minimal amount of principal due on the underlying exposures of a securitization; and (2) exposes the holder of the CEIO to credit risk directly or indirectly associated with the underlying exposures that exceeds a pro rata share of the holder's claim on the underlying exposures, whether through subordination provisions or other credit-enhancement techniques. See 12 CFR 3.2 (OCC); 12 CFR 217.2 (Board); 12 CFR 324.2 (FDIC).

banking organizations to deduct credit-enhancing interest-only strips from common equity tier 1 capital because valuations of credit-enhancing interest-only strips can include a high degree of subjectivity and, just like assets subject to deduction under the current capital rule such as goodwill and other intangible assets, covered banking organizations may not be able to fully realize value from credit-enhancing interest-only strips based on their balance sheet carrying amounts. While a deduction is generally equivalent to a 1,250 percent risk weight when the covered banking organization maintains an 8 percent risk-based capital ratio, given the various capital ratios, buffers, and add-ons applicable to covered banking organizations, applying a deduction provides a more consistent treatment across capital ratios.

*g. Non-performing loan securitizations*

The proposal would define a non-performing loan securitization as a traditional securitization, that is not a resecuritization, where parameter W for the underlying exposures is greater than or equal to 90 percent at the origination cut-off date<sup>101</sup> and at any subsequent date on which exposures are added to or removed from the pool of underlying exposures due to replenishment or restructuring. A securitization exposure that meets the definition of a resecuritization exposure would be excluded from the definition of a non-performing loan securitization.

In a typical non-performing loan securitization, the originating banking organization sells non-performing loans to a securitization at a significant discount to the outstanding loan balances, reflecting the nonperforming nature of the underlying exposures. This nonrefundable purchase price discount functions as a form of credit enhancement to investors. Unlike

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<sup>101</sup> Cut-off date is the date on which the composition of the underlying exposures collateralizing a securitization transaction is established. This means that all exposures to be included in a securitization must already be in existence and meet the non-performing loan criteria as of that date.

securitizations of performing loans, which principally depend on the cash flows of the underlying loans, the performance of non-performing loan securitizations depends in part on the performance of workouts on defaulted loans and on the liquidation of underlying collateral for those loans which are unable to be cured, both which are uncertain and could be volatile.

Consistent with the expanded risk-based approach proposal, the proposal would introduce a specific capital treatment for non-performing loan securitization exposures. A covered banking organization would assign a risk weight of 100 percent to a non-performing loan securitization exposure if the following conditions are satisfied: (1) the transaction structure meets the definition of a traditional securitization; (2) the securitization contains a credit enhancement in the form of a nonrefundable purchase price discount greater than or equal to 50 percent of the outstanding principal balance of the underlying exposures at inception of the transaction; and (3) the covered banking organization's securitization exposure is a senior securitization exposure, as described in section III.E.5.e. of this **SUPPLEMENTARY INFORMATION**.<sup>102</sup> Applying the SEC-SA to senior securitizations of non-performing loans that meet these criteria would result in capital requirements that do not appropriately reflect the nonrefundable purchase price discount associated with these transactions. The SEC-SA is calibrated on the assumption that the underlying exposures at origination of the securitization are generally performing and is therefore inappropriate for senior exposures to securitizations of non-performing loans that meet these criteria.

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<sup>102</sup> If the covered banking organization is an originating banking organization with respect to the non-performing loan securitization, the covered banking organization may maintain risk-based capital against the transferred exposures as if they had not been securitized and must deduct from common equity tier 1 capital any after-tax gain-on-sale resulting from the transaction and any portion of a CEIO strip that does not constitute an after-tax gain-on-sale.

If the non-performing loan securitization exposure is not a senior securitization exposure or the nonrefundable purchase price discount is less than 50 percent, the covered banking organization would be required to apply the SEC-SA to determine the applicable risk weight (including by reflecting all delinquent exposures in the calculation of parameter W), subject to a risk weight floor of 100 percent. Compared to other securitizations, the higher supervisory risk-weight floor of 100 percent for non-performing loan securitization exposures reflects the greater dependence of non-performing loan securitizations on the servicer's ability to generate recovery cashflows through loan workouts, borrower renegotiations, or enforcement against collateral. If the securitization exposure does not meet the requirements for use of the SEC-SA, the proposal would require the covered banking organization to assign a risk weight of 1,250 to the securitization exposure.

*Question 52: The agencies seek comment on the proposed 100 percent risk-weight floor for non-performing loan securitization exposures. What modifications, if any, should the agencies consider to the 100 percent risk-weight floor for non-performing loan securitization exposures and why? Commenters are encouraged to provide data (such as loss history) to support their recommendations.*

*i. Attachment and detachment points for NPL securitizations subject to the SEC-SA*

Under the proposal, the nonrefundable purchase price discount would equal the difference between the outstanding principal balance of the underlying exposures at the time of sale and the price at which these exposures are sold by the securitization originator<sup>103</sup> on a final basis, without recourse, to a company the activities of which are limited to those appropriate for

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<sup>103</sup> While originator typically refers to the party originating the underlying loans, in the non-performing loan context it refers to the party arranging the non-performing loan securitization (that is, the securitizer).

the specific purpose of holding the underlying exposures of a securitization. The purchase price discount would be considered non-refundable when neither the securitization originator nor the original lender is reimbursed with respect to that difference. For any given tranche of the securitization, a covered banking organization may take into account only the initial sale from the securitization originator in the determination of the non-refundable purchase price discount. In cases where the securitization originator underwrites tranches of a non-performing loan securitization for subsequent sale, a covered banking organization that is an investing banking organization may include in the calculation of the nonrefundable purchase price discount the difference between the outstanding principal balance of the underlying exposures at time of sale and the price at which the securitization originator subsequently sells all of the underwritten tranches to unrelated third parties..

Because the calculation of both parameters A and D depend on the current dollar amount of the underlying exposures, any nonrefundable purchase price discount associated with a securitization would be included in both the numerator and denominator of parameters A and D. For example, assume an originating banking organization sells on a final basis, without recourse, a pool of mortgage loans with an outstanding principal balance of \$100 million to a securitization at a price of \$60 million. The nonrefundable purchase price discount would be the difference between the outstanding principal balances of the underlying mortgages at the time of sale to the securitization and the price at which the originating banking organization sold these mortgages to the securitization company (that is, \$40 million). Assume that the securitization company issues \$60 million in securitization tranches of which the originating banking organization purchases the senior \$50 million tranche and an investing banking organization purchases the \$10 million subordinate tranche. Parameter A for the investing banking

organization's exposure would equal 40 percent (that is, the ratio of \$40 million to \$100 million). In this case, the purchase price discount functions as the effective first-loss position in the securitization structure. Likewise, the originating banking organization would treat both the nonrefundable purchase price discount and the investing banking organization's tranche as subordinate and would set parameter A at 50 percent.

If, in the example above, after selling the \$100 million pool of mortgage loans to a securitization company at a price of \$60 million, the originating banking organization underwrites both the senior tranche and the subordinate tranche and later sells both tranches to third parties at a 20 percent discount (that is, the \$10 million subordinated tranche is sold for a price of \$8 million and the \$50 million senior tranche is sold for a price of \$40 million), the proposal would allow the investing banking organizations to assign an attachment point that reflects the extent to which losses have effectively been absorbed by the non-refundable purchase price discount, as measured by the difference between the outstanding principal amount of the underlying exposures (\$100 million) and the aggregate price at which the originating bank subsequently sells those securitization tranches to unrelated third parties (\$48 million). The originating banking organization as underwriter absorbs the additional 20 percent price discount at the sale of the tranches.<sup>104</sup> Thus, the investing banking organization that purchases the \$8 million subordinate tranche would be permitted to assign an attachment point of 52 percent and a detachment point of 60 percent to its securitization exposure; the investing banking organization

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<sup>104</sup> Under the proposal, a purchase price discount would only qualify as a non-refundable purchase price discount if neither the securitization originator nor the original lender receive reimbursement of the discount. If, in the above example, the securitization company repays the originating banking organization, acting in its role as underwriter, for the purchase price discount from the sale of the tranches to third-party investors, the purchase price discount would not qualify as a non-refundable purchase price discount and the investing banking organizations would not be permitted to recognize such a discount in the calculation of parameters A and D.

that purchases the \$40 million senior tranche would be permitted to assign an attachment point of 60 percent and a detachment point of 100 percent to its securitization exposure.

*6. Credit risk mitigation for securitization exposures*

The proposal would incorporate the credit risk mitigation framework for securitization exposures in the current capital rule, with one exception. A covered banking organization that purchases or sells tranching credit protection, whether hedged or unhedged, referencing part of a senior tranche would not be allowed to treat the lower-priority portion that the credit protection does not reference as a senior securitization exposure. For example, if a covered banking organization holds a securitization exposure with an attachment point of 20 percent and a detachment point of 100 percent and the covered banking organization purchases an eligible guarantee with an attachment point of 50 percent and a detachment point of 100 percent, the covered banking organization's residual exposure, which attaches at 20 percent and detaches at 50 percent, would be considered a non-senior securitization exposure, and the covered banking organization would not be permitted to apply the look-through approach to this exposure. A covered banking organization that purchases a mezzanine tranche that attaches at 20 percent and detaches at 50 percent has a similar economic exposure to a covered banking organization that purchases a senior tranche that attaches at 20 percent and detaches at 100 percent and then purchases credit protection that attaches at 50 percent and detaches at 100 percent. Because the former transaction would not be considered a senior securitization exposure eligible for the look-through approach, the latter transaction likewise should not be eligible for the look-through approach. Alternatively, the covered banking organization may choose not to recognize the tranching credit protection. In this case, the proposal would allow the covered banking

organization to treat the securitization exposure (which attaches at 20 percent and detaches at 100 percent) as a senior securitization exposure.

### ***F. Indexing of thresholds***

The capital rule uses certain thresholds to differentiate requirements based on a banking organization's size, risk profile, and complexity as well as on the characteristics of the exposures. However, static dollar-based thresholds can lead to unintended consequences if threshold levels are not periodically updated or indexed to inflation. For example, covered banking organizations can become subject to additional requirements and burden over time for reasons unrelated to changes in their risk profile. Under the proposal, certain dollar-based thresholds would be adjusted in the future to reflect inflation, pursuant to a pre-determined indexing methodology.<sup>105</sup> Indexing dollar-based thresholds would preserve threshold levels in real terms, which would efficiently and transparently preserve the thresholds' intended application and align with intended policy objectives over time.

The proposed indexing methodology would adjust thresholds based on the consumer price index for urban wage earners and clerical workers (CPI-W) published by the U.S. Bureau of Labor Statistics. The use of CPI-W to index thresholds is consistent with other bank regulations, such as those relating to the Community Reinvestment Act and the Board's Regulation CC.<sup>106</sup> Further, the indexing methodology included under the proposal would

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<sup>105</sup> This revision would also be consistent with comments received under EGRPRA as commenters requested indexing of thresholds going forward to reflect inflation.

<sup>106</sup> The agencies' regulations that implement the Community Reinvestment Act define small and intermediate-small banks by reference to asset-size criteria expressed in dollar amounts, which are adjusted annually based on the year-to-year change in inflation through a Federal Register notice. Specifically, this adjustment corresponds to the average of the Consumer Price Index for Urban Wage Earners and Clerical Workers, not seasonally adjusted, for each 12-month period ending in November, with rounding to the nearest million. *See e.g.*, Community Reinvestment Act Regulations Asset-Size Thresholds, 89 FR 106480, 106481 (Dec. 30, 2024). *See also* 12 CFR 229.11.

generally align with the methodology used to adjust certain thresholds within FDIC regulations.<sup>107</sup> Specifically, certain dollar thresholds would be adjusted at the end of every consecutive two-year period based on the cumulative percent change of the non-seasonally adjusted CPI–W since the effective date of any final rule. This two-year period is intended to provide an appropriate cadence for capturing meaningful changes in inflation on a timely basis while minimizing the burden of adjustment. To address the possibility of periods of unusual inflation, the indexing methodology would also allow for discretionary adjustment to thresholds by the agencies during an off year. The proposal would also not lower thresholds in the event of deflation.<sup>108</sup> Additionally, thresholds adjusted under the proposed indexing methodology would be rounded based on the size of the threshold (e.g., billions, millions, thousands), generally, to the nearest two significant digits, as appropriate.<sup>109</sup>

The proposal would index the following thresholds: (1) the \$1 million threshold used to determine whether a mortgage qualifies as a residential mortgage exposure; (2) the \$10 million threshold used to determine whether a company in which a covered banking organization owns equity instruments meets the definition of financial institution; and (3) the \$50 billion threshold used to determine whether a covered banking organization is subject to enhanced public disclosure requirements.

To effectuate threshold changes under the proposal, the agencies would announce threshold adjustments pursuant to the indexing methodology by publishing the updated thresholds. Threshold adjustments would be calculated based on cumulative CPI-W data

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<sup>107</sup> See *Adjusting and Indexing Certain Regulatory Thresholds*, 90 FR 55789 (Dec. 1, 2025).

<sup>108</sup> Any periods of deflation would be reflected in future threshold increases, as threshold adjustments in the future would be based on the positive net cumulative change in CPI–W.

<sup>109</sup> For example, a threshold that would otherwise be calculated as \$5.964 million would be rounded to \$6.0 million, or the nearest \$0.1 million.

through August of the year in which the adjustment is made, relative to the same initial baseline.<sup>110</sup>

*Question 53: What are the advantages and disadvantages of the proposed approach for indexing thresholds? What alternatives should the agencies consider and why? What are the advantages and disadvantages of using a different index for adjusting thresholds, such as nominal GDP or the GDP deflator, instead of CPI-W?*

*Question 54: Are there specific thresholds within the proposal that can result in an increase in operational burden when indexed? If so, which are they and why?*

*Question 55: What are the advantages and disadvantages of discretionary off-year adjustments for periods of unusual inflation? Should the agencies consider a framework for adjustment in off years, such as based on inflation or other threshold and, if so, why?*

#### **IV. Disclosure requirements**

Meaningful public disclosures of a banking organization's activities and the features of its risk profile work in tandem with the regulatory and supervisory frameworks by helping to support robust market discipline. In this way, meaningful public disclosures help to support the safety and soundness of banking organizations and the financial system more broadly.

Under the current capital rule, all covered banking organizations with total consolidated assets \$50 billion or more are subject to the public disclosure requirements.<sup>111</sup> Under the proposal, the \$50 billion total consolidated asset threshold in section \_\_.61 of the capital rule

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<sup>110</sup> The U.S. Bureau of Labor Statistics publishes the CPI-W on a monthly basis.

<sup>111</sup> See 12 CFR §§ \_\_.61 to \_\_.63. For the purposes of the disclosure requirements threshold, total consolidated assets are determined based on the average of a covered banking organization's total consolidated assets in the four most recent quarters or the average of the covered banking organization's total consolidated assets in the most recent consecutive quarters if the Board-regulated institution has not filed such a report for each of the most recent four quarters. See 12 CFR \_\_.61.

would adopt a mechanism to adjust the public disclosure threshold for inflation, as described in Section III.F of this **SUPPLEMENTARY INFORMATION**.<sup>112</sup>

In addition, to account for the changes proposed under this proposal, the agencies anticipate separately proposing revisions to the Consolidated Reports of Condition and Income (Call Report). Similarly, the Board anticipates proposing corresponding revisions to the Consolidated Financial Statements for Holding Companies (FR Y-9C), the Capital Assessments and Stress Testing (FR Y-14A and FR Y-14Q), and the Systemic Risk Report (FR Y-15) to reflect the changes to the capital rule that would be required under this proposal and the expanded risk-based approach proposal.

The agencies are considering proposing reporting changes that would include many of the quantitative disclosure requirements currently provided under section .173 of the current capital rule for Category I and II banking organizations. To reduce duplication in anticipation of these proposed reporting changes, the expanded risk-based approach proposal would remove all quantitative disclosures required under section .173 of the capital rule.<sup>113</sup> Covered banking organizations subject to public disclosure requirements under section .63 of the capital rule would not be subject to the same regulatory reporting requirements as Category I and II banking organizations.<sup>114</sup> As such, this proposal would not make any modifications to the disclosure requirements under section .63 of the capital rule.

*Question 56: Many of the quantitative disclosures required by section .63 of the capital rule are also reported in other publicly available regulatory reports such as the Call Report or*

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<sup>112</sup> See 12 CFR § .2, “Annual inflation index” and 12 CFR § .4.

<sup>113</sup> See section VI. of the expanded risk-based proposal.

<sup>114</sup> For example, the Regulatory Capital Reporting for Institutions Subject to the Advanced Capital Adequacy Framework (FFIEC 101) or the Market Risk Regulatory Report for Institutions Subject to the Market Risk Capital Rule (FFIEC 102).

*FR Y-9C. The agencies request comment on the public disclosure requirements under section \_\_.63 of the current capital rule and whether each of the mandated quantitative disclosures is necessary given other regulatory reporting requirements imposed on banking organizations. What duplicative quantitative disclosures should the agencies consider modifying, and why? What are the advantages and disadvantages of removing all quantitative disclosures from section \_\_.63 and reflecting them in regulatory reports, consistent with the approach being contemplated in the expanded risk-based approach proposal?*

*Question 57: The agencies invite comment on the utility of the proposed public disclosure requirements. What additional considerations, if any, should the agencies consider with regard to the scope and granularity of the proposal's disclosure requirements? What are the advantages and disadvantages of the proposed disclosure requirements?*

## **V. Estimated impact on capital requirements**

As previously discussed, the proposed rule would amend aspects of the capital requirements for covered banking organizations. In particular, the proposed rule would revise the calculation of risk-weighted assets for certain asset classes for covered banking organizations. The changes in risk-weighted assets would in turn affect covered banking organizations' risk-based capital requirements. The proposed rule would also modify the securitization framework and the credit risk mitigation framework. Further, the proposed rule would remove the threshold-based deduction for mortgage servicing assets for covered banking organizations.<sup>115</sup> Finally, the proposed rule would require Category III and IV banking

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<sup>115</sup> This proposed change would also apply to banking organizations that elect to use the community bank leverage ratio framework. In addition, the expanded risk-based proposal would remove the deduction treatment of mortgage servicing assets for Category I and II banking organizations.

organizations to include most components of accumulated other comprehensive income (AOCI) in the numerator of their regulatory capital ratios.

This section estimates the impact of these proposed revisions to the regulatory capital framework on risk-weighted assets and capital requirements. The following section examines the effect on covered banking organizations, their customers, their competitors, and the banking industry at large.

### ***Summary***

The analysis estimates the change in risk-weighted assets and common equity tier 1 and tier 1 capital requirements that would result from the proposal. This impact is estimated separately for holding companies and depository institutions, and for three size groups of these banking organizations: (1) Category III and IV holding companies, which have assets over \$100 billion, and their subsidiaries;<sup>116</sup> (2) covered banking organizations with between \$10 billion and \$100 billion in assets; and (3) covered banking organizations with less than \$10 billion in assets that have not elected to use the community bank leverage ratio (CBLR) framework. The estimated impact of the proposal across all covered banking organizations is summarized by Table V.1. Table V.2 further breaks down the impact across banking organizations in the different size groups.

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<sup>116</sup> Smaller subsidiaries of Category III and IV holding companies are included in only this first group of banking organizations.

**Table V.1:** Summary of the Proposal’s Estimated Impact on Risk-Weighted Assets and Common Equity Tier 1 (CET1) and Tier 1 Capital Requirements (%)

	Risk-Weighted Assets	Capital Requirements	
		CET 1	Tier 1
<b>Covered Depository Institutions</b>			
No AOCI	-8.6	-8.6	-7.4
With AOCI impact <sup>117</sup>		-6.4	-5.7
<b>Covered Holding Companies</b>			
No AOCI	-8.8	-6.8	-6.9
With AOCI impact		-4.8	-5.3

Source: Special data collection, FR Y-9C, FFIEC Call Reports, and agency calculations as described in sections V.D. and V.F.

The agencies estimate that the proposal would decrease aggregate risk-weighted assets by 8.6 percent for covered banking organizations that are depository institutions (covered depository institutions), relative to the current standardized approach. The changes in risk-weighted assets would in turn decrease these depository institutions’ common equity tier 1 capital requirements by 8.6 percent and tier 1 capital requirements by 7.4 percent, after taking into account leverage ratio requirements and before considering changes to the numerator of the capital ratios. The proposed changes would require depository institution subsidiaries of Category III and IV holding companies to recognize AOCI in regulatory capital, subject to a five-year transition

<sup>117</sup> As described below in section V.E, the impact of AOCI is represented as a change in requirements by adding the estimated long-run impact of AOCI on equity to requirements. Under the proposal, recognizing most elements of AOCI in regulatory capital would be mandatory only for Category III and IV banking organizations and their subsidiaries.

period. The agencies assess the impact of AOCI recognition with a long-run perspective and estimate that this proposed change would partially offset the expected decrease in capital requirements. As a result, taking into account AOCI recognition (in addition to leverage ratio requirements), aggregate common equity tier 1 and tier 1 capital requirements for covered depository institutions decrease by 6.4 and 5.7 percent, respectively, as shown in Table V.1.<sup>118</sup>

Similarly, the agencies estimate that the proposal would decrease aggregate risk-weighted assets by 8.8 percent for covered banking organizations that are depository institution holding companies (covered holding companies), relative to the current standardized approach. The changes in risk-weighted assets would in turn decrease these covered holding companies' common equity tier 1 capital requirements by 6.8 percent and tier 1 capital requirements by 6.9 percent, after taking into account leverage ratio requirements and before considering changes to the numerator of the capital ratios. Taking into account AOCI impacts and leverage ratio requirements, covered holding companies would see decreases in common equity tier 1 and tier 1 capital requirements of 4.8 and 5.3 percent, respectively, as shown in Table V.1.

In the current capital regulation framework, Category III and IV holding companies are further subject to a stress capital buffer requirement which would dampen the impact of changes in risk-weighted assets on capital requirements.<sup>119</sup> This stress capital buffer requirement is informed by the Board's supervisory stress test, to which changes have been recently proposed.<sup>120</sup> Table V.2 shows that the impact of the proposed stress test changes as if the

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<sup>118</sup> The impact of AOCI recognition in regulatory capital can be affected by the interest rate environment, bank balance sheet management, and changes in the accounting standards. The estimate reported here represents a long-run average and does not consider the transition provisions (*see Infra* fn [121]).

<sup>119</sup> Stress capital buffer requirements expressed in dollar terms are affected by risk-weighted assets primarily to the extent that they are subject to a floor equal to 2.5 percent of risk-weighted assets.

<sup>120</sup> The "proposed stress test changes" refer to the proposed model changes and revisions to the global market shock component announced in connection with the Board's proposal to enhance the transparency and public

proposed model changes and proposed revisions to the global market shock scenario design had been implemented in the 2024 and 2025 stress tests, independent of other factors that affect the determination of a banking organization’s stress capital buffer requirement.<sup>121</sup> The cumulative estimated impact of the proposal’s risk-weighted asset changes, the long-run average estimate of AOCI recognition, and the proposed stress testing model and scenario changes would decrease

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accountability of the Board’s supervisory stress test. *See* Board, Enhanced Transparency and Public Accountability of the Supervisory Stress Test Models and Scenarios; Modifications to the Capital Planning and Stress Capital Buffer Requirement Rule, Enhanced Prudential Standards Rule, and Regulation LL, 90 FR 51856 (Nov. 18, 2025) (the “Stress Test Transparency Proposal”).

<sup>121</sup> The estimated capital impact described in this cumulative analysis with respect to the proposed stress test changes announced in the Stress Test Transparency Proposal incorporates the underlying data published by the Board in the Stress Test Transparency Proposal, without changes to the underlying data. That proposal included illustrative analysis that considered the potential effects of the proposed stress test model and scenario changes, independent of other factors and components that inform the Board’s stress capital buffer determinations for specific bank holding companies, within the 2024 and 2025 supervisory stress tests. As stated in the Stress Test Transparency Proposal, in aggregate, the proposed stress test model and scenario changes are not expected to materially change capital requirements for bank holding companies subject to the supervisory stress test, across various stress scenarios and jump-off conditions at the start of the test.

Category III and IV holding companies' common equity tier 1 and tier 1 capital requirements by approximately 5.3 and 5.6 percent, respectively.

**Table V.2:** Summary of the Proposal's Estimated Impact on Risk-Weighted Assets and Common Equity Tier 1 (CET1) and Tier 1 Capital Requirements (%), by Banking Organization Size

	Risk-Weighted Assets	Capital Requirements	
		CET 1	Tier 1
<b>Depository Institutions</b>			
Category III/IV Sub., No AOCI	-9.1	-9.1	-7.8
Category III/IV Sub., AOCI		-4.7	-4.3
Assets \$10 to \$100 bn	-8.3	-8.3	-7.5
Assets Below \$10 bn	-7.7	-7.7	-6.6
<b>Holding Companies</b>			
Category III/IV, No AOCI	-9.5	-6.1	-6.4
Category III/IV, AOCI		-3.0	-3.8
Category III/IV, AOCI and Proposed Stress Test Changes		-5.3	-5.6
Assets \$10 to \$100 bn	-7.9	-7.9	-7.9
Assets Below \$10 bn	-7.5	-7.5	-7.4

Source: Special data collection, FR Y-9C, FFIEC Call Reports, and agency calculations as described in sections V.D and V.F.

Importantly, risk-weighted asset and capital impact estimates assume banking activity and risk exposures remain unchanged. As the proposal and its incentives come into effect, covered banking organizations may change their behavior.

## ***Baseline***

This analysis compares estimated outcomes under the proposal to a baseline in which the current capital regulations remain unchanged. For the estimation of economic outcomes in both the proposal and the baseline states, this analysis assumes such states would have in place all other relevant statutes and regulations applicable to covered banking organizations that existed as of June 30, 2025. Covered banking organizations' financials other than items affected by capital requirements in these states are assumed to be identical to those on Reports of Income and Condition (Call Reports) and Consolidated Financial Statements for Holding Companies (FR Y-9C) as of June 30, 2025. In addition, agencies use the results of a special data collection in 2023 to inform its analysis.<sup>122</sup>

In conjunction with this proposal, the agencies are issuing the expanded risk-based proposal that would generally apply to Category I and II banking organizations and any other banking organizations that choose to adopt the proposed expanded risk-based approach, and would also revise the market risk capital framework for banking organizations with significant trading activity. The agencies have also published a notice of proposed rulemaking that would lower the CBLR framework's leverage requirement from 9 percent to 8 percent (CBLR proposal).<sup>123</sup> The majority of this analysis does not address potential overlaps among the three rulemakings. However, where appropriate, this analysis considers interaction effects when these other rulemakings are finalized before or at the same time as the proposal.

## ***Scope***

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<sup>122</sup> See section VII.D.1 of the expanded risk-based proposal for further discussion of the special collection data.

<sup>123</sup> 90 FR 55048 (Dec. 1, 2025).

The proposal would affect risk-weighted asset calculations for all covered banking organizations. As of June 30, 2025, there are 2,741 covered depository institutions and 344 covered holding companies.<sup>124</sup> Table V.3 summarizes the total assets and capital levels for the covered banking organizations.

**Table V.3: Summary of Covered Banking Organizations**

Covered depository institutions	Count	Total Assets (billion)	Risk-Weighted Assets (billion)	CET1 capital (billion)	Tier 1 capital (billion)	Required CET1 capital (billion)	Required Tier 1 capital (billion)
Subsidiaries of Category III and IV holding companies	35	\$6,034	\$4,213	\$604	\$608	\$295	\$371
Total assets between \$10 billion and \$100 billion	115	\$3,272	\$2,426	\$316	\$318	\$170	\$209
Total assets below \$10 billion	2,591	\$2,769	\$2,071	\$295	\$296	\$145	\$179
Total	2,741	\$12,075	\$8,711	\$1,216	\$1,222	\$610	\$759
Covered holding companies	Count	Total Assets (billion)	Risk-Weighted Assets (billion)	CET1 capital (billion)	Tier 1 capital (billion)	Required CET1 capital (billion)	Required Tier 1 capital (billion)
Category III and IV	25	\$6,972	\$4,655	\$597	\$659	\$371	\$449
Total assets between \$10 billion and \$100 billion	109	\$3,351	\$2,431	\$322	\$334	\$170	\$207
Total assets below \$10 billion	210	\$1,100	\$864	\$110	\$115	\$60	\$73
Total	344	\$11,423	\$7,950	\$1,029	\$1,108	\$602	\$729

<sup>124</sup> Holding companies with assets under \$3 billion are not required to report risk-based capital information on the FR Y9-C. For these smaller holding companies, economic activity is largely represented by their depository institution subsidiaries.

Source: FFIEC Call Reports and FR Y-9C, June 30, 2025.

Notes:

Counts of covered banking organizations exclude Category I and II banking organizations and banking organizations that elected to use the CBLR framework as of June 30, 2025. There are 1,714 depository institutions that elected to use the CBLR framework as of June 30, 2025 with \$796 billion in total assets, and 26 holding companies that elected to use the CBLR framework as of June 30, 2025, with \$100 billion in total assets.

Dollar values represent aggregate assets and capital levels for each cohort of depository institutions and holding companies. Assets and capital levels for cohorts may not add up to the totals due to rounding.

CET1 capital and tier 1 capital denote the values that covered banking organizations reported on Call Reports and the FR Y-9C, as applicable, as of June 30, 2025.

Required CET1 capital is 7% of risk-weighted assets for depository institutions (4.5% adequately capitalized threshold plus 2.5% capital conservation buffer), and 4.5% plus 2.5% capital conservation buffer or firm-specific stress capital buffer requirement, as applicable, for holding companies.

Required tier 1 capital equals the maximum of required risk-based tier 1 capital, required leverage tier 1 capital, and supplementary leverage ratio (SLR) required tier 1 capital. Required risk-based tier 1 capital is 8.5% of risk-weighted assets for depository institutions (6% adequately capitalized threshold plus 2.5% capital conservation buffer), and 6% plus 2.5% capital conservation buffer or firm-specific stress capital buffer, as applicable, for holding companies. Required leverage tier 1 capital equals 5% of average assets for depository institutions and 4% of average assets for holding companies.

Required SLR tier 1 capital equals 3% of total leverage exposure for Category III holding companies and subsidiary depository institutions.

For Category III and IV holding companies, required capital considers the average of each holding company's two most recent stress capital buffer requirements, effective as of October 1, 2024 and October 1, 2025.

As shown in Table V.3, Category III and IV entities currently represent the largest share of total risk-weighted assets and capital among covered banking organizations. In contrast, covered banking organizations with total assets under \$10 billion constitute the largest group by number but hold substantially smaller risk-weighted asset shares. Covered banking organizations with total assets between \$10 billion and \$100 billion fall in the middle on both metrics.

***A. Impact on risk-weighted assets by lending category***

Covered banking organizations' risk-based capital requirements are expressed as a percentage of their risk-weighted assets. The proposal would revise calculations of risk-

weighted assets, which would in turn affect these banking organizations' risk-based capital requirements.

In this section, the agencies estimate how the proposed risk weight revisions would directly change covered banking organizations' risk-weighted assets relative to the baseline. Over the long term, covered banking organizations may adjust their asset allocations across categories to re-optimize returns under the new risk weights. The long-term effects of the proposed rule on covered entities' risk-weighted assets may therefore differ from the estimates presented here. This analysis assumes that asset levels reported as of June 30, 2025, remain constant under both the baseline and the proposal.<sup>125</sup>

In developing these estimates, the agencies apply the proposal's risk weights to exposures included in Call Report schedule RC-R and FR Y-9C schedule HC-R for depository institutions and holding companies, respectively. For more information on data and methodology, please see section V.F.

In connection with the expanded risk-based proposal, the agencies have evaluated the appropriateness of risk weights in the current rule. This analysis suggests that lower risk-weights would better align with the actual risks in bank lending activities related to residential mortgage, corporate, and retail exposures, as well as other assets.<sup>126</sup> Informed by this analysis and to have more consistency between the expanded risk-based approach and the standardized approach, the proposal implements the following major changes: (1) broader range of risk weights for residential mortgage exposures, based on LTV ratios and source of repayment, (2) reduction in

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<sup>125</sup> Section VI discusses covered institutions' plausible responses to the proposal and the effects thereof.

<sup>126</sup> "Retail" exposures are not a defined category of exposures under the current or proposed standardized approach. Additionally, as described in Section III.A.2, "other assets" refers to all assets not specifically assigned a different risk weight under the rule and that are not deducted from regulatory capital.

the risk weight assigned to corporate exposures from 100 percent to 95 percent, (3) reduction in the risk weight assigned to other assets from 100 percent to 90 percent and (4) replacement of the 20 percent and 50 percent maturity-based credit conversion factors for commitments that are not unconditionally cancelable with a single 40 percent credit conversion factor. Additionally, the proposal adopts the changes in the expanded risk-based proposal regarding the securitization framework and the credit risk mitigation including the recognition of financial collateral for a broader range of transactions.<sup>127</sup>

To produce a more precise assessment of the impact of the proposal, this analysis estimates the impact on risk-weighted assets to the most granular extent possible given existing regulatory reports. In many cases, the analysis employs simplifying assumptions and relies on aggregated line items from current regulatory reports to estimate the effect of the proposal. See Section V.F for further details.

As mentioned previously, the proposal would modify the capital treatment of residential mortgage exposures. Under the current capital rule, owner-occupied or rented residential mortgage exposures secured by a first lien on one-to-four family residential properties that are prudently underwritten generally receive a 50 percent risk weight. Other residential mortgage exposures receive a 100 percent risk weight. Under the proposal, residential mortgage exposures currently eligible for the 50 percent risk weight would be risk-weighted according to two LTV-based lookup tables, which are applied based on the residential mortgage exposures' source of repayment. Residential mortgage exposures that are not dependent on the cash flows of the underlying real estate would have risk weights that range from 25 percent to 75 percent, whereas residential mortgage exposures that are dependent on the cash flows of the underlying real estate

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<sup>127</sup> See section IV.A.5 of the expanded risk-based approach proposal.

would have risk weights that range from 35 percent to 110 percent. These changes would represent a substantial increase in risk sensitivity of the capital framework.

Due to the limitations of current regulatory reports, the agencies utilize the 2023 special data collection to estimate the LTV distribution of residential mortgage exposures and the proportion of them that are dependent on the cash flows of the underlying real estate. This special data collection indicates that the significant majority of residential mortgage loans by Category III and IV banking organizations would be risk-weighted as residential mortgage exposures that are not dependent on the cash flows of the real estate.<sup>128</sup> Per Table V.4, the analysis indicates that the risk-weighted assets for residential mortgage exposures would decrease by 29.8 percent for covered depository institutions and by 30.4 percent for covered holding companies, relative to the baseline. The decrease in risk-weighted assets would, in turn, result in a significant decrease in the capital required to support residential mortgage lending.

Relating more generally to residential mortgage lending, the proposal would remove the 25 percent deduction threshold for mortgage servicing assets, while retaining the 250 percent risk weight.<sup>129</sup> Per Table V.4, the impact of removing the threshold deduction is not material for risk-weighted assets; however, this proposed change may incentivize banks to re-enter the mortgage servicing business or expand their existing operations.

**Table V.4: Impact on Risk-Weighted Assets**

Current and revised standardized approach (SA) risk-weighted assets, covered banking organizations, billions			
		Depository institutions	Holding companies

<sup>128</sup> The 2023 special collection data indicate that, in aggregate, approximately 97 percent of residential exposures are not dependent on the cash flows of the real estate for firms that submitted data.

<sup>129</sup> The proposal would remove the 25 percent deduction threshold for mortgage servicing assets for all banking organizations subject to the regulatory capital rule, including banking organizations subject to the community bank leverage ratio framework. The 250 percent risk weight for mortgage servicing assets would not apply to banking organizations subject to the community bank leverage ratio framework.

		Current SA	Revised SA	Change	Current SA	Revised SA	Change
General Risk Weights	Residential mortgages	\$755	\$530	-29.8%	\$606	\$421	-30.4%
	Commercial real estate	\$1,896	\$1,801	-5.0%	\$1,426	\$1,354	-5.0%
	Other corporate exposures	\$3,023	\$2,808	-7.1%	\$3,095	\$2,878	-7.0%
	Retail	\$1,297	\$1,167	-10.0%	\$1,182	\$1,063	-10.0%
	Securitization	\$117	\$96	-17.6%	\$108	\$88	-18.0%
	Commitments	\$20	\$17	-11.3%	\$17	\$15	-12.2%
	Other assets from 100% to 90% risk weight	\$473	\$426	-10.0%	\$494	\$445	-10.0%
	MSA deduction elimination	\$0.0	\$0.4		\$0.0	\$0.0	
	Exposures shifting from market risk framework to standardized approach	\$0.0	\$1.3		\$0.0	\$3.3	
	Allowance deduction change	\$0.0	(\$6.5)		\$0.0	(\$5.9)	
	Other assets – risk weights unchanged	\$1,119	\$1,119	0.0%	\$865	\$865	0.0%
Market risk	\$12	\$4.2	-66.2%	\$157	\$95.7	-39.2%	
Credit valuation adjustment (CVA) risk	\$0.0	\$2		\$0.0	\$29.7		
Risk-weighted assets for trading-related activities (market risk and CVA risk, subtotal)	\$12	\$6	-48.4%	\$157	\$125	-20.3%	
Total	\$8,711	\$7,966	-8.6%	\$7,950	\$7,253	-8.8%	

Source: Special data collection of 2023; FFIEC Call Reports; and FR Y-9C, June 30, 2025.

Other corporate exposures category includes unused commitments currently risk-weighted at 100%, and repo currently risk-weighted at 100%; all such exposures are risk-weighted at 95% under the revised SA.

The Commitments row includes all unused commitments except those currently risk-weighted at 100%. All commitments under one year have a credit conversion factor change from 0.2 to 0.4, those over one year have credit conversion factor change from 0.5 to 0.4.

"Allowance deduction change" accounts for the change in deduction for excess adjusted allowance for credit losses (AACL) to risk-weighted assets that occurs when credit risk-weighted assets change. This change in risk-weighted assets would reflect a change in RC-R and HC-R part II, item 29.

The proposal would decrease the risk weight for corporate exposures uniformly by five percentage points. Under both the current and proposed rule, the corporate exposure category is a broad one that includes a wide range of exposures to companies without specific regulatory treatment under the rule.<sup>130</sup> Among these various corporate exposure types, the agencies

<sup>130</sup> In the capital impact analysis of the expanded risk-based approach proposal, corporate exposures do not include any commercial real estate exposures.

separately analyze the impact on commercial real estate, which is generally a material asset class for banking organizations, along with “other corporate exposures.”

As shown in Table V.4, the agencies estimate a decrease in risk-weighted assets of 5 percent for identified exposures to commercial real estate, at both the holding company and depository institution levels, compared to the baseline. The commercial real estate exposures are based on current regulatory reporting items, including multifamily loans, that would likely not qualify for other specialized treatments under the capital rule, such as the treatment for high volatility commercial real estate exposures.

Per Table V.4, the other corporate exposure category is the largest asset class for covered banking organizations in terms of the quantity of risk-weighted assets. Other corporate exposures include a wide range of exposures such commercial and industrial loans, loans to non-depository financial institutions, and certain farm loans, as well as unfunded commitments to companies and repo-style transactions and derivatives. The estimated impact to risk-weighted assets for other corporate exposures in Table V.4 includes estimated changes both due to the risk weight change and due to the exposure measurement change as a result of applying a 40 percent credit conversion factor. Estimated risk-weighted assets for other corporate exposures decrease by approximately 7 percent for covered banking organizations, relative to the baseline. Given its large share, the decrease is close to 30 percent of the total estimated decrease in risk-weighted assets.

The proposed changes to the treatment of commitments would have effects beyond those associated with other corporate exposures. Banking organizations may also extend commitments that are not unconditionally cancelable and that have varying maturities to other entities such as public sector entities. The agencies estimate that the proposed change on such commitments that

were not included in the other corporate exposure category would result in a decrease of risk-weighted assets of 11.3 percent for depository institutions and 12.2 percent for holding companies, relative to the baseline. However, these constitute a relatively small share of overall exposures.

The proposal would also lower the risk weight for other assets from 100 percent to 90 percent. The other asset category in the capital rule includes a range of exposures such as exposures to individuals and other real estate owned that are not otherwise assigned a specialized capital treatment under the rule. To gain a more granular understanding of the proposal's impact, the agencies estimate the impact on retail exposures as well as other assets currently assigned a 100 percent risk weight.

Retail exposures typically include loans to individuals such as credit card loans, revolving credit plans, and automobile loans. Using existing regulatory reporting information, the agencies identified such exposures and per Table V.4, estimate a decrease of 10 percent in risk-weighted assets, relative to the baseline, consistent with the decline in the risk weight from 100 percent to 90 percent. The agencies separately estimate the impact on other assets that are not associated with retail exposures. These exposures can include premises and fixed assets and other real estate owned. Per Table V.4, the agencies estimate a 10 percent decrease in risk-weighted assets for covered banking organizations, relative to the baseline.

As discussed in Section III.E, the agencies are proposing to also include many of the changes to the securitization framework in the revised standardized approach that are also included in the expanded risk-based proposal. These changes would likely serve to lower the capital requirements for a given securitization transaction, incentivize the use of the securitization framework to reduce risk weights for assets held on-balance sheet, and encourage

the sale of pools of assets to securitization trusts, relative to the baseline. Per Table V.4, the agencies estimate that there will be an approximately 18 percent decrease in risk-weighted assets for securitization exposures for covered banking organizations, relative to the baseline.

As noted above, the proposal also includes changes to the credit risk mitigation framework which would increase the options available to substitute the risk weight of loans with the risk weight of financial collateral such as U.S. Treasury securities and cash on deposit. The agencies have not estimated the impact of this proposed change due to insufficient data to develop a reasonably accurate estimate. Given the prevalence of U.S. Treasury securities and deposits in the banking system, the agencies note that the decrease to capital requirements could be significant, although the impact will depend in part on an obligor's willingness to encumber their securities and deposits for a period of time in order to satisfy the proposal's qualifying criteria.

#### ***B. Trading-related impact on risk-weighted assets***

Banking organizations subject to the revised standardized approach would also be subject to capital requirements for market risk and credit valuation adjustment (CVA) risk to the extent that they have significant amounts of trading activity.<sup>131</sup> As discussed in the expanded risk-based proposal, the applicability of the market risk and CVA risk frameworks would be modified relative to the current rule.<sup>132</sup> As a result, some banking organizations would no longer be required to apply the market risk framework and instead would have their trading assets risk-weighted according to the risk weights in the revised standardized approach. Per Table V.4, the agencies estimate that this would result in an increase in risk-weighted assets of \$1 billion for

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<sup>131</sup> Credit valuation adjustment risk is the exposure to changes in the valuation of derivative contracts driven by changes in counterparty credit risk.

<sup>132</sup> See section II.A of the expanded risk-based proposal.

depository institutions and \$3 billion for holding companies, relative to the baseline. However, this change should be considered together with the changes in risk-weighted assets for the market risk and CVA risk frameworks.

Under the current capital rule, depository institutions and holding companies with over \$1 billion in trading assets must calculate market risk-weighted assets. The expanded risk-based proposal would raise the threshold to \$5 billion indexed for inflation to U.S. CPI-W, eliminating the requirement for depository institutions and holding companies with between \$1 billion and \$5 billion in trading assets. The expanded risk-based proposal would also add a CVA risk-weighted asset calculation for depository institutions that are subsidiaries of Category I or II depository institution holding companies and are subject to the market risk framework, and for other banking organizations that are subject to the market risk framework that also have at least \$1 trillion in over-the-counter notional derivative exposure. Eight depository institutions and 17 holding companies subject to the proposed revised standardized approach would be subject to the market risk framework under the expanded risk-based proposal. One of these depository institutions and 6 of these holding companies would also be subject to capital requirements for CVA risk. Raising the market risk threshold removes the market risk requirement for 7 covered depository institutions and 9 covered holding companies.

Revisions to the market risk framework within the expanded risk-based proposal and removal of market risk capital requirements for some covered banking organizations would result in a large decline in aggregate market risk-weighted assets for covered banking organizations, which is partially offset by the addition of the CVA risk requirement. Relative to the baseline, risk-weighted assets for trading-related activities would decrease by 48.4 percent for covered depository institutions and by 20.3 percent for covered holding companies.

However, the changes are small relative to the total reduction in risk-weighted assets under the proposal. For covered depository institutions, the estimated \$6 billion decline in aggregate trading-related risk-weighted assets is less than one percent of the estimated total \$745 billion decline in risk-weighted assets under the proposal, relative to the baseline. For covered holding companies, the estimated \$32 billion decline in aggregate trading-related risk-weighted assets is 4.6 percent of the estimated total \$697 billion decline in risk-weighted assets under the proposal, relative to the baseline. Please see the expanded risk-based proposal for a comprehensive discussion of the regulatory capital and economic effects of the proposed changes to the market risk and CVA risk frameworks.<sup>133</sup>

### ***C. Impact on risk-weighted assets by bank size***

The proposal, together with the market risk and CVA risk capital requirements of the expanded risk-based proposal, would result in an estimated decrease in risk-weighted assets of 8.6 percent for covered depository institutions and 8.8 percent for covered holding companies, per Table V.4, relative to the baseline. Table V.5 presents estimated risk-weighted assets under the baseline and the proposal for three groups of covered banking organizations: Category III and IV; those with total assets between \$10 billion and \$100 billion; and those with assets under \$10 billion (excluding banking organizations that opted into the CBLR framework as of June 30, 2025). Relative to the baseline, total risk-weighted assets under the proposal would decrease by 9.1 percent for Category III and IV depository institutions, by 8.3 percent for depository institutions with assets between \$10 billion and \$100 billion and by 7.7 percent for covered depository institutions with assets under \$10 billion.

#### **Table V.5: Impact on Risk-Weighted Assets by Bank Size**

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<sup>133</sup> See sections VII and VIII.E of the expanded risk-based proposal.

RWA totals	Depository institutions			Holding companies		
Bank Cohort	Current SA	Revised SA	Change	Current SA	Revised SA	Change
Category III and IV	\$4,213	\$3,828	-9.1%	\$4,655	\$4,214	-9.5%
Total assets between \$10 billion and \$100 billion	\$2,426	\$2,225	-8.3%	\$2,431	\$2,239	-7.9%
Total assets below \$10 billion	\$2,071	\$1,913	-7.7%	\$866	\$799	-7.5%

Source: Special data collection of 2023; FFIEC Call Reports; and FR Y-9C, June 30, 2025.

Differences in risk-weighted asset impact across bank size cohorts is driven by differences in the other corporate exposures category as classified in Table V.4, specifically unused commitments. Covered depository institutions and holding companies with assets under \$10 billion have a greater proportion of unused commitments that are not unconditionally cancelable and that have a maturity of under one year, which would, under the proposal, have a credit conversion factor change from 20 percent to 40 percent. This change doubles the recorded exposure amount. Under the proposal, unused commitments that are corporate exposures are risk-weighted at 95 percent, down from 100 percent under the baseline, so the proposal would increase the risk-weighted asset amount for unused commitments under one year by 90 percent, relative to the baseline.<sup>134</sup>

Conversely, Category III and IV depository institutions and holding companies, and to a lesser extent depository institutions and holding companies with assets between \$10 billion and \$100 billion, have a greater proportion of unused commitments that are not unconditionally cancelable and that have a maturity of over one year. The proposal would apply a credit conversion factor of 40 percent to unused commitments over one year, down from a credit

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<sup>134</sup>  $(0.4*95\% - 0.2*100\%) / (0.2*100\%) = 90$  percent

conversion factor of 50 percent under the baseline. The reduction in the credit conversion factor from 50 percent to 40 percent lowers the exposure amount for those unused commitments by 20 percent. The risk-weighted asset amount for unused commitments with a maturity of over one year decreases by 24 percent under the proposal.<sup>135</sup>

All exposures in the other corporate exposures category would have risk weights reduced from 100 percent to 95 percent under the proposal, and a credit conversion factor is applied to unused commitments within this exposure category. Therefore, in the absence of unused commitments, risk-weighted assets for other corporate exposures would decrease by 5 percent under the proposal. For covered depository institutions and holding companies with assets under \$10 billion, risk-weighted assets for other corporate exposures would decline by less than 5 percent (4.3 percent and 4.7 percent, respectively) relative to the baseline, a result that reflects these banking organizations' greater proportion of unused commitments with a maturity of under one year. For Category III and IV depository institutions and for holding companies and depository institutions and holding companies with assets between \$10 billion and \$100 billion, risk-weighted assets for other corporate exposures would decline by more than 5 percent relative to the baseline.<sup>136</sup> This result reflects these banking organizations' greater proportion of unused commitments with a maturity of over one year.

#### ***D. Impact of changes to risk-weighted assets on required capital***

As detailed above, the proposed standardized approach would revise calculations of risk-weighted assets for covered banking organizations. The changes in risk-weighted assets would in turn affect these banking organizations' risk-based capital requirements. The impact on

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<sup>135</sup>  $(0.4*95\% - 0.5*100\%) / (0.5*100\%) = -24$  percent

<sup>136</sup> For additional detail, see section V.G.

required capital would depend on each banking organization's risk exposures as well as the other capital requirements to which the banking organization may or may not be subject. The estimated capital impact considers all applicable minimum capital ratio and buffer requirements, including the stress capital buffer requirement applicable to Category III and IV holding companies. In many instances, this impact analysis summarizes the estimated impact on minimum capital and capital buffer requirements in a single number. However, a banking organization's minimum regulatory capital ratio and capital buffer requirements are separate requirements with distinct, complementary purposes, and banking organizations are subject to different consequences for falling below minimum capital ratio and buffer requirements.<sup>137</sup> Please see section V.F for additional details on the data and estimation methodology.

Section V.E considers the long-run average estimate of the impact of AOCI changes on required capital for Category III and IV holding companies and their depository institution subsidiaries, whereas results presented in this section do not include the impact of AOCI recognition.

As shown in Table V.6, the agencies estimate that for covered depository institutions, the impact of risk-weight changes in the proposal on common equity tier 1 capital requirements would be a decrease of 8.6 percent. For depository institution subsidiaries of Category III and IV holding companies, the risk-weight changes in the proposal would decrease aggregate common equity tier 1 capital requirements by 9.1 percent relative to current requirements. For depository institutions with total assets between \$10 billion to \$100 billion, and for covered depository institutions with total assets below \$10 billion, the aggregate impact of the proposal on common

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<sup>137</sup> Under the capital rule, a banking organization that is subject to risk-based capital requirements must maintain capital ratios above the sum of its minimum requirements and buffer requirements to avoid restrictions on capital distributions and certain discretionary bonus payments.

equity tier 1 capital requirements would be a decrease of 8.3 and 7.7 percent, respectively, relative to the baseline.<sup>138</sup>

Binding tier 1 capital impacts for depository institutions are similar to the impacts for common equity tier 1 capital. However, they may also reflect the requirements of the tier 1 leverage ratio and the supplementary leverage ratio. The agencies estimate that, in aggregate, tier 1 capital requirements for covered depository institutions would decrease by 7.4 percent due to the risk-weight changes in the proposal. For depository institution subsidiaries of Category III and IV holding companies, the agencies estimate that risk-weight changes in the proposal would decrease aggregate tier 1 capital requirements by 7.8 percent relative to current requirements. For depository institutions with total assets between \$10 billion to \$100 billion and for covered depository institutions with total assets below \$10 billion, the aggregate impact of the proposal on tier 1 capital requirements would be an estimated decrease of 7.5 and 6.6 percent, respectively.

**Table V.6.** Covered Depository Institutions: Capital Impact of Changes to Risk-Weighted Assets  
Panel A: Common Equity Tier 1 Minimum Plus Buffer Requirements for Depository Institutions

Depository institutions	Current SA	Revised SA	% change from current
Subsidiaries of Category III and IV holding companies	\$295	\$268	-9.1%
Total assets between \$10 billion and \$100 billion	\$170	\$156	-8.3%
Total assets below \$10 billion	\$145	\$134	-7.7%
Total	\$610	\$558	-8.6%

Panel B: Binding Tier 1 Minimum Plus Buffer Requirements for Depository Institutions

	Current

<sup>138</sup> Both groups of depository institutions exclude subsidiaries of Category I-IV holding companies.

	<b>Current SA</b>	<b>Leverage</b>	<b>SLR</b>	<b>Binding</b>	<b>Revised SA</b>	<b>Revised binding</b>	<b>% change from current</b>
Depository institutions							
Subsidiaries of Category III and IV holding companies	\$358	\$292	\$126	\$371	\$325	\$342	-7.8%
Total assets between \$10 billion and \$100 billion	\$206	\$159	\$0	\$209	\$189	\$193	-7.5%
Total assets below \$10 billion	\$176	\$137	\$0	\$179	\$163	\$167	-6.6%
Total	\$740	\$589	\$126	\$759	\$677	\$702	-7.4%

Source: Special data collection of 2023; FFIEC Call Reports; and FR Y-9C, June 30, 2025.

As shown in Table V.7 and based on the methodology outlined in section V.F, the agencies estimate that, in aggregate, common equity tier 1 capital requirements of covered holding companies would decrease by 6.8 percent due to the risk-weight changes in the proposal. For Category III and IV holding companies, risk-weight changes in the proposal would decrease aggregate common equity tier 1 capital requirements by 6.1 percent relative to current requirements. For holding companies with total assets between \$10 billion to \$100 billion and for covered holding companies with total assets below \$10 billion, the aggregate impact of the proposal on common equity tier 1 capital requirements would be a decrease of 7.9 and 7.5 percent, respectively.

The agencies estimate that the impact of risk-weight changes in the proposal on tier 1 capital requirements for all holding companies combined would be a decrease of 6.9 percent. For Category III and IV holding companies, the agencies estimate that risk-weight changes in the proposal would decrease aggregate tier 1 capital requirements by 6.4 percent relative to current requirements. The aggregate impact of the proposal on tier 1 capital requirements would be a decrease of 7.9 percent for holding companies with total assets between \$10 billion to \$100 billion, and a decrease of 7.4 percent for covered holding companies with total assets below \$10 billion. As discussed above, results in Table V.7 do not include effects of AOCI recognition for Category III and IV banking organizations.

**Table V.7.** Covered Holding Companies: Capital Impact of Changes to Risk-Weighted Assets**Panel A:** Common Equity Tier 1 Minimum Plus Buffer Requirements for Holding Companies

Holding companies	Current	Revised SA	% change from current
Category III and IV	\$371	\$348	-6.1%
Total assets between \$10 billion and \$100 billion	\$170	\$157	-7.9%
Total assets below \$10 billion	\$60	\$56	-7.5%
Total	\$602	\$561	-6.8%

**Panel B:** Binding Tier 1 Minimum Plus Buffer Requirements for Holding Companies

Holding companies	Current				Revised SA	Revised binding	% change from current
	Risk-based	Leverage	SLR	Binding			
Category III and IV	\$441	\$270	\$154	\$449	\$412	\$421	-6.4%
Total assets between \$10 billion and \$100 billion	\$207	\$131	\$0	\$207	\$190	\$190	-7.9%
Total assets below \$10 billion	\$73	\$44	\$0	\$73	\$68	\$68	-7.4%
Total	\$721	\$444	\$154	\$729	\$670	\$679	-6.9%

Source: Special data collection of 2023; FFIEC Call Reports; and FR Y-9C, June 30, 2025.

In addition to the estimated capital impacts discussed above, some covered banking organizations could be affected by a provision in the expanded risk-based proposal that would give them the option to apply the expanded risk-based approach instead of the proposed revised standardized approach. The expanded risk-based proposal includes a discussion of potential impacts of this option for covered banking organizations. Overall, the incentives to adopt the expanded risk-based approach would be limited, in part, by the proposed revisions to the standardized risk weights.

***E. Impact of AOCI recognition***

The proposal would revise the regulatory capital calculation for Category III and IV banking organizations by requiring them to recognize most elements of AOCI in regulatory capital. Under the current capital framework, most Category III and IV banking organizations have opted to exclude AOCI from their regulatory capital. The proposal would withdraw this option and provide a transition period for firms that have made such an election to phase in the effects of recognizing AOCI in their regulatory capital, as discussed in Section II.B.

For Category III and IV holding companies that opted out of the AOCI inclusion, the majority of AOCI is attributable to unrealized losses on current or former available-for-sale securities. Capital market and yield curve developments can at times lead to substantial AOCI fluctuation. Since 2015, the aggregate AOCI related to the security holdings of Category III and IV holding companies fluctuated between an unrealized gain of \$16 billion and an unrealized loss of \$112 billion. Therefore, the agencies assess the impact of AOCI inclusion from a long-run perspective, which provides a more representative measure of the risk and portfolio management practices of banking organizations through the cycle.<sup>139</sup>

The agencies use quarterly FR Y-9C data from 1996 Q1 to 2025 Q3 to estimate the effect of AOCI recognition. A historical data series is used to represent a full range of economic environments and to reduce the influence of short-term volatility. Some of the main factors affecting AOCI, include: 1) the impact of interest rate environment (as interest rates increase, the

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<sup>139</sup> The literature emphasizes that the economic impact of AOCI should be evaluated from a longer-run perspective, as banks dynamically adjust portfolio composition and securities classification in ways that attenuate the relevance of short-run mark-to-market fluctuations (Kim, Kim, and Ryan, 2019, 2025; Granja et al., 2024). Reference sources: Kim, Sehwa, Seil Kim, & Stephen G. Ryan. 2019. "Economic Consequences of the AOCI Filter Removal for Advanced Approaches Banks." *The Accounting Review* 94 (6): 309–335; Kim, Sehwa and Kim, Seil and Ryan, Stephen G., 2025. "Banks' Motivations for Designating Securities as Held to Maturity" Columbia Business School Research Paper No. 4452667, *The Accounting Review*, forthcoming, Available at SSRN: <https://ssrn.com/abstract=4452667>; Granja, Joao and Jiang, Erica Xuewei and Matvos, Gregor and Piskorski, Tomasz, & Seru, Amit, Book Value Risk Management of Banks: Limited Hedging, HTM Accounting, and Rising Interest Rates (April 2, 2024). University of Chicago, Becker Friedman Institute for Economics Working Paper No. 2024-37, Available at SSRN: <https://ssrn.com/abstract=4781916>.

market valuations of available- for-sale securities decline, resulting in higher unrealized losses), 2) the effects of bank's balance sheet management, including reallocation of security holdings from available-for-sale to held-to-maturity, and 3) the effects of accounting rules and standards pertaining to treatment of available-for-sale and held-to-maturity securities. Based on the size of securities portfolios as of 2025 Q3, the estimated long-run average impact of the proposed AOCI inclusion would be to reduce regulatory capital, or effectively increase capital requirements, by \$11.5 billion and \$13.0 billion for all opted-out Category III and IV holding companies and their depository institution subsidiaries, respectively, relative to the baseline.<sup>140</sup>

The agencies estimate that the average long-run effect of the proposed recognition of AOCI on depository institution subsidiaries of Category III and IV holding companies would be equivalent to a 4.5 percent increase in common equity tier 1 capital requirements, relative to the baseline. This 4.5 percent increase would partially offset the estimated 9.1 percent decrease in required common equity tier 1 capital due to risk-weighted asset changes. Therefore, the estimated cumulative impact of the proposal on common equity tier 1 capital requirements for depository institution subsidiaries of Category III and IV holding companies would be a decrease of 4.7 percent. Similarly, the agencies estimate that the average long-run impact of the proposed recognition of AOCI on depository institution subsidiaries of Category III and IV holding companies would be equivalent to a 3.5 percent increase in tier 1 capital requirements, partially

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<sup>140</sup> The -\$11.5 billion estimate is calculated as the amortized cost of securities multiplied by the long-run average AOCI impact factor, which is constructed as follows. First, an AOCI impact is estimated for each holding company that has opted to exclude AOCI from regulatory capital as the sum of (i) net unrealized gains or losses on available for sale debt securities and (ii) held-to-maturity (HTM) securities (where included in AOCI, e.g., due to transfers from AFS to HTM), and (iii) AOCI attributed to defined benefit postretirement plans, i.e. FR Y-9C Schedule HC-R Part I items 9.a, d, and e. This impact is aggregated across all such holding companies and divided by the total amortized cost of their securities, as securities portfolios have historically been the source of almost all AOCI (FR Y-9C Schedule HC-B item 8, columns A and C). This scaled impact is averaged across each quarter from 1996 Q1 to 2025 Q3. The average of these quarterly totals is -81.1 basis points. Similarly, the long-run average AOCI impact factor and the long-run impact for depository institutions that opted to exclude AOCI from regulatory capital is -90 basis points.

offsetting the estimated 7.8 percent decrease in required tier 1 capital due to risk-weighted asset changes. Therefore, the estimated cumulative impact of the proposal on tier 1 capital requirements for depository institution subsidiaries of Category III and IV holding companies would be a decrease of 4.3 percent.<sup>141</sup>

For Category III and IV holding companies, the average long-run impact of AOCI recognition would be equivalent to a 3.1 percent and 2.6 percent relative increase in the respective common equity tier 1 and tier 1 capital requirements, relative to the baseline. The required capital increases would partially offset the estimated 6.1 percent and 6.4 percent decreases in required common equity tier 1 capital and tier 1 capital, respectively, due to risk-weighted asset changes. The cumulative impact of the proposal on common equity tier 1 capital requirements and tier 1 capital requirements for Category III and IV holding companies are estimated to be decreases of 3.0 percent and 3.8, respectively. Note, however, that these estimates of the impact of AOCI do not account for interactions with the stress capital buffer requirement or the five-year transition provisions. Specifically, with AOCI, stress scenarios involving reductions in interest rates would see increases in capital reflecting appreciation in the market value of holding companies' available-for-sale securities, which could affect the size of firms' stress capital buffer and associated capital requirements, and which are not reflected in through-the-cycle long-run estimates on AOCI impact used in this analysis.

Finally, if affected banking organizations do not adjust their AOCI management in response to the proposed changes (for example by adjusting the relative size, fair value hedging, or interest rate sensitivity of their available-for-sale security portfolios), AOCI recognition could

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<sup>141</sup> While the impact on capital ratios without AOCI can be viewed as a point-in-time estimate (as of 2025 Q2), the impact of AOCI is estimated through-the-cycle, without taking into account a 5-year transition period, which creates a mild timing mismatch in a cumulative impact estimation.

increase variation in regulatory capital ratios over time due to market-driven fluctuations in security values.

### ***F. Data and estimation methodology***

The agencies estimated risk-weighted assets under the proposal for covered banking organizations, as of the second quarter of 2025. In developing these estimates, the agencies primarily relied on line items from regulatory financial reports (Consolidated Reports of Condition and Income (Call Reports), FFIEC 101, and FFIEC 102 for depository institutions and FR Y-9C for holding companies, supplemented with data on stress capital buffer requirements.<sup>142</sup> The estimates also rely in part on the distribution of residential real estate exposures across various risk weights contained in the 2023 special data collection, which are used to inform the impact of the proposal’s risk-weight treatment for residential mortgage exposures, as applied to residential mortgage exposure amounts as of the second quarter of 2025.<sup>143</sup>

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<sup>142</sup> Reporting forms issued by the Federal Financial Institutions Examination Council (FFIEC) are available at [www.ffiec.gov](http://www.ffiec.gov) and reporting forms issued by the Federal Reserve Board are available at [www.federalreserve.gov](http://www.federalreserve.gov). The “Call Report” collectively refers to the data from the FFIEC 031, 041, and 051 forms. Specifically, see FFIEC 031 Form Statistics and FFIEC 041 Form Statistics. For FFIEC 051 (“FFIEC 051 Form Statistics”), see FFIEC, Reporting Forms, Consolidated Reports of Condition and Income for a Bank with Domestic Offices Only and Total Assets Less than \$5 Billion: FFIEC 051 (version June 2023). Bulk data download available at: <https://cdr.ffiec.gov/public/PWS/DownloadBulkData.aspx>. Certain financial reports filed by banking organizations, including portions of the FFIEC 101 and FFIEC 102 reports, are not available publicly because they contain confidential supervisory information and are confidential business information of the reporting banking organizations.

<sup>143</sup> To estimate residential real estate risk-weighted assets under the proposal’s residential treatment for the Category III and IV holding companies that participated in the 2023 special data collection and their depository institution subsidiaries, the agencies first calculated firm-specific average residential real estate risk-weights according to the proposal that were informed by the firm-specific loan-to-value distribution of residential mortgage exposures contained in the 2023 special data collection. These firm-specific risk-weights were then applied to residential real estate items currently risk weighted at 50 percent (Schedule RC-R and HC-R items 4.a. Column H and 5.a. Column H). For holding companies that did not submit data under the 2023 special data collection, or depository institutions that did not have a parent holding company that submitted data under the 2023 special data collection, the average of the firm-specific average residential risk-weights that were derived from the 2023 special data collection were applied to each firm’s residential real estate items currently risk weighted at 50 percent (Schedule RC-R and HC-R items 4.a. Column H and 5.a. Column H).

The 2023 special data collection captures respondents' exposures as of June 30, 2023.<sup>144</sup> Of the 37 banking organizations covered by the 2023 proposal, 32 banking organizations (representing 95 percent of the total assets) provided substantially complete data in the collection. For additional information on how this special collection data was employed in the agencies' estimation methodology, please refer to the expanded risk-based proposal.

The 2023 special data collection did not have depository institutions as participants. However, because subsidiary depository institutions are often the most significant operating companies within a covered depository institution holding company, the agency estimates generally assume that the proposal's risk-weight treatment for residential mortgage exposures would impact risk weighted assets and capital requirements of depository institutions subsidiaries of Category III and IV holding companies similarly to their parent holding companies. The agencies acknowledge, however, that there is likely some variation among banking organizations and that the residential mortgage exposures of some depository institutions may not closely resemble those of their holding companies.

For both covered depository institutions and holding companies, the proposal's 95 percent corporate risk weight was applied to an estimate of corporate exposures that are currently risk-weighted at 100 percent. This includes exposures contained in the FR Y-9C and Call Report that are classified as commercial and industrial, agricultural, secured by farmland, commercial real estate, non-depository financial institutions, reverse repurchase agreements, federal funds, unused commitments, available-for-sale securities, and held-to-maturity securities.<sup>145</sup> Similarly,

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<sup>144</sup> One banking organization submitted data as of the third quarter of 2023, instead of as of June 30, 2023.

<sup>145</sup> The agencies first estimate the amount of corporate exposures relative to all exposures that are likely to be predominantly risk-weighted at 100 percent in Call Report Schedule RC-C and FR Y-9C Schedule HC-C, and then applying this ratio to items RC-R 4.d. Column I and 5.d Column I, all other loans and leases held for investment and held for sale, respectively, currently risk-weighted at 100 percent. Corporate exposures from Call Report Schedule

the proposal's retail and other assets risk weight of 90 percent was applied to an estimate of retail and other exposures that are currently risk-weighted at 100 percent. This includes exposures contained within the FR Y-9C and Call Report that are classified as or related to credit cards, other revolving credit plans to individuals, autos, other consumer loans, leases, and other exposures contained in HC-R or RC-R part II. item 8 (All other assets) that are currently risk-weighted at 100 percent.<sup>146</sup>

In addition to the application of the corporate 95 percent risk weight to commitments currently risk-weighted at 100 percent, unused commitments generally were adjusted by the change in credit conversion factor, which increases from 20 percent to 40 percent for commitments with a maturity of less than one year and decreases from 50 percent to 40 percent for commitments with a maturity of greater than one year.<sup>147</sup>

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RC-C and FR Y-9C Schedule HC-C include loans secured by multifamily (item 1.d.), loans secured by nonfarm, nonresidential property (items 1.e.(1) and 1.e.(2)), commercial and industrial loans (items 4.a. and 4.b.), loans to non-depository financial institutions (item 9.a.), loans secured by farmland (item 1.b.), and loans to finance agricultural production (item 3.).

All exposures that are likely to be predominantly risk-weighted at 100 percent include the corporate items listed above, plus the following items: loans

to individuals (items 6.a through 6.d.), and lease financial receivables (items 10.a. and 10.b.).

Additional items from Schedule RC-R and Schedule HC-R that are currently risk-weighted at 100 percent are also added to corporate exposures include: Held-to-maturity securities (item 2.a. Column I), available-for-sale debt securities (item 2.b., adjusted to remove non-trading equity securities item 2.c. from Schedules RC and HC), federal funds sold (item 3.a. Column I), financial standby letters of credit (item 12. Column I), performance standby letters of credit and transaction-related contingent items (item 13. Column I), commercial and similar letters of credit with an original maturity of one year or less (item 14. Column I), repo-style transactions (item 16. Column I), all other off-balance sheet liabilities (item 17. Column I), unused commitments (items 18.a. and 18.b.), and over-the-counter derivatives (item 10. Column I).

<sup>146</sup> The agencies estimate retail and other exposures similarly to corporate exposures, by taking a ratio of retail exposures from Schedules RC-C and HC-C (items 6.a through 6.d.) to all exposures that are likely to be predominantly risk-weighted at 100 percent from Schedules RC-C and HC-C (all items listed previously) and applying this ratio to RC-R 4.d. Column I and 5.d Column I, all other loans and leases held for investment and held for sale, respectively, currently risk-weighted at 100 percent. One additional item from Schedule RC-R and Schedule HC-R that is currently risk-weighted at 100 percent, all other assets (item 8. Column I), is also added to retail and other exposures.

<sup>147</sup> The agencies apply the change in credit conversion factor to unused commitment line items 18.a. (original maturity of one year or less) and 18.b. (original maturity exceeding one year) from Schedules RC-R and HC-R for all risk-weighted columns (Columns C through S).

The proposal would reduce the risk-weight floor for securitizations from 20 percent to 15 percent. The proposal's securitization treatment was proxied by lowering the average risk weight by five percentage points for securitization exposures that are not currently risk-weighted at 1,250 percent.<sup>148</sup>

Due to data limitations, the agencies did not attempt to estimate the impact of the proposal's reverse repurchase agreement exposure methodology, and therefore such exposures were not modified from those currently reported in the FR Y-9C and Call Reports. However, the proposal's 90 percent corporate risk-weight was applied to reverse repurchase agreements currently risk-weighted at 100 percent.<sup>149</sup>

Please refer to the expanded risk-based proposal data and estimation methodology related to market risk and CVA for more information.

*1. Capital impact estimation methodology – regulatory capital buffers and floors*

The impact analysis reported in this section summarizes the estimated impact on minimum capital and capital buffer requirements, taken together. A banking organization's minimum regulatory capital and buffer requirements are separate requirements with distinct, complementary purposes, and banking organizations are subject to different consequences for falling below minimum capital ratio and buffer requirements. The estimated capital impact considers applicable minimum capital ratio and buffer requirements, in particular, including the stress capital buffer requirement. The stress capital buffer requirement depends on risk-weighted assets under both the current capital rule and the proposal. The impact estimates presented here

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<sup>148</sup> The agencies calculate securitization exposures that are not currently risk-weighted at 1,250 percent by summing the following risk-weighted asset items from Columns T and U of Schedules RC-R and HC-R: on-balance sheet securitization exposures (items 9.a through 9.d), and off-balance sheet securitization exposures (item 10.).

<sup>149</sup> The agencies estimate repo-related risk-weighted assets under the proposal by applying the 90 percent corporate risk-weight to Schedule RC-R and HC-R item 16. Column I.

account for the changes to this buffer that are mechanically driven by changes in risk-weighted assets from the proposal.

Under the regulatory capital framework, the risk-weighted assets used to calculate the applicable stress capital buffer requirement are based on balance sheet data from an earlier date than the date of analysis used in the capital impacts contained in this section.<sup>150</sup> To adjust the applicable stress capital buffer to reflect the proposal, the agencies assumed that the percentage difference in risk-weighted assets between the revised standardized approach and the current standardized approach would have been the same on those earlier dates as it would have been on June 30, 2025. The agencies applied this percentage difference in risk-weighted assets to modify the applicable stress capital buffer requirements when estimating the impact of the proposal on capital requirements.

### ***G. Data appendix***

**Table V.G.1: Risk-weighted Asset Impact, Category III and IV Banking Organizations**

Current and revised Standardized Approach, Category III and IV holding companies and depository institution subsidiaries, billions							
		Depository institutions			Holding companies		
		Current SA	Revised SA	Change	Current SA	Revised SA	Change
General Risk Weights	Residential mortgages	\$301	\$214	-29.0%	\$304	\$211	-30.7%
	CRE	\$327	\$310	-5.0%	\$363	\$345	-5.0%
	Other corporate exposures	\$1,607	\$1,474	-8.3%	\$1,955	\$1,806	-7.6%
	Retail	\$998	\$898	-10.0%	\$1,002	\$902	-10.0%
	Securitization	\$76	\$61	-19.5%	\$80	\$65	-18.8%
	Commitments	\$10	\$9	-13.6%	\$11	\$9	-13.0%
	Other assets from 100% to 90% risk-weight	\$245	\$221	-10.0%	\$315	\$284	-10.0%
MSA deduction elimination	\$0.0	\$0.0		\$0.0	\$0.0		

<sup>150</sup> The stress capital buffer requirements applicable to banking organizations as of June 30, 2025, are based on the results of the 2024 supervisory stress test, which utilized balance sheet data and risk-weighted assets from December 31, 2023.

	Exposures shifting from market risk framework to standardized approach	\$0.0	\$0.9		\$0.0	\$1.1	
	Allowance deduction change	\$0.0	(\$4.6)		\$0.0	(\$4.7)	
	Other assets – risk weights unchanged	\$640	\$640	0.0%	\$506	\$506	0.0%
Market risk		\$10	\$4	-63.8%	\$118	\$73	-38.0%
CVA		\$0	\$2		\$0.0	\$17	
RWA for trading-related activities (market risk and CVA, subtotal)		\$10	\$6	-42.0%	\$118	\$90	-23.7%
Total		\$4,213	\$3,828	-9.1%	\$4,655	\$4,214	-9.5%

Source: Special data collection of 2023, FFIEC Call Reports, and FR Y-9C, June 30, 2025.

Corporate category includes unused commitments currently risk-weight at 100 percent, and repo currently risk-weighted at 100 percent; all such exposures are risk-weighted at 95 percent under revised SA.

Commitments include all unused commitments except those currently risk-weighted at 100 percent; those under one year have CCF change from 20 percent to 40 percent, those over one year have CCF change from 50 percent to 40 percent.

**Table V.G.2: Risk-weighted Asset Impact, Banking Organizations with Assets between \$10 billion and \$100 billion**

Current and revised SA, depository institution and holding companies with total assets between \$10 billion and \$100 billion, billions							
		Depository institutions			Holding companies		
		Current SA	Revised SA	Change	Current SA	Revised SA	Change
General Risk Weights	Residential mortgages	\$220	\$153	-30.2%	\$213	\$149	-30.2%
	CRE	\$790	\$751	-5.0%	\$737	\$700	-5.0%
	Other corporate exposures	\$835	\$779	-6.8%	\$900	\$844	-6.3%
	Retail	\$188	\$169	-10.0%	\$137	\$123	-10.0%
	Securitization	\$26	\$22	-16.6%	\$21	\$17	-17.1%
	Commitments	\$5	\$4	-13.3%	\$5	\$4	-11.3%
	Other assets from 100% to 90% risk-weight	\$121	\$109	-10.0%	\$133	\$120	-10.0%
	MSA deduction elimination	\$0.0	\$0.0		\$0.0	\$0.0	
	Exposures shifting from market risk framework to standardized approach	\$0.0	\$0.4		\$0.0	\$2.2	
	Allowance deduction change	\$0.0	(\$1.0)		\$0.0	(\$0.9)	
	Other assets – risk weights unchanged	\$239	\$239	0.0%	\$246	\$246	0.0%
Market risk		\$2.2	\$0.5	-76.9%	\$39	\$23	-42.5%

CVA	\$0.0	\$0.0		\$0.0	\$13	
RWA for trading-related activities (market risk and CVA, subtotal)	\$2.2	\$0.5	-76.9%	\$39	\$36	-9.8%
Total	\$2,426	\$2,225	-8.3%	\$2,431	\$2,239	-7.9%

Source: Special data collection of 2023, FFIEC Call Reports, and FR Y-9C, June 30, 2025.  
Excludes depository institutions subsidiaries of Category I-IV holding companies.

Corporate category includes unused commitments currently risk-weight at 100 percent, and repo currently risk-weighted at 100 percent; all such exposures are risk-weighted at 95 percent under revised SA.  
Commitments include all unused commitments except those currently risk-weighted at 100 percent; those under one year have CCF change from 20 percent to 40 percent, those over one year have CCF change from 50 percent to 40 percent.

**Table V.G.3: Risk-weighted Asset Impact, Banking Organizations with Assets under \$10 billion**

Current and revised SA, covered depository institution and holding companies with total assets under \$10 billion, billions							
		Depository institutions			Holding companies		
		Current SA	Revised SA	Change	Current SA	Revised SA	Change
General Risk Weights	Residential mortgages	\$234	\$163	-30.2%	\$89	\$62	-30.2%
	CRE	\$779	\$740	-5.0%	\$326	\$310	-5.0%
	Other corporate exposures	\$581	\$556	-4.3%	\$239	\$228	-4.7%
	Retail	\$111	\$100	-10.0%	\$43	\$39	-10.0%
	Securitization	\$15	\$13	-10.0%	\$6.7	\$5.9	-11.5%
	Commitments	\$4.9	\$4.7	-4.6%	\$2.1	\$1.9	-9.8%
	Other assets from 100% to 90% risk-weight	\$107	\$96	-10.0%	\$46	\$41	-10.0%
	MSA deduction elimination	\$0.0	\$0.4		\$0.0	\$0.0	
	Exposures shifting from market risk framework to standardized approach	\$0.0	\$0.0		\$0.0	\$0.0	
	Allowance deduction change	\$0.0	(\$0.9)		\$0.0	(\$0.4)	
	Other assets – risk weights unchanged	\$241	\$241	0.0%	\$113	\$113	0.0%
Market risk		\$0.0	\$0.0		\$0.0	\$0.0	
CVA		\$0.0	\$0.0		\$0.0	\$0.0	
RWA for trading-related activities (market risk and CVA, subtotal)		\$0.0	\$0.0		\$0.0	\$0.0	
Total		\$2,071	\$1,913	-7.7%	\$864	\$799	-7.5%

Source: Special data collection of 2023, FFIEC Call Reports, and FR Y-9C, June 30, 2025.  
Excludes depository institutions subsidiaries of Category I-IV holding companies.  
Excludes banking organizations that elected CBLR as of June 30, 2025.

Corporate category includes unused commitments currently risk-weight at 100 percent, and repo currently risk-weighted at 100 percent; all such exposures are risk-weighted at 95 percent under revised SA.

Commitments include all unused commitments except those currently risk-weighted at 100 percent; those under one year have CCF change from 20 percent to 40 percent, those over one year have CCF change from 50 percent to 40 percent.

## **VI. Economic analysis**

This section evaluates the projected economic effect of the proposal by analyzing its key costs and benefits. The proposal aims to improve the alignment of risk weights under the standardized approach to the risks of underlying exposures while maintaining simplicity and capital sufficiency. Improved risk alignment helps avoid unintended inefficiencies and potential misallocation of resources from capital regulation. Covered banking organizations will likely respond differently to these changes based on their financial conditions, business strategies, and market opportunities. Given the effects of regulatory capital requirements on the real economy, the proposal would increase financial intermediation, improve economic efficiency, and support economic growth through capital formation, business expansion, and household wealth-building, while still maintaining appropriate safeguards against financial system risks.

### ***A. Reasonable alternatives***

This analysis begins with an evaluation of alternative approaches to the proposed rule. Specifically, this subsection compares the proposal to three reasonable alternatives for revising risk-weighted asset standards for the covered banking organizations. These alternatives, alongside the proposal, represent different approaches intended to promote robust capital levels while balancing the inherent tradeoff between risk sensitivity and simplicity in the capital framework.

Alternative 1 would require all banking organizations that are subject to risk-based capital requirements to adopt the expanded risk-based approach, as would be required for Category I and II banking organizations under the expanded risk-based proposal. This

alternative would implement a more risk-sensitive capital framework for all affected banking organizations but would also require more operational complexity for smaller banking organizations. Under this alternative, some smaller banking organizations (those with assets under \$10 billion and satisfying the other requirements of the CBLR framework) could choose to avoid the additional operational complexity by adopting the CBLR framework.

In aggregate, the expanded risk-based approach would require covered banking organizations to hold less capital than estimated under the standardized approach, as modified by proposal. Assuming no change in which banking organizations opt into the CBLR framework, under Alternative 1 covered depository institutions' risk-weighted assets would decrease by an estimated 11.6 percent relative to current requirements, compared to the estimated 8.6 percent decrease under the proposal. This reduction in risk-weighted assets would result in a more substantial decrease in regulatory capital requirements for covered depository institutions relative to current requirements under Alternative 1 than under the proposal. However, under this alternative, the compliance burdens associated with the regulatory capital framework for these banking organizations would increase significantly.

Alternative 2 would require adoption of the expanded risk-based approach only for Category III and IV banking organizations while applying the proposal for all other covered banking organizations. Category III and IV banking organizations are the largest and most complex banking organizations not covered by the expanded risk-based proposal.<sup>151</sup> Therefore, these organizations are most likely to be able to absorb the additional costs of operational complexity for the benefit of the enhanced risk sensitivity of the expanded risk-based approach.

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<sup>151</sup> While the expanded risk-based proposal leaves an option for all banking organizations to elect to use the expanded risk-based approach, the impact analysis in this standardized approach proposal assumes that covered banking organizations do not adopt the expanded risk-based approach.

Under Alternative 2, aggregate risk-weighted assets for depository institution subsidiaries of Category III and IV holding companies would decrease by an estimated 9.4 percent, relative to the baseline, slightly more than the estimated 9.1 percent decrease under the proposal.<sup>152</sup> As a result of this similar change in risk-weighted assets, aggregate required capital for depository institutions subsidiaries of Category III and IV holding companies would decrease by a similar amount under Alternative 2 as under the proposal, compared to the baseline.

Alternative 3 would replace the LTV-based risk-weight tables for residential real estate in the proposal with simplified flat risk weights: 35% for residential mortgage exposures not dependent on the cash flows of the real estate and 45% for residential mortgage exposures that are dependent on the cash flows of the real estate. While the proposal modestly increases operational complexity relative to the baseline, this alternative would maintain the simplicity of the current Standardized Approach. However, this alternative lacks the enhanced risk sensitivity that the proposal's LTV-based lookup tables would provide for mortgage exposures.

Under Alternative 3, aggregate risk-weighted assets for covered depository institutions would decrease by an estimated 8.4 percent, relative to the baseline, similar to the estimated 8.6 percent decrease under the proposal. As a result, aggregate required capital for covered depository institutions would decrease by a similar amount under Alternative 3 as under the proposal, compared to the baseline.

The agencies assessed that the provisions of the proposal best balance the competing goals of risk alignment and simplicity, while also promoting robust capital levels. Alternative 1 would impose unnecessary operational complexity on smaller banking organizations, including

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<sup>152</sup> The small difference is due to the close calibration of the proposed standardized approach to the expanded risk-based approach.

those ineligible for the CBLR framework. Covered banking organizations can already elect to use the expanded risk-based proposal when they judge that the adoption is beneficial.

Alternative 2 offers minimal advantages over the current proposal, as Category III and IV banking organizations can already elect to use the expanded risk-based proposal when they judge that the adoption is beneficial. Rather than mandating a specific size threshold for this approach, the proposal appropriately allows banking organizations to make this determination based on their own internal analysis. Alternative 3, while simpler, would generate only modest operational cost savings. Loan-to-value calculations can be automated using existing loan information and smaller banking organizations concerned about compliance costs retain the option to adopt the CBLR framework. Based on these considerations, the agencies assess that the current proposal is the best approach among all these reasonable alternative considerations to most effectively enhance risk sensitivity while limiting additional operational burden and maintaining robust capital standards.

### ***B. Effects on lending***

Bank lending remains the core economic function of the banking sector, with banks continuing to serve as the primary intermediaries supplying credit to households and nonfinancial firms. Within the banking system, covered banking organizations of this proposal play an important role in the U.S. lending landscape, accounting for a little more than one half of total loans and leases outstanding in the banking system as of 2025 Q2.<sup>153</sup>

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<sup>153</sup> The agencies calculate that total loans and leases held for investment and held for sale for covered banking organizations represent about 57.6% of the Call Report and FR Y-9C filers. Data sources are compiled to the top-tier holder level based on reports from FFIEC 031, 041, and 051, as well as FR Y-9C. Line items consist of rcf2122 in FFIEC031, rcon2122 in FFIEC041, rcon2122 in FFIEC051, and bhck2122 in FR Y-9C.

This subsection examines how the proposal could affect lending activities of covered banking organizations. As previously discussed, the proposed rule would generally reduce risk-weighted assets for covered institutions, thereby reducing required capital.<sup>154</sup> The financial intermediation literature provides evidence that when banks face higher risk-based capital requirements, they typically reduce lending to decrease risk-weighted assets and sometimes transfer higher funding costs to borrowers through increased interest rates.<sup>155</sup> Conversely, a reduction in risk weights would, in general, promote lending activities by increasing credit availability and potentially lowering interest rates.

To estimate the potential benefits for lending activity by asset class associated with reduced risk-weighted assets, this analysis employs several simplifying assumptions.

First, banking organizations generally maintain capital levels above regulatory capital requirements, including applicable buffer requirements. This excess – often called the “management buffer” – varies across institutions as it reflects firm-specific considerations. By reducing required capital, the proposed rule would increase the size of these management buffers. Covered banking organizations might respond to this increase in various ways: they could maintain their new management buffer levels, transfer some or all of the additional capital to equity holders, or reduce their management buffers by increasing interest-earning assets.

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<sup>154</sup> Based on the same data source and estimation methodology, fewer than 20 covered banking organizations would experience a slight increase in capital requirements under the proposal. All of these institutions have tier 1 and CET 1 capital ratios over 11 percent under both the proposal and the baseline. The proposal would affect any one of these covered institutions’ capital buffer by no more than half a percentage point.

<sup>155</sup> See, among others, Ragnar E. Juelsrud and Ella Getz Wold, (2020). “Risk-weighted capital requirements and portfolio rebalancing.” *Journal of Financial Intermediation*, 41, 100806; Reint Gropp, Thomas Mosk, Steven Ongena, and Carlo Wix, (2019) “Banks response to higher capital requirements. Evidence from a quasi-natural experiment.” *The Review of Financial Studies* 32, 266-299; Jose M. Berrospide and Rochelle M. Edge, (2024) “Bank capital buffers and lending, firm financing and spending: What can we learn from five years of stress test results?” *Journal of Financial Intermediation* 57, 101061.

For the purpose of this analysis, the agencies apply a general method to estimate lending effects and assume that covered entities experiencing a decrease in capital requirements under the proposal would increase interest-earning assets to target management buffers equal to their current management buffers (as of June 30, 2025).<sup>156</sup> Implicitly, this also assumes that the leverage ratio requirement would not be binding under the proposed capital framework. In other words, this analysis begins by assuming that each covered institution would fully deploy its decrease in risk-weighted assets toward new lending.

Second, this analysis assumes that, under the proposal, each covered institution's marginal propensity to lend any capital in excess of the current management buffer to any particular asset class would be equivalent to the current share of that asset class to total assets. It is plausible that some covered institutions would apply a portion of the incremental management buffers to increase their activity in other asset classes, but to simplify the estimates, this analysis assumes all covered institutions that increase lending would do so within the same asset class.

Following these two assumptions, the agencies adopt a simple approach to estimating asset-class level lending changes. For each asset class, the analysis converts the reduction in risk-weighted assets into potential new lending by dividing the estimated reduction by the proposed applicable risk weight. Specifically, the estimated incremental lending for each affected asset class equals the product of the dollar amount of the reduction in risk-weighted assets for that asset class and the inverse of its average proposed risk weight. Table VI.1 presents asset-class level estimates of the potential lending effects resulting from the proposed

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<sup>156</sup> Covered banking organizations' financials other than items affected by capital requirements in these states are assumed to be identical to those on Reports of Income and Condition (Call Reports) and Consolidated Financial Statements for Holding Companies (FR Y-9C) as of June 30, 2025.

reduction in risk weights. While the way each banking organization responds to the proposal would likely depend on its individual circumstances, this approach provides a broad estimate of the proposal’s potential impact on lending, at the aggregate level.

**Table VI.1** Estimated Additional Balance Sheet Capacity Under the Proposal by Asset Class

(All covered depository institutions. Based on 8.5 percent required capital ratio)

Asset class	Average proposed risk weight	Reduction in risk-weighted assets (billions)	Reduction in required capital (billions)	Additional balance sheet capacity (Potential lending) (billions)
RRE mortgage loans	35%	\$225	\$19.1	\$643
CRE mortgage loans	95%	\$95	\$8.1	\$100
Corporate	95%	\$215	\$18.3	\$226
Retail	90%	\$130	\$11.1	\$144
Securitizations	23%	\$21	\$1.8	\$91
Other assets	90%	\$47	\$4.0	\$52
Totals	N/A	\$733	\$62.3	\$1,256

Source: Special data collection of 2023, FFIEC Call Reports, and FR Y-9C, June 30, 2025.

Note: RRE is residential real estate; CRE is commercial real estate; Securitization risk weight is an estimated average effective risk weight of the proposal.

The agencies recognize that these assumptions may result in overestimates of lending growth—not all covered banking organizations would use all of their additional management buffers to increase interest-earning assets. Decisions on balance sheet deployment would likely depend on other factors such as banking organizations’ strategic plans, growth outlooks, risk assessments, as well as market conditions such as demand for credit driven by factors exogenous to bank capital regulation. In addition, over the long term, covered banking organizations are likely to re-optimize their portfolios to achieve more efficient risk-adjusted returns relative to their risk tolerances and strategic plans.

Additionally, the above analysis considers covered banking organizations in aggregate. As discussed earlier, a small portion of them could see an increase in capital requirements from the proposal. These entities are unlikely to observe an increase in their lending capacity according to the above simplified framework.

Furthermore, numerous credit market supply and demand factors would influence the provision and pricing of loans across different asset classes. Depending on the covered banking organization's underwriting practices and risk appetites, some portion of the incremental lending may increase risk exposures. The agencies do not have the information necessary to determine precisely how each covered banking organization would respond to the proposal. As such, the analysis is intended to illustrate the potential magnitude of aggregate and distributional effects on lending by the proposal.

The expanded risk-based proposal would amend risk weights by asset class for Category I and II banking organizations. For most asset classes, risk-weighted assets applicable to bank lending activities would decline for both covered banking organizations as a result of this proposal and for Category I and II banking organizations as a result of the expanded risk-based proposal. Therefore, to the extent that the proposals cause banking organizations to increase lending, the combined economy-wide impact of the proposals may be larger than the estimates presented herein.

#### *1. Effects on residential real estate lending*

The proposal would generally implement reductions in risk weights for loans secured by residential real estate, whether originated by the covered institution or purchased from another lender. Under the baseline, a prudently underwritten first lien residential mortgage on a property

that is either owner-occupied or rented generally receives a 50 percent risk weight; other residential mortgages receive a 100 percent risk weight. The proposal would assign risk weights to the former according to the loan-to-value (LTV) ratio of the mortgage, among other factors. For this set of mortgage loans, the average risk weight would fall from 50 percent to approximately 35 percent,<sup>157</sup> on average, a 30 percent reduction.

Under the proposal, the agencies estimate that aggregate residential real estate risk-weighted assets for covered depository institutions would fall by an estimated \$225 billion (see Table VI.1), relative to the baseline and holding constant the volume of lending activity. The proposed revised risk weights based on LTV ratios would decline over time as mortgage balances are paid down, potentially adding future balance sheet capacity. The estimates do not account for this. Applying the simplified approach introduced above, this yields an estimate of increased lending capacity by about \$643 billion, as shown in Table VI.1.<sup>158</sup> Should the covered depository institutions choose to increase their residential real estate lending at this scale, it may place downward pressure on loan prices.

## *2. Effects on commercial real estate lending*

Risk weights for non-construction commercial real estate loans would fall from 100 percent to 95 percent under the proposal. This 5 percent reduction in the risk weight would decrease risk-weighted assets by an estimated \$95 billion relative to the baseline, assuming no change in the volume of commercial real estate assets. Applying the methodology introduced

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<sup>157</sup> This 35 percent average proposed risk weight is based on special data collection participant Category III and IV holding companies' residential real estate exposures, as applied to the proposal's LTV-based risk weight classes. Non-Category I and II holding companies that report mortgage data on the FR Y-14 show a similar 34 percent average risk weight under the proposal as of June 30, 2025.

<sup>158</sup> The estimation of the incremental lending effects for the residential real estate is as follows: \$225 billion drop in risk-weighted assets \*  $1 / 35\%$  average proposed risk weight = \$643 billion.

above, this would yield an aggregate \$100 billion that could be applied to additional lending and asset purchases within this asset class. Should the covered depository institutions choose to increase their commercial real estate lending at this scale, it may place downward pressure on loan prices.

### *3. Effects on corporate lending*

Under the baseline, all on-balance-sheet and off-balance-sheet corporate exposures generally receive a 100 percent risk weight. Risk weights for on-balance sheet corporate lending would fall to 95 percent under the proposal, a 5 percent reduction. Off-balance-sheet exposures, typically consisting of unutilized portions of credit lines, are subject to additional considerations through credit conversion factors.

The proposal would reduce corporate lending risk-weighted assets by an estimated \$215 billion, relative to the baseline and holding the volume of lending activity constant. This would yield an aggregate \$226 billion that could be applied to additional lending and asset purchases within this asset class. Should the covered depository institutions choose to increase their corporate lending at this scale, it may place downward pressure on loan prices.

### *4. Effects on retail lending*

Risk weights for retail loans, including but not limited to unsecured personal loans, auto loans, home equity lines of credit, credit cards, other real estate owned, and other assets such as property, plant, and equipment, would decrease from 100 percent to 90 percent. This 10 percent reduction would reduce risk-weighted assets by an estimated \$130 billion, relative to the baseline and assuming no change in the volume or composition of retail loan assets. This would yield an aggregate \$144 billion that could be applied to additional lending and asset purchases within this asset class. Should the covered depository institutions choose to increase their retail lending at this scale, it may place downward pressure on loan prices.

### 5. *Effects on securitization*

The proposal would generally implement reductions in risk weights for securitized assets. There are many factors that affect a banking organization's decision to hold securitized assets or engage in securitization activities. For the purposes of this analysis the agencies estimate the changes in holdings of securitized assets to illustrate the potential balance sheet effects of this aspect of the proposed rule, holding all else equal. The analysis provides an initial upper-bound estimate based on the direct effects of changes in capital requirements within the asset class alone.

The proposal reduces the minimum risk weight for senior securitization positions from 20 percent in the current standardized approach to 15 percent. These proposed changes would reduce risk-weighted assets by an estimated \$21 billion, relative to the baseline, assuming no change in the volume or composition of securitization positions. The proposal would yield an estimated aggregate \$91 billion that could be applied to additional securitization activity. Should the covered banking organizations choose to increase their securitization activities at this scale, it may place downward pressure on prices of securitized assets.<sup>159</sup>

The estimated effects on securitized assets of covered banking organizations are influenced by many factors and, therefore, highly uncertain.<sup>160</sup> First, the propensity to engage in securitization activity can depend on the differences in funding costs for retail deposits, debt, or equity. Second, banking organizations may engage in securitization activity to transfer credit

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<sup>159</sup> Such an increase in securitization activity may also impact their risk profiles.

<sup>160</sup> Discussion based on Deku, Solomon Y., Alper Kara, and Yifan Zhou, (2019), "Securitization, Bank Behavior and Financial Stability: A Systematic Review of the Recent Empirical Literature," *International Review of Financial Analysis* 61: 245-254, and Affinito, Massimiliano and Edoardo Tagliaferri, (2010), "Why Do (or Did?) Banks Securitise Their Loans? Evidence from Italy," *Journal of Financial Stability* 6: 189-202.

risk to third parties and thereby manage the credit risk of their asset portfolios. Third, banking organizations may engage in securitization activity to generate higher returns relative to holding the constituent assets in their portfolio. Finally, the propensity to engage in securitization activity or hold securitized assets can be affected by different regulatory capital treatments for securities and loans.

The estimated volume and distribution of securitization activities for covered banking organizations may also be influenced by interactions between the proposed risk weight changes for different asset classes. The proposal would directly reduce securitization risk weights and capital requirements, thereby incentivizing additional securitization activities, all else equal. However, the assets subject to securitization (e.g., residential- and commercial real estate loans, among others) themselves would experience risk weight changes under the proposal that could influence banking organizations' securitization decisions. For example, proposed reductions in risk weights for residential real estate loans would reduce minimum capital requirements for these assets and decrease banking organizations' incentives to securitize these loans in order to reduce their capital requirements, all else equal. However, the proposal may have little direct effect on their incentives to securitize these loans if they primarily do so as a means of accessing low-cost funding and liquidity, or to manage the quality of their assets.

#### *6. Effects on lending related to other assets*

Other assets not classified within one of the preceding asset classes, such as other real estate owned assets,<sup>161</sup> generally would decrease from a 100 percent risk weight to 90 percent

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<sup>161</sup> "Other real estate owned" assets are defined as real estate acquired in any manner for debts previously contracted (including, but not limited to, real estate acquired through foreclosure and real estate acquired by deed in lieu of foreclosure), even if the bank has not yet received title to the property, and real estate collateral underlying a loan when the bank has obtained physical possession of the collateral. Call Reports Schedule RC-F Instructions, "Other Assets". <https://www.fdic.gov/resources/bankers/call-reports/crinst-031-041/2019/2019-03-rc-f.pdf>.

under the proposal. This 10 percent reduction would reduce risk-weighted assets by an estimated \$47 billion, relative to the baseline and assuming no change in the volume or composition of the assets. The proposal would yield an aggregate \$52 billion that could be applied to additional lending and asset purchases within this asset class. Should the covered depository institutions choose to increase their other assets lending at this scale, it may place downward pressure on loan prices.

In summary, across the six asset classes discussed in this subsection, the agencies' upper-bound estimate shows the proposal could potentially generate up to \$1.26 trillion in new lending and securitization activity, relative to the baseline and predicated on certain assumptions. The potential new lending (\$1.17 trillion, exclusive of securitization effects), equivalent to 9 percent of total loans and leases outstanding among all commercial banking organizations in the U.S.,<sup>162</sup> may support business investment and consumers, and contribute to economic growth.

#### *7. Effects of portfolio re-optimization on lending*

Research finds that changes in regulatory capital frameworks can encourage banking organizations to shift their asset portfolios. This is because in general, banking organizations would optimize portfolio holdings to maximize risk-adjusted returns.<sup>163</sup> Therefore, under the proposal, some covered banking organizations may re-optimize their asset portfolios to the proposed changes in risk weighting. In particular, the more risk-sensitive proposed risk weights

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<sup>162</sup> All commercial banking organizations in the U.S. collectively held \$12.9 trillion in seasonally adjusted loans and leases in bank credit as of June 30, 2025. Federal Reserve, H8 "Assets and Liabilities of Commercial Banks in the United States" Table 2.

<sup>163</sup> Empirical studies supporting this view include Haubrich, Joseph G. and Paul Wachtel, 1993, "Capital Requirements and Shifts in Commercial Bank Portfolios." *Economic Review*, Federal Reserve Bank of Cleveland, vol. 29 (Q III), pages 2-15, and with more recent data, Hoshi, Takeo & Ke Wang, 2021. "Bank Regulatory Reforms and Declining Diversity of Bank Credit Allocation," CARF F-Series working paper, Center for Advanced Research in Finance, Faculty of Economics, The University of Tokyo.

could incentivize covered banking organizations to adjust their loan portfolios to minimize their capital requirements per unit of expected returns within the asset class.

This incentive to reoptimize within an asset class would be prominent in the residential real estate lending sector due to the increased granularity of asset treatment based on LTV ratios. The proposal's introduction of several risk weight classes below the current 50 percent baseline risk weight for prudently underwritten exposures would incentivize covered institutions to originate or purchase lower-LTV residential mortgages and to retain any residential mortgages as servicers, because the risk weights would decline as the outstanding balances and LTVs fall over time. Alternatively, covered banking organizations may quickly sell or securitize high-LTV mortgages that they originate, rather than hold these high risk-weighted assets on their balance sheets. As a result, the proposal could lead to a gradual increase in the share of lower-LTV residential real estate exposures held by covered banking organizations. The agencies do not have the data to provide a robust estimate of this potential effect.

Portfolio re-optimization may also occur across asset classes, as covered institutions may shift investments from one asset class to another to maximize risk-adjusted returns under the proposed new risk weighting system. The proposed 30 percent average reduction in risk weights for residential real estate exposures would strengthen incentives, relative to other asset classes, for covered banking organizations to hold these assets. Incentives to hold asset classes that would receive 10 percent (retail lending, other assets) and 5 percent (commercial real estate, corporate lending) reductions in their risk weights would likely increase as well. Responses from covered banking organizations may include incremental new lending and asset purchases as discussed above, and the shifting of assets currently invested in different asset classes on their balance sheets. The agencies expect these across-asset class reallocations to increase lending,

particularly in residential real estate, retail lending, and other assets that would experience relatively larger drops in their risk weights. To the extent that resources shift away from other asset classes, some reduction in certain lending and securities portfolios may occur. The agencies do not have the data to provide robust estimates of these potential effects.

### ***C. Economic efficiency***

Regulatory capital frameworks that assign capital requirements that are not aligned with risk have distortionary effects on banking organizations' investment decisions. Any such distortion would result in the inefficient allocation of capital by discouraging investments in assets with higher-than-appropriate risk weights. The proposal would revise certain risk weights to improve how regulatory capital ratios capture the underlying economic risks of banking organizations' balance sheets and activities. Covered banking organizations may respond by decreasing their capital levels or increasing their assets or both.<sup>164</sup> Aggregated to an industry level, the proposal's incentives for increased lending, through the revisions to risk weights, may contribute to overall economic efficiency by improving economy-wide financial resource allocation relative to the baseline.<sup>165</sup> Empirical evidence suggests that allocative efficiency is a key contributor to productivity growth and economic output.<sup>166</sup>

### ***D. Effects on competitiveness***

As compared to the baseline, the proposal would generally increase the competitiveness of covered banking organizations, relative to competitors in the markets they serve, through increased economies of scale and reduced funding costs for certain assets with reduced risk

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<sup>164</sup> The agencies discuss covered institutions' responses in Section VII.B in this proposal.

<sup>165</sup> The estimated effects on lending discussed in Section VII.B could vary with the economic cycle and associated fluctuations in credit demand.

<sup>166</sup> Shao, Lin and Rongsheng Tang, 2024, "Allocative Efficiency and the Productivity Slowdown." Bank for International Settlements working paper 1185.

weights. In addition, the proposal would provide more granular risk-weight assignments to residential mortgages, generally increasing the competitiveness of covered institutions in that market.

*1. General competitiveness*

As compared to the baseline, the proposal would decrease tier 1 capital requirements for covered depository institution subsidiaries of Category III and IV holding companies by 4.3 percent and would decrease tier 1 capital requirements for covered depository institutions with assets under \$100 billion by 7.1 percent. At the bank level, the median covered depository institution would experience a tier 1 capital requirement decrease of 6.2 percent, and nearly 10 percent of covered depository institutions would experience a decrease over 10 percent. These lower requirements would allow covered banking organizations to benefit from economies of scale by expanding their balance sheets, potentially increasing their competitiveness. The increased balance sheet capacity would also enable covered banking organizations to adapt to specific changes in the markets they serve or to pursue new markets that may generate long-run efficiency gains.

*2. Competitiveness in specific asset classes*

Regulatory capital requirements impose economic costs on covered banking organizations, including the cost of obtaining capital. When the regulatory capital requirement is tied to a specific asset class, banks may pass a portion of the regulatory capital costs onto the borrower of that asset through reduced lending supply and higher interest rates and fees. As the proposal reduces the regulatory capital costs for certain financial products (through a reduction in the applicable risk weight), covered banking organizations would be able to increase their share of those markets by offering reduced interest rates and fees, along with a greater availability of such financial products.

For example, the proposal would reduce the risk weights, and concomitant regulatory capital costs, of corporate lending by 5 percent.<sup>167</sup> Covered banking organizations that engage in corporate lending may be able to offer lower prices to their customers due to the decrease in regulatory costs. These effects may accrue more to the larger covered banking organizations – as Tables V.G.1-3 shows, Category III and IV depository institutions hold, in dollar terms, approximately twice the volume of non-CRE corporate loans as covered depository institutions with assets between \$10 billion and \$100 billion and three times as much as covered depository institutions with assets below \$10 billion. This ordering is reversed in other markets – covered depository institutions with assets below \$10 billion hold twice as much volume of commercial real estate loans as Category III and IV institutions. The reduction in capital costs under the proposal would make these smaller banking organizations more competitive in this space.

For some assets, the proposal would increase all covered banking organizations' ability to compete with nonbank financial intermediaries. Of particular note, Tables V.G.1-3 show that, in the market for residential real estate lending, all three size categories of covered depository institutions hold approximately the same amount of risk-weighted assets and would accrue similar aggregate reductions in required capital, with concomitant increases in competitiveness for all covered depository institutions relative to nonbanks. The share of bank activity in the residential real estate lending market has decreased substantially since the 2008 financial crisis;<sup>168</sup> the increased competitiveness brought about by the proposal may slow or even partially

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<sup>167</sup> See proposed 12 CFR § \_\_\_\_.32(f).

<sup>168</sup> For example, see Figure 4 of the Financial Stability Oversight Council's Report on Nonbank Mortgage Servicing 2024, available at <https://home.treasury.gov/system/files/261/FSOC-2024-Nonbank-Mortgage-Servicing-Report.pdf>.

reverse the migration of activity to the nonbank sector, particularly in residential mortgage markets.<sup>169</sup>

The proposal would also introduce more granular risk weights for certain assets – particularly residential mortgages that are owner-occupied or rented and meet prudential underwriting standards.<sup>170</sup> Currently, and under the baseline, these exposures are all given identical risk weights of 50 percent. Under the proposal, the exposures’ risk weights would vary according to their cash flow dependency and LTV ratios: from 25 percent for those residential mortgages with LTV ratios of 50 percent or less to 110 percent for those with LTV ratios greater than 100 percent and that are dependent on the cash flows generated by the mortgaged property. Given that risk weights are proportional to the real economic costs of holding required capital, the granularity introduced by the proposal would increase a covered institution’s competitiveness for residential mortgages with low LTV ratios and that are not dependent on the cash flows of the mortgaged property.

This increased competitiveness for specific subgroups of residential real estate loans may drive market activity for the sale of mortgages; some covered institutions may purchase low-LTV loans from nonbanks or other banks that originate-to-distribute. Covered banking organizations may also compete for these loans against mortgage loan securitization entities, both private and government-backed.

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<sup>169</sup> The agencies acknowledge that there could be many reasons that residential real estate lending has migrated to nonbanks, including stricter non-capital regulatory requirements. In addition, nonbanks also innovated technologically and expanded access to borrowers who were underserved by banks after the crisis. See, for example, Greg Buchak, Gregor Matvos, Tomasz Piskorski & Amit Seru, “Fintech, Regulatory Arbitrage, and the Rise of Shadow Banks,” *Journal of Financial Economics*, 130(3), 453–483 (December 2018) (“Buchak et al. (2018)”), <https://doi.org/10.1016/j.jfineco.2018.03.011>.

<sup>170</sup> Among other qualifications delineated in proposed 12 CFR § \_\_\_\_.32(g).

On the other hand, the increased risk weights for high-LTV residential mortgages, or those with cash flows dependent on the mortgaged property, would decrease covered banking organizations' competitiveness in the market for these assets. The proposed regulatory capital cost increase for these high-LTV loans may induce some covered banking organizations to adopt larger originate-to-distribute business lines rather than hold these assets on their balance sheets.

#### *E. Effects on safety and soundness*

As previously discussed in Section VI.B on lending effects and Section VI.C on economic efficiency, lower capital requirements under the proposal could enable up to \$1.17 trillion<sup>171</sup> in additional lending to businesses and consumers, potentially supporting investment and contributing to economic growth. However, these economic benefits must be weighed against a possible modest increase in the risk of bank failures or other economy-wide bank-related stress event. The agencies evaluate the proposal using the academic literature on the effects of capital requirements, as discussed in Section VIII.D of the expanded risk-based proposal, which provides a range of capital levels over which benefits exceed costs in the long run.

Academic literature examines how capital requirements affect the probability of systemic financial crises. The Basel Committee's long-term economic impact assessment of capital and liquidity requirements (BCBS 2010 study) shows that higher capital and liquidity requirements reduce the likelihood of systemic crises.<sup>172</sup> Conversely, lower capital requirements increase this likelihood. In the context of this proposal and using covered depository institutions as the

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<sup>171</sup> As previously noted, the \$1.17 trillion in potential new lending (exclusive of securitization effects) makes up 9 percent of the \$12.9 trillion in seasonally adjusted loans and leases in bank credit held by all commercial banking organizations in the U.S. as of June 30, 2025. Federal Reserve, H8 "Assets and Liabilities of Commercial Banks in the United States" Table 2.

<sup>172</sup> See Basel Committee, "An Assessment of the Long-Term Economic Impact of Stronger Capital and Liquidity Requirements" (Aug. 2010), <https://www.bis.org/publ/bcbs173.pdf> ("BCBS 2010 study").

sample, under the baseline, the aggregate common equity tier 1 capital ratio for covered depository institutions is 14.0 percent.<sup>173</sup> If covered depository institutions reduce their common equity tier 1 capital by the estimated 8.6 percent reduction in requirements, they would maintain an aggregate common equity tier 1 ratio of 12.8 percent relative to current risk-weighted assets. According to models used in the BCBS 2010 study, with no changes in liquidity, a decrease in tangible common equity to risk-weighted assets from 14.0 percent to 12.8 percent would increase the annual probability of a systemic crisis from 0.4 percent to 0.5 percent.<sup>174</sup> However, the study notes the result is subject to considerable model and estimation uncertainty. Moreover, the literature does not agree on the correlation between capital levels and the likelihood of crises. For example, Jorda et al. (2021) finds no robust evidence in long-run data that capital ratios are closely related to rising risks of financial instability.<sup>175</sup>

Beyond systemic effects, lower capital requirements also increase risks at the individual institution level. To the extent that covered banking organizations reduce their capital and increase their leverage in response to the proposal, there would be attendant economic costs due to increased risk of bank failure. All else equal, lower capital increases the size and likelihood of losses at individual institutions, as well as the potential for shifting losses from shareholders to creditors and the Deposit Insurance Fund in the event of failure. Such losses may also lead to spillover effects and additional costs to the financial system. However, as described further

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<sup>173</sup> For depository institutions, \$1,216 billion in common equity tier 1 capital held as of June 30, 2025, divided by \$8,711 billion in RWA under the baseline (from Table V.3) equals about 14 percent.

<sup>174</sup> BCBS 2010 study, Tables 3 and A2.2.

<sup>175</sup> See Oscar Jorda, Björn Richter, Moritz Schularick, and Alan Taylor, “Bank Capital Redux: Solvency, Liquidity, and Crisis,” *The Review of Economic Studies*, Volume 88, Issue 1, January 2021, Pages 260–286, <https://doi.org/10.1093/restud/rdaa040>.

below, the agencies believe that mitigating factors would appropriately offset these safety and soundness risks.

### ***Optimal capital levels***

This subsection presents an abbreviated discussion of the cumulative effects of this proposal and the expanded risk-based proposal through the lens of the academic literature on optimal levels of capital.<sup>176</sup> In Table VI.2, the agencies situate the capital requirements under the proposal in the context of optimal capital levels from the BCBS 2010 study and the extant literature.<sup>177</sup> The agencies caution that significant uncertainties and limitations remain on how to measure these benefits and costs, and different approaches used in various studies yield different estimates of the optimal level of capital.<sup>178</sup> Under the proposal, covered depository institutions are projected to maintain an aggregate common equity tier 1 ratio of 12.8 percent relative to current risk-weighted assets. This level falls within the range of optimal values discussed in the literature.<sup>179</sup>

**Table VI.2:** Estimated Levels of Capital Under the Proposals and Optimal Level of Capital in the Literature

Estimated common equity tier 1 capital ratio under both proposals: 13 percent
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<sup>176</sup> For a more detailed discussion on this literature, see Section VIII.D of the expanded risk-based proposal.

<sup>177</sup> The BCBS 2010 study developed a framework in which the benefits of higher capital stem from a reduced probability of a financial crisis. These benefits can be quantified by estimating the degree to which higher bank capital reduces the probability of a crisis and multiplying this reduction in probability by the expected economic output loss caused by a crisis. The cost of higher capital requirements stems from the increased cost of funding for banks, which can lead to higher interest rates on lending and thus lower economic activity, depending on market structure, competition, and other factors. The trade-off between these benefits and costs yields the optimal level of capital in the banking system.

<sup>178</sup> The studies are discussed further in Sections VIII.D.2 and VIII.D.3 of the expanded risk-based proposal.

<sup>179</sup> The estimated common equity tier 1 capital ratio for the entire U.S. banking industry of about 13 percent, also falls within the range of optimal values. See Section VIII.D of the expanded risk-based proposal.

<b>Study</b>	<b>Optimal Level of Capital</b>
BCBS 2010 study	10 to 14 percent
Fender and Lewrick (2016)	8 to 11 percent
Miles, Yang, and Marcheggiano (2013)	16 to 20 percent
Brooke et al. (2015)	10 to 14 percent
Firestone et al. (2019)	13 to 26 percent
Soederhuizen et al. (2023)	16 to 31 percent
Jorda et al. (2021)	- <sup>a</sup>
Admati and Hellwig (2024)	- <sup>b</sup>
Begenau (2020)	12.4 percent
Begenau and Landvoigt (2022)	16 percent
Elenev et al. (2021)	6 percent
Begenau et al. (2026)	- <sup>c</sup>
Davyduik (2017)	6 percent

Notes:

a. The analytical framework in Jorda et al. (2021) does not yield an estimate of the optimal level of bank capital.

b. Admati and Hellwig (2024) argue that the level of optimal capital in the banking system ought to be much higher than current capital levels.

c. Optimal capital requirements in Begenau et al. (2026) are lower than current values.

Sources:

Basel Committee on Banking Supervision, “An Assessment of the Long-Term Economic Impact of Stronger Capital and Liquidity Requirements” (Aug. 2010) (“BCBS 2010 study”), <https://www.bis.org/publ/bcbs173.pdf>

Ingo Fender and Ulf Lewrick, Monetary and Economic Department, BIS, “Adding it All Up: The Macroeconomic Impact of Basel III and Outstanding Reform Issues,” *BIS Working Papers*, No. 591 (Nov. 2016) (“Fender and Lewrick (2016)”), <https://www.bis.org/publ/work591.pdf>.

David Miles, Jing Yang, and Gilberto Marcheggiano, “Optimal Bank Capital,” 123 *The Economic Journal* 1, 29 Table 10 (Mar. 2013) (“Miles, Yang and Marcheggiano (2013)”), <https://academic.oup.com/ej/article/123/567/1/5080596>.

Martin Brooke, Oliver Bush, Robert Edwards, Jas Ellis, Bill Francis, Rashmi Harimohan, Katharine Neiss, and Caspar Siegert, “Bank of England, Measuring the Macroeconomic Costs and Benefits of Higher UK Bank Capital Requirements,” *Bank of England, Financial Stability Paper* No. 35 (Dec. 2015) (“Brooke et al. (2015)”), <https://www.bankofengland.co.uk/-/media/boe/files/financial-stability-paper/2015/measuring-the-macroeconomic-costs-and-benefits-of.pdf>.

Simon Firestone, Amy Lorenc, and Ben Ranish, “An Empirical Economic Assessment of the Costs and Benefits of Bank Capital in the United States,” 101 *Federal Reserve Bank of St. Louis Review* 203, 203–30 (2019) (“Firestone et al. (2019)”), <https://doi.org/10.20955/r.101.203-30>.

Beau Soederhuizen, Gerrit Hugo van Heuvelen, Rob Luginbuhl, and Bert van Stiphout-Kramer, Netherlands Bureau for Economic Policy Analysis (CPB), “Optimal Capital Ratios for Banks in the Euro Area,” 69 *Journal of Financial Stability*, No. 101164 (Dec. 2023) (“Soederhuizen et al. (2023)”), <https://doi.org/10.1016/j.jfs.2023.101164>.

Oscar Jorda, Björn Richter, Moritz Schularick, and Alan Taylor, “Bank Capital Redux: Solvency, Liquidity, and Crisis,” *The Review of Economic Studies* 88, No. 1: 260–268 (2021) (“Jorda et al. (2021)”), <https://doi.org/10.1093/restud/rdaa040>.

Anat Admati and Martin Hellwig, *The Bankers’ New Clothes: What’s Wrong with Banking and What to Do About It*, New and expanded edition. Princeton, NJ: Princeton University Press. (2024), originally published in 2013 (“Admati and Hellwig (2024)”).

Juliane Begenau, “Capital Requirements, Risk Choice, and Liquidity Provision in a Business-Cycle Model,” *Journal of Financial Economics* 136: 355–378 (May 2020) (“Begenau (2020)”), <https://doi.org/10.1016/j.jfineco.2019.10.004>.

Julaine Begenau and Tim Landvoigt, “Financial Regulation in a Quantitative Model of the Modern Banking System,” *The Review of Economic Studies* 89:1748–1784 (July 2022) (“Begenau and Landvoigt (2022)”), <https://doi.org/10.1093/restud/rdab088>.

Vadim Elenev, Tim Landvoigt, and Stijn Van Nieuwerburgh, “A Macroeconomic Model With Financially Constrained Producers and Intermediaries,” *Econometrica* 89: 1361–1418 (May 2021) (“Elenev et al. (2021)”), <https://doi.org/10.3982/ECTA16438>.

Juliane Begenau, Saki Bigio, Jeremy Majerovitz, and Matias Viegara, “A Q-Theory of Banks,” *The Review of Economic Studies*, 93 (1): 106–143, (Jan. 2026) (“Begenau et al. (2026)”), <https://doi.org/doi:10.1093/restud/rdaf035>.

Tetiana Davydiuk, “Dynamic Bank Capital Requirements,” (Oct. 2017) (“Davydiuk (2017)”), <https://dx.doi.org/10.2139/ssrn.3110800>.

Several limitations exist in applying academic studies on optimal capital levels to evaluate the proposals.<sup>180</sup> First, the literature on optimal capital levels examines the effects due to a direct change in the required capital for a certain quantity of risky assets, rather than changes in

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<sup>180</sup> See section VIII.D.4 of the expanded risk-based proposal for additional details.

capital requirements resulting from revised risk weights, as proposed here. Second, banking organizations use a broad range of loss-absorbing instruments to meet different capital requirements. While a few exceptions, such as Brooke et al. (2015), distinguish between these different capital instruments, most do not. This makes it challenging to determine which capital ratio is most applicable to mapping the results of a given study to the U.S. banking system. Third, optimal capital levels can differ across jurisdictions. For example, differences in the degree to which an economy relies on bank-based versus market-based finance may affect the optimal level of capital in the banking system.<sup>181</sup>

While the proposed capital levels fall within the optimal range identified in the literature and are thus reasonable, several factors may further mitigate the safety and soundness concerns stemming from the estimated reductions in capital requirements. All covered banking organizations would continue to be subject to robust supervisory and regulatory standards, as well as leverage ratio requirements which would provide a backstop to any significant decreases in the tier 1 capital ratio. Additionally, certain depository institutions would continue to be subject to resolution planning requirements. Moreover, capital requirements under the proposal for specific asset classes would generally remain sufficient to cover anticipated losses due to a stress event.<sup>182</sup> As of June 30, 2025, covered depository institutions held more than \$1.2 trillion

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<sup>181</sup> Section VIII.D.4 of the expanded risk-based proposal also notes the limitation that the optimal capital level literature, including the studies based on optimizing macroeconomic agents, almost exclusively focuses on capitalizing for the risks posed by banks' loan portfolios rather than the risk associated with trading activity or the potential macroeconomic effect of changes in the provision of trading activity. Under the proposal, total risk-weighted assets applicable to lending could increase while the change in risk-weighted assets for other banking activities for which the risk weights change in the proposal are *de minimis*. This limitation would not be applicable to evaluating the proposal.

<sup>182</sup> For example, the agencies estimate that, under the proposal, first or subsequent liens on one-to-four family residential properties that are prudently underwritten would have an average risk weight of approximately 35 percent, resulting in a three percent tier 1 capital requirement (equal to 35 percent of the 8.5 percent minimum tier 1 capital ratio) that covered banking organizations must hold against these exposures. This three percent would remain sufficient to cover anticipated mortgage losses under a stress event, as estimated as a result of recent

in common equity tier 1 capital in aggregate.<sup>183</sup> The above analysis suggests that existing levels of capital, in addition to other regulatory requirements noted above, would appropriately mitigate safety and soundness risks.

Finally, as discussed in Section VI.D on competitiveness effects, the proposal may slow or partially reverse the migration of lending activity from the banking sector to the nonbank sector, which has implications for financial stability. Nonbanks are typically less regulated and not subject to the same comprehensive prudential regulations and supervision as banks. To the extent the proposal leads to migration of lending activity back to the regulated banking sector, it could benefit financial stability.

#### ***F. Other costs***

The proposal would impose transitional costs on all covered banking organizations. All covered banking organizations would need to establish or revise internal recordkeeping systems, policies and procedures to track compliance with the amended supervisory capital requirements. Costs to establish internal recordkeeping systems, policies and procedures likely would be non-recurring, whereas costs associated with monitoring the performance of and revising such systems, policies and procedures likely would be ongoing and recurring. For instance, covered banking organizations would now have to separately identify and delineate certain residential mortgages by their cash flow dependencies and their LTV ratios. The agencies do not have the information necessary to estimate these costs but acknowledge that they may be material for

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supervisory stress tests (See 2025 Federal Reserve Stress Test Results (June 2025) at <https://www.federalreserve.gov/publications/files/2025-dfast-results-20250627.pdf>) or in response to the 2023 proposal (See Laurie Goodman and Zhu, Jun, “Bank Capital Notice of Proposed Rulemaking,” (September 18, 2023) at <https://www.urban.org/research/publication/bank-capital-notice-proposed-rulemaking>).

<sup>183</sup> As shown in Table V.3, as of June 30, 2025, covered depository institutions are required to hold common equity tier 1 capital of \$610 billion, in aggregate, and reported common equity tier 1 capital levels of \$1,216 billion.

smaller covered banking organizations or covered banking organizations with significant residential mortgage exposures.<sup>184</sup>

### ***G. Interactions with CBLR proposal***

The agencies anticipate limited interactions between this proposal and the CBLR proposal. Banking organizations that qualify to use and adopt the CBLR framework are considered to have met the minimum risk-based capital requirements; depository institutions that qualify to use and adopt the CBLR framework are considered well-capitalized. Therefore, the agencies anticipate no direct interaction between the proposals, insofar as no banking organizations would face tradeoffs or considerations around satisfying both requirements simultaneously.

The proposal could affect a banking organization's decision to adopt the CBLR framework. CBLR-eligible banking organizations generally face a tradeoff between lower required capital under the risk-based framework<sup>185</sup> and simpler reporting requirements under the CBLR framework. This proposal generally reduces capital requirements under the risk-based capital framework, increasing the benefit of remaining under the risk-based framework. The proposal also slightly increases the reporting complexity of the risk-based framework, which would increase the benefits of adopting CBLR framework. While these changes are relatively minor and do not significantly alter the basic tradeoff between lower required capital under the risk-based framework and simpler reporting requirements under CBLR, they could lead to more CBLR eligible banking organizations choosing to remain subject to the risk-based framework.

### ***H. Conclusion***

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<sup>184</sup> The small number of banking organizations with trading assets between \$1 and \$5 billion that would no longer be subject to market risk capital requirements could see a reduction in compliance costs.

<sup>185</sup> See 90 FR 55048, 55051 (Dec. 1, 2025).

The analysis above represents a thorough estimation of the economic effects of the proposal on covered banking organizations as well as other affected entities, the U.S. banking system and the broader economy, relative to a baseline in which the proposal was not adopted. The agencies estimate that the proposal would generate broad benefits for covered banking organizations as well as their customers and the economy at large. Specifically, the proposal would lower capital requirements and expand, by up to \$1.26 trillion, the balance sheet capacity of covered banking organizations. In addition, the proposal would better align capital requirements with the underlying risk of exposures and increase allocative efficiency. The proposal would decrease risk weights for certain asset classes, which would reduce funding costs for these assets and enhance the competitiveness of covered institutions in applicable markets.

As noted in the analysis, covered banking organizations would likely respond differently based on their business models and market positions – potentially adjusting asset portfolios, modifying management capital buffers, or adopting alternative regulatory capital regimes; this heterogeneity in responses lends uncertainty to the agencies’ analysis. Nevertheless, the agencies estimate that the proposal is likely to lead to increased lending activities in several asset classes. Greater market participation by covered institutions would directly benefit consumers through lower borrowing costs and improved credit access. The projected increase in lending would support economic growth by facilitating capital formation, business expansion, and household wealth-building through homeownership and other forms of credit access.

Costs of the proposal would include a moderate increase in the risk of loss associated with financial instability, bank failure, or other economy-wide bank-related stress events. The agencies believe these costs would be low, given that the capital ratios for covered institutions are significantly higher than the proposed required levels, which in turn are generally higher than

expected stress loss levels and remain within the range of optimal capital levels discussed in the literature. There may also be material transition costs for smaller covered institutions.

Based on the economic analysis summarized above, the agencies conclude that the expected benefits of the proposal justify its expected costs. The agencies invite comment on all aspects of the economic impact analysis.

## **VII. Technical amendments to the capital rule**

### ***A. Accounting Standards Update 2025-08***

On November 12, 2025, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2025-08, “Financial Instruments—Credit Losses (Topic 326): Purchased Loans,” which amends the guidance on accounting for purchased loans. Upon adoption of ASU 2025-08, the population of acquired financial assets subject to the “gross-up approach” will be expanded to include purchased seasoned loans. The “gross-up approach” under U.S. generally accepted accounting practices (GAAP) requires a banking organization to record an allowance for credit losses on purchased credit deteriorated assets<sup>186</sup> as well as purchased seasoned loans as of the date of acquisition with an offsetting gross-up adjustment to the purchase price of the assets or loans.

In the agencies’ final rule implementing the current expected credit losses (CECL) methodology in 2019 (CECL final rule), the agencies amended the capital rule to identify which allowance for credit losses under the new CECL accounting standard would be eligible for inclusion in a covered banking organization’s tier 2 capital.<sup>187</sup> The CECL final rule addressed the treatment of allowance for credit losses related to purchase credit deteriorated assets. As

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<sup>186</sup> Purchase credit deteriorated assets are acquired individual financial assets (or acquired groups of financial assets with shared risk characteristics) that, as of the date of acquisition and as determined by an acquirer’s assessment, have experienced a more-than-insignificant deterioration in credit quality since origination.

<sup>187</sup> See 86 FR 4224 (Feb. 14, 2019).

ASU 2025-08 requires covered banking organizations to apply the gross approach to both purchase credit deteriorated assets and purchased seasoned loans, the agencies are proposing to apply the capital rule's treatment of allowance for credit losses on purchase credit deteriorated (PCD) assets to allowance for credit losses on purchased seasoned loans. In particular, the proposal would modify the term adjusted allowance for credit losses (AACL) adopted in the CECL final rule to exclude credit loss allowances on purchased seasoned loans in addition to those on purchase credit deteriorated assets and available-for-sale (AFS) debt securities. A covered banking organization would continue to be able to include AACL in its tier 2 capital up to 1.25 percent of the covered banking organization's standardized total risk weighted assets (excluding its market risk-weighted assets, if applicable). The proposal would also amend the definition of carrying value to require the carrying value of purchased seasoned loans to be calculated net of allowances for credit losses (ACL) like the capital rule's current treatment of PCD assets.

In defining AACL, the agencies intend to include only those ACLs that have been fully charged against earnings or retained earnings. Including in tier 2 capital ACLs that have not been charged against earnings would diminish the quality of regulatory capital. Because the initial ACL amount for a PSL recorded on a covered banking organization's balance sheet would not be established through a charge to earnings, the agencies believe the treatment currently applied to the initial ACL for purchase credit deteriorated assets also would be appropriate for the ACL on purchased seasoned loans. Due to concerns of undue complexity and burden on covered banking organizations, the agencies are not proposing a bifurcated approach for the treatment of purchased seasoned loans whereby a covered banking organization could include post-acquisition ACLs on PSLs in tier 2 capital when the covered banking organization's

purchased seasoned loan balances exceed a materiality threshold. The agencies believe that requiring covered banking organizations to calculate the carrying value of purchased seasoned loans net of ACLs appropriately offsets the effects of excluding post-acquisition ACLs on PSLs in the calculation of regulatory capital. Therefore, the agencies are proposing to exclude the entire ACL on PSLs from AACL, even though post-acquisition increases in ACLs for PSLs would be established through a charge against earnings.

In addition, the agencies are proposing to amend the definitions of AACL and carrying value to provide the same treatment as purchase credit deteriorated assets to other assets that may in the future become subject to the gross approach following a change to GAAP by FASB.

#### ***B. Allowance for Loan and Lease Losses Definition***

The agencies are proposing a technical amendment to the current capital rule to remove the definition of allowance for loan and lease losses (ALLL) from section \_\_.2 of the capital rule. The definition of ALLL in the current capital rule is no longer meaningful given the introduction and adoption of the current expected credit loss (CECL) methodology by the FASB under ASU 2016-13, “Financial Instruments – Credit Losses (Topic 326).”

#### ***C. Clarifications to procedures, effective dates, and severability***

In § \_\_.1, the proposal would clarify the application of notice and response procedures for reservation of authority actions, would clean up expired effective date provisions, would clarify the criteria for when standards apply to covered banking organizations that change from one category to another. The proposal would introduce a severability provision to clarify the agencies’ intent with respect to the effectiveness of the proposal in the event that any particular provision or application of the rule is determined to be invalid.

### **VIII. Related proposals and proposed amendments to related rules**

#### ***A. Related proposals***

Concurrently with this proposal, the agencies also are issuing a proposal that would modernize the capital requirements applicable to Category I and II banking organizations (expanded risk-based approach) and the market risk capital framework applicable to banking organizations with significant trading activity (expanded risk-based proposal). All other banking organizations would be permitted, but not required, to use the expanded risk-based approach as discussed in section I. of the Supplementary Information section.

The expanded risk-based proposal would include standardized frameworks for credit risk, equity risk, and operational risk, as well as a revised market risk framework. Relative to the current U.S. standardized approach, this new credit risk framework would provide for improved risk sensitivity and granularity by incorporating additional relevant metrics into the treatments for several new and existing exposure categories, including exposures to depository institutions, foreign banks, and credit unions, corporate exposures, project finance exposures, and retail exposures (which could include small- or medium-sized entities). The equity risk framework is largely consistent with the current U.S. standardized approach. The expanded risk-based approach also would introduce a standardized operational risk capital requirement, calculated based on a banking organization's income and expenses. These items would serve as proxies for measuring operational risk and determining an operational risk capital requirement across the range of activities conducted by large U.S. banking organizations.

The revised market risk framework, which would apply to Category I and II banking organizations as well as other banking organizations with significant trading activity, would replace the current market risk capital framework. The revised market risk framework is designed to better capture tail risk and the risk of less liquid positions. It consists of a standardized measure for market risk and a models-based measure for market risk that may be

used with supervisory approval. The agencies are seeking comment on any burden or operational challenges associated with discretionary use of the expanded risk-based approach.

### ***B. Board amendments***

In connection with this proposal, the Board is proposing amendments to certain regulations (Regulation LL, 12 CFR part 238, and Regulation YY, 12 CFR part 252) that reference the capital rule in order to make appropriate conforming amendments to reflect this proposal.

*Question 58: What modifications, if any, should the agencies consider to this proposal or to other rules indirectly affected by this proposal?*

## **IX. Administrative law matters**

### ***A. Paperwork Reduction Act***

Certain provisions of the proposal contain “collections of information” within the meaning of the Paperwork Reduction Act of 1995 (PRA). In accordance with the requirements of the PRA, the agencies may not conduct or sponsor, and a respondent is not required to respond to, an information collection unless it displays a currently valid Office of Management and Budget (OMB) control number. The information collection requirements contained in this joint proposal have been submitted to OMB for review and approval by the OCC and FDIC under section 3507(d) of the PRA (44 U.S.C. 3507(d)) and section 1320.11 of OMB’s implementing regulations (5 CFR Part 1320). The Board reviewed the proposal under the authority delegated to the Board by OMB.

The proposal contains revisions to current information collections subject to the PRA. To implement these requirements, the agencies would revise and extend for three years the Reporting, Recordkeeping, and Disclosure Requirements Associated with Regulatory Capital Rules (OMB Nos. 1557-0318, 3064-0153, and 7100-0313). This information collection is also

being revised by the expanded risk-based proposal. For ease of reference, the proposed revisions to this information collection by this proposal as well as the expanded risk-based proposal will be addressed in a separate Federal Register notice.

The Board would also revise and extend for three years the (1) Financial Statements for Holding Companies (FR Y 9; OMB No. 7100-0128), (2) the Capital Assessments and Stress Testing (FR Y 14A/Q/M; OMB No. 7100-0341), and (3) other affect reports. The proposed revisions to these Board reports will be addressed in a separate Federal Register notice.

Finally, the agencies, under the auspices of the FFIEC, would also propose related revisions to (1) all versions of the Consolidated Reports of Condition and Income (Call Reports) (FFIEC 031, FFIEC 041, and FFIEC 051; OMB Nos. 1557-0081; 3064-0052, and 7100-0036). The proposed revisions to these FFIEC reports will be addressed in one or more separate Federal Register notices.

## ***B. Regulatory Flexibility Act***

### ***FDIC***

The Regulatory Flexibility Act (RFA) generally requires an agency, in connection with a proposed rule, to prepare and make available for public comment an initial regulatory flexibility analysis that describes the impact of the proposed rule on small entities.<sup>188</sup> However, an initial regulatory flexibility analysis is not required if the agency certifies that the proposed rule will not, if promulgated, have a significant economic impact on a substantial number of small entities. The Small Business Administration (SBA) has defined “small entities” to include banking organizations with total assets of less than or equal to \$850 million.<sup>189</sup> For the reasons

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<sup>188</sup> 5 U.S.C. 601 *et seq.*

<sup>189</sup> The SBA defines a small banking organization as having \$850 million or less in assets, where an organization’s “assets are determined by averaging the assets reported on its four quarterly financial statements for the preceding

described below, the FDIC believes that the proposal, if adopted, will have a significant economic effect on a substantial number of FDIC-supervised insured depository institutions that meet the definition of a “small entity” under the RFA (small FDIC-supervised IDI). As such, the FDIC has prepared and is making available for public comment the following initial regulatory flexibility analysis. An initial regulatory flexibility analysis must contain (1) a description of the reasons why action by the agency is being considered; (2) a succinct statement of the objectives of, and legal basis for, the proposed rule; (3) a description of, and, where feasible, an estimate of the number of small entities to which the proposed rule will apply; (4) a description of the projected reporting, recordkeeping, and other compliance requirements of the proposed rule, including an estimate of the classes of small entities that will be subject to the requirement and the type of professional skills necessary for preparation of the report or record; (5) an identification, to the extent practicable, of all relevant Federal rules which may duplicate, overlap with, or conflict with the proposed rule; and (6) a description of any significant alternatives to the proposed rule which accomplish the stated objectives of applicable statutes and minimize any significant economic impact of the proposed rule on small entities.<sup>190</sup> A final regulatory flexibility analysis will be conducted after consideration of comments received during the public comment period.

#### *Reasons why action is being considered*

As noted in Section I. Introduction and overview, in connection with the expanded risk-based proposal, the agencies evaluated the appropriateness of the risk weights applicable to

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year.” See 13 CFR 121.201 (as amended by 87 FR 69118, effective December 19, 2022). In its determination, the “SBA counts the receipts, employees, or other measure of size of the concern whose size is at issue and all of its domestic and foreign affiliates.” See 13 CFR 121.103. Following these regulations, the FDIC uses an insured depository institution’s affiliated and acquired assets, averaged over the preceding four quarters, to determine whether the insured depository institution is “small” for the purposes of RFA.

<sup>190</sup> 5 U.S.C. 603(b)-(c).

exposures at the business-line level. Specifically, the evaluation suggested revisions would be appropriate to the risk weights applicable to residential mortgage exposures, corporate exposures, and certain exposures in the current standardized approach’s “other assets” category. In addition, the agencies considered comments received from the EGRPRA public notices.

*Statement of the objectives and legal basis for the proposal*

As previously noted, the proposed changes aim to improve risk sensitivity while generally retaining the simplicity of the current framework. For further discussion of the policy objectives of the proposal please refer to Section I. Introduction and overview.

The prompt corrective action framework in section 38 of the Federal Deposit Insurance Act (FDI Act) requires the agencies to set capital standards for insured depository institutions that include a risk-based capital requirement and provides that the agencies may establish any additional relevant capital measures to carry out the purpose of that section.<sup>191</sup> Various other statutory authorities provide the agencies with broad discretionary authority to set capital requirements and standards for banking organizations supervised by the agencies, including national banking associations, state-chartered banks, savings associations, and depository institution holding companies.<sup>192</sup> Further, Congress has authorized the agencies to establish

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<sup>191</sup> See 12 U.S.C. 1831o(c)(1)(A), (c)(1)(B)(i).

<sup>192</sup> See 12 U.S.C. 93a (national banking associations); 12 U.S.C. 248(i), 324, 327, 329 (state member banks); 12 U.S.C. 1463 (savings associations); 12 U.S.C. 1467a(g)(1) (savings and loan holding companies); 12 U.S.C. 1844(b) (bank holding companies); 12 U.S.C. 3106 (certain U.S. operations of foreign banking organizations); 12 U.S.C. 3902(1)-(2), 3907(a), 3909(a), (c)(1)-(2) (depository institutions; affiliates of depository institutions, including holding companies; and certain U.S. operations of foreign banking organizations); 12 U.S.C. 5371 (insured depository institutions, depository institution holding companies, and nonbank financial companies supervised by the Board).

enhanced risk-based capital requirements and standards for larger banking organizations subject to the capital rule.<sup>193</sup>

*Description of the proposal and an estimate of the number of small entities*

The proposal would reduce the risk weight applicable to corporate exposures from 100 percent to 95 percent and the risk weight applicable to all assets not specifically assigned a different risk weight under the rule from 100 percent to 90 percent. The proposal would also introduce a broader range of risk weights for residential mortgage exposures, based on more granular risk factors. In addition, the proposal would adopt the same definition of commitment as the expanded risk-based proposal and would align the credit conversion factors for certain off-balance sheet exposures, including equity commitments, with the expanded risk-based proposal. These changes focus on exposure categories that comprise a substantial amount of total risk-weighted assets for covered banking organizations and aim to balance a more risk-sensitive calibration of the requirements with retaining the simplicity of the standardized approach.<sup>194</sup> See Table V.G.1 in the Data Appendix (Section V.G.) for a breakdown of the size of the exposure categories whose treatment would be revised under this proposal.

To improve risk sensitivity, this proposal would also make targeted adjustments to the existing methodologies for determining exposure amounts for counterparty credit risk and risk-weighted asset amounts for securitizations, as well as for recognizing the benefits of credit risk

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<sup>193</sup> *See, e.g.*, section 165 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), as amended by section 401 of the Economic Growth, Regulatory Relief, and Consumer Protection Act, which requires the Board to establish enhanced prudential standards that include risk-based capital requirements for bank holding companies with \$250 billion or more in total consolidated assets.

<sup>194</sup> The calculation of the risk-weighted assets under the expanded risk-based approach is more complex and burdensome than under the standardized approach as it is more granular and includes several additional risk factors. The expanded risk-based approach would also include an operational risk capital requirement and the requirement to use the standardized approach for counterparty credit risk to determine the exposure amount for derivative contracts. Banking organizations subject to the expanded risk-based approach would also be subject to a more risk-sensitive but complex definition of capital, including the requirement to include most elements of accumulated other comprehensive income in regulatory capital.

mitigants. These targeted adjustments would align with adjustments included in the expanded risk-based proposal.

In addition to changes to the calculation of risk-weighted assets, the proposal would modify the definition of regulatory capital by removing the threshold-based deduction of mortgage servicing assets (MSAs). All MSAs would receive a 250 percent risk weight under the proposal, consistent with the risk weight in the current capital rule for MSAs that do not exceed the deduction threshold. This proposed revision would promote mortgage origination and servicing by banking organizations in a risk-appropriate manner and would apply to all banking organizations subject to the regulatory capital rule, including banking organizations subject to the community bank leverage ratio framework.

The proposal would require Category III and IV banking organizations to include most elements of AOCI in common equity tier 1 capital, consistent with the current treatment applicable to Category I and II banking organizations.<sup>195</sup> This change would better reflect the capital adequacy and loss-absorbing capacity of Category III and IV banking organizations in their regulatory capital ratios.

As of June 30, 2025, the FDIC supervises 2,802 depository institutions,<sup>196</sup> of which 2,085 would be considered small entities for the purposes of the RFA.<sup>197</sup>

### *Significant Impact Determination*

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<sup>195</sup> AOCI generally includes accumulated unrealized gains and losses on certain assets and liabilities that have not been included in net income yet are included in equity under U.S. generally accepted accounting principles (for example, unrealized gains and losses on securities designated as available-for-sale).

<sup>196</sup> The count of FDIC-supervised institutions excludes six insured, domestic branches of foreign banks. None would be considered small entities for the purposes of the RFA. Call Report data, June 30, 2025.

<sup>197</sup> Call Report data, June 30, 2025.

To determine if the proposal, if adopted, will have a significant economic effect on a substantial number of small FDIC-supervised IDIs, the analysis focuses on the small FDIC-supervised IDIs that would be subject to the changes to risk-weighted assets under this proposal. As of June 30, 2025, 1,082 small FDIC-supervised IDIs report risk-weighted assets (small FDIC-supervised IDIs that report RWAs).<sup>198</sup> These institutions would have the choice to calculate risk weighted assets based on this proposal or the expanded risk-based proposal. For purposes of this analysis, the FDIC assumed these entities would select the revised standardized approach to calculate their risk-weighted assets. These institutions represent over 51 percent of all small FDIC-supervised IDIs, and they hold over 58 percent of total assets of small FDIC-supervised IDIs.<sup>199</sup>

As discussed in Section V. Estimated impact on capital requirements, the agencies estimate that this proposal, if adopted, would decrease risk-weighted assets and corresponding common equity tier 1 capital requirements for covered depository institutions by approximately \$745 billion and \$52 billion (or 8.6 percent for both), respectively, relative to a baseline in which the current regulations remain unchanged.<sup>200</sup> For small FDIC-supervised IDIs that report RWAs, the FDIC estimates that the proposal would decrease aggregate risk-weighted assets and common equity tier 1 capital requirements by \$19 billion and \$1.3 billion (or 7.8 percent for both), respectively, relative to the baseline.<sup>201</sup> By reducing required capital, the proposal would increase

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<sup>198</sup> Call Report data, June 30, 2025. As of June 30, 2025, 1,003 small, FDIC-supervised IDIs currently elect to use the CBLR framework.

<sup>199</sup> Call Report data, June 30, 2025.

<sup>200</sup> See Section V. Estimated impact on capital requirements, for a discussion of the baseline, data, and the estimation methodology.

<sup>201</sup> Using the data and methodology discussed in Section V. Estimated impact on capital requirements, the FDIC estimates that three small, FDIC-supervised IDIs that report RWAs would experience a slight increase in capital requirements under the proposal.

the size of management buffers.<sup>202</sup> Across the 1,082 small FDIC-supervised IDIs that report RWAs as of June 30, 2025, the proposal would increase the common equity tier 1 management buffer by an average of \$1.2 million, ranging from \$1,600 to \$7.1 million, relative to the baseline.

As noted in Section VI.B. Effects on lending, covered banking organizations, including small FDIC-supervised IDIs, may respond to the proposal in different ways. Many small FDIC-supervised IDIs would likely reduce the additional management buffer under the proposal by expanding their holdings of earning assets. If under the proposal, every small FDIC-supervised IDI that reports RWAs expanded its earning assets to achieve a management buffer equal to its buffer as of June 30, 2025, the result would be an increase in aggregate earning assets of approximately \$31 billion for such institutions and a corresponding increase in aggregate interest income of \$1.1 billion.<sup>203</sup> At the individual institution level, the resulting increase in net interest income would exceed 2.5 percent of total annualized net interest income, as of June 30, 2025, for over 98 percent of small FDIC-supervised IDIs that report RWAs, and exceed 5 percent for over 87 percent of these IDIs.

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<sup>202</sup> IDIs generally maintain capital levels above regulatory capital requirements, including any applicable buffer requirements. The excess above such requirements is called “management buffers.” See VI.B. Effects on lending for a more detailed discussion.

<sup>203</sup> For each small, FDIC-supervised IDI that reports RWAs, the FDIC first estimates the decrease in RWA under the proposal. Second, assuming an increase in balance sheet capacity equal to this decrease in RWA, the FDIC estimates the increase in earning assets for the institution, where earnings assets equals the increase in balance sheet capacity divided by the average risk weight under the proposal. Average risk weight under the proposal is obtained by dividing the total RWA under the proposal by the institution’s assets as of June 30, 2025. Finally, multiplying the increase in earning assets by the institution’s reported annualized net interest margin yields the additional net interest income generated under the proposal.

For example, consider a hypothetical \$500 million small institution with existing RWA of \$350 million, RWA under the proposal of \$325 million, and a net interest margin of 3 percent. It experiences a decrease of \$25 million in RWA under the proposal and its average risk weight under the proposal is 65 percent ( $\$325 \text{ million} / \$500 \text{ million}$ ). Under the proposal, it could generate earning assets of \$38 million, or \$25 million divided by 65 percent. At a hypothetical annualized net interest margin of 3 percent, the \$38 million in additional earning assets would generate \$1.14 million in additional net interest income.

The FDIC recognizes that not all small FDIC-supervised IDIs would deplete all of their additional management buffer under the proposal to accumulate earning assets. Thus, the estimate presented above may overestimate the significance of the impact of the proposal on small FDIC-supervised IDIs that report RWAs. As a sensitivity analysis, the FDIC estimates that even if the small FDIC-supervised IDIs that report RWAs use only a third of their additional management buffer to accumulate earning assets, the resulting increase in net interest income would exceed 2.5 percent of total annualized net interest income, as of June 30, 2025, for over 60 percent of these IDIs, and exceed 5 percent for over 10 percent of these IDIs. Given the size of these potential effects, the FDIC believes the impact of the proposal would likely be significant for a substantial number of small entities.

#### *Economic Impact*

As noted above, the proposal would expand by approximately \$31 billion the aggregate balance sheet capacity of small FDIC-supervised IDIs that report RWAs. The proposal could have other potential economic effects on small FDIC-supervised IDIs, as summarized here and discussed in detail in Section VI. Economic analysis.<sup>204</sup> The proposal would better align capital requirements with the underlying risk of exposures and increase allocative efficiencies. The proposal would decrease risk weights for certain asset classes, which would reduce funding costs for these assets and enhance the competitiveness of small FDIC-supervised IDIs in applicable markets.

As noted in the analysis, small FDIC-supervised IDIs would likely respond differently based on their business models and market positions – potentially adjusting asset portfolios,

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<sup>204</sup> See Section VI.G. Interactions with CBLR proposal for a discussion of the economic impact on the 1,003 small, FDIC-supervised IDIs that currently elect to use the CBLR framework.

modifying management capital buffers, or adopting alternative regulatory capital regimes; this heterogeneity in responses lends uncertainty to the FDIC's analysis. Nevertheless, the FDIC estimates that the proposal is likely to lead to increased lending activities in several asset classes. Greater market participation by small FDIC-supervised IDIs would directly benefit consumers through lower borrowing costs and improved credit access. The projected increase in lending would support economic growth by facilitating capital formation, business expansion, and household wealth-building through homeownership and other forms of credit access.

Costs of the proposal would include a marginal increase in the risk of loss associated with financial instability or failure. The FDIC believes the costs associated with this risk would be low, given that small FDIC-supervised IDIs would continue to be subject to robust supervisory and regulatory standards and leverage requirements and that the estimated common equity tier 1 capital ratio for small FDIC-supervised IDIs that report RWAs under the proposal falls within the range of optimal values discussed in the literature.<sup>205</sup> There may also be transition costs for small FDIC-supervised covered IDIs.

#### *Reporting, recordkeeping, and other compliance requirements of the proposal*

As described in section IX.A., the proposal contains revisions to FDIC's current information collections subject to the Paperwork Reduction Act of 1995 (PRA).<sup>206</sup> To implement these requirements, the FDIC would revise and extend for three years the Reporting, Recordkeeping, and Disclosure Requirements Associated with Regulatory Capital Rules (OMB No. 3064-0153). The FDIC, under the auspices of the FFIEC, would also propose related

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<sup>205</sup> As of June 30, 2025, the 1,082 small, FDIC-supervised IDIs that report RWAs examined in this analysis hold \$37 billion in common equity tier 1 against an estimated \$225 billion in RWA under the proposal, resulting in a common equity tier 1 ratio of approximately 17 percent. See Section VI.E Effects on safety and soundness for additional discussion.

<sup>206</sup> 44 U.S.C. 3501 *et. seq.*

revisions to all versions of the Call Reports (OMB No. 3064-0052). All small FDIC-supervised IDIs that report RWAs would be subject to the revisions. The proposed revisions to these information collections will be addressed in a separate Federal Register notice.

#### *Alternatives Considered*

As discussed in Section VI.A, the agencies compare the proposal to three reasonable alternatives for revising risk-weighted asset standards.

Alternative 1 would require all banking organizations that are subject to risk-based capital requirements to adopt the expanded risk-based approach, as would be required for Category I and II banking organizations under the expanded risk-based proposal. This alternative would implement a more risk-sensitive capital framework for all affected banking organizations but would also require more operational complexity for smaller banking organizations. Under this alternative, some smaller banking organizations (those with assets under \$10 billion and satisfying the other requirements of the CBLR framework) could choose to avoid the additional operational complexity by adopting the CBLR framework.

In aggregate, the expanded risk-based approach would require covered banking organizations to hold less capital than estimated under the standardized approach, as modified by proposal. Assuming no change in which banking organizations opt into the CBLR framework, under Alternative 1, covered depository institutions' risk-weighted assets would decrease by an estimated 11.6 percent relative to current requirements, compared to the estimated 8.6 percent decrease under the proposal. This reduction in risk-weighted assets would result in a more substantial decrease in regulatory capital requirements for covered depository institutions relative to current requirements under Alternative 1 than under the proposal. However, under this

alternative, the compliance burdens associated with the regulatory capital framework for these banking organizations would increase significantly.

Alternative 2 would require the adoption of the expanded risk-based approach only for Category III and IV banking organizations while applying the proposal for all other covered banking organizations. Category III and IV banking organizations are the largest and most complex banking organizations not covered by the expanded risk-based proposal. Therefore, these organizations are most likely to be able to absorb the additional costs of operational complexity for the benefit of the enhanced risk sensitivity of the expanded risk-based approach.

Under Alternative 2, aggregate risk-weighted assets for depository institution subsidiaries of Category III and IV holding companies would decrease by an estimated 9.4 percent, relative to the baseline, slightly more than the estimated 9.1 percent decrease under the proposal.<sup>207</sup> As a result of this similar change in risk-weighted assets, aggregate required capital for depository institutions subsidiaries of Category III and IV holding companies would decrease by a similar amount under Alternative 2 as under the proposal, compared to the baseline.

Alternative 3 would replace the LTV-based risk-weight tables for residential real estate in the proposal with simplified flat risk weights: 35% for residential mortgage exposures not dependent on the cash flows of the real estate and 45% for residential mortgage exposures that are dependent on the cash flows of the real estate. While the proposal modestly increases operational complexity relative to the baseline, this alternative would maintain the simplicity of the current standardized approach for residential mortgage exposures. However, this alternative

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<sup>207</sup> The small difference is due to the close calibration of the proposed standardized approach to the expanded risk-based approach.

lacks the enhanced risk sensitivity that the proposal's LTV-based lookup tables would provide for mortgage exposures.

The agencies assessed that the provisions of the proposal best balance the competing goals of risk alignment and simplicity, while also promoting robust capital levels. Alternative 1 would impose unnecessary operational complexity on smaller banking organizations, including those ineligible for the CBLR framework. Alternative 2 offers minimal advantages over the current proposal, as Category III and IV banking organizations can already elect to use the expanded risk-based proposal when they judge that the adoption is beneficial. Rather than mandating a specific size threshold for this approach, the proposal appropriately allows banking organizations to make this determination based on their own internal analysis. Alternative 3, while simpler, would generate only modest operational cost savings. Loan-to-value calculations can be automated using existing loan information and smaller banking organizations concerned about compliance costs retain the option to adopt the CBLR framework. Based on these considerations, the agencies assess that the current proposal is the best approach among all these reasonable alternative considerations to most effectively enhance risk sensitivity while limiting additional operational burden and maintaining robust capital standards.

#### *Other Statutes and Federal Rules*

The FDIC has not identified any likely duplication, overlap, and/or potential conflict between this proposal and any other federal rule.

The FDIC invites comments on all aspects of the supporting information provided in this RFA section. In particular, would the proposal have any significant effects on small entities that the FDIC has not identified?

#### ***Board***

The Board is providing an initial regulatory flexibility analysis with respect to this proposed rule. The Regulatory Flexibility Act<sup>208</sup> (RFA) requires an agency to consider whether the rules it proposes will have a significant economic impact on a substantial number of small entities.<sup>209</sup> In connection with a proposed rule, the RFA requires an agency to prepare and invite public comment on an initial regulatory flexibility analysis describing the impact of the rule on small entities, unless the agency certifies that the proposed rule, if promulgated, would not have a significant economic impact on a substantial number of small entities. An initial regulatory flexibility analysis must contain: (1) a description of the reasons why action by the agency is being considered; (2) a succinct statement of the objectives of, and legal basis for, the proposed rule; (3) a description of, and, where feasible, an estimate of the number of small entities to which the proposed rule will apply; (4) a description of the projected reporting, recordkeeping, and other compliance requirements of the proposed rule, including an estimate of the classes of small entities that will be subject to the requirement and the type of professional skills necessary for preparation of the report or record; (5) an identification, to the extent practicable, of all relevant Federal rules which may duplicate, overlap with, or conflict with the proposed rule; and (6) a description of any significant alternatives to the proposed rule which accomplish its stated objectives and minimize any significant economic impact of the proposed rule on small entities.<sup>210</sup>

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<sup>208</sup> 5 U.S.C. 601 *et seq.*

<sup>209</sup> Under regulations issued by the U.S. Small Business Administration (SBA), a small entity includes a depository institution, bank holding company, or savings and loan holding company with total assets of \$850 million or less. *See* 13 CFR 121.201. Consistent with the SBA's General Principles of Affiliation, the Board includes the assets of all domestic and foreign affiliates toward the applicable size threshold when determining whether to classify a particular entity as a small entity. *See* 13 CFR 121.103.

<sup>210</sup> 5 U.S.C. 603(b)-(c).

The Board has considered the potential impact of the proposed rule on small entities in accordance with the RFA. The Board is publishing and inviting comment on this initial regulatory flexibility analysis.

As discussed in detail above, the proposed rule would revise the risk-based capital treatment of certain exposure categories under the standardized approach, including the risk weights for traditional lending activities to improve their calibration and risk sensitivity. The proposal would also modify the definition of regulatory capital by removing the threshold-based deduction for mortgage servicing assets for all banking organizations subject to the regulatory capital rule, including banking organizations subject to the community bank leverage ratio framework. In addition, the proposal would require Category III and IV banking organizations to recognize most elements of accumulated other comprehensive income in their regulatory capital. The proposed changes aim to better reflect the risks of these banking organizations' exposures while generally retaining the simplicity of the current framework.

As noted above, the prompt corrective action framework in section 38 of the FDI Act requires the agencies to prescribe capital standards for insured depository institutions that include a risk-based capital requirement and provides that the agencies may establish any additional relevant capital measures to carry out the purpose of that section.<sup>211</sup> Various statutory authorities provide the agencies with broad discretionary authority to set capital requirements and standards for banking organizations supervised by the agencies, including national banking associations,

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<sup>211</sup> See 12 U.S.C. 1831o(c)(1)(A), (c)(1)(B)(i).

state-chartered banks, savings associations, and depository institution holding companies.<sup>212</sup>

Elements of the proposal would also be responsive to comments received from the EGRPRA public notices.<sup>213</sup> Further, Congress has also authorized the agencies to establish risk-based capital requirements and standards for larger banking organizations subject to the capital rule and this proposal.<sup>214</sup>

As of the second quarter of 2025, there were approximately 2,796 small bank holding companies and approximately 157 small savings and loan holding companies, and approximately 443 small state member banks. The proposed rule would apply to all small entities supervised by the Board; however, small entities that are bank holding companies or savings and loan holding companies are generally subject to the Small Bank Holding Company and Savings and Loan Holding Company Policy Statement and would not be impacted by the proposed rule.<sup>215</sup>

While the proposal slightly increases the reporting complexity of the risk-based framework for small entities that have not elected to use the CBLR framework,<sup>216</sup> the proposal

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<sup>212</sup> See 12 U.S.C. 93a (national banking associations); 12 U.S.C. 248(i), 324, 327, 329 (state member banks); 12 U.S.C. 1463 (savings associations); 12 U.S.C. 1467a(g)(1) (savings and loan holding companies); 12 U.S.C. 1844(b) (bank holding companies); 12 U.S.C. 3106 (certain U.S. operations of foreign banking organizations); 12 U.S.C. 3902(1)-(2), 3907(a), 3909(a), (c)(1)-(2) (depository institutions; affiliates of depository institutions, including holding companies; and certain U.S. operations of foreign banking organizations); 12 U.S.C. 5371 (insured depository institutions, depository institution holding companies, and nonbank financial companies supervised by the Board).

<sup>213</sup> The agencies, together with the Federal Financial Institutions Examination Council, commenced a review under the Economic Growth and Regulatory Paperwork Reduction Act of 1996 in 2024 to identify outdated or otherwise unnecessary regulatory requirements. The agencies will continue reviewing and considering these comments as part of any final rulemaking. Public Law 104-208, Div. A, Title II, section 2222, 110 Stat. 3009-414, (1996) (codified at 12 U.S.C. 3311). See also Regulatory Publication and Review Under the Economic Growth and Regulatory Paperwork Reduction Act of 1996, 90 Fed. Reg. 35,241 (Jul. 25, 2025).

<sup>214</sup> See, e.g., section 165 of the Dodd-Frank Act, as amended by section 401 of the Economic Growth, Regulatory Relief, and Consumer Protection Act, which requires the Board to establish enhanced prudential standards that include risk-based capital requirements for bank holding companies with \$250 billion or more in total consolidated assets.

<sup>215</sup> See 12 CFR part 225 appendix C.

<sup>216</sup> As a result of the proposal, small entities that have not elected to use the CBLR framework would need to establish or revise internal recordkeeping systems, policies and procedures to track compliance with the amended

would also generally reduce capital requirements for small entities under the risk-based framework. As described in sections V. and VI. of this **SUPPLEMENTARY INFORMATION**, the improvements in risk sensitivity of capital requirements expected to result from the proposal and associated benefits justify the proposal's expected costs. For small entities, the proposal would provide meaningfully improved risk sensitivity to a large portion of covered banking organizations' exposures from a total risk-weighted assets perspective, while allowing them to avoid the regulatory burden of implementing the expanded risk-based approach set forth in the expanded risk-based proposal. In particular, small entities would not be required to manage potential volatility that may rise from the recognition of AOCI in regulatory capital. They also would avoid mandatory application of SA-CCR and a separate calculation of an operational risk capital requirement. Further, the proposal would amend certain dollar-based regulatory thresholds in the standardized approach to reflect inflation and ensure that such thresholds preserve their intended application in real terms over time.

The Board is aware of no other federal rules that duplicate, overlap, or conflict with the proposal. Although the Board considered several alternatives, as discussed in more detail in section VI.A. of this **SUPPLEMENTARY INFORMATION**, the proposal is the best alternative for improving risk sensitivity while limiting additional operational costs and maintaining robust capital standards, particularly for small entities. Accordingly, the Board believes that there are no significant alternatives to the proposal that would accomplish the stated objectives and minimize the economic impact of the proposal on small entities.

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supervisory capital requirements. For instance, such small entities would now have to separately identify and delineate certain residential mortgages by their cash flow dependencies and their LTVs. Small entities that elect to use the CBLR would not need to implement these changes.

The Board welcomes comment on all aspects of its analysis. In particular, the Board requests that commenters describe the nature of any impact on small entities and provide empirical data to illustrate and support the extent of the impact.

### ***OCC***

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

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

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

As discussed in the Supplementary Information section above, the agencies are proposing to revise their capital requirements to help ensure standards are appropriately calibrated and that the framework is functioning as intended. The primary objective of the proposal is to improve the risk sensitivity of the regulatory capital framework for covered banks. Risk-sensitive capital requirements help align regulatory capital with the underlying risk profile of bank exposures. The proposal also aims to promote appropriately calibrated capital levels, which can enhance the efficiency of capital by limiting systemic risk without unduly constraining routine bank

activities. Together, these features reduce the opportunities for regulatory arbitrage and support prudent risk taking, thereby improving the resilience of individual institutions and the stability of the financial system.

*B. Small Entities Affected by the Proposal*

As of December 31, 2024, the OCC supervised approximately 609 small entities, of which 359 will be impacted by the proposal's changes to risk-based capital requirements.<sup>217</sup> Thus, a substantial number of small entities will be impacted by the proposed rule.

*C. Projected Reporting, Recordkeeping, and Other Compliance Requirements*

This NPR includes changes to the risk-based capital requirements that address the definition of capital and the calculation of risk-weighted assets and affect small banking organizations.

The proposed rules in this NPR that would affect small banking organizations include:

1. Changing the denominator of the risk-based capital ratios by revising the asset and exposure risk weights;
2. Revising the treatment of counterparty credit risk; and
3. Revising the numerator of the risk-based capital ratios by, among other changes, removing the deduction from regulatory capital for concentrations of mortgage servicing assets that exceed 25 percent of common equity tier 1 capital.

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<sup>217</sup> The OCC bases its estimate of the number of small entities on the Small Business Administration's size thresholds for commercial banks and savings institutions NAICS Code: 522110), and trust companies (NAICS Code: 523991), which are \$850 million and \$47 million, respectively. Consistent with the General Principles of Affiliation 13 CFR 121.103(a), the OCC counts the assets of affiliated financial institutions when determining whether to classify an OCC-supervised institution as a small entity. The OCC uses December 31, 2024, to determine size because a "financial institution's assets are determined by averaging the assets reported on its four quarterly financial statements for the preceding year." See footnote 8 of the U.S. Small Business Administration's *Table of Size Requirements*.

These changes are designed to enhance the risk-sensitivity of the calculation of risk-weighted assets. Therefore, capital requirements may go down for some assets and up for others. To comply with the proposed rules in this NPR, covered small banking organizations would be required to change their internal reporting processes. These changes would require some additional personnel training and expenses related to new systems (or modification of existing systems) for calculating regulatory capital ratios. Additionally, covered small banking organizations that hold certain exposures would be required to obtain additional information under the proposed rules in order to determine the applicable risk weights.

To estimate the compliance costs of the proposal, the OCC review the new mandates that affect OCC-supervised banks. OCC staff then considered costs that may arise from compliance with these mandates. The OCC's cost estimate includes an estimate of the time required to implement the mandates and the estimated average hourly wage of the bank employees who might be responsible for tasks associated with achieving this compliance. In the cost estimate, OCC staff used a compensation rate of \$131 per hour.<sup>218</sup>

In determining the total hours needed per bank for one-time implementation costs to ensure compliance with the proposal, OCC staff considered the total hours needed per bank, on average, for systems development, data acquisition, data aggregation and reporting, calculation and verification, training, and risk management. As part of this determination, OCC staff also

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<sup>218</sup> To estimate wages the OCC reviewed May 2024 data for wages (by industry and occupation) from the U.S. Bureau of Labor Statistics (BLS) for credit intermediation and related activities (NAICS 5220A1). To estimate compensation costs associated with the rule, the OCC uses \$131.10 per hour, which is based on the average of the 90th percentile for six occupations adjusted for inflation (3.6 percent as of Q1 2025), plus an additional 35.6 percent for benefits (based on the percent of total compensation allocated to benefits as of Q4 2024 for NAICS 522: credit intermediation and related activities).

considered the scope of applicability of the rule’s key provisions and bank size category.<sup>219</sup>

Based on internal discussions with OCC subject matter experts, OCC staff estimated the total hours needed for one-time implementation efforts per bank.<sup>220</sup> OCC staff then multiply the anticipated total hours by the hourly compensation rate of \$131. The results are summarized below.

### Implementation Cost per Bank and in Aggregate

Category	Count	Total Hours per Bank	Hourly Wage	Cost per Bank	Aggregate Cost per Category
Category III and IV banks subject to risk-based capital requirements	25	5,838	131	\$764,778	\$19,119,450
Non-Category I to IV banks subject to risk-based capital requirements	622	4,192	131	\$549,152	\$341,572,544
Banks electing to use the CBLR framework	308	0	131	\$0	\$0
<b>Total</b>	<b>955</b>				<b>\$ 360,691,994</b>

Aggregating the per bank compliance costs for all 955 affected OCC-supervised banks results in an aggregate one-time implementation cost estimate of approximately \$361 million.

<sup>219</sup> Assuming an average total hour estimate for all banks in a given size category is a simplifying assumption. OCC staff recognize in practice that even across banks within the same category, there would be heterogeneity of time needed to ensure compliance based on size, complexity, balance sheet composition, and market risk approach selected by the bank. OCC staff will look to comment letters for further insight into these costs for the final rule stage.

<sup>220</sup> These compliance cost estimates are subject to considerable uncertainty. They should be interpreted as approximate, order-of-magnitude estimates rather than precise measures of the actual costs individual banks will incur.

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

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

*E. Discussion of Significant Alternatives to the Proposed Rule*

The agencies have sought to incorporate flexibility into the proposed rule and lessen burden and complexity for smaller banking organizations wherever possible, consistent with safety and soundness and applicable law. The agencies are requesting comment on potential options for simplifying the rule and reducing burden.

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

***C. Plain language***

Section 722 of the Gramm-Leach Bliley Act<sup>221</sup> requires the Federal banking agencies to use plain language in all proposed and final rules published after January 1, 2000. The agencies have sought to present the proposed rule in a simple and straightforward manner and invite comments on the use of plain language and whether any part of the proposed rule could be more clearly stated. For example:

- Have the agencies presented the material in an organized manner that meets your needs?

If not, how could this material be better organized?

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<sup>221</sup> Pub. L. 106-102, section 722, 113 Stat. 1338, 1471 (1999).

- Are the requirements in the notice of proposed rulemaking clearly stated? If not, how could the proposed rule be more clearly stated?
- Does the proposed rule contain language that is not clear? If so, which language requires clarification?
- Would a different format (grouping and order of sections, use of headings, paragraphing) make the proposed rule easier to understand? If so, what changes to the format would make the proposed rule easier to understand?
- What else could the agencies do to make the proposed rule easier to understand?

***D. Riegle Community Development and Regulatory Improvement Act of 1994***

Pursuant to section 302(a) of the Riegle Community Development and Regulatory Improvement Act (RCDRIA),<sup>222</sup> in determining the effective date and administrative compliance requirements for new regulations that impose additional reporting, disclosure, or other requirements on insured depository institutions, each Federal banking agency must consider, consistent with principles of safety and soundness and the public interest, any administrative burdens that such regulations would place on depository institutions, including small depository institutions, and customers of depository institutions, as well as the benefits of such regulations. In addition, section 302(b) of RCDRIA requires new regulations and amendments to regulations that impose additional reporting, disclosures, or other new requirements on insured depository institutions generally to take effect on the first day of a calendar quarter that begins on or after the date on which the regulations are published in final form, with certain exceptions, including for good cause.<sup>223</sup>

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<sup>222</sup> 12 U.S.C. 4802(a).

<sup>223</sup> 12 U.S.C. 4802.

The agencies note that comment on these matters has been solicited in other sections of this **SUPPLEMENTARY INFORMATION** section, and that the requirements of RCDRIA will be considered as part of the overall rulemaking process. In addition, the agencies also invite any other comments that further will inform the agencies' consideration of RCDRIA.

***E. OCC Unfunded Mandates Reform Act of 1995 determination***

The OCC has analyzed the proposed rule under the factors in the Unfunded Mandates Reform Act of 1995 (UMRA) (2 U.S.C. 1532). Under this analysis, the OCC considered whether the proposed rule includes a Federal mandate that may result in the expenditure by State, local, and tribal governments, in the aggregate, or by the private sector, of \$100 million or more in any one year (adjusted annually for inflation).

The OCC has determined this proposed rule is likely to result in the expenditure by the private sector of \$100 million or more in any one year (adjusted annually for inflation). The OCC has prepared an impact analysis and identified and considered alternative approaches. When the supplemental proposal is published in the **Federal Register**, the full text of the OCC's analysis will be available at: <http://www.regulations.gov>.

***F. Providing Accountability Through Transparency Act of 2023***

The Providing Accountability Through Transparency Act of 2023 (5 U.S.C. 553(b)(4)) requires that a notice of proposed rulemaking include the internet address of a summary of not more than 100 words in length of the proposed rule, in plain language, that shall be posted on the internet website under section 206(d) of the E-Government Act of 2002 (44 U.S.C. 3501 note).

In summary, the bank regulatory agencies request comment on a proposal to revise the U.S. standardized approach to better align certain capital requirements with the risk of firms' exposures, and ensure that all large banking organizations are required to account for

accumulated other comprehensive income (AOCI) in their regulatory capital to better reflect their loss-absorbing capacity.

The proposal and such a summary can be found at <https://www.regulations.gov>, <https://www.federalreserve.gov/supervisionreg/reglisting.htm>, <https://www.fdic.gov/federal-register-publications>, and <https://occ.gov/topics/laws-and-regulations/occ-regulations/proposed-issuances/index-proposed-issuances.html>.

### ***G. Executive Orders 128866, 13563, and 14192***

Executive Order 12866 (Regulatory Planning and Review)<sup>224</sup> and Executive Order 13563 (Improving Regulation and Regulatory Review)<sup>225</sup> direct agencies to assess the costs and benefits of available regulatory alternatives and, if regulation is necessary, to select regulatory approaches that maximize net benefits. This proposed rule was drafted and reviewed in accordance with Executive Order 12866 and Executive Order 13563. Within OMB, the Office of Information and Regulatory Affairs (OIRA) has determined that this rulemaking is an economically significant regulatory action under Section of 3(f)(1) of Executive 12866. Accordingly, the draft rule was submitted to OIRA for review. As noted in other sections of the **SUPPLEMENTARY INFORMATION** of this document, the agencies have assessed the costs and benefits of this rulemaking and have made a reasoned determination that the benefits of this rulemaking justify its costs. The proposal, if finalized as proposed, is not expected to be an Executive Order 14192 regulatory action.

## **DEPARTMENT OF THE TREASURY**

### **Office of the Comptroller of the Currency**

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<sup>224</sup> E.O. 12866, 58 FR 51735 (Oct 4, 1993).

<sup>225</sup> E.O. 13563, 76 FR 3821 (Jan. 21, 2011).

## 12 CFR Chapter I

For the reasons set forth in the common preamble, the OCC proposes to amend part 3 of chapter I of title 12 of the Code of Federal Regulations as follows:

### PART 3—CAPITAL ADEQUACY STANDARDS

#### 1. The authority citation for part 3 continues to read as follows:

Authority: 12 U.S.C. 93a, 161, 1462, 1462a, 1463, 1464, 1818, 1828(n), 1828 note, 1831n note, 1835, 3907, 3909, 5412(b)(2)(B), and Pub. L. 116–136, 134 Stat. 281.

#### 2. In § 3.1:

- a. Revise paragraphs (c)(4)(i), (e) and (f); and
- b. Add paragraph (g).

The addition and revision read as follows:

#### § 3.1 Purpose, applicability, reservations of authority, and timing.

\* \* \* \* \*

(c) \* \* \*

(4) \* \* \*

(i) Except for an advanced approaches national bank or Federal savings association that is making public disclosures pursuant to the requirements in subpart E of this part, each national bank or Federal savings association with total consolidated assets of \$50 billion or more, as adjusted pursuant to § 3.4, must make the public disclosures described in subpart D of this part.

\* \* \* \* \*

(e) *Notice and response procedures.* In making a determination under this part, unless more specifically provided for, the OCC will apply notice and response procedures in the same manner and to the same extent as the notice and response procedures in 12 CFR 4.404.

(f) *Timing.* A national bank or Federal savings association that changes from one category of national bank or Federal savings association to another of such categories, or that changes from having no category to having a such category, must comply with the requirements of its category in this part, including applicable transition provisions of the requirements in this part, no later than on the first day of the second quarter following the change in the national bank's or Federal savings association's category.

\* \* \* \* \*

(g) *Severability.* If any provision of this part, or the application thereof to any national bank or Federal savings association, is held invalid, such invalidity shall not affect the validity of other provisions or the application of such provision to other national banks or Federal savings associations that can be given effect without the invalid provision or application.

\* \* \* \* \*

3. In § 3.2:

- a. Revise the definition of “Adjusted allowances for credit losses (AACL)”;
- b. Remove the definition of “Allowances for loan and lease losses (ALLL)”;
- c. Revise the definition of “Carrying value”;

- d. Revise the definition for “Category III national bank or Federal savings association”;
- e. Add, in alphabetical order, the definition for “Category IV national bank or Federal savings association”;
- f. Revise the definition for “Commitment”;
- g. Add, in alphabetical order, the definition for “Dependent on the cash flows generated by the real estate”;
- h. Revise the definitions for “Effective notional amount”, “Eligible clean-up call”, and “Eligible guarantee”;
- i. Add, in alphabetical order, the definition for “Eligible prepaid credit protection arrangement”;
- j. Revise paragraph (4)(i)(A) in the definition of “Financial institution”;
- k. Revise the definition for “Netting set”;
- l. Add, in alphabetical order, the definitions for “Non-performing loan securitization (NPL securitization)”, “Nonrefundable purchase price discount (NRPPD)”, and “Prepaid credit protection arrangement”;
- m. Revise the definition for “Protection amount (P)”;
- n. Add, in alphabetical order, the definition for “Qualifying Cross Product Master Netting Agreement”;
- o. Revise paragraphs (3) and (4) of the definition for “Qualifying master netting agreement”;
- p. Revise paragraph (1)(ii) of the definition for “Residential mortgage exposure”;

- q. Remove the definition for “Securitization special purpose entity (SPE)”;
- r. Add, in alphabetical order, the definitions for “Senior securitization exposure” and “Specified supranational entity”;
- s. Revise the definition for “Speculative grade”;
- t. Add, in alphabetical order, the definition for “Synthetic excess spread”;
- u. In the definition of “Standardized total risk-weighted assets”, remove the words “§ 3.42” and add, in their place, the words “§ 3.43”;
- v. Revise the definitions for “Sub-speculative grade”, “Synthetic securitization”, and “Traditional securitization”.

The additions and revisions read as follows:

*Adjusted allowances for credit losses (AACL)* means valuation allowances that have been established through a charge against earnings or retained earnings for expected credit losses on financial assets measured at amortized cost and a lessor’s net investment in leases that have been established to reduce the amortized cost basis of the assets to amounts expected to be collected as determined in accordance with GAAP. For purposes of this part, adjusted allowances for credit losses include allowances for expected credit losses on off-balance sheet credit exposures not accounted for as insurance as determined in accordance with GAAP. Adjusted allowances for credit losses exclude allocated transfer risk reserves and allowances created that reflect credit losses on purchased credit deteriorated assets, purchased seasoned loans, assets required to record an allowance for credit losses through a gross-up adjustment to the purchase price of the asset, and available-for-sale debt securities.

\* \* \* \* \*

*Carrying value* means, with respect to an asset, the value of the asset on the balance sheet of the national bank or Federal savings association as determined in accordance with GAAP. For all assets other than available-for-sale debt securities, purchased credit deteriorated assets, purchased seasoned loans, or assets required to record an allowance for credit losses through a gross-up adjustment to the purchase price of the asset, the carrying value is not reduced by any associated credit loss allowance that is determined in accordance with GAAP.

\* \* \* \* \*

*Category III national bank or Federal savings association* means a national bank or Federal savings association that is not a Category I national bank or Federal savings association, or a Category II national bank or Federal savings association, and that:

(1) Is a subsidiary of a Category III banking organization, as defined pursuant to 12 CFR 252.5 or 12 CFR 238.10, as applicable; or

(2) (i) Has total consolidated assets, calculated based on the average of the national bank's or Federal savings association's total consolidated assets for the four most recent calendar quarters as reported on the Call Report, equal to \$250 billion or more. If the national bank or Federal savings association has not filed the Call Report for each of the four most recent calendar quarters, total consolidated assets is calculated based on its total consolidated assets, as reported on the Call Report, for the most recent quarter or average of the most recent quarters, as applicable; or

(ii) (A) Has total consolidated assets, calculated based on the average of the national bank's or Federal savings association's total consolidated assets for the four most recent calendar

quarters as reported on the Call Report, of \$100 billion or more but less than \$250 billion. If the depository institution has not filed the Call Report for each of the four most recent calendar quarters, total consolidated assets is calculated based on its total consolidated assets, as reported on the Call Report, for the most recent quarter or average of the most recent quarters, as applicable; and

(B) Has at least one of the following in paragraphs (2)(ii)(B)(1) through (3) of this definition, each calculated as the average of the four most recent calendar quarters, or if the national bank or Federal savings association has not filed each applicable reporting form for each of the four most recent calendar quarters, for the most recent quarter or quarters, as applicable:

(1) Total nonbank assets, calculated in accordance with the instructions to the FR Y-9LP or equivalent reporting form, equal to \$75 billion or more;

(2) Off-balance sheet exposure equal to \$75 billion or more. Off-balance sheet exposure is a national bank's or Federal savings association's total exposure, calculated in accordance with the instructions to the FR Y-15 or equivalent reporting form, minus the total consolidated assets of the national bank or Federal savings association, as reported on the Call Report; or

(3) Weighted short-term wholesale funding, calculated in accordance with the instructions to the FR Y-15 or equivalent reporting form, equal to \$75 billion or more.

(iii) After meeting the criteria in paragraph (2)(ii) of this definition, a national bank or Federal savings association continues to be a Category III national bank or Federal savings association until the national bank or Federal savings association:

(A) Has:

(1) Less than \$250 billion in total consolidated assets, as reported on the Call Report, for each of the four most recent calendar quarters;

(2) Less than \$75 billion in total nonbank assets, calculated in accordance with the instructions to the FR Y-9LP or equivalent reporting form, for each of the four most recent calendar quarters;

(3) Less than \$75 billion in weighted short-term wholesale funding, calculated in accordance with the instructions to the FR Y-15 or equivalent reporting form, for each of the four most recent calendar quarters; and

(4) Less than \$75 billion in off-balance sheet exposure for each of the four most recent calendar quarters. Off-balance sheet exposure is a national bank's or Federal savings association's total exposure, calculated in accordance with the instructions to the FR Y-15 or equivalent reporting form, minus the total consolidated assets of the national bank or Federal savings association, as reported on the Call Report; or

(B) Has less than \$100 billion in total consolidated assets, as reported on the Call Report, for each of the four most recent calendar quarters; or

(C) Is a Category II national bank or Federal savings association.

\* \* \* \* \*

*Category IV national bank or Federal savings association* means a national bank or Federal savings association that is not a Category I national bank or Federal savings association, a Category II national bank or Federal savings association, or a Category III national bank or Federal savings association and that:

(1) Is a subsidiary of a Category IV banking organization, as defined pursuant to 12 CFR 252.5 or 12 CFR 238.10, as applicable; or:

(2) Has total consolidated assets, calculated based on the average of the national bank's or Federal savings association's total consolidated assets for the four most recent calendar quarters as reported on the Call Report, of \$100 billion or more. If the national bank or Federal savings association has not filed the Call Report for each of the four most recent calendar quarters, total consolidated assets is calculated based on the average of its total consolidated assets, as reported on the Call Report, for the most recent quarter(s) available.

(3) After meeting the criterion in paragraph (2) of this definition, a national bank or Federal savings association continues to be a Category IV national bank or Federal savings association until it:

(i) Has less than \$100 billion in total consolidated assets, as reported on the Call Report, for each of the four most recent calendar quarters; or

(ii) Is a Category II national bank or Federal savings association or Category III national bank or Federal savings association.

\* \* \* \* \*

*Commitment* means a contractual arrangement, under which a national bank or Federal savings association and an obligor agree to terms applicable to one or more future extensions of credit, purchases of assets, or issuances of credit substitutes by the national bank or Federal savings association, whether or not such arrangement is unconditionally cancelable. A commitment is unconditionally cancellable if, by its terms, it either: (a) provides that a national

bank or Federal savings association is not obligated to extend credit, purchase assets, or issue credit substitutes; or (b) permits a national bank or Federal savings association, at any time, with or without cause, to refuse to extend credit, purchase assets, or issue credit substitutes under the arrangement (to the extent permitted under applicable law).

\* \* \* \* \*

*Dependent on the cash flows generated by the real estate* means, for a real estate exposure, the underwriting, at the time of origination, considers the cash flows generated by lease, rental, or sale of the real estate securing the loan as a source of repayment. For purposes of this definition, a residential mortgage exposure that is secured by the borrower's principal residence is deemed not dependent on the cash flows generated by the real estate.

\* \* \* \* \*

*Effective notional amount* means for an eligible guarantee, eligible credit derivative, or eligible prepaid credit protection arrangement, the lesser of the contractual notional amount of the credit risk mitigant and the exposure amount of the hedged exposure, multiplied by the percentage coverage of the credit risk mitigant.

\* \* \* \* \*

*Eligible clean-up call* means a clean-up call that:

(1) Is exercisable solely at the discretion of the originating national bank or Federal savings association 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) Is only exercisable:

(i) For a traditional securitization, 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;

(ii) For a synthetic securitization, 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;

(iii) Upon the occurrence of a regulatory event that significantly changes the risk-weighted asset amount for the securitization exposure under this part; or

(iv) Upon the occurrence of a tax event that significantly changes the tax treatment of the securitization exposure under applicable tax laws.

\* \* \* \* \*

*Eligible guarantee* means a guarantee that:

(1) Is written;

(2) Is either:

(i) Unconditional, or

(ii) A contingent obligation of the U.S. government or its agencies, the enforceability of which is dependent upon some affirmative action on the part of the beneficiary of the guarantee or a third party (for example, meeting servicing requirements);

(3) Covers all or a pro rata portion of all contractual payments of the obligated party on the reference exposure;

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

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

(6) Except for a guarantee by a sovereign, is legally enforceable against the protection provider in a jurisdiction where the protection provider has sufficient assets against which a judgment may be attached and enforced;

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

(8) Does not increase the beneficiary's cost of credit protection on the guarantee in response to deterioration in the credit quality of the reference exposure;

(9) Is not provided by an affiliate of the national bank or Federal savings association, unless the affiliate is an insured depository institution, foreign bank, securities broker or dealer, or insurance company that:

(i) Does not control the national bank or Federal savings association; and

(ii) Is subject to consolidated supervision and regulation comparable to that imposed on depository institutions, U.S. securities broker-dealers, or U.S. insurance companies (as the case may be); and

(10) Is provided by an eligible guarantor.

\* \* \* \* \*

*Eligible prepaid credit protection arrangement* means a prepaid credit protection arrangement that:

- (1) Is written;
- (2) Is unconditional;
- (3) Covers all or a pro rata portion of all contractual payments due to be paid on the reference exposure or reference exposures;
- (4) Provides that the amount and timing of payments due from the protection purchaser to the protection provider are incorporated into the arrangement and the arrangement only allows these terms to change in the event of a breach of the arrangement by the protection purchaser;
- (5) Provides that entry of the protection provider into receivership, insolvency, liquidation, conservatorship, or similar proceeding does not change the amounts or timing of payments due to be paid by the protection purchaser under the arrangement;
- (6) Is legally valid and enforceable under applicable law of the relevant jurisdictions;
- (7) Upon a failure by the obligor on the one or more reference exposures to make a contractually required payment, or the occurrence of other credit events as described in the arrangement, allows the protection purchaser promptly to reduce the outstanding balance of the initial principal amount due to the protection provider by the loss of the protection purchaser on the reference exposures without input from the protection provider; and

(8) Does not increase the protection purchaser's cost of credit protection in response to deterioration in the credit quality of any of the reference exposure.

\* \* \* \* \*

*Financial institution* means:

\* \* \* \* \*

(4) \* \* \*

(i) \* \* \*

(A) An investment in GAAP equity instruments of the company with an adjusted carrying value or exposure amount equal to or greater than \$10 million, as adjusted pursuant to § 3.4; or

\* \* \* \* \*

*Netting set* means a group of transactions with a single counterparty that are subject to a qualifying master netting agreement. For derivative contracts, netting set also includes a single derivative contract between a national bank or Federal savings association and a single counterparty.

\* \* \* \* \*

*Non-performing loan securitization (NPL securitization)* means a traditional securitization, that is not a resecuritization, where parameter W (as defined in § 3.44(b)(1)) for the underlying exposures in a pool is greater than or equal to 90 percent at the origination cut-off date and at any subsequent date on which exposures are added to or removed from the pool of underlying exposures due to replenishment or restructuring.

*Nonrefundable purchase price discount (NRPPD)* means the difference between the outstanding principal balance of the underlying exposures at the time of sale and the price at which these exposures are sold by the originator to a company the activities of which are limited to those appropriate for the specific purpose of holding the underlying exposures of a securitization, when neither originator nor the original lender are reimbursed for this difference. In cases where the originator underwrites tranches of an NPL securitization for subsequent sale, the NRPPD may include the differences between the outstanding principal balance of the underlying exposures at the time of sale and the price at which all of the tranches are first sold to unrelated third parties. For any given piece of a securitization tranche, only its initial sale from the originator to investors is taken into account in the determination of NRPPD. The purchase prices of subsequent re-sales of a securitization tranche are not considered.

\* \* \* \* \*

*Prepaid credit protection arrangement* means a contractual arrangement under which a protection purchaser transfers the credit risk of one or more reference exposures to a protection provider where:

(1) The protection provider pays an initial principal amount in cash to the protection purchaser at the inception of the transaction; and

(2) The protection purchaser is obligated to repay the initial principal amount to the protection provider on or before the maturity date of the transaction, less any losses that the protection purchaser realizes or otherwise recognizes due to nonpayment of all contractual payments due to be paid on the reference exposure or reference exposures by the obligors.

\* \* \* \* \*

*Protection amount (P)* means, with respect to an exposure hedged by an eligible guarantee, eligible credit derivative, or eligible prepaid credit protection arrangement, or secured by financial collateral, the effective notional amount of the guarantee, credit derivative, or prepaid credit protection arrangement, or the fair value of the financial collateral, reduced to reflect any currency mismatch, maturity mismatch, or lack of restructuring coverage (as provided in § 3.36-3.37 or § 3.120-121, as applicable).

\* \* \* \* \*

*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 the underlying financial transactions are derivative contracts or repo-style transactions that are not cleared transactions. In order to treat an agreement as a qualifying cross-product master netting agreement, a national bank or Federal savings association must comply with the requirements of § 3.3(c) of this part with respect to that agreement.

\* \* \* \* \*

*Qualifying master netting agreement* means a written, legally enforceable agreement provided that:

\* \* \*

(3) The agreement does not contain a walkaway clause (that is, a provision that permits a non-defaulting counterparty to make a lower payment than it otherwise would make under the

agreement, or no payment at all, to a defaulter or the estate of a defaulter, even if the defaulter or the estate of the defaulter is a net creditor under the agreement); and

(4) In order to recognize an agreement as a qualifying master netting agreement for purposes of this subpart, a national bank or Federal savings association must comply with the requirements of § 3.3(d) with respect to that agreement.

\* \* \* \* \*

*Residential mortgage exposure* means an exposure (other than a securitization exposure, equity exposure, statutory multifamily mortgage, or presold construction loan):

(1) \* \* \*

(ii) With an original and outstanding amount of \$1 million or less, as adjusted pursuant to § 3.4, that is primarily secured by a first or subsequent lien on residential property that is not one-to-four family; and

\* \* \* \* \*

*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 national bank or Federal savings association is not required to consider amounts due under interest rate derivative, currency derivative, and servicer cash advance facility contracts; fees due; and 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 derivative, currency derivative, and servicer cash advance facility contracts; fees due; and other similar payments.

\* \* \* \* \*

*Specified supranational entity* means the Bank for International Settlements, the European Central Bank, the European Commission, the International Monetary Fund, the European Stability Mechanism, or the European Financial Stability Facility.

\* \* \* \* \*

*Speculative grade* means that the entity to which the national bank or Federal savings association is exposed through a loan or security, or the reference entity with respect to a credit derivative, has adequate capacity to meet financial commitments in the near term, but is vulnerable to adverse economic conditions, such that should economic conditions deteriorate, the issuer or the reference entity would present an elevated default risk.

\* \* \* \* \*

*Sub-speculative grade* means that the entity to which the national bank or Federal savings association is exposed through a loan or security, or the reference entity with respect to a credit derivative, depends on favorable economic conditions to meet its financial commitments, such that should such economic conditions deteriorate the issuer or the reference entity likely would default on its financial commitments.

\* \* \* \* \*

*Synthetic excess spread* means any contractual provisions in a synthetic securitization that are designed to absorb losses prior to any of the tranches of the securitization structure.

*Synthetic securitization* means a transaction in which:

(1) All or a portion of the credit risk of one or more underlying exposures is retained or transferred to one or more third parties through the use of one or more credit derivatives, guarantees (other than a guarantee that transfers only the credit risk of an individual retail exposure), or prepaid credit protection arrangements;

(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 solely 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).

\* \* \* \* \*

*Traditional securitization* means a transaction in which:

(1) All or a portion of the credit or equity risk of one or more underlying exposures is transferred to one or more third parties other than through the use of credit derivatives, guarantees, or prepaid credit protection arrangements;

(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 solely 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 defined in section 302 of the Small Business Investment Act;

(7) The underlying exposures are not owned by a firm an investment in which qualifies as a community development investment under section 24(Eleventh) of the National Bank Act;

(8) The OCC 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 OCC may deem a transaction that meets the definition of a traditional securitization, notwithstanding paragraph (5), (6), or (7) of this definition, to be a traditional securitization based on the transaction's leverage, risk profile, or economic substance; and

(10) The transaction is not:

(i) An investment fund;

(ii) A collective investment fund (as defined in 12 CFR § 9.18 (national banks), 12 CFR § 151.40 (Federal saving associations));

(iii) An employee benefit plan (as defined in paragraphs (3) and (32) of section 3 of ERISA), a “governmental plan” (as defined in 29 U.S.C. 1002(32)) that complies with the tax deferral qualification requirements provided in the Internal Revenue Code, or any similar employee benefit plan established under the laws of a foreign jurisdiction;

(iv) A synthetic exposure to the capital of a financial institution to the extent deducted from capital under § 3.22; or

(v) Registered with the SEC under the Investment Company Act of 1940 (15 U.S.C. 80a-1) or foreign equivalents thereof.

\* \* \* \* \*

4. Add § 3.4 to read as follows:

**§ 3.4 Threshold Indexing.**

(a) *Methodology.* The dollar thresholds specified in paragraph (c) of this section shall be adjusted by multiplying the baseline threshold values specified in paragraph (c) of this section by one plus the cumulative percent change in the non-seasonally adjusted Consumer Price Index for Urban Wage Earners and Clerical Workers, measured from the effective date of this rule, as further described in paragraph (b) of this section, and shall be rounded in accordance with paragraph (d) of this section.

(b) *Frequency.* (1) *In general – biennial adjustments.* Except as otherwise provided in paragraph (b)(2) and (b)(3) of this section, the adjustments described in paragraph (a) of this section shall be effective on October 1 following each consecutive two year period ending August 30, and using the non-seasonally adjusted Consumer Price Index for Urban Wage Earners and Clerical Workers as of August 30 of that year.

(2) *Off-year adjustments.* In the event that the OCC determines, during a year where no adjustment would be made under paragraph (b)(1), that the non-seasonally adjusted Consumer Price Index for Urban Wage Earners and Clerical Workers, measured over the twelve month period ending August 30 of that year, is such that an adjustment under this section would be appropriate for that year, the OCC may make an adjustment under this section for that year.

(3) *Periods of negative inflation.* Notwithstanding paragraph (b)(1) or (b)(2) of this section, if an adjustment of dollar thresholds using the cumulative percent change of the non-seasonally adjusted Consumer Price Index for Urban Wage Earners and Clerical Workers from the effective date of this rule or the most recent adjustment, as applicable, would not result in an increase from the current dollar thresholds, no adjustment will be made pursuant to paragraph (a) of this section.

(c) *Specified thresholds.* The thresholds in the following sections shall be adjusted in accordance with paragraph (a) of this section relative to the baseline threshold values as specified below.

(1) Section 3.1(c)(4)(i), baseline threshold value \$50 billion.

(2) Section 3.2, paragraph (4)(i)(A) of the definition of “Financial institution,” baseline threshold value \$10 million;

(3) Section 3.2, definition of “Residential mortgage exposure,” baseline threshold value \$1 million;

(4) Section 3.61, baseline threshold value \$50 billion.

(d) *Rounding.* When adjusting thresholds under this section, each threshold shall be rounded based on the size of the threshold (e.g., thousands, millions, billions) to the nearest number with two significant digits.

(e) *Effective date of threshold adjustments.* The OCC shall announce the thresholds adjusted in accordance with this section by publication in the Federal Register. Such adjusted thresholds shall be effective on October 1 of the year during which an adjustment is made.

(f) *Failure to publish in the Federal Register.* In the event, for any reason, the thresholds adjusted in accordance with this section are not published in the Federal Register in a year in which an adjustment is made under this section, the thresholds specified in paragraph (c) of this section will adjust as provided in this section and be effective on October 1, notwithstanding the lack of publication in the Federal Register.

\* \* \* \* \*

5. Add § 3.5 to read as follows:

**§ 3.5 Calculation of loan-to-value (LTV) ratio.**

(a) *Loan-to-value ratio.* The loan-to-value (LTV) ratio must be calculated as the extension of credit divided by the value of the property.

(b) *Extension of credit.* For purposes of a LTV ratio calculated under this § 3.5, the extension of credit is equal to the total outstanding amount of the loan including any undrawn committed amount of the loan.

(c) *Value of the property.* (1) For purposes of a LTV ratio calculated under this § 3.5, the value of the property is the market value of all real estate properties securing or being improved by the extension of credit plus the amount of any readily marketable collateral and other acceptable collateral, as defined in 12 CFR part 34, appendix A to subpart D, that secures the extension of credit, subject to the following:

(i) For exposures subject to 12 CFR part 34, subpart C, the market value of property is a valuation that meets all requirements of that rule.

(ii) For exposures not subject to 12 CFR part 34, subpart C:

(A) The market value of real estate must be obtained from an independent valuation of the property using prudently conservative valuation criteria;

(B) The valuation must be done independently from the national bank's or Federal savings association's origination and underwriting process; and

(C) To ensure that the market value of the real estate is determined in a prudently conservative manner, the valuation must exclude expectations of price increases and must be adjusted downward to account for the potential for the current market price to be significantly above the value that would be sustainable over the life of the loan.

(2) In the case where the exposure includes the financing to purchase the property, the value of the property is the lower of the market value obtained under paragraph (c)(1)(i) or (c)(1)(ii) of this section, as applicable, and the actual acquisition cost.

(3) The value of the property must be measured at the time of origination, except in the following circumstances:

(i) The OCC requires a national bank or Federal savings association to revise the value of the property downward;

(ii) The value of the property must be adjusted downward due to an extraordinary event that results in a permanent reduction of the property value; or

(iii) The value of the property may be increased to reflect modifications made to the property that increase the market value, as determined according to the requirements in paragraphs (c)(1)(i) or (c)(1)(ii) of this section.

(4) Readily marketable collateral and other acceptable collateral, as defined in 12 CFR part 34, appendix A to subpart D, must be appropriately discounted by the national bank or Federal savings association consistent with the national bank's or Federal savings association's usual practices for making loans secured by such collateral.

6. Amend § 3.22 by:

a. Redesignating footnotes 22 through 31 as footnotes 1 through 10; and

b. Revising paragraph (b), the heading of paragraph (d), and paragraph (d)(1).

The revisions read as follows:

### § 3.22 Regulatory capital adjustments and deductions.

\* \* \* \* \*

*(b) Regulatory adjustments to common equity tier 1 capital.*

(1) A national bank or Federal savings association must adjust the sum of common equity tier 1 capital elements pursuant to the requirements set forth in this paragraph (b). Such adjustments to common equity tier 1 capital must be made net of the associated deferred tax effects.

(i) A national bank or Federal savings association that makes an AOCI opt-out election (as defined in paragraph (b)(2) of this section), must make the adjustments required under paragraph (b)(2)(i) of this section.

(ii) A national bank or Federal savings association that is an advanced approaches national bank or Federal savings association, Category III national bank or Federal savings association, or Category IV national bank or Federal savings association, and a national bank or Federal savings association that has not made an AOCI opt-out election (as defined in paragraph (b)(2) of this section), must deduct any accumulated net gains and add any accumulated net losses on cash flow hedges included in AOCI that relate to the hedging of items that are not recognized at fair value on the balance sheet.

(iii) A national bank or Federal savings association must deduct any net gain and add any net loss related to changes in the fair value of liabilities that are due to changes in the national bank's or Federal savings association's own credit risk. An advanced approaches national bank or Federal savings association, Category III national bank or Federal savings association, or

Category IV national bank or Federal savings association must deduct the difference between its credit spread premium and the risk-free rate for derivatives that are liabilities as part of this adjustment.

(2) AOCI opt-out election.

(i) A national bank or Federal savings association that is not an advanced approaches national bank or Federal savings association, Category III national bank or Federal savings association, or Category IV national bank or Federal savings association may make a one-time election to opt out of the requirement to include all components of AOCI (with the exception of accumulated net gains and losses on cash flow hedges related to items that are not fair-valued on the balance sheet) in common equity tier 1 capital (AOCI opt-out election). A national bank or Federal savings association that makes an AOCI opt-out election in accordance with this paragraph (b)(2) must adjust common equity tier 1 capital as follows:

(A) Subtract any net unrealized gains and add any net unrealized losses on available-for-sale securities;

(B) Subtract any accumulated net gains and add any accumulated net losses on cash flow hedges;

(C) Subtract any amounts recorded in AOCI attributed to defined benefit postretirement plans resulting from the initial and subsequent application of the relevant GAAP standards that pertain to such plans (excluding, at the national bank's or Federal savings association's option, the portion relating to pension assets deducted under paragraph (a)(5) of this section); and

(D) Subtract any net unrealized gains and add any net unrealized losses on held-to-maturity securities that are included in AOCI.

(ii) (A) A national bank or Federal savings association that is not an advanced approaches national bank or Federal savings association, Category III national bank or Federal savings association, or Category IV national bank or Federal savings association must make its AOCI opt-out election in the Call Report during the first reporting period after the national bank or Federal savings association is required to comply with subpart A of this part as set forth in § 3.1(f).

(B) Notwithstanding paragraph (b)(ii)(A) of this section, if a national bank or Federal savings association was previously an advanced approaches national bank or Federal savings association, Category III national bank or Federal savings association, or Category IV national bank or Federal savings association, the national bank or Federal savings association must make its AOCI opt-out election in the Call Report during the first reporting period after the national bank or Federal savings association ceased to be an advanced approaches national bank or Federal savings association, Category III national bank or Federal savings association, or Category IV national bank or Federal savings association.

(iii) With respect to a national bank or Federal savings association that is not an advanced approaches national bank or Federal savings association, Category III national bank or Federal savings association, or Category IV national bank or Federal savings association, each of its subsidiary banking organizations that is subject to regulatory capital requirements issued by the Board of Governors of the Federal Reserve, the Federal Deposit Insurance Corporation, or the

Office of the Comptroller of the Currency<sup>[21]</sup> must elect the same option as the national bank or Federal savings association pursuant to this paragraph (b)(2).

(iv) With prior notice to the OCC, a national bank or Federal savings association resulting from a merger, acquisition, or purchase transaction and that is not an advanced approaches national bank or Federal savings association, a Category III national bank or Federal savings association, or a Category IV national bank or Federal savings association, may make a new AOCI opt-out election in the Call Report filed by the resulting national bank or Federal savings association for the first reporting period after it is required to comply with subpart A of this part as set forth in § 3.1(f) if:

(A) Other than as set forth in paragraph (b)(2)(iv)(C) of this section, the merger, acquisition, or purchase transaction involved the acquisition or purchase of all or substantially all of either the assets or voting stock of another banking organization that is subject to regulatory capital requirements issued by the Board of Governors of the Federal Reserve, the Federal Deposit Insurance Corporation, or the Office of the Comptroller of the Currency;<sup>[22]</sup>

(B) Prior to the merger, acquisition, or purchase transaction, only one of the banking organizations involved in the transaction made an AOCI opt-out election under this section; and

(C) A national bank or Federal savings association may, with the prior approval of the OCC, change its AOCI opt-out election under this paragraph (b) in the case of a merger, acquisition, or purchase transaction that meets the requirements set forth at paragraph (b)(2)(iv)(B) of this section, but does not meet the requirements of paragraph (b)(2)(iv)(A) of this section. In making such a determination, the OCC may consider the terms of the merger, acquisition, or purchase transaction, as well as the extent of any changes to the risk profile,

complexity, and scope of operations of the national bank or Federal savings association resulting from the merger, acquisition, or purchase transaction.

\* \* \* \* \*

*(d) Certain DTAs subject to common equity tier 1 capital deduction thresholds.*

(1) A national bank or Federal savings association that is not an advanced approaches national bank or Federal savings association must make deductions from regulatory capital as described in this paragraph (d)(1).

(i) The national bank or Federal savings association must deduct from common equity tier 1 capital elements the amount of DTAs as described in paragraph (d)(1)(ii) of this section that exceeds 25 percent of the sum of the national bank's or Federal savings association's common equity tier 1 capital elements, less adjustments to and deductions from common equity tier 1 capital required under paragraphs (a) through (c)(3) of this section (the 25 percent common equity tier 1 capital deduction threshold).<sup>[29]</sup>

(ii) The national bank or Federal savings association must deduct from common equity tier 1 capital elements the amount of DTAs arising from temporary differences that the national bank or Federal savings association could not realize through net operating loss carrybacks, net of any related valuation allowances and net of DTLs, in accordance with paragraph (e) of this section. A national bank or Federal savings association is not required to deduct from the sum of its common equity tier 1 capital elements DTAs (net of any related valuation allowances and net of DTLs, in accordance with § 3.22(e)) arising from timing differences that the national bank or Federal savings association could realize through net operating loss carrybacks. The national bank or Federal savings association must risk weight these assets at 100 percent. For a national

bank or Federal savings association that is a member of a consolidated group for tax purposes, the amount of DTAs that could be realized through net operating loss carrybacks may not exceed the amount that the national bank or Federal savings association could reasonably expect to have refunded by its parent holding company.

(iii) For purposes of calculating the amount of DTAs subject to deduction pursuant to paragraph (d)(1) of this section, a national bank or Federal savings association may exclude DTAs and DTLs relating to adjustments made to common equity tier 1 capital under paragraph (b) of this section. A national bank or Federal savings association that elects to exclude DTAs relating to adjustments under paragraph (b) of this section also must exclude DTLs and must do so consistently in all future calculations. A national bank or Federal savings association may change its exclusion preference only after obtaining the prior approval of the OCC.

\* \* \* \* \*

<sup>22</sup> These rules include the regulatory capital requirements set forth at 12 CFR part 3 (OCC); 12 CFR part 225 (Board); 12 CFR part 325, and 12 CFR part 390 (FDIC).

\* \* \* \* \*

<sup>29</sup> The amount of the items in paragraph (d)(1) of this section that is not deducted from common equity tier 1 capital must be included in the risk-weighted assets of the national bank or Federal savings association and assigned a 250 percent risk weight.

\* \* \* \* \*

7. In § 3.32:

a. Revise paragraph (f)(1);

b. Revise paragraph (g)(1);

c. Revise paragraph (l)(5).

The revisions read as follows:

**§ 3.32 General risk weights.**

\* \* \* \* \*

**(f) Corporate exposures.**

(1) A national bank or Federal savings association must assign a 95 percent risk weight to all its corporate exposures, except as provided in paragraphs (f)(2) and (f)(3) of this section.

\* \* \* \* \*

**(g) Residential mortgage exposures.**

(1) A national bank or Federal savings association must assign a risk weight in accordance with Table 5 to § 3.32 or Table 6 to § 3.32, as applicable, to a first-lien residential mortgage exposure that:

(i) Is secured by a property that is either owner-occupied or rented;

(ii) Is made in accordance with prudent underwriting standards, including relating to the loan amount as a percent of the appraised value of the property;

(iii) Is not 90 days or more past due or carried in nonaccrual status; and

(iv) Is not restructured or modified, provided that a loan modified or restructured solely pursuant to the U.S. Treasury’s Home Affordable Mortgage Program is not modified or restructured for purposes of this section.

**Table 5. Risk Weights for Residential Mortgages that are Not Dependent on the Cash Flows Generated by the Real Estate based on LTV<sup>1</sup>**

	<b>LTV Ratio ≤ 50%</b>	<b>50% &lt; LTV Ratio ≤ 60%</b>	<b>60% &lt; LTV Ratio ≤ 80%</b>	<b>80% &lt; LTV Ratio ≤ 90%</b>	<b>90% &lt; LTV Ratio ≤ 100%</b>	<b>LTV Ratio &gt; 100%</b>
<b>Risk Weight</b>	25%	30%	35%	45%	55%	75%

<sup>1</sup> LTV is calculated in accordance with § 3.5.

**Table 6. Proposed Risk Weights for Residential Mortgage Exposures Dependent on the Cash Flows Generated by the Real Estate and based on LTV<sup>2</sup>**

	<b>LTV Ratio ≤ 50%</b>	<b>50% &lt; LTV Ratio ≤ 60%</b>	<b>60% &lt; LTV Ratio ≤ 80%</b>	<b>80% &lt; LTV Ratio ≤ 90%</b>	<b>90% &lt; LTV Ratio ≤ 100%</b>	<b>LTV Ratio &gt; 100%</b>
<b>Risk Weight</b>	35%	40%	50%	65%	80%	110%

<sup>1</sup> LTV is calculated in accordance with § 3.5.

(2) A national bank or Federal savings association must assign a 100 percent risk weight to a first-lien residential mortgage exposure that does not meet the criteria in paragraph (g)(1) of this section or for which the national bank or Federal savings association cannot calculate the LTV in accordance with 12 CFR 3.5, and to junior-lien residential mortgage exposures.

(3) For the purpose of this paragraph (g), if a national bank or Federal savings association holds the first-lien and junior-lien(s) residential mortgage exposures, and no other party holds an intervening lien, the national bank or Federal savings association must combine the exposures and treat them as a single first-lien residential mortgage exposure.

\* \* \* \* \*

(1) \* \* \*

(5) A national bank or Federal savings association must assign a 90 percent risk weight to all assets not specifically assigned a different risk weight under this subpart D and that are not deducted from tier 1 or tier 2 capital pursuant to § 3.22.

\* \* \* \* \*

8. In § 3.33:

- a. add paragraph (a)(5);
- b. remove paragraph (b)(2)(ii) and redesignate paragraph (b)(2)(i) as paragraph (b)(2);
- c. revise paragraph (b)(3);
- d. redesignate paragraph (b)(4) as new paragraph (b)(5); and
- e. add new paragraph (b)(4).

The revision reads as follows:

**§ 3.33 Off-balance sheet exposures.**

(a) *General.*

\* \* \* \* \*

(5) For purposes of this section if a commitment does not have an express contractual maximum amount that can be drawn, the committed but undrawn amount of the commitment is equal to the highest total drawn amount over the period since the commitment was created or the prior 24 months, whichever period is shorter, minus the current drawn amount.

\* \* \* \* \*

(b) *Credit conversion factors* -

\* \* \* \* \*

(2) *20 percent CCF.* A national bank or Federal savings association must apply a 20 percent CCF to the amount of self-liquidating, trade-related contingent items that arise from the movement of goods, with an original maturity of one year or less.

(3) *40 percent CCF.* A national bank or Federal savings association must apply a 40 percent CCF to commitments, regardless of the maturity of the facility, unless they qualify for a lower or higher CCF.

(4) *50 percent CCF.* A national bank or Federal savings association must apply a 50 percent CCF to the amount of:

(i) Transaction-related contingent items, including performance bonds, bid bonds, warranties, and performance standby letters of credit; and

(ii) Note issuance facilities and revolving underwriting facilities.

(5) *100 percent CCF.* \* \* \*

\* \* \* \* \*

9. Amend § 3.34 by revising paragraph (c)(2) to read as follows:

**§ 3.34 Derivative contracts.**

\* \* \* \* \*

(c) \* \* \*

(2) As an alternative to the simple approach, a national bank or Federal savings association using CEM under paragraph (b) of this section may recognize the credit risk mitigation benefits of financial collateral that secures such a contract or netting set if the financial collateral is marked-to-fair value on a daily basis and subject to a daily margin maintenance requirement by applying a risk weight to the uncollateralized portion of the exposure, after adjusting the exposure amount calculated under paragraph (b)(1) or (2) of this section using the collateral haircut approach in § 3.37(e). The national bank or Federal savings association must substitute the exposure amount calculated under paragraph (b)(1) or (2) of this section for  $\sum_i E_i$  in the equation in § 3.37(e)(2).

\* \* \* \* \*

10. Amend § 3.36 by revising paragraph (e) to read as follows:

**§ 3.36 Guarantees and credit derivatives: substitution treatment.**

\* \* \* \* \*

(e) *Adjustment for credit derivatives without restructuring as a credit event.* (1) If a national bank or Federal savings association 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 national bank or Federal savings association must apply the adjustment in paragraph (e)(2) of this section to reduce the effective notional amount of the credit derivative unless:

(i) The terms of the hedged exposure and the reference exposure, if different from the hedged exposure, allow the maturity, principal, coupon, currency, or seniority status of the exposure to be amended outside of receivership, insolvency, liquidation, or similar proceeding only by unanimous consent of all parties, and

(ii) The national bank or Federal savings association has conducted sufficient legal review to conclude with a well-founded basis (and maintains sufficient written documentation of that legal review) that the hedged exposure is subject to the U.S. Bankruptcy Code, the Federal Deposit Insurance Act, or a domestic or foreign insolvency regime with similar features that allow for a company to liquidate, reorganize, or restructure and provides for an orderly settlement of creditor claims.

(2) The national bank or Federal savings association must apply the following adjustment to reduce the effective notional amount of any eligible credit derivative that is subject to adjustment under paragraph (e)(1) of this section:

$Pr = Pm \times 0.60$ , where:

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

(ii)  $P_m$  = effective notional amount of the credit risk mitigant (adjusted for maturity mismatch, if applicable).

\* \* \* \* \*

11. Amend § 3.37 to read as follows:

**§ 3.37 Collateralized transactions and prepaid credit protection arrangements.**

(a) *Financial Collateral.* (1) To recognize the risk-mitigating effects of financial collateral, a national bank or Federal savings association may use:

(i) The simple approach in paragraph (b) of this section; or

(ii) The collateral haircut approach in paragraph (e) of this section for repo-style transactions, eligible margin loans, collateralized derivative contracts, and single-product netting sets of such transactions, subject to paragraph (a)(3) of this section.

(2) A national bank or Federal savings association must use the same approach to recognize the risk-mitigating effects of financial collateral for similar exposures or transactions.

(3) A national bank or Federal savings association that has elected under § 3.34(a)(1)(ii) to use the standardized approach for counterparty credit risk (SA-CCR) for derivative contracts may elect to also use SA-CCR for repo-style transactions that are subject to a qualifying cross-product master netting agreement with derivative contracts, subject to the requirements of paragraph (f) of this section. A national bank or Federal savings association that uses SA-CCR to determine the exposure amount of a derivative contract or netting set may use not the simple approach in paragraph (b) of this section or the collateral haircut approach under paragraph (e) of this section for the exposures for which SA-CCR is used.

(b) *The simple approach*—(1) *General requirements*. To qualify for the simple approach under this paragraph (b), the financial collateral must meet the following requirements:

(i) The collateral must be revalued at least every six months;

(ii) The legal mechanism by which financial collateral is pledged or transferred must be enforceable in the relevant jurisdictions and ensure that the national bank or Federal savings association has the contractual right, as applicable to the characteristics of the financial collateral and exposure, to liquidate or take legal possession of the financial collateral, setoff amounts owed to the obligor against amounts owed to the national bank or Federal savings association and close out any transaction giving rise to the secured exposure, in a timely manner, in the event of the default, insolvency or bankruptcy (or one or more otherwise-defined credit events set out in the transaction documentation) of the obligor; and

(iii) The national bank or Federal savings association must be able to reasonably demonstrate the ability to protect and enforce its rights in respect of any financial collateral.

(2) *Risk weight substitution*. (i) A national bank or Federal savings association may apply a risk weight to the portion of an exposure that is secured by financial collateral that meets the requirements of paragraph (b) of this section, up to the protection amount of the financial collateral as adjusted by paragraph (d) of this section, based on the risk weight assigned to the collateral under this subpart. For repurchase agreements, reverse repurchase agreements, and securities lending and borrowing transactions, the collateral is the instruments, gold, and cash the national bank or Federal savings association has borrowed, purchased subject to resale, or taken as collateral from the counterparty under the transaction. Except as provided in paragraph (b)(3)

of this section, the risk weight assigned to the protected portion of the exposure may not be less than 20 percent.

(ii) A national bank or Federal savings association must apply a risk weight to the amount of an exposure in excess of the protection amount of financial collateral securing the exposure based on the risk weight applicable to the exposure under this subpart.

*(3) Exceptions to the 20 percent risk weight floor and other requirements.*

Notwithstanding paragraph (b)(2)(i) of this section, a national bank or Federal savings association may assign a zero percent risk weight up to the protection amount of the financial collateral where:

(i) The financial collateral is cash on deposit; or

(ii) The financial collateral is an exposure to a sovereign that qualifies for a zero percent risk weight under § 3.32, and the national bank or Federal savings association has discounted the fair value of the collateral by 20 percent.

*(c) Eligible prepaid credit protection arrangements. (1) Scope.* A national bank or Federal savings association may recognize the credit risk mitigation benefits of an eligible prepaid credit protection arrangement as provided under this paragraph.

*(2) Application.* This paragraph applies to exposures, including securitization exposures, for which:

(i) Credit risk is fully covered by an eligible prepaid credit protection arrangement; or

(ii) Credit risk is covered on a pro rata basis (that is, on a basis in which the national bank or Federal savings association and the protection provider share losses proportionately) by an eligible prepaid credit protection arrangement.

(3) *Tranching of credit risk.* Exposures on which there is a tranching of credit risk (reflecting at least two different levels of seniority) generally are securitization exposures subject to § 3.41 through § 3.45.

(4) *Multiple eligible prepaid credit protection arrangements.* If multiple eligible prepaid credit protection arrangements cover a single exposure, a national bank or Federal savings association may treat the hedged exposure as multiple separate exposures each covered by a single eligible credit protection arrangement and may calculate a separate risk-weighted asset amount for each separate exposure as described in paragraph (c)(6) of this section.

(5) *Single eligible credit protection arrangements.* If a single eligible credit protection arrangement covers multiple hedged exposures, a national bank or Federal savings association must treat each hedged exposure as covered by a separate eligible credit protection arrangement and must calculate a separate risk-weighted asset amount for each exposure as described in paragraph (c)(6) of this section.

(6) *Prepaid credit protection arrangements—The substitution approach.* (i) *Full coverage.* If an eligible prepaid credit protection arrangement meets the conditions in paragraphs (c)(1) through (5) of this section and the protection amount (P) of the prepaid credit protection arrangement is greater than or equal to the exposure amount of the reference exposure, a national bank or Federal savings association may assign a zero percent risk weight to the reference exposure.

(ii) *Partial coverage.* If an eligible prepaid credit protection arrangement meets the conditions in paragraphs (c)(1) through (5) of this section and the protection amount (P) of the prepaid credit protection arrangement is less than the exposure amount of the reference exposure, the national bank or Federal savings association must treat the reference exposure as two separate exposures (protected and unprotected) in order to recognize the credit risk mitigation benefit of the prepaid credit protection arrangement.

(A) The national bank or Federal savings association may apply a risk-weight of zero percent for the protected exposure.

(B) The national bank or Federal savings association must calculate the risk-weighted asset amount for the unprotected exposure under this subpart D, where the applicable risk weight is that of the unprotected portion of the reference exposure.

(C) The treatment provided in this section is applicable when the credit risk of a reference exposure is covered on a partial pro rata basis and may be applicable when an adjustment is made to the effective notional amount of the prepaid credit protection arrangement under paragraph (d) of this section.

(d) *Required adjustments—(1) Maturity mismatch adjustment.* (i) A national bank or Federal savings association that recognizes the credit risk mitigation benefits of financial collateral under paragraph (b) of this section or of an eligible prepaid credit protection arrangement under paragraph (c) of this section must adjust the amount of credit risk mitigation recognized to reflect any maturity mismatch.

(ii) A maturity mismatch occurs when:

(A) The residual maturity of the legal mechanism by which financial collateral is pledged is less than that of the secured exposure(s); or

(B) The residual maturity of an eligible prepaid credit protection arrangement is less than that of the reference exposure.

(iii) The residual maturity of a secured exposure under paragraph (b) of this section or a reference exposure under paragraph (c) of this section is the longest possible remaining time before the obligated party of the secured exposure or reference exposure is scheduled to fulfil its obligation on the exposure. For purposes of this paragraph (d)(1)(iii):

(A) For an eligible prepaid credit protection arrangement, if the terms of the arrangement include embedded options that may reduce its term, the national bank or Federal savings association (protection purchaser) must adjust the residual maturity. If a call is at the discretion of the protection provider, the residual maturity is at the first call date. If the call is at the discretion of the national bank or Federal savings association (protection purchaser), but the terms of the arrangement at origination contain a positive incentive for the national bank or Federal savings association to cancel the arrangement before contractual maturity, the remaining time to the first call date is the residual maturity.

(B) For financial collateral that is not cash on deposit at the national bank or Federal savings association, but including cash held for the national bank or Federal savings association by a third-party custodian or trustee, the residual maturity of any amount of such financial collateral is the earliest date on which the national bank's or Federal savings association's rights in respect of such amount of financial collateral may be terminated without the pledgor being subject to a contemporaneous requirement to pledge additional financial collateral. For financial

collateral that is cash on deposit at the national bank or Federal savings association, the residual maturity of any amount of such cash collateral is the earliest date on which a depositor may withdraw such amount, notwithstanding any notice requirements or early withdrawal fees or penalties.

(iv) The credit risk mitigation benefits of financial collateral or an eligible prepaid credit protection arrangement with a maturity mismatch may be recognized only if the original maturity of the legal mechanism by which financial collateral is pledged or the eligible prepaid credit protection arrangement is greater than or equal to one year and its residual maturity is greater than three months.

(v) When a maturity mismatch exists, the national bank or Federal savings association must apply the following adjustment to reduce the protection amount:

$$P_m = E \times (t-0.25)/(T-0.25), \text{ where:}$$

(A)  $P_m$  = fair value of the financial collateral or effective notional amount of the eligible prepaid credit protection arrangement, adjusted for maturity mismatch;

(B)  $E$  = fair value of the financial collateral or effective notional amount of the eligible prepaid credit protection arrangement;

(C)  $t$  = the lesser of  $T$  or the residual maturity of the arrangement, expressed in years; and

(D)  $T$  = the lesser of five or the residual maturity of the secured exposure or reference exposure, expressed in years.

(2) *Currency mismatch adjustment.* (i) If a national bank or Federal savings association recognizes the credit risk mitigation benefits of financial collateral under paragraph (b) of this

section or of an eligible prepaid credit protection arrangement under paragraph (c) of this section that is denominated in a currency different from that in which the secured or reference exposure is denominated, the national bank or Federal savings association must apply the following formula to the fair value of the financial collateral or the effective notional amount of the eligible prepaid credit protection arrangement:

$P_c = P_r \times (1 - H_{FX})$ , where:

(A)  $P_c$  = fair value of the financial collateral or the effective notional amount of the eligible prepaid credit protection arrangement, adjusted for currency mismatch (and maturity mismatch, if applicable);

(B)  $P_r$  = fair value of the financial collateral or the effective notional amount of the eligible prepaid credit protection arrangement (adjusted for maturity mismatch, if applicable);  
and

(C)  $H_{FX}$  = haircut appropriate for the currency mismatch between the financial collateral and the secured exposure or the eligible prepaid credit protection arrangement and the reference exposure, as determined under paragraphs (d)(2)(ii) through (iii) of this section.

(ii) Subject to paragraph (d)(2)(iii) of this section, a national bank or Federal savings association must set  $H_{FX}$  equal to eight percent.

(iii) A national bank or Federal savings association must increase  $H_{FX}$  as determined under paragraph (d)(2)(ii) of this section if the national bank or Federal savings association revalues the financial collateral or eligible prepaid credit protection arrangement less frequently than once every 10 business days using the following formula:

$H_{FX} = 8\% \times \sqrt{\frac{T_M}{10}}$ , where  $T_M$  equals the greater of 10 or the number of business days between revaluations.

(e) *Collateral haircut approach—Exposure amount for eligible margin loans and repo-style transactions.* (1) *General.* A national bank or Federal savings association may recognize the credit risk mitigation benefits of financial collateral that secures an eligible margin loan, repo-style transaction, collateralized derivative contract, or netting set of eligible margin loans, repo-style transactions, or collateralized derivative contracts, and of any collateral that secures a repo-style transaction that is included in the national bank’s or Federal savings association’s measure for market risk under subpart F of this part, by using the collateral haircut approach covered in this paragraph (e) of this section.

(2) *Exposure amount calculation.* For purposes of the collateral haircut approach, a national bank or Federal savings association must determine the exposure amount for an eligible margin loan, repo-style transaction, collateralized derivative contract, or netting set of eligible margin loans, repo-style transactions, or collateralized derivative contracts according to the following formula:

$$E^* = \max \left\{ 0; \left( \sum_i E_i - \sum_i C_i \right) + \left( 0.4 \times net_{exposure} \right) + \left( 0.6 \times \frac{gross_{exposure}}{\sqrt{N}} \right) + \left( \sum_{fx} (E_{fx} \times H_{fx}) \right) \right\} \text{ where:}$$

(i)  $E^*$  is the exposure amount of the eligible margin loan, repo-style transaction, or netting set after credit risk mitigation;

(ii)  $E_i$  is:

(A) For eligible margin loans and repo-style transactions and netting sets thereof, the current fair value of the instrument, cash, or gold the national bank or Federal savings association has lent, sold subject to repurchase, or posted as collateral to the counterparty; and

(B) For collateralized derivative contracts and netting sets thereof, the exposure amount of the OTC derivative contract or netting set calculated under § 3.34(b)(1) or (2);

(iii)  $C_i$  is the current fair value of the instrument, cash, or gold the banking organization has borrowed, purchased subject to resale, or taken as collateral from the counterparty;

$$(iv) \text{net}_{exposure} = |\sum_s E_s H_s|;$$

$$(v) \text{gross}_{exposure} = \sum_s E_s |H_s|;$$

(vi)  $E_s$  is the absolute value of the net position in a given instrument or in gold, where the net position in a given instrument or gold equals the sum of the current fair values of the instrument or gold the national bank or Federal savings association has lent, sold subject to repurchase, or posted as collateral to the counterparty, minus the sum of the current fair values of that same instrument or gold the national bank or Federal savings association has borrowed, purchased subject to resale, or taken as collateral from the counterparty;

(vii)  $H_s$  is the haircut appropriate to  $E_s$  as described in Table 1 to § 3.37, as applicable.  $H_s$  has a positive sign if the instrument or gold is net lent, sold subject to repurchase, or posted as collateral to the counterparty;  $H_s$  has a negative sign if the instrument or gold is net borrowed, purchased subject to resale, or taken as collateral from the counterparty;

(viii)  $N$  is the number of instruments with a unique Committee on Uniform Securities Identification Procedures (CUSIP) designation or foreign equivalent that the national bank or

Federal savings association lends, sells subject to repurchase, posts as collateral, borrows, purchases subject to resale, or takes as collateral in the eligible margin loan, repo-style transaction, collateralized derivative contract, or netting set, including all collateral that the national bank or Federal savings association elects to include within the credit risk mitigation framework, except that instruments where the value  $E_s$  is less than one tenth of the value of the largest  $E_s$  in the eligible margin loan, repo-style transaction, collateralized derivative contract, or netting set are not included in the count or gold, with any amount of gold given a value of one;

(ix)  $E_{fx}$  is the absolute value of the net position in each currency  $f_x$  different from the settlement currency;

(x)  $H_{fx}$  is the haircut appropriate for currency mismatch of currency  $f_x$ .

(3) *Market price volatility and currency mismatch haircuts.* (i) A national bank or Federal savings association must use the haircuts for market price volatility ( $H_s$ ) in Table 1 to § 3.37, as adjusted in certain circumstances as provided in paragraphs (e)(3)(iii) through (v) of this section.

**Table 1 to § 3.37—Market Price Volatility Haircuts**

Residual Maturity	Securities issued by a sovereign or an issuer described in § 3.32(b) <sup>1</sup> (percent)	Other investment-grade securities (percent)					
		Issuer risk weight of 0%	Issuer risk weight of 20% or 50%	Issuer risk weight of 100%	GSE exposures	Exposures other than GSE exposures or securitization exposures	Senior securitization exposures with risk weight <100%
Debt Securities	Less than or equal to 1 year	0.5	1.0	15.0	1.0	2.0	4.0

Greater than 1 year and less than or equal to 3 years	2.0	3.0	15.0	4.0	4.0	12.0
Greater than 3 years and less than or equal to 5 years					6.0	
Greater than 5 years and less than or equal to 10 years	4.0	6.0	15.0	8.0	12.0	24.0
Greater than 10 years					20.0	
Main index equities (including convertible bonds) and gold					20.0	
Other publicly traded equities and convertible bonds					30.0	
Mutual funds and exchange traded funds						Highest haircut applicable to any security in which the fund can invest, unless the banking organization can apply the full look-through approach for equity investments in funds §3.53(b), in which case the banking organization may use a weighted average of haircuts applicable to the securities held by the fund.
Cash on deposit					0.0	
Other exposure types <sup>2</sup>					30.0	

<sup>1</sup> Includes a foreign PSE that receives a zero percent risk weight.

<sup>2</sup> Includes senior securitization exposures with a risk weight greater than or equal to 100 percent and sovereign exposures with a risk weight greater than 100 percent.

(ii) For currency mismatches, a national bank or Federal savings association must use a haircut for foreign exchange rate volatility ( $H_{fx}$ ) of 8 percent, as adjusted in certain circumstances under paragraphs (e)(3)(iii) and (iv) of this section.

(iii) For repo-style transactions, a national bank or Federal savings association may multiply the haircuts provided in paragraphs (e)(3)(i) and (ii) of this section by the square root of  $1/2$  (which equals 0.707107).

(iv) A national bank or Federal savings association must adjust the haircuts provided in paragraphs (e)(3)(i) and (ii) of this section upward on the basis of a holding period longer than ten business days for eligible margin loans and derivative contracts that are not client-facing derivative transactions or a holding period longer than five business days for repo-style transactions and client-facing derivative transactions that are not cleared transactions under the following conditions. If the number of trades in a netting set exceeds 5,000 at any time during a quarter, a national bank or Federal savings association must adjust the haircuts provided in paragraphs (e)(3)(i) and (ii) of this section upward on the basis of a holding period of twenty business days for the following quarter except in the calculation of exposure amount for purposes of § 3.35. If a netting set contains one or more trades involving illiquid collateral, a national bank or Federal savings association must adjust the haircuts provided in paragraphs (e)(3)(i) and (ii) of this section upward on the basis of a holding period of twenty business days. If over the two previous quarters more than two margin disputes on a netting set have occurred that lasted longer

than the holding period, then the national bank or Federal savings association must adjust the haircuts provided in paragraphs (e)(3)(i) and (ii) of this section upward for that netting set on the basis of a holding period that is at least two times the minimum holding period for that netting set. The national bank or Federal savings association must adjust the haircuts upward using the following formula:

$$H_a = H_s \sqrt{T_m/T_s}$$

Where:

(A)  $T_m$  equals a holding period of longer than 10 business days for eligible margin loans and derivative contracts other than client-facing derivative transactions or longer than 5 business days for repo-style transactions and client-facing derivative transactions;

(B)  $H_s$  equals the market price volatility haircut provided in Table 1 to § 3.37 or to the foreign exchange rate volatility haircut provided in paragraph (e)(3)(ii) of this section; and

(C)  $T_s$  equals 10 business days for eligible margin loans and derivative contracts other than client-facing derivative transactions or 5 business days for repo-style transactions and client-facing derivative transactions.

(5) If the instruments a national bank or Federal savings association has lent, sold subject to repurchase, or posted as collateral do not meet the definition of financial collateral, the national bank or Federal savings association must use a 30 percent haircut for market price volatility ( $H_s$ ).

(f) *Election to apply SA-CCR to certain repo-style transactions.* (1) A national bank or Federal savings association that elects to determine the exposure amount using SA-CCR for its

derivative contracts under paragraph (a)(1)(ii) of § 3.34 may elect under paragraph (a)(3) of this section to use SA-CCR to determine the exposure amount for a set of repo-style transactions and derivative contracts that are subject to a qualifying cross-product master netting agreement. A national bank or Federal savings association makes such an election with respect to a qualifying cross-product master netting agreement must make the adjustments described in paragraphs (f)(2) and (3) in order to determine the exposure amount of the set of repo-style transactions and derivative contracts under SA-CCR.

(2) The exposure amount of a set of transactions subject to a qualifying cross-product master netting agreement for purposes of (f)(1),  $Exposure\ Amount_{NSCP}$ , must be calculated as follows:

$$\begin{aligned}
 Exposure\ Amount_{NSCP} &= (1 - MR_{NSCP}) * (Exposure\ Amount_{repo-style\ transactions} + Exposure\ Amount_{derivatives}) \\
 &+ MR_{NSCP} * Extended\ SA - CCR\ Exposure\ Amount
 \end{aligned}$$

Where:

(i)  $Exposure\ Amount_{repo-style\ transactions}$  is the exposure amount for repo-style transactions in the netting set that is subject to a qualifying cross-product master netting agreement, calculated using the collateral haircut approach, under paragraph (e) of this section;

(ii)  $Exposure\ Amount_{derivatives}$  is the exposure amount for derivatives in the netting set that is subject to a qualifying cross-product master netting agreement, calculated using the standardized approach to counterparty credit risk, under § 3.132(c)(5);

(iii)  $Extended\ SA - CCR\ Exposure\ Amount$  is the exposure amount for both repo-style transactions and derivatives that are in the netting set that is subject to a qualifying cross-product

master netting agreement, calculated using the standardized approach to counterparty credit risk, under § 3.132(c)(5); and

(iv)  $MR_{NSCP}$  is the Maturity Ratio for a given netting set that is subject to a qualifying cross-product master netting agreement, calculated as follows:

$$MR_{NSCP} = \frac{\sum NAWM \text{ of the repo - style transactions}_i}{\max(\sum NAWM \text{ of the repo - style transactions}_i, \sum NAWM \text{ of the derivative transactions}_i)}$$

Where:

(A)  $\sum NAWM \text{ of the repo - style transactions}_i$  is the notional average weighted maturity of all  $i$  repo-style transactions subject to the qualifying cross-product master netting agreement, subject to a minimum maturity of 10 business days and a maximum maturity of one year for purposes of this calculation.

(B)  $\sum NAWM \text{ of the derivative transactions}_i$  is the notional average weighted maturity of all  $i$  derivative transactions subject to the qualifying cross-product master netting agreement subject to a minimum maturity of 10 business days and a maximum maturity of one year for purposes of this calculation.

(3) For purposes of applying SA-CCR to a repo-style transaction, the national bank or Federal savings association must make the adjustments described in paragraphs (f)(3)(i) through (iii) of this section.

(i) For purposes of this section, the national bank or Federal savings association must:

(A) Treat a repo-style transaction that has multiple underlying instruments as separate repo-style transactions for each distinct underlying instrument;

(B) Treat a repo-style transaction with a debt instrument as the underlying instrument as either a credit derivative that references the underlying debt instrument or an interest rate derivative that references the interest rate of the underlying debt instrument, based on the primary risk factor of the repo-style transaction;

(C) Treat a repo-style transaction with an equity instrument as the underlying instrument as an equity derivative that references the underlying equity instrument;

(D) Not apply paragraph (c)(4) of § 3.132 to a repo-style transaction with an equity instrument as the underlying instrument; and

(E) Treat a repo-style transaction as a client-facing derivative transaction where the national bank or Federal savings association is either acting as a financial intermediary and enters into an offsetting transaction with a qualifying central counterparty (QCCP) or where the national bank or Federal savings association provides a guarantee on the performance of a client on a transaction between the client and a QCCP.

(ii) For purposes of the supervisory delta under paragraph (c)(9)(iii) of § 3.132, a national bank or Federal savings association must use a supervisory delta of 1 for a repurchase transaction or a securities lending transaction, and must use a supervisory delta of -1 for a reverse repurchase transaction or a securities borrowing transaction;

(iii) For purposes of the maturity factor under paragraph (c)(9)(iv) of § 3.132, MPOR cannot be less than five business days plus the periodicity of re-margining expressed in business days minus one business day.

\* \* \* \* \*

12. Amend § 3.41 to read as follows:

**§ 3.41 Operational criteria for recognizing the transfer of risk.**

(a) *Operational criteria for traditional securitizations.* A national bank or Federal savings association that transfers exposures it has originated or purchased to a third party in connection

with a traditional securitization may exclude the exposures from the calculation of its risk-weighted assets only if each condition in this section is satisfied. A national bank or Federal savings association that meets these conditions must hold risk-based capital against any credit risk it retains in connection with the securitization. A national bank or Federal savings association 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 common equity tier 1 capital any after-tax gain-on-sale resulting from the transaction and any portion of a CEIO strip that does not constitute after-tax gain-on-sale. If the transferred exposures are in connection with a resecuritization and all of the conditions in this paragraph (a) are satisfied, the national bank or Federal savings association must exclude the exposures from the calculation of its risk-weighted assets and must hold risk-based capital against any credit risk it retains in connection with the resecuritization. The conditions are:

(1) The exposures are not reported on the national bank's or Federal savings association's consolidated balance sheet under GAAP;

(2) The national bank or Federal savings association has transferred to one or more third parties credit risk associated with the underlying exposures;

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

(4) The securitization does not:

(i) Include 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) Contain an early amortization provision.

(b) *Operational criteria for synthetic securitizations.* For synthetic securitizations, a national bank or Federal savings association may recognize for risk-based capital purposes the use of a credit risk mitigant to hedge underlying exposures only if each condition in this paragraph (b) is satisfied. A national bank or Federal savings association that meets these conditions must hold risk-based capital against any credit risk of the exposures it retains in connection with the synthetic securitization. A national bank or Federal savings association that fails to meet these conditions or chooses not to recognize the credit risk mitigant for purposes of this section must instead hold risk-based capital against the underlying exposures as if they had not been synthetically securitized. If the synthetic securitization is a resecuritization and all of the conditions in this paragraph (b) are satisfied, the national bank or Federal savings association must exclude the underlying securitization exposures from the calculation of its risk-weighted assets and must hold risk-based capital against any credit risk it retains in connection with the resecuritization. The conditions are:

(1) The credit risk mitigant is:

(i) Financial collateral;

(ii) A guarantee that meets all criteria as set forth in the definition of *eligible guarantee* in § 3.2, except for the criteria in paragraph (3) of that definition;

(iii) A credit derivative that is not an nth-to-default credit derivative and that meets all criteria as set forth in the definition of *eligible credit derivative* in § 3.2, except for the criteria in paragraph (3) of the definition of *eligible guarantee* in § 3.2; or

(iv) A prepaid credit protection arrangement that meets all criteria as set forth in the definition of *eligible prepaid credit protection arrangement* in § 3.2, except for the criteria in paragraph (3) of that definition.

(2) The national bank or Federal savings association transfers credit risk associated with the underlying exposures to one or more 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 national bank or Federal savings association to alter or replace the underlying exposures to improve the credit quality of the underlying exposures;

(iii) Increase the national bank's or Federal savings association'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 national bank or Federal savings association 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 national bank or Federal savings association after the inception of the securitization;

(3) The national bank or Federal savings association obtains a well-reasoned opinion from legal counsel that confirms the enforceability of the credit risk mitigant in all relevant jurisdictions;

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

(5) No synthetic excess spread is permitted within the synthetic securitization;

(6) Any applicable minimum payment threshold for the credit risk mitigant is consistent with standard market practice; and

(7) The securitization does not:

(i) Include 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) Contain an early amortization provision.

(c) *Due diligence requirements for securitization exposures.* (1) Except for exposures that are deducted from common equity tier 1 capital and exposures subject to § 3.43(h), if a national bank or Federal savings association is unable to demonstrate to the satisfaction of the OCC a comprehensive understanding of the features of a securitization exposure that would materially affect the performance of the exposure, the national bank or Federal savings association must assign the securitization exposure a risk weight of 1,250 percent. The national bank's or Federal savings association's analysis must be commensurate with the complexity of the securitization exposure and the materiality of the exposure in relation to its capital.

(2) A national bank or Federal savings association must demonstrate its comprehensive understanding of a securitization exposure under paragraph (c)(1) of this section, for each securitization exposure by:

(i) Conducting an analysis of the risk characteristics of a securitization exposure prior to acquiring the exposure and documenting such analysis within 3 business days after acquiring the exposure, considering:

(A) Structural features of the securitization that would materially impact the performance of the exposure, for example, the contractual cash flow waterfall, waterfall-related triggers, credit enhancements, liquidity enhancements, fair value triggers, the performance of organizations that service the exposure, and deal-specific definitions of default;

(B) Relevant information regarding—

(1) The performance of the underlying credit exposure(s), for example, the percentage of loans 30, 60, and 90 days past due; default rates; prepayment rates; loans in foreclosure; property types; occupancy; average credit score or other measures of creditworthiness; average LTV ratio; and industry and geographic diversification data on the underlying exposure(s); and

(2) For resecuritization exposures, in addition to the information described in paragraph (c)(2)(i)(B)(1) of this section, performance information on the underlying securitization exposures, which may include the issuer name and credit quality, and the characteristics and performance of the exposures underlying the securitization exposures; and

(C) Relevant market data of the securitization, for example, bid-ask spread, most recent sales price and historic price volatility, trading volume, implied market rating, and size, depth and concentration level of the market for the securitization; and

(ii) On an on-going basis (no less frequently than quarterly), evaluating, reviewing, and updating as appropriate the analysis required under paragraph (c)(1) of this section for each securitization exposure.

\* \* \* \* \*

13. Amend § 3.42 to read as follows:

**§ 3.42 Exposure amount of a securitization exposure.**

(a) *On-balance sheet securitization exposure.* The exposure amount of an on-balance sheet securitization exposure (excluding a repo-style transaction, eligible margin loan, OTC derivative contract that is not a credit derivative, or cleared transaction that is not a credit derivative) is equal to the national bank's or Federal savings association's carrying value of the exposure. For a credit derivative, a national bank or Federal savings association must apply § 3.43(i) or (j), as applicable.

(b) *Off-balance sheet securitization exposure.* Except as provided in § 3.43(h), the exposure amount of an off-balance sheet securitization exposure that is not a repo-style transaction, eligible margin loan, OTC derivative contract (other than a credit derivative), or cleared transaction (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 an eligible ABCP liquidity facility, the notional amount may be reduced to the maximum potential amount that the national bank or Federal savings association could be required to fund given the ABCP program's current underlying assets (calculated without regard to the current credit quality of those assets).

(c) *Repo-style transaction, eligible margin loan, OTC derivative contract that is not a credit derivative, or cleared transaction that is not a credit derivative.* The exposure 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 exposure amount as calculated in accordance with §§ 3.34 or 3.37, or § 3.33, as applicable, and the exposure amount of a securitization exposure that is a cleared transaction that is not a credit derivative is the exposure amount as calculated in § 3.35.

\* \* \* \* \*

14. Amend § 3.43 to read as follows:

**§ 3.43 Risk-weighted assets for securitization exposures.**

(a) *General approach.* Except as provided elsewhere in this section and in § 3.41:

(1) A national bank or Federal savings association may, subject to the limitation under paragraph (e) of this section, apply the securitization standardized approach (SEC-SA) in § 3.44 to the exposure if the exposure meets the following requirements:

(i) The national bank or Federal savings association has accurate information on  $A$ ,  $D$ ,  $W$ , and  $K_G$  (as defined in § 3.44) for the exposure. Data used to assign the parameters described in this paragraph (a)(1)(i) must be the most currently available data. If the contracts governing the underlying exposures of the securitization require payments on a monthly or quarterly basis, the data used to assign the parameters described in this paragraph (a)(1)(i) must be no more than 91 calendar days old.

(ii) The national bank or Federal savings association has accurate information regarding whether the exposure is a resecuritization exposure.

(2) If the securitization exposure is an interest rate derivative contract, an exchange rate derivative contract, or a cash collateral account related to an interest rate or exchange rate derivative contract, the national bank or Federal savings association must assign a risk weight to the exposure equal to the risk weight of a securitization exposure that is *pari passu* to the interest rate derivative contract or exchange rate derivative contract or, if such an exposure does not exist, the risk weight of any subordinate securitization exposure.

(3) If the national bank or Federal savings association cannot apply, or chooses not to apply, the securitization standardized approach in § 3.44, the national bank or Federal savings association must apply a 1,250 percent risk weight to the exposure.

(b) *Total risk-weighted assets for securitization exposures.* A national bank's or Federal savings association's total risk-weighted assets for securitization exposures equals the sum of the risk-weighted asset amount for securitization exposures that the national bank or Federal savings association risk weights under §§ 3.43 through 3.45, as applicable.

(c) *After-tax gain-on-sale resulting from a securitization.* Notwithstanding any other provision of this subpart, a national bank or Federal savings association must deduct from common equity tier 1 capital any after-tax gain-on-sale resulting from a securitization as well as the portion of a CEIO that does not constitute an after-tax gain-on sale.

(d) *Overlapping exposures.* (1) If a national bank or Federal savings association has multiple securitization exposures that provide duplicative coverage of the underlying exposures of a securitization (such as when a national bank or Federal savings association provides a program-wide credit enhancement and multiple pool-specific liquidity facilities to an ABCP program), the national bank or Federal savings association is not required to hold duplicative risk-based capital against the overlapping position. Instead, the national bank or Federal savings association may apply to the overlapping position the applicable risk-based capital treatment that results in the highest risk-based capital requirement.

(2) If a national bank or Federal savings association has one or more securitization exposures that partially overlap with each other, the national bank or Federal savings association may treat the exposures as overlapping and apply the treatment under paragraph (d)(1). For

purposes of such a treatment under this paragraph (d)(2), the national bank or Federal savings association must include in expanded total risk-weighted assets the risk-weighted asset amount for a hypothetical securitization exposure that would fully overlap with all of the partially overlapping exposures.

(3) If a national bank or Federal savings association has a securitization exposure under this subpart that is an overlapping exposure with a securitization exposure that is a market risk covered position under subpart F of this part, the national bank or Federal savings association may assign to the overlapping securitization exposure the applicable risk-based capital treatment under either this subpart or subpart F, whichever results in the highest risk-based capital requirement.

(e) *Implicit support.* If a national bank or Federal savings association provides support to a securitization in excess of the national bank's or Federal savings association's contractual obligation to provide credit support to the securitization:

(1) The national bank or Federal savings association must calculate a risk-weighted asset amount for underlying exposures associated with the securitization as if the exposures had not been securitized and must deduct from common equity tier 1 capital any after-tax gain-on-sale resulting from the securitization and any portion of a CEIO strip that does not constitute after-tax gain-on-sale; and

(2) The national bank or Federal savings association must disclose publicly:

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

(ii) The risk-based capital impact to the national bank or Federal savings association of providing such implicit support.

(f) *Undrawn portion of a servicer cash advance facility.* (1) Notwithstanding any other provision of this subpart, a national bank or Federal savings association that is a servicer under an eligible servicer cash advance facility is not required to hold risk-based capital against potential future cash advance payments that it may be required to provide under the contract governing the facility.

(2) For a national bank or Federal savings association that acts as a servicer, the exposure amount for a servicer cash advance facility that is not an eligible servicer cash advance facility is equal to the amount of all potential future cash advance payments that the national bank or Federal savings association may be contractually required to provide during the subsequent 12-month period under the contract governing the facility.

(g) *Interest-only mortgage-backed securities.* Notwithstanding any other provision of this subpart, the risk weight for a non-credit-enhancing interest-only mortgage-backed security may not be less than 100 percent.

(h) *Small-business loans and leases on personal property transferred with retained contractual exposure.* (1) Regardless of any other provision of this subpart, a national bank or Federal savings association that has transferred small-business loans and leases on personal property (small-business obligations) with recourse must include in risk-weighted assets only its contractual exposure to the small-business obligations if all the following conditions are met:

(i) The transaction must be treated as a sale under GAAP;

(ii) The national bank or Federal savings association establishes and maintains, pursuant to GAAP, a non-capital reserve sufficient to meet the national bank's or Federal savings association's reasonably estimated liability under the contractual obligation;

(iii) The small-business obligations 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 U.S.C. 632 et seq.); and

(iv) The national bank or Federal savings association is well capitalized as defined in 12 CFR 6.4. For purposes of determining whether a national bank or Federal savings association is well capitalized for purposes of this paragraph (h), the national bank's or Federal savings association's capital ratios must be calculated without regard to the capital treatment for transfers of small-business obligations with recourse specified in paragraph (h)(1) of this section.

(2) The total outstanding amount of contractual exposure retained by a national bank or Federal savings association on transfers of small-business obligations receiving the capital treatment specified in paragraph (h)(1) of this section cannot exceed 15 percent of the national bank's or Federal savings association's total capital.

(3) If a national bank or Federal savings association ceases to be well capitalized under 12 CFR 6.4, or exceeds the 15 percent capital limitation provided in paragraph (h)(2) of this section, the capital treatment specified in paragraph (h)(1) of this section will continue to apply to any transfers of small-business obligations with retained contractual exposure that occurred during the time that the national bank or Federal savings association was well capitalized and did not exceed the capital limit.

(4) The risk-based capital ratios of the national bank or Federal savings association must be calculated without regard to the capital treatment for transfers of small-business obligations specified in paragraph (h)(1) of this section for purposes of:

(i) Determining whether a national bank or Federal savings association is adequately capitalized, undercapitalized, significantly undercapitalized, or critically undercapitalized under the OCC's prompt corrective action regulations; and

(ii) Reclassifying a well-capitalized national bank or Federal savings association to adequately capitalized and requiring an adequately capitalized national bank or Federal savings association to comply with certain mandatory or discretionary supervisory actions as if the national bank or Federal savings association were in the next lower prompt-corrective-action category.

(i) *N<sup>th</sup>-to-default credit derivatives*—(1) *Protection provider*. A national bank or Federal savings association providing protection through a first-to-default or second-or-later-to-default derivative is subject to capital requirements on such instruments under this paragraph (i)(1).

(i) *First-to-default*. For first-to-default derivatives, a national bank or Federal savings association must aggregate by simple summation the risk weights of the assets covered up to a maximum of 1,250 percent and multiply by the nominal amount of the protection provided by the credit derivative to obtain the risk-weighted asset amount.

(ii) *N<sup>th</sup>-to-default*. For second-or-later-to-default derivatives, in aggregating the risk weights, a national bank or Federal savings association may exclude the asset with the lowest risk-weighted amount from the risk-weighted capital calculation. This risk-based capital treatment applies for nth-to-default derivatives for which the n-1 assets with the lowest risk-weighted amounts can be excluded from the risk-weighted capital calculation.

(2) *Protection purchaser*. A national bank or Federal savings association is not permitted to recognize purchased protection in the form of an nth-to-default credit derivative as a credit

risk mitigant. A national bank or Federal savings association must calculate the counterparty credit risk of a purchased *n*<sup>th</sup>-to-default credit derivative under §§ 3.34.

(j) *Guarantees, credit derivatives other than n<sup>th</sup>-to-default credit derivatives, and prepaid credit protection arrangements*—(1) *Protection provider*. For a guarantee, credit derivative (other than an *n*<sup>th</sup>-to-default credit derivative), or prepaid credit protection arrangement provided by a national bank or Federal savings association that covers the full amount or a pro rata share of a securitization exposure's principal and interest, the national bank or Federal savings association must risk-weight the guarantee, credit derivative, or prepaid credit protection arrangement under paragraph (a) of this section as if it held the portion of the securitization exposure covered by the guarantee, credit derivative, or prepaid credit protection arrangement.

(2) *Protection purchaser*. (i) A national bank or Federal savings association that purchases a credit derivative (other than an *n*<sup>th</sup>-to-default credit derivative) that is recognized under § 3.45 as a credit risk mitigant (including via recognized collateral) is not required to compute a separate counterparty credit risk capital requirement under §§ 3.34.

(ii) If a national bank or Federal savings association cannot, or chooses not to, recognize protection purchased in the form of a credit derivative as a credit risk mitigant under § 3.45, the national bank or Federal savings association must determine the exposure amount of the credit derivative under § 3.34.

(A) If the national bank or Federal savings association purchases credit protection from a counterparty, the national bank or Federal savings association must determine the risk weight for the exposure according to § 3.32.

(B) If the national bank or Federal savings association purchases credit protection from a counterparty, the national bank or Federal savings association must determine the risk weight for the exposure according to this section.

(k) *Look-through approach.* (1) Subject to paragraph (k)(2) of this section, a national bank or Federal savings association may assign a risk weight to a senior securitization exposure that is not a resecuritization exposure equal to the greater of:

(i) The weighted-average risk weight, calculated without reference to, or the use of the risk weight under § 3.52(b)(3)(iii), of all the underlying exposures where the weight for each exposure in the weighted-average calculation is determined by the unpaid principal amount of the exposure; and

(ii) 15 percent.

(2) A national bank or Federal savings association may assign a risk weight under this paragraph (k) only if the national bank or Federal savings association has knowledge of the composition of all of the underlying exposures.

(l) *NPL securitization.* Notwithstanding any other provision of this subpart except for paragraph (e) of this section:

(1) If the nonrefundable purchase price discount for the NPL securitization is greater than or equal to 50 percent of the unpaid principal balance of the pool of exposures, the risk weight for a senior securitization exposure to an NPL securitization is 100 percent.

(2) If the national bank or Federal savings association is an originating national bank or Federal savings association with respect to the NPL securitization, the national bank or Federal

savings association may hold risk-based capital against the transferred exposures as if they had not been securitized and must deduct from common equity tier 1 capital any after-tax gain-on-sale resulting from the transaction and any portion of a CEIO that does not constitute an after-tax gain-on-sale.

\* \* \* \* \*

15. Amend § 3.44 to read as follows:

**§ 3.44 Securitization standardized approach (SEC-SA).**

(a) *In general.* The risk weight  $RW_{SEC-SA}$  assigned to a securitization exposure, or portion of a securitization exposure, is calculated according to the following formula:

$$RW_{SEC-SA} = \begin{cases} \max(RW_{FLOOR}, 1,250\% \cdot K_{SEC-SA}), & K_A \leq A \\ \max\left(RW_{FLOOR}, \left(\frac{K_A - A}{D - A}\right) \cdot 1,250\% + \left(\frac{D - K_A}{D - A}\right) \cdot 1,250\% \cdot K_{SEC-SA}\right), & A < K_A < D \\ 1,250\%, & D \leq K_A \end{cases}$$

Where:

(1)  $K_A$  is calculated under paragraph (b) of this section;

(2)  $A$  (attachment point) equals the greater of zero and the ratio, expressed as a decimal value between zero and one, of the current dollar amount of underlying exposures that are subordinated to the exposure of the national bank or Federal savings association to the current dollar amount of the underlying exposures, as adjusted in accordance with paragraph (a)(6) of this section;

(3)  $D$  (detachment point) equals the greater of zero and the sum of the parameter  $A$  and the ratio, expressed as a decimal value between zero and one, of the current dollar amount of the securitization exposures that are ranked senior or pari passu with the exposure (that is, have equal seniority with respect to credit risk) to the current dollar amount of the underlying exposures, as adjusted in accordance with paragraph (a)(6) of this section;

(4)  $RW_{FLOOR}$  equals 100 percent for resecuritization exposures and NPL securitization exposures and 15 percent for all other securitization exposures; and

(5)  $K_{SEC-SA}$  is calculated according to the following formula:

$$K_{SEC-SA} = \frac{e^{a \cdot u} - e^{a \cdot l}}{a \cdot (u - l)}$$

Where:

(i)  $a$  equals  $-\frac{1}{p \cdot K_A}$  (as  $K_A$  is defined in this paragraph (a)), where  $p$  equals 1.5 for a resecuritization exposure and 0.5 for all other securitization exposures;

(ii)  $u$  equals  $D - K_A$  (as  $D$  and  $K_A$  are defined in paragraph (a) of this section);

(iii)  $l$  equals  $\max(A - K_A, 0)$  (as  $A$  and  $K_A$  are defined in paragraph (a) of this section);

and

(iv)  $e$  equals the base of the natural logarithm.

(6) A national bank or Federal savings association must include in the calculation of  $A$  and  $D$  the funded portion of any reserve account funded by the accumulated cash flows from the underlying exposures that is subordinated to the national bank's or Federal savings association's securitization exposure. Interest rate derivative contracts, exchange rate derivative contracts, and

cash collateral accounts related to these contracts must not be included in the calculation of  $A$  and  $D$ . If the securitization exposure includes a nonrefundable purchase price discount, the nonrefundable purchase price discount must be included in the numerator and denominator of  $A$  and  $D$ .

(b) *Calculation of  $K_A$ .*  $K_A$  is calculated under this paragraph (b) according to the following formula:

$$K_A = (1 - W) \cdot K_G + (W \cdot 0.5)$$

Where:

(1)  $W$  equals the ratio, expressed as a decimal value between zero and one, of the sum of the dollar amounts of any underlying exposures of the securitization that are not securitization exposures and that meet any of the criteria in paragraphs (b)(1)(i) through (vii) of this section to the outstanding balance measured in dollars of all underlying exposures:

- (i) Ninety days or more past due;
- (ii) Subject to a bankruptcy or insolvency proceeding;
- (iii) In the process of foreclosure;
- (iv) Held as real estate owned;
- (v) Has contractually deferred payments for 90 days or more, other than principal or interest payments deferred on:
  - (A) Federally guaranteed student loans, in accordance with the terms of those guarantee programs; or

(B) Consumer loans, including non-federally-guaranteed student loans, provided that such payments are deferred pursuant to provisions included in the contract at the time funds are disbursed that provide for period(s) of deferral that are not initiated based on changes in the creditworthiness of the borrower; or

(vi) Is in default; and

(vii) Notwithstanding paragraphs (1)(i) through (vi) of this paragraph, an exposure that is directly and unconditionally guaranteed by the U.S. Government, its central bank, or a U.S. Government agency may be excluded from the calculation of  $W$  up to the amount of the guarantee; and

(2)  $K_G$  equals the weighted average (with unpaid principal used as the weight for each credit exposure and fair value used for each equity exposure) total capital requirement, expressed as a decimal value between zero and one, of the underlying exposures calculated using this subpart D (that is, an average risk weight of 100 percent represents a value of  $K_G$  equal to 0.08), as adjusted in accordance with this paragraph (b)(2). For purposes of  $K_G$ , the determination of the capital requirement associated with an underlying exposure that is an equity exposure cannot use the risk weight under § 3.52(b)(3)(iii). For interest rate derivative contracts and exchange rate derivative contracts, the positive current exposure times the risk weight of the counterparty multiplied by 0.08 must be included in the numerator of  $K_G$  but must be excluded from the denominator of  $K_G$ .

\* \* \* \* \*

16. Amend § 3.45 by:

- a. Adding paragraphs (a)(3) and (a)(4).
- b. Revising paragraph (b).

The additions and revisions read as follows:

**§ 3.45 Recognition of credit risk mitigants for securitization exposures.**

\* \* \* \* \*

(3) If the recognized credit risk mitigant hedges a portion of the national bank’s or Federal savings association’s securitization exposure, the national bank or Federal savings association must calculate its capital requirements for the hedged and unhedged portions of the exposure separately. For each unhedged portion, the national bank or Federal savings association must calculate capital requirements according to § 3.42 and § 3.43. For each hedged portion, the national bank or Federal savings association may recognize the credit risk mitigant under § 3.36 or § 3.37, but only as provided in this section.

(4) When a national bank or Federal savings association purchases or sells credit protection on a portion of a senior tranche, the lower-priority portion, whether hedged or unhedged, must be considered a non-senior securitization exposure.

\* \* \* \* \*

(b) *Mismatches*. A national bank or Federal savings association must make any applicable adjustment to the protection amount as required in § 3.36 for any hedged securitization exposure. In the context of a synthetic securitization, when a credit risk mitigant described in § 3.41(b)(1)(ii) through (iv) covers multiple hedged exposures that have different

residual maturities, the national bank or Federal savings association must use the longest residual maturity of any of the hedged exposures as the residual maturity of all hedged exposures.

\* \* \* \* \*

17. Amend § 3.51 by:

a. Revising paragraph (b).

The revisions read as follows:

**§ 3.51 Introduction and exposure measurement.**

\* \* \* \* \*

(b) *Adjusted carrying value.* For purposes of §§ 3.51 through 3.53, the adjusted carrying value of an equity exposure is:

\* \* \* \* \*

(4) For a commitment to acquire an equity exposure (an equity commitment), the effective notional principal amount of the exposure is multiplied by the following conversion factors (CFs):

(i) Conditional equity commitments receive a 40 percent conversion factor.

(ii) Unconditional equity commitments receive a 100 percent conversion factor.

\* \* \* \* \*

18. Revise § 3.61 to read as follows:

**§ 3.61 Purpose and scope.**

Sections 3.61 through 3.63 of this subpart establish public disclosure requirements related to the capital requirements described in subpart B of this part for a national bank or Federal savings association with total consolidated assets of \$50 billion, as adjusted pursuant to § 3.4, or more as reported on the national bank's or Federal savings association's most recent year-end Call Report, that is not an advanced approaches national bank or Federal savings association making public disclosures pursuant to § 3.172. An advanced approaches national bank or Federal savings association that has not received approval from the OCC to exit parallel run pursuant to § 3.121(d) is subject to the disclosure requirements described in §§ 3.62 and 3.63. A national bank or Federal savings association with total consolidated assets of \$50 billion, as adjusted pursuant to § 3.4, or more as reported on the national bank's or Federal savings association's most recent year-end Call Report, that is not an advanced approaches national bank or Federal savings association making public disclosures subject to § 3.172 must comply with § 3.62 unless it is a consolidated subsidiary of a bank holding company, savings and loan holding company, or depository institution that is subject to the disclosure requirements of § 3.62 or a subsidiary of a non-U.S. banking organization that is subject to comparable public disclosure requirements in its home jurisdiction. For purposes of this section, total consolidated assets are determined based on the average of the national bank's or Federal savings association's total consolidated assets in the four most recent quarters as reported on the Call Report, or the average of the national bank's or Federal savings association's total consolidated assets in the most recent consecutive quarters as reported quarterly on the Call Report, if the national bank or Federal savings association has not filed such a report for each of the most recent four quarters.

\* \* \* \* \*

19. Amend § 3.300 by revising paragraph (a) to read as follows:

### § 3.300 Transitions.

(a) *Transition adjustments for AOCI.* Beginning [January 1, 2027], a Category III national bank or Federal savings association or a Category IV national bank or Federal savings association that had made an AOCI opt-out election under § 3.22(b)(2) effective [December 31, 2026], must subtract from the sum of its common equity tier 1 elements, before making deductions required under § 3.22(c) or (d), the transition AOCI adjustment amount multiplied by the percentage provided in Table 1 to § 3.300. The transition AOCI adjustment amount is the sum of:

- (1) Net unrealized gains or losses on available-for-sale securities, plus
- (2) Accumulated net gains or losses on cash flow hedges, plus
- (3) Any amounts recorded in AOCI attributed to defined benefit postretirement plans resulting from the initial and subsequent application of the relevant GAAP standards that pertain to such plans, plus
- (4) Net unrealized holding gains or losses on held-to-maturity securities that are included in AOCI.

**Table 1 to § 3.300**

#### **Transition AOCI Adjustment**

<b>Transition period</b>	<b>Percentage applicable to transition AOCI adjustment amount</b>
January 1, 2027 to December 31, 2027	100

January 1, 2028 to December 31, 2028	80
January 1, 2029 to December 31, 2029	60
January 1, 2030 to December 31, 2030	40
January 1, 2031 to December 31, 2031	20
January 1, 2032 and thereafter	0

\* \* \* \* \*

**Board of Governors of the Federal Reserve System**

**12 CFR Chapter II**

**Authority and Issuance**

For the reasons set forth in the common preamble, the Board of Governors of the Federal Reserve System proposes to amend chapter II of title 12 of the Code of Federal Regulations as follows:

**PART 217—CAPITAL ADEQUACY OF BANK HOLDING COMPANIES, SAVINGS AND LOAN HOLDING COMPANIES, AND STATE MEMBER BANKS (REGULATION Q)**

20. The authority citation for part 217 continues to read as follows:

**Authority:** 12 U.S.C. 248(a), 321–338a, 481–486, 1462a, 1467a, 1818, 1828, 1831n, 1831o, 1831p-1, 1831w, 1835, 1844(b), 1851, 3904, 3906–3909, 4808, 5365, 5368, 5371, and 5371 note, and sec. 4012, Pub. L. 116–136, 134 Stat. 281.

21. In § 217.1:

- a. Revise paragraphs (c)(5)(i), (e) and (f); and
- b. Add paragraph (h).

The addition and revision read as follows:

**§ 217.1 Purpose, applicability, reservations of authority, and timing.**

\* \* \* \* \*

(c) \* \* \*

(5) \* \* \*

(i) Except for an advanced approaches Board-regulated institution that is making public disclosures pursuant to the requirements in subpart E of this part, each Board-regulated institution with total consolidated assets of \$50 billion or more, as adjusted pursuant to § 217.4, must make the public disclosures described in subpart D of this part.

\* \* \* \* \*

(e) *Notice and response procedures.* In making a determination under this part, unless more specifically provided for, the Board will apply notice and response procedures in the same manner and to the same extent as the notice and response procedures in 12 CFR 263.202.

(f) *Timing.* A Board-regulated institution that changes from one category of Board-regulated institution to another of such categories, or that changes from having no category of Board-regulated institution to having such a category, must comply with the requirements of its category in this part, including applicable transition provisions of the requirements in this part, no later than on the first day of the second quarter following the change in the company’s category.

\* \* \* \* \*

(h) *Severability.* If any provision of this part, or the application thereof to any Board-regulated institution, is held invalid, such invalidity shall not affect the validity of other provisions or the application of such provision to Board-regulated institutions that can be given effect without the invalid provision or application.

\* \* \* \* \*

22. In § 217.2:

- a. Revise the definition of “Adjusted allowances for credit losses (AACL)”;
- b. Remove the definition of “Allowances for loan and lease losses (ALLL)”;
- c. Revise the definition of “Carrying value”;
- d. In the definition of “Category III Board-regulated institution (217.2):
  - i. Remove paragraph (3);
  - ii. Redesignate paragraph (4) as paragraph (3);

- iii. Revise newly redesignated paragraph (3) introductory text;
- iv. Revise newly redesignated paragraph (3)(i); and
- vi. In newly redesignated paragraph (3)(iv) introductory text, remove the words “paragraph (4)(ii) of this definition” and add, in their place, the words “paragraph (3)(ii) of this definition”;
- e. Add, in alphabetical order, the definition for “Category IV Board-regulated institution”;
- f. Revise the definition for “Commitment”;
- g. Add, in alphabetical order, the definition for “Dependent on the cash flows generated by the real estate”;
- h. Revise the definitions for “Effective notional amount”, “Eligible clean-up call”, and “Eligible guarantee”;
- i. Add, in alphabetical order, the definition for “Eligible prepaid credit protection arrangement”;
- j. Revise paragraph (4)(i)(A) in the definition of “Financial institution”;
- k. Revise the definition for “Netting set”;
- l. Add, in alphabetical order, the definitions for “Non-performing loan securitization (NPL securitization)”, “Nonrefundable purchase price discount (NRPPD)”, and “Prepaid credit protection arrangement”;
- m. Revise the definition for “Protection amount (P)”;
- n. Add, in alphabetical order, the definition for “Qualifying Cross Product Master Netting Agreement”;

- o. Revise paragraphs (3) and (4) of the definition for “Qualifying master netting agreement”;
- p. Revise paragraph (1)(ii) of the definition for “Residential mortgage exposure”;
- q. Remove the definition for “Securitization special purpose entity (SPE)”;
- r. Add, in alphabetical order, the definitions for “Senior securitization exposure” and “Specified supranational entity”;
- s. Revise the definition for “Speculative grade”;
- t. In the definition of “Standardized total risk-weighted assets”, remove the words “§ 217.42” and add, in their place, the words “§ 217.43”;
- u. Revise the definition for “Sub-speculative grade”;
- v. Add, in alphabetical order, the definition for “Synthetic excess spread”;
- w. Revise the definitions for “Synthetic securitization”, and “Traditional securitization”.

The additions and revisions read as follows:

*Adjusted allowances for credit losses (AACL)* means valuation allowances that have been established through a charge against earnings or retained earnings for expected credit losses on financial assets measured at amortized cost and a lessor's net investment in leases that have been established to reduce the amortized cost basis of the assets to amounts expected to be collected as determined in accordance with GAAP. For purposes of this part, adjusted allowances for credit losses include allowances for expected credit losses on off-balance sheet credit exposures not accounted for as insurance as determined in accordance with GAAP.

Adjusted allowances for credit losses exclude allocated transfer risk reserves and allowances created that reflect credit losses on purchased credit deteriorated assets, purchased seasoned loans, assets required to record an allowance for credit losses through a gross-up adjustment to the purchase price of the asset, and available-for-sale debt securities.

\* \* \* \* \*

*Carrying value* means, with respect to an asset, the value of the asset on the balance sheet of the Board-regulated institution as determined in accordance with GAAP. For all assets other than available-for-sale debt securities, purchased credit deteriorated assets, purchased seasoned loans, or assets required to record an allowance for credit losses through a gross-up adjustment to the purchase price of the asset, the carrying value is not reduced by any associated credit loss allowance that is determined in accordance with GAAP.

\* \* \* \* \*

*Category III Board-regulated institution* means:

\* \* \* \* \*

(3) A state member bank that is not a Category II Board-regulated institution and that:

(i) Is a subsidiary of a Category III banking organization, as defined pursuant to § 252.5 of this chapter or § 238.10 of this chapter, as applicable; or

\* \* \* \* \*

*Category IV Board-regulated institution* means:

(1) A depository institution holding company that is identified as a Category IV banking organization pursuant to § 252.5 of this chapter or § 238.10 of this chapter, as applicable;

(2) A U.S. intermediate holding company that is identified as a Category IV banking organization pursuant to § 252.5 of this chapter;

(3) A state member bank that is not a Category II Board-regulated institution or Category III Board-regulated institution and that:

(i) Is a subsidiary of a Category IV banking organization, as defined pursuant to § 252.5 of this chapter or § 238.10 of this chapter, as applicable; or

(ii) Has total consolidated assets, calculated based on the average of the depository institution's total consolidated assets for the four most recent calendar quarters as reported on the Call Report of \$100 billion or more. If the depository institution has not filed the Call Report for each of the four most recent calendar quarters, total consolidated assets is calculated based on its total consolidated assets, as reported on the Call Report, for the most recent quarter or the average of the four most recent quarters, as applicable.

(iii) After meeting the criterion in paragraph (3)(ii) of this definition, a state member bank continues to be a Category IV Board-regulated institution until the state member bank:

(A) Has less than \$100 billion in total consolidated assets, as reported on the Call Report, for each of the four most recent calendar quarters; or

(B) Is a Category II or Category III Board-regulated institution.

\* \* \* \* \*

*Commitment* means a contractual arrangement, under which a Board-regulated institution and an obligor agree to terms applicable to one or more future extensions of credit, purchases of assets, or issuances of credit substitutes by the Board-regulated institution, whether or not such arrangement is unconditionally cancelable. A commitment is unconditionally cancelable if, by its terms, it either: (a) provides that a Board-regulated institution is not obligated to extend credit, purchase assets, or issue credit substitutes; or (b) permits a Board-regulated institution, at any time, with or without cause, to refuse to extend credit, purchase assets, or issue credit substitutes under the arrangement (to the extent permitted under applicable law).

\* \* \* \* \*

*Dependent on the cash flows generated by the real estate* means, for a real estate exposure, the underwriting, at the time of origination, considers the cash flows generated by lease, rental, or sale of the real estate securing the loan as a source of repayment. For purposes of this definition, a residential mortgage exposure that is secured by the borrower's principal residence is deemed not dependent on the cash flows generated by the real estate.

\* \* \* \* \*

*Effective notional amount* means for an eligible guarantee, eligible credit derivative, or eligible prepaid credit protection arrangement, the lesser of the contractual notional amount of the credit risk mitigant and the exposure amount of the hedged exposure, multiplied by the percentage coverage of the credit risk mitigant.

\* \* \* \* \*

*Eligible clean-up call* means a clean-up call that:

(1) Is exercisable solely at the discretion of the originating Board-regulated institution 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) Is only exercisable:

(i) For a traditional securitization, 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;

(ii) For a synthetic securitization, 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;

(iii) Upon the occurrence of a regulatory event that significantly changes the risk-weighted asset amount for the securitization exposure under applicable risk-weighted asset standards; or

(iv) Upon the occurrence of a tax event that significantly changes the tax treatment of the securitization exposure under applicable tax laws.

\* \* \* \* \*

*Eligible guarantee* means a guarantee that:

(1) Is written;

(2) Is either:

(i) Unconditional, or

(ii) A contingent obligation of the U.S. government or its agencies, the enforceability of which is dependent upon some affirmative action on the part of the beneficiary of the guarantee or a third party (for example, meeting servicing requirements);

(3) Covers all or a pro rata portion of all contractual payments of the obligated party on the reference exposure;

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

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

(6) Except for a guarantee by a sovereign, is legally enforceable against the protection provider in a jurisdiction where the protection provider has sufficient assets against which a judgment may be attached and enforced;

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

(8) Does not increase the beneficiary's cost of credit protection on the guarantee in response to deterioration in the credit quality of the reference exposure;

(9) Is not provided by an affiliate of the Board-regulated institution, unless the affiliate is an insured depository institution, foreign bank, securities broker or dealer, or insurance company that:

(i) Does not control the Board-regulated institution; and

(ii) Is subject to consolidated supervision and regulation comparable to that imposed on depository institutions, U.S. securities broker-dealers, or U.S. insurance companies (as the case may be); and

(10) Is provided by an eligible guarantor.

\* \* \* \* \*

*Eligible prepaid credit protection arrangement* means a prepaid credit protection arrangement that:

(1) Is written;

(2) Is unconditional;

(3) Covers all or a pro rata portion of all contractual payments due to be paid on the reference exposure or reference exposures;

(4) Provides that the amount and timing of payments due from the protection purchaser to the protection provider are incorporated into the arrangement and the arrangement only allows these terms to change in the event of a breach of the arrangement by the protection purchaser;

(5) Provides that entry of the protection provider into receivership, insolvency, liquidation, conservatorship, or similar proceeding does not change the amounts or timing of payments due to be paid by the protection purchaser under the arrangement;

(6) Is legally valid and enforceable under applicable law of the relevant jurisdictions;

(7) Upon a failure by the obligor on the one or more reference exposures to make a contractually required payment, or the occurrence of other credit events as described in the arrangement, allows the protection purchaser promptly to reduce the outstanding balance of the initial principal amount due to the protection provider by the loss of the protection purchaser on the reference exposures without input from the protection provider; and

(8) Does not increase the protection purchaser's cost of credit protection in response to deterioration in the credit quality of any of the reference exposure.

\* \* \* \* \*

*Financial institution* means:

\* \* \* \* \*

(4) \* \* \*

(i) \* \* \*

(A) An investment in GAAP equity instruments of the company with an adjusted carrying value or exposure amount equal to or greater than \$10 million, as adjusted pursuant to § 217.4; or

\* \* \* \* \*

*Netting set* means a group of transactions with a single counterparty that are subject to a qualifying master netting agreement. For derivative contracts, netting set also includes a single derivative contract between a Board-regulated institution and a single counterparty.

\* \* \* \* \*

*Non-performing loan securitization (NPL securitization)* means a traditional securitization, that is not a resecuritization, where parameter W (as defined in § 217.44(b)(1)) for the underlying exposures in a pool is greater than or equal to 90 percent at the origination cut-off date and at any subsequent date on which exposures are added to or removed from the pool of underlying exposures due to replenishment or restructuring.

*Nonrefundable purchase price discount (NRPPD)* means the difference between the outstanding principal balance of the underlying exposures at the time of sale and the price at which these exposures are sold by the originator to a company the activities of which are limited to those appropriate for the specific purpose of holding the underlying exposures of a securitization, when neither originator nor the original lender are reimbursed for this difference. In cases where the originator underwrites tranches of an NPL securitization for subsequent sale, the NRPPD may include the differences between the outstanding principal balance of the underlying exposures at the time of sale and the price at which all of the tranches are first sold to unrelated third parties. For any given piece of a securitization tranche, only its initial sale from the originator to investors is taken into account in the determination of NRPPD. The purchase prices of subsequent re-sales of a securitization tranche are not considered.

\* \* \* \* \*

*Prepaid credit protection arrangement* means a contractual arrangement under which a protection purchaser transfers the credit risk of one or more reference exposures to a protection provider where:

(1) The protection provider pays an initial principal amount in cash to the protection purchaser at the inception of the transaction; and

(2) The protection purchaser is obligated to repay the initial principal amount to the protection provider on or before the maturity date of the transaction, less any losses that the protection purchaser realizes or otherwise recognizes due to nonpayment of all contractual payments due to be paid on the reference exposure or reference exposures by the obligors.

\* \* \* \* \*

*Protection amount (P)* means, with respect to an exposure hedged by an eligible guarantee, eligible credit derivative, or eligible prepaid credit protection arrangement, or secured by financial collateral, the effective notional amount of the guarantee, credit derivative, or prepaid credit protection arrangement, or the fair value of the financial collateral, reduced to reflect any currency mismatch, maturity mismatch, or lack of restructuring coverage (as provided in § 217.36-217.37 or § 217.120-121, as applicable).

\* \* \* \* \*

*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 the underlying financial transactions are derivative contracts or repo-style transactions that are not cleared transactions. In order to treat an agreement as a qualifying cross-product master netting agreement, a Board-regulated institution must comply with the requirements of § 217.3(c) of this part with respect to that agreement.

\* \* \* \* \*

*Qualifying master netting agreement* means a written, legally enforceable agreement provided that:

\* \* \*

(3) The agreement does not contain a walkaway clause (that is, a provision that permits a non-defaulting counterparty to make a lower payment than it otherwise would make under the agreement, or no payment at all, to a defaulter or the estate of a defaulter, even if the defaulter or the estate of the defaulter is a net creditor under the agreement); and

(4) In order to recognize an agreement as a qualifying master netting agreement for purposes of this subpart, a Board-regulated institution must comply with the requirements of § 217.3(d) with respect to that agreement.

\* \* \* \* \*

*Residential mortgage exposure* means an exposure (other than a securitization exposure, equity exposure, statutory multifamily mortgage, or presold construction loan):

(1) \* \* \*

(ii) With an original and outstanding amount of \$1 million or less, as adjusted pursuant to § 217.4, that is primarily secured by a first or subsequent lien on residential property that is not one-to-four family; and

\* \* \* \* \*

*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 Board-regulated institution is not required to consider amounts due under interest rate derivative, currency derivative, and servicer cash advance facility contracts; fees due; and 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 derivative, currency derivative, and servicer cash advance facility contracts; fees due; and other similar payments.

\* \* \* \* \*

*Specified supranational entity* means the Bank for International Settlements, the European Central Bank, the European Commission, the International Monetary Fund, the European Stability Mechanism, or the European Financial Stability Facility.

\* \* \* \* \*

*Speculative grade* means that the entity to which the Board-regulated institution is exposed through a loan or security, or the reference entity with respect to a credit derivative, has adequate capacity to meet financial commitments in the near term, but is vulnerable to adverse economic conditions, such that should economic conditions deteriorate, the issuer or the reference entity would present an elevated default risk.

\* \* \* \* \*

*Sub-speculative grade* means that the entity to which the Board-regulated institution is exposed through a loan or security, or the reference entity with respect to a credit derivative, depends on favorable economic conditions to meet its financial commitments, such that should such economic conditions deteriorate the issuer or the reference entity likely would default on its financial commitments.

\* \* \* \* \*

*Synthetic excess spread* means any contractual provisions in a synthetic securitization that are designed to absorb losses prior to any of the tranches of the securitization structure.

\* \* \* \* \*

*Synthetic securitization* means a transaction in which:

(1) All or a portion of the credit risk of one or more underlying exposures is retained or transferred to one or more third parties through the use of one or more credit derivatives, guarantees (other than a guarantee that transfers only the credit risk of an individual retail exposure), or prepaid credit protection arrangements;

(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 solely 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).

\* \* \* \* \*

*Traditional securitization* means a transaction in which:

- (1) All or a portion of the credit or equity risk of one or more underlying exposures is transferred to one or more third parties other than through the use of credit derivatives, guarantees, or prepaid credit protection arrangements;
- (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 solely 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 defined in section 302 of the Small Business Investment Act;
- (7) The underlying exposures are not owned by a firm an investment in which qualifies as a community development investment under section 24(Eleventh) of the National Bank Act;
- (8) The Board 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 Board may deem a transaction that meets the definition of a traditional securitization, notwithstanding paragraph (5), (6), or (7) of this definition, to be a traditional securitization based on the transaction's leverage, risk profile, or economic substance; and

(10) The transaction is not:

(i) An investment fund;

(ii) A collective investment fund (as defined in 12 CFR 208.34);

(iii) An employee benefit plan (as defined in paragraphs (3) and (32) of section 3 of ERISA), a “governmental plan” (as defined in 29 U.S.C. 1002(32)) that complies with the tax deferral qualification requirements provided in the Internal Revenue Code, or any similar employee benefit plan established under the laws of a foreign jurisdiction;

(iv) A synthetic exposure to the capital of a financial institution to the extent deducted from capital under § 217.22; or

(v) Registered with the SEC under the Investment Company Act of 1940 (15 U.S.C. 80a-1) or foreign equivalents thereof.

\* \* \* \* \*

23. Add § 217.4 to read as follows:

**§ 217.4 Threshold Indexing.**

(a) *Methodology.* The dollar thresholds specified in paragraph (c) of this section shall be adjusted by multiplying the baseline threshold values specified in paragraph (c) of this section by one plus the cumulative percent change in the non-seasonally adjusted Consumer Price Index for Urban Wage Earners and Clerical Workers, measured from the effective date of this rule, as further described in paragraph (b) of this section, and shall be rounded in accordance with paragraph (d) of this section.

(b) *Frequency.* (1) *In general – biennial adjustments.* Except as otherwise provided in paragraph (b)(2) and (b)(3) of this section, the adjustments described in paragraph (a) of this section shall be effective on October 1 following each consecutive two year period ending August 30, and using the non-seasonally adjusted Consumer Price Index for Urban Wage Earners and Clerical Workers as of August 30 of that year.

(2) *Off-year adjustments.* In the event that the [AGENCY] determines, during a year where no adjustment would be made under paragraph (b)(1), that the non-seasonally adjusted Consumer Price Index for Urban Wage Earners and Clerical Workers, measured over the twelve month period ending August 30 of that year, is such that an adjustment under this section would be appropriate for that year, the [AGENCY] may make an adjustment under this section for that year.

(3) *Periods of negative inflation.* Notwithstanding paragraph (b)(1) or (b)(2) of this section, if an adjustment of dollar thresholds using the cumulative percent change of the non-seasonally adjusted Consumer Price Index for Urban Wage Earners and Clerical Workers from the effective date of this rule or the most recent adjustment, as applicable, would not result in an

increase from the current dollar thresholds, no adjustment will be made pursuant to paragraph (a) of this section.

(c) *Specified thresholds.* The thresholds in the following sections shall be adjusted in accordance with paragraph (a) of this section relative to the baseline threshold values as specified below.

(1) Section 217.1(c)(5)(i), baseline threshold value \$50 billion.

(2) Section 217.2, paragraph (4)(i)(A) of the definition of “Financial institution,” baseline threshold value \$10 million;

(3) Section 217.2, definition of “Residential mortgage exposure,” baseline threshold value \$1 million;

(4) Section 217.61, baseline threshold value \$50 billion.

(d) *Rounding.* When adjusting thresholds under this section, each threshold shall be rounded based on the size of the threshold (e.g., thousands, millions, billions) to the nearest number with two significant digits.

(e) *Effective date of threshold adjustments.* The [AGENCY] shall announce the thresholds adjusted in accordance with this section by publication in the Federal Register. Such adjusted thresholds shall be effective on October 1 of the year during which an adjustment is made.

(f) *Failure to publish in the Federal Register.* In the event, for any reason, the thresholds adjusted in accordance with this section are not published in the Federal Register in a year in which an adjustment is made under this section, the thresholds specified in paragraph (c) of this

section will adjust as provided in this section and be effective on October 1, notwithstanding the lack of publication in the Federal Register.

\* \* \* \* \*

24. Add § 217.5 to read as follows:

**§ 217.5 Calculation of loan-to-value (LTV) ratio.**

(a) *Loan-to-value ratio.* The loan-to-value (LTV) ratio must be calculated as the extension of credit divided by the value of the property.

(b) *Extension of credit.* For purposes of a LTV ratio calculated under this § 217.5, the extension of credit is equal to the total outstanding amount of the loan including any undrawn committed amount of the loan.

(c) *Value of the property.* (1) For purposes of a LTV ratio calculated under this § 217.5, the value of the property is the market value of all real estate properties securing or being improved by the extension of credit plus the amount of any readily marketable collateral and other acceptable collateral, as defined in 12 CFR part 208, appendix C, that secures the extension of credit, subject to the following:

(i) For exposures subject to [APPRAISAL RULE], the market value of property is a valuation that meets all requirements of that rule.

(ii) For exposures not subject to [APPRAISAL RULE]:

(A) The market value of real estate must be obtained from an independent valuation of the property using prudently conservative valuation criteria;

(B) The valuation must be done independently from the Board-regulated institution's origination and underwriting process; and

(C) To ensure that the market value of the real estate is determined in a prudently conservative manner, the valuation must exclude expectations of price increases and must be adjusted downward to account for the potential for the current market price to be significantly above the value that would be sustainable over the life of the loan.

(2) In the case where the exposure includes the financing to purchase the property, the value of the property is the lower of the market value obtained under paragraph (c)(1)(i) or (c)(1)(ii) of this section, as applicable, and the actual acquisition cost.

(3) The value of the property must be measured at the time of origination, except in the following circumstances:

(i) The [AGENCY] requires a Board-regulated institution to revise the value of the property downward;

(ii) The value of the property must be adjusted downward due to an extraordinary event that results in a permanent reduction of the property value; or

(iii) The value of the property may be increased to reflect modifications made to the property that increase the market value, as determined according to the requirements in paragraphs (c)(1)(i) or (c)(1)(ii) of this section.

(4) Readily marketable collateral and other acceptable collateral, as defined in 12 CFR part 208, appendix C, must be appropriately discounted by the Board-regulated institution

consistent with the Board-regulated institution's usual practices for making loans secured by such collateral.

25. Amend § 217.22 by:

- a. Redesignating footnotes 22 through 31 as footnotes 1 through 10; and
- b. Revising paragraph (b), the heading of paragraph (d), and paragraph (d)(1).

The revisions read as follows:

**§ 217.22 Regulatory capital adjustments and deductions.**

\* \* \* \* \*

*(b) Regulatory adjustments to common equity tier 1 capital.*

(1) A Board-regulated institution must adjust the sum of common equity tier 1 capital elements pursuant to the requirements set forth in this paragraph (b). Such adjustments to common equity tier 1 capital must be made net of the associated deferred tax effects.

(i) A Board-regulated institution that makes an AOCI opt-out election (as defined in paragraph (b)(2) of this section), must make the adjustments required under paragraph (b)(2)(i) of this section.

(ii) A Board-regulated institution that is an advanced approaches Board-regulated institution, Category III Board-regulated institution, or Category IV Board-regulated institution, and a Board-regulated institution that has not made an AOCI opt-out election (as defined in paragraph (b)(2) of this section), must deduct any accumulated net gains and add any

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

(iii) A Board-regulated institution must deduct any net gain and add any net loss related to changes in the fair value of liabilities that are due to changes in the Board-regulated institution's own credit risk. An advanced approaches Board-regulated institution, Category III Board-regulated institution, or Category IV Board-regulated institution must deduct the difference between its credit spread premium and the risk-free rate for derivatives that are liabilities as part of this adjustment.

(2) AOCI opt-out election.

(i) A Board-regulated institution that is not an advanced approaches Board-regulated institution, Category III Board-regulated institution, or Category IV Board-regulated institution may make a one-time election to opt out of the requirement to include all components of AOCI (with the exception of accumulated net gains and losses on cash flow hedges related to items that are not fair-valued on the balance sheet) in common equity tier 1 capital (AOCI opt-out election). A Board-regulated institution that makes an AOCI opt-out election in accordance with this paragraph (b)(2) must adjust common equity tier 1 capital as follows:

(A) Subtract any net unrealized gains and add any net unrealized losses on available-for-sale securities;

(B) Subtract any accumulated net gains and add any accumulated net losses on cash flow hedges;

(C) Subtract any amounts recorded in AOCI attributed to defined benefit postretirement plans resulting from the initial and subsequent application of the relevant GAAP standards that pertain to such plans (excluding, at the Board-regulated institution's option, the portion relating to pension assets deducted under paragraph (a)(5) of this section); and

(D) Subtract any net unrealized gains and add any net unrealized losses on held-to-maturity securities that are included in AOCI.

(ii) (A) A Board-regulated institution that is not an advanced approaches Board-regulated institution, Category III Board-regulated institution, or Category IV Board-regulated institution must make its AOCI opt-out election in the Call Report, for a state member bank, or FR Y-9C, for a bank holding company or savings and loan holding company, during the first reporting period after the Board-regulated institution is required to comply with subpart A of this part as set forth in § 217.1(f).

(B) Notwithstanding paragraph (b)(ii)(A) of this section, if a Board-regulated institution was previously an advanced approaches Board-regulated institution, Category III Board-regulated institution, or Category IV Board-regulated institution, the Board-regulated institution must make its AOCI opt-out election in the Call Report, for a state member bank, or FR Y-9C, for a bank holding company or savings and loan holding company, during the first reporting period after the Board-regulated institution ceased to be an advanced approaches Board-regulated institution, Category III Board-regulated institution, or Category IV Board-regulated institution.

(iii) Each depository institution subsidiary of a Board-regulated institution that is not an advanced approaches Board-regulated institution, Category III Board-regulated institution, or

Category IV Board-regulated institution must elect the same option as the Board-regulated institution pursuant to paragraph (b)(2) of this section.

(iv) With prior notice to the Board, a Board-regulated institution resulting from a merger, acquisition, or purchase transaction and that is not an advanced approaches Board-regulated institution, a Category III Board-regulated institution, or a Category IV Board-regulated institution, may make a new AOCI opt-out election in the Call Report (for a state member bank), or FR Y-9C or FR Y-9SP, as applicable (for bank holding companies or savings and loan holding companies) filed by the resulting Board-regulated institution for the first reporting period after it is required to comply with subpart A of this part as set forth in § 217.1(f) if:

(A) Other than as set forth in paragraph (b)(2)(iv)(C) of this section, the merger, acquisition, or purchase transaction involved the acquisition or purchase of all or substantially all of either the assets or voting stock of another banking organization that is subject to regulatory capital requirements issued by the Board of Governors of the Federal Reserve, the Federal Deposit Insurance Corporation, or the Office of the Comptroller of the Currency;<sup>1</sup>

(B) Prior to the merger, acquisition, or purchase transaction, only one of the banking organizations involved in the transaction made an AOCI opt-out election under this section; and

(C) A Board-regulated institution may, with the prior approval of the Board, change its AOCI opt-out election under this paragraph (b) in the case of a merger, acquisition, or purchase transaction that meets the requirements set forth at paragraph (b)(2)(iv)(B) of this section, but does not meet the requirements of paragraph (b)(2)(iv)(A) of this section. In making such a determination, the Board may consider the terms of the merger, acquisition, or purchase transaction, as well as the extent of any changes to the risk profile, complexity, and scope of

operations of the Board-regulated institution resulting from the merger, acquisition, or purchase transaction.

(3) *Regulatory capital requirement for insurance underwriting risks.* A bank holding company or savings and loan holding company must deduct an amount equal to the regulatory capital requirement for insurance underwriting risks established by the regulator of any insurance underwriting activities of the company. The bank holding company or savings and loan holding company must take the deduction 50 percent from tier 1 capital and 50 percent from tier 2 capital. If the amount deductible from tier 2 capital exceeds the Board-regulated institution's tier 2 capital, the Board-regulated institution must deduct the excess from tier 1 capital.

\* \* \* \* \*

(d) *Certain DTAs subject to common equity tier 1 capital deduction thresholds.*

(1) A Board-regulated institution that is not an advanced approaches Board-regulated institution must make deductions from regulatory capital as described in this paragraph (d)(1).

(i) The Board-regulated institution must deduct from common equity tier 1 capital elements the amount of DTAs as described in paragraph (d)(1)(ii) of this section that exceeds 25 percent of the sum of the Board-regulated institution's common equity tier 1 capital elements, less adjustments to and deductions from common equity tier 1 capital required under paragraphs (a) through (c)(3) of this section (the 25 percent common equity tier 1 capital deduction threshold).<sup>8</sup>

(ii) The Board-regulated institution must deduct from common equity tier 1 capital elements the amount of DTAs arising from temporary differences that the Board-regulated

institution could not realize through net operating loss carrybacks, net of any related valuation allowances and net of DTLs, in accordance with paragraph (e) of this section. A Board-regulated institution is not required to deduct from the sum of its common equity tier 1 capital elements DTAs (net of any related valuation allowances and net of DTLs, in accordance with § 217.22(e)) arising from timing differences that the Board-regulated institution could realize through net operating loss carrybacks. The Board-regulated institution must risk weight these assets at 100 percent. For a state member bank that is a member of a consolidated group for tax purposes, the amount of DTAs that could be realized through net operating loss carrybacks may not exceed the amount that the state member bank could reasonably expect to have refunded by its parent holding company.

(iii) For purposes of calculating the amount of DTAs subject to deduction pursuant to paragraph (d)(1) of this section, a Board-regulated institution may exclude DTAs and DTLs relating to adjustments made to common equity tier 1 capital under paragraph (b) of this section. A Board-regulated institution that elects to exclude DTAs relating to adjustments under paragraph (b) of this section also must exclude DTLs and must do so consistently in all future calculations. A Board-regulated institution may change its exclusion preference only after obtaining the prior approval of the Board.

\* \* \* \* \*

<sup>1</sup> These rules include the regulatory capital requirements set forth at 12 CFR part 3 (OCC); 12 CFR part 225 (Board); 12 CFR part 325, and 12 CFR part 390 (FDIC).

\* \* \* \* \*

<sup>8</sup> The amount of the items in paragraph (d)(1) of this section that is not deducted from common equity tier 1 capital must be included in the risk-weighted assets of the Board-regulated institution and assigned a 250 percent risk weight.

\* \* \* \* \*

26. In § 217.32:

- a. Revise paragraph (f)(1);
- b. Revise paragraph (g);
- c. Revise paragraph (l)(5).

The revisions read as follows:

**§ 217.32 General risk weights.**

\* \* \* \* \*

**(f) Corporate exposures.**

(1) A Board-regulated institution must assign a 95 percent risk weight to all its corporate exposures, except as provided in paragraphs (f)(2) and (f)(3) of this section.

\* \* \* \* \*

**(g) Residential mortgage exposures.**

(1) A Board-regulated institution must assign a risk weight in accordance with Table 5 to § 217.32 or Table 6 to § 217.32, as applicable, to a first-lien residential mortgage exposure that:

- (i) Is secured by a property that is either owner-occupied or rented;
- (ii) Is made in accordance with prudent underwriting standards, including relating to the loan amount as a percent of the appraised value of the property;
- (iii) Is not 90 days or more past due or carried in nonaccrual status; and
- (iv) Is not restructured or modified, provided that a loan modified or restructured solely pursuant to the U.S. Treasury’s Home Affordable Mortgage Program is not modified or restructured for purposes of this section.

**Table 5. Risk Weights for Residential Mortgages that are Not Dependent on the Cash Flows Generated by the Real Estate based on LTV<sup>1</sup>**

	<b>LTV Ratio ≤ 50%</b>	<b>50% &lt; LTV Ratio ≤ 60%</b>	<b>60% &lt; LTV Ratio ≤ 80%</b>	<b>80% &lt; LTV Ratio ≤ 90%</b>	<b>90% &lt; LTV Ratio ≤ 100%</b>	<b>LTV Ratio &gt; 100%</b>
<b>Risk Weight</b>	25%	30%	35%	45%	55%	75%

<sup>1</sup> LTV is calculated in accordance with § 217.5.

**Table 6. Proposed Risk Weights for Residential Mortgage Exposures Dependent on the Cash Flows Generated by the Real Estate and based on LTV<sup>1</sup>**

	<b>LTV Ratio ≤ 50%</b>	<b>50% &lt; LTV Ratio ≤ 60%</b>	<b>60% &lt; LTV Ratio ≤ 80%</b>	<b>80% &lt; LTV Ratio ≤ 90%</b>	<b>90% &lt; LTV Ratio ≤ 100%</b>	<b>LTV Ratio &gt; 100%</b>
<b>Risk Weight</b>	35%	40%	50%	65%	80%	110%

<sup>1</sup> LTV is calculated in accordance with § 217.5.

(2) A Board-regulated institution must assign a 100 percent risk weight to a first-lien residential mortgage exposure that does not meet the criteria in paragraph (g)(1) of this section or for which the Board-regulated institution cannot calculate the LTV in accordance with 12 CFR 217.5, and to junior-lien residential mortgage exposures.

(3) For the purpose of this paragraph (g), if a Board-regulated institution holds the first-lien and junior-lien(s) residential mortgage exposures, and no other party holds an intervening lien, the Board-regulated institution must combine the exposures and treat them as a single first-lien residential mortgage exposure.

\* \* \* \* \*

(1) \* \* \*

(5) A Board-regulated institution must assign a 90 percent risk weight to all assets not specifically assigned a different risk weight under this subpart D and that are not deducted from tier 1 or tier 2 capital pursuant to § 217.22.

\* \* \* \* \*

27. Amend § 217.33 by:

- a. Adding paragraph (a)(5); and
- b. Revising paragraph (b).

The revisions read as follows:

**§ 217.33 Off-balance sheet exposures.**

(a) \* \* \*

(5) For purposes of this section, if a commitment does not have an express contractual maximum amount that can be drawn, the committed but undrawn amount of the commitment is equal to the highest total drawn amount over the period since the commitment was created or the prior 24 months, whichever period is shorter, minus the current drawn amount.

\* \* \* \* \*

(b) *Credit conversion factors*—

(1) *Zero percent CCF*. A Board-regulated institution must apply a zero percent CCF to the unused portion of a commitment that is unconditionally cancelable by the Board-regulated institution.

(2) *20 percent CCF*. A Board-regulated institution must apply a 20 percent CCF to the amount of self-liquidating trade-related contingent items that arise from the movement of goods, with an original maturity of one year or less.

(3) *40 percent CCF*. A Board-regulated institution must apply a 40 percent CCF to commitments, regardless of the maturity of the facility, unless they qualify for a lower or higher CCF.

(4) *50 percent CCF*. A Board-regulated institution must apply a 50 percent CCF to the amount of:

(i) Transaction-related contingent items, including performance bonds, bid bonds, warranties, and performance standby letters of credit; and

(ii) Note issuance facilities and revolving underwriting facilities.

(5) *100 percent CCF*. A Board-regulated institution must apply a 100 percent CCF to the amount of the following off-balance-sheet items and other similar transactions:

(i) Guarantees;

(ii) Repurchase agreements (the off-balance sheet component of which equals the sum of the current fair values of all positions the Board-regulated institution has sold subject to repurchase);

(iii) Credit-enhancing representations and warranties that are not securitization exposures;

(iv) Off-balance sheet securities lending transactions (the off-balance sheet component of which equals the sum of the current fair values of all positions the Board-regulated institution has lent under the transaction);

(v) Off-balance sheet securities borrowing transactions (the off-balance sheet component of which equals the sum of the current fair values of all non-cash positions the Board-regulated institution has posted as collateral under the transaction);

(vi) Financial standby letters of credit; and

(vii) Forward agreements.

\* \* \* \* \*

28. Amend § 217.34 by revising paragraph (c)(2) to read as follows:

**§ 217.34 Derivative contracts.**

\* \* \* \* \*

(c) \* \* \*

(2) As an alternative to the simple approach, a Board-regulated institution using CEM under paragraph (b) of this section may recognize the credit risk mitigation benefits of financial collateral that secures such a contract or netting set if the financial collateral is marked-to-fair value on a daily basis and subject to a daily margin maintenance requirement by applying a risk weight to the uncollateralized portion of the exposure, after adjusting the exposure amount calculated under paragraph (b)(1) or (2) of this section using the collateral haircut approach in § 217.37(e). The Board-regulated institution must substitute the exposure amount calculated under paragraph (b)(1) or (2) of this section for  $\sum_i E_i$  in the equation in § 217.37(e)(2).

\* \* \* \* \*

29. Amend § 217.36 by revising paragraph (e) to read as follows:

**§ 217.36 Guarantees and credit derivatives: substitution treatment.**

\* \* \* \* \*

(e) *Adjustment for credit derivatives without restructuring as a credit event.* (1) If a Board-regulated institution 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 Board-regulated institution

must apply the adjustment in paragraph (e)(2) of this section to reduce the effective notional amount of the credit derivative unless:

(i) The terms of the hedged exposure and the reference exposure, if different from the hedged exposure, allow the maturity, principal, coupon, currency, or seniority status of the exposure to be amended outside of receivership, insolvency, liquidation, or similar proceeding only by unanimous consent of all parties; and

(ii) The Board-regulated institution has conducted sufficient legal review to conclude with a well-founded basis (and maintains sufficient written documentation of that legal review) that the hedged exposure is subject to the U.S. Bankruptcy Code, the Federal Deposit Insurance Act, or a domestic or foreign insolvency regime with similar features that allow for a company to liquidate, reorganize, or restructure and provides for an orderly settlement of creditor claims.

(2) The Board-regulated institution must apply the following adjustment to reduce the effective notional amount of any eligible credit derivative that is subject to adjustment under paragraph (e)(1) of this section:

$Pr = Pm \times 0.60$ , where:

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

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

\* \* \* \* \*

30. Revise § 217.37 to read as follows:

**§ 217.37 Collateralized transactions and prepaid credit protection arrangements.**

(a) *Financial Collateral.* (1) To recognize the risk-mitigating effects of financial collateral, a Board-regulated institution may use:

(i) The simple approach in paragraph (b) of this section; or

(ii) The collateral haircut approach in paragraph (e) of this section for repo-style transactions, eligible margin loans, collateralized derivative contracts, and single-product netting sets of such transactions, subject to paragraph (a)(3) of this section.

(2) A Board-regulated institution must use the same approach to recognize the risk-mitigating effects of financial collateral for similar exposures or transactions.

(3) A Board-regulated institution that has elected under § 217.34(a)(1)(ii) to use the standardized approach for counterparty credit risk (SA-CCR) for derivative contracts may elect to also use SA-CCR for repo-style transactions that are subject to a qualifying cross-product master netting agreement with derivative contracts, subject to the requirements of paragraph (f) of this section. A Board-regulated institution that uses SA-CCR to determine the exposure amount of a derivative contract or netting set may use not the simple approach in paragraph (b) of this section or the collateral haircut approach under paragraph (e) of this section for the exposures for which SA-CCR is used.

(b) *The simple approach—(1) General requirements.* To qualify for the simple approach under this paragraph (b), the financial collateral must meet the following requirements:

(i) The collateral must be revalued at least every six months;

(ii) The legal mechanism by which financial collateral is pledged or transferred must be enforceable in the relevant jurisdictions and ensure that the Board-regulated institution has the contractual right, as applicable to the characteristics of the financial collateral and exposure, to liquidate or take legal possession of the financial collateral, setoff amounts owed to the obligor against amounts owed to the Board-regulated institution and close out any transaction giving rise to the secured exposure, in a timely manner, in the event of the default, insolvency or bankruptcy (or one or more otherwise-defined credit events set out in the transaction documentation) of the obligor; and

(iii) The Board-regulated institution must be able to reasonably demonstrate the ability to protect and enforce its rights in respect of any financial collateral.

(2) *Risk weight substitution.* (i) A Board-regulated institution may apply a risk weight to the portion of an exposure that is secured by financial collateral that meets the requirements of paragraph (b) of this section, up to the protection amount of the financial collateral as adjusted by paragraph (d) of this section, based on the risk weight assigned to the collateral under this subpart. For repurchase agreements, reverse repurchase agreements, and securities lending and borrowing transactions, the collateral is the instruments, gold, and cash the Board-regulated institution has borrowed, purchased subject to resale, or taken as collateral from the counterparty under the transaction. Except as provided in paragraph (b)(3) of this section, the risk weight assigned to the protected portion of the exposure may not be less than 20 percent.

(ii) A Board-regulated institution must apply a risk weight to the amount of an exposure in excess of the protection amount of financial collateral securing the exposure based on the risk weight applicable to the exposure under this subpart.

(3) *Exceptions to the 20 percent risk weight floor and other requirements.*

Notwithstanding paragraph (b)(2)(i) of this section, a Board-regulated institution may assign a zero percent risk weight up to the protection amount of the financial collateral where:

(i) The financial collateral is cash on deposit; or

(ii) The financial collateral is an exposure to a sovereign that qualifies for a zero percent risk weight under § 217.32, and the Board-regulated institution has discounted the fair value of the collateral by 20 percent.

(c) *Eligible prepaid credit protection arrangements.* (1) *Scope.* A Board-regulated institution may recognize the credit risk mitigation benefits of an eligible prepaid credit protection arrangement as provided under this paragraph.

(2) *Application.* This paragraph applies to exposures, including securitization exposures, for which:

(i) Credit risk is fully covered by an eligible prepaid credit protection arrangement; or

(ii) Credit risk is covered on a pro rata basis (that is, on a basis in which the Board-regulated institution and the protection provider share losses proportionately) by an eligible prepaid credit protection arrangement.

(3) *Tranching of credit risk.* Exposures on which there is a tranching of credit risk (reflecting at least two different levels of seniority) generally are securitization exposures subject to § 217.41 through § 217.45.

(4) *Multiple eligible prepaid credit protection arrangements.* If multiple eligible prepaid credit protection arrangements cover a single exposure, a Board-regulated institution may treat

the hedged exposure as multiple separate exposures each covered by a single eligible credit protection arrangement and may calculate a separate risk-weighted asset amount for each separate exposure as described in paragraph (c)(6) of this section.

(5) *Single eligible credit protection arrangements.* If a single eligible credit protection arrangement covers multiple hedged exposures, a Board-regulated institution must treat each hedged exposure as covered by a separate eligible credit protection arrangement and must calculate a separate risk-weighted asset amount for each exposure as described in paragraph (c)(6) of this section.

(6) *Prepaid credit protection arrangements—The substitution approach.* (i) *Full coverage.* If an eligible prepaid credit protection arrangement meets the conditions in paragraphs (c)(1) through (5) of this section and the protection amount (P) of the prepaid credit protection arrangement is greater than or equal to the exposure amount of the reference exposure, a Board-regulated institution may assign a zero percent risk weight to the reference exposure.

(ii) *Partial coverage.* If an eligible prepaid credit protection arrangement meets the conditions in paragraphs (c)(1) through (5) of this section and the protection amount (P) of the prepaid credit protection arrangement is less than the exposure amount of the reference exposure, the Board-regulated institution must treat the reference exposure as two separate exposures (protected and unprotected) in order to recognize the credit risk mitigation benefit of the prepaid credit protection arrangement.

(A) The Board-regulated institution may apply a risk-weight of zero percent for the protected exposure.

(B) The Board-regulated institution must calculate the risk-weighted asset amount for the unprotected exposure under this subpart D, where the applicable risk weight is that of the unprotected portion of the reference exposure.

(C) The treatment provided in this section is applicable when the credit risk of a reference exposure is covered on a partial pro rata basis and may be applicable when an adjustment is made to the effective notional amount of the prepaid credit protection arrangement under paragraph (d) of this section.

(d) *Required adjustments*—(1) *Maturity mismatch adjustment*. (i) A Board-regulated institution that recognizes the credit risk mitigation benefits of financial collateral under paragraph (b) of this section or of an eligible prepaid credit protection arrangement under paragraph (c) of this section must adjust the amount of credit risk mitigation recognized to reflect any maturity mismatch.

(ii) A maturity mismatch occurs when:

(A) The residual maturity of the legal mechanism by which financial collateral is pledged is less than that of the secured exposure(s); or

(B) The residual maturity of an eligible prepaid credit protection arrangement is less than that of the reference exposure.

(iii) The residual maturity of a secured exposure under paragraph (b) of this section or a reference exposure under paragraph (c) of this section is the longest possible remaining time before the obligated party of the secured exposure or reference exposure is scheduled to fulfil its obligation on the exposure. For purposes of this paragraph (d)(1)(iii):

(A) For an eligible prepaid credit protection arrangement, if the terms of the arrangement include embedded options that may reduce its term, the Board-regulated institution (protection purchaser) must adjust the residual maturity. If a call is at the discretion of the protection provider, the residual maturity is at the first call date. If the call is at the discretion of the Board-regulated institution (protection purchaser), but the terms of the arrangement at origination contain a positive incentive for the Board-regulated institution to cancel the arrangement before contractual maturity, the remaining time to the first call date is the residual maturity.

(B) For financial collateral that is not cash on deposit at the Board-regulated institution, but including cash held for the Board-regulated institution by a third-party custodian or trustee, the residual maturity of any amount of such financial collateral is the earliest date on which the Board-regulated institution's rights in respect of such amount of financial collateral may be terminated without the pledgor being subject to a contemporaneous requirement to pledge additional financial collateral. For financial collateral that is cash on deposit at the Board-regulated institution, the residual maturity of any amount of such cash collateral is the earliest date on which a depositor may withdraw such amount, notwithstanding any notice requirements or early withdrawal fees or penalties.

(iv) The credit risk mitigation benefits of financial collateral or an eligible prepaid credit protection arrangement with a maturity mismatch may be recognized only if the original maturity of the legal mechanism by which financial collateral is pledged or the eligible prepaid credit protection arrangement is greater than or equal to one year and its residual maturity is greater than three months.

(v) When a maturity mismatch exists, the Board-regulated institution must apply the following adjustment to reduce the protection amount:

$$P_m = E \times (t-0.25)/(T-0.25), \text{ where:}$$

(A)  $P_m$  = fair value of the financial collateral or effective notional amount of the eligible prepaid credit protection arrangement, adjusted for maturity mismatch;

(B)  $E$  = fair value of the financial collateral or effective notional amount of the eligible prepaid credit protection arrangement;

(C)  $t$  = the lesser of  $T$  or the residual maturity of the arrangement, expressed in years; and

(D)  $T$  = the lesser of five or the residual maturity of the secured exposure or reference exposure, expressed in years.

(2) *Currency mismatch adjustment.* (i) If a Board-regulated institution recognizes the credit risk mitigation benefits of financial collateral under paragraph (b) of this section or of an eligible prepaid credit protection arrangement under paragraph (c) of this section that is denominated in a currency different from that in which the secured or reference exposure is denominated, the Board-regulated institution must apply the following formula to the fair value of the financial collateral or the effective notional amount of the eligible prepaid credit protection arrangement:

$$P_c = P_r \times (1 - H_{FX}), \text{ where:}$$

(A)  $P_c$  = fair value of the financial collateral or the effective notional amount of the eligible prepaid credit protection arrangement, adjusted for currency mismatch (and maturity mismatch, if applicable);

(B)  $P_r$  = fair value of the financial collateral or the effective notional amount of the eligible prepaid credit protection arrangement (adjusted for maturity mismatch, if applicable); and

(C)  $H_{FX}$  = haircut appropriate for the currency mismatch between the financial collateral and the secured exposure or the eligible prepaid credit protection arrangement and the reference exposure, as determined under paragraphs (d)(2)(ii) through (iii) of this section.

(ii) Subject to paragraph (d)(2)(iii) of this section, a Board-regulated institution must set  $H_{FX}$  equal to eight percent.

(iii) A Board-regulated institution must increase  $H_{FX}$  as determined under paragraph (d)(2)(ii) of this section if the Board-regulated institution revalues the financial collateral or eligible prepaid credit protection arrangement less frequently than once every 10 business days using the following formula:

$$H_{FX} = 8\% \times \sqrt{\frac{T_M}{10}}, \text{ where } T_M \text{ equals the greater of 10 or the number of business days between revaluations.}$$

(e) *Collateral haircut approach—Exposure amount for eligible margin loans and repo-style transactions.* (1) *General.* A Board-regulated institution may recognize the credit risk mitigation benefits of financial collateral that secures an eligible margin loan, repo-style transaction, collateralized derivative contract, or netting set of eligible margin loans, repo-style transactions, or collateralized derivative contracts, and of any collateral that secures a repo-style transaction that is included in the Board-regulated institution's measure for market risk under

subpart F of this part, by using the collateral haircut approach covered in this paragraph (e) of this section.

(2) *Exposure amount calculation.* For purposes of the collateral haircut approach, a Board-regulated institution must determine the exposure amount for an eligible margin loan, repo-style transaction, collateralized derivative contract, or netting set of eligible margin loans, repo-style transactions, or collateralized derivative contracts according to the following formula:

$$E^* = \max \left\{ 0; \left( \sum_i E_i - \sum_i C_i \right) + \left( 0.4 \times net_{exposure} \right) + \left( 0.6 \times \frac{gross_{exposure}}{\sqrt{N}} \right) + \left( \sum_{fx} (E_{fx} \times H_{fx}) \right) \right\} \text{ where:}$$

(i)  $E^*$  is the exposure amount of the eligible margin loan, repo-style transaction, collateralized derivative contract, or netting set after credit risk mitigation;

(ii)  $E_i$  is:

(A) For eligible margin loans and repo-style transactions and netting sets thereof, the current fair value of the instrument, cash, or gold the Board-regulated institution has lent, sold subject to repurchase, or posted as collateral to the counterparty; and,

(B) For collateralized derivative contracts and netting sets thereof, the exposure amount of the OTC derivative contract or netting set calculated under § 217.34(b)(1) or (2);

(iii)  $C_i$  is the current fair value of the instrument, cash, or gold the banking organization has borrowed, purchased subject to resale, or taken as collateral from the counterparty;

$$(iv) \text{ net}_{exposure} = \left| \sum_s E_s H_s \right|;$$

$$(v) \text{ gross}_{exposure} = \sum_s E_s |H_s|;$$

(vi)  $E_s$  is the absolute value of the net position in a given instrument or in gold, where the net position in a given instrument or gold equals the sum of the current fair values of the instrument or gold the Board-regulated institution has lent, sold subject to repurchase, or posted as collateral to the counterparty, minus the sum of the current fair values of that same instrument or gold the Board-regulated institution has borrowed, purchased subject to resale, or taken as collateral from the counterparty;

(vii)  $H_s$  is the haircut appropriate to  $E_s$  as described in Table 1 to § 217.37, as applicable.  $H_s$  has a positive sign if the instrument or gold is net lent, sold subject to repurchase, or posted as collateral to the counterparty;  $H_s$  has a negative sign if the instrument or gold is net borrowed, purchased subject to resale, or taken as collateral from the counterparty;

(viii)  $N$  is the number of instruments with a unique Committee on Uniform Securities Identification Procedures (CUSIP) designation or foreign equivalent that the Board-regulated institution lends, sells subject to repurchase, posts as collateral, borrows, purchases subject to resale, or takes as collateral in the eligible margin loan, repo-style transaction, collateralized derivative contract, or netting set, including all collateral that the Board-regulated institution elects to include within the credit risk mitigation framework, except that instruments where the value  $E_s$  is less than one tenth of the value of the largest  $E_s$  in the eligible margin loan, repo-style transaction, collateralized derivative contract, or netting set are not included in the count or gold, with any amount of gold given a value of one;;

(ix)  $E_{f_x}$  is the absolute value of the net position in each currency  $f_x$  different from the settlement currency;

(x)  $H_{f_x}$  is the haircut appropriate for currency mismatch of currency  $f_x$ .

(3) *Market price volatility and currency mismatch haircuts.* (i) A Board-regulated institution must use the haircuts for market price volatility ( $H_s$ ) in Table 1 to § 217.37, as adjusted in certain circumstances as provided in paragraphs (e)(3)(iii) through (v) of this section.

**Table 1 to § 217.37—Market Price Volatility Haircuts**

Residual Maturity		Securities issued by a sovereign or an issuer described in § 217.32(b) <sup>1</sup>			Other investment-grade securities (percent)		
		Issuer risk weight of 0%	Issuer risk weight of 20% or 50%	Issuer risk weight of 100%	GSE exposures	Exposures other than GSE exposures or securitization exposures	Senior securitization exposures with risk weight <100%
Debt Securities	Less than or equal to 1 year	0.5	1.0	15.0	1.0	2.0	4.0
	Greater than 1 year and less than or equal to 3 years	2.0	3.0	15.0	4.0	4.0	12.0
	Greater than 3 years and less than or equal to 5 years					6.0	
	Greater than 5 years and less than or equal	4.0	6.0	15.0	8.0	12.0	24.0

to 10 years		
Greater than 10 years		20.0
Main index equities (including convertible bonds) and gold		20.0
Other publicly traded equities and convertible bonds		30.0
Mutual funds and exchange traded funds	Highest haircut applicable to any security in which the fund can invest, unless the banking organization can apply the full look-through approach for equity investments in funds §217.53(b), in which case the banking organization may use a weighted average of haircuts applicable to the securities held by the fund.	
Cash on deposit		0.0
Other exposure types <sup>2</sup>		30.0

<sup>1</sup> Includes a foreign PSE that receives a zero percent risk weight.

<sup>2</sup> Includes senior securitization exposures with a risk weight greater than or equal to 100 percent and sovereign exposures with a risk weight greater than 100 percent.

(ii) For currency mismatches, a Board-regulated institution must use a haircut for foreign exchange rate volatility ( $H_{fx}$ ) of 8 percent, as adjusted in certain circumstances under paragraphs (e)(3)(iii) and (iv) of this section.

(iii) For repo-style transactions, a Board-regulated institution may multiply the haircuts provided in paragraphs (e)(3)(i) and (ii) of this section by the square root of  $1/2$  (which equals 0.707107).

(iv) A Board-regulated institution must adjust the haircuts provided in paragraphs (e)(3)(i) and (ii) of this section upward on the basis of a holding period longer than ten business days for eligible margin loans and derivative contracts that are not client-facing derivative transactions or a holding period longer than five business days for repo-style transactions and client-facing derivative transactions that are not cleared transactions under the following conditions. If the number of trades in a netting set exceeds 5,000 at any time during a quarter, a Board-regulated institution must adjust the haircuts provided in paragraphs (e)(3)(i) and (ii) of this section upward on the basis of a holding period of twenty business days for the following quarter except in the calculation of exposure amount for purposes of § 217.35. If a netting set contains one or more trades involving illiquid collateral, a Board-regulated institution must adjust the haircuts provided in paragraphs (e)(3)(i) and (ii) of this section upward on the basis of a holding period of twenty business days. If over the two previous quarters more than two margin disputes on a netting set have occurred that lasted longer than the holding period, then the Board-regulated institution must adjust the haircuts provided in paragraphs (e)(3)(i) and (ii) of this section upward for that netting set on the basis of a holding period that is at least two times the minimum holding period for that netting set. The Board-regulated institution must adjust the haircuts upward using the following formula:

$$H_a = H_s \sqrt{T_m/T_s}$$

Where:

(A)  $T_m$  equals a holding period of longer than 10 business days for eligible margin loans and derivative contracts other than client-facing derivative transactions or longer than 5 business days for repo-style transactions and client-facing derivative transactions;

(B)  $H_s$  equals the market price volatility haircut provided in Table 1 to § 217.37 or to the foreign exchange rate volatility haircut provided in paragraph (e)(3)(ii) of this section; and

(C)  $T_s$  equals 10 business days for eligible margin loans and derivative contracts other than client-facing derivative transactions or 5 business days for repo-style transactions and client-facing derivative transactions.

(v) If the instruments a Board-regulated institution has lent, sold subject to repurchase, or posted as collateral do not meet the definition of financial collateral, the Board-regulated institution must use a 30 percent haircut for market price volatility ( $H_s$ ).

(f) *Election to apply SA-CCR to certain repo-style transactions.* (1) A Board-regulated institution that elects to determine the exposure amount using SA-CCR for its derivative contracts under paragraph (a)(1)(ii) of § 217.34 may elect under paragraph (a)(3) of this section to use SA-CCR to determine the exposure amount for a set of repo-style transactions and derivative contracts that are subject to a qualifying cross-product master netting agreement. A Board-regulated institution that makes such an election with respect to a qualifying cross-product master netting agreement must make the adjustments described in paragraphs (f)(2) and (3) in order to determine the exposure amount of the set of repo-style transactions and derivative contracts under SA-CCR.

(2) The exposure amount of a set of transactions subject to a qualifying cross-product master netting agreement for purposes of (f)(1),  $Exposure\ Amount_{NSCP}$ , must be calculated as follows:

$$\begin{aligned}
& \text{Exposure Amount}_{NSCP} \\
&= (1 - MR_{NSCP}) * (\text{Exposure Amount}_{repo-style transactions} + \text{Exposure Amount}_{derivatives}) \\
&+ MR_{NSCP} * \text{Extended SA} - \text{CCR Exposure Amount}
\end{aligned}$$

Where:

(i) *Exposure Amount<sub>repo-style transactions</sub>* is the exposure amount for repo-style transactions in the netting set that is subject to a qualifying cross-product master netting agreement, calculated using the collateral haircut approach, under paragraph (e) of this section;

(ii) *Exposure Amount<sub>derivatives</sub>* is the exposure amount for derivatives in the netting set that is subject to a qualifying cross-product master netting agreement, calculated using the standardized approach to counterparty credit risk, under § 217.132(c)(5);

(iii) *Extended SA – CCR Exposure Amount* is the exposure amount for both repo-style transactions and derivatives that are in the netting set that is subject to a qualifying cross-product master netting agreement, calculated using the standardized approach to counterparty credit risk, under § 217.132(c)(5); and

(iv) *MR<sub>NSCP</sub>* is the Maturity Ratio for a given netting set that is subject to a qualifying cross-product master netting agreement, calculated as follows:

$$MR_{NSCP} = \frac{\sum NAWM \text{ of the repo - style transactions}_i}{\max(\sum NAWM \text{ of the repo - style transactions}_i, \sum NAWM \text{ of the derivative transactions}_i)}$$

Where:

(A)  $\sum NAWM \text{ of the repo - style transactions}_i$  is the notional average weighted maturity of all *i* repo-style transactions subject to the qualifying cross-product master netting agreement, subject to a minimum maturity of 10 business days and a maximum maturity of one year for purposes of this calculation.

(B)  $\sum NAWM \text{ of the derivative transactions}_i$  is the notional average weighted maturity of all *i* derivative transactions subject to the qualifying cross-product master

netting agreement subject to a minimum maturity of 10 business days and a maximum maturity of one year for purposes of this calculation.

(3) For purposes of applying SA-CCR to a repo-style transaction, the Board-regulated must make the adjustments described in paragraphs (f)(3)(i) through (iii) of this section.

(i) For purposes of this section, the Board-regulated institution must:

(A) Treat a repo-style transaction that has multiple underlying instruments as separate repo-style transactions for each distinct underlying instrument;

(B) Treat a repo-style transaction with a debt instrument as the underlying instrument as either a credit derivative that references the underlying debt instrument or an interest rate derivative that references the interest rate of the underlying debt instrument, based on the primary risk factor of the repo-style transaction;

(C) Treat a repo-style transaction with an equity instrument as the underlying instrument as an equity derivative that references the underlying equity instrument;

(D) Not apply paragraph (c)(4) of § 217.132 to a repo-style transaction with an equity instrument as the underlying instrument; and

(E) Treat a repo-style transaction as a client-facing derivative transaction where the Board-regulated institution is either acting as a financial intermediary and enters into an offsetting transaction with a qualifying central counterparty (QCCP) or where the Board-regulated institution provides a guarantee on the performance of a client on a transaction between the client and a QCCP.

(ii) For purposes of the supervisory delta under paragraph (c)(9)(iii) of § 217.132, a Board-regulated institution must use a supervisory delta of 1 for a repurchase transaction or a securities lending transaction, and must use a supervisory delta of -1 for a reverse repurchase transaction or a securities borrowing transaction;

(iii) For purposes of the maturity factor under paragraph (c)(9)(iv) of § 217.132, MPOR cannot be less than five business days plus the periodicity of re-margining expressed in business days minus one business day.

\* \* \* \* \*

31. Revise § 217.41 to read as follows:

**§ 217.41 Operational criteria for recognizing the transfer of risk.**

(a) *Operational criteria for traditional securitizations.* A Board-regulated institution that transfers exposures it has originated or purchased to a third party in connection with a traditional securitization may exclude the exposures from the calculation of its risk-weighted assets only if each condition in this section is satisfied. A Board-regulated institution that meets these conditions must hold risk-based capital against any credit risk it retains in connection with the securitization. A Board-regulated institution 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 common equity tier 1 capital any after-tax gain-on-sale resulting from the transaction and any portion of a CEIO strip that does not constitute after-tax gain-on-sale. If the transferred exposures are in connection with a resecuritization and all of the conditions in this paragraph (a) are satisfied, the Board-regulated institution must exclude the exposures from the

calculation of its risk-weighted assets and must hold risk-based capital against any credit risk it retains in connection with the resecuritization. The conditions are:

(1) The exposures are not reported on the Board-regulated institution's consolidated balance sheet under GAAP;

(2) The Board-regulated institution has transferred to one or more third parties credit risk associated with the underlying exposures;

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

(4) The securitization does not:

(i) Include 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) Contain an early amortization provision.

(b) *Operational criteria for synthetic securitizations.* For synthetic securitizations, a Board-regulated institution may recognize for risk-based capital purposes the use of a credit risk mitigant to hedge underlying exposures only if each condition in this paragraph (b) is satisfied. A Board-regulated institution that meets these conditions must hold risk-based capital against any credit risk of the exposures it retains in connection with the synthetic securitization. A Board-regulated institution that fails to meet these conditions or chooses not to recognize the credit risk mitigant for purposes of this section must instead hold risk-based capital against the underlying exposures as if they had not been synthetically securitized. If the synthetic securitization is a resecuritization and all of the conditions in this paragraph (b) are satisfied, the Board-regulated institution must exclude the underlying securitization exposures from the calculation of its risk-

weighted assets and must hold risk-based capital against any credit risk it retains in connection with the resecuritization. The conditions are:

(1) The credit risk mitigant is:

(i) Financial collateral;

(ii) A guarantee that meets all criteria as set forth in the definition of *eligible guarantee* in § 217.2, except for the criteria in paragraph (3) of that definition;

(iii) A credit derivative that is not an nth-to-default credit derivative and that meets all criteria as set forth in the definition of *eligible credit derivative* in § 217.2, except for the criteria in paragraph (3) of the definition of *eligible guarantee* in § 217.2; or

(iv) A prepaid credit protection arrangement that meets all criteria as set forth in the definition of *eligible prepaid credit protection arrangement* in § 217.2, except for the criteria in paragraph (3) of that definition.

(2) The Board-regulated institution transfers credit risk associated with the underlying exposures to one or more 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 Board-regulated institution to alter or replace the underlying exposures to improve the credit quality of the underlying exposures;

(iii) Increase the Board-regulated institution'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 Board-regulated institution 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 Board-regulated institution after the inception of the securitization;

(3) The Board-regulated institution obtains a well-reasoned opinion from legal counsel that confirms the enforceability of the credit risk mitigant in all relevant jurisdictions;

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

(5) No synthetic excess spread is permitted within the synthetic securitization;

(6) Any applicable minimum payment threshold for the credit risk mitigant is consistent with standard market practice; and

(7) The securitization does not:

(i) Include 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) Contain an early amortization provision.

(c) *Due diligence requirements for securitization exposures.* (1) Except for exposures that are deducted from common equity tier 1 capital and exposures subject to § 217.43(h), if a Board-regulated institution is unable to demonstrate to the satisfaction of the Board a comprehensive understanding of the features of a securitization exposure that would materially affect the performance of the exposure, the Board-regulated institution must assign the securitization exposure a risk weight of 1,250 percent. The Board-regulated institution's analysis must be

commensurate with the complexity of the securitization exposure and the materiality of the exposure in relation to its capital.

(2) A Board-regulated institution must demonstrate its comprehensive understanding of a securitization exposure under paragraph (c)(1) of this section, for each securitization exposure by:

(i) Conducting an analysis of the risk characteristics of a securitization exposure prior to acquiring the exposure and documenting such analysis within 3 business days after acquiring the exposure, considering:

(A) Structural features of the securitization that would materially impact the performance of the exposure, for example, the contractual cash flow waterfall, waterfall-related triggers, credit enhancements, liquidity enhancements, fair value triggers, the performance of organizations that service the exposure, and deal-specific definitions of default;

(B) Relevant information regarding—

(1) The performance of the underlying credit exposure(s), for example, the percentage of loans 30, 60, and 90 days past due; default rates; prepayment rates; loans in foreclosure; property types; occupancy; average credit score or other measures of creditworthiness; average LTV ratio; and industry and geographic diversification data on the underlying exposure(s); and

(2) For resecuritization exposures, in addition to the information described in paragraph (c)(2)(i)(B)(1) of this section, performance information on the underlying securitization exposures, which may include the issuer name and credit quality, and the characteristics and performance of the exposures underlying the securitization exposures; and

(C) Relevant market data of the securitization, for example, bid-ask spread, most recent sales price and historic price volatility, trading volume, implied market rating, and size, depth and concentration level of the market for the securitization; and

(ii) On an on-going basis (no less frequently than quarterly), evaluating, reviewing, and updating as appropriate the analysis required under paragraph (c)(1) of this section for each securitization exposure.

\* \* \* \* \*

32. Revise § 217.42 to read as follows:

**§ 217.42 Exposure amount of a securitization exposure.**

(a) *On-balance sheet securitization exposure.* (1) The exposure amount of an on-balance sheet securitization exposure (excluding an available-for-sale or held-to-maturity security where the Board-regulated institution has made an AOCI opt-out election under § 217.22(b)(2), a repo-style transaction, eligible margin loan, OTC derivative contract that is not a credit derivative, or cleared transaction that is not a credit derivative) is equal to the Board-regulated institution's carrying value of the exposure. For a credit derivative, a Board-regulated institution must apply § 217.43(i) or (j), as applicable.

(2) The exposure amount of an on-balance sheet securitization exposure that is an available-for-sale or held-to-maturity security held by a Board-regulated institution that has made an AOCI opt-out election under § 217.22(b)(2) is the Board-regulated institution's carrying value (including net accrued but unpaid interest and fees), less any net unrealized gains on the exposure and plus any net unrealized losses on the exposure.

(b) *Off-balance sheet securitization exposure.* Except as provided in § 217.43(h), the exposure amount of an off-balance sheet securitization exposure that is not a repo-style transaction, eligible margin loan, OTC derivative contract (other than a credit derivative), or cleared transaction (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 an eligible ABCP liquidity facility, the notional amount may be reduced to the maximum potential amount that the Board-regulated institution could be required to fund given the ABCP program's current underlying assets (calculated without regard to the current credit quality of those assets).

(c) *Repo-style transaction, eligible margin loan, OTC derivative contract that is not a credit derivative, or cleared transaction that is not a credit derivative.* The exposure 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 exposure amount as calculated in accordance with §§ 217.34 or 217.37, or § 217.33, as applicable, and the exposure amount of a securitization exposure that is a cleared transaction that is not a credit derivative is the exposure amount as calculated in § 217.35.

\* \* \* \* \*

33. Revise § 217.43 to read as follows:

**§ 217.43 Risk-weighted assets for securitization exposures.**

(a) *General approach.* Except as provided elsewhere in this section and in § 217.41:

(1) A Board-regulated institution may, subject to the limitation under paragraph (e) of this section, apply the securitization standardized approach (SEC-SA) in § 217.44 to the exposure if the exposure meets the following requirements:

(i) The Board-regulated institution has accurate information on  $A$ ,  $D$ ,  $W$ , and  $K_G$  (as defined in § 217.44) for the exposure. Data used to assign the parameters described in this paragraph (a)(1)(i) must be the most currently available data. If the contracts governing the underlying exposures of the securitization require payments on a monthly or quarterly basis, the data used to assign the parameters described in this paragraph (a)(1)(i) must be no more than 91 calendar days old.

(ii) The Board-regulated institution has accurate information regarding whether the exposure is a resecuritization exposure.

(2) If the securitization exposure is an interest rate derivative contract, an exchange rate derivative contract, or a cash collateral account related to an interest rate or exchange rate derivative contract, the Board-regulated institution must assign a risk weight to the exposure equal to the risk weight of a securitization exposure that is *pari passu* to the interest rate derivative contract or exchange rate derivative contract or, if such an exposure does not exist, the risk weight of any subordinate securitization exposure.

(3) If the Board-regulated institution cannot apply, or chooses not to apply, the securitization standardized approach in § 217.44, the Board-regulated institution must apply a 1,250 percent risk weight to the exposure.

(b) *Total risk-weighted assets for securitization exposures.* A Board-regulated institution's total risk-weighted assets for securitization exposures equals the sum of the risk-weighted asset amount for securitization exposures that the Board-regulated institution risk weights under §§ 217.43 through 217.45, as applicable.

(c) *After-tax gain-on-sale resulting from a securitization.* Notwithstanding any other provision of this subpart, a Board-regulated institution must deduct from common equity tier 1 capital any after-tax gain-on-sale resulting from a securitization as well as the portion of a CEIO that does not constitute an after-tax gain-on sale.

(d) *Overlapping exposures.* (1) If a Board-regulated institution has multiple securitization exposures that provide duplicative coverage of the underlying exposures of a securitization (such as when a Board-regulated institution provides a program-wide credit enhancement and multiple pool-specific liquidity facilities to an ABCP program), the Board-regulated institution is not required to hold duplicative risk-based capital against the overlapping position. Instead, the Board-regulated institution may apply to the overlapping position the applicable risk-based capital treatment that results in the highest risk-based capital requirement.

(2) If a Board-regulated institution has two or more securitization exposures that partially overlap with each other, the Board-regulated institution may treat the exposures as overlapping and apply the treatment under paragraph (d)(1). For purposes of such a treatment under this paragraph (d)(2), the Board-regulated institution must include in expanded total risk-weighted assets the risk-weighted asset amount for a hypothetical securitization exposure that would fully overlap with all of the partially overlapping exposures.

(3) If a Board-regulated institution has a securitization exposure under this subpart that is an overlapping exposure with a securitization exposure that is a market risk covered position under subpart F of this part, the Board-regulated institution may assign to the overlapping securitization exposure the applicable risk-based capital treatment under either this subpart or subpart F, whichever results in the highest risk-based capital requirement.

(e) *Implicit support.* If a Board-regulated institution provides support to a securitization in excess of the Board-regulated institution's contractual obligation to provide credit support to the securitization:

(1) The Board-regulated institution must calculate a risk-weighted asset amount for underlying exposures associated with the securitization as if the exposures had not been securitized and must deduct from common equity tier 1 capital any after-tax gain-on-sale resulting from the securitization and any portion of a CEIO strip that does not constitute after-tax gain-on-sale; and

(2) The Board-regulated institution must disclose publicly:

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

(ii) The risk-based capital impact to the Board-regulated institution of providing such implicit support.

(f) *Undrawn portion of a servicer cash advance facility.* (1) Notwithstanding any other provision of this subpart, a Board-regulated institution that is a servicer under an eligible servicer cash advance facility is not required to hold risk-based capital against potential future cash advance payments that it may be required to provide under the contract governing the facility.

(2) For a Board-regulated institution that acts as a servicer, the exposure amount for a servicer cash advance facility that is not an eligible servicer cash advance facility is equal to the amount of all potential future cash advance payments that the Board-regulated institution may be contractually required to provide during the subsequent 12-month period under the contract governing the facility.

(g) *Interest-only mortgage-backed securities.* Notwithstanding any other provision of this subpart, the risk weight for a non-credit-enhancing interest-only mortgage-backed security may not be less than 100 percent.

(h) *Small-business loans and leases on personal property transferred with retained contractual exposure.* (1) Regardless of any other provision of this subpart, a Board-regulated institution that has transferred small-business loans and leases on personal property (small-business obligations) with recourse must include in risk-weighted assets only its contractual exposure to the small-business obligations if all the following conditions are met:

(i) The transaction must be treated as a sale under GAAP;

(ii) The Board-regulated institution establishes and maintains, pursuant to GAAP, a non-capital reserve sufficient to meet the Board-regulated institution's reasonably estimated liability under the contractual obligation;

(iii) The small-business obligations 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 U.S.C. 632 et seq.); and

(iv) The Board-regulated institution is well capitalized for purposes of the Prompt Corrective Action framework (12 U.S.C. 1831o). For purposes of determining whether a Board-regulated institution is well capitalized for purposes of this paragraph (h), the Board-regulated institution's capital ratios must be calculated without regard to the capital treatment for transfers of small-business obligations with recourse specified in paragraph (h)(1) of this section.

(2) The total outstanding amount of contractual exposure retained by a Board-regulated institution on transfers of small-business obligations receiving the capital treatment specified in

paragraph (h)(1) of this section cannot exceed 15 percent of the Board-regulated institution's total capital.

(3) If a Board-regulated institution ceases to be well capitalized, or exceeds the 15 percent capital limitation provided in paragraph (h)(2) of this section, the capital treatment specified in paragraph (h)(1) of this section will continue to apply to any transfers of small-business obligations with retained contractual exposure that occurred during the time that the Board-regulated institution was well capitalized and did not exceed the capital limit.

(4) The risk-based capital ratios of the Board-regulated institution must be calculated without regard to the capital treatment for transfers of small-business obligations specified in paragraph (h)(1) of this section for purposes of:

(i) Determining whether a Board-regulated institution is adequately capitalized, undercapitalized, significantly undercapitalized, or critically undercapitalized under the Board's prompt corrective action regulations; and

(ii) Reclassifying a well-capitalized Board-regulated institution to adequately capitalized and requiring an adequately capitalized Board-regulated institution to comply with certain mandatory or discretionary supervisory actions as if the Board-regulated institution were in the next lower prompt-corrective-action category.

(i) *N<sup>th</sup>-to-default credit derivatives—(1) Protection provider.* A Board-regulated institution providing protection through a first-to-default or second-or-later-to-default derivative is subject to capital requirements on such instruments under this paragraph (i)(1).

(i) *First-to-default.* For first-to-default derivatives, a Board-regulated institution must aggregate by simple summation the risk weights of the assets covered up to a maximum of 1,250

percent and multiply by the nominal amount of the protection provided by the credit derivative to obtain the risk-weighted asset amount.

(ii) *Nth-to-default*. For second-or-later-to-default derivatives, in aggregating the risk weights, a Board-regulated institution may exclude the asset with the lowest risk-weighted amount from the risk-weighted capital calculation. This risk-based capital treatment applies for nth-to-default derivatives for which the n-1 assets with the lowest risk-weighted amounts can be excluded from the risk-weighted capital calculation.

(2) *Protection purchaser*. A Board-regulated institution is not permitted to recognize purchased protection in the form of an nth-to-default credit derivative as a credit risk mitigant. A Board-regulated institution must calculate the counterparty credit risk of a purchased nth-to-default credit derivative under §§ 217.34.

(j) *Guarantees, credit derivatives other than n<sup>th</sup>-to-default credit derivatives, and prepaid credit protection arrangements*—(1) *Protection provider*. For a guarantee, credit derivative (other than an n<sup>th</sup>-to-default credit derivative), or prepaid credit protection arrangement provided by a Board-regulated institution that covers the full amount or a pro rata share of a securitization exposure's principal and interest, the Board-regulated institution must risk-weight the guarantee, credit derivative, or prepaid credit protection arrangement under paragraph (a) of this section as if it held the portion of the securitization exposure covered by the guarantee, credit derivative, or prepaid credit protection arrangement.

(2) *Protection purchaser*. (i) A Board-regulated institution that purchases a credit derivative (other than an n<sup>th</sup>-to-default credit derivative) that is recognized under § 217.45 as a

credit risk mitigant (including via recognized collateral) is not required to compute a separate counterparty credit risk capital requirement under §§ 217.34.

(ii) If a Board-regulated institution cannot, or chooses not to, recognize protection purchased in the form of a credit derivative as a credit risk mitigant under § 217.45, the Board-regulated institution must determine the exposure amount of the credit derivative under § 217.34.

(A) If the Board-regulated institution purchases credit protection from a counterparty the activities of which are limited to those appropriate for the specific purpose of holding the underlying exposures of a securitization, the Board-regulated institution must determine the risk weight for the exposure according to § 217.32.

(B) If the Board-regulated institution purchases credit protection from a counterparty the activities of which are limited to those appropriate for the specific purpose of holding the underlying exposures of a securitization, the Board-regulated institution must determine the risk weight for the exposure according to this section.

(k) *Look-through approach.* (1) Subject to paragraph (k)(2) of this section, a Board-regulated institution may assign a risk weight to a senior securitization exposure that is not a resecuritization exposure equal to the greater of:

(i) The weighted-average risk weight, calculated without reference to, or the use of, the risk weight under § 217.52(b)(3)(iii), of all the underlying exposures where the weight for each exposure in the weighted-average calculation is determined by the unpaid principal amount of the exposure; and

(ii) 15 percent.

(2) A Board-regulated institution may assign a risk weight under this paragraph (k) only if the Board-regulated institution has knowledge of the composition of all of the underlying exposures.

(1) *NPL securitization.* Notwithstanding any other provision of this subpart except for paragraph (e) of this section:

(1) If the nonrefundable purchase price discount for the NPL securitization is greater than or equal to 50 percent of the unpaid principal balance of the pool of exposures, the risk weight for a senior securitization exposure to an NPL securitization is 100 percent.

(2) If the Board-regulated institution is an originating Board-regulated institution with respect to the NPL securitization, the Board-regulated institution may hold risk-based capital against the transferred exposures as if they had not been securitized and must deduct from common equity tier 1 capital any after-tax gain-on-sale resulting from the transaction and any portion of a CEIO that does not constitute an after-tax gain-on-sale.

\* \* \* \* \*

34. Revise § 217.44 to read as follows:

**§ 217.44 Securitization standardized approach (SEC-SA).**

(a) *In general.* The risk weight  $RW_{SEC-SA}$  assigned to a securitization exposure, or portion of a securitization exposure, is calculated according to the following formula:

$$RW_{SEC-SA} = \begin{cases} \max(RW_{FLOOR}, 1,250\% \cdot K_{SEC-SA}), & K_A \leq A \\ \max\left(RW_{FLOOR}, \left(\frac{K_A - A}{D - A}\right) \cdot 1,250\% + \left(\frac{D - K_A}{D - A}\right) \cdot 1,250\% \cdot K_{SEC-SA}\right), & A < K_A < D \\ 1,250\%, & D \leq K_A \end{cases}$$

Where:

(1)  $K_A$  is calculated under paragraph (b) of this section;

(2)  $A$  (attachment point) equals the greater of zero and the ratio, expressed as a decimal value between zero and one, of the current dollar amount of underlying exposures that are subordinated to the exposure of the Board-regulated institution to the current dollar amount of the underlying exposures, as adjusted in accordance with paragraph (a)(6) of this section;

(3)  $D$  (detachment point) equals the greater of zero and the sum of parameter  $A$  and the ratio, expressed as a decimal value between zero and one, of the current dollar amount of the securitization exposures that are ranked senior or pari passu with the exposure (that is, have equal seniority with respect to credit risk) to the current dollar amount of the underlying exposures, as adjusted in accordance with paragraph (a)(6) of this section;

(4)  $RW_{FLOOR}$  equals 100 percent for resecuritization exposures and NPL securitization exposures and 15 percent for all other securitization exposures; and

(5)  $K_{SEC-SA}$  is calculated according to the following formula:

$$K_{SEC-SA} = \frac{e^{a \cdot u} - e^{a \cdot l}}{a \cdot (u - l)}$$

Where:

(i)  $a$  equals  $-\frac{1}{p \cdot K_A}$  (as  $K_A$  is defined in this paragraph (a)), where  $p$  equals 1.5 for a resecuritization exposure and 0.5 for all other securitization exposures;

(ii)  $u$  equals  $D - K_A$  (as  $D$  and  $K_A$  are defined in paragraph (a) of this section);

(iii)  $l$  equals  $\max(A - K_A, 0)$  (as  $A$  and  $K_A$  are defined in paragraph (a) of this section);

and

(iv)  $e$  equals the base of the natural logarithm.

(6) A Board-regulated institution must include in the calculation of  $A$  and  $D$  the funded portion of any reserve account funded by the accumulated cash flows from the underlying exposures that is subordinated to the Board-regulated institution's securitization exposure. Interest rate derivative contracts, exchange rate derivative contracts, and cash collateral accounts related to these contracts must not be included in the calculation of  $A$  and  $D$ . If the securitization exposure includes a nonrefundable purchase price discount, the nonrefundable purchase price discount must be included in the numerator and denominator of  $A$  and  $D$ .

(b) *Calculation of  $K_A$ .*  $K_A$  is calculated under this paragraph (b) according to the following formula:

$$K_A = (1 - W) \cdot K_G + (W \cdot 0.5)$$

Where:

(1)  $W$  equals the ratio, expressed as a decimal value between zero and one, of the sum of the dollar amounts of any underlying exposures of the securitization that are not securitization exposures and that meet any of the criteria in paragraphs (b)(1)(i) through (vii) of this section to the outstanding balance, measured in dollars, of all underlying exposures:

(i) Ninety days or more past due;

(ii) Subject to a bankruptcy or insolvency proceeding;

(iii) In the process of foreclosure;

(iv) Held as real estate owned;

(v) Has contractually deferred payments for 90 days or more, other than principal or interest payments deferred on:

(A) Federally guaranteed student loans, in accordance with the terms of those guarantee programs; or

(B) Consumer loans, including non-federally-guaranteed student loans, provided that such payments are deferred pursuant to provisions included in the contract at the time funds are disbursed that provide for period(s) of deferral that are not initiated based on changes in the creditworthiness of the borrower; or

(vi) Is in default; and

(vii) Notwithstanding paragraphs (1)(i) through (vi) of this paragraph, an exposure that is directly and unconditionally guaranteed by the U.S. Government, its central bank, or a U.S. Government agency may be excluded from the calculation of  $W$  up to the amount of the guarantee; and

(2)  $K_G$  equals the weighted average (with unpaid principal used as the weight for each credit exposure and fair value used for each equity exposure) total capital requirement, expressed as a decimal value between zero and one, of the underlying exposures calculated using this subpart D (that is, an average risk weight of 100 percent represents a value of  $K_G$  equal to 0.08),

as adjusted in accordance with this paragraph (b)(2). For purposes of  $K_G$ , the determination of the capital requirement associated with an underlying exposure that is an equity exposure cannot use the risk weight under § 217.52(b)(3)(iii). For interest rate derivative contracts and exchange rate derivative contracts, the positive current exposure times the risk weight of the counterparty multiplied by 0.08 must be included in the numerator of  $K_G$  but must be excluded from the denominator of  $K_G$ .

\* \* \* \* \*

35. Amend § 217.45 by:

- a. Adding paragraphs (a)(3) and (a)(4).
- b. Revising paragraph (b).

The additions and revisions read as follows:

**§ 217.45 Recognition of credit risk mitigants for securitization exposures.**

\* \* \* \* \*

(3) If the recognized credit risk mitigant hedges a portion of the Board-regulated institution's securitization exposure, the Board-regulated institution must calculate its capital requirements for the hedged and unhedged portions of the exposure separately. For each unhedged portion, the Board-regulated institution must calculate capital requirements according to § 217.42 and § 217.43. For each hedged portion, the Board-regulated institution may recognize the credit risk mitigant under § 217.36 or § 217.37, but only as provided in this section.

(4) When a Board-regulated institution purchases or sells credit protection on a portion of a senior tranche, the lower-priority portion, whether hedged or unhedged, must be considered a non-senior securitization exposure.

\* \* \* \* \*

(b) *Mismatches*. A Board-regulated institution must make any applicable adjustment to the protection amount as required in § 217.36 for any hedged securitization exposure. In the context of a synthetic securitization, when a credit risk mitigant described in § 217.41(b)(1)(ii) through (iv) covers multiple hedged exposures that have different residual maturities, the Board-regulated institution must use the longest residual maturity of any of the hedged exposures as the residual maturity of all hedged exposures.

\* \* \* \* \*

36. Revise § 217.51(b)(4) to read as follows:

**§ 217.51 Introduction and exposure measurement.**

\* \* \* \* \*

(b) \* \* \*

(4) For a commitment to acquire an equity exposure (an equity commitment), the effective notional principal amount of the exposure is multiplied by the following conversion factors (CFs):

(i) Conditional equity commitments receive a 40 percent conversion factor.

(ii) Unconditional equity commitments receive a 100 percent conversion factor.

\* \* \* \* \*

37. Revise § 217.61 to read as follows:

**§ 217.61 Purpose and scope.**

Sections 217.61 through 217.63 of this subpart establish public disclosure requirements related to the capital requirements described in subpart B of this part for a Board-regulated institution with total consolidated assets of \$50 billion, as adjusted pursuant to § 217.4, or more as reported on the Board-regulated institution's most recent year-end Call Report, for a state member bank, or FR Y-9C, for a bank holding company or savings and loan holding company, as applicable that is not an advanced approaches Board-regulated institution making public disclosures pursuant to § 217.172. An advanced approaches Board-regulated institution that has not received approval from the Board to exit parallel run pursuant to § 217.121(d) is subject to the disclosure requirements described in §§ 217.62 and 217.63. A Board-regulated institution with total consolidated assets of \$50 billion, as adjusted pursuant to § 217.4, or more as reported on the Board-regulated institution's most recent year-end Call Report, for a state member bank, or FR Y-9C, for a bank holding company or savings and loan holding company, as applicable, that is not an advanced approaches Board-regulated institution making public disclosures subject to § 217.172 must comply with § 217.62 unless it is a consolidated subsidiary of a bank holding company, savings and loan holding company, or depository institution that is subject to the disclosure requirements of § 217.62 or a subsidiary of a non-U.S. banking organization that is subject to comparable public disclosure requirements in its home jurisdiction. For purposes of this section, total consolidated assets are determined based on the average of the Board-regulated institution's total consolidated assets in the four most recent quarters as reported on the Call

Report, for a state member bank, or FR Y-9C, for a bank holding company or savings and loan holding company, as applicable; or the average of the Board-regulated institution's total consolidated assets in the most recent consecutive quarters as reported quarterly on the Board-regulated institution's Call Report, for a state member bank, or FR Y-9C, for a bank holding company or savings and loan holding company, as applicable if the Board-regulated institution has not filed such a report for each of the most recent four quarters.

\* \* \* \* \*

38. Amend § 217.300 by revising paragraph (a) to read as follows:

**§ 217.300 Transitions.**

(a) *Transition adjustments for AOCI.* Beginning [January 1, 2027], a Category III Board-regulated institution or a Category IV Board-regulated institution that had made an AOCI opt-out election under § 217.22(b)(2) effective [December 31, 2026], must subtract from the sum of its common equity tier 1 elements, before making deductions required under § 217.22(c) or (d), the transition AOCI adjustment amount multiplied by the percentage provided in Table 1 to § 217.300. The transition AOCI adjustment amount is the sum of:

(1) Net unrealized gains or losses on available-for-sale securities, plus

(2) Accumulated net gains or losses on cash flow hedges, plus

(3) Any amounts recorded in AOCI attributed to defined benefit postretirement plans resulting from the initial and subsequent application of the relevant GAAP standards that pertain to such plans, plus

(4) Net unrealized holding gains or losses on held-to-maturity securities that are included in AOCI.

Table 1 to § 217.300

### Transition AOCI Adjustment

Transition period	Percentage applicable to transition AOCI adjustment amount
January 1, 2027 to December 31, 2027	100
January 1, 2028 to December 31, 2028	80
January 1, 2029 to December 31, 2029	60
January 1, 2030 to December 31, 2030	40
January 1, 2031 to December 31, 2031	20
January 1, 2032 and thereafter	0

\* \* \* \* \*

### PART 238—SAVINGS AND LOAN HOLDING COMPANIES (REGULATION LL)

39. The authority citation for part 238 continues to read as follows:

**Authority:** 5 U.S.C. 552, 559; 12 U.S.C. 1462, 1462a, 1463, 1464, 1467, 1467a, 1468, 5365; 1813, 1817, 1829e, 1831i, 1972; 15 U.S.C. 78l.

### Subpart Q—Single-Counterparty Credit Limits for Covered Savings and Loan Holding Companies

## **§ 238.154 [Amended]**

40. In paragraph (h)(1) of § 238.154, remove the words “§ 217.37(c)(3)(ii)” and add in their place “§ 217.37(d)(2)”.

## **PART 252—ENHANCED PRUDENTIAL STANDARDS (REGULATION YY)**

41. The authority citation for part 252 continues to read as follows:

**Authority:** 12 U.S.C. 321–338a, 481–486, 1467a, 1818, 1828, 1831n, 1831o, 1831p–1, 1831w, 1835, 1844(b), 1844(c), 3101 *et seq.*, 3101 note, 3904, 3906–3909, 4808, 5361, 5362, 5365, 5366, 5367, 5368, 5371.

### **Subpart H—Single-Counterparty Credit Limits**

## **§ 252.74 [Amended]**

42. In paragraph (h)(1) of § 252.74, remove the words “§ 217.37(c)(3)(ii)” and add in their place “§ 217.37(d)(2)”.

### **Subpart Q—Single-Counterparty Credit Limits**

## **§ 252.174 [Amended]**

43. In paragraph (h)(1) of § 252.174, remove the words “§ 217.37(c)(3)(ii)” and add in their place “§ 217.37(d)(2)”.

## **Federal Deposit Insurance Corporation**

### **12 CFR Chapter III**

#### **Authority and Issuance**

For the reasons stated in the common preamble, the Federal Deposit Insurance Corporation proposes to amend 12 CFR part 324 as follows:

#### **PART 324— CAPITAL ADEQUACY OF FDIC-SUPERVISED INSTITUTIONS**

44. The authority citation for part 324 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; 5371; 5412; Pub. L. 102–233, 105 Stat. 1761, 1789, 1790 (12 U.S.C. 1831n note); Pub. L. 102–242, 105 Stat. 2236, 2355, as amended by Pub. L. 103–325, 108 Stat. 2160, 2233 (12 U.S.C. 1828 note); Pub. L. 102–242, 105 Stat. 2236, 2386, as amended by Pub. L. 102–550, 106 Stat. 3672, 4089 (12 U.S.C. 1828 note); Pub. L. 111–203, 124 Stat. 1376, 1887 (15 U.S.C. 78o–7 note), Pub. L. 115–174; section 4014 § 201, Pub. L. 116–136, 134 Stat. 281 (15 U.S.C. 9052).

#### **Subpart A— General Provisions**

45. In § 324.1:

- a. Revise paragraphs (c)(4)(i), (e) and (f); and
- b. Add paragraph (g).

The addition and revision read as follows:

#### **§ 324.1 Purpose, applicability, reservations of authority, and timing.**

\* \* \* \* \*

(4) \* \* \*

(i) Except for an advanced approaches FDIC-supervised institution that is making public disclosures pursuant to the requirements in subpart E of this part, each FDIC-supervised institution with total consolidated assets of \$50 billion or more, as adjusted pursuant to § 324.4, must make the public disclosures described in subpart D of this part.

\* \* \* \* \*

(e) *Notice and response procedures.* In making a determination under this part, unless more specifically provided for, the FDIC will apply notice and response procedures in the same manner and to the same extent as the notice and response procedures in 12 CFR 324.7(c).

\* \* \* \* \*

(f) *Transitions and timing—(1) Transitions.* Notwithstanding any other provision of this part, an FDIC-supervised institution must make any adjustments provided in subpart G of this part for purposes of implementing this part.

(2) *Timing.* An FDIC-supervised institution that changes from one category to another category, or that changes from having no category to having a category, must comply with the requirements of its category in this part, including applicable transition provisions of the requirements in this part, no later than on the first day of the second quarter following the change in the FDIC-supervised institution's category.

\* \* \* \* \*

(g) *Severability*. If any provision of this part, or the application thereof to any FDIC-supervised institution, is held invalid, such invalidity shall not affect the validity of other provisions or the application of such provision to other FDIC-supervised institutions that can be given effect without the invalid provision or application.

\* \* \* \* \*

46. In § 324.2:

- a. Revise the definition for “Adjusted allowances for credit losses (AACL)”;
- b. Remove the definition for “Allowances for loan and lease losses (ALLL)”;
- c. Revise the definition for “Carrying value”;
- d. Revise the definition for “Category III FDIC-supervised institution (324.2)”;
- e. Add, in alphabetical order, the definition for “Category IV FDIC-supervised institution”;
- f. Revise the definition for “Commitment”;
- g. Add, in alphabetical order, the definition for “Dependent on the cash flows generated by the real estate”;
- h. Revise the definitions for “Effective notional amount”, “Eligible clean-up call”, and “Eligible guarantee”;
- i. Add, in alphabetical order, the definition for “Eligible prepaid credit protection arrangement”;

- j. Revise paragraph (4)(i)(A) in the definition of “Financial institution”;
- k. Revise the definition for “Netting set”;
- l. Add, in alphabetical order, definitions for “Non-performing loan securitization (NPL securitization)”, “ Nonrefundable purchase price discount (NRPPD)”, and “Prepaid credit protection arrangement”;
- m. Revise the definition for “Protection amount (P)”;
- n. Add, in alphabetical order, the definition for “Qualifying Cross-Product Master Netting Agreement”;
- o. Revise paragraph (1)(ii) of the definition for “Residential mortgage exposure”;
- p. Remove the definition for “Securitization special purpose entity (SPE)”;
- q. Add, in alphabetical order, the definitions for “Senior securitization exposure” and “Specified supranational entity”;
- r. Revise the definition for “Speculative grade”;
- s. In the definition of “Standardized total risk-weighted assets”, remove the words “§ 324.42” and add, in their place, the words “§ 324.43”;
- t. Revise the definition for “Sub-speculative grade”;
- u. Add, in alphabetical order, the definition for “Synthetic excess spread”;
- v. Revise the definitions for “Synthetic securitization”, and “Traditional securitization”.

The additions and revisions read as follows:

**§ 324.2 Definitions.**

*Adjusted allowances for credit losses (AACL)* means valuation allowances that have been established through a charge against earnings or retained earnings for expected credit losses on financial assets measured at amortized cost and a lessor's net investment in leases that have been established to reduce the amortized cost basis of the assets to amounts expected to be collected as determined in accordance with GAAP. For purposes of this part, adjusted allowances for credit losses include allowances for expected credit losses on off-balance sheet credit exposures not accounted for as insurance as determined in accordance with GAAP. Adjusted allowances for credit losses exclude allocated transfer risk reserves and allowances created that reflect credit losses on purchased credit deteriorated assets, purchased seasoned loans, assets required to record an allowance for credit losses through a gross-up adjustment to the purchase price of the asset, and available-for-sale debt securities.

\* \* \* \* \*

*Carrying value* means, with respect to an asset, the value of the asset on the balance sheet of the FDIC-supervised institution as determined in accordance with GAAP. For all assets other than available-for-sale debt securities, purchased credit deteriorated assets, purchased seasoned loans, or assets required to record an allowance for credit losses through a gross-up adjustment to the purchase price of the asset, the carrying value is not reduced by any associated credit loss allowance that is determined in accordance with GAAP.

\* \* \* \* \*

*Category III FDIC-supervised institution* means an FDIC-supervised institution that is not a Category II FDIC-supervised institution and that

(1) Is a subsidiary of a Category III banking organization, as defined pursuant to 12 CFR 252.5 or 12 CFR 238.10, as applicable; or

(2)(i) Has total consolidated assets, calculated based on the average of the FDIC-supervised institution's total consolidated assets for the four most recent calendar quarters as reported on the Call Report, equal to \$250 billion or more. If the FDIC-supervised institution has not filed the Call Report for each of the four most recent calendar quarters, total consolidated assets is calculated based on its total consolidated assets, as reported on the Call Report, for the most recent quarter or average of the most recent quarters, as applicable; or

(ii)(A) Has total consolidated assets, calculated based on the average of the FDIC-supervised institution's total consolidated assets for the four most recent calendar quarters as reported on the Call Report, of \$100 billion or more but less than \$250 billion. If the FDIC-supervised institution has not filed the Call Report for each of the four most recent calendar quarters, total consolidated assets is calculated based on its total consolidated assets, as reported on the Call Report, for the most recent quarter or average of the most recent quarters, as applicable; and

(B) Has at least one of the following in paragraphs (2)(ii)(B)(1) through (3) of this definition, each calculated as the average of the four most recent calendar quarters, or if the FDIC-supervised institution has not filed each applicable reporting form for each of the four most recent calendar quarters, for the most recent quarter or quarters, as applicable:

(1) Total nonbank assets, calculated in accordance with the instructions to the FR Y-9LP or equivalent reporting form, equal to \$75 billion or more;

(2) Off-balance sheet exposure equal to \$75 billion or more. Off-balance sheet exposure is the FDIC-supervised institution's total exposure, calculated in accordance with the instructions to the FR Y-15 or equivalent reporting form, minus the FDIC-supervised institution's total consolidated assets, as reported on the Call Report; or

(3) Weighted short-term wholesale funding, calculated in accordance with the instructions to the FR Y-15 or equivalent reporting form, equal to \$75 billion or more.

(iii) After meeting the criteria in paragraph (2)(ii) of this definition, an FDIC-supervised institution continues to be a Category III FDIC-supervised institution until the FDIC-supervised institution:

(A) Has:

(1) Less than \$250 billion in total consolidated assets, as reported on the Call Report, for each of the four most recent calendar quarters;

(2) Less than \$75 billion in total nonbank assets, calculated in accordance with the instructions to the FR Y-9LP or equivalent reporting form, for each of the four most recent calendar quarters;

(3) Less than \$75 billion in weighted short-term wholesale funding, calculated in accordance with the instructions to the FR Y-15 or equivalent reporting form, for each of the four most recent calendar quarters; and

(4) Less than \$75 billion in off-balance sheet exposure for each of the four most recent calendar quarters. Off-balance sheet exposure is an FDIC-supervised institution's total exposure, calculated in accordance with the instructions to the FR Y-15 or equivalent reporting form,

minus the total consolidated assets of the FDIC-supervised institution, as reported on the Call Report; or

(B) Has less than \$100 billion in total consolidated assets, as reported on the Call Report, for each of the four most recent calendar quarters; or

(C) Is a Category II FDIC-supervised institution

*Category IV FDIC-supervised institution means* an FDIC-supervised institution that is not a Category II FDIC-supervised institution or a Category III FDIC-supervised institution, and that:

(1) Is a subsidiary of a Category IV banking organization, as defined pursuant to 12 CFR 252.5 or 12 CFR 238.10, as applicable; or:

(2) Has total consolidated assets, calculated based on the average of the FDIC-supervised institution's total consolidated assets for the four most recent calendar quarters as reported on the Call Report, of \$100 billion or more. If the FDIC-supervised institution has not filed the Call Report for each of the four most recent calendar quarters, total consolidated assets is calculated based on the average of its total consolidated assets, as reported on the Call Report, for the most recent quarter(s) available.

(3) After meeting the criterion in paragraph (2) of this definition, an FDIC-supervised institution continues to be a Category IV FDIC-supervised institution until it:

(i) Has less than \$100 billion in total consolidated assets, as reported on the Call Report, for each of the four most recent calendar quarters; or

(ii) Is a Category II FDIC-supervised institution or Category III FDIC-supervised institution.

\* \* \* \* \*

*Commitment* means a contractual arrangement, under which an FDIC-supervised institution and an obligor agree to terms applicable to one or more future extensions of credit, purchases of assets, or issuances of credit substitutes by the FDIC-supervised institution, whether or not such arrangement is unconditionally cancelable. A commitment is unconditionally cancelable if, by its terms, it either: (a) provides that an FDIC-supervised institution is not obligated to extend credit, purchase assets, or issue credit substitutes; or (b) permits an FDIC-supervised institution, at any time, with or without cause, to refuse to extend credit, purchase assets, or issue credit substitutes under the arrangement (to the extent permitted under applicable law).

\* \* \* \* \*

*Dependent on the cash flows generated by the real estate* means, for a real estate exposure, the underwriting, at the time of origination, considers the cash flows generated by lease, rental, or sale of the real estate securing the loan as a source of repayment. For purposes of this definition, a residential mortgage exposure that is secured by the borrower's principal residence is deemed not dependent on the cash flows generated by the real estate.

\* \* \* \* \*

*Effective notional amount* means for an eligible guarantee, eligible credit derivative, or eligible prepaid credit protection arrangement, the lesser of the contractual notional amount of

the credit risk mitigant and the exposure amount of the hedged exposure, multiplied by the percentage coverage of the credit risk mitigant.

\* \* \* \* \*

*Eligible clean-up call* means a clean-up call that:

(1) Is exercisable solely at the discretion of the originating FDIC-supervised institution 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) Is only exercisable:

(i) For a traditional securitization, 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;

(ii) For a synthetic securitization, 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;

(iii) Upon the occurrence of a regulatory event that significantly changes the risk-weighted asset amount for the securitization exposure under applicable risk-weighted asset standards; or

(iv) Upon the occurrence of a tax event that significantly changes the tax treatment of the securitization exposure under applicable tax laws.

\* \* \* \* \*

*Eligible guarantee* means a guarantee that:

(1) Is written;

(2) Is either:

(i) Unconditional, or

(ii) A contingent obligation of the U.S. government or its agencies, the enforceability of which is dependent upon some affirmative action on the part of the beneficiary of the guarantee or a third party (for example, meeting servicing requirements);

(3) Covers all or a pro rata portion of all contractual payments of the obligated party on the reference exposure;

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

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

(6) Except for a guarantee by a sovereign, is legally enforceable against the protection provider in a jurisdiction where the protection provider has sufficient assets against which a judgment may be attached and enforced;

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

(8) Does not increase the beneficiary's cost of credit protection on the guarantee in response to deterioration in the credit quality of the reference exposure;

(9) Is not provided by an affiliate of the FDIC-supervised institution, unless the affiliate is an insured depository institution, foreign bank, securities broker or dealer, or insurance company that:

(i) Does not control the FDIC-supervised institution; and

(ii) Is subject to consolidated supervision and regulation comparable to that imposed on depository institutions, U.S. securities broker-dealers, or U.S. insurance companies (as the case may be); and

(10) Is provided by an eligible guarantor.

\* \* \* \* \*

*Eligible prepaid credit protection arrangement* means a prepaid credit protection arrangement that:

(1) Is written;

(2) Is unconditional;

(3) Covers all or a pro rata portion of all contractual payments due to be paid on the reference exposure or reference exposures;

(4) Provides that the amount and timing of payments due from the protection purchaser to the protection provider are incorporated into the arrangement and the arrangement only allows these terms to change in the event of a breach of the arrangement by the protection purchaser;

(5) Provides that entry of the protection provider into receivership, insolvency, liquidation, conservatorship, or similar proceeding does not change the amounts or timing of payments due to be paid by the protection purchaser under the arrangement;

(6) Is legally valid and enforceable under applicable law of the relevant jurisdictions;

(7) Upon a failure by the obligor on the one or more reference exposures to make a contractually required payment, or the occurrence of other credit events as described in the arrangement, allows the protection purchaser promptly to reduce the outstanding balance of the initial principal amount due to the protection provider by the loss of the protection purchaser on the reference exposures without input from the protection provider; and

(8) Does not increase the protection purchaser's cost of credit protection in response to deterioration in the credit quality of any of the reference exposure.

\* \* \* \* \*

*Financial institution* means:

\* \* \* \* \*

(4) \* \* \*

(i) \* \* \*

(A) An investment in GAAP equity instruments of the company with an adjusted carrying value or exposure amount equal to or greater than \$10 million, as adjusted pursuant to § 324.4;

or

\* \* \* \* \*

*Netting set* means a group of transactions with a single counterparty that are subject to a qualifying master netting agreement. For derivative contracts, netting set also includes a single derivative contract between an FDIC-supervised institution and a single counterparty.

\* \* \* \* \*

*Non-performing loan securitization (NPL securitization)* means a traditional securitization, that is not a resecuritization, where parameter *W* (as defined in § 324.44(b)(1)) for the underlying exposures in a pool is greater than or equal to 90 percent at the origination cut-off date and at any subsequent date on which exposures are added to or removed from the pool of underlying exposures due to replenishment or restructuring.

*Nonrefundable purchase price discount (NRPPD)* means the difference between the outstanding principal balance of the underlying exposures at the time of sale and the price at which these exposures are sold by the originator to a company the activities of which are limited to those appropriate for the specific purpose of holding the underlying exposures of a securitization, when neither originator nor the original lender are reimbursed for this difference. In cases where the originator underwrites tranches of an NPL securitization for subsequent sale, the NRPPD may include the differences between the outstanding principal balance of the underlying exposures at the time of sale and the price at which all of the tranches are first sold to unrelated third parties. For any given piece of a securitization tranche, only its initial sale from the originator to investors is taken into account in the determination of NRPPD. The purchase prices of subsequent re-sales of a securitization tranche are not considered.

\* \* \* \* \*

*Prepaid credit protection arrangement* means a contractual arrangement under which a protection purchaser transfers the credit risk of one or more reference exposures to a protection provider where:

(1) The protection provider pays an initial principal amount in cash to the protection purchaser at the inception of the transaction; and

(2) The protection purchaser is obligated to repay the initial principal amount to the protection provider on or before the maturity date of the transaction, less any losses that the protection purchaser realizes or otherwise recognizes due to nonpayment of all contractual payments due to be paid on the reference exposure or reference exposures by the obligors.

\* \* \* \* \*

*Protection amount (P)* means, with respect to an exposure hedged by an eligible guarantee, eligible credit derivative, or eligible prepaid credit protection arrangement, or secured by financial collateral, the effective notional amount of the guarantee, credit derivative, or prepaid credit protection arrangement, or the fair value of the financial collateral, reduced to reflect any currency mismatch, maturity mismatch, or lack of restructuring coverage (as provided in §§ 324.36-324.37 or § 324.120-121, as applicable).

\* \* \* \* \*

*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 the underlying financial transactions are derivative contracts or repo-style

transactions that are not cleared transactions. In order to treat an agreement as a qualifying cross-product master netting agreement, an FDIC-supervised institution must comply with the requirements of § 324.3(c) of this part with respect to that agreement.

\* \* \* \* \*

*Residential mortgage exposure* means an exposure (other than a securitization exposure, equity exposure, statutory multifamily mortgage, or presold construction loan):

(1) \* \* \*

(ii) With an original and outstanding amount of \$1 million or less, as adjusted pursuant to § 324.4, that is primarily secured by a first or subsequent lien on residential property that is not one-to-four family; and

\* \* \* \* \*

*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, an FDIC-supervised institution is not required to consider amounts due under interest rate derivative, currency derivative, and servicer cash advance facility contracts; fees due; and 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

derivative, currency derivative, and servicer cash advance facility contracts; fees due; and other similar payments.

\* \* \* \* \*

*Specified supranational entity* means the Bank for International Settlements, the European Central Bank, the European Commission, the International Monetary Fund, the European Stability Mechanism, or the European Financial Stability Facility.

\* \* \* \* \*

*Speculative grade* means that the entity to which the FDIC-supervised institution is exposed through a loan or security, or the reference entity with respect to a credit derivative, has adequate capacity to meet financial commitments in the near term, but is vulnerable to adverse economic conditions, such that should economic conditions deteriorate, the issuer or the reference entity would present an elevated default risk.

\* \* \* \* \*

*Sub-speculative grade* means that the entity to which the FDIC-supervised institution is exposed through a loan or security, or the reference entity with respect to a credit derivative, depends on favorable economic conditions to meet its financial commitments, such that should such economic conditions deteriorate the issuer or the reference entity likely would default on its financial commitments.

\* \* \* \* \*

*Synthetic excess spread* means any contractual provisions in a synthetic securitization that are designed to absorb losses prior to any of the tranches of the securitization structure.

\* \* \* \* \*

*Synthetic securitization* means a transaction in which:

(1) All or a portion of the credit risk of one or more underlying exposures is retained or transferred to one or more third parties through the use of one or more credit derivatives, guarantees (other than a guarantee that transfers only the credit risk of an individual retail exposure), or prepaid credit protection arrangements;

(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 solely 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).

\* \* \* \* \*

*Traditional securitization* means a transaction in which:

(1) All or a portion of the credit or equity risk of one or more underlying exposures is transferred to one or more third parties other than through the use of credit derivatives, guarantees, or prepaid credit protection arrangements;

(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 solely 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 defined in section 302 of the Small Business Investment Act;

(7) The underlying exposures are not owned by a firm an investment in which qualifies as a community development investment under section 24(Eleventh) of the National Bank Act;

(8) The FDIC 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 FDIC may deem a transaction that meets the definition of a traditional securitization, notwithstanding paragraph (5), (6), or (7) of this definition, to be a traditional securitization based on the transaction's leverage, risk profile, or economic substance; and

(10) The transaction is not:

(i) An investment fund;

(ii) A collective investment fund (as defined in 12 CFR 344.3 (state nonmember bank), and 12 CFR 390.203 (state savings association));

(iii) An employee benefit plan (as defined in paragraphs (3) and (32) of section 3 of ERISA), a “governmental plan” (as defined in 29 U.S.C. 1002(32)) that complies with the tax deferral qualification requirements provided in the Internal Revenue Code, or any similar employee benefit plan established under the laws of a foreign jurisdiction;

(iv) A synthetic exposure to the capital of a financial institution to the extent deducted from capital under § 324.22; or

(v) Registered with the SEC under the Investment Company Act of 1940 (15 U.S.C. 80a-1) or foreign equivalents thereof.

\* \* \* \* \*

47.[--]. Redesignate § 324.4 as § 324.6 and § 324.5 as § 324.7.

48. Add § 324.4 to read as follows:

**§ 324.4 Threshold Indexing.**

(a) *Methodology.* The dollar thresholds specified in paragraph (c) of this section shall be adjusted by multiplying the baseline threshold values specified in paragraph (c) of this section by one plus the cumulative percent change in the non-seasonally adjusted Consumer Price Index for Urban Wage Earners and Clerical Workers, measured from the effective date of this rule, as further described in paragraph (b) of this section, and shall be rounded in accordance with paragraph (d) of this section.

(b) *Frequency.* (1) *In general – biennial adjustments.* Except as otherwise provided in paragraph (b)(2) and (b)(3) of this section, the adjustments described in paragraph (a) of this section shall be effective on October 1 following each consecutive two year period ending August 30, and using the non-seasonally adjusted Consumer Price Index for Urban Wage Earners and Clerical Workers as of August 30 of that year.

(2) *Off-year adjustments.* In the event that the FDIC determines, during a year where no adjustment would be made under paragraph (b)(1), that the non-seasonally adjusted Consumer Price Index for Urban Wage Earners and Clerical Workers, measured over the twelve month period ending August 30 of that year, is such that an adjustment under this section would be appropriate for that year, the FDIC may make an adjustment under this section for that year.

(3) *Periods of negative inflation.* Notwithstanding paragraph (b)(1) or (b)(2) of this section, if an adjustment of dollar thresholds using the cumulative percent change of the non-seasonally adjusted Consumer Price Index for Urban Wage Earners and Clerical Workers from the effective date of this rule or the most recent adjustment, as applicable, would not result in an increase from the current dollar thresholds, no adjustment will be made pursuant to paragraph (a) of this section.

(c) *Specified thresholds.* The thresholds in the following sections shall be adjusted in accordance with paragraph (a) of this section relative to the baseline threshold values as specified below.

(1) Section 324.1(c)(4)(i), baseline threshold value \$50 billion;

(2) Section 324.2, paragraph (4)(i)(A) of the definition of “Financial institution,” baseline threshold value \$10 million;

(3) Section 324.2, definition of “Residential mortgage exposure,” baseline threshold value \$1 million; and

(4) Section 324.61, baseline threshold value \$50 billion.

(d) *Rounding.* When adjusting thresholds under this section, each threshold shall be rounded based on the size of the threshold (e.g., thousands, millions, billions) to the nearest number with two significant digits.

(e) *Effective date of threshold adjustments.* The FDIC shall announce the thresholds adjusted in accordance with this section by publication in the Federal Register. Such adjusted thresholds shall be effective on October 1 of the year during which an adjustment is made.

(f) *Failure to publish in the Federal Register.* In the event, for any reason, the thresholds adjusted in accordance with this section are not published in the Federal Register in a year in which an adjustment is made under this section, the thresholds specified in paragraph (c) of this section will adjust as provided in this section and be effective on October 1, notwithstanding the lack of publication in the Federal Register.

\* \* \* \* \*

49. Add § 324.5 to read as follows:

**§ 324.5 Calculation of loan-to-value (LTV) ratio.**

(a) *Loan-to-value ratio.* The loan-to-value (LTV) ratio must be calculated as the extension of credit divided by the value of the property.

(b) *Extension of credit.* For purposes of a LTV ratio calculated under this § 324.5, the extension of credit is equal to the total outstanding amount of the loan including any undrawn committed amount of the loan.

(c) *Value of the property.* (1) For purposes of a LTV ratio calculated under this § 324.5, the value of the property is the market value of all real estate properties securing or being improved by the extension of credit plus the amount of any readily marketable collateral and other acceptable collateral, as defined in 12 CFR part 365, Subpart A, Appendix A, that secures the extension of credit, subject to the following:

(i) For exposures subject to 12 CFR part 323, subpart A, the market value of property is a valuation that meets all requirements of that rule.

(ii) For exposures not subject to 12 CFR part 323, subpart A:

(A) The market value of real estate must be obtained from an independent valuation of the property using prudently conservative valuation criteria;

(B) The valuation must be done independently from the FDIC-supervised institution's origination and underwriting process; and

(C) To ensure that the market value of the real estate is determined in a prudently conservative manner, the valuation must exclude expectations of price increases and must be adjusted downward to account for the potential for the current market price to be significantly above the value that would be sustainable over the life of the loan.

(2) In the case where the exposure includes the financing to purchase the property, the value of the property is the lower of the market value obtained under paragraph (c)(1)(i) or (c)(1)(ii) of this section, as applicable, and the actual acquisition cost.

(3) The value of the property must be measured at the time of origination, except in the following circumstances:

(i) The FDIC requires an FDIC-supervised institution to revise the value of the property downward;

(ii) The value of the property must be adjusted downward due to an extraordinary event that results in a permanent reduction of the property value; or

(iii) The value of the property may be increased to reflect modifications made to the property that increase the market value, as determined according to the requirements in paragraphs (c)(1)(i) or (c)(1)(ii) of this section.

(4) Readily marketable collateral and other acceptable collateral, as defined in 12 CFR part 365, Subpart A, Appendix A, must be appropriately discounted by the FDIC-supervised institution consistent with the FDIC-supervised institution's usual practices for making loans secured by such collateral.

### **Subpart C—Definition of Capital**

50. Amend § 324.22 by:

- a. Redesignating footnotes 22 through 31 as footnotes 1 through 10, respectively;
- b. Revising paragraph (b), the heading of paragraph (d), and paragraph (d)(1).

The revisions read as follows:

**§ 324. 22 Regulatory capital adjustments and deductions.**

\* \* \* \* \*

*(b) Regulatory adjustments to common equity tier 1 capital.*

(1) An FDIC-supervised institution must adjust the sum of common equity tier 1 capital elements pursuant to the requirements set forth in this paragraph (b). Such adjustments to common equity tier 1 capital must be made net of the associated deferred tax effects.

(i) An FDIC-supervised institution that makes an AOCI opt-out election (as defined in paragraph (b)(2) of this section), must make the adjustments required under paragraph (b)(2)(i) of this section.

(ii) An FDIC-supervised institution that is an advanced approaches FDIC-supervised institution, Category III FDIC-supervised institution, or Category IV FDIC-supervised institution, and an FDIC-supervised institution that has not made an AOCI opt-out election (as defined in paragraph (b)(2) of this section), must deduct any accumulated net gains and add any accumulated net losses on cash flow hedges included in AOCI that relate to the hedging of items that are not recognized at fair value on the balance sheet.

(iii) An FDIC-supervised institution must deduct any net gain and add any net loss related to changes in the fair value of liabilities that are due to changes in the FDIC-supervised institution's own credit risk. An advanced approaches FDIC-supervised institution, Category III FDIC-supervised institution, or Category IV FDIC-supervised institution must deduct the

difference between its credit spread premium and the risk-free rate for derivatives that are liabilities as part of this adjustment.

(2) AOCI opt-out election.

(i) An FDIC-supervised institution that is not an advanced approaches FDIC-supervised institution, Category III FDIC-supervised institution, or Category IV FDIC-supervised institution may make a one-time election to opt out of the requirement to include all components of AOCI (with the exception of accumulated net gains and losses on cash flow hedges related to items that are not fair-valued on the balance sheet) in common equity tier 1 capital (AOCI opt-out election). An FDIC-supervised institution that makes an AOCI opt-out election in accordance with this paragraph (b)(2) must adjust common equity tier 1 capital as follows:

(A) Subtract any net unrealized gains and add any net unrealized losses on available-for-sale securities;

(B) Subtract any accumulated net gains and add any accumulated net losses on cash flow hedges;

(C) Subtract any amounts recorded in AOCI attributed to defined benefit postretirement plans resulting from the initial and subsequent application of the relevant GAAP standards that pertain to such plans (excluding, at the FDIC-supervised institution's option, the portion relating to pension assets deducted under paragraph (a)(5) of this section); and

(D) Subtract any net unrealized gains and add any net unrealized losses on held-to-maturity securities that are included in AOCI.

(ii) (A) An FDIC-supervised institution that is not an advanced approaches FDIC-supervised institution, Category III FDIC-supervised institution, or Category IV FDIC-supervised institution must make its AOCI opt-out election in the Call Report, during the first reporting period after the FDIC-supervised institution is required to comply with subpart A of this part as set forth in § 324.1(f).

(B) Notwithstanding paragraph (b)(ii)(A) of this section, if an FDIC-supervised institution was previously an advanced approaches FDIC-supervised institution, Category III FDIC-supervised institution, or Category IV FDIC-supervised institution, the FDIC-supervised institution must make its AOCI opt-out election in the Call Report, during the first reporting period after the FDIC-supervised institution ceased to be an advanced approaches FDIC-supervised institution, Category III FDIC-supervised institution, or Category IV FDIC-supervised institution.

(iii) Each depository institution subsidiary of an FDIC-supervised institution that is not an advanced approaches FDIC-supervised institution, Category III FDIC-supervised institution, or Category IV FDIC-supervised institution must elect the same option as the FDIC-supervised institution pursuant to paragraph (b)(2) of this section.

(iv) With prior notice to the FDIC, an FDIC-supervised institution resulting from a merger, acquisition, or purchase transaction and that is not an advanced approaches FDIC-supervised institution, Category III FDIC-supervised institution, or Category IV FDIC-supervised institution may make a new AOCI opt-out election in its Call Report filed by the resulting FDIC-supervised institution for the first reporting period after it is required to comply with subpart A of this part as set forth in § 324.1(f) if:

(A) Other than as set forth in paragraph (b)(2)(iv)(C) of this section, the merger, acquisition, or purchase transaction involved the acquisition or purchase of all or substantially all of either the assets or voting stock of another banking organization that is subject to regulatory capital requirements issued by the Federal Reserve, the FDIC, or the OCC<sup>1</sup>;

(B) Prior to the merger, acquisition, or purchase transaction, only one of the banking organizations involved in the transaction made an AOCI opt-out election under this section; and

(C) An FDIC-supervised institution may, with the prior approval of the FDIC, change its AOCI opt-out election under this paragraph (b) in the case of a merger, acquisition, or purchase transaction that meets the requirements set forth at paragraph (b)(2)(iv)(B) of this section, but does not meet the requirements of paragraph (b)(2)(iv)(A) of this section. In making such a determination, the FDIC may consider the terms of the merger, acquisition, or purchase transaction, as well as the extent of any changes to the risk profile, complexity, and scope of operations of the FDIC-supervised institution resulting from the merger, acquisition, or purchase transaction.

\* \* \* \* \*

(d) *Certain DTAs subject to common equity tier 1 capital deduction thresholds.*

(1) A FDIC institution that is not an advanced approaches FDIC-supervised institution must make deductions from regulatory capital as described in this paragraph (d)(1).

(i) The FDIC-supervised institution must deduct from common equity tier 1 capital elements the amount of DTAs as described in paragraph (d)(1)(ii) of this section that exceeds 25 percent of the sum of the FDIC-supervised institution's common equity tier 1 capital elements,

less adjustments to and deductions from common equity tier 1 capital required under paragraphs (a) through (c)(3) of this section (the 25 percent common equity tier 1 capital deduction threshold).<sup>8</sup>

(ii) The FDIC-supervised institution must deduct from common equity tier 1 capital elements the amount of DTAs arising from temporary differences that the FDIC-supervised institution could not realize through net operating loss carrybacks, net of any related valuation allowances and net of DTLs, in accordance with paragraph (e) of this section. An FDIC-supervised institution is not required to deduct from the sum of its common equity tier 1 capital elements DTAs (net of any related valuation allowances and net of DTLs, in accordance with § 324.22(e)) arising from timing differences that the FDIC-supervised institution could realize through net operating loss carrybacks. The FDIC-supervised institution must risk weight these assets at 100 percent. For an FDIC-supervised institution that is a member of a consolidated group for tax purposes, the amount of DTAs that could be realized through net operating loss carrybacks may not exceed the amount that the FDIC-supervised institution could reasonably expect to have refunded by its parent holding company.

(iii) For purposes of calculating the amount of DTAs subject to deduction pursuant to paragraph (d)(1) of this section, an FDIC-supervised institution may exclude DTAs and DTLs relating to adjustments made to common equity tier 1 capital under paragraph (b) of this section. An FDIC-supervised institution that elects to exclude DTAs relating to adjustments under paragraph (b) of this section also must exclude DTLs and must do so consistently in all future calculations. An FDIC-supervised institution may change its exclusion preference only after obtaining the prior approval of the FDIC.

\* \* \* \* \*

<sup>1</sup> These rules include the regulatory capital requirements set forth at 12 CFR part 3 (OCC); 12 CFR part 217 (Board); 12 CFR part 324 (FDIC).

\* \* \* \* \*

<sup>8</sup> The amount of the items in paragraph (d)(1) of this section that is not deducted from common equity tier 1 capital must be included in the risk-weighted assets of the FDIC-supervised institution and assigned a 250 percent risk weight.

\* \* \* \* \*

#### **Subpart D—Risk-Weighted Assets—Standardized Approach**

\* \* \* \* \*

51. In § 324.32:

- a. Revise paragraph (f)(1);
- b. Revise paragraph (g);
- c. Revise paragraph (l)(5).

The revisions read as follows:

#### **§ 324.32 General risk weights.**

\* \* \* \* \*

**(f) Corporate exposures.**

(1) An FDIC-supervised institution must assign a 95 percent risk weight to all its corporate exposures, except as provided in paragraphs (f)(2) and (f)(3) of this section.

\* \* \* \* \*

**(g) Residential mortgage exposures.**

(1) An FDIC-supervised institution must assign a risk weight in accordance with Table 5 to § 324.32 or Table 6 to § 324.32, as applicable, to a first-lien residential mortgage exposure that:

(i) Is secured by a property that is either owner-occupied or rented;

(ii) Is made in accordance with prudent underwriting standards, including relating to the loan amount as a percent of the appraised value of the property;

(iii) Is not 90 days or more past due or carried in nonaccrual status; and

(iv) Is not restructured or modified, provided that a loan modified or restructured solely pursuant to the U.S. Treasury’s Home Affordable Mortgage Program is not modified or restructured for purposes of this section.

**Table 5. Risk Weights for Residential Mortgages that are Not Dependent on the Cash Flows Generated by the Real Estate based on LTV<sup>1</sup>**

	<b>LTV Ratio ≤ 50%</b>	<b>50% &lt; LTV Ratio ≤ 60%</b>	<b>60% &lt; LTV Ratio ≤ 80%</b>	<b>80% &lt; LTV Ratio ≤ 90%</b>	<b>90% &lt; LTV Ratio ≤ 100%</b>	<b>LTV Ratio &gt; 100%</b>

<b>Risk</b>	25%	30%	35%	45%	55%	75%
<b>Weight</b>						

<sup>1</sup> LTV is calculated in accordance with § 324.5.

**Table 6. Proposed Risk Weights for Residential Mortgage Exposures Dependent on the Cash Flows Generated by the Real Estate and based on LTV<sup>1</sup>**

	<b>LTV Ratio ≤ 50%</b>	<b>50% &lt; LTV Ratio ≤ 60%</b>	<b>60% &lt; LTV Ratio ≤ 80%</b>	<b>80% &lt; LTV Ratio ≤ 90%</b>	<b>90% &lt; LTV Ratio ≤ 100%</b>	<b>LTV Ratio &gt; 100%</b>
<b>Risk</b>	35%	40%	50%	65%	80%	110%
<b>Weight</b>						

<sup>1</sup> LTV is calculated in accordance with § 324.5.

(2) An FDIC-supervised institution must assign a 100 percent risk weight to a first-lien residential mortgage exposure that does not meet the criteria in paragraph (g)(1) of this section or for which the FDIC-supervised institution cannot calculate the LTV in accordance with 12 CFR 324.5, and to junior-lien residential mortgage exposures.

(3) For the purpose of this paragraph (g), if an FDIC-supervised institution holds the first-lien and junior-lien(s) residential mortgage exposures, and no other party holds an intervening lien, the FDIC-supervised institution must combine the exposures and treat them as a single first-lien residential mortgage exposure.

\* \* \* \* \*

(1) \* \* \*

(5) An FDIC-supervised institution must assign a 90 percent risk weight to all assets not specifically assigned a different risk weight under this subpart and that are not deducted from tier 1 or tier 2 capital pursuant to § 324.22.

\* \* \* \* \*

52. Amend § 324.33 by:

- a. Adding paragraph (a)(5); and
- b. Revising paragraph (b).

The revisions read as follows:

**§ 324.33 Off-balance sheet exposures.**

(a) \* \* \*

(5) For purposes of this section, if a commitment does not have an express contractual maximum amount that can be drawn, the committed but undrawn amount of the commitment is equal to the highest total drawn amount over the period since the commitment was created or the prior 24 months, whichever period is shorter, minus the current drawn amount.

\* \* \* \* \*

(b) *Credit conversion factors*—

(1) *Zero percent CCF*. An FDIC-supervised institution must apply a zero percent CCF to the unused portion of a commitment that is unconditionally cancelable by the FDIC-supervised institution.

(2) *20 percent CCF*. An FDIC-supervised institution must apply a 20 percent CCF to the amount of self-liquidating trade-related contingent items that arise from the movement of goods, with an original maturity of one year or less.

(3) *40 percent CCF*. An FDIC-supervised institution must apply a 40 percent CCF to commitments, regardless of the maturity of the facility, unless they qualify for a lower or higher CCF.

(4) *50 percent CCF*. An FDIC-supervised institution must apply a 50 percent CCF to the amount of:

(i) Transaction-related contingent items, including performance bonds, bid bonds, warranties, and performance standby letters of credit; and

(ii) Note issuance facilities and revolving underwriting facilities.

(5) *100 percent CCF*. An FDIC-supervised institution must apply a 100 percent CCF to the amount of the following off-balance-sheet items and other similar transactions:

(i) Guarantees;

(ii) Repurchase agreements (the off-balance sheet component of which equals the sum of the current fair values of all positions the FDIC-supervised institution has sold subject to repurchase);

(iii) Credit-enhancing representations and warranties that are not securitization exposures;

(iv) Off-balance sheet securities lending transactions (the off-balance sheet component of which equals the sum of the current fair values of all positions the FDIC-supervised institution has lent under the transaction);

(v) Off-balance sheet securities borrowing transactions (the off-balance sheet component of which equals the sum of the current fair values of all non-cash positions the FDIC-supervised institution has posted as collateral under the transaction);

(vi) Financial standby letters of credit; and

(vii) Forward agreements.

\* \* \* \* \*

53. Amend § 324.34 by revising paragraph (c)(2) to read as follows:

**§ 324.34 Derivative contracts.**

\* \* \* \* \*

(c) \* \* \*

(2) As an alternative to the simple approach, an FDIC-supervised institution using CEM under paragraph (b) of this section may recognize the credit risk mitigation benefits of financial collateral that secures such a contract or netting set if the financial collateral is marked-to-fair value on a daily basis and subject to a daily margin maintenance requirement by applying a risk weight to the uncollateralized portion of the exposure, after adjusting the exposure amount

calculated under paragraph (b)(1) or (2) of this section using the collateral haircut approach in § 324.37(e). The FDIC-supervised institution must substitute the exposure amount calculated under paragraph (b)(1) or (2) of this section for  $\sum_i E_i$  in the equation in § 324.37(e)(2).

\* \* \* \* \*

54. Amend § 324.36 by revising paragraph (e) to read as follows:

**§ 324.36 Guarantees and credit derivatives: substitution treatment.**

\* \* \* \* \*

(e) *Adjustment for credit derivatives without restructuring as a credit event.* (1) If an FDIC-supervised institution 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 FDIC-supervised institution must apply the adjustment in paragraph (e)(2) of this section to reduce the effective notional amount of the credit derivative unless:

(i) The terms of the hedged exposure and the reference exposure, if different from the hedged exposure, allow the maturity, principal, coupon, currency, or seniority status of the exposure to be amended outside of receivership, insolvency, liquidation, or similar proceeding only by unanimous consent of all parties; and

(ii) The FDIC-supervised institution has conducted sufficient legal review to conclude with a well-founded basis (and maintains sufficient written documentation of that legal review) that the hedged exposure is subject to the U.S. Bankruptcy Code, the Federal Deposit Insurance

Act, or a domestic or foreign insolvency regime with similar features that allow for a company to liquidate, reorganize, or restructure and provides for an orderly settlement of creditor claims.

(2) The FDIC-supervised institution must apply the following adjustment to reduce the effective notional amount of any eligible credit derivative that is subject to adjustment under paragraph (e)(1) of this section:

$Pr = Pm \times 0.60$ , where:

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

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

\* \* \* \* \*

55. Amend § 324.37 to read as follows:

**§ 324.37 Collateralized transactions and prepaid credit protection arrangements.**

(a) *Financial Collateral.* (1) To recognize the risk-mitigating effects of financial collateral, an FDIC-supervised institution may use:

(i) The simple approach in paragraph (b) of this section; or

(ii) The collateral haircut approach in paragraph (e) of this section for repo-style transactions, eligible margin loans, collateralized derivative contracts, and single-product netting sets of such transactions, subject to paragraph (a)(3) of this section.

(2) An FDIC-supervised institution must use the same approach to recognize the risk-mitigating effects of financial collateral for similar exposures or transactions.

(3) An FDIC-supervised institution that has elected under § 324.34(a)(1)(ii) to use the standardized approach for counterparty credit risk (SA-CCR) for derivative contracts may elect to also use SA-CCR for repo-style transactions that are subject to a qualifying cross-product master netting agreement with derivative contracts, subject to the requirements of paragraph (f) of this section. An FDIC-supervised institution that uses SA-CCR to determine the exposure amount of a derivative contract or netting set may use not the simple approach in paragraph (b) of this section or the collateral haircut approach under paragraph (e) of this section for the exposures for which SA-CCR is used.

(b) *The simple approach* —(1) *General requirements.* To qualify for the simple approach under this paragraph (b), the financial collateral must meet the following requirements:

(i) The collateral must be revalued at least every six months;

(ii) The legal mechanism by which financial collateral is pledged or transferred must be enforceable in the relevant jurisdictions and ensure that the FDIC-supervised institution has the contractual right, as applicable to the characteristics of the financial collateral and exposure, to liquidate or take legal possession of the financial collateral, setoff amounts owed to the obligor against amounts owed to the FDIC-supervised institution and close out any transaction giving rise to the secured exposure, in a timely manner, in the event of the default, insolvency or bankruptcy (or one or more otherwise-defined credit events set out in the transaction documentation) of the obligor; and

(iii) The FDIC-supervised institution must be able to reasonably demonstrate the ability to protect and enforce its rights in respect of any financial collateral.

(2) *Risk weight substitution.* (i) An FDIC-supervised institution may apply a risk weight to the portion of an exposure that is secured by financial collateral that meets the requirements of paragraph (b) of this section, up to the protection amount of the financial collateral as adjusted by paragraph (d) of this section, based on the risk weight assigned to the collateral under this subpart. For repurchase agreements, reverse repurchase agreements, and securities lending and borrowing transactions, the collateral is the instruments, gold, and cash the FDIC-supervised institution has borrowed, purchased subject to resale, or taken as collateral from the counterparty under the transaction. Except as provided in paragraph (b)(3) of this section, the risk weight assigned to the protected portion of the exposure may not be less than 20 percent.

(ii) An FDIC-supervised institution must apply a risk weight to the amount of an exposure in excess of the protection amount of financial collateral securing the exposure based on the risk weight applicable to the exposure under this subpart.

(3) *Exceptions to the 20 percent risk-weight floor and other requirements.*

Notwithstanding paragraph (b)(2)(i) of this section, an FDIC-supervised institution may assign a zero percent risk weight up to the protection amount of the financial collateral where:

(i) The financial collateral is cash on deposit; or

(ii) The financial collateral is an exposure to a sovereign that qualifies for a zero percent risk weight under § 324.32, and the FDIC-supervised institution has discounted the fair value of the collateral by 20 percent.

(c) *Eligible prepaid credit protection arrangements.* (1) *Scope.* An FDIC-supervised institution may recognize the credit risk mitigation benefits of an eligible prepaid credit protection arrangement as provided under this paragraph.

(2) *Application.* This paragraph applies to exposures, including securitization exposures, for which:

(i) Credit risk is fully covered by an eligible prepaid credit protection arrangement; or

(ii) Credit risk is covered on a pro rata basis (that is, on a basis in which the FDIC-supervised institution and the protection provider share losses proportionately) by an eligible prepaid credit protection arrangement.

(3) *Tranching of credit risk.* Exposures on which there is a tranching of credit risk (reflecting at least two different levels of seniority) generally are securitization exposures subject to § 324.41 through § 324.45.

(4) *Multiple eligible prepaid credit protection arrangements.* If multiple eligible prepaid credit protection arrangements cover a single exposure, an FDIC-supervised institution may treat the hedged exposure as multiple separate exposures each covered by a single eligible credit protection arrangement and may calculate a separate risk-weighted asset amount for each separate exposure as described in paragraph (c)(6) of this section.

(5) *Single eligible credit protection arrangements.* If a single eligible credit protection arrangement covers multiple hedged exposures, an FDIC-supervised institution must treat each hedged exposure as covered by a separate eligible credit protection arrangement and must

calculate a separate risk-weighted asset amount for each exposure as described in paragraph (c)(6) of this section.

(6) *Prepaid credit protection arrangements—The substitution approach.* (i) *Full coverage.* If an eligible prepaid credit protection arrangement meets the conditions in paragraphs (c)(1) through (5) of this section and the protection amount (P) of the prepaid credit protection arrangement is greater than or equal to the exposure amount of the reference exposure, an FDIC-supervised institution may assign a zero percent risk weight to the reference exposure.

(ii) *Partial coverage.* If an eligible prepaid credit protection arrangement meets the conditions in paragraphs (c)(1) through (5) of this section and the protection amount (P) of the prepaid credit protection arrangement is less than the exposure amount of the reference exposure, the FDIC-supervised institution must treat the reference exposure as two separate exposures (protected and unprotected) in order to recognize the credit risk mitigation benefit of the prepaid credit protection arrangement.

(A) The FDIC-supervised institution may apply a risk-weight of zero percent for the protected exposure.

(B) The FDIC-supervised institution must calculate the risk-weighted asset amount for the unprotected exposure under this subpart D, where the applicable risk weight is that of the unprotected portion of the reference exposure.

(C) The treatment provided in this section is applicable when the credit risk of a reference exposure is covered on a partial pro rata basis and may be applicable when an adjustment is made to the effective notional amount of the prepaid credit protection arrangement under paragraph (d) of this section.

(d) *Required adjustments*—(1) *Maturity mismatch adjustment*. (i) An FDIC-supervised institution that recognizes the credit risk mitigation benefits of financial collateral under paragraph (b) of this section or of an eligible prepaid credit protection arrangement under paragraph (c) of this section must adjust the amount of credit risk mitigation recognized to reflect any maturity mismatch.

(ii) A maturity mismatch occurs when:

(A) The residual maturity of the legal mechanism by which financial collateral is pledged is less than that of the secured exposure(s); or

(B) The residual maturity of an eligible prepaid credit protection arrangement is less than that of the reference exposure.

(iii) The residual maturity of a secured exposure under paragraph (b) of this section or a reference exposure under paragraph (c) of this section is the longest possible remaining time before the obligated party of the secured exposure or reference exposure is scheduled to fulfill its obligation on the exposure. For purposes of this paragraph (d)(1)(iii):

(A) For an eligible prepaid credit protection arrangement, if the terms of the arrangement include embedded options that may reduce its term, the FDIC-supervised institution (protection purchaser) must adjust the residual maturity. If a call is at the discretion of the protection provider, the residual maturity is at the first call date. If the call is at the discretion of the FDIC-supervised institution (protection purchaser), but the terms of the arrangement at origination contain a positive incentive for the FDIC-supervised institution to cancel the arrangement before contractual maturity, the remaining time to the first call date is the residual maturity.

(B) For financial collateral that is not cash on deposit at the FDIC-supervised institution, but including cash held for the FDIC-supervised institution by a third-party custodian or trustee, the residual maturity of any amount of such financial collateral is the earliest date on which the FDIC-supervised institution's rights in respect of such amount of financial collateral may be terminated without the pledgor being subject to a contemporaneous requirement to pledge additional financial collateral. For financial collateral that is cash on deposit at the FDIC-supervised institution, the residual maturity of any amount of such cash collateral is the earliest date on which a depositor may withdraw such amount, notwithstanding any notice requirements or early withdrawal fees or penalties.

(iv) The credit risk mitigation benefits of financial collateral or an eligible prepaid credit protection arrangement with a maturity mismatch may be recognized only if the original maturity of the legal mechanism by which financial collateral is pledged or the eligible prepaid credit protection arrangement is greater than or equal to one year and its residual maturity is greater than three months.

(v) When a maturity mismatch exists, the FDIC-supervised institution must apply the following adjustment to reduce the protection amount:

$$P_m = E \times (t-0.25)/(T-0.25), \text{ where:}$$

(A)  $P_m$  = fair value of the financial collateral or effective notional amount of the eligible prepaid credit protection arrangement, adjusted for maturity mismatch;

(B)  $E$  = fair value of the financial collateral or effective notional amount of the eligible prepaid credit protection arrangement;

(C)  $t$  = the lesser of  $T$  or the residual maturity of the arrangement, expressed in years; and

(D)  $T$  = the lesser of five or the residual maturity of the secured exposure or reference exposure, expressed in years.

(2) *Currency mismatch adjustment.* (i) If an FDIC-supervised institution recognizes the credit risk mitigation benefits of financial collateral under paragraph (b) of this section or of an eligible prepaid credit protection arrangement under paragraph (c) of this section that is denominated in a currency different from that in which the secured or reference exposure is denominated, the FDIC-supervised institution must apply the following formula to the fair value of the financial collateral or the effective notional amount of the eligible prepaid credit protection arrangement:

$P_c = P_r \times (1 - H_{FX})$ , where:

(A)  $P_c$  = fair value of the financial collateral or the effective notional amount of the eligible prepaid credit protection arrangement, adjusted for currency mismatch (and maturity mismatch, if applicable);

(B)  $P_r$  = fair value of the financial collateral or the effective notional amount of the eligible prepaid credit protection arrangement (adjusted for maturity mismatch, if applicable);  
and

(C)  $H_{FX}$  = haircut appropriate for the currency mismatch between the financial collateral and the secured exposure or the eligible prepaid credit protection arrangement and the reference exposure, as determined under paragraphs (d)(2)(ii) through (iii) of this section.

(ii) Subject to paragraph (d)(2)(iii) of this section, an FDIC-supervised institution must set  $H_{FX}$  equal to eight percent.

(iii) An FDIC-supervised institution must increase  $H_{FX}$  as determined under paragraph (d)(2)(ii) of this section if the FDIC-supervised institution revalues the financial collateral or eligible prepaid credit protection arrangement less frequently than once every 10 business days using the following formula:

$$H_{FX} = 8\% \times \sqrt{\frac{T_M}{10}}, \text{ where } T_M \text{ equals the greater of 10 or the number of business days}$$

between revaluations.

(e) *Collateral haircut approach — Exposure amount for eligible margin loans and repo-style transactions.* (1) *General.* An FDIC-supervised institution may recognize the credit risk mitigation benefits of financial collateral that secures an eligible margin loan, repo-style transaction, collateralized derivative contract, or netting set of eligible margin loans, repo-style transactions, or collateralized derivative contracts, and of any collateral that secures a repo-style transaction that is included in the FDIC-supervised institution's measure for market risk under subpart F of this part, by using the collateral haircut approach covered in this paragraph (e) of this section.

(2) *Exposure amount calculation.* For purposes of the collateral haircut approach, an FDIC-supervised institution must determine the exposure amount for an eligible margin loan, repo-style transaction, collateralized derivative contract, or netting set of eligible margin loans, repo-style transactions, or collateralized derivative contracts according to the following formula:

$$E^* = \max \left\{ 0; (\sum_i E_i - \sum_i C_i) + (0.4 \times net_{exposure}) + \left( 0.6 \times \frac{gross_{exposure}}{\sqrt{N}} \right) + (\sum_{fx} (E_{fx} \times H_{fx})) \right\} \text{ where:}$$

(i)  $E^*$  is the exposure amount of the eligible margin loan, repo-style transaction, collateralized derivative contract, or netting set after credit risk mitigation;

(ii)  $E_i$  is:

(A) For eligible margin loans and repo-style transactions and netting sets thereof, the current fair value of the instrument, cash, or gold the FDIC-supervised institution has lent, sold subject to repurchase, or posted as collateral to the counterparty; and

(B) For collateralized derivative contracts and netting sets thereof, the exposure amount of the OTC derivative contract or netting set calculated under § 324.34(b)(1) or (2);

(iii)  $C_i$  is the current fair value of the instrument, cash, or gold the banking organization has borrowed, purchased subject to resale, or taken as collateral from the counterparty;

(iv)  $net_{exposure} = |\sum_s E_s H_s|$ ;

(v)  $gross_{exposure} = \sum_s E_s |H_s|$ ;

(vi)  $E_s$  is the absolute value of the net position in a given instrument or in gold, where the net position in a given instrument or gold equals the sum of the current fair values of the instrument or gold the FDIC-supervised institution has lent, sold subject to repurchase, or posted as collateral to the counterparty, minus the sum of the current fair values of that same instrument or gold the FDIC-supervised institution has borrowed, purchased subject to resale, or taken as collateral from the counterparty;

(vii)  $H_s$  is the haircut appropriate to  $E_s$  as described in Table 1 to § 324.37, as applicable.  $H_s$  has a positive sign if the instrument or gold is net lent, sold subject to repurchase, or posted as collateral to the counterparty;  $H_s$  has a negative sign if the instrument or gold is net borrowed, purchased subject to resale, or taken as collateral from the counterparty;

(viii)  $N$  is the number of instruments with a unique Committee on Uniform Securities Identification Procedures (CUSIP) designation or foreign equivalent that the FDIC-supervised institution lends, sells subject to repurchase, posts as collateral, borrows, purchases subject to resale, or takes as collateral in the eligible margin loan, repo-style transaction, collateralized derivative contract, or netting set, including all collateral that the FDIC-supervised institution elects to include within the credit risk mitigation framework, except that instruments where the value  $E_s$  is less than one tenth of the value of the largest  $E_s$  in the eligible margin loan, repo-style transaction, collateralized derivative contract, or netting set are not included in the count or gold, with any amount of gold given a value of one;

(ix)  $E_{f_x}$  is the absolute value of the net position in each currency  $f_x$  different from the settlement currency;

(x)  $H_{f_x}$  is the haircut appropriate for currency mismatch of currency  $f_x$ .

(3) *Market price volatility and currency mismatch haircuts.* (i) An FDIC-supervised institution must use the haircuts for market price volatility ( $H_s$ ) in Table 1 to § 324.37, as adjusted in certain circumstances as provided in paragraphs (e)(3)(iii) through (v) of this section.

**Table 1 to § 324.37—Market Price Volatility Haircuts**

Residual Maturity		Securities issued by a sovereign or an issuer described in § 324.32(b) <sup>1</sup> (percent)				Other investment-grade securities (percent)	
		Issuer risk weight of 0%	Issuer risk weight of 20% or 50%	Issuer risk weight of 100%	GSE exposures	Exposures other than GSE exposures or securitization exposures	Senior securitization exposures with risk weight <100%
Debt Securities	Less than or equal to 1 year	0.5	1.0	15.0	1.0	2.0	4.0
	Greater than 1 year and less than or equal to 3 years	2.0	3.0	15.0	4.0	4.0	12.0
	Greater than 3 years and less than					6.0	

	or equal to 5 years						
	Greater than 5 years and less than or equal to 10 years	4.0	6.0	15.0	8.0	12.0	24.0
	Greater than 10 years					20.0	
Main index equities (including convertible bonds) and gold			20.0				
Other publicly traded equities and convertible bonds			30.0				
Mutual funds and exchange traded funds			Highest haircut applicable to any security in which the fund can invest, unless the banking organization can apply the full look-through approach for equity investments in funds §324.53(b), in which case the banking organization may use a weighted average of haircuts applicable to the securities held by the fund.				

Cash on deposit	0.0
Other exposure types <sup>2</sup>	30.0

<sup>1</sup> Includes a foreign PSE that receives a zero percent risk weight.

<sup>2</sup> Includes senior securitization exposures with a risk weight greater than or equal to 100 percent and sovereign exposures with a risk weight greater than 100 percent.

(ii) For currency mismatches, an FDIC-supervised institution must use a haircut for foreign exchange rate volatility ( $H_{fx}$ ) of 8.0 percent, as adjusted in certain circumstances under paragraphs (e)(3)(iii) and (iv) of this section.

(iii) For repo-style transactions, an FDIC-supervised institution may multiply the haircuts provided in paragraphs (e)(3)(i) and (ii) of this section by the square root of  $1/2$  (which equals 0.707107).

(iv) An FDIC-supervised institution must adjust the haircuts provided in paragraphs (e)(3)(i) and (ii) of this section upward on the basis of a holding period longer than ten business days for eligible margin loans and derivative contracts that are not client-facing derivative transactions or a holding period longer than five business days for repo-style transactions and client-facing derivative transactions that are not cleared transactions under the following conditions. If the number of trades in a netting set exceeds 5,000 at any time during a quarter, an FDIC-supervised institution must adjust the haircuts provided in paragraphs (e)(3)(i) and (ii) of this section upward on the basis of a holding period of twenty business days for the following quarter except in the calculation of exposure amount for purposes of § 324.35. If a netting set

contains one or more trades involving illiquid collateral, an FDIC-supervised institution must adjust the haircuts provided in paragraphs (e)(3)(i) and (ii) of this section upward on the basis of a holding period of twenty business days. If over the two previous quarters more than two margin disputes on a netting set have occurred that lasted longer than the holding period, then the FDIC-supervised institution must adjust the haircuts provided in paragraphs (e)(3)(i) and (ii) of this section upward for that netting set on the basis of a holding period that is at least two times the minimum holding period for that netting set. The FDIC-supervised institution must adjust the haircuts upward using the following formula:

$$H_a = H_s \sqrt{T_m/T_s}$$

Where:

(A)  $T_m$  equals a holding period of longer than 10 business days for eligible margin loans and derivative contracts other than client-facing derivative transactions or longer than 5 business days for repo-style transactions and client-facing derivative transactions;

(B)  $H_s$  equals the market price volatility haircut provided in Table 1 to § 324.37 or to the foreign exchange rate volatility haircut provided in paragraph (e)(3)(ii) of this section; and

(C)  $T_s$  equals 10 business days for eligible margin loans and derivative contracts other than client-facing derivative transactions or 5 business days for repo-style transactions and client-facing derivative transactions.

(v) If the instruments an FDIC-supervised institution has lent, sold subject to repurchase, or posted as collateral do not meet the definition of financial collateral, the FDIC-supervised institution must use a 30.0 percent haircut for market price volatility ( $H_s$ ).

(f) *Election to apply SA-CCR to certain repo-style transactions.* (1) An FDIC-supervised institution that elects to determine the exposure amount using SA-CCR for its derivative contracts under paragraph (a)(1)(ii) of § 324.34 may elect under paragraph (a)(3) of this section to use SA-CCR to determine the exposure amount for a set of repo-style transactions and derivative contracts that are subject to a qualifying cross-product master netting agreement. An FDIC-supervised institution that makes such an election with respect to a qualifying cross-product master netting agreement must make the adjustments described in paragraphs (f)(2) and (3) in order to determine the exposure amount of the set of repo-style transactions and derivative contracts under SA-CCR.

(2) The exposure amount of a set of transactions subject to a qualifying cross-product master netting agreement for purposes of (f)(1),  $Exposure\ Amount_{NSCP}$ , must be calculated as follows:

$$\begin{aligned}
 Exposure\ Amount_{NSCP} &= (1 - MR_{NSCP}) \\
 &\quad * (Exposure\ Amount_{repo-style\ transactions} + Exposure\ Amount_{derivatives}) \\
 &\quad + MR_{NSCP} * Extended\ SA - CCR\ Exposure\ Amount
 \end{aligned}$$

Where:

(i)  $Exposure\ Amount_{repo-style\ transactions}$  is the exposure amount for repo-style transactions in the netting set that is subject to a qualifying cross-product master netting agreement, calculated using the collateral haircut approach, under paragraph (e) of this section;

(ii) *Exposure Amount<sub>derivatives</sub>* is the exposure amount for derivatives in the netting set that is subject to a qualifying cross-product master netting agreement, calculated using the standardized approach to counterparty credit risk, under § 324.132(c)(5);

(iii) *Extended SA – CCR Exposure Amount* is the exposure amount for both repo-style transactions and derivatives that are in the netting set that is subject to a qualifying cross-product master netting agreement, calculated using the standardized approach to counterparty credit risk, under § 324.132(c)(5); and

(iv)  $MR_{NSCP}$  is the Maturity Ratio for a given netting set that is subject to a qualifying cross-product master netting agreement, calculated as follows:

$$MR_{NSCP} = \frac{\sum NAWM \text{ of the repo – style transactions}_i}{\max(\sum NAWM \text{ of the repo – style transactions}_i, \sum NAWM \text{ of the derivative transactions}_i)}$$

Where:

(A)  $\sum NAWM \text{ of the repo – style transactions}_i$  is the notional average weighted maturity of all  $i$  repo-style transactions subject to the qualifying cross-product master netting agreement, subject to a minimum maturity of 10 business days and a maximum maturity of one year for purposes of this calculation.

(B)  $\sum NAWM \text{ of the derivative transactions}_i$  is the notional average weighted maturity of all  $i$  derivative transactions subject to the qualifying cross-product master netting agreement subject to a minimum maturity of 10 business days and a maximum maturity of one year for purposes of this calculation.

(3) For purposes of applying SA-CCR to a repo-style transaction, the FDIC-supervised must make the adjustments described in paragraphs (f)(3)(i) through (iii) of this section.

(i) For purposes of this section, the FDIC-supervised institution must:

(A) Treat a repo-style transaction that has multiple underlying instruments as separate repo-style transactions for each distinct underlying instrument;

(B) Treat a repo-style transaction with a debt instrument as the underlying instrument as either a credit derivative that references the underlying debt instrument or an interest rate derivative that references the interest rate of the underlying debt instrument, based on the primary risk factor of the repo-style transaction;

(C) Treat a repo-style transaction with an equity instrument as the underlying instrument as an equity derivative that references the underlying equity instrument;

(D) Not apply paragraph (c)(4) of § 324.132 to a repo-style transaction with an equity instrument as the underlying instrument; and

(E) Treat a repo-style transaction as a client-facing derivative transaction where the FDIC-supervised institution is either acting as a financial intermediary and enters into an offsetting transaction with a qualifying central counterparty (QCCP) or where the FDIC-supervised institution provides a guarantee on the performance of a client on a transaction between the client and a QCCP.

(ii) For purposes of the supervisory delta under paragraph (c)(9)(iii) of § 324.132, an FDIC-supervised institution must use a supervisory delta of 1 for a repurchase transaction or a

securities lending transaction, and must use a supervisory delta of -1 for a reverse repurchase transaction or a securities borrowing transaction;

(iii) For purposes of the maturity factor under paragraph (c)(9)(iv) of § 324.132, MPOR cannot be less than five business days plus the periodicity of re-margining expressed in business days minus one business day.

\* \* \* \* \*

56. Amend § 324.41 to read as follows:

**§ 324.41 Operational criteria for recognizing the transfer of risk.**

(a) *Operational criteria for traditional securitizations.* An FDIC-supervised institution that transfers exposures it has originated or purchased to a third party in connection with a traditional securitization may exclude the exposures from the calculation of its risk-weighted assets only if each condition in this section is satisfied. An FDIC-supervised institution that meets these conditions must hold risk-based capital against any credit risk it retains in connection with the securitization. An FDIC-supervised institution 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 common equity tier 1 capital any after-tax gain-on-sale resulting from the transaction and any portion of a CEIO strip that does not constitute after-tax gain-on-sale. If the transferred exposures are in connection with a resecuritization and all of the conditions in this paragraph (a) are satisfied, the FDIC-supervised institution must exclude the exposures from the calculation of its risk-weighted assets and must hold risk-based capital against any credit risk it retains in connection with the resecuritization. The conditions are:

(1) The exposures are not reported on the FDIC-supervised institution's consolidated balance sheet under GAAP;

(2) The FDIC-supervised institution has transferred to one or more third parties credit risk associated with the underlying exposures;

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

(4) The securitization does not:

(i) Include 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) Contain an early amortization provision.

(b) *Operational criteria for synthetic securitizations.* For synthetic securitizations, an FDIC-supervised institution may recognize for risk-based capital purposes the use of a credit risk mitigant to hedge underlying exposures only if each condition in this paragraph (b) is satisfied. An FDIC-supervised institution that meets these conditions must hold risk-based capital against any credit risk of the exposures it retains in connection with the synthetic securitization. An FDIC-supervised institution that fails to meet these conditions or chooses not to recognize the credit risk mitigant for purposes of this section must instead hold risk-based capital against the underlying exposures as if they had not been synthetically securitized. If the synthetic securitization is a resecuritization and all of the conditions in this paragraph (b) are satisfied, the FDIC-supervised institution must exclude the underlying securitization exposures from the calculation of its risk-weighted assets and must hold risk-based capital against any credit risk it retains in connection with the resecuritization. The conditions are:

(1) The credit risk mitigant is:

(i) Financial collateral;

(ii) A guarantee that meets all criteria as set forth in the definition of “eligible guarantee” in § 324.2, except for the criteria in paragraph (3) of that definition;

(iii) A credit derivative that is not an nth-to-default credit derivative and that meets all criteria as set forth in the definition of “eligible credit derivative” in § 324.2, except for the criteria in paragraph (3) of the definition of “eligible guarantee” in § 324.2; or

(iv) A prepaid credit protection arrangement that meets all criteria as set forth in the definition of “eligible prepaid credit protection arrangement” in § 324.2, except for the criteria in paragraph (3) of that definition.

(2) The FDIC-supervised institution transfers credit risk associated with the underlying exposures to one or more 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 FDIC-supervised institution to alter or replace the underlying exposures to improve the credit quality of the underlying exposures;

(iii) Increase the FDIC-supervised institution'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 FDIC-supervised institution 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 FDIC-supervised institution after the inception of the securitization;

(3) The FDIC-supervised institution obtains a well-reasoned opinion from legal counsel that confirms the enforceability of the credit risk mitigant in all relevant jurisdictions;

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

(5) No synthetic excess spread is permitted within the synthetic securitization;

(6) Any applicable minimum payment threshold for the credit risk mitigant is consistent with standard market practice; and

(7) The securitization does not:

(i) Include 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) Contain an early amortization provision.

(c) *Due diligence requirements for securitization exposures.* (1) Except for exposures that are deducted from common equity tier 1 capital and exposures subject to § 324.43(h), if an FDIC-supervised institution is unable to demonstrate to the satisfaction of the FDIC a comprehensive understanding of the features of a securitization exposure that would materially affect the performance of the exposure, the FDIC-supervised institution must assign the securitization exposure a risk weight of 1,250 percent. The FDIC-supervised institution's analysis

must be commensurate with the complexity of the securitization exposure and the materiality of the exposure in relation to its capital.

(2) An FDIC-supervised institution must demonstrate its comprehensive understanding of a securitization exposure under paragraph (c)(1) of this section, for each securitization exposure by:

(i) Conducting an analysis of the risk characteristics of a securitization exposure prior to acquiring the exposure, and documenting such analysis within 3 business days after acquiring the exposure, considering:

(A) Structural features of the securitization that would materially impact the performance of the exposure, for example, the contractual cash flow waterfall, waterfall-related triggers, credit enhancements, liquidity enhancements, fair value triggers, the performance of organizations that service the exposure, and deal-specific definitions of default;

(B) Relevant information regarding—

(1) The performance of the underlying credit exposure(s), for example, the percentage of loans 30, 60, and 90 days past due; default rates; prepayment rates; loans in foreclosure; property types; occupancy; average credit score or other measures of creditworthiness; average LTV ratio; and industry and geographic diversification data on the underlying exposure(s); and

(2) For resecuritization exposures, in addition to the information described in paragraph (c)(2)(i)(B)(1) of this section, performance information on the underlying securitization exposures, which may include the issuer name and credit quality, and the characteristics and performance of the exposures underlying the securitization exposures; and

(C) Relevant market data of the securitization, for example, bid-ask spread, most recent sales price and historic price volatility, trading volume, implied market rating, and size, depth and concentration level of the market for the securitization; and

(ii) On an on-going basis (no less frequently than quarterly), evaluating, reviewing, and updating as appropriate the analysis required under paragraph (c)(1) of this section for each securitization exposure.

\* \* \* \* \*

57. Amend § 324.42 to read as follows:

**§ 324.42 Exposure amount of a securitization exposure.**

(a) *On-balance sheet securitization exposure.* (1) The exposure amount of an on-balance sheet securitization exposure (excluding an available-for-sale or held-to-maturity security where the FDIC-supervised institution has made an AOCI opt-out election under § 324.22(b)(2), a repo-style transaction, eligible margin loan, OTC derivative contract that is not a credit derivative, or cleared transaction that is not a credit derivative) is equal to the FDIC-supervised institution's carrying value of the exposure. For a credit derivative, an FDIC-supervised institution must apply § 324.43(i) or (j), as applicable.

(2) The exposure amount of an on-balance sheet securitization exposure that is an available-for-sale or held-to-maturity security held by an FDIC-supervised institution that has made an AOCI opt-out election under § 324.22(b)(2) is the Board-regulated institution's carrying value (including net accrued but unpaid interest and fees), less any net unrealized gains on the exposure and plus any net unrealized losses on the exposure.

(b) *Off-balance sheet securitization exposure.* Except as provided in § 324.43(h), the exposure amount of an off-balance sheet securitization exposure that is not a repo-style transaction, eligible margin loan, OTC derivative contract (other than a credit derivative), or cleared transaction (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 an eligible ABCP liquidity facility, the notional amount may be reduced to the maximum potential amount that the FDIC-supervised institution could be required to fund given the ABCP program's current underlying assets (calculated without regard to the current credit quality of those assets).

(c) *Repo-style transaction, eligible margin loan, OTC derivative contract that is not a credit derivative, or cleared transaction that is not a credit derivative.* The exposure 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 exposure amount as calculated in accordance with §§ 324.34 or 324.37, or § 324.33 as applicable, and the exposure amount of a securitization exposure that is a cleared transaction that is not a credit derivative is the exposure amount as calculated in § 324.35.

\* \* \* \* \*

58. Amend § 324.43 to read as follows:

**§ 324.43 Risk-weighted assets for securitization exposures.**

(a) *General approach.* Except as provided elsewhere in this section and in § 324.41:

(1) An FDIC-supervised institution may, subject to the limitation under paragraph (e) of this section, apply the securitization standardized approach (SEC-SA) in § 324.44 to the exposure if the exposure meets the following requirements:

(i) The FDIC-supervised institution has accurate information on  $A$ ,  $D$ ,  $W$ , and  $K_G$  (as defined in § 324.44) for the exposure. Data used to assign the parameters described in this paragraph (a)(1)(i) must be the most currently available data. If the contracts governing the underlying exposures of the securitization require payments on a monthly or quarterly basis, the data used to assign the parameters described in this paragraph (a)(1)(i) must be no more than 91 calendar days old.

(ii) The FDIC-supervised institution has accurate information regarding whether the exposure is a resecuritization exposure.

(2) If the securitization exposure is an interest rate derivative contract, an exchange rate derivative contract, or a cash collateral account related to an interest rate or exchange rate derivative contract, the FDIC-supervised institution must assign a risk weight to the exposure equal to the risk weight of a securitization exposure that is *pari passu* to the interest rate derivative contract or exchange rate derivative contract or, if such an exposure does not exist, the risk weight of any subordinate securitization exposure.

(3) If the FDIC-supervised institution cannot apply, or chooses not to apply, the securitization standardized approach in § 324.44, the FDIC-supervised institution must apply a 1,250 percent risk weight to the exposure.

(b) *Total risk-weighted assets for securitization exposures.* An FDIC-supervised institution's total risk-weighted assets for securitization exposures equals the sum of the risk-

weighted asset amount for securitization exposures that the FDIC-supervised institution risk weights under §§ 324.43 through 324.45, as applicable.

(c) *After-tax gain-on-sale resulting from a securitization.* Notwithstanding any other provision of this subpart, an FDIC-supervised institution must deduct from common equity tier 1 capital any after-tax gain-on-sale resulting from a securitization as well as the portion of a CEIO that does not constitute an after-tax gain-on sale.

(d) *Overlapping exposures.* (1) If an FDIC-supervised institution has multiple securitization exposures that provide duplicative coverage to the underlying exposures of a securitization (such as when an FDIC-supervised institution provides a program-wide credit enhancement and multiple pool-specific liquidity facilities to an ABCP program), the FDIC-supervised institution is not required to hold duplicative risk-based capital against the overlapping position. Instead, the FDIC-supervised institution may apply to the overlapping position the applicable risk-based capital treatment that results in the highest risk-based capital requirement.

(2) If an FDIC-supervised institution has two or more securitization exposures that partially overlap with each other, the FDIC-supervised institution may treat the exposures as overlapping and apply the treatment under paragraph (d)(1). For purposes of such a treatment under this paragraph (d)(2), the FDIC-supervised institution must include in expanded total risk-weighted assets the risk-weighted asset amount for a hypothetical securitization exposure that would fully overlap with all of the partially overlapping exposures.

(3) If an FDIC-supervised institution has a securitization exposure under this subpart that is an overlapping exposure with a securitization exposure that is a market risk covered position

under subpart F of this part, the FDIC-supervised institution may assign to the overlapping securitization exposure the applicable risk-based capital treatment under either this subpart or subpart F, whichever results in the highest risk-based capital requirement.

(e) *Implicit support.* If an FDIC-supervised institution provides support to a securitization in excess of the FDIC-supervised institution's contractual obligation to provide credit support to the securitization:

(1) The FDIC-supervised institution must calculate a risk-weighted asset amount for underlying exposures associated with the securitization as if the exposures had not been securitized and must deduct from common equity tier 1 capital any after-tax gain-on-sale resulting from the securitization and any portion of a CEIO strip that does not constitute after-tax gain-on-sale; and

(2) The FDIC-supervised institution must disclose publicly:

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

(ii) The risk-based capital impact to the FDIC-supervised institution of providing such implicit support.

(f) *Undrawn portion of a servicer cash advance facility.*

(1) Notwithstanding any other provision of this subpart, an FDIC-supervised institution that is a servicer under an eligible servicer cash advance facility is not required to hold risk-based capital against potential future cash advance payments that it may be required to provide under the contract governing the facility.

(2) For an FDIC-supervised institution that acts as a servicer, the exposure amount for a servicer cash advance facility that is not an eligible servicer cash advance facility is equal to the amount of all potential future cash advance payments that the FDIC-supervised institution may be contractually required to provide during the subsequent 12 month period under the contract governing the facility.

(g) *Interest-only mortgage-backed securities.* Notwithstanding any other provision of this subpart, the risk weight for a non-credit-enhancing interest-only mortgage-backed security may not be less than 100 percent.

(h) *Small-business loans and leases on personal property transferred with retained contractual exposure.*

(1) Regardless of any other provision of this subpart, an FDIC-supervised institution that has transferred small-business loans and leases on personal property (small-business obligations) with recourse must include in risk-weighted assets only its contractual exposure to the small-business obligations if all the following conditions are met:

(i) The transaction must be treated as a sale under GAAP.

(ii) The FDIC-supervised institution establishes and maintains, pursuant to GAAP, a non-capital reserve sufficient to meet the FDIC-supervised institution's reasonably estimated liability under the contractual obligation.

(iii) The small-business obligations 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 U.S.C. 632 et seq.); and

(iv) The FDIC-supervised institution is well capitalized for purposes of the Prompt Corrective Action framework (12 U.S.C. 1831o). For purposes of determining whether an FDIC-supervised institution is well capitalized for purposes of this paragraph (h), the FDIC-supervised institution's capital ratios must be calculated without regard to the capital treatment for transfers of small-business obligations under this paragraph (h).

(2) The total outstanding amount of contractual exposure retained by an FDIC-supervised institution on transfers of small-business obligations receiving the capital treatment specified in paragraph (h)(1) of this section cannot exceed 15 percent of the FDIC-supervised institution's total capital.

(3) If an FDIC-supervised institution ceases to be well capitalized under subpart H of this part or exceeds the 15 percent capital limitation provided in paragraph (h)(2) of this section, the capital treatment specified in paragraph (h)(1) of this section will continue to apply to any transfers of small-business obligations with retained contractual exposure that occurred during the time that the FDIC-supervised institution was well capitalized and did not exceed the capital limit.

(4) The risk-based capital ratios of the FDIC-supervised institution must be calculated without regard to the capital treatment for transfers of small-business obligations specified in paragraph (h)(1) of this section for purposes of:

(i) Determining whether an FDIC-supervised institution is adequately capitalized, undercapitalized, significantly undercapitalized, or critically undercapitalized under subpart H of this part; and

(ii) Reclassifying a well-capitalized FDIC-supervised institution to adequately capitalized and requiring an adequately capitalized FDIC-supervised institution to comply with certain mandatory or discretionary supervisory actions as if the FDIC-supervised institution were in the next lower prompt-corrective-action category.

(i) *Nth-to-default credit derivatives* —(1) *Protection provider*. An FDIC-supervised institution providing protection through a first-to-default or second-or-later-to-default derivative is subject to capital requirements on such instruments under this paragraph (i)(1).

(i) *First-to-default*. For first-to-default derivatives, an FDIC-supervised institution must aggregate by simple summation the risk weights of the assets covered up to a maximum of 1,250 percent and multiply by the nominal amount of the protection provided by the credit derivative to obtain the risk-weighted asset amount.

(ii) *Nth-to-default*. For second-or-later-to-default derivatives, in aggregating the risk weights, an FDIC-supervised institution may exclude the asset with the lowest risk-weighted amount from the risk-weighted capital calculation. This risk-based capital treatment applies for nth-to-default derivatives for which the n-1 assets with the lowest risk-weighted amounts can be excluded from the risk-weighted capital calculation.

(2) *Protection purchaser*. An FDIC-supervised institution is not permitted to recognize purchased protection in the form of an nth-to-default credit derivative as a credit risk mitigant. An FDIC-supervised institution must calculate the counterparty credit risk of a purchased nth-to-default credit derivative under § 324.34.

(j) *Guarantees, credit derivatives other than nth-to-default credit derivatives, and prepaid credit protection arrangements* —(1) *Protection provider*. For a guarantee, credit

derivative (other than an nth-to-default credit derivative), or prepaid credit protection arrangement provided by an FDIC-supervised institution that covers the full amount or a pro rata share of a securitization exposure's principal and interest, the FDIC-supervised institution must risk weight the guarantee, credit derivative, or prepaid credit protection arrangement under paragraph (a) of this section as if it held the portion of the securitization exposure covered by the guarantee, credit derivative, or prepaid credit protection arrangement.

(2) *Protection purchaser.* (i) An FDIC-supervised institution that purchases a credit derivative (other than an nth-to-default credit derivative) that is recognized under § 324.45 as a credit risk mitigant (including via recognized collateral ) is not required to compute a separate counterparty credit risk capital requirement under § 324.34.

(ii) If an FDIC-supervised institution cannot, or chooses not to, recognize protection purchased in the form of a credit derivative as a credit risk mitigant under § 324.45, the FDIC-supervised institution must determine the exposure amount of the credit derivative under § 324.34.

(A) If the FDIC-supervised institution purchases credit protection from a counterparty the activities of which are limited to those appropriate for the specific purpose of holding the underlying exposures of a securitization, the FDIC-supervised institution must determine the risk weight for the exposure according to § 324.32.

(B) If the FDIC-supervised institution purchases credit protection from a counterparty the activities of which are limited to those appropriate for the specific purpose of holding the underlying exposures of a securitization, the FDIC-supervised institution must determine the risk weight for the exposure according to this section.

(k) *Look-through approach.* (1) Subject to paragraph (k)(2) of this section, an FDIC-supervised institution may assign a risk weight to a senior securitization exposure that is not a resecuritization exposure equal to the greater of:

(i) The weighted-average risk weight, calculated without reference to, or the use of, the risk weight under § 324.52(b)(3)(iii), of all the underlying exposures where the weight for each exposure in the weighted-average calculation is determined by the unpaid principal amount of the exposure; and

(ii) 15 percent.

(2) An FDIC-supervised institution may assign a risk weight under this paragraph (k) only if the FDIC-supervised institution has knowledge of the composition of all of the underlying exposures.

(l) *NPL securitization.* Notwithstanding any other provision of this subpart except for paragraph (e) of this section:

(1) If the nonrefundable purchase price discount for the NPL securitization is greater than or equal to 50 percent of the unpaid principal balance of the pool of exposures, the risk weight for a senior securitization exposure to an NPL securitization is 100 percent.

(2) If the FDIC-supervised institution is an originating FDIC-supervised institution with respect to the NPL securitization, the FDIC-supervised institution may hold risk-based capital against the transferred exposures as if they had not been securitized and must deduct from common equity tier 1 capital any after-tax gain-on-sale resulting from the transaction and any portion of a CEIO that does not constitute an after-tax gain-on-sale.

\* \* \* \* \*

59. Amend § 324.44 to read as follows:

**§ 324.44 Securitization standardized approach (SEC-SA).**

(a) *In general.* The risk weight  $RW_{SEC-SA}$  assigned to a securitization exposure, or portion of a securitization exposure, is calculated according to the following formula:

$$RW_{SEC-SA} = \begin{cases} \max(RW_{FLOOR}, 1,250\% \cdot K_{SEC-SA}), & K_A \leq A \\ \max\left(RW_{FLOOR}, \left(\frac{K_A - A}{D - A}\right) \cdot 1,250\% + \left(\frac{D - K_A}{D - A}\right) \cdot 1,250\% \cdot K_{SEC-SA}\right), & A < K_A < D \\ 1,250\%, & D \leq K_A \end{cases}$$

Where:

(1)  $K_A$  is calculated under paragraph (b) of this section;

(2)  $A$  (attachment point) equals the greater of zero and the ratio, expressed as a decimal value between zero and one, of the current dollar amount of underlying exposures that are subordinated to the exposure of the FDIC-supervised institution to the current dollar amount of the underlying exposures, as adjusted in accordance with paragraph (a)(6) of this section;

(3)  $D$  (detachment point) equals the greater of zero and the sum of parameter  $A$  and the ratio, expressed as a decimal value between zero and one, of the current dollar amount of the securitization exposures that are ranked senior or pari passu with the exposure (that is, have equal seniority with respect to credit risk) to the current dollar amount of the underlying exposures, as adjusted in accordance with paragraph (a)(6) of this section;

(4)  $RW_{FLOOR}$  equals 100 percent for resecuritization exposures and NPL securitization exposures and 15 percent for all other securitization exposures; and

(5)  $K_{SEC-SA}$  is calculated according to the following formula:

$$K_{SEC-SA} = \frac{e^{a \cdot u} - e^{a \cdot l}}{a \cdot (u - l)}$$

Where:

(i)  $a$  equals  $-\frac{1}{p \cdot K_A}$  (as  $K_A$  is defined in this paragraph (a)), where  $p$  equals 1.5 for a resecuritization exposure and 0.5 for all other securitization exposures;

(ii)  $u$  equals  $D - K_A$  (as  $D$  and  $K_A$  are defined in paragraph (a) of this section);

(iii)  $l$  equals  $\max(A - K_A, 0)$  (as  $A$  and  $K_A$  are defined in paragraph (a) of this section);

and

(iv)  $e$  equals the base of the natural logarithm.

(6) An FDIC-supervised institution must include in the calculation of  $A$  and  $D$  the funded portion of any reserve account funded by the accumulated cash flows from the underlying exposures that is subordinated to the FDIC-supervised institution's securitization exposure. Interest rate derivative contracts, exchange rate derivative contracts, and cash collateral accounts related to these contracts must not be included in the calculation of  $A$  and  $D$ . If the securitization exposure includes a nonrefundable purchase price discount, the nonrefundable purchase price discount must be included in the numerator and denominator of  $A$  and  $D$ .

(b) *Calculation of  $K_A$ .*  $K_A$  is calculated under this paragraph (b) according to the following formula:

$$K_A = (1 - W) \cdot K_G + (W \cdot 0.5)$$

Where:

(1)  $W$  equals the ratio, expressed as a decimal value between zero and one, of the sum of the dollar amounts of any underlying exposures of the securitization that are not securitization exposures and that meet any of the criteria in paragraphs (b)(1)(i) through (vii) of this section to the outstanding balance, measured in dollars, of all underlying exposures:

(i) Ninety days or more past due;

(ii) Subject to a bankruptcy or insolvency proceeding;

(iii) In the process of foreclosure;

(iv) Held as real estate owned;

(v) Has contractually deferred payments for 90 days or more, other than principal or interest payments deferred on:

(A) Federally guaranteed student loans, in accordance with the terms of those guarantee programs; or

(B) Consumer loans, including non-federally guaranteed student loans, provided that such payments are deferred pursuant to provisions included in the contract at the time funds are disbursed that provide for period(s) of deferral that are not initiated based on changes in the creditworthiness of the borrower; or

(vi) Is in default; and

(vii) Notwithstanding paragraphs (1)(i) through (vi) of this paragraph, an exposure that is directly and unconditionally guaranteed by the U.S. Government, its central bank, or a U.S. Government agency may be excluded from the calculation of  $W$  up to the amount of the guarantee; and

(2)  $K_G$  equals the weighted average (with unpaid principal used as the weight for each credit exposure and fair value used for each equity exposure) total capital requirement, expressed as a decimal value between zero and one, of the underlying exposures calculated using this subpart D (that is, an average risk weight of 100 percent represents a value of  $K_G$  equal to 0.08), as adjusted in accordance with this paragraph (b)(2). For purposes of  $K_G$ , the determination of the capital requirement associated with an underlying exposure that is an equity exposure cannot use the risk weight under § 324.52(b)(3)(iii). For interest rate derivative contracts and exchange rate derivative contracts, the positive current exposure times the risk weight of the counterparty multiplied by 0.08 must be included in the numerator of  $K_G$  but must be excluded from the denominator of  $K_G$ .

\* \* \* \* \*

60. Amend § 324.45 by:

- a. Adding paragraphs (a)(3) and (a)(4).
- b. Revising paragraph (b).

The additions and revisions read as follows:

**§ 324.45 Recognition of credit risk mitigants for securitization exposures.**

\* \* \* \* \*

(3) If the recognized credit risk mitigant hedges a portion of the FDIC-supervised institution's securitization exposure, the FDIC-supervised institution must calculate its capital requirements for the hedged and unhedged portions of the exposure separately. For each unhedged portion, the FDIC-supervised institution must calculate capital requirements according to § 324.42 and § 324.43. For each hedged portion, the FDIC-supervised institution may recognize the credit risk mitigant under § 324.36 or § 324.37, but only as provided in this section.

(4) When an FDIC-supervised institution purchases or sells credit protection on a portion of a senior tranche, the lower-priority portion, whether hedged or unhedged, must be considered a non-senior securitization exposure.

(b) *Mismatches.* An FDIC-supervised institution must make any applicable adjustment to the protection amount as required in § 324.36 for any hedged securitization exposure. In the context of a synthetic securitization, when a credit risk mitigant described in § 324.41(b)(1)(ii) through (iv) covers multiple hedged exposures that have different residual maturities, the FDIC-supervised institution must use the longest residual maturity of any of the hedged exposures as the residual maturity of all hedged exposures.

\* \* \* \* \*

61. Revise § 324.51(b)(4) to read as follows:

**§ 324.51 Introduction and exposure measurement.**

\* \* \* \* \*

(b) \* \* \*

(4) For a commitment to acquire an equity exposure (an equity commitment), the effective notional principal amount of the exposure is multiplied by the following conversion factors (CFs):

(i) Conditional equity commitments receive a 40 percent conversion factor.

(ii) Unconditional equity commitments receive a 100 percent conversion factor.

\* \* \* \* \*

62. Revise § 324.61 to read as follows:

**§ 324.61 Purpose and scope.**

Sections 324.61 through 324.63 of this subpart establish public disclosure requirements related to the capital requirements described in subpart B of this part for an FDIC-supervised institution with total consolidated assets of \$50 billion, as adjusted pursuant to § 324.4, or more as reported on the FDIC-supervised institution's most recent year-end Call Report that is not an advanced approaches FDIC-supervised institution making public disclosures pursuant to § 324.172. An advanced approaches FDIC-supervised institution that has not received approval from the FDIC to exit parallel run pursuant to § 324.121(d) is subject to the disclosure requirements described in §§ 324.62 and 324.63. An FDIC-supervised institution with total consolidated assets of \$50 billion, as adjusted pursuant to § 324.4, or more as reported on the FDIC-supervised institution's most recent year-end Call Report that is not an advanced approaches FDIC-supervised institution making public disclosures subject to § 324.172 must

comply with § 324.62 unless it is a consolidated subsidiary of a bank holding company, savings and loan holding company, or depository institution that is subject to the disclosure requirements of § 324.62 or a subsidiary of a non-U.S. banking organization that is subject to comparable public disclosure requirements in its home jurisdiction. For purposes of this section, total consolidated assets are determined based on the average of the FDIC-supervised institution's total consolidated assets in the four most recent quarters as reported on the Call Report; or the average of the FDIC-supervised institution's total consolidated assets in the most recent consecutive quarters as reported quarterly on the FDIC-supervised institution's Call Report if the FDIC-supervised institution has not filed such a report for each of the most recent four quarters.

\* \* \* \* \*

63. Amend § 324.300 by revising paragraph (a) to read as follows:

**§ 324.300 Transitions.**

(a) *Transition adjustments for AOCI.* Beginning [January 1, 2027], a Category III FDIC-supervised institution or a Category IV FDIC-supervised institution that had made an AOCI opt-out election under § 324.22(b)(2) effective [December 31, 2026], must subtract from the sum of its common equity tier 1 elements, before making deductions required under § 324.22(c) or (d), the transition AOCI adjustment amount multiplied by the percentage provided in Table 1 to § 324.300. The transition AOCI adjustment amount is the sum of:

- (1) Net unrealized gains or losses on available-for-sale securities, plus
- (2) Accumulated net gains or losses on cash flow hedges, plus

(3) Any amounts recorded in AOCI attributed to defined benefit postretirement plans resulting from the initial and subsequent application of the relevant GAAP standards that pertain to such plans, plus

(4) Net unrealized holding gains or losses on held-to-maturity securities that are included in AOCI.

Table 1 to § 324.300

• <b>Transition AOCI Adjustment</b>	
• <b>Transition period</b>	• <b>Percentage applicable to transition AOCI adjustment amount</b>
• January 1, 2027 to December 31, 2027	• 100
• January 1, 2028 to December 31, 2028	• 80
• January 1, 2029 to December 31, 2029	• 60
• January 1, 2030 to December 31, 2030	• 40
• January 1, 2031 to December 31, 2031	• 20
• January 1, 2032 and thereafter	• 0

\* \* \* \* \*

**Jonathan V. Gould,**  
*Comptroller of the Currency.*

By order of the Board of Governors of the Federal Reserve System.

**Benjamin W. McDonough,**  
*Secretary of the Board.*

Federal Deposit Insurance Corporation.

By order of the Board of Directors,

Dated at Washington, DC, on March [ ], 2026.

**Jennifer M. Jones,**  
*Deputy Executive Secretary.*