causes for the changes in regulatory capital ratios and any other information required by the Corporation.

(2) The description of aggregate losses and net income must include the cumulative losses and cumulative net income over the planning horizon, and the description of each regulatory capital ratio must include the beginning value, ending value, and minimum value of each ratio over the planning horizon.

(c) Confidential treatment of information submitted. The confidentiality of information submitted to the Corporation under this subpart and related materials will be determined in accordance with applicable law including any available exemptions under the Freedom of Information Act (5 U.S.C. 552(b)) and the FDIC’s Rules and Regulations regarding the Disclosure of Information (12 CFR Part 309).

§ 325.207 Publication of stress test results.

(a) Publication date. (1) A $10 billion to $50 billion covered bank must publish a summary of the results of its annual stress test in the period starting June 15 and ending June 30.

(2) An over $50 billion covered bank must publish a summary of the results of its annual stress tests in the period starting March 15 and ending March 31.

(b) Publication method. The summary required under this section may be published on the covered bank’s Web site or in any other forum that is reasonably accessible to the public. A covered bank that is a consolidated subsidiary of a bank holding company or savings and loan holding company that is required to conduct an annual company-run stress test under applicable regulations of the Board of Governors of the Federal Reserve System will be deemed to have satisfied the public disclosure requirements under this subpart if it publishes a summary of its stress test results with its parent bank holding company’s or savings and loan holding company’s summary of stress test results. Subsidiary covered banks electing to satisfy their public disclosure requirement in this manner must include a summary of changes in regulatory capital ratios of such covered bank over the planning horizon, and an explanation of the most significant causes for the changes in regulatory capital ratios.

(c) Information to be disclosed in the summary. A covered bank must disclose the following information regarding the severely adverse scenario if it is not a consolidated subsidiary of a parent bank holding company or savings and loan holding company that has elected to make its disclosure under section 203(d):

(1) A description of the types of risks included in the stress test;

(2) A summary description of the methodologies used in the stress test;

(3) Estimates of aggregate losses, pre-provision net revenue, provision for loan and lease losses, net income, and pro forma capital ratios (including regulatory and any other capital ratios specified by the FDIC); and

(4) An explanation of the most significant causes for the changes in the regulatory capital ratios.

(d) Content of results. (1) The disclosure of aggregate losses, pre-provision net revenue, provisions for loan and lease losses, and net income under this section must be on a cumulative basis over the planning horizon.

(2) The disclosure of regulatory capital ratios and any other capital ratios specified by the Corporation under this section must include the beginning value, ending value, and minimum value of each ratio over the planning horizon.

APPENDIX A TO PART 325—STATEMENT OF POLICY ON RISK-BASED CAPITAL

Capital adequacy is one of the critical factors that the FDIC is required to analyze when taking action on various types of applications and when conducting supervisory activities related to the safety and soundness of individual banks and the banking system. In view of this, the FDIC’s Board of Directors has adopted part 325 of its regulations, which sets forth (1) minimum standards of capital adequacy for insured state nonmember banks and (2) standards for determining when an insured bank is in an unsafe or unsound condition by reason of the amount of its capital.

This capital maintenance regulation was designed to establish, in conjunction with other Federal bank regulatory agencies, uniform capital standards for all federally-regulated banking organizations, regardless of size. The uniform capital standards were
based on ratios of capital to total assets. While those leverage ratios have served as a useful tool for assessing capital adequacy, the FDIC believes there is a need for a capital measure that is more explicitly and systematically sensitive to the risk profiles of individual banks. As a result, the FDIC’s Board of Directors has adopted this Statement of Policy on Risk-Based Capital to supplement the part 325 regulation. This statement of policy does not replace or eliminate the existing part 325 capital-to-total assets leverage ratios.

The framework set forth in this statement of policy consists of (1) a definition of capital for risk-based capital purposes, and (2) a system for calculating risk-weighted assets by assigning assets and off balance sheet items to broad risk categories. A bank’s risk-based capital ratio is calculated by dividing its qualifying total capital base (the numerator of the ratio) by its risk-weighted assets (the denominator). Table I outlines the definition of capital and provides a general explanation of how the risk-based capital ratio is calculated. Table II summarizes the risk weights and risk categories, and Table III sets forth the credit conversion factors for off-balance sheet items. Additional explanations of the capital definitions, the risk-weighted asset calculations, and the minimum risk-based capital ratio guidelines are provided in Sections I, II and III of this statement of policy.

In addition, when certain banks that engage in trading activities calculate their risk-based capital ratio under this appendix A, they must also refer to appendix C of this part, which incorporates capital charges for certain market risks into the risk-based capital ratio. When calculating their risk-based capital ratio under this appendix A, such banks are required to refer to appendix C of this part for supplemental rules to determine qualifying and excess capital, calculate risk-weighted assets, calculate market risk equivalent assets and add them to risk-weighted assets, and calculate risk-based capital ratios as adjusted for market risk.

This statement of policy applies to all FDIC-insured state-chartered banks (excluding insured branches of foreign banks) that are not members of the Federal Reserve System, hereafter referred to as state nonmember banks, regardless of size, and to all circumstances in which the FDIC is required to evaluate the capital of a banking organization. Therefore, the risk-based capital framework set forth in this statement of policy will be used in the examination and supervisory process as well as in the analysis of applications that the FDIC is required to act upon.

The risk-based capital ratio focuses principally on broad categories of credit risk, however, the ratio does not take account of many other factors that can affect a bank’s financial condition. These factors include overall interest rate risk exposure, liquidity, funding and market risks; the quality and level of earnings; investment, loan portfolio, and other concentrations of credit risk, certain risks arising from nontraditional activities; the quality of loans and investments; the effectiveness of loan and investment policies; and management’s overall ability to monitor and control financial and operating risks, including the risk presented by concentrations of credit and nontraditional activities. In addition to evaluating capital ratios, an overall assessment of capital adequacy must take account of each of these other factors, including, in particular, the level and severity of problem and adversely classified assets as well as a bank’s interest rate risk as measured by the bank’s exposure to declines in the economic value of its capital due to changes in interest rates. For this reason, the final supervisory judgment on a bank’s capital adequacy may differ significantly from the conclusions that might be drawn solely from the absolute level of the bank’s risk-based capital ratio.

In light of these other considerations, banks generally are expected to operate above the minimum risk-based capital ratio. Banks contemplating significant expansion plans, as well as those institutions with high or inordinate levels of risk, should hold capital commensurate with the level and nature of the risks to which they are exposed.

I. DEFINITION OF CAPITAL FOR THE RISK-BASED CAPITAL RATIO

A bank’s qualifying total capital base consists of two types of capital elements: core capital elements (Tier 1) and supplementary capital elements (Tier 2). To qualify as an element of Tier 1 or Tier 2 capital, a capital instrument should not contain or be subject to any conditions, covenants, terms, restrictions, or provisions that are inconsistent with safe and sound banking practices.

A. The Components of Qualifying Capital (see Table I)

1. Core capital elements (Tier 1) consists of:

   i. Common stockholders’ equity capital (includes common stock and related surplus, undistributed profits, disclosed capital reserves that represent a segregation of undistributed profits, and foreign currency translation adjustments, less net unrealized holding gains on available-for-sale equity securities with readily determinable fair values);
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§ 325.5(f) and (g) of this part will not be recognized for risk-based capital purposes.

(d) Minority interests in small business investment companies, investment funds that hold nonfinancial equity investments (as defined in section II.B.(6)(ii) of this appendix A), and subsidiaries that are engaged in nonfinancial activities are not included in the bank’s Tier 1 or total capital base if the bank’s interest in the company or fund is held under one of the legal authorities listed in section II.B.(6)(ii) of this appendix A.

2. Supplementary capital elements (Tier 2) consist of:

i. Allowance for loan and lease losses, up to a maximum of 1.25 percent of risk-weighted assets;

ii. Cumulative perpetual preferred stock, long-term preferred stock (original maturity of at least 20 years), and any related surplus;

iii. Perpetual preferred stock (and any related surplus) where the dividend is reset periodically based, in whole or part, on the bank’s current credit standing, regardless of whether the dividends are cumulative or noncumulative;

iv. Hybrid capital instruments, including mandatory convertible debt securities;

v. Term subordinated debt and intermediate-term preferred stock (original average maturity of five years or more) and any related surplus; and

vi. Net unrealized holding gains on equity securities (subject to the limitations discussed in paragraph I.A.2.(f) of this section).

The maximum amount of Tier 2 capital that may be recognized for risk-based capital purposes is limited to 100 percent of Tier 1 capital (after any deductions for disallowed intangibles and disallowed deferred tax assets). In addition, the combined amount of term subordinated debt and intermediate-term preferred stock that may be treated as part of Tier 2 capital for risk-based capital purposes is limited to 50 percent of Tier 1 capital. Amounts in excess of these limits may be issued but are not included in the calculation of the risk-based capital ratio.

(a) Allowance for loan and lease losses. Allowances for loan and lease losses are reserves that have been established through a charge against earnings to absorb future losses on loans or lease financing receivables. Allowances for loan and lease losses
exclude allocated transfer risk reserves, and reserves created against identified losses.

This risk-based capital framework provides a phasedown during the transition period of the extent to which the allowance for loan and lease losses may be included in an institution’s capital base. By year-end 1990, the allowance for loan and lease losses, as an element of supplementary capital, may constitute no more than 1.5 percent of risk-weighted assets and, by year-end 1992, no more than 1.25 percent of risk-weighted assets.

(b) Preferred stock. Perpetual preferred stock is defined as preferred stock that does not have a maturity date, that cannot be redeemed at the option of the holder, and that has no other provisions that will require future redemption of the issue. Long-term preferred stock includes limited-life preferred stock with an original maturity of 20 years or more, provided that the stock cannot be redeemed at the option of the holder prior to maturity, except with the prior approval of the FDIC.

Cumulative perpetual preferred stock and long-term preferred stock qualify for inclusion in supplementary capital provided that the instruments can absorb losses while the issuer operates as a going concern (a fundamental characteristic of equity capital) and provided the issuer has the option to defer payment of dividends on these instruments. Given these conditions, and the perpetual or long-term nature of the instruments, there is no limit on the amount of these preferred stock instruments that may be included with Tier 2 capital.

Noncumulative perpetual preferred stock where the dividend is reset periodically based, in whole or in part, on the bank’s current credit standing, including auction rate, money market, or remarketable preferred stock, are also assigned to Tier 2 capital without limit, provided the above conditions are met.

Hybrid capital instruments. Hybrid capital instruments include instruments that have certain characteristics of both debt and equity. In order to be included as supplementary capital elements, these instruments should meet the following criteria:

1. The instrument should be unsecured, subordinated to the claims of depositors and general creditors, and fully paid-up.

2. The instrument should not be redeemable at the option of the holder prior to maturity, except with the prior approval of the FDIC. This requirement implies that holders of such instruments may not accelerate the payment of principal except in the event of bankruptcy, insolvency, or reorganization.

3. The instrument should be available to participate in losses while the issuer is operating as a going concern. (Term subordinated debt would not meet this requirement.) To satisfy this requirement, the instrument should convert to common or perpetual preferred stock in the event that the sum of the undivided profits and capital surplus accounts of the issuer results in a negative balance.

4. The instrument should provide the option for the issuer to defer principal and interest payments if: (a) The issuer does not report a profit in the preceding annual period, defined as combined profits (i.e., net income) for the most recent four quarters, and (b) the issuer eliminates cash dividends on its common and preferred stock.

Mandatory convertible debt securities, which are subordinated debt instruments that require the issuer to convert such instruments into common or perpetual preferred stock by a date at or before the maturity of the debt instruments, will qualify as hybrid capital instruments provided the majority of these instruments is 12 years or less and the instruments meet the criteria set forth below for “term subordinated debt.” There is no limit on the amount of hybrid capital instruments that may be included within Tier 2 capital.

(d) Term subordinated debt and intermediate-term preferred stock. The aggregate amount of term subordinated debt (excluding mandatory convertible debt securities) and intermediate-term preferred stock (including any related surplus) that may be treated as Tier 2 capital for risk-based capital purposes is limited to 50 percent of Tier 1 capital. Term subordinated debt and intermediate-term preferred stock should have an original average maturity of at least five years to qualify as supplementary capital and should not be redeemable at the option of the holder prior to maturity, except with the prior approval of the FDIC. For state nonmember banks, a term subordinated debt instrument is an obligation other than a deposit obligation that:

1. Bears on its face, in boldface type, the following: This obligation is not a deposit.
and is not insured by the Federal Deposit Insurance Corporation;

(2)(i) Has a maturity of at least five years; or

(ii) In the case of an obligation or issue that provides for scheduled repayments of principal, has an average maturity of at least five years; provided that the Director of the Division of Supervision and Consumer Protection (DSC) may permit the issuance of an obligation or issue with a shorter maturity or average maturity if the Director has determined that exigent circumstances require the issuance of such obligation or issue; provided further that the provisions of this paragraph I.A.2.(d)(2) shall not apply to mandatory convertible debt obligations or issues;

(3) States express that the obligation:

(i) Is subordinated and junior in right of payment to the issuing bank’s obligations to its depositors and to the bank’s other obligations to its general and secured creditors; and

(ii) Is ineligible as collateral for a loan by the issuing bank;

(4) Is unsecured;

(5) States expressly that the issuing bank may not retire any part of its obligation without the prior written consent of the FDIC or other primary federal regulator; and

(6) Includes, if the obligation is issued to a depository institution, a specific waiver of the right of offset by the lending depository institution.

Subordinated debt obligations issued prior to December 2, 1987 that satisfied the definition of the term “subordinated note and debenture” that was in effect prior to that date also will be deemed to be term subordinated debt for risk-based capital purposes. An optional redemption (“call”) provision in a subordinated debt instrument that is exercisable by the issuing bank in less than five years will not be deemed to constitute a maturity of less than five years, provided that the obligation otherwise has a stated contractual maturity of at least five years; the call is exercisable solely at the discretion or option of the holder of the obligation; and the call is exercisable only with the express prior written consent of the FDIC under 12 U.S.C. 1829(i)(1) at the time early redemption or retirement is sought, and such consent has not been given in advance at the time of issuance of the obligation. Optional redemption provisions will be accorded similar treatment when determining the perpetual nature and/or maturity of preferred stock and other capital instruments.

(e) Discount of limited-life supplementary capital instruments. As a limited-life capital instrument approaches maturity, the instrument begins to take on characteristics of a short-term obligation and becomes less like a component of capital. Therefore, for risk-based capital purposes, the outstanding amount of term subordinated debt and limited-life preferred stock eligible for inclusion in capital will be adjusted downward, or discounted, as the instruments approach maturity. Each limited-life capital instrument will be discounted by reducing the outstanding amount of the capital instrument eligible for inclusion as supplementary capital by a fifth of the original amount (less redemptions) each year during the instrument’s last five years before maturity. Such instruments, therefore, will have no capital value when they have a remaining maturity of less than a year.

1. Unrealized gains on equity securities and unrealized gains (losses) on other assets. Up to 45 percent of pretax net unrealized holding gains (that is, the excess, if any, of the fair value over historical cost) on available-for-sale equity securities with readily determinable fair values may be included in supplementary capital. However, the FDIC may exclude all or a portion of these unrealized gains from Tier 2 capital if the FDIC determines that the equity securities are not prudently valued. Unrealized gains (losses) on other types of assets, such as bank premises and available-for-sale debt securities, are not included in supplementary capital, but the FDIC may take these unrealized gains (losses) into account as additional factors when assessing a bank’s overall capital adequacy.

B. Deductions from Capital and Other Adjustments

Certain assets are deducted from a bank’s capital base for the purpose of calculating the numerator of the risk-based capital ratio. These assets include:

(1) All intangible assets other than mortgage servicing assets, nonmortgage servicing assets and purchased credit card relationships. These disallowed intangibles are deducted from the core capital (Tier 1) elements.

4 Any assets deducted from capital when computing the numerator of the risk-based capital ratio will also be excluded from risk-weighted assets when computing the denominator of the ratio.

5 In addition to mortgage servicing assets, nonmortgage servicing assets and purchased credit card relationships, certain other intangibles may be allowed if explicitly approved by the FDIC as part of the bank’s regulatory capital on a specific case basis. In evaluating whether other types of intangibles should be recognized for regulatory capital purposes on a specific case basis, the FDIC will accord special attention to the

Continued
(2) Investments in unconsolidated banking and finance subsidiaries. This includes any equity or debt capital investments in banking or finance subsidiaries if the subsidiaries are not consolidated for regulatory capital requirements. Generally, these investments are not consolidated for regulatory capital purposes.

A. General Procedures

1. Under the risk-based capital framework, a bank's balance sheet assets and credit equivalent amounts of off-balance sheet items are assigned to one of four broad risk categories according to the obligor or, if relevant, the guarantor or the nature of the collateral. The aggregate dollar amount in each category is then multiplied by the risk weight assigned to that category. The resulting weighted values from each of the four risk categories are added together and this sum is the risk-weighted assets total that, as adjusted, comprises the denominator of the risk-based capital ratio.

2. The risk-weighted amounts for all off-balance sheet items are determined by a two-step process. First, the notional principal or face value, amount of each off-balance sheet item generally is multiplied by a credit conversion factor to arrive at a balance sheet credit equivalent amount. Second, the credit equivalent amount generally is assigned to the appropriate risk category, like any balance sheet asset, according to the obligor or, if relevant, the guarantor or the nature of the collateral.

They are not consolidated for regulatory capital purposes.
3. The Director of the Division of Supervision and Consumer Protection (DSC) may, on a case-by-case basis, determine the appropriate risk weight for any asset or credit equivalent that is not commensurate with the risk of the exposure otherwise specified in this Appendix A or that imposes risks on a bank that are not commensurate with the risk of the exposure otherwise specified in this Appendix A for the off-balance sheet item. In making such a determination, the Director of the Division of Supervision and Consumer Protection (DSC) will consider the similarity of the asset or off-balance sheet item to assets or off-balance sheet items explicitly treated in sections II.B and II.C of this appendix A, as well as other relevant factors.

4. The Director of the Division of Supervision and Consumer Protection (DSC) may, on a case-by-case basis, determine that the regulatory capital treatment for an exposure or other relationship to an entity that is not subject to consolidation on the balance sheet is not commensurate with the risk of the exposure and the relationship of the bank to the entity. In making this determination, the Director of DSC may require the bank to treat the entity as if it were consolidated on the balance sheet of the bank for risk-based capital purposes and calculate the appropriate risk-based capital ratios accordingly.


Section II.A.5 of this appendix provides optional transition provisions for a State nonmember bank that is required for financial and regulatory reporting purposes, as a result of its implementation of Statement of Financial Accounting Standards No. 167, Amendments to FASB Interpretation No. 46(R) (FAS 167), to consolidate certain variable interest entities (VIEs) as defined under United States generally accepted accounting principles (GAAP). These transition provisions apply through the end of the fourth quarter following the date of a bank’s implementation of FAS 167 (implementation date).

1. Exclusion period.

(a) Exclusion of risk-weighted assets for the first and second quarters. For the first two quarters after the implementation date (exclusion period), including for the two calendar quarter-end regulatory report dates within those quarters, a bank may exclude from risk-weighted assets:

1. Subject to the limitations in paragraph iii. of this section II.A.5, assets held by a VIE, provided that the following conditions are met:

(i) The VIE existed prior to the implementation date,

(ii) The bank did not consolidate the VIE on its balance sheet for calendar quarter-end regulatory report dates prior to the implementation date,

(iii) The bank must consolidate the VIE on its balance sheet beginning as of the implementation date as a result of its implementation of FAS 167, and

(iv) The bank excludes all assets held by VIEs described in paragraphs i.(a)(1)(i) through (iii) of this section II.A.5, and

2. Subject to the limitations in paragraph iii. of this section II.A.5, assets held by a VIE that is a consolidated asset-backed commercial paper (ABCP) program, provided that the following conditions are met:

(i) The bank is the sponsor of the ABCP program,

(ii) Prior to the implementation date, the bank consolidated the VIE onto its balance sheet under GAAP and excluded the VIE’s assets from the bank’s risk-weighted assets, and

(iii) The bank chooses to exclude all assets held by ABCP program VIEs described in paragraphs i.(a)(2)(i) and (ii) of this section II.A.5.

(b) Risk-weighted assets during exclusion period. During the exclusion period, including the two calendar quarter-end regulatory report dates within the exclusion period, a bank adopting the optional provisions of this paragraph i. of this section II.A.5 must calculate risk-weighted assets for its contractual exposures to the VIEs referenced in paragraph i. of this section II.A.5 on the implementation date and include this calculated amount in its risk-weighted assets. Such contractual exposures may include direct-credit substitutes, recourse obligations, residual interests, liquidity facilities, and loans.

(c) Inclusion of ALLL in Tier 2 capital for the first and second quarters. During the exclusion period, including for the two calendar quarter-end regulatory report dates within the exclusion period, a bank that excludes VIE assets from risk-weighted assets pursuant to paragraph i.(a) of this section II.A.5 may include in Tier 2 capital the full amount of the allowance for loan and lease losses (ALLL) calculated as of the implementation date that is attributable to the assets it excludes pursuant to paragraph i.(a) of this section II.A.5 (inclusion amount). The amount of ALLL includable in Tier 2 capital in accordance with this paragraph shall not be subject to the limitations set forth in paragraph i. of section I.A.2.

ii. Phase-in period.
(a) Exclusion amount. For purposes of this paragraph ii. of this section II.A.5, exclusion amount is defined as the amount of risk-weighted assets excluded in paragraph i.(a) of this section II.A.5 as of the implementation date.

(b) Risk-weighted assets for the third and fourth quarters. A bank that excludes assets of consolidated VIEs from risk-weighted assets pursuant to paragraph i.(a) of this section II.A.5 may, for the third and fourth quarters after the implementation date (phase-in period), including for the two calendar quarter-end regulatory report dates within those quarters, exclude from risk-weighted assets 50 percent of the exclusion amount, provided that the bank may not include in risk-weighted assets pursuant to this paragraph an amount less than the aggregate risk-weighted assets calculated pursuant to paragraph i.(b) of this section II.A.5.

(c) Inclusion of ALLL in Tier 2 capital for the third and fourth quarters. A bank that excludes assets of consolidated VIEs from risk-weighted assets pursuant to paragraph ii.(b) of this section II.A.5 may, for the phase-in period, include in Tier 2 capital 50 percent of the inclusion amount it included in Tier 2 capital during the exclusion period, notwithstanding the limit on including ALLL in Tier 2 capital in paragraph i. of section I.A.2.

iii. Implicit recourse limitation. Notwithstanding any other provision in this section II.A.5, assets held by a VIE to which the bank has provided recourse through credit enhancement beyond any contractual obligation to support assets it has sold may not be excluded from risk-weighted assets.

B. Other Considerations

1. Indirect Holdings of Assets. Some of the assets on a bank’s balance sheet may represent an indirect holding of a pool of assets; for example, mutual funds. An investment in shares of a mutual fund whose portfolio consists solely of various securities or money market instruments that, if held separately, would be assigned to different risk categories, generally is assigned to the risk category appropriate to the highest risk-weighted asset that the fund is permitted to hold in accordance with the stated investment objectives set forth in its prospectus. The bank may, at its option, assign the investment on a pro rata basis to different risk categories according to the investment limits in the fund’s prospectus, but in no case will indirect holdings through shares in any mutual fund be assigned to a risk weight less than 20 percent. If the bank chooses to assign its investment on a pro rata basis, and the sum of the investment limits in the fund’s prospectus exceeds 100 percent, the bank must assign risk weights in descending order. If, in order to maintain a necessary degree of short-term liquidity, a fund is permitted to hold an insignificant amount of its assets in short-term, highly liquid securities of superior credit quality that do not qualify for a preferential risk weight, such securities will generally be disregarded in determining the risk category to which the bank’s holdings in the overall fund should be assigned. The prudent use of hedging instruments by a mutual fund to reduce the risk of its assets will not increase the risk weighting of the mutual fund investment. For example, the use of hedging instruments by a mutual fund to reduce the interest rate risk of its government bond portfolio will not increase the risk weight of that fund above the 20 percent category. Nonetheless, if the fund engages in any activities that appear speculative in nature or has any other characteristics that are inconsistent with the preferential risk weighting assigned to the fund’s assets, holdings in the fund will be assigned to the 100 percent risk category.

2. Collateral. In determining risk weights of various assets, the only forms of collateral that are formally recognized by the risk-based capital framework are cash on deposit in the lending bank; securities issued or guaranteed by the central governments of the OECD-based group of countries,11 U.S. Government agencies, or U.S. Government-sponsored agencies; and securities issued or guaranteed by multilateral lending institutions or regional development banks. Claims fully secured by such collateral are assigned to the 20 percent risk category. The extent

11The OECD-based group of countries comprises all members of the Organization for Economic Cooperation and Development (OECD) regardless of entry date, as well as countries that have concluded special lending arrangements with the International Monetary Fund (IMF) associated with the IMF’s General Arrangements to Borrow, but excludes any country that has rescheduled its external sovereign debt within the previous five years. As of November 1995, the OECD included the following countries: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Iceland, Ireland, Italy, Japan, Luxembourg, Mexico, the Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, the United Kingdom, and the United States; and Saudi Arabia had concluded special lending arrangements with the IMF associated with the IMF’s General Arrangements to Borrow. A rescheduling of external sovereign debt generally would include any renegotiation of terms arising from a country’s inability or unwillingness to meet its external debt service obligations, but generally would not include renegotiations of debt in the normal course of business, such as a renegotiation to allow the borrower to take advantage of a decline in interest rates or other change in market conditions.
to which these securities are recognized as collateral for risk-based capital purposes is determined by their current market value. If a claim is partially secured, the portion of the claim that is not covered by the collateral is assigned to the risk category appropriate to the obligor or, if relevant, the guarantor:

3. Guarantees. Guarantees of the OECD and non-OECD central governments, U.S. Government agencies, U.S. Government-sponsored agencies, state and local governments of the OECD-based group of countries, multilateral lending institutions and regional development banks, U.S. depositary institutions, foreign banks, and qualifying OECD-based securities firms are also recognized. If a claim is partially guaranteed, the portion of the claim that is not fully covered by the guarantee is assigned to the risk category appropriate to the obligor or, if relevant, the collateral.

4. Maturity. Maturity is generally not a factor in assigning items to risk categories with the exceptions of claims on non-OECD banks, commitments, and interest rate and foreign exchange rate related contracts. Except for commitments, short-term is defined as one year or less remaining maturity and long-term is defined as over one year remaining maturity. In the case of commitments, short-term is defined as one year or less original maturity and long-term is defined as over one year original maturity. ¹²

5. Recourse, Direct Credit Substitutes, Residual Interests and Mortgage- and Asset-Backed Securities. For purposes of this section II.B.5 of this appendix A, the following definitions will apply.

a. Definitions—(1) Credit derivative means a contract that allows one party (the “protection purchaser”) to transfer the credit risk of an asset or off-balance sheet credit exposure to another party (the “protection provider”). The value of a credit derivative is dependent, at least in part, on the credit performance of the “reference asset.”

(2) Credit-enhancing interest only strip is defined in §325.2(g).

(3) Credit-enhancing representations and warranties means representations and warranties that are made or assumed in connection with a transfer of assets (including loan servicing assets) and that obligate the bank to protect investors from losses arising from credit risk in the assets transferred or the loans serviced. Credit-enhancing representations and warranties include promises to protect a party from losses resulting from the default or nonperformance of another party or from an insufficiency in the value of the collateral. Credit-enhancing representations and warranties do not include:

(i) Early default clauses and similar warranties that permit the return of, or premium refund clauses covering, 1-4 family residential first mortgage loans that quality for a 50 percent risk weight for a period not to exceed 120 days from the date of transfer. These warranties may cover only those loans that were originated within 1 year of the date of transfer;

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

(iii) Warranties that permit the return of assets in instances of misrepresentation, fraud or incomplete documentation.

(4) Direct credit substitute means an arrangement in which a bank assumes, in form or in substance, credit risk associated with an on-or off-balance sheet credit exposure that was not previously owned by the bank (third-party asset) and the risk assumed by the bank exceeds the pro rata share of the bank’s interest in the third-party asset. If the bank has no claim on the third-party asset, then the bank’s assumption of any credit risk with respect to the third party asset is a direct credit substitute. Direct credit substitutes include, but are not limited to:

(i) Financial standby letters of credit, which includes any letter of credit or similar arrangement, however named or described, that support financial claims on a third party that exceed a bank’s pro rata share of losses in the financial claim;

(ii) Guarantees, surety arrangements, credit derivatives, and similar instruments backing financial claims;

(iii) Purchased subordinated interests or securities that absorb more than their pro rata share of credit losses from the underlying assets;

(iv) Credit derivative contracts under which the bank assumes more than its pro rata share of credit risk on a third party asset or exposure;

(v) Loans or lines of credit that provide credit enhancement for the financial obligations of an account party;

(vi) Purchased loan servicing assets if the servicer:

(A) Is responsible for credit losses with the loans being serviced;

(B) Is responsible for making servicer cash advances (unless the advances are not direct credit substitutes because they meet the conditions specified in section II.B.5(a)(9) of this Appendix A), or

(C) Makes or assumes credit-enhancing representations and warranties with respect to the loans serviced;

¹²Through year-end 1992, remaining rather than original maturity may be used for determining term to maturity for commitments.
(vii) Clean-up calls on third party assets. Clean-up calls that are exercisable at the option of the bank (as servicer or as an affiliate of the servicer) when the pool balance is 10 percent or less of the original pool balance are not direct credit substitutes; and

(viii) Liquidity facilities that provide liquidity support to ABCP (other than eligible ABCP liquidity facilities).

(5) Eligible ABCP liquidity facility means a liquidity facility supporting ABCP, in form or in substance, that is subject to an asset quality test at the time of draw that excludes funding against assets that are 90 days or more past due or in default. In addition, if the assets that an eligible ABCP liquidity facility is required to fund against are externally rated assets or exposures at the inception of the facility, the facility can be used to fund only those assets or exposures that are externally rated investment grade at the time of funding. Notwithstanding the eligibility requirements set forth in the two preceding sentences, a liquidity facility will be considered an eligible ABCP liquidity facility if the assets that are funded under the liquidity facility and which do not meet the eligibility requirements are guaranteed, either conditionally or unconditionally, by the U.S. government or its agencies, or by the central government of an OECD country.

(6) Externally rated means that an instrument or obligation has received a credit rating from a nationally recognized statistical rating organization.

(7) Face amount means the notional principal, or face value, amount of an off-balance sheet item; the amortized cost of an asset not held for trading purposes; and the fair value of a trading asset.

(8) Financial asset means cash or other monetary instrument, evidence of debt, evidence of an ownership interest in an entity, or a contract that conveys a right to receive or exchange cash or another financial instrument from another party.

(9) Financial standby letter of credit means a letter of credit or similar arrangement that represents an irrevocable obligation to a third-party beneficiary:

(i) To receive money borrowed by, or advanced to, or for the account of, a second party (the account party), or

(ii) To make payment on behalf of the account party, in the event that the account party fails to fulfill its obligation to the beneficiary.

(10) Liquidity facility means a legally binding commitment to provide liquidity support to ABCP by lending to, or purchasing assets from, any structure, program, or conduit in the event that funds are required to repay maturing ABCP.

(11) Mortgage servicer cash advance means funds that a residential mortgage servicer advances to ensure an uninterrupted flow of payments, including advances made to cover foreclosure costs or other expenses to facilitate the timely collection of the loan. A mortgage servicer cash advance is not a recourse obligation or a direct credit substitute if:

(i) The mortgage servicer is entitled to full reimbursement and this right is not subordinated to other claims on the cash flows from the underlying asset pool; or

(ii) For any one loan, the servicer’s obligation to make nonreimbursable advances is contractually limited to an insignificant amount of the outstanding principal of that loan.

(12) Nationally recognized statistical rating organization (NRSRO) means an entity recognized by the Division of Market Regulation of the Securities and Exchange Commission (or any successor Division) (Commission) as a nationally recognized statistical rating organization for various purposes, including the Commission’s uniform net capital requirements for brokers and dealers (17 CFR 240.15c3–1).

(13) Recourse means an arrangement in which a bank retains, in form or in substance, of any credit risk directly or indirectly associated with an asset it has sold (in accordance with generally accepted accounting principles) that exceeds a pro rata share of the bank’s claim on the asset. If a bank has no claim on an asset it has sold, then the retention of any credit risk is recourse. A recourse obligation typically arises when an institution transfers assets in a sale and retains an obligation to repurchase the assets or absorb losses due to a default of principal or interest or any other deficiency in the performance of the underlying obligor or some other party. Recourse may exist implicitly where a bank provides credit enhancement beyond any contractual obligation to support assets it has sold. The following are examples of recourse arrangements:

(i) Credit-enhancing representations and warranties made on the transferred assets;

(ii) Loan servicing assets retained pursuant to an agreement under which the bank:

(A) Is responsible for losses associated with the loans being serviced, or

(B) Is responsible for making mortgage servicer cash advances (unless the advances are not a recourse obligation because they meet the conditions specified in section II.B.5(a)(11) of this Appendix A);

(iii) Retained subordinated interests that absorb more than their pro rata share of losses from the underlying assets;

(iv) Assets sold under an agreement to repurchase, if the assets are not already included on the balance sheet;

(v) Loan strips sold without contractual recourse where the maturity of the transferred portion of the loan is shorter than the
(vi) Credit derivative contracts under which the bank retains more than its pro rata share of credit risk on transferred assets;

(vii) Clean-up calls at inception that are greater than 10 percent of the balance of the original pool balance that are exercisable at the option of the bank are not recourse arrangements; and

(viii) Liquidity facilities that provide liquidity support to ABCP (other than eligible ABCP liquidity facilities).

(14) Residual interest means any on-balance sheet asset that represents an interest (including a beneficial interest) created by a transfer that qualifies as a sale (in accordance with generally accepted accounting principles (GAAP)) of financial assets, whether through a securitization or otherwise, and that exposes a bank to credit risk directly or indirectly associated with the transferred assets that exceeds a pro rata share of the bank's claim on the assets, whether through subordination provisions or other credit enhancement techniques. Residual interests generally include credit-enhancing IOs, spread accounts, cash collateral accounts, retained subordinated interests, other forms of over-collateralization, and similar assets that function as a credit enhancement. Residual interests further include those exposures that, in substance, cause the bank to retain the credit risk of an asset or exposure that had qualified as a residual interest before it was sold. Residual interests generally do not include interests purchased from a third party, except that purchased credit-enhancing IOs are residual interests for purposes of the risk-based capital treatment in this appendix.

(15) Risk participation means a participation in which the originating party remains liable to the beneficiary for the full amount of an obligation (e.g., a direct credit substitute) notwithstanding that another party has acquired a participation in that obligation.

(16) Securitization means the pooling and re-packaging by a special purpose entity of assets or other credit exposures into securities that can be sold to investors. Securitization includes transactions that create stratified credit risk positions whose performance is dependent upon an underlying pool of credit exposures, including loans and commitments.

(17) Sponsor means a bank that establishes an ABCP program; approves the sellers permitted to participate in the program; approves the asset pools to be purchased by the program; or administers the ABCP program by monitoring the assets, arranging for debt placement, compiling monthly reports, or ensuring compliance with the program documents and with the program’s credit and investment policy.

(18) Structured finance program means a program where receivable interests and asset-backed securities issued by multiple participants are purchased by a special purpose entity that repackages those exposures into securities that can be sold to investors. Structured finance programs allocate credit risks, generally, between the participants and credit enhancement provided to the program.

(19) Traded position means a position that is externally rated and is retained, assumed or issued in connection with an asset securitization, where there is a reasonable expectation that, in the near future, the rating will be relied upon by unaffiliated investors to purchase the position; or an unaffiliated third party to enter into a transaction involving the position, such as a purchase, loan, or repurchase agreement.

(b) Credit equivalent amounts and risk weights of recourse obligations and direct credit substitutes—(1) General rule for determining the credit-equivalent amount. Except as otherwise provided, the credit-equivalent amount for a recourse obligation or direct credit substitute is the full amount of the credit-enhanced assets for which the bank directly or indirectly retains or assumes credit risk multiplied by a 100% conversion factor. Thus, a bank that extends a partial direct credit substitute, e.g., a financial standby letter of credit that absorbs the first 10 percent of loss on a transaction, must maintain capital against the full amount of the assets being supported.

(2) Risk-weight factor. To determine the bank’s risk-weighted assets for an off-balance sheet recourse obligation or a direct credit substitute, the credit equivalent amount is assigned to the risk category appropriate to the obligor in the underlying transaction, after considering any associated guarantees or collateral. For a direct credit substitute that is an on-balance sheet asset, e.g., a purchased subordinated security, a bank must calculate risk-weighted assets using the amount of the direct credit substitute and the full amount of the assets it supports, i.e., all the more senior positions in the structure. The treatment covered in this paragraph (b) is subject to the low-level exposure rule provided in section II.B.5(h)(1) of this appendix A.

(c) Credit equivalent amount and risk weight of participations in, and syndications of, direct credit substitutes. Subject to the low-level exposure rule provided in section II.B.5(h)(1) of this appendix A, the credit equivalent amount for a participation interest in, or syndication of, a direct credit substitute (excluding purchased credit-enhancing interest-only strips) is calculated and risk weighted as follows:

(1) Treatment for direct credit substitutes for which a bank has conveyed a risk participation.
In the case of a direct credit substitute in which a bank has conveyed a risk participation, the full amount of the assets that are supported by the direct credit substitute is converted to a credit equivalent amount using a 100% conversion factor. However, the pro rata share of the credit equivalent amount that has been conveyed through a risk participation is then assigned to whichever risk-weight category is lower: the risk-weight category appropriate to the obligor in the underlying transaction, after considering any associated guarantees or collateral, or the risk-weight category appropriate to the party acquiring the participation. The pro rata share of the credit equivalent amount that has not been participated out is assigned to the risk-weight category appropriate to the obligor, guarantor, or collateral. For example, the pro rata share of the full amount of the assets supported, in whole or in part, by a direct credit substitute conveyed as a risk participation to a U.S. domestic depository institution or an OECD bank is assigned to the 20 percent risk category.

(2) Treatment for direct credit substitutes in which the bank has acquired a risk participation. In the case of a direct credit substitute in which the bank has acquired a risk participation, the acquiring bank’s pro rata share of the direct credit substitute is multiplied by the full amount of the assets supported, and converted using a 100% credit conversion factor. The resulting credit equivalent amount is then assigned to the risk-weight category appropriate to the obligor in the underlying transaction, after considering any associated guarantees or collateral.

(3) Treatment for direct credit substitutes related to syndications. In the case of a direct credit substitute that takes the form of a syndication where each party is obligated only for its pro rata share of the risk and there is no recourse to the originating entity, each bank’s credit equivalent amount will be calculated by multiplying only its pro rata share of the assets supported by the direct credit substitute by a 100% conversion factor. The resulting credit equivalent amount is then assigned to the risk-weight category appropriate to the obligor in the underlying transaction, after considering any associated guarantees or collateral.

(4) Externally rated positions: credit-equivalent amounts and risk weights. (d) Traded positions. With respect to a recourse obligation, direct credit substitute, residual interest (other than a credit-enhancing interest-only strip) or mortgage- or asset-backed security that is a “traded position” and that has received an external rating on a long-term position that is one grade below investment grade, the bank may multiply the face amount of the position by the appropriate risk weight, determined in accordance with Table A or B of this appendix A, as appropriate. If a traded position receives more than one external rating, the lowest rating will apply.

\[
\text{TABLE A}
\]

<table>
<thead>
<tr>
<th>Long-term rating category</th>
<th>Examples</th>
<th>Risk weight (in percent)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Highest or second highest investment grade</td>
<td>AAA, AA</td>
<td>20</td>
</tr>
<tr>
<td>Third highest investment grade</td>
<td>A-1, A-2</td>
<td>50</td>
</tr>
<tr>
<td>Lowest investment grade</td>
<td>BBB</td>
<td>100</td>
</tr>
<tr>
<td>One category below investment grade</td>
<td>BB</td>
<td>200</td>
</tr>
</tbody>
</table>

\[
\text{TABLE B}
\]

<table>
<thead>
<tr>
<th>Short-term rating category</th>
<th>Examples</th>
<th>Risk weight (in percent)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Highest investment grade</td>
<td>A-1, P-1</td>
<td>20</td>
</tr>
<tr>
<td>Second highest investment grade</td>
<td>A-2, P-2</td>
<td>50</td>
</tr>
<tr>
<td>Lowest investment grade</td>
<td>A-3, P-3</td>
<td>100</td>
</tr>
</tbody>
</table>

(2) Non-traded positions. A recourse obligation, direct credit substitute, residual interest (but not a credit-enhancing interest-only strip) or mortgage- or asset-backed security extended in connection with a securitization that is not a “traded position” may be assigned a risk weight in accordance with section II.B.5(d)(1) of this appendix A if:

\[13\] A risk participation with a remaining maturity of one year or less that is conveyed to a non-OECD bank is also assigned to the 20 percent risk category.

\[14\] Stripped mortgage-backed securities and similar instruments, such as interest-only strips that are not credit-enhancing and principal-only strips, must be assigned to the 100% risk category.
(i) It has been externally rated by more than one NRSRO;
(ii) It has received an external rating on a long-term position that is one category below investment grade or better or a short-term position that is investment grade by all NRSROs providing a rating;
(iii) The ratings are publicly available; and
(iv) The ratings are based on the same criteria used to rate traded positions. If the ratings are different, the lowest rating will determine the risk category to which the recourse obligation, direct credit substitute, residual interest, or mortgage- or asset-backed security will be assigned.

(e) Senior positions not externally rated. For a recourse obligation, direct credit substitute, residual interest or mortgage- or asset-backed security that is not externally rated but is senior in all features to a traded position (including collateralization and maturity), a bank may apply a risk weight to the face amount of the senior position in accordance with section II.B.5(d)(1) of this appendix A, based upon the risk weight of the traded position, subject to any current or prospective supervisory guidance and the bank satisfying the FDIC that this treatment is appropriate. This section will apply only if the traded position provides substantial credit support for the entire life of the unrated position.

(d) Residual interests—(1) Concentration limit on credit-enhancing interest-only strips. In addition to the capital requirement provided by section II.B.5(f)(2) of this appendix A, a bank must deduct from Tier 1 capital the face amount of all credit-enhancing interest-only strips in excess of 25 percent of Tier 1 capital in accordance with §325.5(f)(3).

(2) Credit-enhancing interest-only strip capital requirement. After applying the concentration limit to credit-enhancing interest-only strips in accordance with §325.5(f)(3), a bank must maintain risk-based capital for a credit-enhancing interest-only strip, equal to the remaining face amount of the credit-enhancing interest-only strip (net of the remaining proportional amount of any existing associated deferred tax liability recorded on the balance sheet), even if the amount of risk-based capital required to be maintained exceeds the full risk-based capital requirement for the assets transferred. Transactions that, in substance, result in the retention of credit risk associated with a transferred credit-enhancing interest-only strip will be treated as if the credit-enhancing interest-only strip was retained by the bank and not transferred.

(3) Other residual interests capital requirement. Except as otherwise provided in section II.B.5(d) or (e) of this appendix A, a bank must maintain risk-based capital for a residual interest (excluding a credit-enhancing interest-only strip) equal to the face amount of the residual interest (net of any existing associated deferred tax liability recorded on the balance sheet), even if the amount of risk-based capital required to be maintained exceeds the full risk-based capital requirement for the assets transferred. Transactions that, in substance, result in the retention of credit risk associated with a transferred residual interest will be treated as if the residual interest was retained by the bank and not transferred.

(4) Residual interests and other recourse obligations. Where the aggregate capital requirement for residual interests (including credit-enhancing interest-only strips) and recourse obligations arising from the same transfer of assets exceed the full risk-based capital requirement for assets transferred, a bank must maintain risk-based capital equal to the greater of the risk-based capital requirement for the residual interest as calculated under sections II.B.5(f)(2) through (3) of this appendix A or the full risk-based capital requirement for the assets transferred.

(g) Positions that are not rated by an NRSRO. A bank’s position (other than a residual interest) in a securitization or structured finance program that is not rated by an NRSRO may be risk-weighted based on the bank’s determination of the credit rating of the position, as specified in Table C of this appendix A, multiplied by the face amount of the position. In order to qualify for this treatment, the bank’s system for determining the credit rating of the position must meet one of the three alternative standards set out in section II.B.5(g)(1) through (3) of this appendix A.

<table>
<thead>
<tr>
<th>Rating category</th>
<th>Examples</th>
<th>Risk Weight (in percent)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment grade</td>
<td>BBB or better</td>
<td>100</td>
</tr>
<tr>
<td>One category below investment grade</td>
<td>BB</td>
<td>200</td>
</tr>
</tbody>
</table>

(1) Internal risk rating used for asset-backed programs. A bank extends a direct credit substitute (but not a purchased credit-enhancing interest-only strip) to an asset-backed commercial paper program sponsored by the bank and the bank is able to demonstrate to the satisfaction of the FDIC, prior to relying upon its use, that the bank’s internal credit
risk rating system is adequate. Adequate internal credit risk rating systems usually contain the following criteria:

1. The internal credit risk rating system is an integral part of the bank’s risk management system that explicitly incorporates the full range of risks arising from a bank’s participation in securitization activities.

2. Internal credit ratings are linked to measurable outcomes, such as the probability that the position will experience any loss, the position’s expected loss given default, and the degree of variance in losses given default on that position.

3. The internal credit risk rating system must separately consider the risk associated with the underlying loans or borrowers, and the risk associated with the structure of a particular securitization transaction.

4. The internal credit risk rating system identifies gradations of risk among “pass” assets and other risk positions.

5. The internal credit risk rating system must have clear, explicit criteria (including for subjective factors), that are used to classify assets into each internal risk grade.

6. The bank must have independent credit risk management or loan review personnel assigning or reviewing the credit risk ratings.

7. An internal audit procedure should periodically verify that internal risk ratings are assigned in accordance with the bank’s established criteria.

8. The bank must monitor the performance of the internal credit risk ratings assigned to nonrated, nontraded direct credit substitutes over time to determine the appropriateness of the initial credit risk rating assignment and adjust individual credit risk ratings, or the overall internal credit risk ratings system, as needed; and

9. The internal credit risk rating system must make credit risk rating assumptions that are consistent with, or more conservative than, the credit risk rating assumptions and methodologies of NRSROs.

(2) Program Ratings. A bank extends a direct credit substitute or retains a recourse obligation (but not a residual interest) extended in connection with a structured finance program. In order to rely on the rating determined by the computer program, the bank must demonstrate to the FDIC’s satisfaction that the rating corresponds to the bank’s established criteria; and

(h) Limitations on risk-based capital requirements—(1) Low-level exposure rule. If the maximum exposure to loss retained or assumed by a bank in connection with a recourse obligation, a direct credit substitute, or a residual interest is less than the effective risk-based capital requirement for the credit-enhanced assets, the risk-based capital required under this appendix A is limited to the bank’s maximum contractual exposure, less any recourse liability account established in accordance with generally accepted accounting principles. This limitation does not apply when a bank provides credit enhancement beyond any contractual obligation to support assets it has sold.

(2) Mortgage-related securities or participation certificates retained in a mortgage loan swap. If a bank holds a mortgage-related security or a participation certificate as a result of a mortgage loan swap with recourse, capital is required to support the recourse obligation plus the percentage of the mortgage-related security or participation certificate that is not covered by the recourse obligation. The total amount of capital required for the on-balance sheet asset and the recourse obligation, however, is limited to the capital requirement for the underlying loans, calculated as if the bank continued to

15 The adequacy of a bank’s use of its internal credit risk rating system must be demonstrated to the FDIC considering the criteria listed in this section and the size and complexity of the credit exposures assumed by the bank.
hold these loans as an on-balance sheet asset.

(3) Related on-balance sheet assets. If a recourse obligation or direct credit substitute asset is a related on-balance sheet asset, the asset is risk-weighted only under this section II.B.5 of this appendix, except in the case of loan servicing assets and similar arrangements with embedded recourse obligations or direct credit substitutes. In that case, the on-balance sheet servicing assets and the related recourse obligations or direct credit substitutes must both be separately risk weighted and incorporated into the risk-based capital calculation.

1) Alternative Capital Calculation for Small Business Obligations—(1) Definitions. For purposes of this section II.B.5(a):

(a) Qualified bank means a bank that:

(i) Is well capitalized as defined in §325.103(b)(1) without applying the capital treatment described in this section II.B.5(a); or

(ii) Is adequately capitalized as defined in §325.103(b)(2) without applying the capital treatment described in this section II.B.5(a) and has received written permission by order of the FDIC to apply the capital treatment described in this section II.B.5(a).

(b) Related on-balance sheet assets.

(i) Small business means a business that meets the criteria for a small business concern established by the Small Business Administration in 13 CFR part 121 pursuant to 15 U.S.C. 632.

(ii) Capital and reserve requirements. Notwithstanding the risk-based capital treatment outlined in any other paragraph (other than paragraph (i) of this section II.B.5), with respect to a transfer with recourse of a small business loan or a lease to a small business of personal property that is a sale under generally accepted accounting principles, and for which the bank establishes and maintains a non-capital reserve under generally accepted accounting principles sufficient to meet the reasonable estimated liability of the bank under the recourse arrangement; a qualified bank may elect to include only the face amount of its recourse in its risk-weighted assets for purposes of calculating the bank’s risk-based capital ratio.

(3) Limit on aggregate amount of recourse. The total outstanding amount of recourse retained by a qualified bank with respect to transfers of small business loans and leases to small businesses of personal property and included in the risk-weighted assets of the bank as described in section II.B.5(a)(2) of this appendix A may not exceed 15 percent of the bank’s total risk-based capital, unless the FDIC specifies a greater amount by order.

(4) Bank that ceases to be qualified or that exceeds aggregate limit. If a bank ceases to be a qualified bank or exceeds the aggregate limit in section II.B.5(a)(3) of this appendix A, the bank may continue to apply the capital treatment described in section II.B.5(a)(2) of this appendix A to transfers of small business loans and leases to small businesses of personal property that occurred when the bank was qualified and did not exceed the limit.

5) Prompt correction action not affected. (i) A bank shall compute its capital without regard to this section II.B.5(a) for purposes of prompt corrective action (12 U.S.C. 1811a) unless the bank is a well capitalized bank (without applying the capital treatment described in this section II.B.5(a)) and, after applying the capital treatment described in this section II.B.5(a), the bank would be well capitalized.

(ii) A bank shall compute its capital without regard to this section II.B.5(a) for purposes of 12 U.S.C. 1831o(g) regardless of the bank’s capital level.

6) Nonfinancial equity investments. (i) General. A bank must deduct from its Tier 1 capital the sum of the appropriate percentage (as determined below) of the adjusted carrying value of all nonfinancial equity investments held by the bank or by its direct or indirect subsidiaries. For purposes of this section II.B.5(a), investments held by a bank include all investments held directly or indirectly by the bank or by any of its subsidiaries.

(ii) Scope of nonfinancial equity investments. A nonfinancial equity investment means any equity investment held by the bank in a nonfinancial company: through a small business investment company (SBIC) under section 302(b) of the Small Business Investment Act of 1958 (15 U.S.C. 682(b)); under the portfolio investment provisions of Regulation K issued by the Board of Governors of the Federal Reserve System (12 CFR 211.8(c)(3)); or under section 24 of the Federal Deposit Insurance Act (12 U.S.C. 1831I(a)), other than an investment held in accordance with section 24(f) of that Act.16 A nonfinancial company is an entity that engages in any activity that has not been determined to be permissible for

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16 An equity investment made under section 302(b) of the Small Business Investment Act of 1958 in a SBIC that is not consolidated with the bank is treated as a nonfinancial equity investment.

17 The Board of Directors of the FDIC, acting directly, may, in exceptional cases and after a review of the proposed activity, permit a lower capital deduction for investments approved by the Board of Directors under section 24 of the FDIC Act so long as the bank’s investments under section 24 and SBIC investments represent, in the aggregate, less than 15 percent of the Tier 1 capital of the bank. The FDIC reserves the authority to impose higher capital charges on any investment where appropriate.
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the bank to conduct directly, or to be financial in nature or incidental to financial activities under section 4(k) of the Bank Holding Company Act (12 U.S.C. 1843(k)).

(A) The bank must deduct from its Tier 1 capital the sum of the appropriate percentages, as set forth in the table following this paragraph, of the adjusted carrying value of all nonfinancial equity investments held by the bank. The amount of the percentage deduction increases as the aggregate amount of nonfinancial equity investments held by the bank increases as a percentage of the bank’s Tier 1 capital.

DEDUCTION FOR NONFINANCIAL EQUITY INVESTMENTS

<table>
<thead>
<tr>
<th>Aggregate adjusted carrying value of all nonfinancial equity investments held directly or indirectly by the bank (as a percentage of the Tier 1 capital of the bank)</th>
<th>Deduction from Tier 1 Capital (as a percentage of the adjusted carrying value of the investment)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than 15 percent</td>
<td>8 percent.</td>
</tr>
<tr>
<td>15 percent to 24.99 percent</td>
<td>12 percent.</td>
</tr>
<tr>
<td>25 percent and above</td>
<td>25 percent.</td>
</tr>
</tbody>
</table>

1 For purposes of calculating the adjusted carrying value of nonfinancial equity investments as a percentage of Tier 1 capital, Tier 1 capital is defined as the sum of core capital elements net of goodwill and net of all identifiable intangible assets other than mortgage servicing assets, nonmortgage servicing assets and purchased credit card relationships, but prior to the deduction for any disallowed mortgage servicing assets, any disallowed nonmortgage servicing assets, any disallowed purchased credit card relationships, any disallowed credit-enhancing interest-only strips (both purchased and retained), any disallowed deferred tax assets, and any nonfinancial equity investments.

(B) These deductions are applied on a marginal basis to the portions of the adjusted carrying value of nonfinancial equity investments that fall within the specified ranges of the parent bank’s Tier 1 capital. For example, if the adjusted carrying value of all nonfinancial equity investments held by a bank equals 20 percent of the Tier 1 capital of the bank, then the amount of the deduction would be 8 percent of the adjusted carrying value of all investments up to 15 percent of the bank’s Tier 1 capital, and 12 percent of the adjusted carrying value of all investments in excess of 15 percent of the bank’s Tier 1 capital.

(C) The total adjusted carrying value of any nonfinancial equity investment that is subject to deduction under this paragraph is excluded from the bank’s risk-weighted assets for purposes of computing the denominator of the bank’s risk-based capital ratio and from total assets for purposes of calculating the denominator of the leverage ratio.15

(D) This Appendix establishes minimum risk-based capital ratios and banks are at all times expected to maintain capital commensurate with the level and nature of the risks to which they are exposed. The risk to a bank from nonfinancial equity investments increases with its concentration in such investments and strong capital levels above the minimum requirements are particularly important when a bank has a high degree of concentration in nonfinancial equity investments (e.g., in excess of 50 percent of Tier 1 capital). The FDIC intends to monitor banks and apply heightened supervision to equity investment activities as appropriate, including where the bank has a high degree of concentration in nonfinancial equity investments, to ensure that each bank maintains capital levels that are appropriate in light of its equity investment activities. The FDIC also reserves authority to impose a higher capital charge in any circumstances, such as the level of risk of the particular investment or portfolio of investments, the risk management systems of the bank, or other information, indicate that a higher minimum capital requirement is appropriate.

(iv) SBIC investments. (A) No deduction is required for nonfinancial equity investments that are held by a bank through one or more SBICs that are consolidated with the bank or in one or more SBICs that are not consolidated with the bank to the extent that all such investments, in the aggregate, do not exceed 15 percent of the bank’s Tier 1 capital. Any nonfinancial equity investment that is held through an SBIC or in an SBIC and that is not required to be deducted from Tier 1 capital under this section II.B.6(iv) will be assigned a 100 percent risk-weight and included in the bank’s consolidated risk-weighted assets.19

15 For example, if 8 percent of the adjusted carrying value of a nonfinancial equity investment is deducted from Tier 1 capital, the entire adjusted carrying value of the investment will be excluded from both risk-weighted assets and total assets in calculating the respective denominators for the risk-based capital and leverage ratios.

19 If a bank has an investment in a SBIC that is consolidated for accounting purposes but that is not wholly owned by the bank, the adjusted carrying value of the bank’s nonfinancial equity investments through the SBIC is equal to the bank’s proportionate share of the adjusted carrying value of the
(B) To the extent the adjusted carrying value of all nonfinancial equity investments that a bank holds through one or more SBICs that are consolidated with the bank or in one or more SBICs that are not consolidated with the bank exceeds, in the aggregate, 15 percent of the bank’s Tier 1 capital, the appropriate percentage of such amounts (as set forth in the table in section II.B.(6)(iii)(A)) must be deducted from the bank’s common stockholders’ equity in determining the bank’s Tier 1 capital. In addition, the aggregate adjusted carrying value of all nonfinancial equity investments held by a bank through a consolidated SBIC and in a nonconsolidated SBIC (including any investments for which no deduction is required) must be included in determining, for purposes of the table in section II.B.(6)(iii)(A), the total amount of nonfinancial equity investments held by the bank in relation to its Tier 1 capital.

(v) Transition provisions. No deduction under this section II.B.(6) is required to be made with respect to the adjusted carrying value of any nonfinancial equity investment (or portion of such an investment) that was made by the bank prior to March 13, 2000, or that was made by the bank after such date pursuant to a binding written commitment entered into prior to March 13, 2000, provided that in either case the bank has continuously held the investment since the relevant investment date.21 For purposes of this section II.B.(6)(v) a nonfinancial equity investment made prior to March 13, 2000, includes any shares or other interests received by the bank through a stock split or stock dividend on an investment made prior to March 13, 2000, provided the bank provides no consideration for the shares or interests received and the transaction does not materially increase the bank’s proportional interest in the company. The exercise on or after March 13, 2000, of options or warrants acquired prior to March 13, 2000, is not considered to be an investment made prior to March 13, 2000, if the bank provides any consideration for the shares or interests received upon exercise of the options or warrants. Any nonfinancial equity investment (or portion thereof) that is not required to be deducted from Tier 1 capital under this section II.B.(6)(v) must be included in determining the total amount of nonfinancial equity investments held by the bank in relation to its Tier 1 capital for purposes of the table in section II.B.(6)(iii)(A).

SBIC’s investments in nonfinancial companies. The remainder of the SBIC’s adjusted carrying value (i.e., the minority interest holders’ proportionate share) is excluded from the risk-weighted assets of the bank. If a bank has an investment in a SBIC that is not consolidated for accounting purposes and has current information that identifies the percentage of the SBIC’s assets that are equity investments in nonfinancial companies, the bank may reduce the adjusted carrying value of its investment in the SBIC proportionately to reflect the percentage of the adjusted carrying value of the SBIC’s assets that are not equity investments in nonfinancial companies. If a bank reduces the adjusted carrying value of its investment in a non-consolidated SBIC to reflect financial investments of the SBIC, the amount of the adjustment will be risk weighted at 100 percent and included in the bank’s risk-weighted assets.

21For example, if a bank made an equity investment in 100 shares of a nonfinancial company prior to March 13, 2000, the adjusted carrying value of that investment would not be subject to a deduction under this section II.B.(6). However, if the bank made any additional equity investment in the company after March 13, 2000, such as by purchasing additional shares of the company (including through the exercise of options or warrants acquired before or after March 13, 2000) or by making a capital contribution to the company and such investment was not made pursuant to a binding written commitment entered into before March 13, 2000, the adjusted carrying value of the additional investment would be subject to a deduction under this section II.B.(6). In addition, if the bank sold and repurchased, after March 13, 2000, 40 shares of the company, the adjusted carrying value of those 40 shares would be subject to a deduction under this section II.B.(6).
held as available-for-sale (AFS), the adjusted carrying value of the investments would be the aggregate carrying value of those investments (as reflected on the consolidated balance sheet of the bank) less any unrealized gains on those investments that are included in other comprehensive income and not reflected in Tier 1 capital, and associated deferred tax liabilities.

(B) As discussed above with respect to consolidated SBICs, some equity investments may be in companies that are consolidated for accounting purposes. For investments in a nonfinancial company that is consolidated for accounting purposes under generally accepted accounting principles, the bank’s adjusted carrying value of the investment is determined under the equity method of accounting (net of any intangibles associated with the investment that are deducted from the bank’s core capital in accordance with section I.A.(1) of this appendix A). Even though the assets of the nonfinancial company are consolidated for accounting purposes, these assets (as well as the credit equivalent amounts of the company’s off-balance sheet items) should be excluded from the bank’s risk-weighted assets for regulatory capital purposes.

(vii) Equity investments. For purposes of this section II.B.(6), an equity investment means any equity instrument (including common stock, preferred stock, partnership interests, interests in limited liability companies, trust certificates and warrants and call options that give the holder the right to purchase an equity instrument), any equity feature of a debt instrument (such as a warrant or call option), and any debt instrument that is convertible into equity where the instrument or feature is held under one of the legal authorities listed in section II.B.(6)(ii) of this appendix A. An investment in any other instrument (including subordinated debt) may be treated as an equity investment if, in the judgment of the FDIC, the instrument is the functional equivalent of equity or exposes the bank to essentially the same risks as an equity instrument.

6. Asset-backed commercial paper programs. a. An asset-backed commercial paper (ABCP) program means a program that primarily issues externally rated commercial paper backed by assets or other exposures held in a bankruptcy-remote, special purpose entity. b. If a bank has multiple overlapping exposures (such as a program-wide credit enhancement and multiple pool-specific liquidity facilities) to an ABCP program that is not consolidated for risk-based capital purposes, the bank is not required to hold capital under duplicative risk-based capital requirements under this appendix against the overlapping position. Instead, the bank should apply to the overlapping position the applicable risk-based capital treatment that results in the highest capital charge.

C. Risk Weights for Balance Sheet Assets (see Table II)

The risk based capital framework contains five risk weight categories—0 percent, 20 percent, 50 percent, 100 percent, and 200 percent. In general, if a particular item can be placed in more than one risk category, it is assigned to the category that has the lowest risk weight. An explanation of the components of each category follows:

Category 1—Zero Percent Risk Weight. a. This category includes cash (domestic and foreign) owned and held in all offices of the bank or in transit; balances due from Federal Reserve Banks and central banks in other OECD countries; the portions of local currency claims on or unconditionally guaranteed by non-OECD central governments to the extent that the bank has liabilities booked in that currency; and gold bullion held in the bank’s own vaults or in another bank’s vaults on an allocated basis, to the extent it is offset by gold bullion liabilities.

b. The zero percent risk category also includes direct claims (including securities, loans, and leases) on, and the portions of claims that are unconditionally guaranteed by, OECD central governments and U.S.

22 Unrealized gains on available-for-sale equity investments may be included in Tier 2 capital to the extent permitted under section I.A.(2)(f) of this appendix A. In addition, the net unrealized losses on available-for-sale equity investments are deducted from Tier 1 capital in accordance with section I.A.(1) of this appendix A.

23 All other bullion holdings are to be assigned to the 100 percent risk weight category.

24 For purposes of determining the appropriate risk weights for this risk-based capital framework, the terms claims and securities refer to loans or other debt obligations of the entity on whom the claim is held. Investments in the form of stock or equity holdings in commercial or financial firms are generally assigned to the 100 percent risk category.

25 A central government is defined to include departments and ministries, including the central bank, of the central government. The U.S. central bank includes the 12 Federal Reserve Banks. The definition of central government does not include state, provincial or local governments or commercial enterprises owned by the central government. In addition, it does not include local government entities or commercial enterprises whose obligations are guaranteed by the central government. OECD central governments are defined as central governments of the
Government agencies. Federal Reserve Bank stock also is included in this category.

c. This category also includes claims on, and claims guaranteed by, qualifying securities firms incorporated in the United States or other members of the OECD-based group of countries that are collateralized by cash on deposit in the lending bank or by securities and guarantees by the United States or OECD central governments (including U.S. government agencies), provided that a positive margin of collateral is required to be maintained on such a claim on a daily basis, taking into account any change in a bank’s exposure to the obligor or counterparty under the claim in relation to the market value of the collateral held in support of the claim.

Category 2—20 Percent Risk Weight. a. This category includes short-term claims (including demand deposits) on, and portions of short-term claims that are guaranteed by, U.S. depository institutions and foreign banks. 25 Portions of claims collateralized by cash held in a segregated deposit account of the lending bank; cash items in process of collection, both foreign and domestic; and long-term claims on, and portions of long-term claims guaranteed by, U.S. depository institutions and OECD banks. 30 This category also includes a claim on, or guaranteed by, qualifying securities firms incorporated in the United States or other members of the OECD-based group of countries.

OECD-based group of countries. Non-OECD central governments are defined as central governments of countries that do not belong to the OECD-based group of countries. 26 For risk-based capital purposes U.S. Government agency is defined as an instrumentality of the U.S. Government whose debt obligations are fully and explicitly guaranteed as to the timely payment of principal and interest by the full faith and credit of the U.S. Government. These agencies include the Government National Mortgage Association (GNMA), the Veterans Administration (VA), the Federal Housing Administration (FHA), the Farmers Home Administration (FHA), the Export-Import Bank (Exim Bank), the Overseas Private Investment Corporation (OPIC), the Commodity Credit Corporation (CCC), and the Small Business Administration (SBA). U.S. Government agencies generally do not directly issue securities to the public; however, a number of U.S. Government agencies, such as GNMA, guarantee securities that are publicly held.

Claims guaranteed by U.S. depository institutions and foreign banks include risk participations in both bankers acceptances and standby letters of credit, as well as participations in commitments, that are conveyed to other U.S. depository institutions or foreign banks.

U.S. depository institutions are defined to include branches (foreign and domestic) of federally-insured banks and depository institutions chartered and headquartered in the 50 states of the United States, the District of Columbia, Puerto Rico, and U.S. territories and possessions. The definition encompasses banks, mutual or stock savings banks, savings or building and loan associations, cooperative banks, credit unions, international banking facilities of domestic depository institutions, and U.S.-chartered depository institutions owned by foreigners. However, this definition excludes branches and agencies of foreign banks located in the U.S. and banks holding companies.

Foreign banks are distinguished as either OECD banks or non-OECD banks. OECD banks include banks and their branches (foreign and domestic) organized under the laws of countries (other than the U.S.) that belong to the OECD-based group of countries. Non-OECD banks include banks and their branches (foreign and domestic) organized under the laws of countries that do not belong to the OECD-based group of countries. For risk-based capital purposes, a bank is defined as an institution that engages in the business of banking; is recognized as a bank by the bank supervisory or monetary authorities of the country of its organization or principal banking operations; receives deposits to a substantial extent in the regular course of business; and has the power to accept demand deposits.

Long-term claims on, or guaranteed by, non-OECD banks and all claims on bank holding companies are assigned to the 100 percent risk weight category, as are holdings of bank-issued securities that qualify as capital of the issuing banks for risk-based capital purposes.

Claims on a qualifying securities firm that are instruments the firm, or its parent company, uses to satisfy its applicable capital requirements are not eligible for this risk weight.

With regard to securities firms incorporated in the United States, qualifying securities firms are those securities firms that are broker-dealers registered with the Securities and Exchange Commission (SEC) and are in compliance with the SEC’s net capital rule, 17 CFR 240.15c3-1. With regard to securities firms incorporated in any other country in the OECD-based group of countries, qualifying securities firms are those securities firms that a bank is able to demonstrate are subject to consolidated supervision and regulation (covering their direct and indirect subsidiaries, but not necessarily their parent organizations) comparable to that imposed Continued
provided that: the qualifying securities firm has a long-term issuer credit rating, or a rating on at least one issue of long-term debt, in one of the three highest investment grade rating categories from a nationally recognized statistical rating organization; or the claim is guaranteed by the firm’s parent company and the parent company has such a rating. If ratings are available from more than one rating agency, the lowest rating will be used to determine whether the rating requirement has been met. This category also includes claims collateralized by securities that are liquid and readily marketable; and

(1) Is a reverse repurchase/repurchase agreement or securities lending/borrowing transaction executed using standard industry documentation;

(2) Is collateralized by debt or equity securities that are liquid and readily marketable;

(3) Is marked-to-market daily;

(4) Is subject to a daily margin maintenance requirement under the standardized documentation; and

(5) Can be liquidated, terminated, or accelerated immediately in bankruptcy or similar proceeding, and the security or collateral agreement will not be stayed or avoided, under applicable law of the relevant jurisdiction.

33 For example, a claim is exempt from the automatic stay in bankruptcy in the United States if it arises under a securities contract or a repurchase agreement subject to section 555 or 559 of the Bankruptcy Code, respectively (11 U.S.C. 555 or 559), a qualified financial guaranty claims on in one of the three highest investment grade rating categories from a nationally recognized statistical rating organization; or the claim is guaranteed by the firm’s parent company and the parent company has such a rating. If ratings are available from more than one rating agency, the lowest rating will be used to determine whether the rating requirement has been met. This category also includes claims collateralized by securities that are liquid and readily marketable; and

(1) Is a reverse repurchase/repurchase agreement or securities lending/borrowing transaction executed using standard industry documentation;

(2) Is collateralized by debt or equity securities that are liquid and readily marketable;

(3) Is marked-to-market daily;

(4) Is subject to a daily margin maintenance requirement under the standardized documentation; and

(5) Can be liquidated, terminated, or accelerated immediately in bankruptcy or similar proceeding, and the security or collateral agreement will not be stayed or avoided, under applicable law of the relevant jurisdiction.

33 For example, a claim is exempt from the automatic stay in bankruptcy in the United States if it arises under a securities contract or a repurchase agreement subject to section 555 or 559 of the Bankruptcy Code, respectively (11 U.S.C. 555 or 559), a qualified financial guaranty claim on collateral under section 11(e)(8) of the Federal Deposit Insurance Act (12 U.S.C. 1821(e)(8)), or a netting contract between financial institutions under sections 401–407 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (12 U.S.C. 4401–4407), or the Board’s Regulation EE (12 CFR part 231).

34 For risk-based capital purposes, U.S. Government-sponsored agencies are defined as agencies originally established or chartered by the U.S. Government to serve public purposes specified by the U.S. Congress but whose debt obligations are not explicitly guaranteed by the full faith and credit of the U.S. Government. These agencies include the Federal Home Loan Mortgage Corporation (FHLMC), the Federal National Mortgage Association (FNMA), the Farm Credit System, the Federal Home Loan Bank System, and the Student Loan Marketing Association (SLMA). For risk-based capital purposes, claims on U.S. Government-sponsored agencies also include capital stock in a Federal Home Loan Bank that is held as a condition of membership in that Bank.

35 For risk-based capital purposes, a conditional guarantee is deemed to exist if the viability of the guarantee by the OECD central government or the U.S. Government agency is dependent upon some affirmative action (e.g., servicing requirements on the part of the beneficiary of the guarantee). Portions of claims that are unconditionally guaranteed by OECD central governments or U.S. Government agencies are assigned to the zero percent risk category.

36 Claims on, or guaranteed by, states or other political subdivisions of countries that do not belong to the OECD-based group of countries are to be placed in the 100 percent risk weight category.
the International Bank for Reconstruction and Development (World Bank), International Finance Corporation the Inter-American Development Bank, the Asian Development Bank, the African Development Bank, the European Investment Bank, the European Bank for Reconstruction and Development, the Nordic Investment Bank, and other multilateral lending institutions or regional development institutions in which the U.S. Government is a shareholder or contributing member, as well as portions of claims guaranteed by such organizations or collateralized by their securities.

d. This category also includes recourse obligations, direct credit substitutes, residual interests (other than a credit-enhancing interest-only strip) and asset- or mortgage-backed securities rated in the highest or second highest investment grade category, e.g., AAA, AA, in the case of long-term ratings, or the highest rating category, e.g., A–1, P–1, in the case of short-term ratings.

a. Category 3—50 Percent Risk Weight. This category includes loans fully secured by first liens on one-to-four family residential properties, provided that such loans have been approved in accordance with prudent underwriting standards, including standards relating to the loan amount as a percent of the appraised value of the property, and provided that the loans are not past due 90 days or more or carried in nonaccrual status. The types of loans that qualify as loans secured by one-to-four family residential properties are listed in the instructions for preparation of the Consolidated Reports of Condition and Income. These properties may be either owner-occupied or rented. In addition, for risk-based capital purposes, loans secured by one-to-four family residential properties include loans to builders with substantial project equity for the construction of one-to-four family residences that have been presold under firm contracts to purchasers who have obtained firm commitments for permanent qualifying mortgage loans and have made substantial earnest money deposits. Such loans to builders will be considered prudently underwritten only if the bank has obtained sufficient documentation that the buyer of the home intends to purchase the home (i.e., has a legally binding written sales contract) and has the ability to obtain a mortgage loan sufficient to purchase the home (i.e., has a firm written commitment for permanent financing of the home upon completion), provided the following criteria are met:

   By order of the Board of Directors.

   1. The purchaser is an individual(s) who intends to occupy the residence and is not a partnership, joint venture, trust, corporation, or any other entity (including an entity acting as a sole proprietorship) that is purchasing one or more of the homes for speculative purposes;

   2. The builder must incur at least the first ten percent of the direct costs (i.e., actual costs of the land, labor, and material) before any drawdown is made under the construction loan and the construction loan may not exceed 80 percent of the sales price of the presold home;

   3. The purchaser has made a substantial "earnest money deposit" of no less than three percent of the sales price of the home and the deposit must be subject to forfeiture if the purchaser terminates the sales contract; and

   4. The earnest money deposit must be held in escrow by the bank financing the builder or by an independent party in a fiduciary capacity and the escrow agreement must provide that, in the event of default arising from the cancellation of the sales contract by the buyer, the escrow funds must first be used to defray any costs incurred by the bank.

b. This category also includes loans fully secured by first liens on multifamily residential properties, provided that:

   a. This category includes loans fully secured by first liens on multifamily residential properties referred to as "the International Bank for Reconstruction and Development (World Bank), International Finance Corporation the Inter-American Development Bank, the Asian Development Bank, the African Development Bank, the European Investment Bank, the European Bank for Reconstruction and Development, the Nordic Investment Bank, and other multilateral lending institutions or regional development institutions in which the U.S. Government is a shareholder or contributing member, as well as portions of claims guaranteed by such organizations or collateralized by their securities.

   b. This category also includes recourse obligations, direct credit substitutes, residual interests (other than a credit-enhancing interest-only strip) and asset- or mortgage-backed securities rated in the highest or second highest investment grade category, e.g., AAA, AA, in the case of long-term ratings, or the highest rating category, e.g., A–1, P–1, in the case of short-term ratings.

   a. Category 3—50 Percent Risk Weight. This category includes loans fully secured by first liens on one-to-four family residential properties, provided that such loans have been approved in accordance with prudent underwriting standards, including standards relating to the loan amount as a percent of the appraised value of the property, and provided that the loans are not past due 90 days or more or carried in nonaccrual status. The types of loans that qualify as loans secured by one-to-four family residential properties are listed in the instructions for preparation of the Consolidated Reports of Condition and Income. These properties may be either owner-occupied or rented. In addition, for risk-based capital purposes, loans secured by one-to-four family residential properties include loans to builders with substantial project equity for the construction of one-to-four family residences that have been presold under firm contracts to purchasers who have obtained firm commitments for permanent qualifying mortgage loans and have made substantial earnest money deposits. Such loans to builders will be considered prudently underwritten only if the bank has obtained sufficient documentation that the buyer of the home intends to purchase the home (i.e., has a legally binding written sales contract) and has the ability to obtain a mortgage loan sufficient to purchase the home (i.e., has a firm written commitment for permanent financing of the home upon completion), provided the following criteria are met:

   By order of the Board of Directors.

   1. The purchaser is an individual(s) who intends to occupy the residence and is not a partnership, joint venture, trust, corporation, or any other entity (including an entity acting as a sole proprietorship) that is purchasing one or more of the homes for speculative purposes;

   2. The builder must incur at least the first ten percent of the direct costs (i.e., actual costs of the land, labor, and material) before any drawdown is made under the construction loan and the construction loan may not exceed 80 percent of the sales price of the presold home;

   3. The purchaser has made a substantial "earnest money deposit" of no less than three percent of the sales price of the home and the deposit must be subject to forfeiture if the purchaser terminates the sales contract; and

   4. The earnest money deposit must be held in escrow by the bank financing the builder or by an independent party in a fiduciary capacity and the escrow agreement must provide that, in the event of default arising from the cancellation of the sales contract by the buyer, the escrow funds must first be used to defray any costs incurred by the bank.
(1) The loan amount does not exceed 80 percent of the value of the property securing the loan as determined by the most current appraisal or evaluation, whichever may be appropriate (75 percent if the interest rate on the loan changes over the term of the loan);

(2) For the property’s most recent fiscal year, the ratio of annual net operating income generated by the property (before payment of any debt service on the loan) to annual debt service on the loan is not less than 120 percent (115 percent if the interest rate on the loan changes over the term of the loan) or, in the case of a property owned by a cooperative housing corporation or nonprofit organization, the property generates sufficient cash flow to provide comparable protection to the bank;

(3) Amortization of principal and interest on the loan occurs over a period of not more than 30 years;

(4) The minimum original maturity for repayment of principal on the loan is not less than seven years;

(5) All principal and interest payments have been made on a timely basis in accordance with the terms of the loan for at least one year before the loan is placed in this category;

(6) The loan is not 90 days or more past due or carried in nonaccrual status; and

(7) The loan has been made in accordance with prudent underwriting standards.

c. This category also includes revenue (non-general obligation) bonds or similar obligations, including loans and leases, that are obligations of states or political subdivisions of the United States or other OECD central governments that entail some degree of transfer risk;43

d. This category also includes recourse obligations, direct credit substitutes, residual interests (other than a credit-enhancing interest-only strip) and asset- or mortgage-backed securities rated in an third highest investment grade category, e.g., A, in the case of long-term ratings, or the second highest rating category, e.g., A-2, P-2, in the case of short-term ratings.

Category 4—100 Percent Risk Weight. (a) All assets not included in the categories above in section II.C of this appendix A, except the assets specifically included in the 200 percent category below in section II.C of this appendix A and assets that are otherwise risk weighted in accordance with section II.B.5 of this appendix A, are assigned to this category, which comprises standard risk assets.

The bulk of the assets typically found in a loan portfolio would be assigned to the 100 percent category.

(b) This category includes:

(1) Long-term claims on, and the portions of long-term claims that are guaranteed by, non-OECD banks, and all claims on non-OECD central governments that entail some degree of transfer risk;43

(2) All claims on foreign and domestic private-sector obligors not included in the categories above in section II.C of this appendix A (including loans to nondepository financial institutions and bank holding companies);

(3) Claims on commercial firms owned by the public sector;

(4) Customer liabilities to the bank on acceptances outstanding involving standard risk claims;44

43Such assets include all non-local currency claims on, and the portions of claims that are guaranteed by, non-OECD central governments and those portions of local currency claims on, or guaranteed by, non-OECD central governments that exceed the local currency liabilities held by the bank.

44Customer liabilities on acceptances outstanding involving nonstandard risk claims, such as claims on U.S. depository institutions, are assigned to the risk category appropriate to the identity of the obligor or, if relevant, the nature of the collateral or guarantees backing the claims. Portions of acceptances conveyed as risk participations to U.S. depository institutions or foreign banks are assigned to the 20 percent risk category appropriate to short-term claims guaranteed by U.S. depository institutions and foreign banks.
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(5) Investments in fixed assets, premises, and other real estate owned;
(6) Common and preferred stock of corporations, including stock acquired for debts previously contracted;
(7) Commercial and consumer loans (except those assigned to lower risk categories due to recognized guarantees or collateral and loans secured by residential property that qualify for a lower risk weight);
(b) Recourse obligations, direct credit substitutes, residual interests (other than a credit-enhancing interest-only strip) and asset- or mortgage-backed securities rated in the lowest investment grade category, e.g., BBB, as well as certain positions (but not residual interests) which the bank rates pursuant to section II.B.5(g) of this appendix A;
(b) Industrial-development bonds and similar obligations issued under the auspices of states or political subdivisions of the OECD-based group of countries for the benefit of a private party or enterprise where that party or enterprise, not the government entity, is obligated to pay the principal and interest;
(10) All obligations of states or political subdivisions of countries that do not belong to the OECD-based group; and
(11) Stripped mortgage-backed securities and similar instruments, such as interest-only strips that are not credit-enhancing and principal-only strips.
(12) Claims representing capital of a qualifying securities firm;
(c) The following assets also are assigned a risk weight of 100 percent if they have not already been deducted from capital: investments in unconsolidated companies, joint ventures, or associated companies; instruments that qualify as capital issued by other banks; deferred tax assets; and mortgage servicing assets, nonmortgage servicing assets, and purchased credit card relationships.
(d) Subject to the requirements below, a bank may assign an asset not included in the categories above to the risk weight category applicable under the capital guidelines for bank holding companies (12 CFR part 225, appendix A), provided that all of the following conditions apply:
(1) The bank is not authorized to hold the asset under applicable law other than debt previously contracted or similar authority; and
(2) The risks associated with the asset are substantially similar to the risks of assets that are otherwise assigned to a risk weight category less than 100 percent under this appendix.
Category 5—200 Percent Risk Weight. This category includes:
(a) Externally rated recourse obligations, direct credit substitutes, residual interests (other than a credit-enhancing interest-only strip), and asset- and mortgage-backed securities that are rated one category below the lowest investment grade category, e.g., BB, to the extent permitted in section II.B.5(d) of this appendix A; and
(b) A position (but not a residual interest) in a securitization or structured finance program that is not rated by an NRSRO for which the bank determines that the credit risk is equivalent to one category below investment grade, e.g., BB, to the extent permitted in section II.B.5(g) of this appendix A.

D. Conversion Factors for Off-Balance Sheet Items (see Table III)

The face amount of an off-balance sheet item is generally incorporated into the risk-weighted assets in two steps. The face amount is first multiplied by a credit conversion factor, except as otherwise specified in section II.B.5 of this appendix A for direct credit substitutes and recourse obligations. The resultant credit equivalent amount is assigned to the appropriate risk category according to the obligor or, if relevant, the guarantor, the nature of any collateral, or external credit ratings.46

1. Items With a 100 Percent Conversion Factor. (a) Except as otherwise provided in section II.B.5 of this appendix A, the full amount of an asset or transaction supported, in whole or in part, by a direct credit substitute or a recourse obligation. Direct credit substitutes and recourse obligations are defined in section II.B.5 of this appendix A.
(b) Sale and repurchase agreements, if not already included on the balance sheet, and forward agreements. Forward agreements are legally binding contractual obligations to purchase assets with drawdown which is certain at a specified future date. Such obligations include forward purchases, forward forward deposits placed, and partly-paid shares and securities; they do not include commitments to make residential mortgage loans or forward foreign exchange contracts.
(c) Securities lent by a bank are treated in one of two ways, depending upon whether the lender is exposed to risk of loss. If a bank, as agent for a customer, lends the customer’s...
Commitments are defined as any legally binding arrangements that obligate a bank to extend credit in the form of loans or lease financing receivables; to purchase loans, securities, or other assets; or to participate in loans and leases. Commitments also include overdraft facilities, revolving credit, home equity and mortgage lines of credit, eligible ABCP liquidity facilities, and similar transactions. Normally, commitments involve a written contract or agreement and a commitment fee, or some other form of consideration. Commitments are included in weighted-risk assets regardless of whether they contain material adverse change clauses or other provisions that are intended to relieve the issuer of its funding obligation under certain conditions. In the case of commitments structured as syndications, where the bank is obligated solely for its pro rata share, only the bank’s proportional share of the syndicated commitment is taken into account in calculating the risk-based capital ratio.

ii. Banks that are subject to the market risk rules in appendix C to part 325 are required to convert the notional amount of eligible ABCP liquidity facilities, in form or in substance, with an original maturity of over one year that are carried in the trading account at 50 percent to determine the appropriate credit equivalent amount even though those facilities are structured or characterized as derivatives or other trading book assets. Liquidity facilities that support ABCP, in form or in substance, (including those positions to which the market risk rules may not be applied as set forth in section 2(a) of appendix C of this part) that are not eligible ABCP liquidity facilities are to be considered recourse obligations or direct credit substitutes, and assessed the appropriate risk-based capital treatment in accordance with section II.B.5. of this appendix.

c.1. Commitments are defined as any legally binding arrangements that obligate a bank to extend credit in the form of loans or lease financing receivables; to purchase loans, securities, or other assets; or to participate in loans and leases. Commitments also include overdraft facilities, revolving credit, home equity and mortgage lines of credit, eligible ABCP liquidity facilities, and similar transactions. Normally, commitments involve a written contract or agreement and a commitment fee, or some other form of consideration. Commitments are included in weighted-risk assets regardless of whether they contain material adverse change clauses or other provisions that are intended to relieve the issuer of its funding obligation under certain conditions. In the case of commitments structured as syndications, where the bank is obligated solely for its pro rata share, only the bank’s proportional share of the syndicated commitment is taken into account in calculating the risk-based capital ratio.

ii. Banks that are subject to the market risk rules in appendix C to part 325 are required to convert the notional amount of eligible ABCP liquidity facilities, in form or in substance, with an original maturity of over one year that are carried in the trading account at 50 percent to determine the appropriate credit equivalent amount even though those facilities are structured or characterized as derivatives or other trading book assets. Liquidity facilities that support ABCP, in form or in substance, (including those positions to which the market risk rules may not be applied as set forth in section 2(a) of appendix C of this part) that are not eligible ABCP liquidity facilities are to be considered recourse obligations or direct credit substitutes, and assessed the appropriate risk-based capital treatment in accordance with section II.B.5. of this appendix.

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other similar arrangements also are converted at 50 percent. These are facilities under which a borrower can issue on a revolving basis short-term notes in its own name, but for which the underwriting banks have a legally binding commitment either to purchase any notes the borrower is unable to sell by the rollover date or to advance funds to the borrower.

3. Items With a 20 Percent Conversion Factor. Short-term, self-liquidating, trade-related contingencies which arise from the movement of goods are converted at 20 percent. Such contingencies include commercial letters of credit and other documentary letters of credit collateralized by the underlying shipments.

4. Items With a 10 Percent Conversion Factor.

a. Unused portions of eligible ABCP liquidity facilities with an original maturity of one year or less that provide liquidity support to ABCP also are converted at 10 percent.

b. Banks that are subject to the market risk rules in appendix C to part 325 are required to convert the notional amount of eligible ABCP liquidity facilities, in form or in substance, with an original maturity of one year or less that are carried in the trading account at 10 percent to determine the appropriate credit equivalent amount even though those facilities are structured or characterized as derivatives or other trading book assets. Liquidity facilities that provide liquidity support to ABCP, in form or in substance, (including those positions to which the market risk rules may not be applied as set forth in section 2(a) of appendix C of this part) that are not eligible ABCP liquidity facilities are to be considered recourse obligations or direct credit substitutes and assessed the appropriate risk-based capital requirement in accordance with section II.B.5. of this appendix.

5. Items With a Zero Percent Conversion Factor. These include unused portions of commitments, with the exception of eligible ABCP liquidity facilities, with an original maturity of one year or less, or which are unconditionally cancelable at any time, provided a separate credit decision is made before each drawing under the facility. Unused portions of retail credit card lines and related plans are deemed to be short-term commitments if the bank, in accordance with applicable law, has the unconditional option to cancel the credit line at any time.

E. Derivative Contracts (Interest Rate, Exchange Rate, Commodity (including precious metal) and Equity Derivative Contracts)

1. Credit equivalent amounts are computed for each of the following off-balance-sheet derivative contracts:

(a) Interest Rate Contracts
   (i) Single currency interest rate swaps.
   (ii) Basis swaps.
   (iii) Forward rate agreements.

(b) Exchange Rate Contracts
   (i) Cross-currency interest rate swaps.
   (ii) Forward foreign exchange contracts.

(c) Commodity (including precious metal) or Equity Derivative Contracts
   (i) Commodity- or equity-linked swaps.
   (ii) Commodity- or equity-linked options purchased.

(d) Any other instrument linked to exchange rates that gives rise to similar credit risks.

2. Exchange rate contracts with an original maturity of 14 calendar days or less and derivative contracts traded on exchanges that require daily receipt and payment of cash variation margin may be excluded from the risk-based ratio calculation. Gold contracts are accorded the same treatment as exchange rate contracts except gold contracts with an original maturity of 14 calendar days or less are included in the risk-based calculation. Over-the-counter options purchased are included and treated in the same way as other derivative contracts.

3. Credit Equivalent Amounts for Derivative Contracts. (a) The credit equivalent amount of a derivative contract that is not subject to a qualifying bilateral netting contract in accordance with section II.B.5. of this appendix A is equal to the sum of:

   (i) The current exposure (which is equal to the mark-to-market value, if positive, and is sometimes referred to as the replacement cost) of the contract; and

   (ii) An estimate of the potential future credit exposure.

(b) The current exposure is determined by the mark-to-market value of the contract. If the mark-to-market value is positive, then the current exposure is equal to that mark-to-market value. If the mark-to-market value is zero or negative, then the current exposure is zero.

(c) The potential future credit exposure of a contract, including a contract with a negative mark-to-market value, is estimated by multiplying the notional principal amount

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Mark-to-market values are measured in dollars, regardless of the currency or currencies specified in the contract and should reflect changes in both underlying rates, prices and indices, and counterparty credit quality.
of the contract by a credit conversion factor. Banks should, subject to examiner review, use the effective rather than the apparent or stated notional amount in this calculation. The credit conversion factors are:

<table>
<thead>
<tr>
<th>Conversion Factor Matrix</th>
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</thead>
<tbody>
<tr>
<td>Remaining maturity</td>
</tr>
<tr>
<td>One year or less</td>
</tr>
<tr>
<td>More than one year to five years</td>
</tr>
<tr>
<td>More than five years</td>
</tr>
</tbody>
</table>

(d) For contracts that are structured to settle outstanding exposure on specified dates and where the terms are reset such that the market value of the contract is zero on these specified dates, the remaining maturity is equal to the time until the next reset date. For interest rate contracts with remaining maturities of more than one year and that meet these criteria, the conversion factor is subject to a minimum value of 0.5 percent.

(e) For contracts with multiple exchanges of principal, the conversion factors are to be multiplied by the number of remaining payments in the contract. Derivative contracts not explicitly covered by any of the columns of the conversion factor matrix are to be treated as "other commodities."

(f) No potential future exposure is calculated for single currency interest rate swaps in which payments are made based upon two floating rate indices (so-called "riding floating or basis swaps"); the credit exposure on these contracts is evaluated solely on the basis of their mark-to-market values.

4. Risk Weights and Avoidance of Double Counting. (a) Once the credit equivalent amount for a derivative contract, or a group of derivative contracts subject to a qualifying bilateral netting agreement, has been determined, that amount is assigned to the risk category appropriate to the counterparty, or, if relevant, the guarantor or the nature of any collateral. However, the maximum weight that will be applied to the credit equivalent amount of such contracts is 50 percent.

(b) In certain cases, credit exposures arising from the derivative contracts covered by these guidelines may already be reflected, in part, on the balance sheet. To avoid double counting such exposures in the assessment of capital adequacy and, perhaps, assigning inappropriate risk weights, counterparty credit exposures arising from the types of instruments covered by these guidelines may need to be excluded from balance sheet assets in calculating a bank’s risk-based capital ratio.

(c) The FDIC notes that the conversion factors set forth in section II.E.3. of appendix A, which are based on observed volatilities of the particular types of instruments, are subject to review and modification in light of changing volatilities or market conditions.

(d) Examples of the calculation of credit equivalent amounts for these types of contracts are contained in Table IV of this appendix A.

5. Netting. (a) For purposes of this appendix A, netting refers to the offsetting of positive and negative mark-to-market values when determining a current exposure to be used in the calculation of a credit equivalent amount. Any legally enforceable form of bilateral netting (that is, netting with a single counterparty) of derivative contracts is recognized for purposes of calculating the credit equivalent amount provided that:

(i) The netting is accomplished under a written netting contract that creates a single legal obligation, covering all included individual contracts, with the effect that the bank would have a claim or obligation to receive or pay, respectively, only the net amount of the sum of the positive and negative mark-to-market values on included individual contracts in the event that a counterparty, or a counterparty to whom the contract has been validly assigned, fails to perform due to default, bankruptcy, liquidation, or similar circumstances;

(ii) The bank obtains a written and reasoned legal opinion(s) representing that in the event of a legal challenge, including one resulting from default, insolvency, bankruptcy or similar circumstances, the relevant court and administrative authorities would find the bank’s exposure to be such a net amount under:

1. The law of the jurisdiction in which the counterparty is chartered or the equivalent location in the case of noncorporate entities and, if a branch of the counterparty is involved, then also under the law of the jurisdiction in which the branch is located;

2. The law that governs the individual contracts covered by the netting contract; and

3. The law that governs the netting contract.

(iii) The bank establishes and maintains procedures to ensure that the legal characteristics of netting contracts are kept under
review in the light of possible changes in relevant law; and
(iv) The bank maintains in its file documentation adequate to support the netting of derivative contracts, including a copy of the bilateral netting contract and necessary legal opinions.
(b) A contract containing a walkaway clause is not eligible for netting for purposes of calculating the credit equivalent amount.\(^{50}\)
(c) By netting individual contracts for the purpose of calculating its credit equivalent amount, a bank represents that it has met the requirements of this appendix A and all the appropriate documents are in the bank’s files and available for inspection by the FDIC. Upon determination by the FDIC that a bank’s files are inadequate or that a netting contract may not be legally enforceable under any one of the bodies of law described in paragraphs (ii)(1) through (3) of section II.E.5.(a) of this appendix A, underlying individual contracts may be treated as though they were not subject to the netting contract.
(d) The credit equivalent amount of derivative contracts that are subject to a qualifying bilateral netting contract is calculated by adding:
(i) The net current exposure of the netting contract; and
(ii) The sum of the estimates of potential future exposure for all individual contracts subject to the netting contract, adjusted to take into account the effects of the netting contract.\(^{51}\)
(e) The net current exposure is the sum of all positive and negative mark-to-market values of the individual contracts subject to the netting contract. If the net sum of the mark-to-market values is positive, then the net current exposure is equal to that sum. If the net sum of the mark-to-market values is zero or negative, then the net current exposure is zero.
(f) The effects of the bilateral netting contract on the gross potential future exposure are recognized through application of a formula, resulting in an adjusted add-on amount \(A_{\text{adj}}\). The formula, which employs the ratio of net current exposure to gross current exposure (NGR) is expressed as:
\[
A_{\text{adj}} = (0.4 \times A_{\text{gross}}) + 0.6(\text{NGR} \times A_{\text{gross}})
\]
\(^{50}\) For purposes of this section, a walkaway clause means a provision in a netting contract that permits a non-defaulting counterparty to make lower payments than it would make otherwise under the contract, or no payment at all, to a defaulter or to the estate of a defaulter, even if a defaulter or the estate of a defaulter is a net creditor under the contract.

The effect of this formula is that \(A_{\text{adj}}\) is the weighted average of \(A_{\text{gross}}\) and \(A_{\text{gross}}\) adjusted by the NGR.
(g) The NGR may be calculated in either one of two ways—referred to as the counterparty-by-counterparty approach and the aggregate approach.
(i) Under the counterparty-by-counterparty approach, the NGR is the ratio of the net current exposure of the netting contract to the gross current exposure of the netting contract. The gross current exposure is the sum of the current exposures of all individual contracts subject to the netting contract calculated in accordance with section II.E. of this appendix A.
(ii) Under the aggregate approach, the NGR is the ratio of the sum of all of the net current exposures for qualifying bilateral netting contracts to the sum of all of the gross current exposures for those netting contracts (each gross current exposure is calculated in the same manner as in section II.E.5.(g)(i) of this appendix A). Net negative mark-to-market values to individual counterparties cannot be used to offset net positive current exposures to other counterparties.
(iii) A bank must use consistently either the counterparty-by-counterparty approach of the aggregate approach to calculate the NGR. Regardless of the approach used, the NGR should be applied individually to each qualifying bilateral netting contract to determine the adjusted add-on for that netting contract.

III. MINIMUM RISK-BASED CAPITAL RATIO

Subject to section II.B.5. of this appendix A, banks generally will be expected to meet a minimum ratio of qualifying total capital to risk-weighted assets of 8 percent, of which at least 4 percentage points should be in the form of core capital (Tier 1). Any bank that does not meet the minimum risk-based capital ratio, or whose capital is otherwise considered inadequate, generally will be expected to develop and implement a capital plan for achieving an adequate level of capital, consistent with the provisions of this risk-based capital framework and §325.104, the specific circumstances affecting the individual bank, and the requirements of any related agreements between the bank and the FDIC.

\(^{51}\) For purposes of calculating potential future credit exposure for foreign exchange contracts and other similar contracts in which notional principal is equivalent to cash flows, total notional principal is defined as the net receipts to each party falling due on each value date in each currency.
TABLE I—DEFINITION OF QUALIFYING CAPITAL

<table>
<thead>
<tr>
<th>Components</th>
<th>Minimum requirements</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) CORE CAPITAL (Tier 1)</td>
<td>Must equal or exceed 4% of weighted-risk assets.</td>
</tr>
<tr>
<td>(a) Common stockholders’ equity</td>
<td>No limit.</td>
</tr>
<tr>
<td>(b) Noncumulative perpetual preferred stock and any related surplus.</td>
<td>No limit.</td>
</tr>
<tr>
<td>(c) Minority interest in equity accounts of consolidated</td>
<td>No limit.</td>
</tr>
<tr>
<td>(d) All intangible assets other than certain mortgage servicing assets, nonmortgage servicing assets and purchased credit card relationships.</td>
<td>No limit.</td>
</tr>
<tr>
<td>(e) Less: Certain credit-enhancing interest-only strips and nonfinancial equity investments required to be deducted from capital.</td>
<td>No limit.</td>
</tr>
<tr>
<td>(f) Less: Certain deferred tax assets.</td>
<td>No limit.</td>
</tr>
<tr>
<td>(2) SUPPLEMENTARY CAPITAL (Tier 2)</td>
<td>Total of tier 2 is limited to 100% of tier 1.</td>
</tr>
<tr>
<td>(a) Allowance for loan and lease losses</td>
<td>Limited to 10% of weighted-risk assets.</td>
</tr>
<tr>
<td>(b) Unrealized gains on certain equity securities.</td>
<td>Limited to 4% of pretax net unrealized gains.</td>
</tr>
<tr>
<td>(c) Cumulative perpetual and long-term preferred stock (original maturity of 20 years or more) and any related surplus.</td>
<td>No limit within tier 2; long-term preferred is amortized for capital purposes as it approaches maturity.</td>
</tr>
<tr>
<td>(d) Auction rate and similar preferred stock (both cumulative and non-cumulative).</td>
<td>No limit within Tier 2.</td>
</tr>
<tr>
<td>(e) Hybrid capital instruments (including mandatory convertible debt securities).</td>
<td>No limit within Tier 2.</td>
</tr>
<tr>
<td>(f) Term subordinated debt and intermediate-term preferred stock (original weighted average maturity of five years or more).</td>
<td>Term subordinated debt and intermediate-term preferred stock are limited to 50% of Tier 1 and amortized for capital purposes as they approach maturity.</td>
</tr>
<tr>
<td>(3) DEDUCTIONS (from sum of tier 1 and tier 2)</td>
<td>On a case-by-case basis or as a matter of policy after formal consideration of relevant issues.</td>
</tr>
<tr>
<td>(a) Investments in banking and finance subsidiaries that are not consolidated for regulatory capital purposes</td>
<td>Must equal or exceed 8% of weighted-risk assets.</td>
</tr>
<tr>
<td>(b) Intentional, reciprocal cross-holdings of capital securities issued by banks</td>
<td></td>
</tr>
<tr>
<td>(c) Minority interest in equity accounts of consolidated joint ventures</td>
<td></td>
</tr>
<tr>
<td>(4) TOTAL CAPITAL</td>
<td></td>
</tr>
</tbody>
</table>

1No express limits are placed on the amounts of nonvoting common, noncumulative perpetual preferred stock, and minority interests that may be recognized as part of Tier 1 capital. However, voting common stockholders’ equity capital generally will be expected to be the dominant form of Tier 1 capital and banks should avoid undue reliance on other Tier 1 capital elements.

2The amounts of mortgage servicing assets, nonmortgage servicing assets and purchased credit card relationships that can be recognized for purposes of calculating Tier 1 capital are subject to the limitations set forth in § 325.5(f). All deductions are for capital purposes only; deductions would not affect accounting treatment.

3The amounts of credit-enhancing interest-only strips that can be recognized for purposes of calculating Tier 1 capital are subject to the limitations set forth in § 325.5(f). The amounts of nonfinancial equity investments that must be deducted for purposes of calculating Tier 1 capital are set forth in section II.B.(6) of appendix A to part 325.

4Deferred tax assets are subject to the capital limitations set forth in § 325.5(g).

5Amounts in excess of limitations are permitted but do not qualify as capital.

6Unrealized gains on equity securities are subject to the capital limitations set forth in paragraph I.A(2)(f) of appendix A to part 325.

Calculation of the Risk-Based Capital Ratio

When calculating the risk-based capital ratio under the framework set forth in this statement of policy, qualifying total capital (the numerator) is divided by risk-weighted assets (the denominator). The process of determining the numerator for the ratio is summarized in Table I. The calculation of the denominator is based on the risk weights and conversion factors that are summarized in Tables II and III.

When determining the amount of risk-weighted assets, balance sheet assets are assigned an appropriate risk weight (see Table II) and off-balance sheet items are first converted to a credit equivalent amount (see Table III) and then assigned to one of the risk weight categories set forth in Table II.

The balance sheet assets and the credit equivalent amount of off-balance sheet items are then multiplied by the appropriate risk weight percentages and the sum of these risk-weighted amounts is the gross risk-weighted asset figure used in determining the denominator of the risk-based capital ratio. Any items deducted from capital when computing the amount of qualifying capital may also be excluded from risk-weighted assets when calculating the denominator for the risk-based capital ratio.

TABLE II—SUMMARY OF RISK WEIGHTS AND RISK CATEGORIES

Category 1—Zero Percent Risk Weight

(1) Cash (domestic and foreign).
Federal Deposit Insurance Corporation

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(2) Balances due from Federal Reserve Banks and central banks in other OECD countries.

(3) Direct claims on, and portions of claims unconditionally guaranteed by, the U.S. Treasury, U.S. Government agencies,1 or central governments in other OECD countries.

(4) Portions of local currency claims on, or unconditionally guaranteed by, non-OECD central governments (including non-OECD central banks), to the extent the bank has liabilities booked in that currency.

(5) Gold bullion held in the bank’s own vaults or in another bank’s vaults on an allocated basis, to the extent that it is offset by gold bullion liabilities.

(6) Federal Reserve Bank stock.

(7) Claims on, or guaranteed by, qualifying securities firms incorporated in the United States or other members of the OECD-based group of countries that are collateralized by cash on deposit in the lending bank or by securities issued or guaranteed by the United States or OECD central governments (including U.S. government agencies), provided that a positive margin of collateral is required to be maintained on such a claim on a daily basis, taking into account any change in a bank’s exposure to the obligor or counterparty under the claim in relation to the market value of the collateral held in support of the claim.

Category 2—20 Percent Risk Weight

(1) Cash items in the process of collection.

(2) All claims (long- and short-term) on, and portions of claims (long- and short-term) guaranteed by, U.S. depository institutions and OECD banks.

(3) Short-term (remaining maturity of one year or less) claims on, and portions of short-term claims guaranteed by, non-OECD central banks.

(4) Portions of loans and other claims conditionally guaranteed by the U.S. Treasury, U.S. Government agencies,1 or central governments in other OECD countries and portions of local currency claims conditionally guaranteed by non-OECD central governments to the extent that the bank has liabilities booked in that currency.

(5) Securities and other claims on, and portions of claims guaranteed by, U.S. Government-sponsored agencies.2

1For the purpose of calculating the risk-based capital ratio, a U.S. Government agency is defined as an instrumentality of the U.S. Government whose obligations are fully and explicitly guaranteed as to the timely repayment of principal and interest by the full faith and credit of the U.S. Government.

2For the purpose of calculating the risk-based capital ratio, a U.S. Government-sponsored agency is defined as an agency origin-

(6) Portions of loans and other claims (including repurchase agreements) collateralized1 by securities issued or guaranteed by the U.S. Treasury, U.S. Government agencies, U.S. Government-sponsored agencies or central governments in other OECD countries.

(7) Portions of loans and other claims collateralized2 by cash on deposit in the lending bank.

(8) General obligation claims on, and portions of claims guaranteed by, the full faith and credit of states or other political subdivisions of OECD countries, including U.S. state and local governments.

(9) Claims on, and portions of claims guaranteed by, official multilateral lending institutions or regional development institutions in which the U.S. Government is a shareholder or a contributing member.

(10) Portions of claims collateralized3 by securities issued by official multilateral lending institutions or regional development institutions in which the U.S. Government is a shareholder or contributing member.

(11) Investments in shares of mutual funds whose portfolios are permitted to hold only assets that qualify for the zero or 20 percent risk categories.

(12) Recourse obligations, direct credit substitutes, residual interests (other than credit-enhancing interest-only strips) and asset or mortgage-backed securities rated in either of the two highest investment grade categories, e.g., AAA or AA, in the case of long-term ratings, or the highest rating category, e.g., A–1, P–1, in the case of short-term ratings.

(13) Claims on, and claims guaranteed by, qualifying securities firms incorporated in the United States or other member of the OECD-based group of countries provided that:

a. The qualifying securities firm has a rating in one of the top three investment grade rating categories from a nationally recognized statistical rating organization; or

b. The claim is guaranteed by a qualifying securities firm’s parent company with such a rating.

(14) Certain collateralized claims on qualifying securities firms in the United States or other member of the OECD-based group of countries, without regard to satisfaction of the rating standard, provided that the claim arises under a contract that:

1For the purpose of calculating the risk-based capital ratio, a U.S. Government agency is defined as an instrumentality of the U.S. Government whose obligations are fully and explicitly guaranteed as to the timely repayment of principal and interest by the full faith and credit of the U.S. Government.

2For the purpose of calculating the risk-based capital ratio, a U.S. Government-sponsored agency is defined as an agency origi-

3Degree of collateralization is determined by current market value.
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a. Is a reverse repurchase/repurchase agreement or securities lending/borrowing transaction executed under standard industry documentation;
b. Is collateralized by liquid and readily marketable debt or equity securities;
c. Is marked to market daily;
d. Is subject to a daily margin maintenance requirement under the standard documentation; and

e. Can be liquidated, terminated, or accelerated immediately in bankruptcy or similar proceeding, and the security or collateral agreement will not be stayed or avoided, under applicable law of the relevant country.

Category 3—50 Percent Risk Weight

(1) Loans fully secured by first liens on one-to-four family residential properties (including certain presold residential construction loans), provided that the loans were approved in accordance with prudent underwriting standards and are not past due 90 days or more or carried in nonaccrual status.

(2) Loans fully secured by first liens on multifamily residential properties that have been prudently underwritten and meet specified requirements with respect to loan-to-value ratio, level of annual net operating income to required debt service, maximum amortization period, minimum original maturity, and demonstrated timely repayment performance.

(3) Recourse obligations, direct credit substitutes, residual interests (other than credit-enhancing interest-only strips) and asset- or mortgage-backed securities rated in the third-highest investment grade category, e.g., A, in the case of long-term ratings, or the second highest rating category, e.g., A–2, P–2, in the case of short-term ratings.

(4) Revenue bonds or similar obligations, including loans and leases, that are obligations of U.S. state or political subdivisions of the United States or other OECD countries but for which the government entity is committed to repay the debt only out of revenues from the specific projects financed.

(5) Credit equivalent amounts of interest rate and foreign exchange rate related contracts, except for those assigned to a lower risk category.

Category 4—100 Percent Risk Weight

(1) All other claims on private obligors.

(2) Claims on, or guaranteed by, non-OECD banks with a remaining maturity exceeding one year.

(3) Claims on non-OECD central governments that are not included in item 4 of Category 1 or Item 3 of Category 2, and all claims on non-OECD state and local governments.

(4) Obligations issued by U.S. state or local governments or other OECD local governments (including industrial development authorities and similar entities) that are repayable solely by a private party or enterprise.

(5) Premises, plant, and equipment; other fixed assets; and other real estate owned.

(6) Investments in any unconsolidated subsidiaries, joint ventures, or associated companies—if not deducted from capital.

(7) Instruments issued by other banking organizations that qualify as capital.

(8) Claims on commercial firms owned by the U.S. Government or foreign governments.

(9) Recourse obligations, direct credit substitutes, residual interests (other than credit-enhancing interest-only strips) and asset- and mortgage-backed securities that are rated one category below the lowest investment grade category, e.g., BB, to the extent permitted in section II.B.5(d) of this appendix A; and

(10) A position (but not a residual interest) extended in connection with a securitization or structured financing program that is not rated by an NRSRO for which the bank determines that the credit risk is equivalent to one category below investment grade, e.g., BB, to the extent permitted in section II.B.5(g) of this appendix A.

[54 FR 11509, Mar. 21, 1989]

EDITORIAL NOTE: For Federal Register citations affecting appendix A to part 325, see the List of CFR Sections Affected, which appears in the Finding Aids section of the printed volume and at www.fdsys.gov.

EDITORIAL NOTE: At 76 FR 37629, June 28, 2011, appendix A to part 325 was amended, however, the amendment could not be incorporated due to the inaccurate amendatory instruction. The new footnote 45 could not be added because there was no text for a new 45 to incorporate.

4 In general, for each off-balance sheet item, a conversion factor (see Table III) must be applied to determine the “credit equivalent amount” prior to assigning the off-balance sheet item to a risk weight category.