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

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

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

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

(e) *Credit derivatives without restructuring as a credit event.* If a national bank or Federal savings association recognizes an eligible credit derivative that does not include as a credit event a restructuring of the hedged exposure involving forgiveness or postponement of principal, interest, or fees that results in a credit loss event (that is, a charge-off, specific provision, or other similar debit to the profit and loss account), the national bank or Federal savings association must apply the following adjustment to the effective notional amount of the credit derivative:

$$P_r = P_m \times 0.60,$$

where:

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

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

(f) *Currency mismatch.* (1) If a national bank or Federal savings association recognizes an eligible guarantee or eligible credit derivative that is denominated in a currency different from that in which the hedged exposure is denominated, the national bank or Federal savings association must apply the following formula to the effective notional amount of the guarantee or credit derivative:

$$P_c = P_{r\ x}\ (1 - H_{FX}),$$

where:

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

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

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

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

(i) The own-estimates haircuts in § 3.132(b)(2)(iii);

(ii) The simple VaR methodology in § 3.132(b)(3); or

(iii) The internal models methodology in § 3.132(d).

(3) A national bank or Federal savings association must adjust H_{FX} calculated in paragraph (f)(2) of this section upward if the national bank or Federal savings association revalues the guarantee or credit derivative less frequently than once every ten business days using the square root of time formula provided in § 3.132(b)(2)(iii)(A)(*2*).

§ 3.135 Guarantees and credit derivatives: double default treatment.

(a) *Eligibility and operational criteria for double default treatment.* A national bank or Federal savings association may recognize the credit risk mitigation benefits of a guarantee or credit derivative covering an exposure described in § 3.134(a)(1) by applying the double default treatment in this section if all the following criteria are satisfied:

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

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

(ii) An eligible credit derivative that meets the requirements of § 3.134(b)(2) and that is issued by an eligible double default guarantor.

(2) The guarantee or credit derivative is:

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

(ii) An nth-to-default credit derivative (subject to the requirements of §3.142(m).

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

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

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

(ii) An affiliate of the guarantor.

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

(6) The national bank or Federal savings association has implemented a process (which has received the prior, written approval of the OCC) to detect excessive correlation between the creditworthiness of the obligor of the hedged exposure and the protection provider. If excessive correlation is present, the national bank or Federal savings association may not use the double default treatment for the hedged exposure.

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

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

(1) For the protected exposure, the national bank or Federal savings association must set EAD equal to P and calculate its risk-weighted asset amount as provided in paragraph (e) of this section; and

(2) For the unprotected exposure, the national bank or Federal savings association must set EAD equal to the EAD of the original exposure minus P and then calculate its risk-weighted asset amount as provided in §3.131.

(d) *Mismatches*. For any hedged exposure to which a national bank or Federal savings association applies double default treatment under this part, the national bank or Federal savings association must make applicable adjustments to the protection amount as required in §3.134(d), (e), and (f).

(e) *The double default dollar risk-based capital requirement*. The dollar risk-based capital requirement for a hedged exposure to which a national bank or Federal savings association has applied double default treatment is K_{DD} multiplied by the EAD of the exposure. K_{DD} is calculated according to the following formula:

$$K_{DD} = K_o \times (0.15 + 160 \times PD_g),$$

Where:

(1)

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

(2) PD_g = PD of the protection provider.

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

(4) LGD_g =

(i) The lower of the LGD of the hedged exposure (not adjusted to reflect the guarantee or credit derivative) and the LGD of the guarantee or credit derivative, if the guarantee or credit derivative provides the national bank or Federal savings association with the option to receive immediate payout on triggering the protection; or

(ii) The LGD of the guarantee or credit derivative, if the guarantee or credit derivative does not provide the national bank or Federal savings association with the option to receive immediate payout on triggering the protection; and

(5) ρ_{os} (asset value correlation of the obligor) is calculated according to the appropriate formula for (R) provided in Table 1 in § 3.131, with PD equal to PD_o.

(6) b (maturity adjustment coefficient) is calculated according to the formula for b provided in Table 1 in § 3.131, with PD equal to the lesser of PD_o and PD_g; and

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

§ 3.136 Unsettled transactions.

(a) *Definitions.* For purposes of this section:

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

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

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

(4) The positive current exposure of a national bank or Federal savings association for a transaction is the difference between the transaction value at the agreed settlement price and the current market price of the transaction, if the difference results in a credit exposure of the national bank or Federal savings association to the counterparty.

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

(1) Cleared transactions that are subject to daily marking-to-market and daily receipt and payment of variation margin;

(2) Repo-style transactions, including unsettled repo-style transactions (which are addressed in §§ 3.131 and 132);

(3) One-way cash payments on OTC derivative contracts (which are addressed in §§ 3. 131 and 132); or

(4) Transactions with a contractual settlement period that is longer than the normal settlement period (which are treated as OTC derivative contracts and addressed in §§ 3.131 and 132).

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

(d) *Delivery-versus-payment (DvP) and payment-versus-payment (PvP) transactions.* A national bank or Federal savings association must hold risk-based capital against any DvP or PvP transaction with a normal settlement period if the national bank's or Federal savings association's counterparty has not made delivery or payment within five business days after the settlement date. The national bank or Federal savings association must determine its risk-weighted asset amount for such a transaction by multiplying the positive current exposure of the transaction for the national bank or Federal savings association by the appropriate risk weight in Table 1 to § 3.136.

TABLE 1 TO § 3.136—RISK WEIGHTS FOR UNSETTLED DVP AND PVP TRANSACTIONS

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