(iii) Any Board-regulated institution that elects to use this subpart to calculate its risk-based capital requirements.

(iv) Is a subsidiary of a bank holding company or savings and loan holding company that uses the advanced approaches pursuant to 12 CFR part 217 to calculate its total risk-weighted assets; or

(v) Elects to use this subpart to calculate its total risk-weighted assets.

(2) A bank that is subject to this subpart shall remain subject to this subpart unless the Board determines in writing that application of this subpart is not appropriate in light of the Board-regulated institution's asset size, level of complexity, risk profile, or scope of operations. In making a determination under this paragraph (b), the Board will apply notice and response procedures in the same manner and to the same extent as the notice and response procedures in 12 CFR 263.202.

(3) A market risk Board-regulated institution must exclude from its calculation of risk-weighted assets under this subpart the risk-weighted asset amounts of all covered positions, as defined in subpart F of this part (except foreign exchange positions that are not trading positions, over-the-counter derivative positions, cleared transactions, and unsettled transactions).

(c) *Principle of conservatism.* Notwithstanding the requirements of this subpart, a Board-regulated institution may choose not to apply a provision of this subpart to one or more exposures provided that:

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

(2) The Board-regulated institution appropriately manages the risk of each such exposure;

(3) The Board-regulated institution notifies the Board in writing prior to applying this principle to each such exposure; and

(4) The exposures to which the Board-regulated institution applies this principle are not, in the aggregate, material to the Board-regulated institution.

[Reg. Q, 78 FR 62157 and 62285, Oct. 11, 2013, as amended at 78 FR 62288, Oct. 11, 2013]

§ 217.101 Definitions.

(a) Terms that are set forth in § 217.2 and used in this subpart have the definitions assigned thereto in § 217.2.

(b) For the purposes of this subpart, the following terms are defined as follows:

Advanced internal ratings-based (IRB) systems means an advanced approaches Board-regulated institution's internal risk rating and segmentation system; risk parameter quantification system; data management and maintenance system; and control, oversight, and validation system for credit risk of wholesale and retail exposures.

Advanced systems means an advanced approaches Board-regulated institution's advanced IRB systems, operational risk management processes, operational risk data and assessment systems, operational risk quantification systems, and, to the extent used by the Board-regulated institution, the internal models methodology, advanced CVA approach, double default excessive correlation detection process, and internal models approach (IMA) for equity exposures.

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

Benchmarking means the comparison of a Board-regulated institution's internal estimates with relevant internal and external data or with estimates based on other estimation techniques.

Bond option contract means a bond option, bond future, or any other instrument linked to a bond that gives rise to similar counterparty credit risk.

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

Credit default swap (CDS) means a financial contract executed under standard industry documentation that allows one party (the protection purchaser) to transfer the credit risk of one or more exposures (reference exposure(s)) to another party (the protection provider) for a certain period of time.

Credit valuation adjustment (CVA) means the fair value adjustment to reflect counterparty credit risk in valuation of OTC derivative contracts.

Default—For the purposes of calculating capital requirements under this subpart:

(1) *Retail*. (i) A retail exposure of a Board-regulated institution is in default if:

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

(B) The exposure is 120 days past due, in the case of retail exposures that are not residential mortgage exposures or revolving exposures; or

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

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

(iii) A retail exposure in default remains in default until the Board-regulated institution has reasonable assurance of repayment and performance for all contractual principal and interest payments on the exposure.

(2) *Wholesale*. (i) A Board-regulated institution's wholesale obligor is in default if:

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

(B) The obligor is past due more than 90 days on any material credit obligation(s) to the Board-regulated institution.[25]

(ii) An obligor in default remains in default until the Board-regulated institution has reasonable assurance of repayment and performance for all contractual principal and interest payments on all exposures of the Board-regulated institution to the obligor (other than exposures that have been fully written-down or charged-off).

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

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

Effective maturity (M) of a wholesale exposure means:

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

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

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

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

(2) For repo-style transactions, eligible margin loans, and OTC derivative contracts subject to a qualifying master netting agreement for which the Board-regulated institution does not apply the internal models approach in section 132(d), the weighted-average remaining maturity (measured in years, whole or fractional) of the individual transactions subject to the qualifying master netting agreement, with the weight of each individual transaction set equal to the notional amount of the transaction.

(3) For repo-style transactions, eligible margin loans, and OTC derivative contracts for which the Board-regulated institution applies the internal models approach in § 217.132(d), the value determined in § 217.132(d)(4).

Eligible double default guarantor, with respect to a guarantee or credit derivative obtained by a Board-regulated institution, means:

(1) *U.S.-based entities*. A depository institution, a bank holding company, a savings and loan holding company, or a securities broker or dealer registered with the SEC under the Securities Exchange Act, if at the time the guarantee is issued or anytime thereafter, has issued and outstanding an unsecured debt security without credit enhancement that is investment grade.

(2) *Non-U.S.-based entities*. A foreign bank, or a non-U.S.-based securities firm if the Board-regulated institution demonstrates that the guarantor is subject to consolidated supervision and regulation comparable to that imposed on U.S. depository institutions, or securities broker-dealers) if at the time the guarantee is issued or anytime thereafter, has issued and outstanding an unsecured debt security without credit enhancement that is investment grade.

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

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

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

Eligible purchased wholesale exposure means a purchased wholesale exposure that:

(1) The Board-regulated institution or securitization SPE purchased from an unaffiliated seller and did not directly or indirectly originate;

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

(3) Provides the Board-regulated institution or securitization SPE with a claim on all proceeds from the exposure or a pro rata interest in the proceeds from the exposure;

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

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

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

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

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

Exposure at default (EAD) means:

(1) For the on-balance sheet component of a wholesale exposure or segment of retail exposures (other than an OTC derivative contract, a repo-style transaction or eligible margin loan for

which the Board-regulated institution determines EAD under §217.132, a cleared transaction, or default fund contribution), EAD means the Board-regulated institution's carrying value (including net accrued but unpaid interest and fees) for the exposure or segment less any allocated transfer risk reserve for the exposure or segment.

(2) For the off-balance sheet component of a wholesale exposure or segment of retail exposures (other than an OTC derivative contract, a repo-style transaction or eligible margin loan for which the Board-regulated institution determines EAD under §217.132, cleared transaction, or default fund contribution) in the form of a loan commitment, line of credit, trade-related letter of credit, or transaction-related contingency, EAD means the Board-regulated institution's best estimate of net additions to the outstanding amount owed the Board-regulated institution, including estimated future additional draws of principal and accrued but unpaid interest and fees, that are likely to occur over a one-year horizon assuming the wholesale exposure or the retail exposures in the segment were to go into default. This estimate of net additions must reflect what would be expected during economic downturn conditions. For the purposes of this definition:

(i) Trade-related letters of credit are short-term, self-liquidating instruments that are used to finance the movement of goods and are collateralized by the underlying goods.

(ii) Transaction-related contingencies relate to a particular transaction and include, among other things, performance bonds and performance-based letters of credit.

(3) For the off-balance sheet component of a wholesale exposure or segment of retail exposures (other than an OTC derivative contract, a repo-style transaction, or eligible margin loan for which the Board-regulated institution determines EAD under §217.132, cleared transaction, or default fund contribution) in the form of anything other than a loan commitment, line of credit, trade-related letter of credit, or transaction-related contingency, EAD means the notional amount of the exposure or segment.

(4) EAD for OTC derivative contracts is calculated as described in §217.132. A Board-regulated institution also may determine EAD for repo-style transactions and eligible margin loans as described in §217.132.

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

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

IMM exposure means a repo-style transaction, eligible margin loan, or OTC derivative for which a Board-regulated institution calculates its EAD using the internal models methodology of §217.132(d).

Internal operational loss event data means, with respect to a Board-regulated institution, gross operational loss amounts, dates, recoveries, and relevant causal information for operational loss events occurring at the Board-regulated institution.

Loss given default (LGD) means:

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

(i) Zero;

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

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

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

(i) Zero;

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

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

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

Obligor means the legal entity or natural person contractually obligated on a wholesale exposure, except that a Board-regulated institution may treat the following exposures as having separate obligors:

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

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

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

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

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

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

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

(1) Internal fraud, which means the operational loss event type category that comprises operational losses resulting from an act involving at least one internal party of a type intended to defraud, misappropriate property, or circumvent regulations, the law, or company policy excluding diversity- and discrimination-type events.

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

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

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

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

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

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

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

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

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

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

(2) An exposure to an individual or company for business purposes if the Board-regulated institution's consolidated business credit exposure to the individual or company is $1 million or less.

Probability of default (PD) means:

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

(2) For a segment of non-defaulted retail exposures, the Board-regulated institution's empirically based best estimate of the long-run average one-year default rate for the exposures in the segment, capturing the average default experience for exposures in the segment over a mix of economic conditions (including economic downturn conditions) sufficient to provide a reasonable estimate of the average one-year default rate over the economic cycle for the segment.

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

Qualifying cross-product master netting agreement means a qualifying master netting agreement that provides for termination and close-out netting across multiple types of financial transactions or qualifying master netting agreements in the event of a counterparty's default, provided that the underlying financial transactions are OTC derivative contracts, eligible margin loans, or repo-style transactions. In order to treat an agreement as a qualifying cross-product master netting agreement for purposes of this subpart, a Board-regulated institution must comply with the requirements of § 217.3(c) of this part with respect to that agreement.

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

(1) Is revolving (that is, the amount outstanding fluctuates, determined largely by a borrower's decision to borrow and repay up to a pre-established maximum amount, except for an outstanding amount that the borrower is required to pay in full every month);

(2) Is unsecured and unconditionally cancelable by the Board-regulated institution to the fullest extent permitted by Federal law; and

(3)(i) Has a maximum contractual exposure amount (drawn plus undrawn) of up to $100,000; or

(ii) With respect to a product with an outstanding amount that the borrower is required to pay in full every month, the total outstanding amount does not in practice exceed $100,000.

(4) A segment of exposures that contains one or more exposures that fails to meet paragraph (3)(ii) of this definition must be treated as a segment of other retail exposures for the 24 month period following the month in which the total outstanding amount of one or more exposures individually exceeds $100,000.

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

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

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

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

Total wholesale and retail risk-weighted assets means the sum of:

(1) Risk-weighted assets for wholesale exposures that are not IMM exposures, cleared transactions, or default fund contributions to non-defaulted obligors and segments of non-defaulted retail exposures;

(2) Risk-weighted assets for wholesale exposures to defaulted obligors and segments of defaulted retail exposures;

(3) Risk-weighted assets for assets not defined by an exposure category;

(4) Risk-weighted assets for non-material portfolios of exposures;

(5) Risk-weighted assets for IMM exposures (as determined in § 217.132(d));

(6) Risk-weighted assets for cleared transactions and risk-weighted assets for default fund contributions (as determined in § 217.133); and

(7) Risk-weighted assets for unsettled transactions (as determined in § 217.136).

Unexpected operational loss (UOL) means the difference between the Board-regulated institution's operational risk exposure and the Board-regulated institution's expected operational loss.

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

Wholesale exposure means a credit exposure to a company, natural person, sovereign, or governmental entity (other than a securitization exposure, retail exposure, pre-sold construction loan, or equity exposure).

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

QUALIFICATION

§ 217.121 Qualification process.

(a) *Timing.* (1) A Board-regulated institution that is described in § 217.100(b)(1)(i) and (ii) must adopt a written implementation plan no later than six months after the date the Board-regulated institution meets a criterion in that section. The implementation plan must incorporate an