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(v) Recovery rate volatility as it relates to the propensity for recovery rates to affect tranche prices; and

(vi) To the extent the comprehensive risk measure incorporates the benefits of dynamic hedging, the static nature of the hedge over the liquidity horizon must be recognized. In such cases, a Board-regulated institution must:

(A) Choose to model the rebalancing of the hedge consistently over the relevant set of trading positions;

(B) Demonstrate that the inclusion of rebalancing results in a more appropriate risk measurement;

(C) Demonstrate that the market for the hedge is sufficiently liquid to permit rebalancing during periods of stress; and

(D) Capture in the comprehensive risk model any residual risks arising from such hedging strategies;

(3) The Board-regulated institution must use market data that are relevant in representing the risk profile of the Board-regulated institution's correlation trading positions in order to ensure that the Board-regulated institution fully captures the material risks of the correlation trading positions in its comprehensive risk measure in accordance with this section; and

(4) The Board-regulated institution must be able to demonstrate that its model is an appropriate representation of comprehensive risk in light of the historical price variation of its correlation trading positions.

(c) *Requirements for stress testing.* (1) A Board-regulated institution must at least weekly apply specific, supervisory stress scenarios to its portfolio of correlation trading positions that capture changes in:

(i) Default rates;

(ii) Recovery rates;

(iii) Credit spreads;

(iv) Correlations of underlying exposures; and

(v) Correlations of a correlation trading position and its hedge.

(2) *Other requirements.* (i) A Board-regulated institution must retain and make available to the Board the results of the supervisory stress testing, including comparisons with the capital requirements generated by the Board-regulated institution's comprehensive risk model.

(ii) A Board-regulated institution must report to the Board promptly any instances where the stress tests indicate any material deficiencies in the comprehensive risk model.

(d) *Calculation of comprehensive risk capital requirement.* The comprehensive risk capital requirement is the greater of:

(1) The average of the comprehensive risk measures over the previous 12 weeks; or

(2) The most recent comprehensive risk measure.

### §217.210 Standardized measurement method for specific risk

(a) *General requirement.* A Board-regulated institution must calculate a total specific risk add-on for each portfolio of debt and equity positions for which the Board-regulated institution's VaR-based measure does not capture all material aspects of specific risk and for all securitization positions that are not modeled under §217.209. A Board-regulated institution must calculate each specific risk add-on in accordance with the requirements of this section. Notwithstanding any other definition or requirement in this subpart, a position that would have qualified as a debt position or an equity position but for the fact that it qualifies as a correlation trading position under paragraph (2) of the definition of correlation trading position in §217.2, shall be considered a debt position or an equity position, respectively, for purposes of this section 210 of this subpart.

(1) The specific risk add-on for an individual debt or securitization position that represents sold credit protection is capped at the notional amount of the credit derivative contract. The specific risk add-on for an individual debt or securitization position that represents purchased credit protection is capped at the current fair value of the transaction plus the absolute value of the present value of all remaining payments to the protection seller under the transaction. This sum is equal to the value of the protection leg of the transaction.

(2) For debt, equity, or securitization positions that are derivatives with linear payoffs, a Board-regulated institution must assign a specific risk-

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weighting factor to the fair value of the effective notional amount of the underlying instrument or index portfolio, except for a securitization position for which the Board-regulated institution directly calculates a specific risk add-on using the SFA in paragraph (b)(2)(vii)(B) of this section. A swap must be included as an effective notional position in the underlying instrument or portfolio, with the receiving side treated as a long position and the paying side treated as a short position. For debt, equity, or securitization positions that are derivatives with nonlinear payoffs, a Board-regulated institution must risk weight the fair value of the effective notional amount of the underlying instrument or portfolio multiplied by the derivative's delta.

(3) For debt, equity, or securitization positions, a Board-regulated institution may net long and short positions (including derivatives) in identical issues or identical indices. A Board-regulated institution may also net positions in depositary receipts against an opposite position in an identical equity in different markets, provided that the Board-regulated institution includes the costs of conversion.

(4) A set of transactions consisting of either a debt position and its credit derivative hedge or a securitization position and its credit derivative hedge has a specific risk add-on of zero if:

(i) The debt or securitization position is fully hedged by a total return swap (or similar instrument where there is a matching of swap payments and changes in fair value of the debt or securitization position);

(ii) There is an exact match between the reference obligation of the swap and the debt or securitization position;

(iii) There is an exact match between the currency of the swap and the debt or securitization position; and

(iv) There is either an exact match between the maturity date of the swap and the maturity date of the debt or securitization position; or, in cases where a total return swap references a portfolio of positions with different maturity dates, the total return swap maturity date must match the maturity date of the underlying asset in

that portfolio that has the latest maturity date.

(5) The specific risk add-on for a set of transactions consisting of either a debt position and its credit derivative hedge or a securitization position and its credit derivative hedge that does not meet the criteria of paragraph (a)(4) of this section is equal to 20.0 percent of the capital requirement for the side of the transaction with the higher specific risk add-on when:

(i) The credit risk of the position is fully hedged by a credit default swap or similar instrument;

(ii) There is an exact match between the reference obligation of the credit derivative hedge and the debt or securitization position;

(iii) There is an exact match between the currency of the credit derivative hedge and the debt or securitization position; and

(iv) There is either an exact match between the maturity date of the credit derivative hedge and the maturity date of the debt or securitization position; or, in the case where the credit derivative hedge has a standard maturity date:

(A) The maturity date of the credit derivative hedge is within 30 business days of the maturity date of the debt or securitization position; or

(B) For purchased credit protection, the maturity date of the credit derivative hedge is later than the maturity date of the debt or securitization position, but is no later than the standard maturity date for that instrument that immediately follows the maturity date of the debt or securitization position. The maturity date of the credit derivative hedge may not exceed the maturity date of the debt or securitization position by more than 90 calendar days.

(6) The specific risk add-on for a set of transactions consisting of either a debt position and its credit derivative hedge or a securitization position and its credit derivative hedge that does not meet the criteria of either paragraph (a)(4) or (a)(5) of this section, but in which all or substantially all of the price risk has been hedged, is equal to the specific risk add-on for the side of the transaction with the higher specific risk add-on.

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(b) *Debt and securitization positions.* (1) The total specific risk add-on for a portfolio of debt or securitization positions is the sum of the specific risk add-ons for individual debt or securitization positions, as computed under this section. To determine the specific risk add-on for individual debt or securitization positions, a Board-regulated institution must multiply the absolute value of the current fair value of each net long or net short debt or securitization position in the portfolio by the appropriate specific risk-weighting factor as set forth in paragraphs (b)(2)(i) through (b)(2)(vii) of this section.

(2) For the purpose of this section, the appropriate specific risk-weighting factors include:

(i) *Sovereign debt positions.* (A) In accordance with Table 1 to §217.210, a Board-regulated institution must assign a specific risk-weighting factor to a sovereign debt position based on the CRC applicable to the sovereign, and, as applicable, the remaining contractual maturity of the position, or if there is no CRC applicable to the sovereign, based on whether the sovereign entity is a member of the OECD. Notwithstanding any other provision in this subpart, sovereign debt positions that are backed by the full faith and credit of the United States are treated as having a CRC of 0.

TABLE 1 TO §217.210—SPECIFIC RISK-WEIGHTING FACTORS FOR SOVEREIGN DEBT POSITIONS

	Specific risk-weighting factor (in percent)	
CRC:		
0-1 .....	0.0	
2-3 .....	Remaining contractual maturity of 6 months or less ..	0.25
	Remaining contractual maturity of greater than 6 and up to and including 24 months.	1.0
	Remaining contractual maturity exceeds 24 months	1.6
4-6 .....	8.0	
7 .....	12.0	
OECD Member with No CRC .....	0.0	
Non-OECD Member with No CRC .....	8.0	
Sovereign Default .....	12.0	

(B) Notwithstanding paragraph (b)(2)(i)(A) of this section, a Board-regulated institution may assign to a sovereign debt position a specific risk-weighting factor that is lower than the applicable specific risk-weighting factor in Table 1 to §217.210 if:

(1) The position is denominated in the sovereign entity’s currency;

(2) The Board-regulated institution has at least an equivalent amount of liabilities in that currency; and

(3) The sovereign entity allows banks under its jurisdiction to assign the lower specific risk-weighting factor to the same exposures to the sovereign entity.

(C) A Board-regulated institution must assign a 12.0 percent specific risk-weighting factor to a sovereign debt

position immediately upon determination a default has occurred; or if a default has occurred within the previous five years.

(D) A Board-regulated institution must assign a 0.0 percent specific risk-weighting factor to a sovereign debt position if the sovereign entity is a member of the OECD and does not have a CRC assigned to it, except as provided in paragraph (b)(2)(i)(C) of this section.

(E) A Board-regulated institution must assign an 8.0 percent specific risk-weighting factor to a sovereign debt position if the sovereign is not a member of the OECD and does not have a CRC assigned to it, except as provided in paragraph (b)(2)(i)(C) of this section.

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(ii) *Certain supranational entity and multilateral development bank debt positions.* A Board-regulated institution may assign a 0.0 percent specific risk-weighting factor to a debt position that is an exposure to the Bank for International Settlements, the European Central Bank, the European Commission, the International Monetary Fund, or an MDB.

(iii) *GSE debt positions.* A Board-regulated institution must assign a 1.6 percent specific risk-weighting factor to a debt position that is an exposure to a GSE. Notwithstanding the foregoing, a Board-regulated institution must assign an 8.0 percent specific risk-weighting factor to preferred stock issued by a GSE.

(iv) *Depository institution, foreign bank, and credit union debt positions.* (A) Except as provided in paragraph (b)(2)(iv)(B) of this section, a Board-regulated institution must assign a specific risk-weighting factor to a debt position that is an exposure to a depository institution, a foreign bank, or a credit union, in accordance with Table 2 to §217.210, based on the CRC that corresponds to that entity's home country or the OECD membership status of that entity's home country if there is no CRC applicable to the entity's home country, and, as applicable, the remaining contractual maturity of the position.

TABLE 2 TO §217.210—SPECIFIC RISK-WEIGHTING FACTORS FOR DEPOSITORY INSTITUTION, FOREIGN BANK, AND CREDIT UNION DEBT POSITIONS

	Specific risk-weighting factor (in percent)	
CRC 0-2 or OECD Member with No CRC .....	Remaining contractual maturity of 6 months or less	0.25
	Remaining contractual maturity of greater than 6 and up to and including 24 months.	1.0
	Remaining contractual maturity exceeds 24 months	1.6
CRC 3 .....	8.0	
CRC 4-7 .....	12.0	
Non-OECD Member with No CRC .....	8.0	
Sovereign Default .....	12.0	

(B) A Board-regulated institution must assign a specific risk-weighting factor of 8.0 percent to a debt position that is an exposure to a depository institution or a foreign bank that is includable in the depository institution's or foreign bank's regulatory capital and that is not subject to deduction as a reciprocal holding under §217.22.

(C) A Board-regulated institution must assign a 12.0 percent specific risk-weighting factor to a debt position that is an exposure to a foreign bank immediately upon determination that a default by the foreign bank's home country has occurred or if a default by the foreign bank's home country has occurred within the previous five years.

(v) *PSE debt positions.* (A) Except as provided in paragraph (b)(2)(v)(B) of this section, a Board-regulated institution must assign a specific risk-

weighting factor to a debt position that is an exposure to a PSE in accordance with Tables 3 and 4 to §217.210 depending on the position's categorization as a general obligation or revenue obligation based on the CRC that corresponds to the PSE's home country or the OECD membership status of the PSE's home country if there is no CRC applicable to the PSE's home country, and, as applicable, the remaining contractual maturity of the position, as set forth in Tables 3 and 4 of this section.

(B) A Board-regulated institution may assign a lower specific risk-weighting factor than would otherwise apply under Tables 3 and 4 of this section to a debt position that is an exposure to a foreign PSE if:

(1) The PSE's home country allows banks under its jurisdiction to assign a

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lower specific risk-weighting factor to such position; and

(2) The specific risk-weighting factor is not lower than the risk weight that corresponds to the PSE’s home country in accordance with Tables 3 and 4 of this section.

(C) A Board-regulated institution must assign a 12.0 percent specific risk-weighting factor to a PSE debt position immediately upon determination that a default by the PSE’s home country has occurred or if a default by the PSE’s home country has occurred within the previous five years.

**TABLE 3 TO §217.210—SPECIFIC RISK-WEIGHTING FACTORS FOR PSE GENERAL OBLIGATION DEBT POSITIONS**

	General obligation specific risk-weighting factor (in percent)	
CRC 0–2 or OECD Member with No CRC .....	Remaining contractual maturity of 6 months or less	0.25
	Remaining contractual maturity of greater than 6 and up to and including 24 months.	1.0
	Remaining contractual maturity exceeds 24 months	1.6
CRC 3 .....	8.0	
CRC 4–7 .....	12.0	
Non-OECD Member with No CRC .....	8.0	
Sovereign Default .....	12.0	

**TABLE 4 TO §217.210—SPECIFIC RISK-WEIGHTING FACTORS FOR PSE REVENUE OBLIGATION DEBT POSITIONS**

	Revenue obligation specific risk-weighting factor (in percent)	
CRC 0–1 or OECD Member with No CRC .....	Remaining contractual maturity of 6 months or less	0.25
	Remaining contractual maturity of greater than 6 and up to and including 24 months.	1.0
	Remaining contractual maturity exceeds 24 months	1.6
CRC 2–3 .....	8.0	
CRC 4–7 .....	12.0	
Non-OECD Member with No CRC .....	8.0	
Sovereign Default .....	12.0	

(vi) *Corporate debt positions.* Except as otherwise provided in paragraph (b)(2)(vi)(B) of this section, a Board-regulated institution must assign a specific risk-weighting factor to a corporate debt position in accordance with the investment grade methodology in paragraph (b)(2)(vi)(A) of this section.

(A) *Investment grade methodology.* (1) For corporate debt positions that are exposures to entities that have issued

and outstanding publicly traded instruments, a Board-regulated institution must assign a specific risk-weighting factor based on the category and remaining contractual maturity of the position, in accordance with Table 5 to §217.210. For purposes of this paragraph (b)(2)(vi)(A)(1), the Board-regulated institution must determine whether the position is in the investment grade or not investment grade category.

**TABLE 5 TO §217.210—SPECIFIC RISK-WEIGHTING FACTORS FOR CORPORATE DEBT POSITIONS UNDER THE INVESTMENT GRADE METHODOLOGY**

Category	Remaining contractual maturity	Specific risk-weighting factor (in percent)
Investment Grade .....	6 months or less .....	0.50

TABLE 5 TO §217.210—SPECIFIC RISK-WEIGHTING FACTORS FOR CORPORATE DEBT POSITIONS UNDER THE INVESTMENT GRADE METHODOLOGY—Continued

Category	Remaining contractual maturity	Specific risk-weighting factor (in percent)
	Greater than 6 and up to and including 24 months ...	2.00
	Greater than 24 months .....	4.00
Non-investment Grade .....		12.00

(2) A Board-regulated institution must assign an 8.0 percent specific risk-weighting factor for corporate debt positions that are exposures to entities that do not have publicly traded instruments outstanding.

(B) *Limitations.* (1) A Board-regulated institution must assign a specific risk-weighting factor of at least 8.0 percent to an interest-only mortgage-backed security that is not a securitization position.

(2) A Board-regulated institution shall not assign a corporate debt position a specific risk-weighting factor that is lower than the specific risk-weighting factor that corresponds to the CRC of the issuer’s home country, if applicable, in table 1 of this section.

(vii) *Securitization positions.* (A) General requirements. (1) A Board-regulated institution that is not an advanced approaches Board-regulated institution must assign a specific risk-weighting factor to a securitization position using either the simplified supervisory formula approach (SSFA) in paragraph (b)(2)(vii)(C) of this section (and §217.211) or assign a specific risk-weighting factor of 100 percent to the position.

(2) A Board-regulated institution that is an advanced approaches Board-regulated institution must calculate a specific risk add-on for a securitization position in accordance with paragraph (b)(2)(vii)(B) of this section if the Board-regulated institution and the securitization position each qualifies to use the SFA in §217.143. A Board-regulated institution that is an advanced approaches Board-regulated institution with a securitization position that does not qualify for the SFA under paragraph (b)(2)(vii)(B) of this section may assign a specific risk-weighting factor to the securitization position using the SSFA in accordance with paragraph

(b)(2)(vii)(C) of this section or assign a specific risk-weighting factor of 100 percent to the position.

(3) A Board-regulated institution must treat a short securitization position as if it is a long securitization position solely for calculation purposes when using the SFA in paragraph (b)(2)(vii)(B) of this section or the SSFA in paragraph (b)(2)(vii)(C) of this section.

(B) *SFA.* To calculate the specific risk add-on for a securitization position using the SFA, a Board-regulated institution that is an advanced approaches Board-regulated institution must set the specific risk add-on for the position equal to the risk-based capital requirement as calculated under §217.143.

(C) *SSFA.* To use the SSFA to determine the specific risk-weighting factor for a securitization position, a Board-regulated institution must calculate the specific risk-weighting factor in accordance with §217.211.

(D) *N<sup>th</sup>-to-default credit derivatives.* A Board-regulated institution must determine a specific risk add-on using the SFA in paragraph (b)(2)(vii)(B) of this section, or assign a specific risk-weighting factor using the SSFA in paragraph (b)(2)(vii)(C) of this section to an n<sup>th</sup>-to-default credit derivative in accordance with this paragraph (b)(2)(vii)(D), regardless of whether the Board-regulated institution is a net protection buyer or net protection seller. A Board-regulated institution must determine its position in the n<sup>th</sup>-to-default credit derivative as the largest notional amount of all the underlying exposures.

(1) For purposes of determining the specific risk add-on using the SFA in paragraph (b)(2)(vii)(B) of this section or the specific risk-weighting factor for an n<sup>th</sup>-to-default credit derivative using

the SSFA in paragraph (b)(2)(vii)(C) of this section the Board-regulated institution must calculate the attachment point and detachment point of its position as follows:

(i) The attachment point (parameter A) is the ratio of the sum of the notional amounts of all underlying exposures that are subordinated to the Board-regulated institution's position to the total notional amount of all underlying exposures. For purposes of the SSFA, parameter A is expressed as a decimal value between zero and one. For purposes of using the SFA in paragraph (b)(2)(vii)(B) of this section to calculate the specific add-on for its position in an  $n^{\text{th}}$ -to-default credit derivative, parameter A must be set equal to the credit enhancement level (L) input to the SFA formula in section 143 of this subpart. In the case of a first-to-default credit derivative, there are no underlying exposures that are subordinated to the Board-regulated institution's position. In the case of a second-or-subsequent-to-default credit derivative, the smallest (n-1) notional amounts of the underlying exposure(s) are subordinated to the Board-regulated institution's position.

(ii) The detachment point (parameter D) equals the sum of parameter A plus the ratio of the notional amount of the Board-regulated institution's position in the  $n^{\text{th}}$ -to-default credit derivative to the total notional amount of all underlying exposures. For purposes of the SSFA, parameter A is expressed as a decimal value between zero and one. For purposes of using the SFA in paragraph (b)(2)(vii)(B) of this section to calculate the specific risk add-on for its position in an  $n^{\text{th}}$ -to-default credit derivative, parameter D must be set to equal the L input plus the thickness of tranche T input to the SFA formula in §217.143 of this subpart.

(2) A Board-regulated institution that does not use the SFA in paragraph (b)(2)(vii)(B) of this section to determine a specific risk-add on, or the SSFA in paragraph (b)(2)(vii)(C) of this section to determine a specific risk-weighting factor for its position in an  $n^{\text{th}}$ -to-default credit derivative must assign a specific risk-weighting factor of 100 percent to the position.

(c) *Modeled correlation trading positions.* For purposes of calculating the comprehensive risk measure for modeled correlation trading positions under either paragraph (a)(2)(i) or (a)(2)(ii) of §217.209, the total specific risk add-on is the greater of:

(1) The sum of the Board-regulated institution's specific risk add-ons for each net long correlation trading position calculated under this section; or

(2) The sum of the Board-regulated institution's specific risk add-ons for each net short correlation trading position calculated under this section.

(d) *Non-modeled securitization positions.* For securitization positions that are not correlation trading positions and for securitizations that are correlation trading positions not modeled under §217.209, the total specific risk add-on is the greater of:

(1) The sum of the Board-regulated institution's specific risk add-ons for each net long securitization position calculated under this section; or

(2) The sum of the Board-regulated institution's specific risk add-ons for each net short securitization position calculated under this section.

(e) *Equity positions.* The total specific risk add-on for a portfolio of equity positions is the sum of the specific risk add-ons of the individual equity positions, as computed under this section. To determine the specific risk add-on of individual equity positions, a Board-regulated institution must multiply the absolute value of the current fair value of each net long or net short equity position by the appropriate specific risk-weighting factor as determined under this paragraph (e):

(1) The Board-regulated institution must multiply the absolute value of the current fair value of each net long or net short equity position by a specific risk-weighting factor of 8.0 percent. For equity positions that are index contracts comprising a well-diversified portfolio of equity instruments, the absolute value of the current fair value of each net long or net

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short position is multiplied by a specific risk-weighting factor of 2.0 percent.<sup>29</sup>

(2) For equity positions arising from the following futures-related arbitrage strategies, a Board-regulated institution may apply a 2.0 percent specific risk-weighting factor to one side (long or short) of each position with the opposite side exempt from an additional capital requirement:

(i) Long and short positions in exactly the same index at different dates or in different market centers; or

(ii) Long and short positions in index contracts at the same date in different, but similar indices.

(3) For futures contracts on main indices that are matched by offsetting positions in a basket of stocks comprising the index, a Board-regulated institution may apply a 2.0 percent specific risk-weighting factor to the futures and stock basket positions (long and short), provided that such trades are deliberately entered into and separately controlled, and that the basket of stocks is comprised of stocks representing at least 90.0 percent of the capitalization of the index. A main index refers to the Standard & Poor's 500 Index, the FTSE All-World Index, and any other index for which the Board-regulated institution can demonstrate to the satisfaction of the Board that the equities represented in the index have liquidity, depth of market, and size of bid-ask spreads comparable to equities in the Standard & Poor's 500 Index and FTSE All-World Index.

(f) *Due diligence requirements for securitization positions.* (1) A Board-regulated institution must demonstrate to the satisfaction of the Board a comprehensive understanding of the features of a securitization position that would materially affect the performance of the position by conducting and documenting the analysis set forth in paragraph (f)(2) of this section. The Board-regulated institution's analysis must be commensurate with the complexity of the securitization position

and the materiality of the position in relation to capital.

(2) A Board-regulated institution must demonstrate its comprehensive understanding for each securitization position by:

(i) Conducting an analysis of the risk characteristics of a securitization position prior to acquiring the position and document such analysis within three business days after acquiring position, considering:

(A) Structural features of the securitization that would materially impact the performance of the position, for example, the contractual cash flow waterfall, waterfall-related triggers, credit enhancements, liquidity enhancements, fair value triggers, the performance of organizations that service the position, and deal-specific definitions of default;

(B) Relevant information regarding the performance of the underlying credit exposure(s), for example, the percentage of loans 30, 60, and 90 days past due; default rates; prepayment rates; loans in foreclosure; property types; occupancy; average credit score or other measures of creditworthiness; average loan-to-value ratio; and industry and geographic diversification data on the underlying exposure(s);

(C) Relevant market data of the securitization, for example, bid-ask spreads, most recent sales price and historical price volatility, trading volume, implied market rating, and size, depth and concentration level of the market for the securitization; and

(D) For resecuritization positions, performance information on the underlying securitization exposures, for example, the issuer name and credit quality, and the characteristics and performance of the exposures underlying the securitization exposures.

(ii) On an on-going basis (no less frequently than quarterly), evaluating, reviewing, and updating as appropriate the analysis required under paragraph (f)(1) of this section for each securitization position.

### §217.211 Simplified supervisory formula approach (SSFA).

(a) *General requirements.* To use the SSFA to determine the specific risk-weighting factor for a securitization

<sup>29</sup> A portfolio is well-diversified if it contains a large number of individual equity positions, with no single position representing a substantial portion of the portfolio's total fair value.