

## Federal Reserve System

### 12 CFR Chapter II

#### Authority and Issuance

For the reasons set forth in the joint preamble, the Board of Governors of the Federal Reserve System proposes to amend parts 208 and 225 of chapter II of title 12 of the Code of Federal Regulations as follows:

#### **PART 208 -- MEMBERSHIP OF STATE BANKING INSTITUTIONS IN THE FEDERAL RESERVE SYSTEM (REGULATION H)**

1. The authority citation for part 208 continues to read as follows:

**Authority:** 12 U.S.C. 24, 36, 92a, 93a, 248(a), 248(c), 321-338a, 371d, 461, 481-486, 601, 611, 1814, 1816, 1818, 1820(d)(9), 1823(j), 1828(o), 1831, 1831o, 1831p-1, 1831r-1, 1831w, 1831x, 1835a, 1882, 2901-2907, 3105, 3310, 3331-3351, and 3906-3909; 15 U.S.C. 78b, 78l(b), 78l(g), 78l(i), 78o-4(c)(5), 78q, 78q-1, and 78w; 31 U.S.C. 5318; 42 U.S.C. 4012a, 4104a, 4104b, 4106, and 4128.

2. In appendix A to part 208, the following amendments are proposed:

- a. Section I, Overview, is revised.
- b. In section II, Definition of Qualifying Capital for the Risk-Based Capital Ratio, the first paragraph is revised.
- c. In section III.A, Procedures, the first paragraph is revised, the fifth paragraph is redesignated as the sixth paragraph, and a new fifth paragraph is added.
- d. In section III.C, the first paragraph is revised.
- e. Section IV is removed and a new section IV, Alternative Approach for Computing Weighted Risk Assets and Off-Balance-Sheet Items, is added.
- f. Attachment I is removed.

## Appendix A To Part 208 – Capital Adequacy Guidelines For State Member Banks: Risk-Based Measure

### I. \* \* \*

The Board of Governors of the Federal Reserve System has adopted a risk-based capital measure to assist in the assessment of the capital adequacy of state member banks.<sup>1</sup> The principal objectives of this measure are to: (i) make regulatory capital requirements more sensitive to differences in risk profiles among banks; (ii) factor off-balance sheet exposures into the assessment of capital adequacy; (iii) minimize disincentives to holding liquid, low-risk assets; and (iv) achieve greater consistency in the evaluation of the capital adequacy of major banks throughout the world.<sup>2</sup>

The risk-based capital guidelines include both a definition of capital and a framework for calculating weighted risk 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 capital (the numerator of the ratio) by its weighted risk assets (the denominator).<sup>3</sup> The definition of qualifying capital is outlined in section II, and the procedures for calculating weighted risk assets are discussed in Sections III and IV.

In addition, when certain banks that engage in trading activities calculate their risk-based capital ratios under this appendix A, they must also refer to appendix E of this part, which incorporates capital charges for certain market risks into the risk-based capital ratios. When

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<sup>1</sup> A leverage capital measure for state member banks is outlined in appendix B of this part.

<sup>2</sup> The risk-based capital measure is based upon a framework developed jointly by supervisory authorities from the countries represented on the Basel Committee on Banking Supervision (Basel Supervisors' Committee) and endorsed by the Group of Ten Central Bank Governors. The framework is described in a paper prepared by the Basel Supervisors' Committee entitled "International Convergence of Capital Measurement," July 1988.

<sup>3</sup> Banks will initially be expected to utilize period-end amounts in calculating their risk-based capital ratios. When necessary and appropriate, ratios based on average balances may also be calculated on a case-by-case basis. Moreover, to the extent banks have data on average balances that can be used to calculate risk-based ratios, the Federal Reserve will take such data into account.

calculating their risk-based capital ratios under this appendix A, such banks are required to refer to appendix E of this part for supplemental rules to determine qualifying and excess capital, calculate weighted risk assets, calculate market risk equivalent assets, and calculate risk-based capital ratios adjusted for market risk.

The risk-based capital guidelines apply to all state member banks on a consolidated basis. They are to be used in the examination and supervisory process as well as in the analysis of applications acted upon by the Federal Reserve. Thus, in considering an application filed by a state member bank, the Federal Reserve will take into account the bank's risk-based capital ratios, the reasonableness of its capital plans, and the extent to which it meets the risk-based capital standards.

The risk-based capital ratios focus principally on broad categories of credit risk, although the framework for assigning assets and off-balance-sheet items to risk categories does incorporate elements of transfer risk, as well as limited instances of interest rate and market risk. The framework incorporates risks arising from traditional banking activities as well as risks arising from nontraditional activities. The risk-based capital ratios do not, however, incorporate other factors that can affect an institution's financial condition. These factors include overall interest-rate exposure; liquidity, funding and market risks; the quality and level of earnings; investment, loan portfolio, and other concentrations of credit; 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 risks presented by concentrations of credit and nontraditional activities.

In addition to evaluating capital ratios, an overall assessment of capital adequacy must take account of those factors, including, in particular, the level and severity of problem and

classified assets as well as a 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 conclusions that might be drawn solely from the level of its risk-based capital ratios.

The risk-based capital guidelines establish a *minimum* ratio of qualifying total capital to weighted risk assets of 8 percent, of which at least 4 percentage points must be in the form of tier 1 capital. In light of the considerations just discussed, banks generally are expected to operate well above the minimum risk-based ratios. In particular, banks contemplating significant expansion proposals are expected to maintain strong capital levels substantially above the minimum ratios and should not allow significant diminution of financial strength below these strong levels to fund their expansion plans. Institutions with high or inordinate levels of risk are also expected to operate well above minimum capital standards. In all cases, institutions should hold capital commensurate with the level and nature of the risks to which they are exposed. Banks that do not meet the minimum risk-based capital standard, or that are otherwise considered to be inadequately capitalized, are expected to develop and implement plans acceptable to the Federal Reserve for achieving adequate levels of capital within a reasonable period of time.

The Board will monitor the implementation and effect of these guidelines in relation to domestic and international developments in the banking industry. When necessary and appropriate, the Board will consider the need to modify the guidelines in light of any significant changes in the economy, financial markets, banking practices, or other relevant factors.

## II. \* \* \*

A bank's qualifying total capital consists of two types of capital components: "core capital elements" (comprising tier 1 capital) and "supplementary capital elements" (comprising tier 2 capital). These capital elements and the various limits, restrictions, and deductions to which they are subject, are discussed in this section II.

\* \* \* \* \*

## III. \* \* \*

## A. \* \* \*

Assets and credit-equivalent amounts of off-balance-sheet items of state member banks are assigned to one of several broad risk categories, according to the obligor, or, if relevant, the guarantor, the nature of the collateral, or an external rating. The aggregate dollar value of the amount in each category is then multiplied by the risk weight associated with the category. The resulting weighted values from each of the risk categories are added together, and this sum is the bank's total weighted risk assets that comprise the denominator of the risk-based capital ratios.

\* \* \* \* \*

A bank may elect to apply the alternative procedures for computing weighted risk assets set forth in section IV of this appendix A ("Alternative Approach"). The Federal Reserve also may require a bank to apply the Alternative Approach if the Federal Reserve determines that the Alternative Approach would produce risk-based capital requirements that more accurately reflect the risk profile of the bank or would otherwise enhance the safety and soundness of the bank. A bank that applies the Alternative Approach must apply all the procedures set forth in section IV of this appendix A and also must apply all the procedures set forth in this section that are not inconsistent with the procedures in section IV.

\* \* \* \* \*

C. \*\*\*

Assets and on-balance-sheet credit equivalent amounts are assigned to the following risk weight categories: 0 percent, 20 percent, 50 percent, or 100 percent. A brief explanation of the components of each category follows.

\* \* \* \* \*

#### IV. ALTERNATIVE APPROACH FOR COMPUTING WEIGHTED RISK ASSETS AND OFF-BALANCE-SHEET ITEMS

##### A. Scope of Application

A bank may elect to use the Alternative Approach for computing weighted risk assets and off-balance sheet items set forth in this section IV by giving the Federal Reserve written notice on the first day of the quarter during which the bank elects to begin using the Alternative Approach. A bank that has elected to apply the Alternative Approach may opt out of the Alternative Approach after it has given the Federal Reserve 30 days prior written notice. The Federal Reserve may require a bank to apply the Alternative Approach if the Federal Reserve determines that the Alternative Approach would produce risk-based capital requirements that more accurately reflect the risk profile of the bank or would otherwise enhance the safety and soundness of the bank.

A bank that applies the Alternative Approach must apply all the procedures set forth in this section IV and also must apply all the procedures set forth in section III that are not inconsistent with the procedures in section IV.

##### B. External Ratings, Collateral, Guarantees, and Other Considerations

1. External Credit Ratings. A bank must use Table 1 in this section IV.B.1. to assign risk weights to covered claims with an original maturity of one year or more and Table 2 in this section IV.B.1. to assign risk weights to covered claims with an original maturity of less than one

year. Covered claims are all claims other than (i) claims on an excluded entity, (ii) loans to non-sovereigns that do not have an external rating, and (iii) OTC derivative contracts. Excluded entities are (i) the U.S. central government and U.S. government agencies, (ii) state and local governments of the United States and other countries of the OECD, (iii) U.S. government-sponsored agencies, and (iv) U.S. depository institutions and foreign banks.

A bank must use column three of the tables for covered claims on a non-U.S. sovereign<sup>58</sup> and column four of the tables for covered claims on an entity other than a non-U.S. sovereign (excluding securitization exposures). A bank must use column five of the tables for covered claims that are securitization exposures, which include asset-backed securities, mortgage-backed securities, recourse obligations, direct credit substitutes, and residual interests (other than credit-enhancing interest-only strips).

**Table 1: Risk Weights Based on Long-Term External Ratings**

| Long-term rating category                           | Rating  | Non-U.S. Sovereign Risk Weight* | Non-Sovereign Risk Weight | Securitization Exposure Risk Weight |
|---|---------|---------------------------------|---------------------------|-------------------------------------|
| Highest investment grade rating                     | AAA     | 0 percent                       | 20 percent                | 20 percent                          |
| Second-highest investment grade rating              | AA      | 20 percent                      | 20 percent                | 20 percent                          |
| Third-highest investment grade rating               | A       | 20 percent                      | 35 percent                | 35 percent                          |
| Lowest investment grade rating – plus               | BBB+    | 35 percent                      | 50 percent                | 50 percent                          |
| Lowest investment grade rating – naught             | BBB     | 50 percent                      | 75 percent                | 75 percent                          |
| Lowest investment grade rating – negative           | BBB-    | 75 percent                      | 100 percent               | 100 percent                         |
| One category below investment grade – plus & naught | BB+, BB | 75 percent                      | 150 percent               | 200 percent                         |
| One category below investment grade – negative      | BB-     | 100 percent                     | 200 percent               | 200 percent                         |
| Two or more categories below investment grade       | B, CCC  | 150 percent                     | 200 percent               | **                                  |
| Unrated   | n/a     | 200 percent                     | 200 percent               | **                                  |

\* Claims collateralized by AAA-rated non-U.S. sovereign debt would be assigned to the 20 percent risk weight category.

\*\* Apply the risk-based capital requirements set forth in section III.B.3.b. of this appendix A.

<sup>58</sup> For purposes of this section IV, a sovereign is defined as a central government, including its agencies, departments, ministries, and the central bank. This definition does not include state, provincial, or local governments, or commercial enterprises owned by a central government.

**Table 2: Risk Weights Based on Short-Term External Ratings**

| <b>Short-term rating category</b>      | <b>Examples</b> | <b>Non-U.S. Sovereign Risk Weight*</b> | <b>Non-Sovereign Risk Weight</b> | <b>Securitization Exposure Risk Weight</b> |
|--|-----------------|--|----------------------------------|--|
| Highest investment grade rating *      | A-1, P-1        | 0 percent                              | 20 percent                       | 20 percent                                 |
| Second-highest investment grade rating | A-2, P-2        | 20 percent                             | 35 percent                       | 35 percent                                 |
| Lowest investment grade rating         | A-3, P-3        | 50 percent                             | 75 percent                       | 75 percent                                 |
| Unrated                                | --              | 100 percent                            | 100 percent                      | 100 percent                                |

\* Claims collateralized by A1/P1 rated sovereign debt would be assigned to the 20 percent risk weight category.

For purposes of this section IV, an external rating is defined as a credit rating that is assigned by an NRSRO, provided that the credit rating:

- a. Fully reflects the entire amount of credit risk with regard to all payments owed on the claim (that is, the rating must fully reflect the credit risk associated with timely repayment of principal and interest);
- b. Is monitored by the issuing NRSRO;
- c. Is published in an accessible public form (for example, on the NRSRO's web site or in financial media); and
- d. Is, or will be, included in the issuing NRSRO's publicly available ratings transition matrix which tracks the performance and stability (or ratings migration) of an NRSRO's issued external ratings for the specific type of claim (for example, corporate debt).

In addition, an unrated covered claim on a non-U.S. sovereign that has an external rating from an NRSRO should be deemed to have an external rating equal to the sovereign's issuer rating. If a claim has two or more external ratings, the bank must use the least favorable external rating to risk weight the claim. Similarly, if a claim has components that are assigned different external ratings, the lowest component rating must be applied to the entire claim. For



example, if a securitization exposure has a principal component externally rated BBB, but the interest component is externally rated B, the entire exposure will be subject to the gross-up treatment accorded to a securitization exposure rated B or lower. Similarly, if a portion of a specific claim is unrated, then the entire claim must be treated as if it were unrated. The Federal Reserve retains the authority to override the use of certain ratings or the ratings on certain instruments, either on a case-by-case basis or through broader supervisory policy, if necessary or appropriate to address the risk that an instrument poses to banking organizations.

2. Collateral. In addition to the forms of recognized financial collateral set forth in section III.B.1. of this appendix A, a bank also may recognize as collateral (i) covered claims in the form of liquid and readily marketable debt securities that are externally rated no less than investment grade and (ii) liquid and readily marketable debt securities guaranteed by non-U.S. sovereigns whose issuer rating is at least investment grade. Claims, or portions of claims, collateralized by such collateral may be assigned to the risk weight appropriate to the collateral's external rating as set forth in Table 1 or 2 of section IV.B.1. For example, the portion of a claim collateralized with an AA-rated mortgage-backed security is assigned to the 20 percent risk weight category.

Subject to the final sentence of this paragraph, there is, however, a 20 percent risk weight floor on collateralized claims under this section IV. Thus, the portion of a claim collateralized by a security issued by a non-U.S. sovereign with an issuer rating of AAA would be assigned to the 20 percent risk weight category instead of the zero percent risk weight category. The procedures set forth in section III of this appendix A continue to apply, however, to claims collateralized by securities issued or guaranteed by OECD central governments for which a positive margin of collateral is maintained on a daily basis, fully taking into account any change in the bank's exposure to the obligor and counterparty under the claim in relation to the market

value of the collateral held to support the claim.

In the event that the external rating of a security used to collateralize a claim results in a higher risk weight than would have otherwise been assigned to the claim, then the lower risk weight appropriate to the underlying claim could be applied.

3. Guarantees. Claims, or portions of claims, guaranteed by a third-party entity (other than an excluded entity) whose unsecured long-term senior debt (without credit enhancements) is externally rated at least investment grade or by a non-U.S. sovereign that has an issuer rating of at least investment grade may be assigned to the risk weight of the guarantor as set forth in Table 1 of section IV.B.1., corresponding to the protection provider's long-term senior debt rating (or issuer rating in the case of a non-U.S. sovereign), provided that the guarantee:

- a. Is written and unconditional,
- b. Covers all or a pro rata portion of contractual payments of the obligor on the underlying claim,
- c. Gives the beneficiary a direct claim against the protection provider,
- d. Is non-cancelable by the protection provider for reasons other than the breach of contract by the beneficiary,
- e. Is legally enforceable against the protection provider in a jurisdiction where the protection provider has sufficient assets against which a judgment may be attached and enforced, and
- f. Requires the protection provider to make payment to the beneficiary upon default of the obligor on the underlying claim without first requiring the beneficiary to demand payment from the obligor.

C. Residential Mortgages

1. A bank may separate its residential mortgage portfolio into two subportfolios, where the first subportfolio includes mortgage loans originated by the bank or acquired by the bank prior to the date the bank becomes subject to this section IV and the second includes mortgage loans originated or acquired by the bank after that date. The bank may apply the risk-based capital treatment set forth in section III of this appendix A to the first subportfolio while applying the requirements set forth in this section IV to the second subportfolio. A bank that does not so separate its residential mortgage portfolio must apply the capital treatment in this section IV to all of its qualifying residential mortgage exposures. If a bank at any time opts-out of the Alternative Approach and, subsequently, again becomes subject to this section IV, it may not apply the procedures set forth in this section IV.C.1.

2. Subject to section IV.C.1., a bank assigns its residential mortgage exposures to risk weight categories based on their loan-to-value (LTV) or combined loan-to-value (CLTV) ratios, as appropriate, in accordance with Tables 3 and 4 of sections IV.C.3.a. and IV.C.3.b., respectively, but must risk-weight a nonqualifying residential mortgage exposure at no less than 100 percent. Residential mortgage exposures include all loans secured by a lien on a one- to four-family residential property<sup>59</sup> that is either owner-occupied or rented. Qualifying residential mortgage exposures are residential mortgage exposures that (1) have been made in accordance with prudent underwriting standards; (2) are performing in accordance with their original terms; (3) are not 90 days or more past due or carried in nonaccrual status; and (4) are not made for the purpose of speculative property development. Nonqualifying residential mortgage exposures are residential mortgage exposures other than qualifying residential mortgage exposures.

3. For purposes of Tables 3 and 4, LTV is defined as (i) the current outstanding principal balance of the loan less the amount covered by any loan-level private mortgage

insurance (“PMI”) divided by (ii) the most recent purchase price of the property or the most recent appraisal or evaluation value of the property (if the appraisal or evaluation is more recent than the most recent purchase and was obtained by the bank in connection with an extension of new credit). Loan-level PMI means insurance (i) provided by a non-affiliated PMI provider whose unsecured long-term senior debt (without credit enhancements) is externally rated at least the third highest investment grade by an NRSRO, and (ii) which protects a mortgage lender in the event of the default of a mortgage borrower up to a predetermined portion of the value of a residential mortgage exposure. For purposes of the loan-level PMI definition, (i) an affiliate of a company means any company that controls, is controlled by, or is under common control with, the company; and (ii) a person or company controls a company if it owns, controls, or has power to vote 25 percent or more of a class of voting securities of the company or consolidates the company for financial reporting purposes. CLTV for a junior lien mortgage is defined as (i) the current outstanding principal balance of the junior mortgage and all more senior mortgages less the amount covered by any loan-level PMI covering the junior lien divided by (ii) the most recent purchase price of the property or the most recent appraisal or evaluation value of the property (if the appraisal or evaluation is more recent than the most recent purchase and was obtained by the bank in connection with an extension of new credit). The procedures for residential mortgage exposures that have negative amortization features are set forth in section IV.C.3.c.

a. First Lien Residential Mortgage Exposures

First lien residential mortgage exposures are risk-weighted in accordance with Table 3 of this section IV.C.3.a. (with nonqualifying residential mortgage exposures subject to a risk weight floor of 100 percent). If a bank holds both the senior and junior lien(s) on a residential property

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<sup>59</sup> Loans that qualify as mortgages that are secured by 1- to 4-family residential properties are listed in the

and no other party holds an intervening lien, the bank's claims are treated as a single claim secured by a senior lien for purposes of determining the LTV ratio and assigning a risk weight.

**Table 3: Risk Weights for First Lien Residential Mortgage Exposures**

| Loan-to-Value Ratio | Risk Weight |
|---------------------|-------------|
| Up to 60%           | 20%         |
| >60% and up to 80%  | 35%         |
| >80% and up to 85%  | 50%         |
| >85% and up to 90%  | 75%         |
| >90% and up to 95%  | 100%        |
| >95%                | 150%        |

b. Stand-Alone Junior Liens

Stand-alone junior lien residential mortgage exposures, including structured mortgages and home equity lines of credit, must be risk weighted using the CLTV ratio of the stand-alone junior lien and all senior liens in accordance with Table 4 (with nonqualifying residential mortgage exposures subject to a risk weight floor of 100 percent).

**Table 4: Risk Weights for Stand-Alone Junior Lien Residential Mortgage Exposures**

| Combined Loan-to-Value Ratio | Risk Weight |
|------------------------------|-------------|
| Up to 60%                    | 75%         |
| >60% and up to 90%           | 100%        |
| >90%                         | 150%        |

c. Residential Mortgage Exposures With Negative Amortization Features

Residential mortgage exposures with negative amortization features are assigned to a risk weight category using a loan's current LTV ratio in accordance with Table 3 of section IV.C.3.a. Any remaining potential increase in the mortgage's principal balance permitted through the negative amortization feature is to be treated as a long-term commitment and converted to an on-balance sheet credit equivalent amount as set forth in section III.D.2. of this appendix. The credit equivalent amount of the commitment is then risk-weighted according to Table 3 based on the loan's "highest contractual LTV ratio." The highest contractual LTV ratio of a mortgage loan equals the current outstanding principal balance of the loan plus the credit equivalent amount of the remaining negative amortization "commitment" less the amount covered by any loan-level PMI divided by the most recent purchase price of the property or the most recent appraisal or evaluation value of the property (if the appraisal or evaluation is more recent than the most recent purchase and was obtained by the bank in connection with an extension of new credit). A bank with a stand-alone second lien where the more senior lien(s) can negatively amortize must first adjust the principal amount of those senior or intervening liens that can negatively amortize to reflect the maximum contractual loan amount as if it were to fully negatively amortize under the applicable contract. The adjusted LTV would then be added to the stand-alone junior lien to calculate the appropriate CLTV.

D. Short-Term Commitments

Unused portions of commitments with an original maturity of one year or less (including eligible asset backed commercial paper liquidity facilities) (that is, short-term commitments) are converted using the 10 percent conversion factor. Unconditionally cancelable commitments, as defined in section III.D.2.b. of this appendix, retain the zero percent conversion factor. Short-term commitments to originate one- to four-family residential mortgage loans provided in the

ordinary course of business that are not treated as a derivative under GAAP will continue to be converted to an on-balance-sheet credit equivalent amount using the zero percent conversion factor.

E. Securitizations of Revolving Credit with Early Amortization Provisions

1. Definitions

a. Early amortization provision means a provision in the documentation governing a securitization that, when triggered, causes investors in the securitization exposures to be repaid before the original stated maturity of the securitization exposures, unless the provision is triggered solely by events not directly related to the performance of the underlying exposures or the originating bank (such as material changes in tax laws or regulations).

b. Excess spread means gross finance charge collections and other income received by a trust or special purpose entity minus interest paid to the investors in the securitization exposures, servicing fees, charge-offs, and other similar trust or special purpose entity expenses.

c. Excess spread trapping point is the point at which the bank is required by the documentation governing a securitization to divert and hold excess spread in a spread or reserve account, expressed as a percentage.

d. Investors' interest is the total amount of securitization exposures issued by a trust or special purpose entity to investors.

e. Revolving credit means a line of credit where the borrower is permitted to vary both the drawn amount and the amount of repayment within an agreed limit.

2. A bank that securitizes revolving credits where the securitization structure contains an early amortization provision must maintain risk-based capital against the investors' interest as required under this section. Capital for securitizations of revolving credit exposures that incorporate early-amortization provisions will be assessed based on a comparison of the

securitization's annualized three-month average excess spread against the excess spread trapping point. To calculate the securitization's excess spread trapping point ratio, a bank must calculate the three-month average of 1) the dollar amount of excess spread divided by 2) the outstanding principal balance of underlying pool of exposures at the end of each of the prior three months. The annualized three month average of excess spread is then divided by the excess spread trapping point that is required by the securitization structure. The excess spread trapping point ratio is compared to the ratios contained in Table 5 of section IV.E.3 to determine the appropriate conversion factor to apply to the investor's interest. The amount of investor's interest after conversion is then assigned capital in accordance with that appropriate to the underlying obligor, collateral or guarantor. For securitizations that do not require excess spread to be trapped, or that specify trapping points based primarily on performance measures other than the three-month average excess spread, the excess spread trapping point is 4.5 percent.

3. For a bank subject to the early amortization requirements in this section IV.E., if the aggregate risk-based capital requirement for residual interests, direct credit substitutes, other securitization exposures, and early amortization provisions in connection with the same securitization of revolving credit exposures exceeds the risk-based capital requirement on the underlying securitized assets, then the capital requirement for the securitization transaction will be limited to the greater of the risk-based capital requirement for 1) residual interests or 2) the underlying securitized assets calculated as if the bank continued to hold the assets on its balance sheet.



**Table 5: Early Amortization Credit Conversion Factor**

| Excess Spread Trapping Point Ratio      | Credit Conversion Factor (CCF) |
|---|--------------------------------|
| 133.33 percent or more                  | 0 percent                      |
| less than 133.33 percent to 100 percent | 5 percent                      |
| less than 100 percent to 75 percent     | 15 percent                     |
| less than 75 percent to 50 percent      | 50 percent                     |
| Less than 50 percent                    | 100 percent                    |

F. Risk Weights for Derivatives

A bank may not apply the 50 percent risk weight cap for derivative contract counterparties set forth in section III.E. of this appendix A.

**PART 225 – BANK HOLDING COMPANIES AND CHANGE IN BANK CONTROL  
(REGULATION Y)**

1. The authority citation for part 225 continues to read as follows:

**Authority:** 12 U.S.C. 1817(j)(13), 1818, 1828(o), 1831i, 1831p-1, 1843(c)(8), 1844(b), 1972(1), 3106, 3108, 3310, 3331-3351, 3907, and 3909; 15 U.S.C. 6801 and 6805.1.

2. In Appendix A to part 225, the following amendments are proposed:

- a. Section I, Overview, is revised.
- b. In section III.A, Procedures, the first paragraph is revised, the fourth paragraph is redesignated as the fifth paragraph, and a new fourth paragraph is added.
- c. In section III.C, the first paragraph is revised.
- d. Section IV is removed and a new section IV, Alternative Approach for Computing Weighted Risk Assets and Off-Balance-Sheet Items, is added.
- e. Attachment I is removed.

**Appendix A To Part 225 – Capital Adequacy Guidelines For Bank Holding Companies:  
Risk-Based Measure**

## I. \* \* \*

The Board of Governors of the Federal Reserve System has adopted a risk-based capital measure to assist in the assessment of the capital adequacy of bank holding companies (banking organizations).<sup>1</sup> The principal objectives of this measure are to: (i) make regulatory capital requirements more sensitive to differences in risk profiles among banking organizations; (ii) factor off-balance sheet exposures into the assessment of capital adequacy; (iii) minimize disincentives to holding liquid, low-risk assets; and (iv) achieve greater consistency in the evaluation of the capital adequacy of major banking organizations throughout the world.<sup>2</sup>

The risk-based capital guidelines include both a definition of capital and a framework for calculating weighted risk assets by assigning assets and off-balance sheet items to broad risk categories. An institution's risk-based capital ratio is calculated by dividing its qualifying capital (the numerator of the ratio) by its weighted risk assets (the denominator).<sup>3</sup> The definition of qualifying capital is outlined in section II, and the procedures for calculating weighted risk assets are discussed in sections III and IV.

In addition, when certain organizations that engage in trading activities calculate their risk-based capital ratios under this appendix A, they must also refer to appendix E of this part, which incorporates capital charges for certain market risks into the risk-based capital ratios. When calculating their risk-based capital ratios under this appendix A, such organizations are required to refer to appendix E of this part for supplemental rules to determine qualifying and

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<sup>1</sup> A leverage capital measure for bank holding companies is outlined in appendix D of this part.

<sup>2</sup> The risk-based capital measure is based upon a framework developed jointly by supervisory authorities from the countries represented on the Basel Committee on Banking Supervision (Basel Supervisors' Committee) and endorsed by the Group of Ten Central Bank Governors. The framework is described in a paper prepared by the Basel Supervisors' Committee entitled "International Convergence of Capital Measurement," July 1988.

<sup>3</sup> Banking organizations will initially be expected to utilize period-end amounts in calculating their risk-based capital ratios. When necessary and appropriate, ratios based on average balances may also be calculated on a case-by-case basis. Moreover, to the extent banking organizations have data on average balances that can be used to calculate risk-based ratios, the Federal Reserve will take such data into account.

excess capital, calculate weighted risk assets, calculate market risk equivalent assets, and calculate risk-based capital ratios adjusted for market risk.

The risk-based capital guidelines apply on a consolidated basis to bank holding companies with consolidated assets of \$500 million or more. For bank holding companies with less than \$500 million in consolidated assets, the guidelines will be applied on a bank-only basis unless: (a) The parent bank holding company is engaged in nonbank activity involving significant leverage;<sup>4</sup> or (b) the parent company has a significant amount of outstanding debt that is held by the general public.

The risk-based capital guidelines are to be used in the inspection and supervisory process as well as in the analysis of applications acted upon by the Federal Reserve. Thus, in considering an application filed by a bank holding company, the Federal Reserve will take into account the organization's risk-based capital ratio, the reasonableness of its capital plans, and the extent to which it meets the risk-based capital standards.

The risk-based capital ratios focus principally on broad categories of credit risk, although the framework for assigning assets and off-balance-sheet items to risk categories does incorporate elements of transfer risk, as well as limited instances of interest rate and market risk. The risk-based capital ratio does not, however, incorporate other factors that can affect an organization's financial condition. These factors include overall interest-rate exposure; liquidity, funding and market risks; the quality and level of earnings; investment or loan portfolio concentrations; the quality of loans and investments, the effectiveness of loan and investment policies; and management's ability to monitor and control financial and operating risks.

In addition to evaluating capital ratios, an overall assessment of capital adequacy must take account of these other factors, including, in particular, the level and severity of problem and

classified assets. For this reason, the final supervisory judgment on an organization's capital adequacy may differ significantly from conclusions that might be drawn solely from the level of the organization's risk-based capital ratio.

The risk-based capital guidelines establish a *minimum* ratio of qualifying total capital to weighted risk assets of 8 percent, of which at least 4 percentage points must be in the form of tier 1 capital. In light of the considerations just discussed, banking organizations generally are expected to operate well above the minimum risk-based ratios. In particular, banking organizations contemplating significant expansion proposals are expected to maintain strong capital levels substantially above the minimum ratios and should not allow significant diminution of financial strength below these strong levels to fund their expansion plans. Institutions with high or inordinate levels of risk are also expected to operate well above minimum capital standards. In all cases, institutions should hold capital commensurate with the level and nature of the risks to which they are exposed. Banking organizations that do not meet the minimum risk-based capital standard, or that are otherwise considered to be inadequately capitalized, are expected to develop and implement plans acceptable to the Federal Reserve for achieving adequate levels of capital within a reasonable period of time.

The Board will monitor the implementation and effect of these guidelines in relation to domestic and international developments in the banking industry. When necessary and appropriate, the Board will consider the need to modify the guidelines in light of any significant changes in the economy, financial markets, banking practices, or other relevant factors.

\* \* \* \* \*

III. \* \* \*

A. \* \* \*

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<sup>4</sup> A parent company that is engaged in significant off-balance sheet activities would generally be deemed to be

Assets and credit-equivalent amounts of off-balance-sheet items of bank holding companies are assigned to one of several broad risk categories, according to the obligor, or, if relevant, the guarantor, the nature of the collateral, or an external rating. The aggregate dollar value of the amount in each category is then multiplied by the risk weight associated with the category. The resulting weighted values from each of the risk categories are added together, and this sum is the banking organization's total weighted risk assets that comprise the denominator of the risk-based capital ratios.

\* \* \* \* \*

A bank holding company may elect to apply the alternative procedures for computing weighted risk assets set forth in section IV of this appendix A ("Alternative Approach"). The Federal Reserve also may require a bank holding company to apply the Alternative Approach if the Federal Reserve determines that the Alternative Approach would produce risk-based capital requirements that more accurately reflect the risk profile of the banking organization or would otherwise enhance the safety and soundness of the institution. A bank holding company that applies the Alternative Approach must apply all the procedures set forth in section IV of this appendix A and also must apply all the procedures set forth in this section that are not inconsistent with the procedures in section IV.

\* \* \* \* \*

C. \*\*\*

Assets and on-balance-sheet credit equivalent amounts are assigned to the following risk weight categories: 0 percent, 20 percent, 50 percent, or 100 percent. A brief explanation of the components of each category follows.

\* \* \* \* \*

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engaged in activities that involve significant leverage.

#### IV. ALTERNATIVE APPROACH FOR COMPUTING WEIGHTED RISK ASSETS AND OFF-BALANCE-SHEET ITEMS

##### A. Scope of Application

A bank holding company may elect to use the Alternative Approach for computing weighted risk assets and off-balance sheet items set forth in this section IV by giving the Federal Reserve written notice on the first day of the quarter during which the banking organization elects to begin using the Alternative Approach. A bank holding company that has elected to apply the Alternative Approach may opt out of the Alternative Approach after it has given the Federal Reserve 30 days prior written notice. The Federal Reserve may require a bank holding company to apply the Alternative Approach if the Federal Reserve determines that the Alternative Approach would produce risk-based capital requirements that more accurately reflect the risk profile of the banking organization or would otherwise enhance the safety and soundness of the institution.

A bank holding company that applies the Alternative Approach must apply all the procedures set forth in this section IV and also must apply all the procedures set forth in section III that are not inconsistent with the procedures in section IV.

##### B. External Ratings, Collateral, Guarantees, and Other Considerations

1. External Credit Ratings. A bank holding company must use Table 1 in this section IV.B.1. to assign risk weights to covered claims with an original maturity of one year or more and Table 2 in this section IV.B.1. to assign risk weights to covered claims with an original maturity of less than one year. Covered claims are all claims other than (i) claims on an excluded entity, (ii) loans to non-sovereigns that do not have an external rating, and (iii) OTC derivative contracts. Excluded entities are (i) the U.S. central government and U.S. government agencies, (ii) state and local governments of the United States and other countries of the OECD,

(iii) U.S. government-sponsored agencies, and (iv) U.S. depository institutions and foreign banks.

A bank holding company must use column three of the tables for covered claims on a non-U.S. sovereign<sup>58</sup> and column four of the tables for covered claims on an entity other than a non-U.S. sovereign (excluding securitization exposures). A bank holding company must use column five of the tables for covered claims that are securitization exposures, which include asset-backed securities, mortgage-backed securities, recourse obligations, direct credit substitutes, and residual interests (other than credit-enhancing interest-only strips).

**Table 1: Risk Weights Based on Long-Term External Ratings**

| <b>Long-term rating category</b>                    | <b>Rating</b> | <b>Non-U.S. Sovereign Risk Weight*</b> | <b>Non-Sovereign Risk Weight</b> | <b>Securitization Exposure Risk Weight</b> |
|---|---------------|--|----------------------------------|--|
| Highest investment grade rating                     | AAA           | 0 percent                              | 20 percent                       | 20 percent                                 |
| Second-highest investment grade rating              | AA            | 20 percent                             | 20 percent                       | 20 percent                                 |
| Third-highest investment grade rating               | A             | 20 percent                             | 35 percent                       | 35 percent                                 |
| Lowest investment grade rating – plus               | BBB+          | 35 percent                             | 50 percent                       | 50 percent                                 |
| Lowest investment grade rating – naught             | BBB           | 50 percent                             | 75 percent                       | 75 percent                                 |
| Lowest investment grade rating – negative           | BBB-          | 75 percent                             | 100 percent                      | 100 percent                                |
| One category below investment grade – plus & naught | BB+, BB       | 75 percent                             | 150 percent                      | 200 percent                                |
| One category below investment grade – negative      | BB-           | 100 percent                            | 200 percent                      | 200 percent                                |
| Two or more categories below investment grade       | B, CCC        | 150 percent                            | 200 percent                      | **   |
| Unrated   | n/a           | 200 percent                            | 200 percent                      | **   |

\* Claims collateralized by AAA-rated non-U.S. sovereign debt would be assigned to the 20 percent risk weight category.

\*\* Apply the risk-based capital requirements set forth in section III.B.3.b. of this appendix A.

<sup>58</sup> For purposes of this section IV, a sovereign is defined as a central government, including its agencies, departments, ministries, and the central bank. This definition does not include state, provincial, or local governments, or commercial enterprises owned by a central government.

**Table 2: Risk Weights Based on Short-Term External Ratings**

| <b>Short-term rating category</b>      | <b>Examples</b> | <b>Non-U.S. Sovereign Risk Weight*</b> | <b>Non-Sovereign Risk Weight</b> | <b>Securitization Exposure Risk Weight</b> |
|--|-----------------|--|----------------------------------|--|
| Highest investment grade rating *      | A-1, P-1        | 0 percent                              | 20 percent                       | 20 percent                                 |
| Second-highest investment grade rating | A-2, P-2        | 20 percent                             | 35 percent                       | 35 percent                                 |
| Lowest investment grade rating         | A-3, P-3        | 50 percent                             | 75 percent                       | 75 percent                                 |
| Unrated                                | --              | 100 percent                            | 100 percent                      | 100 percent                                |

\* Claims collateralized by A1/P1 rated sovereign debt would be assigned to the 20 percent risk weight category.

For purposes of this section IV, an external rating is defined as a credit rating that is assigned by an NRSRO, provided that the credit rating:

- a. Fully reflects the entire amount of credit risk with regard to all payments owed on the claim (that is, the rating must fully reflect the credit risk associated with timely repayment of principal and interest);
- b. Is monitored by the issuing NRSRO;
- c. Is published in an accessible public form (for example, on the NRSRO's web site or in financial media); and
- d. Is, or will be, included in the issuing NRSRO's publicly available ratings transition matrix which tracks the performance and stability (or ratings migration) of an NRSRO's issued external ratings for the specific type of claim (for example, corporate debt).

In addition, an unrated covered claim on a non-U.S. sovereign that has an external rating from an NRSRO should be deemed to have an external rating equal to the sovereign's issuer rating. If a claim has two or more external ratings, the bank holding company must use the least favorable external rating to risk weight the claim. Similarly, if a claim has components that are assigned different external ratings, the lowest component rating must be applied to the entire claim. For example, if a securitization exposure has a principal component externally rated



BBB, but the interest component is externally rated B, the entire exposure will be subject to the gross-up treatment accorded to a securitization exposure rated B or lower. Similarly, if a portion of a specific claim is unrated, then the entire claim must be treated as if it were unrated. The Federal Reserve retains the authority to override the use of certain ratings or the ratings on certain instruments, either on a case-by-case basis or through broader supervisory policy, if necessary or appropriate to address the risk that an instrument poses to banking organizations.

2. Collateral. In addition to the forms of recognized financial collateral set forth in section III.B.1 of this appendix A, a bank holding company also may recognize as collateral (i) covered claims in the form of liquid and readily marketable debt securities that are externally rated no less than investment grade and (ii) liquid and readily marketable debt securities guaranteed by non-U.S. sovereigns whose issuer rating is at least investment grade. Claims, or portions of claims, collateralized by such collateral may be assigned to the risk weight appropriate to the collateral's external rating as set forth in Table 1 or 2 of section IV.B.1. For example, the portion of a claim collateralized with an AA-rated mortgage-backed security is assigned to the 20 percent risk weight category.

Subject to the final sentence of this paragraph, there is, however, a 20 percent risk weight floor on collateralized claims under this section IV. Thus, the portion of a claim collateralized by a security issued by a non-U.S. sovereign with an issuer rating of AAA would be assigned to the 20 percent risk weight category instead of the zero percent risk weight category. The procedures set forth in section III of this appendix A continue to apply, however, to claims collateralized by securities issued or guaranteed by OECD central governments for which a positive margin of collateral is maintained on a daily basis, fully taking into account any change in the banking organization's exposure to the obligor and counterparty under the claim in relation to the market value of the collateral held to support the claim.

In the event that the external rating of a security used to collateralize a claim results in a higher risk weight than would have otherwise been assigned to the claim, then the lower risk weight appropriate to the underlying claim could be applied.

3. Guarantees. Claims, or portions of claims, guaranteed by a third party entity (other than an excluded entity) whose unsecured long-term senior debt (without credit enhancements) is externally rated at least investment grade or by a non-U.S. sovereign that has an issuer rating of at least investment grade may be assigned to the risk weight of the guarantor as set forth in Table 1 of section IV.B.1 corresponding to the protection provider's long-term senior debt rating (or issuer rating in the case of a non-U.S. sovereign), provided that the guarantee:

- a. Is written and unconditional,
- b. Covers all or a pro rata portion of contractual payments of the obligor on the underlying claim,
- c. Gives the beneficiary a direct claim against the protection provider,
- d. Is non-cancelable by the protection provider for reasons other than the breach of contract by the beneficiary,
- e. Is legally enforceable against the protection provider in a jurisdiction where the protection provider has sufficient assets against which a judgment may be attached and enforced, and
- f. Requires the protection provider to make payment to the beneficiary upon default of the obligor on the underlying claim without first requiring the beneficiary to demand payment from the obligor.

C. Residential Mortgages

1. A bank holding company may separate its residential mortgage portfolio into two subportfolios, where the first subportfolio includes mortgage loans originated by the banking

organization or acquired by the banking organization prior to the date the institution becomes subject to this section IV and the second includes mortgage loans originated or acquired by the bank holding company after that date. The bank holding company may apply the risk-based capital treatment set forth in section III of this appendix A to the first subportfolio while applying the requirements set forth in this section IV to the second subportfolio. A bank holding company that does not so separate its residential mortgage portfolio must apply the capital treatment in this section IV to all of its qualifying residential mortgage exposures. If a banking organization at any time opts-out of the Alternative Approach and, subsequently, again becomes subject to this section IV, it may not apply the procedures set forth in this section IV.C.1.

2. Subject to section IV.C.1., a bank holding company assigns its residential mortgage exposures to risk weight categories based on their loan-to-value (LTV) or combined loan-to-value (CLTV) ratios, as appropriate, in accordance with Tables 3 and 4 of sections IV C.3.a. and IV.C.3.b., respectively, but must risk-weight a nonqualifying residential mortgage exposure at no less than 100 percent. Residential mortgage exposures include all loans secured by a lien on a one- to four-family residential property<sup>59</sup> that is either owner-occupied or rented. Qualifying residential mortgage exposures are residential mortgage exposures that (1) have been made in accordance with prudent underwriting standards; (2) are performing in accordance with their original terms; (3) are not 90 days or more past due or carried in nonaccrual status; and (4) are not made for the purpose of speculative property development. Nonqualifying residential mortgage exposures are residential mortgage exposures other than qualifying residential mortgage exposures.

3. For purposes of Tables 3 and 4, LTV is defined as (i) the current outstanding principal balance of the loan less the amount covered by any loan-level private mortgage

insurance (“PMI”) divided by (ii) the most recent purchase price of the property or the most recent appraisal or evaluation value of the property (if the appraisal or evaluation is more recent than the most recent purchase and was obtained by the bank holding company in connection with an extension of new credit). Loan-level PMI means insurance (i) provided by a non-affiliated PMI provider whose unsecured long-term senior debt (without credit enhancements) is externally rated at least the third highest investment grade by an NRSRO, and (ii) which protects a mortgage lender in the event of the default of a mortgage borrower up to a predetermined portion of the value of residential mortgage exposure. For purposes of the loan level PMI definition, (i) an affiliate of a company means any company that controls, is controlled by, or is under common control with, the company; and (ii) a person or company controls a company if it owns, controls, or has power to vote 25 percent or more of a class of voting securities of the company or consolidates the company for financial reporting purposes. CLTV for a junior lien mortgage is defined as (i) the current outstanding principal balance of the junior mortgage and all more senior mortgages less the amount covered by any loan-level PMI covering the junior lien divided by (ii) the most recent purchase price of the property or the most recent appraisal or evaluation value of the property (if the appraisal or evaluation is more recent than the most recent purchase and was obtained by the bank holding company in connection with an extension of new credit). The procedures for residential mortgage exposures that have negative amortization features are set forth in section IV.C.3.c.

a. First Lien Residential Mortgage Exposures

First lien residential mortgage exposures are risk-weighted in accordance with Table 3 of this section IV.C.3.a (with nonqualifying residential mortgage exposures subject to a risk weight floor of 100 percent). If a banking organization holds both the senior and junior lien(s) on a

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<sup>59</sup> Loans that qualify as mortgages that are secured by 1- to 4-family residential properties are listed in the

residential property and no other party holds an intervening lien, the banking organization's claims are treated as a single claim secured by a senior lien for purposes of determining the LTV ratio and assigning a risk weight.

**Table 3: Risk Weights for First Lien Residential Mortgage Exposures**

| Loan-to-Value Ratio | Risk Weight |
|---------------------|-------------|
| Up to 60%           | 20%         |
| >60% and up to 80%  | 35%         |
| >80% and up to 85%  | 50%         |
| >85% and up to 90%  | 75%         |
| >90% and up to 95%  | 100%        |
| >95%                | 150%        |

b. Stand-Alone Junior Liens

Stand-alone junior lien residential mortgage exposures, including structured mortgages and home equity lines of credit, must be risk weighted using the CLTV ratio of the stand-alone junior lien and all senior liens in accordance with Table 4 (with nonqualifying residential mortgage exposures subject to a risk weight floor of 100 percent).

**Table 4: Risk Weights for Stand-Alone Junior Lien Residential Mortgage Exposures**

| Combined Loan-to-Value Ratio | Risk Weight |
|------------------------------|-------------|
| Up to 60%                    | 75%         |
| >60% and up to 90%           | 100%        |
| >90%                         | 150%        |

c. Residential Mortgage Exposures With Negative Amortization Features

Residential mortgage exposures with negative amortization features are assigned to a risk weight category using a loan's current LTV ratio in accordance with Table 3 of section IV.C.3.a. Any remaining potential increase in the mortgage's principal balance permitted through the negative amortization feature is to be treated as a long-term commitment and converted to an on-balance sheet credit equivalent amount as set forth in section III.D.2. of this appendix. The credit equivalent amount of the commitment is then risk-weighted according to Table 3 based on the loan's "highest contractual LTV ratio." The highest contractual LTV ratio of a mortgage loan equals the current outstanding principal balance of the loan plus the credit equivalent amount of the remaining negative amortization "commitment" less the amount covered by any loan-level PMI divided by the most recent purchase price of the property or the most recent appraisal or evaluation value of the property (if the appraisal or evaluation is more recent than the most recent purchase and was obtained by the bank holding company in connection with an extension of new credit). A bank holding company with a stand-alone second lien where the more senior lien(s) can negatively amortize must first adjust the principal amount of those senior or intervening liens that can negatively amortize to reflect the maximum contractual loan amount as if it were to fully negatively amortize under the applicable contract. The adjusted LTV would then be added to the stand-alone junior lien to calculate the appropriate CLTV.

D. Short-Term Commitments

Unused portions of commitments with an original maturity of one year or less (including eligible asset backed commercial paper liquidity facilities) (that is, short-term commitments) are converted using the 10 percent conversion factor. Unconditionally cancelable commitments, as defined in section III.D.2.b. of this appendix, retain the zero percent conversion factor. Short-term commitments to originate one- to four-family residential mortgage loans provided in the

ordinary course of business that are not treated as a derivative under GAAP will continue to be converted to an on-balance-sheet credit equivalent amount using the zero percent conversion factor.

E. Securitizations of Revolving Credit with Early Amortization Provisions

1. Definitions

a. Early amortization provision means a provision in the documentation governing a securitization that, when triggered, causes investors in the securitization exposures to be repaid before the original stated maturity of the securitization exposures, unless the provision is triggered solely by events not directly related to the performance of the underlying exposures or the originating banking organization (such as material changes in tax laws or regulations).

b. Excess spread means gross finance charge collections and other income received by a trust or special purpose entity minus interest paid to the investors in the securitization exposures, servicing fees, charge-offs, and other similar trust or special purpose entity expenses.

c. Excess spread trapping point is the point at which the banking organization is required by the documentation governing a securitization to divert and hold excess spread in a spread or reserve account, expressed as a percentage.

d. Investors' interest is the total amount of securitization exposure issued by a trust or special purpose entity to investors.

e. Revolving credit means a line of credit where the borrower is permitted to vary both the drawn amount and the amount of repayment within an agreed limit.

2. A bank holding company that securitizes revolving credits where the securitization structure contains an early amortization provision must maintain risk-based capital against the investors' interest as required under this section. Capital for securitizations of revolving credit exposures that incorporate early-amortization provisions will be assessed based

on a comparison of the securitization's annualized three-month average excess spread against the excess spread trapping point. To calculate the securitization's excess spread trapping point ratio, a bank holding company must calculate the three-month average of 1) the dollar amount of excess spread divided by 2) the outstanding principal balance of underlying pool of exposures at the end of each of the prior three months. The annualized three month average of excess spread is then divided by the excess spread trapping point that is required by the securitization structure. The excess spread trapping point ratio is compared to the ratios contained in Table 5 of section IV.E.3 to determine the appropriate conversion factor to apply to the investor's interest. The amount of investor's interest after conversion is then assigned capital in accordance with that appropriate to the underlying obligor, collateral or guarantor. For securitizations that do not require excess spread to be trapped, or that specify trapping points based primarily on performance measures other than the three-month average excess spread, the excess spread trapping point is 4.5 percent.

3. For a banking organization subject to the early amortization requirements in this section IV.E., if the aggregate risk-based capital requirement for residual interests, direct credit substitutes, other securitization exposures, and early amortization provisions in connection with the same securitization of revolving credit exposures exceeds the risk-based capital requirement on the underlying securitized assets, then the capital requirement for the securitization transaction will be limited to the greater of the risk-based capital requirement for 1) residual interests or 2) the underlying securitized assets calculated as if the banking organization continued to hold the assets on its balance sheet.



Table 5: Early Amortization Credit Conversion Factor

| Excess Spread Trapping Point Ratio      | Credit Conversion Factor (CCF) |
|---|--------------------------------|
| 133.33 percent or more                  | 0 percent                      |
| less than 133.33 percent to 100 percent | 5 percent                      |
| less than 100 percent to 75 percent     | 15 percent                     |
| less than 75 percent to 50 percent      | 50 percent                     |
| Less than 50 percent                    | 100 percent                    |

F. Risk Weights for Derivatives

A bank holding company may not apply the 50 percent risk weight cap for derivative contract counterparties set forth in section III.E. of this appendix A.