

6714-01-P

FEDERAL DEPOSIT INSURANCE CORPORATION

12 CFR Parts 303, 308, 324, 327, 333, 337, 347, 349, 360, 362, 363, 364, 365, 390, and 391

RIN 3064-AD95

Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Capital Adequacy, Transition Provisions, Prompt Corrective Action, Standardized Approach for Risk-weighted Assets, Market Discipline and Disclosure Requirements, Advanced Approaches Risk-Based Capital Rule, and Market Risk Capital Rule

AGENCY: Federal Deposit Insurance Corporation.

ACTION: Final rule.

SUMMARY: The Federal Deposit Insurance Corporation (FDIC) is adopting as final an interim final rule that revised the risk-based and leverage capital requirements for FDIC-supervised institutions, with no substantive changes. This final rule is substantively identical to a joint final rule issued by the Office of the Comptroller of the Currency (OCC) and the Board of Governors of the Federal Reserve System (Federal Reserve) (together, with the FDIC, the agencies). The interim final rule became effective on January 1, 2014; however, the mandatory compliance date for FDIC-supervised institutions that are not subject to the advanced internal ratings-based approaches (advanced approaches) is January 1, 2015.

DATES: Effective date: January 1, 2014. Mandatory compliance date: January 1, 2014 for advanced approaches FDIC-supervised institutions; January 1, 2015 for all other FDIC-supervised institutions.

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SUPPLEMENTARY INFORMATION:

I. Introduction

On August 30, 2012, the agencies published in the Federal Register three joint notices of proposed rulemaking seeking public comment on revisions to their risk-based and leverage capital requirements and the methodologies for calculating risk-weighted assets under the standardized and advanced approaches (each, a proposal, and together, the notices of proposed rulemaking (NPRs), the proposed rules, or the proposals).¹ The proposed rules, in part, reflected revisions to international capital standards adopted by the Basel Committee on Banking Supervision (BCBS) and described in, Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems (Basel III), as well as subsequent changes to the Basel III framework and recent BCBS consultative papers.² The proposals also included certain provisions that are required under, or maintain consistency with, the Dodd-Frank Wall Street

¹ 77 FR 52792 (August 30, 2012); 77 FR 52888 (August 30, 2012); 77 FR 52978 (August 30, 2012).

² Basel III was published in December 2010 and revised in June 2011. The text is available at <http://www.bis.org/publ/bcbs189.htm>. The BCBS is a committee of banking supervisory authorities, which was established by the central bank governors of the G-10 countries in 1975. More information regarding the BCBS and its membership is available at <http://www.bis.org/bcbs/about.htm>. Documents issued by the BCBS are available through the Bank for International Settlements web site at <http://www.bis.org>.

Reform and Consumer Protection Act (the Dodd-Frank Act).³ After considering the public comments received on the NPRs, on September 10, 2013, the FDIC issued the three proposals as a consolidated interim final rule (Basel III interim final rule).⁴

Concurrent with the adoption of the Basel III interim final rule, the agencies issued a related joint notice of proposed rulemaking that would adopt enhanced supplementary leverage ratio standards for large, interconnected U.S. banking organizations and their insured depository institution subsidiaries (enhanced supplementary leverage ratio NPR).⁵ The Basel III interim final rule sought comments on the interaction between the Basel III interim final rule and the enhanced supplementary leverage ratio standards NPR. The FDIC is now issuing as final its Basel III interim final rule with no substantive changes.

II. Summary of the Comments and the Final Rule

A. Comments

In response to the Basel III interim final rule, the FDIC received three public comments from two banking organizations and one trade association representing the financial services industry. This section of the preamble provides a discussion of the comment letters and the FDIC's response to them.

One commenter encouraged the FDIC to seek public comment earlier in the development process of new international capital standards. Specifically, the commenter stated that while developing international capital standards among the BCBS members the FDIC should issue an advance notice of proposed rulemaking describing prospective revisions to those standards so

³ Pub. L. 111-203, 124 Stat. 1376, 1435-38 (2010).

⁴ 78 FR 55340 (Sept. 10, 2013). The OCC and the Federal Reserve issued the three proposals as a consolidated final rule that was substantively identical to the FDIC's Basel III interim final rule (78 FR 62018 (Oct. 11, 2013)).

⁵ 78 FR 51101 (Aug. 20, 2013).

that U.S. banking organizations can more fully understand the implications for the U.S. banking sector and the U.S. economy as a whole. The commenter also recommended conducting an empirical study of the impact on the U.S. banking system, bank customers in particular, and the economy in general, resulting from the U.S. implementation of any international capital standards adopted by the BCBS. The FDIC notes that the BCBS seeks public comment, including from U.S. banking organizations, in connection with its development of international capital standards. As members of the BCBS the agencies are actively engaged in this process, which also includes quantitative impact analyses to assess the impact of proposed capital standards.

Another commenter requested that the FDIC revise the credit conversion factors (CCFs) for trade related, self-liquidating financing for on-balance sheet exposures for up to one year, provided that the banking organization has proper documentation to substantiate the transaction. This commenter also requested that the FDIC use the same country risk classification ratings (CRC) as the OECD without any further downgrades for exposures to foreign banking organizations. For the reasons stated in the Basel III interim final rule, the final rule adopts the CCFs and CRC methodology set forth in the interim final rule without any substantive change.⁶

The commenter also encouraged the FDIC to reconsider several of the issues raised by commenters responding to the three proposals issued in 2012. For example, the commenter requested that the FDIC reconsider the treatment under the Basel III interim final rule for capital instruments issued by banking organizations that are organized as S-corporations; the limitation on the amount of mortgage servicing assets that may be included in common equity tier 1 capital; the deduction of collateralized debt obligations supported by trust preferred securities; the

⁶ 78 FR 55402-03.

inclusion of accumulated other comprehensive income (AOCI) in common equity tier 1 capital; and the 150 percent risk weight for certain delinquent exposures. For the reasons stated in the Basel III interim final rule, the final rule adopts these provisions without substantive change.⁷

Another commenter requested that the FDIC reconsider whether to recognize financial guaranty insurers as guarantees under the definition of “eligible guarantor” set forth in the Basel III interim final rule. The commenter stated that such an exclusion fails to recognize the risk mitigating benefits that may be associated with financial guarantee insurance. The FDIC believes that guarantees issued by these types of entities can exhibit wrong-way risk and that modifying the definition of eligible guarantor to accommodate these entities or entities that are not investment grade would be contrary to one of the key objectives of the capital framework, which is to mitigate interconnectedness and systemic vulnerabilities within the financial system. Therefore, the FDIC is finalizing the definition of “eligible guarantor” with no change.

B. The Final Rule⁸

The FDIC is adopting the Basel III interim final rule as a final rule with no substantive changes. The only changes in this final rule are technical revisions to conform it to the final rules issued by the Federal Reserve and the OCC. For example, the final rule uses the correct compliance date, January 1, 2015, in section 324.63(a) rather than January 1, 2014 as used in the Basel III interim final rule. Also, several sections of the final rule have been clarified to read, “this paragraph (x)”, instead of “this paragraph,” to match internal references in the final rule adopted by the Federal Reserve and the OCC.

⁷ 78 FR 55354 (S-corporations), 78 FR 55388 (MSAs), 78 FR 55386 (TruPs), 78 FR 55346 (AOCI); and 78 FR 55407-08 (delinquent exposures).

⁸ For a section-by-section summary of the final rule see 78 FR 55340 (Sept. 10, 2013).

Consistent with the Basel III interim final rule, the final rule is intended to improve both the quality and quantity of FDIC-supervised institutions' capital.⁹ The final rule implements a revised definition of regulatory capital, a new common equity tier 1 minimum capital requirement, a higher minimum tier 1 capital requirement, and, for FDIC-supervised institutions subject to the advanced approaches, a supplementary leverage ratio that incorporates a broader set of exposures in the denominator measure (that is, total leverage exposure).¹⁰ The final rule incorporates these new requirements into the FDIC's prompt corrective action (PCA) framework. In addition, the final rule establishes limits on an FDIC-supervised institution's capital distributions and certain discretionary bonus payments if the institution does not hold a specified amount of common equity tier 1 capital in addition to the amount necessary to meet its minimum risk-based capital requirements. The final rule amends the methodologies for determining risk-weighted assets for all FDIC-supervised institutions, and adopts changes to the FDIC's regulatory capital requirements that meet the requirements of and are consistent with section 171 and section 939A of the Dodd-Frank Act.¹¹ In addition, the FDIC notes that while portions of the final rule refer to circumstances where a party becomes subject to receivership, the final rule is intended to govern matters relating to capital requirements and should not be construed as an indication of FDIC receivership rules or policies.

⁹ FDIC-supervised institutions include state nonmember banks and state savings associations. The term banking organizations includes national banks, state member banks, state nonmember banks, state and Federal savings associations, and top-tier bank holding companies domiciled in the United States not subject to the Federal Reserve's Small Bank Holding Company Policy Statement (12 CFR part 225, appendix C)), as well as top-tier savings and loan holding companies domiciled in the United States, except certain savings and loan holding companies that are substantially engaged in insurance underwriting or commercial activities.

¹⁰ The supplementary leverage ratio is defined as the simple arithmetic mean of the ratio of the banking organization's tier 1 capital to total leverage exposure calculated as of the last day of each month in the reporting quarter.

¹¹ Pub. L. 111-203, 124 Stat. 1376, 1435-38 (2010).

The final rule codifies the FDIC's regulatory capital rules, which have previously resided in various appendices to their respective regulations, into a harmonized integrated regulatory framework. In addition, the final rule amends the market risk capital rule (market risk rule) to apply to state savings associations.

III. Regulatory Flexibility Act

In general, section 4 of the Regulatory Flexibility Act (5 U.S.C. 604) (RFA) requires an agency to prepare a final regulatory flexibility analysis (FRFA) for a final rule unless the agency certifies that the rule will not, if promulgated, have a significant economic impact on a substantial number of small entities (defined for purposes of the RFA to include banking entities with total assets of \$500 million or less). Pursuant to the RFA, the agency must make the FRFA available to members of the public and must publish the FRFA, or a summary thereof, in the Federal Register. The FDIC published a summary of its FRFA in the Federal Register with the Basel III interim final rule.¹² The FDIC did not receive comments on the FRFA provided in the interim final rule. As such, and consistent with the FRFA in the Basel III interim final rule, the FDIC is publishing the following summary of its FRFA.¹³

For purposes of the FRFA, the FDIC analyzed the potential economic impact of the final rule on FDIC-supervised institutions with total assets of \$500 million or less (small FDIC-supervised institutions).

¹² 78 FR 55465-55468.

¹³ The FDIC published a summary of its initial regulatory flexibility analysis (IRFA) in connection with each of the proposed rules in accordance with Section 3(a) of the Regulatory Flexibility Act, 5 U.S.C. 603 (RFA). In the IRFAs provided in connection with the proposed rules, the FDIC requested comment on all aspects of the IRFAs, and, in particular, on any significant alternatives to the proposed rules applicable to covered small FDIC-supervised institutions that would minimize their impact on those entities. In the IRFA provided by the FDIC in connection with the proposal to revise the advanced approaches (77 FR 52978 (August 30, 2012)), the FDIC determined that there would not be a significant economic impact on a substantial number of small FDIC-supervised institutions and published a certification and a short explanatory statement pursuant to section 605(b) of the RFA.

As discussed in more detail below, the FDIC believes that this final rule may have a significant economic impact on a substantial number of the small entities under its jurisdiction.

A. Statement of the Need for, and Objectives of, the Final Rule

As discussed in the Supplementary Information section of the preamble to this final rule, the FDIC is revising its regulatory capital requirements to promote safe and sound banking practices, implement Basel III and other aspects of the Basel capital framework, harmonize capital requirements between types of FDIC-supervised institutions, and codify capital requirements.

Additionally, this final rule is consistent with certain requirements under the Dodd-Frank Act by: (1) revising regulatory capital requirements to remove references to, and requirements of reliance on, credit ratings,¹⁴ and (2) imposing new or revised minimum capital requirements on certain FDIC-supervised institutions.¹⁵

Under section 38(c)(1) of the Federal Deposit Insurance Act, the FDIC may prescribe capital standards for depository institutions that it regulates.¹⁶ The FDIC also must establish capital requirements under the International Lending Supervision Act for institutions that it regulates.¹⁷

B. Description and Estimate of Small FDIC-supervised institutions Affected by the Final Rule

Under regulations issued by the Small Business Administration,¹⁸ a small entity includes a depository institution with total assets of \$500 million or less. As of December 31, 2013, the

¹⁴ See 15 U.S.C. 78o-7, note.

¹⁵ See 12 U.S.C. 5371.

¹⁶ See 12 U.S.C. 1831o(c).

¹⁷ See 12 U.S.C. 3907.

¹⁸ See 13 CFR 121.201.

FDIC supervised approximately 3,394 small state nonmember banks and 303 small state savings associations.

C. Projected Reporting, Recordkeeping, and other Compliance Requirements

The final rule may impact small FDIC-supervised institutions in several ways. The final rule affects small FDIC-supervised institutions' regulatory capital requirements by changing the qualifying criteria for regulatory capital, including required deductions and adjustments, and modifying the risk-weight treatment for some exposures. The final rule also requires small FDIC-supervised institutions to meet a new minimum common equity tier 1 capital to risk-weighted assets ratio of 4.5 percent and an increased minimum tier 1 capital to risk-weighted assets ratio of 6 percent. Under the final rule, all FDIC-supervised institutions would remain subject to a 4 percent minimum tier 1 leverage ratio requirement.¹⁹ The final rule imposes limitations on capital distributions and discretionary bonus payments for small FDIC-supervised institutions that do not hold a minimum buffer of common equity tier 1 capital above the minimum ratios.

The final rule also includes changes to the general risk-based capital requirements that address the calculation of risk-weighted assets. Specifically, the final rule:

- Introduces a higher risk weight for certain past due exposures and acquisition, development, and construction real estate loans;
- Provides a more risk sensitive approach to exposures to non-U.S. sovereigns and non-U.S. public sector entities;

¹⁹ Beginning on January 1, 2018, advanced approaches FDIC-supervised institutions also would be required to satisfy a minimum tier 1 capital to total leverage exposure ratio requirement (the supplementary leverage ratio) of 3 percent. Advanced approaches FDIC-supervised institutions should refer to section 10 of subpart B of the final rule.

- Replaces references to credit ratings with new measures of creditworthiness;²⁰
- Provides more comprehensive recognition of collateral and guarantees; and
- Provides a more favorable capital treatment for transactions cleared through qualifying central counterparties.

As a result of the new requirements, some small FDIC-supervised institutions may have to alter their capital structure (including by raising new capital or increasing retention of earnings) in order to achieve compliance.

The FDIC has excluded from its analysis any burden associated with changes to the Consolidated Reports of Income and Condition for small FDIC-supervised institutions (FFIEC 031 and 041; OMB Nos. 7100-0036, 3064-0052, 1557-0081). Through the FFIEC, the FDIC and the other federal banking agencies published information collection changes in the regulatory reporting requirements to reflect the requirements of the final rule separately that include associated estimates of burden.²¹ The FDIC, and the other federal banking agencies, also expects to publish additional information collection changes in the regulatory reporting requirements for risk-weighted assets in the immediate future. Further analysis of the projected reporting requirements imposed by the final rule is located in the Paperwork Reduction Act section, below.

Most small FDIC-supervised institutions hold capital in excess of the minimum leverage and risk-based capital requirements set forth in the final rule. Although the capital requirements under the final rule are not expected to significantly impact the capital structure of these

²⁰ Section 939A of the Dodd-Frank Act addresses the use of credit ratings in Federal regulations. Accordingly, the final rule introduces alternative measures of creditworthiness for foreign debt, securitization positions, and resecuritization positions.

²¹ 79 FR 2527-01 (Jan. 14, 2014).

institutions, the FDIC expects that some may change internal capital allocation policies and practices to accommodate the requirements of the final rule. For example, an institution may elect to raise capital to return its excess capital position to the levels maintained prior to implementation of the final rule.

A comparison of the capital requirements in the final rule on a fully-implemented basis to the minimum requirements under the general risk-based capital rules shows that approximately 74 small FDIC-supervised institutions with total assets of \$500 million or less currently do not hold sufficient capital to satisfy the requirements of the final rule. Those institutions, which represent approximately three percent of small FDIC-supervised institutions, collectively would need to raise approximately \$233 million in regulatory capital to meet the minimum capital requirements under the final rule.

To estimate the cost to small FDIC-supervised institutions of the new capital requirement, the FDIC examined the effect of this requirement on capital structure and the overall cost of capital.²² The cost of financing a small FDIC-supervised institution is the weighted average cost of its various financing sources, which amounts to a weighted average cost of capital reflecting many different types of debt and equity financing. Because interest payments on debt are tax deductible, a more leveraged capital structure reduces corporate taxes, thereby lowering funding costs, and the weighted average cost of financing tends to decline as leverage increases. Thus, an increase in required equity capital would – all else equal – increase the cost of capital for that institution. This effect could be offset to some extent if the additional capital protection caused the risk premium demanded by the institution’s counterparties to decline sufficiently. The FDIC did not try to measure this effect. This increased cost in the most

²² See Merton H. Miller, (1995), “Do the M & M propositions apply to banks?” *Journal of Banking & Finance*, Vol. 19, pp. 483-489.

burdensome year would be tax benefits foregone: the capital requirement, multiplied by the interest rate on the debt displaced and by the effective marginal tax rate for the small FDIC-supervised institutions affected by the final rule. The effective marginal corporate tax rate is affected not only by the statutory Federal and state rates, but also by the probability of positive earnings and the offsetting effects of personal taxes on required bond yields. Graham (2000) considers these factors and estimates a median marginal tax benefit of \$9.40 per \$100 of interest.²³ So, using an estimated interest rate on debt of 6 percent, the FDIC estimated that for institutions with total assets of \$500 million or less, the annual tax benefits foregone on \$233 million of capital switching from debt to equity is approximately \$1.3 million per year ($\$233 \text{ million} * 0.06 \text{ (interest rate)} * 0.094 \text{ (median marginal tax savings)}$). Averaged across 74 institutions, the cost is approximately \$18,000 per institution per year.

Working with the other agencies, the FDIC also estimated the direct compliance costs related to financial reporting as a result of the final rule. This aspect of the final rule likely will require additional personnel training and expenses related to new systems (or modification of existing systems) for calculating regulatory capital ratios, in addition to updating risk weights for certain exposures. The FDIC assumes that small FDIC-supervised institutions will spend approximately \$43,000 per institution to update reporting system and change the classification of existing exposures. Based on comments from the industry, the FDIC increased this estimate from the \$36,125 estimate used in the proposed rules. The FDIC believes that this revised cost estimate is more conservative because it has increased even though many of the labor-intensive provisions proposed in the NPRs have been excluded from the final rule. For example, small

²³ See John R. Graham, (2000), How Big Are the Tax Benefits of Debt?, Journal of Finance, Vol. 55, No. 5, pp. 1901-1941. Graham points out that ignoring the offsetting effects of personal taxes would increase the median marginal tax rate to \$31.5 per \$100 of interest.

FDIC-supervised institutions have the option to maintain the current reporting methodology for gains and losses classified as Available for Sale (AFS) thus eliminating the need to update systems. Additionally, the exposures for which the risk weights are changing typically represent a small portion of assets (less than 5 percent) on institutions' balance sheets. Additionally, small FDIC-supervised institutions can maintain existing risk weights for residential mortgage exposures, eliminating the need for those institutions to reclassify existing mortgage exposures. The FDIC estimates that the \$43,000 in direct compliance costs will represent a burden for approximately 34 percent of small FDIC-supervised institutions with total assets of \$500 million or less. For purposes of this FRFA, the FDIC defines significant burden as an estimated cost greater than 2.5 percent of total non-interest expense or 5 percent of annual salaries and employee benefits. The direct compliance costs are the most significant cost since few small FDIC-supervised institutions will need to raise capital to meet the minimum ratios, as noted above.

D. Steps taken to Minimize the Economic Impact on Small FDIC-Supervised Institutions; Significant Alternatives

As discussed in the Basel III interim final rule, the FDIC made several significant revisions to the proposals in response to public comments. For example, under the final rule, non-advanced approaches FDIC-supervised institutions will be permitted to elect to exclude amounts reported as AOCI when calculating regulatory capital, to the same extent currently permitted under the general risk-based capital rules.²⁴ In addition, for purposes of calculating risk-weighted assets under the standardized approach, the FDIC is not adopting the proposed

²⁴ For most non-advanced approaches FDIC-supervised institutions, this will be a one-time only election. However, in certain limited circumstances, such as a merger of organizations that have made different elections, the FDIC may permit the resultant entity to make a new election.

treatment for 1-4 family residential mortgages, which would have required small FDIC-supervised institutions to categorize residential mortgage loans into one of two categories based on certain underwriting standards and product features, and then risk weight each loan based on its loan-to-value ratio. The FDIC also is retaining the 120-day safe harbor from recourse treatment for loans transferred pursuant to an early default provision. The FDIC believes that these changes will meaningfully reduce the compliance burden of the final rule for small FDIC-supervised institutions. For instance, in contrast to the proposal, the final rule does not require small FDIC-supervised institutions to review existing mortgage loan files, purchase new software to track loan-to-value ratios, train employees on the new risk-weight methodology, or hold more capital for exposures that would have been deemed category 2 under the proposed rule. Similarly, the option to elect to retain the current treatment of AOCI will reduce the burden associated with managing the volatility in regulatory capital resulting from changes in the value of a small FDIC-supervised institutions' AFS debt securities portfolio due to shifting interest rate environments. The FDIC believes these modifications substantially reduce compliance burden for small FDIC-supervised institutions.

IV. Paperwork Reduction Act

In accordance with the requirements of the Paperwork Reduction Act (PRA) of 1995 (44 U.S.C. 3501-3521), the FDIC may not conduct or sponsor, and the respondent is not required to respond to, an information collection unless it displays a currently valid Office of Management and Budget (OMB) control number.

In conjunction with the proposed rules, the FDIC submitted the information collection requirements contained therein to OMB for review. In response, OMB filed comments with the FDIC in accordance with 5 CFR 1320.11(c) withholding PRA approval and instructing that the collection should

be resubmitted to OMB at the final rule stage. As instructed by OMB, the information collection requirements contained in this final rule were submitted by the FDIC to OMB for review in connection with the adoption of the Basel III interim final rule under the PRA, under OMB Control No. 3064-0153. On January 24, 2014, OMB approved the FDIC's information collection request for a six-month period under emergency clearance procedures.

The final rule contains the same information collection requirements subject to the PRA that were included in the Basel III interim final rule. They are found in sections 324.3, 324.22, 324.35, 324.37, 324.41, 324.42, 324.62, 324.63 (including tables), 324.121, through 324.124, 324.132, 324.141, 324.142, 324.153, 324.173 (including tables). Therefore, the FDIC will submit another information collection request for extension without change of the currently approved collection for the typical three-year period.

The information collection requirements contained in sections 324.203, through 324.210, and 324.212 concerning market risk are approved by OMB under Control No. 3604-0178.

V. Plain Language

Section 722 of the Gramm-Leach-Bliley Act requires the FDIC to use plain language in all proposed and final rules published after January 1, 2000. The agencies have sought to present the final rule in a simple and straightforward manner and did not receive any comments on the use of plain language.

VI. Small Business Regulatory Enforcement Fairness Act of 1996

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996, or "SBREFA," the FDIC must advise the OMB as to whether the final rule constitutes a "major"

rule.²⁵ If a rule is major, its effectiveness will generally be delayed for 60 days pending congressional review.

In accordance with SBREFA, the FDIC has advised the OMB that this final rule is a major rule for the purpose of congressional review. Following OMB's review, the FDIC will file the appropriate reports with Congress and the Government Accountability Office so that the final rule may be reviewed.

List of Subjects in 12 CFR Part 303

- Administrative practice and procedure
- Banks
- banking
- Bank merger
- Branching
- Foreign investments
- Golden parachute payments
- Insured branches
- Interstate branching
- Reporting and recordkeeping requirements
- Savings associations

List of Subjects in 12 CFR Part 308

- Administrative practice and procedure
- Banks
- Banking
- Claims
- Crime
- Equal access to justice
- Ex parte communications
- Hearing procedure
- Lawyers
- Penalties
- State nonmember banks

²⁵ 5 U.S.C. 801 et seq.

List of Subjects in 12 CFR Part 324

- Administrative practice and procedure
- Banks
- banking
- Capital Adequacy
- Reporting and recordkeeping requirements
- Savings associations
- State non-member banks

List of Subjects in 12 CFR Part 327

- Bank deposit insurance
- Banks
- banking
- Savings associations

List of Subjects in 12 CFR Part 333

- Banks
- Banking
- Corporate powers

List of Subjects in 12 CFR Part 337

- Banks
- Banking
- Reporting and recordkeeping requirements
- Savings associations
- Securities

List of Subjects in 12 CFR Part 347

- Authority delegations (Government agencies)
- Bank deposit insurance
- Banks
- Banking
- Credit
- Foreign banking
- Investments
- Reporting and recordkeeping requirements
- United States investments abroad

List of Subjects in 12 CFR Part 349

- Foreign banking

- Banks
- Banking

List of Subjects in 12 CFR Part 360

- Banks
- Banking
- Investments

List of Subjects in 12 CFR Part 362

- Administrative practice and procedure
- Authority delegations (Government agencies)
- Bank deposit insurance
- Banks
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List of Subjects in 12 CFR Part 363

- Accounting
- Administrative practice and procedure
- Banks
- Banking
- Reporting and recordkeeping requirements

List of Subjects in 12 CFR Part 364

- Administrative practice and procedure
- Bank deposit insurance
- Banks
- Banking
- Reporting and recordkeeping requirements
- Safety and Soundness

List of Subjects in 12 CFR Part 365

- Banks
- Banking
- Mortgages

List of Subjects in 12 CFR Part 390

- Administrative practice and procedure
- Advertising

- Aged
- Credit
- Civil rights
- Conflicts of interest
- Crime
- Equal employment opportunity
- Ethics
- Fair housing
- Governmental employees
- Home mortgage disclosure
- Individuals with disabilities
- OTS employees
- Reporting and recordkeeping requirements
- Savings associations

List of Subjects in 12 CFR Part 391

- Administrative practice and procedure
- Advertising
- Aged
- Credit
- Civil rights
- Conflicts of interest
- Crime
- Equal employment opportunity
- Ethics
- Fair housing
- Governmental employees
- Home mortgage disclosure
- Individuals with disabilities
- OTS employees
- Reporting and recordkeeping requirements
- Savings associations

Authority and Issuance

For the reasons set forth in the preamble, the interim rule amending chapter III of title 12 of the Code of Federal Regulations, which was published at 78 FR 55340 on September 10, 2013, is adopted as a final rule with the following changes:

PART 324 CAPITAL ADEQUACY OF FDIC-SUPERVISED INSTITUTIONS

1. The authority citation for part 324 continues to read as follows:

Authority: 12 U.S.C. 1815(a), 1815(b), 1816, 1818(a), 1818(b), 1818(c), 1818(t), 1819(Tenth), 1828(c), 1828(d), 1828(i), 1828(n), 1828(o), 1831o, 1835, 3907, 3909, 4808; 5371; 5412; Pub. L. 102-233, 105 Stat. 1761, 1789, 1790 (12 U.S.C. 1831n note); Pub. L. 102-242, 105 Stat. 2236, 2355, as amended by Pub. L. 103-325, 108 Stat. 2160, 2233 (12 U.S.C. 1828 note); Pub. L. 102-242, 105 Stat. 2236, 2386, as amended by Pub. L. 102-550, 106 Stat. 3672, 4089 (12 U.S.C. 1828 note); Pub. L. 111-203, 124 Stat. 1376, 1887 (15 U.S.C. 78o-7 note).

2. Revise the definitions of financial institution, high volatility commercial real estate, and netting set in § 324.2 to read as follows:

§ 324.2 Definitions.

Financial institution means:

* * *

(6) Any other company that the FDIC may determine is a financial institution based on activities similar in scope, nature, or operation to those of the entities included in paragraphs (1) through (4) of this definition.

* * * * *

High volatility commercial real estate (HVCRE) exposure means * * *

(2) * * *

(i) Would qualify as an investment in community development under 12 U.S.C. 338a or 12 U.S.C. 24 (Eleventh), as applicable, or as a “qualified investment” under 12 CFR part 345, and

* * * * *

Netting set means

* * *

(1) That is not subject to such a master netting agreement; or

* * * * *

3. Revise paragraph (a) in § 324.3 to read as follows:

§ 324.3 Operational requirements for counterparty credit risk.

(a) Cleared transaction. In order to recognize certain exposures as cleared transactions pursuant to paragraphs (1)(ii), (iii), or (iv) of the definition of “cleared transaction” in § 324.2, the exposures must meet the applicable requirements set forth in this paragraph

(a). * * * * *

4. Revise paragraph (b)(4) in § 324.10 to read as follows:

§ 324.10 Minimum capital requirements.

(b) * * *

(4) Leverage ratio. An FDIC-supervised institution’s leverage ratio is the ratio of the FDIC-supervised institution’s tier 1 capital to the FDIC-supervised institution’s average total consolidated assets as reported on the FDIC-supervised institution’s Call Report minus amounts deducted from tier 1 capital under § 324.22(a), (c), and (d).

* * * * *

5. Revise paragraph (b)(1)(iv)(C) in § 324.11 to read as follows:

§ 324.11 Capital conservation buffer and countercyclical capital buffer amount.

(b) * * *

(1) * * *

(iv) * * *

(C) The location of a securitization exposure is the location of the underlying exposures, or, if the underlying exposures are located in more than one national jurisdiction, the national jurisdiction where the underlying exposures with the largest aggregate unpaid principal balance are located. For purposes of this paragraph (b), the location of an underlying exposure shall be the location of the borrower, determined consistent with paragraph (b)(1)(iv)(A) of this section.

* * * * *

6. Revise paragraph (c)(2)(i) in § 324.21 to read as follows:

§ 324.21 Minority interest.

(c) * * *

(2) * * *

(i) The amount of common equity tier 1 capital the subsidiary must hold, or would be required to hold pursuant to paragraph (b) of this section, to avoid restrictions on distributions and discretionary bonus payments under § 324.11 or equivalent standards established by the subsidiary's home country supervisor; or

* * * * *

7. Revise § 324.22 as follows:

§ 324.22 Regulatory capital adjustments and deductions.

a. Revise paragraph (a) to read as follows:

(a) Regulatory capital deductions from common equity tier 1 capital. An FDIC-supervised institution must deduct from the sum of its common equity tier 1 capital elements the items set forth in this paragraph (a):

* * * * *

b. Revise paragraph (b)(1) to read as follows:

(b) * * *

(1) An FDIC-supervised institution must adjust the sum of common equity tier 1 capital elements pursuant to the requirements set forth in this paragraph (b). Such adjustments to common equity tier 1 capital must be made net of the associated deferred tax effects.

* * * * *

c. Revise the first sentence in paragraph (b)(2)(iv)(C) to read as follows:

(b) * * *

(2) * * *

(iv) * * *

(C) An FDIC-supervised institution may, with the prior approval of the FDIC, change its AOCI opt-out election under this paragraph (b) in the case of a merger, acquisition, or purchase transaction that meets the requirements set forth at paragraph (b)(2)(iv)(B) of this section, but does not meet the requirements of paragraph (b)(2)(iv)(A).

* * * * *

d. Revise the last sentence, but not footnote 21, in paragraph (c)(4)(i) to read as follows:

(c) * * *

(4) * * *

(i) * * * In addition, an FDIC-supervised institution that underwrites a failed underwriting, with the prior written approval of the FDIC, for the period of time stipulated by the FDIC, is not required to deduct a non-significant investment in the capital of an unconsolidated financial institution pursuant to this paragraph (c) to the extent the investment is related to the failed underwriting.

* * * * *

e. Revise the last sentence in paragraph (c)(5) to read as follows:

(c) * * *

(5) * * * In addition, with the prior written approval of the FDIC, for the period of time stipulated by the FDIC, an FDIC-supervised institution that underwrites a failed underwriting is not required to deduct a significant investment in the capital of an unconsolidated financial institution pursuant to this paragraph (c) if such investment is related to such failed underwriting.

* * * * *

f. Revise paragraph (d)(1) to read as follows:

(d) * * *

(1) An FDIC-supervised institution must deduct from common equity tier 1 capital elements the amount of each of the items set forth in this paragraph (d) that, individually, exceeds 10 percent of the sum of the FDIC-supervised institution's common equity tier 1 capital elements, less adjustments to and deductions from common equity tier 1 capital required under paragraphs (a) through (c) of this section (the 10 percent common equity tier 1 capital deduction threshold).

* * * * *

g. Revise paragraph (d)(3) to read as follows:

(d) * * *

(3) For purposes of calculating the amount of DTAs subject to the 10 and 15 percent common equity tier 1 capital deduction thresholds, an FDIC-supervised institution may exclude DTAs and DTLs relating to adjustments made to common equity tier 1 capital

under § paragraph (b) of this section. An FDIC-supervised institution that elects to exclude DTAs relating to adjustments under paragraph (b) of this section also must exclude DTLs and must do so consistently in all future calculations. An FDIC-supervised institution may change its exclusion preference only after obtaining the prior approval of the FDIC.

* * * * *

h. Revise paragraph (e)(3) to read as follows:

(e) * * *

(3) For purposes of calculating the amount of DTAs subject to the threshold deduction in paragraph (d) of this section, the amount of DTAs that arise from net operating loss and tax credit carryforwards, net of any related valuation allowances, and of DTAs arising from temporary differences that the FDIC-supervised institution could not realize through net operating loss carrybacks, net of any related valuation allowances, may be offset by DTLs (that have not been netted against assets subject to deduction pursuant to paragraph (e)(1) of this section) subject to the conditions set forth in this paragraph (e).

* * * * *

i. Revise paragraph (e)(5) to read as follows:

(e) * * *

(5) An FDIC-supervised institution must net DTLs against assets subject to deduction under this section in a consistent manner from reporting period to reporting period. An FDIC-supervised institution may change its preference regarding the manner in which it nets DTLs against specific assets subject to deduction under this section only after obtaining the prior approval of the FDIC.

* * * * *

j. Revise paragraph (h)(2)(iii)(B)(1) to read as follows:

(h) * * *

(2) * * *

(iii) * * *

(B) * * *

(1) The highest stated investment limit (in percent) for investments in the FDIC-supervised institution's own capital instruments or the capital of unconsolidated financial institutions as stated in the prospectus, partnership agreement, or similar contract defining permissible investments of the investment fund; or

* * * * *

k. Revise paragraph (h)(3)(i) to read as follows:

(h) * * *

(3) * * *

(i) The maturity of the short position must match the maturity of the long position, or the short position has a residual maturity of at least one year (maturity requirement); or

* * * * *

l. Revise paragraph (h)(3)(iii)(A) to read as follows:

(h) * * *

(3) * * *

(iii) * * *

(A) An FDIC-supervised institution may only net a short position against a long position in the FDIC-supervised institution's own capital instrument under paragraph (c)(1) of this section if the short position involves no counterparty credit risk.

* * * * *

8. Revise paragraph (k) in § 324.32 to read as follows:

§ 324.32 General risk weights.

(k) Past due exposures. Except for a sovereign exposure or a residential mortgage exposure, an FDIC-supervised institution must determine a risk weight for an exposure that is 90 days or more past due or on nonaccrual according to the requirements set forth in this paragraph (k).

* * * * *

9. Revise paragraph (a)(1)(ii)(B) in § 324.34 to read as follows:

§ 324.34 OTC derivative contracts.

(a) * * *

(1) * * *

(ii) * * *

(B) For purposes of calculating either the PFE under this paragraph (a) or the gross PFE under paragraph (a)(2) of this section for exchange rate contracts and other similar contracts in which the notional principal amount is equivalent to the cash flows, notional principal amount is the net receipts to each party falling due on each value date in each currency.

* * * * *

10. Revise § 324.35 as follows:

§ 324.35 Cleared transactions.

a. Revise paragraph (b)(2)(i)(A) to read as follows:

(b) * * *

(2) * * *

(i) * * *

(A) The exposure amount for the derivative contract or netting set of derivative contracts, calculated using the methodology used to calculate exposure amount for OTC derivative contracts under § 324.34; plus

* * * * *

b. Revise paragraph (b)(2)(ii)(A) to read as follows:

(b) * * *

(2) * * *

(ii) * * *

(A) The exposure amount for the repo-style transaction calculated using the methodologies under § 324.37(c); plus

* * * * *

c. Revise paragraph (c)(2)(i)(A) to read as follows:

(c) * * *

(2) * * *

(i) * * *

(A) The exposure amount for the derivative contract, calculated using the methodology to calculate exposure amount for OTC derivative contracts under § 324.34; plus

* * * * *

d. Revise paragraph (c)(2)(ii)(A) to read as follows:

(c) * * *

(2) * * *

(ii) * * *

(A) The exposure amount for repo-style transactions calculated using methodologies under § 324.37(c); plus

* * * * *

e. Revise paragraph (d)(3)(i)(F) to read as follows:

(d) * * *

(3) * * *

(i) * * *

(F) Where a QCCP has provided its K_{CCP} , an FDIC-supervised institution must rely on such disclosed figure instead of calculating K_{CCP} under this paragraph (d), unless the FDIC-supervised institution determines that a more conservative figure is appropriate based on the nature, structure, or characteristics of the QCCP.

* * * * *

f. Revise the second sentence in paragraph (d)(3)(ii)(A) to read as follows:

(d) * * *

(3) * * *

(ii) * * *

(A) * * * For purposes of this paragraph (d), for derivatives A_{Net} is defined in § 324.34(a)(2)(ii) and for repo-style transactions, A_{Net} means the exposure amount as defined in § 324.37(c)(2) using the methodology in § 324.37(c)(3);

* * * * *

11. Revise paragraph (c)(4)(i)(A) in § 324.37 to read as follows:

§ 324.37 Collateralized transactions.

(c) * * *

(4) * * *

(i) * * *

(A) An FDIC-supervised institution must use a 99th percentile one-tailed confidence interval.

* * * * *

12. Revise the first sentence in paragraph (b) in § 324.41 to read as follows:

§ 324.41 Operational requirements for securitization exposures.

(b) Operational criteria for synthetic securitizations. For synthetic securitizations, an FDIC-supervised institution may recognize for risk-based capital purposes the use of a credit risk mitigant to hedge underlying exposures only if each condition in this paragraph (b) is satisfied.

* * * * *

13. Revise § 324.42 as follows:

§ 324.42 Risk-weighted assets for securitization exposures.

a. Revise the second sentence in paragraph (h)(1)(iv) to read as follows:

(h) * * *

(1) * * *

(iv) For purposes of determining whether an FDIC-supervised institution is well capitalized for purposes of this paragraph (h), the FDIC-supervised institution's capital

ratios must be calculated without regard to the capital treatment for transfers of small-business obligations under this paragraph (h).

* * * * *

b. Revise the first sentence in paragraph (i)(1) to read as follows:

(i) * * *

(1) Protection provider. An FDIC-supervised institution may assign a risk weight using the SSFA in § 324.43 to an nth-to-default credit derivative in accordance with this paragraph (i).

* * * * *

14. Revise § 324.43 as follows:

§ 324.43 Simplified supervisory formula approach (SSFA) and the gross-up approach.

a. Revise the last sentence in paragraph (c) to read as follows:

(c) * * * The risk weight assigned to a securitization exposure, or portion of a securitization exposure, as appropriate, is the larger of the risk weight determined in accordance with this paragraph (c) or paragraph (d) of this section and a risk weight of 20 percent.

* * * * *

b. Revise paragraph (e)(3)(i) to read as follows:

(e) * * *

(3) * * *

(i) The exposure amount of the FDIC-supervised institution's securitization exposure;
and

* * * * *

15. Revise paragraph (a)(3)(i)(A) in § 324.51 to read as follows:

§ 324.51 Introduction and exposure measurement.

(a) * * *

(3) * * *

(i) * * *

(A) The policy owner of a separate account an amount equal to the shortfall between the fair value and cost basis of the separate account when the policy owner of the separate account surrenders the policy; or

* * * * *

16. Revise the last sentence in paragraph (a) of § 324.63 to read as follows:

§ 324.63 Disclosures by FDIC-supervised institutions described in § 324.61.

(a) * * * The FDIC-supervised institution must make these disclosures publicly available for each of the last three years (that is, twelve quarters) or such shorter period beginning on January 1, 2015.

* * * * *

17. Revise the last sentence in paragraph (a) of § 324.124 to read as follows:

§ 324.124 Merger and acquisition transitional arrangements.

(a) * * * If an FDIC-supervised institution relies on this paragraph (a), the FDIC-supervised institution must disclose publicly the amounts of risk-weighted assets and qualifying capital calculated under this subpart for the acquiring FDIC-supervised institution and under subpart D of this part for the acquired company.

* * * * *

18. Revise the first sentence of paragraph (e)(4) in § 324.131 to read as follows:

§ 324.131 Mechanics for calculating total wholesale and retail risk-weighted assets.

(e) * * *

(4) Non-material portfolios of exposures. The risk-weighted asset amount of a portfolio of exposures for which the FDIC-supervised institution has demonstrated to the FDIC's satisfaction that the portfolio (when combined with all other portfolios of exposures that the FDIC-supervised institution seeks to treat under this paragraph (e)) is not material to the FDIC-supervised institution is the sum of the carrying values of on-balance sheet exposures plus the notional amounts of off-balance sheet exposures in the portfolio. * * * * *

19. Revise § 324.132 as follows:

§ 324.132 Counterparty credit risk of repo-style transactions, eligible margin loans, and OTC derivative contracts.

a. Revise the second sentence in paragraph (d)(2)(iv)(A) to read as follows:

(d) * * *

(2) * * *

(iv) * * *

(A) * * * For purposes of this paragraph (d), CVA does not include any adjustments to common equity tier 1 capital attributable to changes in the fair value of the FDIC-supervised institution's liabilities that are due to changes in its own credit risk since the inception of the transaction with the counterparty.

* * * * *

b. Revise the second to last sentence in paragraph (d)(5)(iii)(B) to read as follows:

(d) * * *

(5) * * *

(iii) * * *

(B) * * * If the periodicity of the receipt of collateral is N-days, the minimum margin period of risk is the minimum margin period of risk under this paragraph (d) plus N minus 1. * * * * *

20. Revise paragraph (d)(3)(i)(F) in § 324.133 to read as follows:

§ 324.133 Cleared transactions.

(d) * * *

(3) * * *

(i) * * *

(F) Where a QCCP has provided its K_{CCP} , an FDIC-supervised institution must rely on such disclosed figure instead of calculating K_{CCP} under this paragraph (d), unless the FDIC-supervised institution determines that a more conservative figure is appropriate based on the nature, structure, or characteristics of the QCCP.

* * * * *

21. Revise § 324.142 as follows:

§ 324.142 Risk-weighted assets for securitization exposures.

a. Revise the second sentence in paragraph (k)(1)(iv) to read as follows:

(k) * * *

(1) * * *

(iv) * * * For purposes of determining whether an FDIC-supervised institution is well capitalized for purposes of this paragraph (k), the FDIC-supervised institution's capital

ratios must be calculated without regard to the capital treatment for transfers of small-business obligations with recourse specified in paragraph (k)(1) of this section.

* * * * *

b. Revise the first sentence in paragraph (l)(1) to read as follows:

(l) * * *

(1) Protection provider. An FDIC-supervised institution must determine a risk weight using the supervisory formula approach (SFA) pursuant to § 324.143 or the simplified supervisory formula approach (SSFA) pursuant to § 324.144 for an nth-to-default credit derivative in accordance with this paragraph (l). * * * * *

c. Revise paragraph (m)(2)(ii)(B) to read as follows:

(m) * * *

(2) * * *

(ii) * * *

(B) If the FDIC-supervised institution purchases the credit protection from a counterparty that is a securitization SPE, the FDIC-supervised institution must determine the risk weight for the exposure according to this section, including paragraph (a)(5) of this section for a credit derivative that has a first priority claim on the cash flows from the underlying exposures of the securitization SPE (notwithstanding amounts due under interest rate or currency derivative contracts, fees due, or other similar payments).

* * * * *

22. Revise the last sentence in paragraph (c) in § 324.144 to read as follows:

§ 324.144 Simplified supervisory formula approach (SSFA).

(c) * * * The risk weight assigned to a securitization exposure, or portion of a securitization exposure, as appropriate, is the larger of the risk weight determined in accordance with this paragraph (c), paragraph (d) of this section, and a risk weight of 20 percent.

* * * * *

23. Revise the last sentence in paragraph (e) of § 324.210 to read as follows:

§ 324.210 Standardized measurement method for specific risk

(e) * * * To determine the specific risk add-on of individual equity positions, an FDIC-supervised 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):

* * * * *

24. Revise the last two sentences in paragraph (c) of § 324.211 to read as follows:

(c) * * * The values of parameters A and D, relative to K_A determine the specific risk-weighting factor assigned to a position as described in this paragraph (c) and paragraph (d) of this section. The specific risk-weighting factor assigned to a securitization position, or portion of a position, as appropriate, is the larger of the specific risk-weighting factor determined in accordance with this paragraph (c), paragraph (d) of this section, and a specific risk-weighting factor of 1.6 percent.

* * * * *

Dated at Washington, D.C., this 18th day of March, 2014.

By order of the Board of Directors.

Federal Deposit Insurance Corporation.

Robert E. Feldman,

Executive Secretary.