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DIVISION OF BANKING
SUPERVISION AND REGULATION

BASEL COORDINATION COMMITTEE
(BCC) BULLETIN

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SUBJECT: Guidance Statement on Implied Support

Background

The Federal Reserve Board's advanced approaches risk-based capital rule (rule), in general, does not specify whether a bank or bank holding company (referred to hereafter as "banking organization") may recognize for capital purposes support provided to an obligor by a third party that is not in the form of a contractual obligation, and thus, incorporate such implied support into its risk-rating systems.[1]

The preamble to the rule states that "in determining an obligor risk rating, a banking organization should consider key obligor attributes, including both quantitative and qualitative factors that could affect the obligor's default risk."[2] While the rule does not specifically prescribe quantitative and qualitative factors that must be included in the risk rating process, section 22(c)(2) of the rule provides that "[d]ata used to estimate the risk parameters must be relevant to the [bank]'s actual wholesale and retail exposures, and of sufficient quality to support the determination of risk-based capital requirements for the exposures."

General Implementation Guidance

Evidence of the likelihood of implied support may, in certain circumstances, meet the standard (described above) from section 22(c)(2) of the rule. Before considering such implied support, a banking organization should be able to establish, with supporting documentation, that the third party is of good credit quality and is likely, willing, and able to provide financial support to the obligor. In most cases, implied support meeting these criteria would come from a parent or an affiliate of the borrower.

Under section 22(k) of the rule, a banking organization must adequately document all material aspects of its advanced systems. Therefore, a banking organization should perform and document comprehensive due diligence to assess the support provider's likelihood, willingness,

[1] 12 CFR part 208, appendix F (state member banks) and 12 CFR part 225, appendix G (bank holding companies).

[2] 72 *Fed. Reg.* 69327 (December 7, 2007).

and capacity to support the obligor in downturn conditions or when the obligor is in financial distress. If the support provider is the parent company to the obligor, the banking organization should analyze the likelihood that the support provider will maintain its financial strength in such conditions. To assess the willingness to support the obligor, a banking organization should, when applicable, consider any prior situations where the provider of implied support has supported or failed to support the obligor or other obligors in similar circumstances, extended credit to the obligor at beneficial rates, or made large-scale investments of cash or resources in the obligor. Under section 22(c)(3) of the rule, a banking organization must produce appropriately conservative risk-parameter estimates when the banking organization has limited relevant data, including when assessing the likelihood of support. This is especially critical absent any historical instances or evidence of prior support during downturn or other challenging conditions for the obligor. Additionally, it is important that a banking organization's policies should outline its practices, controls, and documentation requirements with regard to third-party support.

The banking organization should be able to quantify the obligor's risk rating both with and without the implied third-party support and track this information throughout the term of the relationship for all obligors for which it recognizes implied support. In addition, when support is provided by an obligor's parent corporation, banking organizations should ensure that the provision of significant implied support by the parent corporation to a subsidiary or subsidiaries is appropriately incorporated into the parent corporation's obligor rating. Supervisors will review the impact of implied support on obligors' risk ratings and quantification, and ensure that the banking organization is not inappropriately recognizing double default effects or the implied support in the same manner as an eligible guarantee. Further, supervisors will review a banking organization's associated validation activities.

A banking organization may not recognize implied support from the U.S. government. Section 22(c)(4) of the rule states that a banking organization's "risk parameter estimation process should not rely on the possibility of U.S. government financial assistance, except for financial assistance that the U.S. government has a legally binding commitment to provide."