

**DRAFT**

**DEPARTMENT OF THE TREASURY**  
**Office of the Comptroller of the Currency**  
**12 CFR Part 3, Appendix 3**  
[Docket No. \_\_\_\_ ]  
RIN \_\_\_\_ - \_\_\_\_

**FEDERAL RESERVE SYSTEM**  
**12 CFR Parts 208 and 225**  
[Regulation H and Y; Docket No. R-1087]

**FEDERAL DEPOSIT INSURANCE CORPORATION**  
**12 CFR Part 325**  
RIN \_\_\_\_ - \_\_\_\_

**Risk-Based Capital Guidelines; Market Risk Measure; Securities Borrowing Transactions**  
**AGENCIES:** Office of the Comptroller of the Currency, Treasury; Board of Governors of the Federal Reserve System; and Federal Deposit Insurance Corporation.

**ACTION:** Final rule.

**SUMMARY:** The Office of the Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve System (Board), and the Federal Deposit Insurance Corporation (FDIC) (collectively, the Agencies) are issuing a final rule that amends their market risk rules to revise the risk-based capital treatment for cash collateral that is posted in connection with securities borrowing transactions. This final rule will make permanent, and expand the scope of, an interim final rule issued in 2000 (the interim rule) that reduced the capital requirement for certain cash-collateralized securities borrowing transactions of banks and bank holding companies (banking organizations) that have adopted the market risk rule. This action more appropriately aligns the capital requirements for these transactions with the risk involved and provides a capital treatment for U.S. banking organizations that is more in line with the capital treatment to which their domestic and foreign competitors are subject.

**EFFECTIVE DATE:** [INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]

**FOR FURTHER INFORMATION CONTACT:**

OCC: Margot Schwadron, Risk Expert, Capital Policy (202) 874-6022, or Carl Kaminski, Attorney, Legislative and Regulatory Activities Division (202) 874-5090, Office of the Comptroller of the Currency, 250 E Street, SW, Washington, DC 20219.

Board: Norah Barger, Associate Director, Division of Banking Supervision and Regulation, (202) 452-2402, David Adkins, Supervisory Financial Analyst, Division of Banking Supervision and Regulation, (202) 452-5259, Juan C. Climent, Supervisory Financial Analyst, Division of Banking Supervision and Regulation, (202) 872-7526, or Mark Van Der Weide, Senior Counsel, Legal Division, (202) 452-2263. For the hearing impaired only, Telecommunication Device for the Deaf (TDD), (202) 263-4869.

FDIC: Jason Cave, Acting Associate Director, Division of Supervision and Consumer Protection, (202) 898-3548, John Feid, Senior Capital Markets Specialist, Division of

Supervision and Consumer Protection, (202) 898-8649, or Michael B. Phillips, Counsel, (202/898-3581), Legal Division, Federal Deposit Insurance Corporation, 550 17th Street, NW, Washington, DC 20429.

## **SUPPLEMENTARY INFORMATION:**

### **I. Background**

Neither the July 1988 agreement entitled “International Convergence of Capital Measurement and Capital Standards” (Basel Accord) nor the risk-based capital guidelines adopted by the Agencies in 1989 (the 1989 rules) specifically address securities borrowing transactions.<sup>1</sup> At that time, the involvement of U.S. banking organizations in corporate debt and equity securities trading activities was limited. However, in recent years, U.S. banking organizations have been authorized to engage in, and have engaged in, trading activities to a significantly greater extent. Securities borrowing transactions serve an important function in the operation of securities markets. They are used in conjunction with short sales, securities fails (securities sold but not made available for delivery on the settlement date), and option and arbitrage positions. Securities are also borrowed in order to be pledged against public fund deposits. Securities borrowing enhances market efficiency and provides an important source of liquidity to the securities markets.

In a typical securities borrowing transaction, a party (for example, a banking organization) borrows securities from a securities lender and posts collateral in the form of cash or highly marketable securities with the securities lender (or an agent acting on behalf of the securities lender) in an amount that fully covers the value of the securities borrowed plus an additional margin, usually ranging from two to five percent. In accordance with U.S. generally accepted accounting principles (GAAP), cash collateral posted with the securities lender is treated as a receivable on the books of the securities borrower (that is, it is treated as a cash loan from the securities borrower to the securities lender). Under the 1989 rules, the securities borrower is required to hold capital against the full amount of this receivable—that is, the amount of the collateral posted. In contrast, under the 1989 rules, where a securities borrower posts collateral in the form of securities and those securities continue to be carried on the borrower’s books, it does not incur a capital charge on the posting of the securities as collateral because under GAAP no receivable from the counterparty is booked on the balance sheet.

### **II. Interim Final Rule**

In December 2000, the Agencies issued the interim rule with request for comment addressing the risk-based capital treatment of securities borrowing transactions where the borrower posts cash collateral.<sup>2</sup> In developing the interim rule, the Agencies recognized that securities borrowing is a long-established financial activity that historically has resulted in an exceedingly low level of losses. Accordingly, the application of a standard 100 percent risk weight to the full amount of the cash collateral posted to support such borrowings resulted in a

---

<sup>1</sup> The Basel Accord was developed by the Basel Committee on Banking Supervision and endorsed by the central bank governors of the Group of Ten (G-10) countries. The Basel Accord provides a framework for assessing the capital adequacy of a depository institution by risk weighting its assets and off-balance sheet exposures primarily based on credit risk. The Basel Committee on Banking Supervision consists of representatives of the supervisory authorities and central banks from the Group of Ten countries (Belgium, Canada, France, Germany, Italy, Japan, Netherlands, Sweden, Switzerland, United Kingdom, United States) and Luxembourg. See 54 FR 4168 (January 27, 1989) (OCC), 54 FR 4186 (January 27, 1989) (Board), 54 FR 11509 (March 21, 1989) (FDIC).

<sup>2</sup> See 65 FR 75856 (December 5, 2000), 12 CFR part 3, appendix B (OCC), 12 CFR part 208, appendix A, 12 CFR part 225, appendix A (Board), 12 CFR part 325, appendix C (FDIC).

capital charge that was excessively high, not only in light of the risk involved in the transactions, but also in comparison to the capital required by other U.S. and non-U.S. regulators of financial firms for the same transactions. The Agencies also noted that, under the 1989 rules, a banking organization incurred no capital charge when it borrowed securities and posted securities to collateralize the borrowing, even though the organization was at risk for the amount by which the collateral posted exceeded the value of the securities borrowed. As a result, securities borrowing transactions in which cash collateral was used were penalized relative to those where securities were used as collateral.

To address the case where securities borrowing transactions are collateralized by cash, the Agencies issued the interim rule with a request for comment that would better reflect the low risk of such transactions. The interim rule applied only to banking organizations that had adopted the market risk rule because only banking organizations with significant trading activity tend to engage in securities borrowing in any volume. Banking organizations that had not adopted the market risk rule continued to be subject to the risk-based capital treatment set forth in the 1989 rules for all their securities borrowing transactions.

Under the interim rule, banking organizations that have adopted the market risk rule for assessing capital adequacy for trading positions could exclude from risk-weighted assets receivables arising from the posting of cash collateral associated with securities borrowing transactions to the extent such receivables were collateralized by the market value of the securities borrowed, subject to all of the following conditions:

1. the transaction is based on securities includable in the trading book that are liquid and readily marketable;
2. the transaction is marked to market daily;
3. the transaction is subject to daily margin maintenance requirements; and
4. the transaction is a securities contract under section 555 of the Bankruptcy Code (11 U.S.C. § 555), a qualified financial contract under section 11(e)(8) of the Federal Deposit Insurance Act (12 U.S.C. § 1821(e)(8)), or a netting contract between or among financial institutions under sections 401-407 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (12 U.S.C. §§ 4401-4407), or the Board's Regulation EE (12 CFR Part 231).

Under this treatment, the amount of the receivable created in connection with the posting of cash collateral in a securities borrowing transaction that is excluded from the securities borrower's adjusted risk-weighted assets is limited to the portion that is collateralized by the market value of the securities borrowed. The uncollateralized portion, which equals the difference between the amount of cash collateral that the securities borrower posts in support of the borrowing and the current market value of the securities borrowed, is assigned to the risk weight appropriate to the securities lender.

The interim rule did not change the risk-based capital treatment for the posting of securities collateral, as opposed to cash collateral. However, the Agencies indicated that pending revisions to the Basel Accord could require a charge for such borrowing transactions and, accordingly, the U.S. risk-based capital treatment could change in the future.

#### Comments Received

The Agencies received comment letters from eight respondents. The commenters uniformly supported the interim rule. With regard to the issue of whether the interim rule should be limited to only those banking organizations that have implemented the market risk rules, the three commenters who addressed this issue expressed support for the extension of the interim rule to all banking organizations. On the issue of whether the interim rule should be amended to impose a capital charge on securities-collateralized borrowing transactions, the Agencies

received five comments. Views on this issue were mixed as three commenters did not support a capital charge, while two expressed mild support. Another commenter suggested eliminating the requirement that the transaction be a securities contract under the Bankruptcy Code, a qualified financial contract under the Federal Deposit Insurance Act (FDIA), or a netting contract under the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) or the Board's Regulation EE. The commenter suggested that a banking organization should be permitted to exclude securities borrowing receivables for risk-based capital purposes as long as the pledge of the borrowed securities is legally enforceable in the event the counterparty failed.

On November 17, 2005, the Federal Reserve Board hosted a meeting for all institutions subject to the market risk rule to discuss finalizing the interim rule. The meeting, which representatives of the OCC and the FDIC also attended, allowed all parties subject to the interim rule to discuss their positions with respect to how to finalize the interim rule on securities borrowing. The Agencies made clear that they were not seeking a group opinion or consensus, but rather seeking advice from the participants on an individual basis to better understand some of the issues. Most meeting participants expressed the view that it was important to finalize the interim rule in a way that grants capital relief to securities borrowing transactions in line with the spirit of the interim rule.

At the meeting, various banking organizations noted that while the first three criteria of the interim rule were appropriate for securities borrowing transactions to qualify for the capital treatment under the interim rule, the fourth criterion presented challenges. Various banking organizations also indicated that a strict reading of the fourth criterion would prevent transactions with counterparties that are not subject to the U.S. Bankruptcy Code, the FDIA, or FDICIA from qualifying for that treatment. In particular, transactions with non-U.S. counterparties may not meet the interim rule's fourth criterion. Uncertainty also exists with regard to transactions with counterparties that are subject to state insolvency regimes or, like pension funds, that are not subject to a statutory insolvency regime.

Several participants stated that an important risk mitigant in securities borrowing transactions is that they typically are conducted on either an overnight or an open basis, which gives both counterparties the right to effectively close out at any time. This feature ensures that the banking organization has the ability to terminate the transactions early should the banking organization detect counterparty credit risk problems, effectively reducing counterparty credit risk to very low levels. Because an open or overnight transaction allows a banking organization to terminate promptly transactions with counterparties whose financial condition is deteriorating, events of default such as failure to post margin are very seldom encountered. Many institutions present at the meeting indicated that, in large part because of the ability to terminate transactions at will, defaults on securities borrowing transactions have been extremely rare, and defaults resulting in losses have been even rarer. Following this meeting, several banking organizations submitted detailed technical suggestions on how to amend the interim rule to deal with their concerns.

### **III. Final Rule**

After consideration of the comments received, the Agencies are issuing a final rule (the final rule) identical to the interim rule with one exception. Specifically, the fourth criterion, which requires that a cash-collateralized securities borrowing transaction be a securities contract for purposes of the Bankruptcy Code, a qualified financial contract for purposes of the FDIA, or a netting contract for purposes of FDICIA or Regulation EE, will be replaced with the following:

4. (A) The transaction is a securities contract for the purposes of section 555 of the Bankruptcy Code (11 U.S.C. 555), a qualified financial contract for the purposes of section 11(e)(8) of the Federal Deposit Insurance Act (12 U.S.C. 1821(e)(8)), or a netting contract

between or among financial institutions for the purposes of sections 401-407 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (12 U.S.C. 4401-4407), or the Board's Regulation EE (12 CFR Part 231); or

(B) If the transaction does not meet the criteria set forth in paragraph 4. (A) of this section, then either:

(i) The banking organization has conducted sufficient legal review to reach a well-founded conclusion that (1) the securities borrowing agreement executed in connection with the transaction provides the banking organization the right to accelerate, terminate, and close-out on a net basis all transactions under the agreement and to liquidate or set off collateral promptly upon an event of counterparty default, including in a bankruptcy, insolvency, or other similar proceeding of the counterparty and (2) under applicable law of the relevant jurisdiction, its rights under the agreement are legal, valid, binding, and enforceable and any exercise of rights under the agreement will not be stayed or avoided; or

(ii) The transaction is either overnight or unconditionally cancelable at any time by the banking organization, and the banking organization has conducted sufficient legal review to reach a well-founded conclusion that (1) the securities borrowing agreement executed in connection with the transaction provides the banking organization the right to accelerate, terminate, and close-out on a net basis all transactions under the agreement and to liquidate or set off collateral promptly upon an event of counterparty default and (2) under the law governing the agreement, its rights under the agreement are legal, valid, binding, and enforceable.

The fourth criterion has been revised to broaden the types of securities borrowing transactions that qualify for the interim rule. Subpart (A) preserves the existing method of qualification. It is the responsibility of the banking organization to determine if the transaction meets the criteria of subpart (A). If the transaction does not meet the criteria under subpart (A), or if there is uncertainty about it, the banking organization can rely on the criteria of subpart (B) to apply the capital treatment set forth in this final rule. Subpart (B) extends the treatment set forth in the interim rule to transactions that are exempt from any automatic stay in bankruptcy, insolvency, or similar proceedings or that are conducted on a basis that is either overnight or that provides the banking organization the unconditional right to terminate that transaction at will. In this regard, the Agencies will not view a reasonably short notice period, typically no more than the standard settlement period associated with the securities borrowed, as detracting from the unconditionality of the banking organization's termination rights. With regard to overnight transactions, the counterparty generally should have no expectation, either explicit or implicit, that the banking organization will automatically roll over the transaction.

Under subpart (B), transactions may qualify only if the banking organization has conducted sufficient legal review to conclude that its rights under the agreement under which the transactions are executed is legal, valid, binding, and enforceable. No such review is required for transactions qualifying under subpart (A). For transactions executed under standard industry contracts, trade groups representing the financial services industry with established expertise often commission and maintain a library of current legal opinions with respect to the legal status, validity, binding effect, and enforceability of such contracts with various counterparties under the laws of a number of jurisdictions. While the Agencies do not discourage a banking organization from obtaining a specific legal opinion tailored to a particular transaction, a banking organization's review of the legal opinions described above to determine the legal status, validity, binding effect, and enforceability of a particular contract with a specific counterparty, for example, generally would meet the requirement for sufficient legal review under subpart (B).

The Agencies believe that the revisions to the fourth criterion set forth in the final rule resolve, in a manner that preserves safety and soundness, technical difficulties banking organizations may have had in meeting this criterion for a number of securities borrowing transactions.

At this time, the Agencies have decided not to extend the final rule beyond those banking organizations subject to the market risk rules. In general, securities borrowings are used to support trading activities and, thus, typically only banking organizations subject to the market risk rules could realize a more than de minimis benefit from the capital treatment set out in this final rule. With regard to the issue of assessing a capital charge on securities-collateralized securities borrowing transactions, the Agencies believe that while imposing such a charge would provide for a more consistent risk-based treatment of securities borrowing transactions in general, the enhanced consistency would impose additional burden on the affected banking organization with only a minimal increase in risk-based capital requirements. Accordingly, the Agencies will take no action on this issue at this time.

The Agencies note that the treatment set forth in the final rule for securities borrowing differs from, and could result in lower capital charges than, the treatment set forth in the Basel II framework. The U.S. implementation of that framework could result in a capital treatment that differs significantly from that set forth in the final rule.

### **Effective Date**

This final rule is effective as of [INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]. Pursuant to 5 U.S.C. 553, each of the Agencies may issue a rule without delaying its effectiveness if the agency finds good cause for the immediate effective date.

For the following reasons, the Agencies find good cause to issue this rule without a delayed effective date. First, in all respects, except one, the final rule is identical to the interim final rule that has been in effect since 2000. Thus, banking institutions are already subject to similar requirements. Second, the new provision in the final rule broadens the types of securities transactions that qualify for the risk-based capital treatment provided in the interim rule. The final rule thus relieves a restriction on U.S. banking organizations and fosters consistency among international institutions consistent with safety and soundness. Elimination of the costs and burdens associated with the restriction that is being removed warrants making this rule effective without a delayed effective date.

Subject to certain exceptions, 12 U.S.C. 4802(b)(1) provides that new regulations and amendments to regulations prescribed by a Federal banking agency that impose additional reporting, disclosure, or other new requirements on an insured depository institution must take effect on the first day of a calendar quarter that begins on or after the date on which the regulations are published in final form. Like the interim rule, the final rule imposes no additional reporting, disclosure, or other new requirements on insured depository institutions. Instead, it relieves a restriction. For this reason, section 4802(b)(1) does not apply to this rulemaking. Alternatively, section 4802(b)(1)(A) provides that the Agencies may, upon finding good cause to do so, determine that a regulation should become effective without a delayed effective date. As noted in the previous paragraph, the Agencies find good cause to issue this rule without a delayed effective date.

### **Regulatory Flexibility Act Analysis**

Pursuant to section 605(b) of the Regulatory Flexibility Act, the Agencies have determined that this final rule would not have a significant impact on a substantial number of

small entities in accord with the spirit and purposes of the Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*). The final rule is only applicable to banking organizations subject to the market risk rules, which typically apply to large banking organizations with significant trading operations. Therefore, the Agencies do not believe this final rule will likely have a significant impact on a substantial number of small entities. Moreover, the overall impact of this final rule is to reduce regulatory burden. Accordingly, a regulatory flexibility analysis is not required.

### **Paperwork Reduction Act**

The Agencies have determined that this final rule does not involve a collection of information pursuant to the provisions of the Paperwork Reduction Act of 1995 (44 U.S.C. 3501 *et seq.*).

### **OCC Executive Order 12866**

This rule will apply only to the small number of banks that are subject to the market risk rules. For those banks, the rule more accurately aligns the risk-based capital charge with the low risk of securities borrowing transactions, illustrated by a long-established history of exceedingly low levels of losses. Also, the rule will make the capital treatment comparable to that of other U.S. and non-U.S. regulators of financial firms for the same transactions. The OCC has determined that this joint final rule is not a significant regulatory action under Executive Order 12866.

### **OCC Unfunded Mandates Reform Act of 1995 Determinations**

Section 202 of the Unfunded Mandates Reform Act of 1995, Pub. L. 104-4 (Unfunded Mandates Act) requires that an agency prepare a budgetary impact statement before promulgating a rule that includes a Federal mandate that may result in expenditure by State, local, and tribal governments, in the aggregate, or by the private sector, of \$100 million or more in any one year. If a budgetary impact statement is required, section 205 of the Unfunded Mandates Act also requires an agency to identify and consider a reasonable number of regulatory alternatives before promulgating a rule. As discussed in the preamble, this final rule is limited to banks subject to the market risk rules and to securities borrowing transactions collateralized with cash. The OCC, therefore, has determined that the final rule will not result in expenditures by State, local, or tribal governments, or by the private sector of \$100 million or more. Accordingly, the OCC has not prepared a budgetary impact statement or specifically addressed the regulatory alternatives considered.

### **OCC Executive Order 13132**

The OCC has determined that this rule does not have any Federalism implications, as required by Executive Order 13132, because it would not have substantial direct effects on the States, on the relationship between the national government and the States, or on the distribution of power and responsibilities among the various levels of government.

### **List of Subjects**

#### 12 CFR Part 3

Administrative practice and procedure, Capital, National banks, Reporting and recordkeeping requirements, Risk.

#### 12 CFR Part 208

Accounting, Agriculture, Banks, banking, Confidential business information, Crime, Currency, Federal Reserve System, Mortgages, Reporting and recordkeeping requirements, Securities.

12 CFR Part 225

Administrative practice and procedure, Banks, banking, Federal Reserve System, Holding companies, Reporting and recordkeeping requirements, Securities.

12 CFR Part 325

Administrative practice and procedure, Bank deposit insurance, Banks, banking, Capital adequacy, Reporting and recordkeeping requirements, Savings associations, State non-member banks.

**Department of Treasury  
Office of the Comptroller of the Currency  
12 CFR Chapter 1**

**Authority and Issuance**

For the reasons set out in the joint preamble, part 3 of chapter I of title 12 of the Code of Federal Regulations is amended as follows:

**PART 3--MINIMUM CAPITAL RATIOS; ISSUANCE OF DIRECTIVES**

1. The authority citation for part 3 continues to read as follows:

**Authority:** 12 U.S.C. 93a, 161, 1818, 1828(n), 1828 note, 1831n note, 1835, 3907 and 3909.

2. In appendix A to part 3, in section 3, revise paragraph (a)(4) by revising footnote 12a to read as follows:

**APPENDIX A TO PART 3—RISKED BASED CAPITAL GUIDELINES**

Section 3. Risk Categories/Weights for On-Balance Sheet Assets and Off-Balance Sheet Items.

\* \* \* \* \*

(a) \* \* \*

(4) 100 percent risk weight. All other assets not specified above,<sup>12a</sup> including:

\* \* \* \* \*

3. In appendix B to part 3, in section 3, revise paragraph (a)(1) to read as follows:

**APPENDIX B TO PART 3—RISK-BASED CAPITAL GUIDELINES; MARKET RISK ADJUSTMENT**

Section 3. Adjustments to the Risk-Based Capital Ratio Calculations.

(a) \* \* \*

(1) Adjusted risk-weighted assets. (i) Covered positions. Calculate adjusted risk-weighted assets, which equal risk-weighted assets (as determined in accordance with appendix A of this part), excluding the risk-weighted amount of all covered positions (except foreign exchange positions outside the trading account and over-the-counter derivatives positions).<sup>7</sup>

(ii) Securities borrowing transactions. In calculating adjusted risk-weighted assets, a bank also may exclude a receivable that results from the bank's posting of cash collateral in a securities borrowing transaction to the extent that the receivable is collateralized by the market value of the borrowed securities and subject to the following conditions:

- (A) The borrowed securities must be includable in the trading account and must be liquid and readily marketable;
- (B) The borrowed securities must be marked to market daily;
- (C) The receivable must be subject to a daily margining requirement; and

(D) (1) The transaction is a securities contract for the purposes of section 555 of the Bankruptcy Code (11 U.S.C. 555), a qualified financial contract for the purposes of section 11(e)(8) of the Federal Deposit Insurance Act (12 U.S.C. 1821(e)(8)), or a netting contract between or among financial institutions for the purposes of sections 401-407 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (12 U.S.C. 4401-4407), or the Board's Regulation EE (12 CFR Part 231); or

(2) If the transaction does not meet the criteria set forth in paragraph (a)(1)(ii)(D)(1) of this section, then either:

(i) The bank has conducted sufficient legal review to reach a well-founded conclusion that (1) the securities borrowing agreement executed in connection with the transaction provides the bank the right to accelerate, terminate, and close-out on a net basis all transactions under the agreement and to liquidate or set off collateral promptly upon an event of counterparty default, including in a bankruptcy, insolvency, or other similar proceeding of the counterparty and (2) under applicable law of the relevant jurisdiction, its rights under the agreement are legal, valid, binding, and enforceable and any exercise of rights under the agreement will not be stayed or avoided; or

(ii) The transaction is either overnight or unconditionally cancelable at any time by the bank, and the bank has conducted sufficient legal review to reach a well-founded conclusion that (1) the securities borrowing agreement executed in connection with the transaction provides the bank the right to accelerate, terminate, and close-out on a net basis all transactions under the agreement and to liquidate or set off collateral promptly upon an event of counterparty default and (2) under the law governing the agreement, its rights under the agreement are legal, valid, binding, and enforceable.

\* \* \* \* \*

<sup>7</sup> Foreign exchange positions outside the trading account and all over-the-counter derivative positions, whether or not in the trading account, must be included in adjusted risk-weighted assets as determined in appendix A of this part 3.

\* \* \* \* \*

## **Federal Reserve System 12 CFR Chapter II**

### **Authority and Issuance**

For the reasons set forth in the joint preamble, part 208 of chapter II of title 12 of the Code of Federal Regulations is amended as set forth below:

### **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, 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, 6801, and 6805; 31 U.S.C. 5318; 42 U.S.C. 4012a, 4104a, 4104b, 4106, and 4128.

2. In appendix E to part 208, under section 3, paragraph (a)(1) is revised to read as follows:

### **APPENDIX E TO PART 208 -- CAPITAL ADEQUACY GUIDELINES FOR STATE MEMBER BANKS; MARKET RISK MEASURE**

\* \* \* \* \*

### Section 3. Adjustments to the Risk-Based Capital Ratio Calculations

(a) \* \* \*

(1) Adjusted risk-weighted assets. Calculate adjusted risk-weighted assets, which equals risk-weighted assets (as determined in accordance with appendix A of this part) excluding the risk-weighted amounts of all covered positions (except foreign-exchange positions outside the trading account and over-the-counter derivative positions)<sup>7</sup> and receivables arising from the posting of cash collateral that is associated with securities borrowing transactions to the extent the receivables are collateralized by the market value of the borrowed securities, provided that the following conditions are met:

- (i) The transaction is based on securities includable in the trading book that are liquid and readily marketable,
- (ii) The transaction is marked to market daily,
- (iii) The transaction is subject to daily margin maintenance requirements, and
- (iv)(A) The transaction is a securities contract for the purposes of section 555 of the Bankruptcy Code (11 U.S.C. 555), a qualified financial contract for the purposes of section 11(e)(8) of the Federal Deposit Insurance Act (12 U.S.C. 1821(e)(8)), or a netting contract between or among financial institutions for the purposes of sections 401-407 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (12 U.S.C. 4401-4407), or the Board's Regulation EE (12 CFR Part 231); or

(B) If the transaction does not meet the criteria set forth in paragraph (iv)(A) of this section, then either:

(1) The bank has conducted sufficient legal review to reach a well-founded conclusion that (1) the securities borrowing agreement executed in connection with the transaction provides the bank the right to accelerate, terminate, and close-out on a net basis all transactions under the agreement and to liquidate or set off collateral promptly upon an event of counterparty default, including in a bankruptcy, insolvency, or other similar proceeding of the counterparty and (2) under applicable law of the relevant jurisdiction, its rights under the agreement are legal, valid, binding, and enforceable and any exercise of rights under the agreement will not be stayed or avoided; or

(2) The transaction is either overnight or unconditionally cancelable at any time by the bank, and the bank has conducted sufficient legal review to reach a well-founded conclusion that (1) the securities borrowing agreement executed in connection with the transaction provides the bank the right to accelerate, terminate, and close-out on a net basis all transactions under the agreement and to liquidate or set off collateral promptly upon an event of counterparty default and (2) under the law governing the agreement, its rights under the agreement are legal, valid, binding, and enforceable.

\* \* \* \* \*

<sup>7</sup> Foreign-exchange positions outside the trading account and all over-the-counter derivative positions, whether or not in the trading account, must be included in adjusted risk-weighted assets as determined in appendix A of this part.

\* \* \* \* \*

### **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.

2. In appendix E to part 225, under section 3, paragraph (a)(1) is revised to read as follows:

**APPENDIX E TO PART 225 -- CAPITAL ADEQUACY GUIDELINES FOR BANK HOLDING COMPANIES; MARKET RISK MEASURE**

\* \* \* \* \*

Section 3. Adjustments to the Risk-Based Capital Ratio Calculations

(a) \* \* \*

(1) Adjusted risk-weighted assets. Calculate adjusted risk-weighted assets, which equals risk-weighted assets (as determined in accordance with appendix A of this part) excluding the risk-weighted amounts of all covered positions (except foreign-exchange positions outside the trading account and over-the-counter derivative positions)<sup>7</sup> and receivables arising from the posting of cash collateral that is associated with securities borrowing transactions to the extent the receivables are collateralized by the market value of the borrowed securities, provided that the following conditions are met:

- (i) The transaction is based on securities includable in the trading book that are liquid and readily marketable,
- (ii) The transaction is marked to market daily,
- (iii) The transaction is subject to daily margin maintenance requirements, and
- (iv)(A) The transaction is a securities contract for the purposes of section 555 of the Bankruptcy Code (11 U.S.C. 555), a qualified financial contract for the purposes of section 11(e)(8) of the Federal Deposit Insurance Act (12 U.S.C. 1821(e)(8)), or a netting contract between or among financial institutions for the purposes of sections 401-407 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (12 U.S.C. 4401-4407), or the Board's Regulation EE (12 CFR Part 231); or

(B) If the transaction does not meet the criteria set forth in paragraph (iv)(A) of this section, then either:

(1) The banking organization has conducted sufficient legal review to reach a well-founded conclusion that (1) the securities borrowing agreement executed in connection with the transaction provides the banking organization the right to accelerate, terminate, and close-out on a net basis all transactions under the agreement and to liquidate or set off collateral promptly upon an event of counterparty default, including in a bankruptcy, insolvency, or other similar proceeding of the counterparty and (2) under applicable law of the relevant jurisdiction, its rights under the agreement are legal, valid, binding, and enforceable and any exercise of rights under the agreement will not be stayed or avoided; or

(2) The transaction is either overnight or unconditionally cancelable at any time by the banking organization, and the banking organization has conducted sufficient legal review to reach a well-founded conclusion that (1) the securities borrowing agreement executed in connection with the transaction provides the banking organization the right to accelerate, terminate, and close-out on a net basis all transactions under the agreement and to liquidate or set off collateral promptly upon an event of counterparty default and (2) under the law governing the agreement, its rights under the agreement are legal, valid, binding, and enforceable.

\* \* \* \* \*

<sup>7</sup> Foreign-exchange positions outside the trading account and all over-the-counter derivative positions, whether or not in the trading account, must be included in adjusted risk-weighted assets as determined in appendix A of this part.

\* \* \* \* \*

**Federal Deposit Insurance Corporation  
12 CFR Chapter III**

**Authority and Issuance**

For the reasons set forth in the joint preamble, part 325 of chapter III of title 12 of the Code of Federal Regulations is amended as follows:

**PART 325 – CAPITAL MAINTENANCE**

1. The authority citation for part 325 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; Pub. L. 102-233, 105 Stat. 1761, 1789, 1790 (12 U.S.C. 1831n note); Pub. L. 102-242, 105 Stat. 2236, 2355, 2386 (12 U.S.C. 1828 note).

2. In appendix C to part 325, under section 3, paragraph (a)(1) is revised to read as follows:

**APPENDIX C TO PART 325 – RISK-BASED CAPITAL FOR STATE NON-MEMBER BANKS: MARKET RISK**

\* \* \* \* \*

Section 3. Adjustments to the Risk-Based Capital Ratio Calculations

(a) \* \* \*

(1) Adjusted risk-weighted assets. Calculate adjusted risk-weighted assets, which equals risk-weighted assets (as determined in accordance with appendix A of this part), excluding the risk-weighted amounts of all covered positions (except foreign exchange positions outside the trading account and over-the-counter derivative positions)<sup>7</sup> and receivables arising from the posting of cash collateral that is associated with securities borrowing transactions to the extent the receivables are collateralized by the market value of the borrowed securities, provided that the following conditions are met:

- (i) the transaction is based on securities includable in the trading book that are liquid and readily marketable,
- (ii) the transaction is marked to market daily,
- (iii) the transaction is subject to daily margin maintenance requirements, and
- (iv)(A) The transaction is a securities contract for the purposes of section 555 of the Bankruptcy Code (11 U.S.C. 555), a qualified financial contract for the purposes of section 11(e)(8) of the Federal Deposit Insurance Act (12 U.S.C. 1821(e)(8)), or a netting contract between or among financial institutions for the purposes of sections 401-407 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (12 U.S.C. 4401-4407), or the Board's Regulation EE (12 CFR Part 231); or

(B) If the transaction does not meet the criteria set forth in paragraph (iv)(A) of this section, then either:

(1) The bank has conducted sufficient legal review to reach a well-founded conclusion that (1) the securities borrowing agreement executed in connection with the transaction provides the bank the right to accelerate, terminate, and close-out on a net basis all transactions under the agreement and to liquidate or set off collateral promptly upon an event of counterparty default, including in a bankruptcy, insolvency, or other similar proceeding of the counterparty and (2) under applicable law of the relevant jurisdiction, its rights under the

agreement are legal, valid, binding, and enforceable and any exercise of rights under the agreement will not be stayed or avoided; or

(2) The transaction is either overnight or unconditionally cancelable at any time by the bank, and the bank has conducted sufficient legal review to reach a well-founded conclusion that (1) the securities borrowing agreement executed in connection with the transaction provides the bank the right to accelerate, terminate, and close-out on a net basis all transactions under the agreement and to liquidate or set off collateral promptly upon an event of counterparty default and (2) under the law governing the agreement, its rights under the agreement are legal, valid, binding, and enforceable.

\* \* \* \* \*

<sup>7</sup> Foreign-exchange positions outside the trading account and all over-the-counter derivative positions, whether or not in the trading account, must be included in adjusted risk-weighted assets as determined in appendix A of this part.

\* \* \* \* \*

**[THIS SIGNATURE PAGE RELATES TO THE JOINT FINAL RULE ON “RISK-BASED CAPITAL GUIDELINES; MARKET RISK MEASURE; SECURITIES BORROWING TRANSACTIONS”]**

---

Date

---

**John C. Dugan**  
*Comptroller of the Currency*

**[THIS SIGNATURE PAGE RELATES TO THE JOINT FINAL RULE ON “RISK-BASED CAPITAL GUIDELINES; MARKET RISK MEASURE; SECURITIES BORROWING TRANSACTIONS”]**

By order of the Board of Governors of the Federal Reserve System [INSERT DATE HERE].

Jennifer J. Johnson  
Secretary of the Board

**[THIS SIGNATURE PAGE RELATES TO THE JOINT FINAL RULE ON “RISK-BASED CAPITAL GUIDELINES; MARKET RISK MEASURE; SECURITIES BORROWING TRANSACTIONS”]**

By order of the Board of Directors.  
Dated at Washington, DC, this            day of            2006.  
Federal Deposit Insurance Corporation.

**Robert E. Feldman,**  
Executive Secretary.  
(SEAL)