

DEPARTMENT OF THE TREASURY
Office of the Comptroller of the Currency
12 CFR Part 3, Appendix 3
[Docket No. 00-28]
RIN 1557-AB14

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 3064-AC46

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: Interim rule with request for comment.

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 an interim rule with a request for comment that amends their market risk rules to revise the capital treatment for cash collateral that is posted in connection with certain securities borrowing transactions. The effect of the interim rule is to more appropriately align the capital requirements for these transactions with the risk involved and to provide a capital treatment for U.S. banking organizations that is more in line with the capital treatment applied to their domestic and foreign competitors.

DATES: This interim rule is effective January 4, 2001. U.S. banking organizations may apply the provisions of this interim rule beginning December 5, 2000. Comments must be received by January 19, 2001.

ADDRESSES: Comments should be directed to:

OCC: Written comments may be submitted electronically to regs.comments@occ.treas.gov or by mail to Docket No. 00-28, Communications Division, Third Floor, Office of the Comptroller of the Currency, 250 E Street, SW, Washington, DC 20219. Comments will be available for inspection and photocopying at that address.

Board: Comments, which should refer to Docket No. R-1087, may be mailed to Ms. Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, 20th and C Streets, NW, Washington, DC 20551, or mailed electronically to regs.comments@federalreserve.gov. Comments addressed to Ms. Johnson may be delivered to the Board's mailroom between 8:45 a.m. and 5:15 p.m., and to the security control room outside of those hours. Both the mailroom and the security control room are accessible from the courtyard entrance on 20th Street between Constitution Avenue and C Street, NW. Comments

may be inspected in Room MP-500 between 9 a.m. and 5 p.m. weekdays pursuant to § 261.12, except as provided in § 261.14 of the Board's Rules Regarding Availability of Information, 12 CFR 261.12 and 261.14.

FDIC: Written comments should be addressed to Robert E. Feldman, Executive Secretary, Attention: Comments/OES, Federal Deposit Insurance Corporation, 550 17th Street, NW, Washington, DC 20429. Comments may be hand delivered to the guard station at the rear of the 550 17th Street Building (located on F Street), on business days between 7:00 a.m. and 5:00 p.m. (Fax number: (202) 898-3838; Internet address: comments@fdic.gov). Comments may be inspected and photocopied in the FDIC Public Information Center, Room 100, 801 17th Street, NW, Washington, DC, between 9:00 a.m. and 4:30 p.m. on business days.

FOR FURTHER INFORMATION CONTACT:

OCC: Roger Tufts, Senior Economic Advisor, Capital Policy (202) 874-5070, or Ron Shimabukuro, Senior 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, Assistant Director (202/452-2402), or David Adkins, Supervisory Financial Analyst (202/452-5259), Division of Banking Supervision and Regulation. For the hearing impaired only, Telecommunication Device for the Deaf (TDD), Janice Simms (202/872-4984), Board of Governors of the Federal Reserve System, 20th and C Streets, NW, Washington, DC 20551.

FDIC: Stephen G. Pfeifer, Examination Specialist (202/898-8904), Accounting Section, Division of Supervision; Michael B. Phillips, Counsel, (202/898-3581), Legal Division, Federal Deposit Insurance Corporation, 550 17th Street, NW, Washington, DC 20429.

SUPPLEMENTARY INFORMATION: Securities borrowing transactions were not specifically addressed in the July 1988 agreement entitled “International Convergence of Capital Measurement and Capital Standards” (Basel Accord), nor in the risk-based capital guidelines adopted by the Agencies in 1989.¹ 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 experienced a rapid growth of such activities, and it is recognized that securities borrowing transactions serve an important function in the operation of securities markets. Securities borrowings 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) needing to borrow securities obtains the securities from a securities lender and posts collateral in the form of cash or highly marketable securities with the securities lender (or

¹ 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.

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, 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, who is the obligor). Under the existing capital rules, the securities borrower must hold capital against the full amount of this receivable, i.e., the collateral posted. The borrowed securities generally remain on the balance sheet of the securities lender, and, therefore, no additional capital charge is incurred by the securities borrower. Where a securities borrower posts collateral in the form of securities that continue to be carried on the borrower's books, the only capital charge incurred by the borrower under the present guidelines is that associated with a direct holding of the securities.

The Agencies recognize that securities borrowing is a long-established financial activity that historically has resulted in an exceedingly low level of losses. Applying a standard 100 percent risk weight to the full amount of the cash collateral posted to support such borrowings, the Agencies further recognize, results in a capital charge that is inordinately 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. Further, under the current capital rules, a banking organization incurs no incremental capital charge when it borrows securities and posts securities to collateralize the borrowing, even though it is at risk for the amount by which the collateral exceeds the value of the securities borrowed.

The Agencies are issuing an interim rule that better reflects the low risk of securities borrowing and the posting of cash collateral in connection with such transactions and brings the capital requirements for U.S. banking organizations into better alignment with the capital requirements of other U.S. and non-U.S. regulators of financial institutions.

Specifically, the Agencies are adopting an interim rule that permits banking organizations under the market risk rules to exclude from risk-weighted assets receivables arising from the posting of cash collateral associated with securities borrowing transactions to the extent such receivables are collateralized by the market value of the securities borrowed, subject to 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 for the purposes of section 555 of the Bankruptcy Code (11 U.S.C. 555), a qualified financial contract for the purpose 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).

Under this treatment, the amount of the receivable created in connection with the posting of cash collateral in a securities borrowing transaction that would be 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, would be assigned to the risk weight appropriate to the obligor.

The Agencies note that the Basel Accord is currently under revision. These revisions could result in a more risk-sensitive treatment for securities borrowing transactions. Accordingly, banking organizations should be aware that this capital treatment under the market risk rules is subject to change pending the outcome of the Basel revisions, which may call for higher capital charges for securities borrowing and similar transactions.

The Agencies welcome comment on all aspects of this interim rule. In particular, the Agencies request industry views on the capital treatment of the posting of securities collateral associated with securities borrowing transactions. Under the current capital rules and the interim rule, the posting of securities collateral will continue to not incur a capital charge even though the securities borrower is at risk (as it is where cash is posted as collateral) for the amount by which the securities collateral exceeds the value of the securities borrowed. The Agencies recognize that a strong case can be made for achieving a greater consistency between the treatment of the posting of cash collateral and the posting of securities collateral by requiring a capital charge on the amount by which the market value of the securities posted as collateral exceeds the market value of securities borrowed. This could be accomplished under the present capital framework, for example, by requiring the difference in the market value of the securities posted as collateral and that of the securities borrowed to be treated as a securities lending transaction. Under such a treatment, the difference would be converted at 100 percent to an on-balance sheet credit equivalent amount and risk-weighted according to the obligor. Industry views are sought on whether the Agencies should seek to further equalize the capital treatment of cash and securities collateral posted in support of a securities borrowing transaction.

In addition, the Agencies are specifically interested in whether this revision to the calculation of the capital requirement for securities borrowing transactions should be limited only to those banking organizations that have implemented the market risk rules. Under the interim rule, no reduction in the capital requirement for these securities borrowing transactions is available to banking organizations that have not implemented an approved value-at-risk model. Accordingly, comment is sought on whether the capital treatment of securities borrowing should be modified within the non-trading portion of the risk-based capital calculation.

Regulatory Flexibility Act Analysis

Pursuant to section 605(b) of the Regulatory Flexibility Act, the Agencies have determined that this interim 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.*). Accordingly, a regulatory flexibility analysis is not required. The interim rule would reduce regulatory burden. The rule will only affect banking organizations that operate under the market risk rules which limits the applicability of the rule to organizations with significant trading operations. The rule will reduce regulatory burden for banking organizations that engage in securities borrowing transactions.

Administrative Procedure Act

Pursuant to section 553 of the Administrative Procedure Act, 5 U.S.C. 553, the Agencies find good cause for issuing this interim rule in advance of the receipt of comments from interested parties. Currently, U.S. banking organizations are at a competitive disadvantage versus certain foreign organizations because of differing capital treatment for securities borrowing transactions. The Agencies find that it is contrary to the public interest for U.S. banking organizations to be subject to more stringent rules (resulting in higher regulatory capital requirements) than direct competitor institutions outside of the U.S. that have capital charges determined from rules that are consistent with the interim rule. This rule relieves a restriction on banking organizations and fosters consistency among international institutions prior to year-end, but does not raise safety and soundness concerns. The Agencies are seeking public comment on the interim rule.

Paperwork Reduction Act

The Agencies have determined that this interim 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 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 interim rule is limited to banking organizations subject to the market risk rules and to securities borrowing transactions collateralized with cash. The OCC, therefore, has determined that the interim 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.

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 adding new 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,^{12a} including:

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

^{12a} A bank subject to the market risk capital requirements pursuant to appendix B of this part 3 may calculate the capital requirement for qualifying securities borrowing transactions pursuant to section 3(a)(1)(ii) of appendix B of this part 3.

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

(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).⁷

(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
- (E) The securities borrowing transaction must be a securities contract for purposes of section 555 of the Bankruptcy Code (11 U.S.C. 555741(7)), a qualified financial contract for 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 purposes of sections 401-407 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (12 U.S.C. 4401-4407) or Regulation EE (12 CFR Part 231).

11/20/00

Date

(Signed) John D. Hawke, Jr.

John D. Hawke, Jr.
Comptroller of the Currency

⁷ 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 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**

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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)⁷ 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,
- (iv) the transaction is a securities contract for the purposes of section 555 of the Bankruptcy Code (11U.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).

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⁷ 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 the 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)⁷ 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,
- (iv) 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).

* * * * *

By order of the Board of Governors of the Federal Reserve System, November 24, 2000.

(Signed) Jennifer J. Johnson

Jennifer J. Johnson
Secretary of the Board

⁷ 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 the 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

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

(a) Risk-based capital ratio denominator.

* * * * *

(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)⁷ 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,
- (iv) 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).

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⁷ 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 the adjusted risk weighted assets as determined in appendix A of this part.

By order of the Board of Directors.
Dated at Washington, DC, this 21st day of November 2000.
Federal Deposit Insurance Corporation.

(Signed) James D. LaPierre

James D. LaPierre,
Deputy Executive Secretary