BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D.C. 20551

DIVISION OF BANKING
SUPERVISION AND REGULATION

August 21, 2007

Mr. H. Rodgin Cohen
Sullivan & Cromwell LLP
125 Broad Street
New York, NY 10004-2498

Dear Mr. Cohen:

I am writing in response to your request for guidance as to the risk weight applicable to certain collateralized loans of cash ("Credits") under the Board's risk-based capital guidelines ("Guidelines") for state member banks and bank holding companies ("banking organizations"). You state in your letter that the Credits would satisfy the following conditions:

1) Each Credit is secured by collateral consisting of securities that the Guidelines do not formally recognize (that is, the collateral does not take the form of cash on deposit in the bank or a subsidiary lending institution; securities issued or guaranteed by the central governments of OECD-based countries, U.S. government agencies, or U.S. government-sponsored agencies; or securities issued by multi-lateral institutions or regional development banks).

2) The collateral has a value that the banking organization believes is in excess of the amount of the cash loaned, with the amount of the excess depending on the creditworthiness of the obligor and other relevant credit considerations.

3) The collateral for each Credit is marked to market by the banking organization each business day, and each Credit is subject to daily margin-maintenance requirements under the banking organization's internal requirements.

4) Each Credit will be (i) if the obligor is an insured depository institution within the meaning of the Federal Deposit Insurance Act (the "FDIA"), a qualified financial contract within the meaning of section 11(e)(8) of the FDIA, and (ii) if the obligor is not an insured depository institution, a contract subject to comparable provisions of the U.S. Bankruptcy Code, such that the exercise by the banking organization of its enforcement and liquidation rights is free of the automatic stay provided for in section 362 of the Bankruptcy Code. Each banking organization will have a reasonable basis for concluding that it would be able to liquidate the collateral for its Credits without undue delay, even in the case of bankruptcy or insolvency of the obligor.

Under the Guidelines, a claim that is secured by collateral that the Guidelines do not formally recognize generally receives the risk weight applicable to the obligor. Claims on most private sector obligors are assigned the standard risk weight of 100 percent. Thus, in most cases, the notional amount of such claims is subject to a 100 percent risk weight.[1] Under the Guidelines, however, there are four principal ways in which claims such as the Credits may be assigned a lower risk weight than 100 percent.

First, the notional amount of a Credit may be assigned a risk weight of 20 percent if the obligor of the Credit is (i) a U.S. depository institution (as defined in the Guidelines); (ii) a foreign bank (as defined in the Guidelines); or (iii) a qualifying securities firm (as defined in the Guidelines) that has a long-term issuer credit rating or a rating on a long-term debt issue of A- or better from a nationally recognized statistical rating organization ("NRSRO").[2]

Second, the notional amount of a Credit may receive a risk weight of 20 percent if the Credit is (i) guaranteed by a U.S. depository institution or a foreign bank or (ii) extended to a qualifying securities firm and guaranteed by the securities firm's parent company so long as that parent company has a long-term rating of A- or better from an NRSRO.[3]

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[1] 12 CFR part 225, App. A, § III.C.4; 12 CFR part 208, App. A, § III.C.4.

[2] 12 CFR part 225, App. A, § III.C.2.a. and d.; 12 CFR part 208, App. A, § III.C.2.a. and d.

[3] 12 CFR part 225, App. A, § III.C.2.d.; 12 CFR part 208, App. A, § III.C.2.d.

Third, the notional amount of a Credit extended to a qualifying securities firm may receive a 20 percent risk weight under the Guidelines, without regard to the NRSRO rating criteria discussed above, if the Credit (i) is documented as a reverse repurchase agreement or securities borrowing transaction using standard industry documentation; (ii) is collateralized by debt or equity securities that are liquid and readily marketable;[4] (iii) is marked to market daily; (iv) is subject to daily margin-maintenance requirements; and (v) can be liquidated, terminated, or accelerated immediately in bankruptcy or similar proceeding without the security or collateral agreement being stayed or avoided under applicable law.[5] You have indicated that the Credits would satisfy conditions (iii) through (v) above. Accordingly, the Credits could qualify for the 20 percent risk weight under this third alternative if the banking organization were to document the Credits as reverse repurchase agreements or securities borrowing transactions using standard industry documentation and if the Credits were collateralized by securities that are liquid and readily marketable.

Fourth, if a banking organization has adopted the market risk capital rule and documents the Credit as a securities borrowing transaction, another treatment would be available for the Credit under the Guidelines. In this case, the banking organization could exclude the Credit from risk-weighted assets to the extent of the market value of the borrowed securities (that is, to the extent of the collateral securing the Credit), provided that the Credit (i) is based on securities includable in the trading book that are liquid and readily marketable; (ii) is marked to market daily; (iii) is subject to daily margin maintenance requirements; and (iv) is done on an overnight basis, is unconditionally cancelable by the banking organization, or is effectively exempt from automatic stay in bankruptcy.[6]

You have indicated that the Credits would satisfy conditions (ii) through (iv) above and that the collateral for a Credit would have a value that the banking organization extending the Credit believes is in excess of the amount of the cash transferred by the banking organization to the obligor. Accordingly, the Credits could be excluded in their entirety from risk-weighted assets under this fourth alternative if the banking organization were to document the Credits as securities

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[4] The Guidelines do not define "liquid and readily marketable." As a general matter, a security that has a robust historical record of an active market characterized by daily market prices would be deemed "liquid and readily marketable."

[5] 12 CFR part 225, App. A, § III.C.2.d.; 12 CFR part 208, App. A, § III.C.2.d.

[6] 12 CFR part 225, App. E, § 3(a)(1); 12 CFR part 208, App. E, § 3(a)(1).

borrowing transactions and the Credits were to involve securities that are includable in the trading book and liquid and readily marketable. The Federal Reserve would expect the banking organization to have a reasonable and appropriate basis for valuing the collateral. Under the Guidelines, this fourth alternative treatment does not require that the Credit be motivated by the banking organization's desire to borrow securities; a Credit motivated by a desire of the banking organization to lend cash would qualify so long as the conditions set forth above are met. We note that if the collateral value were less than the notional amount of the Credit, only the difference between the two would be risk weighted. The risk weight would be determined by the identity of the obligor in accordance with the discussion above.

This determination is based on the specific facts and circumstances of the transactions described in your correspondence and this letter. Any material change in those facts and circumstances may result in a different view or in a revocation of this guidance.

Please direct any questions to Norah Barger, Associate Director, at 202-452-2402; Mark Van Der Weide, Senior Counsel, at 202-452-2263; or Allison Breault, Attorney, at 202-452-3124.

Sincerely yours,

Roger T. Cole

Roger T. Cole

Director