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Subpart A—Minimum Capital

§ 1750.1 General.

The regulation contained in this subpart A sets forth the methodology for computing the minimum capital requirement for each Enterprise. The board of directors of each Enterprise is responsible for ensuring that the Enterprise maintains capital at a level that is sufficient to ensure the continued financial viability of the Enterprise and that equals or exceeds the minimum capital requirement contained in this subpart A.

§ 1750.2 Definitions.

For purposes of this subpart A, the following definitions shall apply.

Affiliate means any entity that controls, is controlled by, or is under common control with, an Enterprise, except as otherwise provided by the Director.

Commitment means any contractual, legally binding agreement that obligates an Enterprise to purchase or to securitize mortgages.

Core Capital—

(1) Means the sum of (as determined in accordance with generally accepted accounting principles) —

(i) The par or stated value of outstanding common stock;

(ii) The par or stated value of outstanding perpetual, noncumulative preferred stock;

(iii) Paid-in capital; and

(iv) Retained earnings; and

(2) Does not include debt instruments or any amounts the Enterprise could be required to pay at the option of an investor to retire capital instruments.

Director means the Director of OFHEO.

Enterprise means the Federal National Mortgage Association and any affiliate thereof or the Federal Home Loan Mortgage Corporation and any affiliate thereof.

Foreign exchange rate contracts—

(1) Means cross-currency interest rate swaps, forward foreign exchange contracts, currency options purchased (including currency options purchased over-the-counter), and any other instrument that gives rise to similar credit risks; and

(2) Does not mean foreign exchange rate contracts with an original maturity of 14 calendar days or less and foreign exchange rate contracts traded on exchanges that require daily payment of variation margins.

Interest rate contracts—

(1) Means single currency interest rate swaps, basis swaps, forward rate agreements, interest rate options purchased (including caps, collars, and floors purchased), over-the-counter options purchased, and any other instrument that gives rise to similar credit risks (including when-issued securities and forward deposits accepted); and

(2) Does not mean such instruments traded on exchanges that require daily payment of variation margins.

Mortgage-backed security means a security, investment, or substantially equivalent instrument that represents an interest in a pool of loans secured by mortgages or deeds of trust where the principal or interest payments to the in-

vestor in the security or substantially equivalent instrument are guaranteed or effectively guaranteed by an Enterprise.

Multifamily credit enhancement means any guarantee, pledge, purchase arrangement, or other obligation or commitment provided or entered into by an Enterprise with respect to multifamily mortgages to provide credit enhancement, liquidity, interest rate support, and other guarantees and enhancements for revenue bonds issued by a state or local governmental unit (including a housing finance agency) or other bond issuer.

1992 Act means the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, found at Title XIII of the Housing and Community Development Act of 1992, Pub. L. 102-550, 12 U.S.C. 4501 *et seq.*

Notional amount means the face value of the underlying financial instrument(s) on which an interest rate or foreign exchange rate contract is based.

Off-balance sheet obligation means a binding agreement, contract, or similar arrangement that requires or may require future payment(s) in money or kind by another party to an Enterprise, or that effectively guarantees all or part of such payment(s) to third parties (including commitments), where such agreement or contract is a source of credit risk that is not included on its balance sheet.

OFHEO means the Office of Federal Housing Enterprise Oversight.

Other off-balance sheet obligations means all off-balance sheet obligations of an Enterprise that are not mortgage-backed securities or substantially equivalent instruments and that are not resecuritized mortgage-backed

securities, such as real estate mortgage investment conduits or similar resecured instruments.

Perpetual, noncumulative preferred stock means preferred stock that—

- (1) Does not have a maturity date;
- (2) Provides the issuer the ability and the legal right to eliminate dividends and does not permit the accruing or payment of impaired dividends;
- (3) Cannot be redeemed at the option of the holder; and
- (4) Has no other provisions that will require future redemption of the issue, in whole or in part, or that will reset the dividend periodically based, in whole or in part, on the Enterprise's current credit standing, such as auction rate, money market, or remarketable preferred stock, or that may cause the dividend to increase to a level that could create an incentive for the issuer to redeem the instrument, such as exploding rate stock.

Qualifying collateral means cash on deposit; securities issued or guaranteed by the central governments of the OECD-based group of countries,¹ United States Government agencies, or United States Government-sponsored agencies; and securities issued by mul-

tilateral lending institutions or regional development banks.

§ 1750.3 Procedure and timing.

(a) Each Enterprise shall file with the Director a minimum capital report each quarter or at such other times as the Director requires, in his or her sole discretion. The report shall contain the information that responds to all of the items required by OFHEO in written instructions to the Enterprise, including, but not limited to:

- (1) Estimate of the minimum capital requirement;
- (2) Estimate of core capital overage or shortfall relative to the estimated minimum capital requirement;
- (3) Such other information as may be required by the Director.

(b) The quarterly minimum capital report shall be submitted not later than April 30, July 30, October 30, and January 30 of each year.

(c) Each minimum capital report shall be submitted in writing and in such other format as may be required by the Director.

(d) In the event an Enterprise makes an adjustment to its financial statements for a quarter or a date for which the information was requested,

¹ The OECD-based group of countries comprises full members of the Organization for Economic Cooperation and Development (OECD) regardless of entry date, as well as countries that have concluded special lending arrangements with the International Monetary Fund (IMF) associated with the IMF's General Arrangements to Borrow, but excludes any country that has rescheduled its external sovereign debt within the previous 5 years. A rescheduling of external sovereign debt generally would include any renegotiation of terms arising from a country's mobility or unwillingness to meet its external debt service obligations, but generally not include any renegotiation to allow the borrower to take advantage of a decline in interest rate or other change in market conditions. As of November 1995, the OECD countries included the following countries: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Iceland, Ireland, Italy, Japan, Luxembourg, Mexico, the Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, the United Kingdom, and the United States; and Saudi Arabia has concluded special lending arrangements with the IMF associated with the IMF's General Arrangements to Borrow.

which would cause an adjustment to a minimum capital report, the Enterprise shall file with the Director an amended minimum capital report not later than 3 business days after the date of such adjustment.

(e) Each minimum capital report or any amended minimum capital report shall contain a declaration by an officer authorized by the board of directors of the Enterprise to make such a declaration, including, but not limited to a president, vice president, or treasurer, that the report is true and correct to the best of such officer's knowledge and belief.

§ 1750.4 Minimum capital requirement computation.

(a) The minimum capital requirement for each Enterprise shall be computed by adding the following amounts:

(1) 2.50 percent times the aggregate on-balance sheet assets of the Enterprise;

(2) 0.45 percent times the unpaid principal balance of mortgage-backed securities and substantially equivalent instruments that were issued or guaranteed by the Enterprise;

(3) 0.45 percent of 50 percent of the average dollar amount of commitments outstanding each quarter over the preceding four quarters;

(4) 0.45 percent of the outstanding principal amount of bonds with multifamily credit enhancements;

(5) 0.45 percent of the dollar amount of sold portfolio remittances pending;

(6)(i) 3.00 percent of the credit equivalent amount of interest rate contracts and foreign exchange rate contracts, except to the extent of the current market value of posted qualifying collateral, computed in accordance with

appendix A to this subpart;

(ii) 1.50 percent of the market value of qualifying collateral posted to secure interest rate and foreign exchange rate contracts, not to exceed the credit equivalent amount of such contracts, computed in accordance with appendix A to this subpart; and

(7) 0.45 percent of the outstanding amount, credit equivalent amount, or other measure determined appropriate by the Director, of other off-balance sheet obligations (excluding commitments, multifamily credit enhancements, sold portfolio remittances pending, and interest rate contracts and foreign exchange rate contracts), except as adjusted by the Director to reflect differences in the credit risk of such obligations in relation to mortgage-backed securities.

(b) Any asset or financial obligation that is properly classifiable in more than one of the categories enumerated in paragraphs (a)(1) through (7) of this section shall be classified in the category that yields the highest minimum capital requirement.

(c) As used in this section, the term "preceding four quarters" means the last day of the quarter just ended (or the date for which the minimum capital report is filed, if different), and the three preceding quarter-ends.

§ 1750.5 Removed. 67 FR 19321, April 19, 2002.

Appendix A to Subpart A of Part 1750—Minimum Capital Components for Interest Rate and Foreign Exchange Rate Contracts

1. The minimum capital components for interest rate and foreign ex-

change rate contracts are computed on the basis of the credit equivalent amounts of such contracts. Credit equivalent amounts are computed for each of the following off-balance sheet interest rate and foreign exchange rate contracts:

- a. *Interest Rate Contracts*
 - i. Single currency interest rate swaps.
 - ii. Basis swaps.
 - iii. Forward rate agreements.
 - iv. Interest rate options purchased (including caps, collars, and floors purchased).
 - v. Any other instrument that gives rise to similar credit risks (including when-issued securities and forward deposits accepted).
- b. *Foreign Exchange Rate Contracts*
 - i. Cross-currency interest rate swaps.
 - ii. Forward foreign exchange rate contracts.
 - iii. Currency options purchased.
 - iv. Any other instrument that gives rise to similar credit risks.

2. Foreign exchange rate contracts with an original maturity of 14 calendar days or less and foreign exchange rate contracts traded on exchanges that require daily payment of variation margins are excluded from the minimum capital requirement computation. Over-the-counter options purchased, however, are included and treated in the same way as the other interest rate and foreign exchange rate contracts.

3. *Calculation of Credit Equivalent Amounts*

a. The minimum capital components for interest rate and foreign exchange rate contracts are computed on the basis of the credit equivalent

amounts of such contracts. The credit equivalent amount of an off-balance sheet interest rate and foreign exchange rate contract that is not subject to a qualifying bilateral netting contract in accordance with this appendix A is equal to the sum of the current exposure (sometimes referred to as the replacement cost) of the contract and an estimate of the potential future credit exposure over the remaining life of the contract.

b. The current exposure is determined by the mark-to-market value of the contract. If the mark-to-market value is positive, then the current exposure is the mark-to-market value. If the mark-to-market value is zero or negative, then the current exposure is zero. Mark-to-market values are measured in United States dollars, regardless of the currency or currencies specified in the contract, and should reflect changes in the relevant rates, as well as counterparty credit quality.

c. The potential future credit exposure of a contract, including a contract with a negative mark-to-market value, is estimated by multiplying the notional principal amount of the contract by a credit conversion factor. The effective rather than the apparent or stated notional amount must be used in this calculation. The credit conversion factors are:

Remaining Maturity	Interest Rate Contracts (percent)	Foreign Exchange Contracts Rate (percent)
1 year or less	0.0	1.0
Over 1 year	0.5	5.0

d. Because foreign exchange rate contracts involve an exchange of principal upon maturity, and foreign exchange rates are generally more volatile than interest rates, higher conversion factors have been established for foreign exchange rate contracts than for interest rate contracts.

e. No potential future credit exposure is calculated for single currency interest rate swaps in which payments are made based upon two floating rate indexes, so-called floating/floating or basis swaps. The credit exposure on these contracts is evaluated solely on the basis of their mark-to-market values.

4. *Avoidance of Double Counting*

In certain cases, credit exposures arising from the interest rate and foreign exchange instruments covered by this appendix A may already be reflected, in part, on the balance sheet. To avoid double counting such exposures in the assessment of capital adequacy, counterparty credit exposures arising from the types of instruments covered by this appendix A may need to be excluded from balance sheet assets in calculating the minimum capital requirement.

5. *Collateral*

a. The sufficiency of collateral for off-balance sheet items is determined by the market value of the collateral in relation to the credit equivalent amount. Collateral held against a netting contract is not recognized for minimum capital standard purposes unless it is legally available to support the single legal obligation created by the netting contract. Excess collateral held against one contract or a group of contracts for which a recognized netting agreement

exists may not be considered.

b. The only forms of collateral that are formally recognized by the minimum capital standard framework are cash on deposit; securities issued or guaranteed by the central governments of the OECD-based group of countries, United States Government agencies, or United States Government-sponsored agencies; and securities issued by multilateral lending institutions or regional development banks.

6. *Netting*

a. For purposes of this appendix A, netting refers to the offsetting of positive and negative mark-to-market values in the determination of a current exposure to be used in the calculation of a credit equivalent amount. Any legally enforceable form of bilateral netting (that is, netting with a single counterparty) of interest rate and foreign exchange rate contracts is recognized for purposes of calculating the credit equivalent amount provided that the following criteria are met:

i. Netting must be accomplished under a written netting contract that creates a single legal obligation, covering all included individual contracts, with the effect that the Enterprise would have a claim to receive, or obligation to pay, only the net amount of the sum of the positive and negative mark-to-market values on included individual contracts in the event that a counterparty, or a counterparty to whom the contract has been validly assigned, fails to perform due to default, insolvency, liquidation, or similar circumstances.

ii. The Enterprise must obtain a written and reasoned legal opinion(s) representing that in the event of a legal challenge—including one resulting from default, insolvency, liquidation, or

similar circumstances—the relevant court and administrative authorities would find the Enterprise’s exposure to be such a net amount under—

A. The law of the jurisdiction in which the counterparty is chartered or the equivalent location in the case of noncorporate entities, and if a branch of the counterparty is involved, then also under the law of the jurisdiction in which the branch is located;

B. The law that governs the individual contracts covered by the netting contract; and

C. The law that governs the netting contract.

iii. The Enterprise must establish and maintain procedures to ensure that the legal characteristics of netting contracts are kept under review in the event of possible changes in relevant law.

iv. The Enterprise must maintain in its files documentation adequate to support the netting of rate contracts, including a copy of the bilateral netting contract and necessary legal opinions.

b. A contract containing a walk-away clause is not eligible for netting for purposes of calculating the credit equivalent amount.²

c. By netting individual contracts for the purpose of calculating its credit equivalent amount, the Enterprise represents that it has met the requirements of this appendix A and all the appropriate documents are in the Enterprise’s files and available for inspection by

OFHEO. OFHEO may determine that an Enterprise’s files are inadequate or that a netting contract, or any of its underlying individual contracts, may not be legally enforceable under any one of the bodies of law described in this appendix A. If such a determination is made, the netting contract may be disqualified from recognition for minimum capital standard purposes or underlying individual contracts may be treated as though they are not subject to the netting contract.

d. The credit equivalent amount of interest rate and foreign exchange rate contracts that are subject to a qualifying bilateral netting contract is calculated by adding the current exposure of the netting contract and the sum of the estimates of the potential future credit exposures on all individual contracts subject to the netting contract, estimated in accordance with paragraph 3 of this appendix A. Offsetting contracts in the same currency maturing on the same date will have lower current exposure. Therefore, for purposes of calculating potential future credit exposure to a netting counterparty for foreign exchange rate contracts and other similar contracts in which notional principal is equivalent to cash flows, total notional principal is defined as the net receipts falling due on each value date in each currency.

e. The current exposure of the netting contract is determined by summing all positive and negative mark-to-market values of the individual contracts included in the netting contract. If the net sum of the mark-to-market values is positive, then the current exposure of the netting contract is equal to that sum. If the net sum of the mark-to-market values is zero or negative,

² A walkaway clause is a provision in a netting contract that permits a non-defaulting counterparty to make lower payments than it would make otherwise under the contract, or no payment at all, to a defaulter or to the estate of a defaulter, even if the defaulter or the estate of the defaulter is a net creditor under the contract.

then the current exposure of the netting contract is zero. OFHEO may determine that a netting contract qualifies for minimum capital standard netting treatment even though certain individual contracts may not qualify. In such instances, the nonqualifying contracts should be treated as individual contracts that are not subject to the netting contract.

f. In the event a netting contract covers contracts that are normally excluded from the minimum capital requirement computation—for example, foreign exchange rate contracts with an original maturity of 14 calendar days or less, or instruments traded on exchanges that require daily payment of variation margin—an Enterprise may elect consistently either to include or exclude all mark-to-market values of such contracts when determining net current exposure.