DEPARTMENT OF THE TREASURY

Office of the Comptroller of the Currency

12 CFR Part 3

[Docket No. 06-xx]

RIN 1557- AC95

FEDERAL RESERVE SYSTEM

12 CFR Parts 208 and 225

[Regulations H and Y; Docket No. R-1238]

FEDERAL DEPOSIT INSURANCE CORPORATION

12 CFR Part 325

RIN 3064-AC96

DEPARTMENT OF THE TREASURY

Office of Thrift Supervision

12 CFR Part 567

[No. 2006-xx]

RIN 1550-AB98

Risk-Based Capital Guidelines; Capital Adequacy Guidelines; Capital Maintenance: Domestic Capital Modifications

AGENCIES: Office of the Comptroller of the Currency, Treasury; Board of Governors of the Federal Reserve System; Federal Deposit Insurance Corporation; and Office of Thrift Supervision, Treasury.

ACTION: Joint notice of proposed rulemaking.

SUMMARY: The Office of the Comptroller of the Currency (OCC), Board of Governors of the Federal Reserve System (Board), Federal Deposit Insurance Corporation (FDIC), and Office of Thrift Supervision (OTS) (collectively, the Agencies) are proposing revisions to the existing risk-based capital framework that would enhance its risk sensitivity without unduly increasing regulatory burden. These changes would apply to banks, bank holding companies, and savings associations (banking organizations). A banking organization would be able to elect to adopt these proposed revisions or remain subject to the Agencies' existing risk-based capital rules, unless it uses the Advanced Capital Adequacy Framework proposed in the notice of proposed rulemaking published on September 25, 2006 (Basel II NPR).

In this notice of proposed rulemaking (NPR or Basel IA), the Agencies are proposing to expand the number of risk weight categories, allow the use of external credit ratings to risk weight certain exposures, expand the range of recognized collateral and eligible guarantors, use loan-to-value ratios to risk weight most residential mortgages, increase the credit conversion factor for certain commitments with an original maturity of one year or less, assess a charge for early amortizations in securitizations of revolving exposures, and remove the 50 percent limit on the risk weight for certain derivative transactions. A banking organization would have to apply all the proposed changes if it chose to use these revisions.

Finally, in Section III of this NPR, the Agencies seek further comment on possible alternatives for implementing the "International Convergence of Capital Measurement and Capital Standards: A Revised Framework" (Basel II) in the United States as proposed in the

Basel II NPR.

DATES: Comments on this joint notice of proposed rulemaking must be received by [insert date [90] days after publication in the Federal Register].

ADDRESSES: Comments should be directed to:

OCC: You should include OCC and Docket Number 06-xx in your comment. You may submit comments by any of the following methods:

- **Federal eRulemaking Portal**: http://www.regulations.gov. Follow the instructions for submitting comments.
- **OCC Web Site**: http://www.occ.treas.gov. Click on "Contact the OCC," scroll down and click on "Comments on Proposed Regulations."
- **E-mail address**: regs.comments@occ.treas.gov.
- **Fax**: (202) 874-4448.
- **Mail**: Office of the Comptroller of the Currency, 250 E Street, SW, Mail Stop 1-5, Washington, DC 20219.
- **Hand Delivery/Courier**: 250 E Street, SW, Attn: Public Information Room, Mail Stop 1-5, Washington, DC 20219.

Instructions: All submissions received must include the Agency name (OCC) and docket number or Regulatory Information Number (RIN) for this notice of proposed rulemaking. In general, OCC will enter all comments received into the docket without change, including any business or personal information that you provide. You may review comments and other related materials by any of the following methods:

- **Viewing Comments Personally**: You may personally inspect and photocopy comments at the OCC's Public Information Room, 250 E Street, SW, Washington, DC. You can make an appointment to inspect comments by calling (202) 874-5043.
- **Viewing Comments Electronically**: You may request e-mail or CD-ROM copies of comments that the OCC has received by contacting the OCC's Public Information Room at regs.comments@occ.treas.gov.
- **Docket**: You may also request available background documents and project summaries using the methods described above.

Board: You may submit comments, identified by Docket No. R-1238, by any of the following methods:

- **Agency Web Site:** http://www.federalreserve.gov. Follow the instructions for submitting comments at http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm.
- **Federal eRulemaking Portal:** http://www.regulations.gov. Follow the instructions for submitting comments.
- **E-mail:** regs.comments@federalreserve.gov. Include docket number in the subject line of the message.
- **FAX:** (202) 452-3819 or (202) 452-3102.
- **Mail:** Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, NW, Washington, DC 20551.

All public comments are available from the Board's website at http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm as submitted, unless modified for technical reasons. Accordingly, your comments will not be edited to remove any identifying or contact information. Public comments may also be viewed electronically or in paper form in

Room MP-500 of the Board's Martin Building (20th and C Street, NW) between 9:00 a.m. and 5:00 p.m. on weekdays.

FDIC: You may submit by any of the following methods:

- **Federal eRulemaking Portal:** http://www.regulations.gov. Follow the instructions for submitting comments.
- **Agency Web site:** http://www.FDIC.gov/regulations/laws/federal/propose.html
- **Mail:** Robert E. Feldman, Executive Secretary, Attention: Comments/Legal ESS, Federal Deposit Insurance Corporation, 550 17th Street, NW, Washington, DC 20429.
- **Hand Delivered/Courier:** 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.
- **E-mail:** comments@FDIC.gov.
- **Public Inspection:** Comments may be inspected and photocopied in the FDIC Public Information Center, Room E-1002, 3502 Fairfax Drive, Arlington, VA 22226, between 9:00 a.m. and 5:00 p.m. on business days.

Instructions: Submissions received must include the Agency name and title for this notice. Comments received will be posted without change to http://www.FDIC.gov/regulations/laws/federal/propose.html, including any personal information provided.

OTS: You may submit comments, identified by No. 2006-xx, by any of the following methods:

- **Federal eRulemaking Portal:** http://www.regulations.gov. Follow the instructions for submitting comments.
- **E-mail address:** regs.comments@ots.treas.gov. Please include No. 2006-xx in the subject line of the message and include your name and telephone number in the message.

- **Fax:** (202) 906-6518.
- **Mail:** Regulation Comments, Chief Counsel's Office, Office of Thrift Supervision, 1700 G Street, NW, Washington, DC 20552, Attention: No. 2006-xx.
- **Hand Delivery/Courier:** Guard's Desk, East Lobby Entrance, 1700 G Street, NW, from 9:00 a.m. to 4:00 p.m. on business days, Attention: Regulation Comments, Chief Counsel's Office, Attention: No. 2006-xx.

Instructions: All submissions received must include the Agency name and docket number or Regulatory Information Number (RIN) for this rulemaking. All comments received will be posted without change to the OTS Internet Site at http://www.ots.treas.gov/pagehtml.cfm?catNumber=67&an=1, including any personal information provided.

Docket: For access to the docket to read background documents or comments received, go to http://www.ots.treas.gov/pagehtml.cfm?catNumber=67&an=1.

In addition, you may inspect comments at the Public Reading Room, 1700 G Street, NW, by appointment. To make an appointment for access, call (202) 906-5922, send an e-mail to public.info@ots.treas.gov, or send a facsimile transmission to (202) 906-7755. (Prior notice identifying the materials you will be requesting will assist us in serving you.) We schedule appointments on business days between 10:00 a.m. and 4:00 p.m. In most cases, appointments will be available the next business day following the date we receive a request.

FOR FURTHER INFORMATION CONTACT:

OCC: Nancy Hunt, Risk Expert, (202) 874-4923; or Kristin Bogue, Risk Expert, (202) 874-5411, Capital Policy Division; Ron Shimabukuro, Special Counsel, 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: Thomas R. Boemio, Senior Project Manager, Policy, (202) 452-2982; Barbara Bouchard, Deputy Associate Director, (202) 452-3072; William Tiernay, Supervisory Financial Analyst (202) 872-7579; or Juan C. Climent, Supervisory Financial Analyst, (202) 872-7526 Division of Banking Supervision and Regulation; or Mark E. Van Der Weide, Senior Counsel, (202) 452-2263, Legal Division. For the hearing impaired *only*, Telecommunication Device for the Deaf (TDD), (202) 263-4869.

FDIC: Karl R. Reitz, Capital Markets Specialist, (202) 898-3857, or Bobby R. Bean, Chief, Policy Section Capital Markets Branch, (202) 898-3575, Division of Supervision and Consumer Protection; or Benjamin W. McDonough, Attorney, (202) 898-7411, or Michael B. Phillips, Counsel, (202) 898-3581, Supervision and Legislation Branch, Legal Division, Federal Deposit Insurance Corporation, 550 17th Street, NW, Washington, DC 20429.

OTS: Teresa Scott, Senior Project Manager, Supervision Policy (202) 906-6478; or Karen Osterloh, Special Counsel, Regulation and Legislation Division, Chief Counsel's Office, (202) 906-6639; Office of Thrift Supervision, 1700 G Street, NW, Washington, DC 20552.

SUPPLEMENTARY INFORMATION:

I. Background

In 1989, the Office of the Comptroller of the Currency (OCC), Board of Governors of the Federal Reserve System (Board), Federal Deposit Insurance Corporation (FDIC), and Office of Thrift Supervision (OTS) (collectively, the Agencies) implemented a risk-based capital framework for U.S. banking organizations.[1] The Agencies based the framework on the "International Convergence of Capital Measurement and Capital Standards" (Basel I), published

[1] 12 CFR part 3, appendix A (OCC); 12 CFR parts 208 and 225, appendix A (Board); 12 CFR part 325, appendix A (FDIC); and 12 CFR part 567 (OTS). The risk-based capital rules generally do not apply to bank holding companies with less than $500 million in assets. 71 FR 9897 (February 28, 2006).

by the Basel Committee on Banking Supervision (Basel Committee) in 1988.[2] Basel I addressed certain weaknesses in the various regulatory capital regimes that were in force in most of the world's major banking jurisdictions. In the United States, the Basel I-based framework established a uniform regulatory capital system that captured some of the risks not otherwise captured by the regulatory capital to total assets ratio, provided some modest differentiation of regulatory capital based on broadly defined risk-weight categories, and encouraged banking organizations to strengthen their capital positions.

Consistent with Basel I, the Agencies' existing risk-based capital rules generally assign each credit exposure to one of five broad categories of credit risk, which allows for only limited differentiation in the assessment of credit risk for most exposures. Since the implementation of Basel I-based capital rules, the Agencies have made numerous revisions to these rules in response to changes in financial market practices and accounting standards as well as to implement legislative mandates and address safety and soundness issues. Over time, these revisions have modestly increased the degree of risk sensitivity of the Agencies' risk-based capital rules. The Agencies and the industry generally agree that the existing risk-based capital rules could be modified to better reflect the risks present in many banking organizations' portfolios without imposing undue regulatory burden. In recent years, however, the Agencies have limited modifications to the existing risk-based capital rules while international efforts to create a new risk-based capital framework were in process.

In June 2004, the Basel Committee introduced a new, more risk-sensitive capital adequacy framework, "International Convergence of Capital Measurement and Capital

[2] The Basel Committee on Banking Supervision was established in 1974 by central banks and governmental authorities with bank supervisory responsibilities. Current member countries are Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, the Netherlands, Spain, Sweden, Switzerland, the United Kingdom, and the United States.

Standards: A Revised Framework" (Basel II).[3] Basel II is designed to promote improved risk measurement and management processes and better align minimum capital requirements with risk. For credit risk, Basel II includes three approaches for regulatory capital: standardized, foundation internal ratings-based, and advanced internal ratings-based. For operational risk, Basel II also includes three methodologies: basic indicator, standardized, and advanced measurement.

In August 2003, the Agencies issued an advance notice of proposed rulemaking (Basel II ANPR), which explained how the Agencies might implement Basel II in the United States.[4] On September 25, 2006, the Agencies issued a notice of proposed rulemaking that provides the industry with a more definitive proposal for implementing Basel II in the United States (Basel II NPR).[5]

The Basel II NPR identifies two types of U.S. banking organizations that would use the Basel II rules: those for which application of the rules would be mandatory (core banks), and those that might voluntarily apply the rules (opt-in banks) (collectively referred to as Basel II banking organizations). In general, the Basel II NPR defines a core bank as a banking organization that has consolidated total assets of $250 billion or more, has consolidated on-balance sheet foreign exposure of $10 billion or more, or is a subsidiary of a Basel II banking organization. The Basel II NPR presents the advanced internal ratings-based approach for credit risk and the advanced measurement approach for operational risk. However, the Agencies did seek comment in the Basel II NPR on whether U.S. banking organizations subject to the

[3] The complete text for Basel II as amended in November 2005 is available on the Bank for International Settlements Web site at http://www.bis.org/publ/bcbs118.htm.
[4] As stated in its preamble, the Basel II ANPR was based on the consultative document "The New Basel Capital Accord" that was published by the Basel Committee on April 29, 2003. The Basel II ANPR anticipated the issuance of a final revised accord. See 68 FR 45900 (August 4, 2003).
[5] 71 FR 55830 (September 25, 2006).

advanced approaches in the proposed rule (that is, core banks and opt-in banks) should be permitted to use other credit and operational risk approaches provided for in Basel II. The Agencies are seeking further comment on possible alternatives for Basel II banking organizations in Section III of this NPR.

The complexity and cost associated with implementing Basel II in the United States effectively limit its application to those banking organizations that are able to take advantage of economies of scale and absorb the costs associated with the enhanced risk management practices required of Basel II banking organizations. Thus, the implementation of Basel II would create a bifurcated regulatory capital framework in the United States: one set of rules for Basel II banking organizations, and another for banking organizations that do not use the proposed Basel II capital rules (non-Basel II banking organizations).

In comments responding to the Basel II ANPR, Congressional testimony, and other industry communications, several banking organizations, trade associations, and others raised concerns about the competitive effects of a bifurcated regulatory framework on community and regional banking organizations. Among other broad concerns, these commenters asserted that implementing the Basel II capital regime in the United States could result in lower minimum regulatory capital requirements for Basel II banking organizations with respect to certain types of credit exposures. As a result, regulatory capital requirements for similar products could differ depending on the capital regime under which a banking organization operates. Community and regional banking organizations asserted that this would put them at a competitive disadvantage.

To assist in quantifying the potential effects of implementing Basel II in the United States, the Agencies conducted a quantitative impact study during late 2004 and early 2005 (QIS

4).[6] QIS 4 was a comprehensive survey completed on a best efforts basis by 26 of the largest U.S. banking organizations using their own internal estimates of the key risk parameters driving the capital requirements under the Basel II framework. The results of the study suggested that the aggregate minimum risk-based capital requirements for the 26 banking organizations could drop approximately 15.5 percent relative to the existing Basel I-based framework. The QIS 4 results also indicated dispersion in capital requirements across banking organizations and portfolios, which was attributed in part to differences in the underlying data and methodologies used by banking organizations to quantify risk and their overall readiness to implement a Basel II framework. The Basel II NPR contains several provisions designed to limit potential reductions in minimum regulatory capital, such as an extended transition period during which the Agencies can thoroughly review those Basel II systems that are subject to supervisory oversight.

On October 20, 2005, the Agencies issued an advanced notice of proposed rulemaking soliciting public comment on possible revisions to U.S. risk-based capital rules that would apply to non-Basel II banking organizations (Basel IA ANPR).[7] The proposals in this NPR are based on those initial conceptual approaches and take into consideration the public comments that the Agencies received.

Together, the Agencies received 73 public comments from banking, trade, and other organizations and individuals. Generally, most commenters supported the Agencies' goal to make the risk-based capital rules more risk-sensitive. Several larger banking organizations and industry groups favored increased risk sensitivity, but argued that many of the proposed revisions should be optional so that banking organizations may weigh the costs and benefits of using the revisions. Several non-Basel II banking organizations and industry groups argued that the U.S.

[6] "Summary Findings of the Fourth Quantitative Impact Study," Joint Agency press release, February 24, 2006.
[7] 70 FR 61068 (October 20, 2005).

risk-based capital rules should allow banking organizations to use internal assessments of risk to determine their capital requirements. A few commenters endorsed a proposal for a four-tier capital framework that would apply different approaches to banking organizations based on the size and complexity, and the robustness of a banking organization's internal ratings systems. The commenters' proposal included an approach that would permit some non-Basel II banking organizations to use internal rating-based systems.

One commenter suggested tying Basel IA capital requirements directly to the aggregate results for Basel II calculations. This commenter suggested that Basel IA capital charges should link by loan category to the average risk-based capital requirements of the Basel II banking organizations for that loan category, plus a small premium to recognize the substantial costs of implementing Basel II.

Most smaller and midsize banking organizations generally requested that any changes to the existing capital rules be simple and not require large data gathering and monitoring expenses. A number of the smallest banking organizations said that they do not wish to have any changes in the capital rules that apply to them. They noted that they already hold significantly more regulatory capital than the Agencies' risk-based capital rules require and, therefore, amending the rules would have little or no effect.

This NPR makes a number of proposals that should improve the risk sensitivity of the existing risk-based capital rules. The Agencies, however, are not proposing to allow a non-Basel II banking organization to use internal risk ratings or to use its internal risk measurement processes to calculate risk-based capital requirements for any new categories of exposures.[8] The

[8] The Agencies' existing capital rules, however, would continue to permit the use of internal ratings for a direct credit substitute (but not a purchased credit-enhancing interest-only strip) assumed in connection with an asset-backed commercial paper program sponsored by a banking organization. 12 CFR part 3, appendix A section 4(g)

Agencies believe that the use of these internal ratings and measurement processes should require the systems controls, supervisory oversight, and other qualification requirements that are proposed in the Basel II NPR.

The Agencies also believe that any proposal to tie capital requirements under Basel IA to the capital charges that would result under the proposed Basel II rules is premature. The Agencies anticipate that the Basel II transition phase would not be completed until 2011 at the earliest. The Agencies also have other concerns about the commenter's proposal including the absence of a capital charge for operational risk; the method by which any premium over the Basel II charges would be determined; difficulties in defining comparable portfolios; and the need to periodically update capital requirements, which would significantly increase complexity and burden.

II. Proposed Changes

In considering revisions to the existing risk-based capital rules, the Agencies were guided by five broad principles. A revised framework must: (1) promote safe and sound banking practices and a prudent level of regulatory capital; (2) maintain a balance between risk sensitivity and operational feasibility; (3) avoid undue regulatory burden; (4) create appropriate incentives for banking organizations; and (5) mitigate material distortions in the risk-based capital requirements for large and small banking organizations.

The Agencies are concerned about potential competitive disadvantages that could result from capital requirements that differ depending on the capital regime under which a banking organization operates. By allowing non-Basel II banking organizations the choice of adopting all of the provisions in this proposal or continuing to use the existing risk-based capital rules, the

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(OCC); 12 CFR parts 208 and 225, appendix A, section III.B.3.F (Board); 12 CFR part 325, appendix A, section II.B.5.(g)(1) (FDIC); and 12 CFR 567.6(b)(4) (OTS).

proposed regulation is intended to help maintain the competitive position of these banks relative to Basel II banking organizations. Moreover, the proposed rule strives for better alignment of capital and risk, with capital requirements potentially higher for organizations with riskier exposures and lower for those with safer exposures. The Agencies seek to achieve these objectives while balancing operational feasibility and regulatory burden considerations.

In this NPR, the Agencies are proposing to:

- Allow non-Basel II banking organizations the choice of adopting all of the revisions in this proposal or continuing to use the existing risk-based capital rules. The voluntary nature of this proposed rule gives banking organizations the opportunity to weigh the various costs and benefits to them of adopting the new system.
- Increase the number of risk weight categories to which credit exposures may be assigned.
- Use external credit ratings to risk weight certain exposures.
- Expand the range of recognized collateral and eligible guarantors.
- Use loan-to-value ratios to risk weight most residential mortgages.
- Increase the credit conversion factor for various commitments with an original maturity of one year or less.
- Assess a risk-based capital charge for early amortizations in securitizations of revolving exposures.
- Remove the 50 percent limit on the risk weight for certain derivative transactions.

The existing risk-based capital requirements focus primarily on credit risk and do not impose explicit capital charges for interest rate, operational, or other risks. These risks, however, are implicitly covered by the existing risk-based capital rules. The risk-based capital charges proposed in this NPR continue the implicit coverage of risks other than credit risk. Moreover,

the Agencies are not proposing revisions to the existing leverage ratio requirement (that is, the ratio of Tier 1 capital to total assets).[9]

To ensure safety and soundness, the Agencies intend to closely monitor the level of risk-based capital at those banking organizations that choose to opt in to Basel IA. Any significant decline in the aggregate level of risk-based capital for these banking organizations may warrant modifications to the proposed risk-based capital rules.

Question 1: The Agencies welcome comments on all aspects of these proposals, especially suggestions for reducing the burden that may be associated with these proposals. The Agencies believe that a banking organization that chooses to adopt these proposals will generally be able to do so with data it currently uses as part of its credit approval and portfolio management processes. Commenters are particularly requested to address whether any of the proposed changes would require data that are not currently available as part of the organization's existing credit approval and portfolio management systems.

A. Opt-In Proposal

In the Basel IA ANPR, the Agencies recognized that certain banking organizations might not want to assume the additional burden that might accompany a more risk-sensitive approach and might prefer to continue to apply the existing risk-based capital rules. Additionally, many commenters, particularly community bank respondents, favored an approach that would allow well-capitalized banking organizations to remain under the existing risk-based capital rules. For these commenters, limiting regulatory burden was a higher priority than increasing the risk sensitivity of their risk-based capital charges. One group of midsize banking organizations recommended applying the proposed rules only to banking organizations with assets of $500

[9] 12 CFR 3.6(b) and (c) (OCC); 12 CFR part 208, appendix B and 12 CFR part 225, appendix D (Board); 12 CFR part 325.3 (FDIC); and 12 CFR 567.8 (OTS).

million or greater. Some commenters noted the risk of "cherry picking" in permitting a choice between the framework discussed in the Basel IA ANPR and the existing risk-based capital rules, or adoption of parts of each.

The Agencies are proposing that a non-Basel II banking organization may, if it chooses, adopt the revisions in this proposed rule. If a banking organization chooses to use these proposed capital rules, however, it would be required to implement them in their entirety. The Agencies are proposing to permit a banking organization to adopt these proposals by notifying its primary Federal supervisor. Before a banking organization decides to opt in to these proposals, the Agencies expect that the organization would review its ability to collect and utilize the information required and evaluate the potential impact on its regulatory capital. A banking organization that chooses to adopt these proposals (that is, opts in) would also be able to request returning to the existing capital rules by first notifying its primary Federal supervisor. In its review of such a request, the primary Federal supervisor would ensure that the risk-based capital requirements appropriately reflect the risk profile of the banking organization and the change is not for purposes of capital arbitrage. Further, the Agencies expect that a banking organization would not alternate between the existing and proposed risk-based capital rules. The Agencies would reserve the authority to require a banking organization to calculate its minimum risk-based capital requirements in accordance with this proposal or the existing risk-based capital rules.

Under this proposal, a non-Basel II banking organization could continue to calculate its risk-based capital requirements using the existing risk-based capital rules. In this case, the banking organization would not need to notify its primary Federal supervisor or take any other action. As noted, above, however, the Agencies would retain the authority to require a non-

Basel II banking organization to use either the existing or the proposed risk-based capital rules if the banking organization's primary Federal supervisor determines that a particular capital rule is more appropriate for the risk profile of the banking organization.

Question 2: The Agencies seek comment on all aspects of the proposal to allow banks to opt in to and out of the proposed rules. Specifically, the Agencies seek comment on any operational challenges presented by the proposed rules. How far in advance should a banking organization be required to notify its primary Federal supervisor that it intends to implement the proposed rule? If a banking organization wishes to "opt out" of the proposed rule, what criteria should guide the review of a request to opt out? When should a banking organization's election to opt in or opt out be effective? In addition, the Agencies seek comment on the appropriateness of requiring a banking organization to apply the proposed Basel IA capital rules based on a banking organization's asset size, level of complexity, risk profile, or scope of operations.

B. Increase the Number of Risk Weight Categories

The Agencies' existing risk-based capital rules contain five risk-weight categories: zero, 20, 50, 100, and 200 percent. Differentiation of credit quality among individual exposures is generally limited to these few risk-weight categories. In the Basel IA ANPR, the Agencies suggested adding four new risk-weight categories (35, 75, 150, and 350 percent) and invited comment on whether: (1) increasing the number of risk-weight categories would allow supervisors to more closely align capital requirements with risk; (2) the suggested additional risk-weight categories would be appropriate; (3) the risk-based capital framework should include more risk-weight categories than the four suggested; and (4) increasing the number of risk-weight categories would impose unnecessary burden on banking organizations.

Commenters generally supported increasing the number of risk-weight categories to

enhance the overall risk-sensitivity of the risk-based capital rules. However, many commenters noted that adding too many categories could make the rules too complex. Several commenters argued that the 350 percent risk weight is too high and suggested that any new risk-weight categories should be lower than 100 percent to reflect the lower risks associated with certain mortgages and other high-quality assets. A few commenters suggested that the Agencies create a new 10 percent risk weight category to account for very low-risk assets.

The Agencies agree with the commenters that increasing the number of risk-weight categories would allow for greater risk sensitivity than the existing risk-based capital rules. Accordingly, the Agencies propose to add 35, 75, and 150 percent risk-weight categories. The Agencies believe that adding a 150 percent risk weight category and expanding the use of the existing 200 percent risk weight category would allow for somewhat greater differentiation of credit risk among more risky exposures than is permitted by the existing capital rules. At the same time, for certain types of relatively low-risk exposures, the existing risk-based capital charge may be higher than warranted. Therefore, the 35 and 75 percent risk weight categories provide an opportunity to increase the risk sensitivity of the regulatory capital charges for these exposures.

The Agencies agree that the credit risks covered by this NPR generally do not warrant a 350 percent category, and are not proposing to add this risk weight. Question 3: The Agencies seek comment on whether these or any other new risk weight categories would be appropriate. More specifically, the Agencies are interested in any comments regarding whether any categories of assets might warrant a risk weight higher than 200 percent and what risk weight might be appropriate for such assets. The Agencies also solicit comment on whether a 10 percent risk weight category would be appropriate and what exposures should be included in this risk weight

category.

C. Use of External Credit Ratings to Risk Weight Exposures

The Agencies' existing risk-based capital rules permit the use of external credit ratings issued by a nationally recognized statistical rating organization (NRSRO) [10] to assign risk weights to recourse obligations, direct credit substitutes (DCS), residual interests (other than a credit-enhancing interest-only strip), and asset- and mortgage-backed securities.[11] For example, AAA- and AA-rated mortgage-backed securities[12] are assigned to the 20 percent risk weight category while BB-rated mortgage-backed securities are assigned to the 200 percent risk weight category. When the Agencies revised the risk-based capital rules to allow for the use of external credit ratings issued by an NRSRO for the types of exposures listed above, the Agencies acknowledged that such ratings could be used to determine the risk-based capital requirements for other types of debt instruments, such as rated corporate debt.

In the Basel IA ANPR, the Agencies suggested expanding the use of NRSRO ratings to determine the risk-based capital charge for most categories of NRSRO-rated exposures, including sovereign and corporate debt securities and rated loans. The Agencies indicated, however, that they were considering retaining the existing risk-based capital treatment for U.S. government and agency exposures, U.S. government-sponsored entity exposures, and municipal obligations. Tables 1 and 2 in the Basel IA ANPR matched ratings and possible corresponding

[10] An NRSRO is an entity recognized by the Division of Market Regulation of the Securities and Exchange Commission (SEC) as a nationally recognized statistical rating organization for various purposes, including the SEC's uniform net capital requirements for brokers and dealers 17 CFR 240.15c3-1). On September 29, 2006, the President signed the Credit Rating Agency Reform Act of 2006 (Reform Act) (Pub. L. 109-291) into law. The Reform Act requires a credit rating agency that wants to represent itself as an NRSRO to register with the SEC. The Agencies may review their risk-based capital rules, guidance and proposals from time to time in order to determine whether any modification of the Agencies' definition of an NRSRO is appropriate.

[11] Some synthetic structures may also be subject to the external rating approach. For example, certain credit-linked notes issued from a synthetic securitization are risk weighted according to the rating given to the notes. 66 FR 59614, 59622 (November 29, 2001).

[12] The ratings designations (for example, "AAA," "BBB," "A-1," and "P-1"), are illustrative and do not indicate any preference for, or endorsement of, any particular rating agency description system.

risk weights for long- and short-term exposures. The Agencies requested comment on the use of other methodologies to assign risk weights to unrated exposures.

Many commenters supported the use of external ratings in principle but noted that non-Basel II banking organizations' holdings of securities and loans generally are not rated. Thus, they suggested that the expansion of the use of NRSRO ratings would have little impact on these banking organizations. A few commenters also asserted that using NRSRO ratings might discourage lending to non-rated entities.

Many commenters argued that the risk weights suggested in the Basel IA ANPR were too high. In particular, many commenters said that the 350 percent and 200 percent risk weights for exposures rated BB+ and lower would be unnecessarily punitive. A few commenters also expressed concerns about NRSRO ratings generally. These commenters said that there are too few NRSROs to ensure adequate market discipline, NRSROs are inadequately supervised, and NRSRO ratings often react too slowly to crises.

A number of commenters suggested alternative methods for differentiating risk among commercial exposures and making the capital requirements for these exposures more risk sensitive. Many larger banking organizations suggested allowing an internal risk measurement approach to determine risk-based capital requirements. Some smaller banking organizations sought increased recognition of a variety of risk mitigation techniques, such as personal guarantees and collateral.

The Agencies acknowledge that expanding the use of external ratings may have little effect on the risk-based capital requirements for existing loan portfolios at most banking organizations. To the extent that assets in a banking organization's investment portfolio are rated, however, the Agencies believe that using external ratings will improve risk sensitivity of

the capital charges for these assets. Furthermore, implementing broader use of external ratings would also provide a basis for expanding recognition of eligible guarantees and recognized collateral. Accordingly, the Agencies are proposing to expand the use of external ratings for purposes of determining the risk-based capital charge for certain externally rated exposures as described below in the sections on direct exposures, recognized collateral, and eligible guarantees.

An external rating would be defined as a credit rating that is assigned by an NRSRO, provided that the credit rating (1) fully reflects the entire amount of credit risk with regard to all payments owed to the holder and the credit risk associated with timely repayment of principal and interest; (2) is published in an accessible public form, for example, on the NRSRO's web site and in financial media; (3) is monitored by the NRSRO; and (4) is, or will be, included in the issuing NRSRO's publicly available transition matrix.[13] If an exposure has two or more external ratings, the banking organization must use the lowest assigned external rating to risk weight the exposure. If an exposure has components that are assigned different external ratings, a banking organization would be required to assign the lowest rating to the entire exposure. If a component is not externally rated, the entire exposure would be treated as unrated.

i. Direct Exposures

The Agencies are proposing to use external ratings to risk weight (1) sovereign[14] debt and debt securities, and (2) debt securities issued by and rated loans to non-sovereign entities including securities firms, insurance companies, bank holding companies, savings and loan holding companies, multilateral lending and regional development institutions, partnerships,

[13] A transition matrix tracks the performance and stability (or ratings migration) of an NRSRO's issued external ratings.

[14] A sovereign is defined as a central government, including its agencies, departments, ministries, and the central bank. A sovereign does not include state, provincial, or local governments, or commercial enterprises owned by a central government.

limited liability companies, business trusts, special purpose entities, associations and other similar organizations. External ratings for direct exposures to sovereigns would be based on the external rating of the exposure or, if the exposure is unrated, on the sovereign's issuer rating. Direct exposures to non-sovereigns would be risk weighted based on the external rating of the exposure. For example, a banking organization would assign any AAA-rated debt security issued by a corporation, insurance company, or securities firm to the 20 percent risk weight category. The Agencies are, however, not proposing to permit the use of issuer ratings for non-sovereigns.

The risk weights for direct exposures are detailed in Table 1 (long-term exposures) and Table 2 (short-term exposures) below. The Agencies are also proposing to replace the existing risk-weight tables for externally rated recourse obligations, DCS, residual interests (other than a credit-enhancing interest-only strip), and asset- and mortgage-backed securities[15] with the risk weights in Tables 1 and 2.[16] This proposed treatment would apply to all externally rated exposures unless the banking organization uses a market risk rule.[17] For a banking organization that uses a market risk rule, this treatment applies only to externally rated exposures held in the banking book.

The Agencies intend to retain the existing risk-based capital treatment for direct

[15] 12 CFR part 3, appendix A, section 4, Tables B and C (OCC); 12 CFR parts 208 and 225, appendix A, section III.B.3.c.i. (Board); 12 CFR part 325, appendix A, section II.B.5.(d) (FDIC); and 12 CFR 567.6(b) (OTS) (the Recourse Rule).

[16] With the exception of the clarification of the definition of an external rating and the proposed risk-based capital charge for securitizations with early amortization features described in section F of this NPR, the Agencies are not proposing to make other changes to the existing risk-based capital rules for recourse obligations, DCS, and residual interests. See 12 CFR part 3, appendix A, section 4 (OCC); 12 CFR parts 208 and 225, appendix A, section III.B.3 (Board); 12 CFR part 325, appendix A, section II.B.5 (FDIC); and 12 CFR 567.6(b) (OTS) (Recourse Rule).

[17] See 12 CFR part 3, appendix B (OCC); 12 CFR parts 208 and 225, appendix E (Board); and 12 CFR part 325 appendix C (FDIC). The Agencies issued an NPR that proposes revisions to the Market Risk rules. OTS does not currently have a market risk rule, but has proposed to add a new rule on this topic in the Market Risk NPR. See 71 FR 55958 (September 25, 2006).

exposures to public-sector entities,[18] the U.S. government and its agencies, U.S. government-sponsored agencies, and depository institutions (U.S. and foreign) and for unrated loans made to non-sovereign entities. Exposures issued by these entities are not subject to Table 1 or 2.

Table 1: Proposed Risk Weights Based on External Ratings for Long-Term Exposures

Long-term rating category	**Example**	**Sovereign Risk Weight** (in percent)	**Non-Sovereign Risk Weight** (in percent)	**Securitization Exposure[1] Risk Weight** (in percent)
Highest investment grade rating	AAA	0	20	20
Second-highest investment grade rating	AA	20	20	20
Third-highest investment grade rating	A	20	35	35
Lowest-investment grade rating-plus	BBB+	35	50	50
Lowest-investment grade rating	BBB	50	75	75
Lowest-investment grade rating-minus	BBB-	75	100	100
One category below investment grade	BB+, BB	75	150	200
One category below investment grade-minus	BB-	100	200	200
Two or more categories below investment grade	B, CCC	150	200	[1]
Unrated[2]	n/a	200	200	[1]

Table 2: Proposed Risk Weights Based on External Ratings for Short-Term Exposures

Short-term rating category	**Example**	**Sovereign Risk Weight** (in percent)	**Non-Sovereign Risk Weight** (in percent)	**Securitization Exposure[1] Risk Weight** (in percent)
Highest investment grade rating	A-1, P-1	0	20	20

[18] Public-sector entities include states, local authorities and governmental subdivisions below the central government level in an Organization for Economic Cooperation and Development (OECD) country. In the United States, this definition encompasses a state, county, city, town, or other municipal corporation, a public authority, and generally any publicly-owned entity that is an instrument of a state or municipal corporation. This definition does not include commercial companies owned by the public sector. The OECD-based group of countries comprises all full members of the OECD, as well as countries that have concluded special lending arrangements with the International Monetary Fund (IMF) associated with the Fund's General Arrangements to Borrow.

Second-highest investment grade rating	A-2, P-2	20	35	35
Lowest investment grade rating	A-3, P-3	50	75	75
Unrated[2]	n/a	100	100	[1]

[1] A securitization exposure includes asset- and mortgage-backed securities, recourse obligations, DCS, and residuals (other than a credit-enhancing interest-only strip). For long-term securitization exposures that are externally rated more than one category below investment grade, short-term exposures that are rated below investment grade, or any unrated securitization exposures, the existing risk-based capital treatment as described in the Agencies' Recourse Rule would be used

[2] Unrated sovereign exposures and unrated debt securities issued by non-sovereigns would receive the risk weight indicated in Tables 1 and 2. Other unrated exposures, for example, unrated loans to non-sovereigns, would continue to be risk weighted under the existing risk-based capital rules.

The proposed risk weights in Tables 1 and 2 are generally consistent with the historical default rates reported in the default studies published by NRSROs. The Agencies believe that the additional application of external ratings to the exposures specified above would improve the risk sensitivity of the capital treatment for those exposures. Furthermore, the Agencies believe that the revised risk-weight tables for externally rated recourse obligations, DCS, residual interests (other than credit-enhancing interest only-strips), and asset- and mortgage-backed securities would also better reflect risk than the Agencies' existing risk-based capital rules.

Under the proposal, the Agencies would retain their authority to reassign an exposure to a different risk weight on a case-by-case basis to address the risk of a particular exposure.

ii. Recognized Financial Collateral

The Agencies' existing risk-based capital rules recognize limited types of collateral: (1) cash on deposit; (2) securities issued or guaranteed by central governments of the OECD countries; (3) securities issued or guaranteed by the U.S. government or its agencies; (4) securities issued or guaranteed by U.S. government-sponsored agencies; and (5) securities issued

by certain multilateral lending institutions or regional development banks.[19] In the past, the banking industry has commented that the Agencies should recognize a wider array of collateral types for purposes of reducing risk-based capital requirements.

In the Basel IA ANPR, the Agencies noted that they were considering expanding the list of recognized collateral to include short- or long-term debt securities (for example, corporate and asset- and mortgage-backed securities) that are externally rated at least investment grade by an NRSRO, or issued or guaranteed by a sovereign central government that is externally rated at least investment grade by an NRSRO. Consistent with the proposed treatment for direct exposures, the Basel IA ANPR suggested assigning exposures or portions of exposures collateralized by financial collateral to risk-weight categories based on the external rating of that collateral. To use this expanded list of collateral, the Basel IA ANPR considered requiring a banking organization to have collateral management systems to track collateral and readily determine its realizable value. The Agencies sought comment on whether this approach for expanding the scope of recognized collateral would improve risk sensitivity without being overly burdensome.

Many commenters supported expanding the list of recognized collateral, but several also noted that using NRSRO ratings would have little effect on most community banks. Some commenters suggested reducing the risk weights applied to exposures secured by any collateral that is legally perfected and has objective methods of valuation or can be readily marked-to-market. Many commenters also stated that any collateral valuation and monitoring requirements likely would be too costly to benefit smaller community banks.

To increase the risk sensitivity of the existing risk-based capital rules, the Agencies are

[19] The Agencies' rules for collateral transactions, however, differ somewhat as described in the Agencies' joint report to Congress. "Joint Report: Differences in Accounting and Capital Standards among the Federal Banking Agencies," 70 FR 15379 (March 25, 2005).

proposing to revise the list of recognized collateral to include a broader array of externally rated, liquid, and readily marketable financial instruments. The revised list would incorporate long- and short-term debt securities and securitization exposures that are:

a. Issued or guaranteed by a sovereign where such securities are externally rated at least investment grade by an NRSRO; or an exposure issued or guaranteed by a sovereign with an issuer rating that is at least investment grade; or

b. Issued by non-sovereigns where such securities are externally rated at least investment grade by an NRSRO.

Consistent with the Agencies' existing risk-based capital rules, the Agencies propose to continue to recognize collateral that is either issued or guaranteed by certain sovereigns. For non-sovereign exposures, however, the Agencies propose that the collateral itself must be externally rated investment grade or better to qualify as recognized collateral. The Agencies believe that this more conservative approach for recognizing non-sovereign collateral is appropriate and expect that any guarantee provided by a non-sovereign would be reflected in the external rating of the collateral.

A banking organization would assign exposures collateralized by financial collateral externally rated at least investment grade to the appropriate risk weight in Table 1 or 2 above. If an exposure is partially collateralized, a banking organization could assign the portions of exposures collateralized by the market value of the externally rated collateral to the appropriate risk weight category in Tables 1 and 2 of this NPR. For example, the portion of an exposure collateralized by the market value of a AAA-rated corporate debt security would be assigned to the 20 percent risk weight category. The Agencies are proposing a minimum risk weight of 20 percent for collateralized exposures except as noted below.

The Agencies have decided to retain their respective risk-based capital rules that govern the following collateral: cash, securities issued or guaranteed by the U.S. government or its agencies, and securities issued or guaranteed by U.S. government-sponsored agencies. The Agencies are also retaining the existing risk-based capital rules for exposures collateralized by securities issued or guaranteed by other OECD central governments that meet certain criteria.[20]

iii. Eligible Guarantors

Under the Agencies' existing risk-based capital rules, the recognition of third party guarantees is limited to guarantees provided by central governments of OECD countries, U.S. government and government-sponsored entities, public-sector entities in OECD countries, multilateral lending institutions and regional development banks, depository institutions and qualifying securities firms in OECD countries, depository institutions in non-OECD countries (short-term claims), and central governments of non-OECD countries (local currency exposures only).

In the Basel IA ANPR, the Agencies suggested expanding the scope of eligible guarantors to include any entity whose long-term senior debt has been assigned an external credit rating of at least investment grade by an NRSRO. The applicable risk weight for guaranteed exposures would be based on the risk weights corresponding to the rating of the long-term debt of the guarantor.

Most commenters supported, in principle, expanding the list of eligible guarantors. However, many commenters noted that very few community and midsize banking organizations have exposures that are guaranteed by externally rated entities. Thus, many commenters suggested that this provision would have little impact unless the proposed revisions recognized

[20] 12 CFR part 3, appendix A, section 3(a)(1)(viii) (OCC);and 12 CFR parts 208 and 225, appendix A, section III.C.1 (Board).

more types of guarantees.

The Agencies believe that the range of eligible third-party guarantors under the existing risk-based capital rules is restrictive and ignores market practice. As a result, the Agencies are proposing to expand the list of eligible guarantors by recognizing entities that have long-term senior debt (without credit enhancement) rated at least investment grade by an NRSRO or, in the case of a sovereign, an issuer rating that is at least investment grade. Under this NPR, a recognized third-party guarantee would have to:

(1) Be written and unconditional, and, for a sovereign guarantee, be backed by the full faith and credit of the sovereign;

(2) Cover all or a pro rata portion of contractual payments of the obligor on the reference exposure;[21]

(3) Give the beneficiary a direct claim against the protection provider;

(4) Be non-cancelable by the protection provider for reasons other than the breach of the contract by the beneficiary;

(5) Be legally enforceable against the protection provider in a jurisdiction where the protection provider has sufficient assets against which a judgment may be attached and enforced; and

(6) Require the protection provider to make payment to the beneficiary on the occurrence of a default (as defined in the guarantee) of the obligor on the reference exposure without first requiring the beneficiary to demand payment from the obligor.

To be considered an eligible guarantor, a sovereign or its senior long-term debt (without credit enhancement) must be externally rated at least investment grade. Non-sovereigns must

[21] If an exposure is partially guaranteed, the pro rata portion not covered by the guarantee would be assigned to the risk weight category appropriate to the obligor, after consideration of collateral and external ratings.

have long-term senior debt (without credit enhancement) that is externally rated at least investment grade. Under this proposal, a banking organization could assign the portions of exposures guaranteed by eligible guarantors to the proposed risk weight category corresponding to the external rating of the eligible guarantors' long-term senior debt in accordance with Table 1 above.

The Agencies would retain the existing risk-weight treatment of exposures guaranteed by the U.S. government and its agencies, U.S. government-sponsored agencies, public-sector entities, depository institutions in OECD countries, and depository institutions in non-OECD countries (short-term exposures only).

Question 4: The Agencies solicit comment on all aspects of the proposed use of external ratings including the appropriateness of the risk weights, expanded collateral, and additional eligible guarantors. The Agencies also seek comment on whether to exclude certain externally rated exposures from the ratings treatment as proposed or to use external ratings as a measure for all externally rated exposures, collateral, and guarantees. Alternatively, should the Agencies retain the existing risk-based capital treatment for certain types of exposures, for example, qualifying securities firms? The Agencies are also interested in comments on all aspects of the scope of the terms sovereign, non-sovereign, and securitization exposures. Specifically, the Agencies seek comment on the scope of these terms, whether they should be expanded to cover other entities, or whether any entities included in these definitions should be excluded.

iv. Government-Sponsored Agencies

One area of particular interest to the Agencies is the risk weighting of exposures to U.S. government-sponsored agencies, also commonly referred to as government-sponsored entities (GSEs). The Agencies' existing risk-based capital regulations assign a 20 percent risk weight to

exposures issued or guaranteed by GSEs. The Basel IA NPR proposes to retain this risk-based capital treatment. The Agencies are aware that there are various types of ratings that might increase the risk sensitivity of risk weights assigned to GSE exposures. For example, NRSROs rate the creditworthiness of short-term senior debt, senior unsecured debt, subordinated debt and preferred stock of some GSEs. These ratings on individual exposures, however, are often based in part on the NRSROs' assessment of the extent to which the U.S. government might come to the financial aid of a GSE if necessary. In this context, and as indicated in the preamble to the Basel II NPR, the Agencies do not believe that risk weight determinations should be based on the possibility of U.S. government financial assistance, except for the financial assistance the U.S. government has legally committed to provide. The Agencies believe the existing approach has thus far met this objective. However, the Agencies also note that as part of the October 19, 2000 agreement with their regulator,[22] both Fannie Mae and Freddie Mac agreed to obtain and disclose annually ratings that would "assess the risk to the government, or the independent financial strength, of each of the companies."[23]

In accordance with the agreement, Fannie Mae and Freddie Mac currently obtain and disclose separate ratings from two NRSROs – Standard & Poor's (S&P) and Moody's Investors Service (Moody's). The S&P "risk to the government rating" uses the same scale as its standard corporate credit ratings. Currently, Fannie Mae and Freddie Mac both have a risk to the government issuer rating of AA- from S&P, which is unchanged from the initial AA- issuer rating that S&P initially provided in 2001. Moody's "bank financial strength rating" (BFSR) uses a scale of A-E. In 2002, Moody's provided a BFSR of A- to both GSEs. On March 28, 2005, Moody's downgraded Fannie Mae's BFSR to B+. Based on Moody's mapping of BFSRs

[22] "Freddie Mac and Fannie Mae Enhancements to Capital Strength, Disclosure and Market Discipline", October 19, 2000 (agreement between the GSEs and the Office of Federal Housing Enterprise Oversight).
[23] Ibid, p. 2.

to Moody's basic credit assessment ratings, A- is the equivalent of an Aa1 and B+ maps to an Aa2.

Both the risk to government rating and the BFSR (collectively, financial strength ratings) are issuer ratings that evaluate the financial strength of each GSE without respect to any implied financial assistance from the U.S. government. These financial strength ratings are published and monitored by the issuing NRSRO but they are not included in the NRSROs' transition matrices. These ratings are an indicator of each GSE's overall financial condition and safety and soundness and, thus, do not apply to any specific financial obligation or the probability of timely payment thereof.[24] If the Agencies were to use these S&P and Moody's financial strength ratings to risk weight exposures to Fannie Mae and Freddie Mac in a manner similar to the use of external ratings for rated exposures as proposed in the Basel IA NPR, the current ratings would map to a 20 percent risk weight.

Question 5: The Agencies are considering whether to use financial strength ratings to determine risk weights for exposures to GSEs, where this type of rating is available, and are seeking comment how a financial strength rating might be applied. For example, should the financial strength rating be mapped to the non-sovereign risk weights in Tables 1 and 2? Should these ratings apply to all GSE exposures including short- and long-term debt, mortgage-backed securities, collateral, and guarantees? How should exposures to a GSE that lacks a financial strength rating be risk weighted? Are there any requirements in addition to publication and on-going monitoring that should be incorporated into the definition of an acceptable financial strength rating?

[24] Moody's and S&P's financial strength ratings would not meet the definition of an "external rating" as proposed forth in this NPR. Furthermore, the difficulty of defining an event of default and the lack of default data suggest that it would not be feasible to incorporate this type of rating into a transition matrix.

Question 6: The Agencies also seek comment on whether to exclude certain other externally rated exposures from the ratings treatment as proposed or to use external ratings as a measure for additional externally rated exposures, collateral, and guarantees. Should the proposed ratings treatment be applicable for direct exposures to public sector entities or depository institutions? Likewise, should the proposed ratings treatment be applicable to exposures guaranteed by public sector entities or depository institutions, and to exposures collateralized by debt securities issued by those entities?

D. Mortgage Loans Secured by a Lien on a One-to-Four Family Residential Property

i. First Lien Risk Weights

The Agencies' existing risk-based capital rules assign first-lien, one-to-four family residential mortgages to either the 50 percent or 100 percent risk weight category. Most mortgage loans secured by a first lien on a one-to-four family residential property (first lien mortgages) meet the criteria to receive a 50 percent risk weight.[25] The broad assignment of most first lien mortgages to the 50 percent risk weight category has been criticized for not being sufficiently risk sensitive.

In the Basel IA ANPR, the Agencies stated they were considering options to make the risk-based capital requirement for residential mortgages more risk sensitive while not unnecessarily increasing regulatory burden. One option was to base the capital requirement on loan-to-value ratios (LTV), determined after consideration of private mortgage insurance (PMI). This option was illustrated by an LTV risk weight table that suggested risk weights of 20, 35, 50, and 100 percent.

Another option discussed in the Basel IA ANPR was to assign risk weights based on

[25] 12 CFR part 3 appendix A section 3(c)(iii) (OCC); 12 CFR parts 208 and 225 appendix A section III.C.3 (Board); 12 CFR part 325, appendix A, section II.C.3 (FDIC); and 12 CFR 567.1 (definition of "qualifying mortgage loan") and 12 CFR 567.6(a)(1)(iii)(B) (50 percent risk weight) (OTS).

LTV in combination with an evaluation of borrower creditworthiness. Under this scenario, different ranges of LTV could be paired with specified credit assessments, such as credit scores. A first lien mortgage with a lower LTV made to a borrower with higher creditworthiness would receive a lower risk weight than a loan with higher LTV made to a borrower with lower creditworthiness.

The Agencies received many comments about how to risk weight first lien mortgages. Many commenters cautioned against rules that would be burdensome and costly to implement. Commenters generally supported the use of LTV and stated that use of LTV in assigning risk weights would not be overly burdensome because LTV information is collected when lenders originate mortgage loans.

Some commenters supported the use of a matrix based on LTV and a measure of creditworthiness, to further improve the risk sensitivity of the risk weights assigned to residential mortgage loans. They stated that this approach would address both collateral and borrower risk and would mirror current practices among mortgage lenders. Other commenters expressed concern about the potential burden of this approach, particularly for smaller banking organizations. Some commenters noted that certain credit assessment measures such as credit-scoring models vary by region or credit reporting agency, and may harm lower income borrowers, borrowers without credit histories, and borrowers who have experienced unusual financial difficulties. Many of these commenters suggested that the use of credit scores as a measure of borrower creditworthiness be optional to alleviate the burden for some smaller banking organizations.

To increase the risk sensitivity of the existing risk-based capital rules while minimizing the overall burden to banking organizations, the Agencies are proposing to risk weight first lien

mortgages based on LTV. LTV is a meaningful indicator of potential loss and the likelihood of borrower default. Consequently, under this proposal a banking organization would assign a risk weight for a first lien mortgage, including mortgages held for sale and mortgages held in portfolio as outlined in Table 3.

Table 3: Proposed LTV and Risk Weights for 1-4 Family First Liens

Loan-to-Value Ratios (in percent)	**Risk Weight** (in percent)
60 or less	20
Greater than 60 and less than or equal to 80	35
Greater than 80 and less than or equal to 85	50
Greater than 85 and less than or equal to 90	75
Greater than 90 and less than or equal to 95	100
Greater than 95	150

The Agencies believe the implementation of this proposed approach would not impose a significant burden on banking organizations because LTV information is readily available and is commonly used in the underwriting process.

The Agencies believe that the use of LTV would enhance the risk sensitivity of regulatory capital but it remains a fairly simple measurement of risk. Use of LTV in risk weighting first lien mortgages does not substitute for, or otherwise release a banking organization from, its obligation to have prudent loan underwriting and risk management practices that are consistent with the size, type, and risk of a mortgage product. Through the supervisory process, the Agencies would continue to ensure that banking organizations engage in prudent underwriting and risk management practices consistent with existing rules, supervisory

guidance, and safety and soundness. The Agencies would continue to reserve the authority to require banking organizations to hold additional capital where appropriate.

In general, Table 3 would apply to first lien mortgages. The Agencies would maintain their respective risk-based capital criteria for a first lien mortgage (for example, prudent underwriting) to receive a risk weight less than 100 percent.[26] Table 3 would not apply to loans to builders secured by certain pre-sold properties, which are subject to a statutory 50 percent risk weight.[27] Other loans to builders for the construction of residential property would continue to be subject to a 100 percent risk weight. The Agencies would maintain their respective capital treatment for a one-to-four family residential mortgage loan to a borrower for the construction of the borrower's own home.[28] Question 7: The Agencies seek comment on all aspects of using LTV to determine the risk weights for first lien mortgages.

The Agencies' existing risk-based capital rules place certain privately-issued mortgage-backed securities that do not carry the guarantee of a government or a government-sponsored entity (for example, unrated senior positions) in the 50 percent risk weight category, provided the underlying mortgages would qualify for a 50 percent risk weight. The Agencies intend to continue to risk weight these privately-issued mortgage-backed securities using the risk weights assigned to underlying mortgages under the Agencies' existing capital rules. Question 8: The Agencies seek comment on this treatment and other methods for risk-weighting these privately-

[26] 12 CFR part 3 appendix A, section 3(3)(iii) (OCC); 12 CFR Parts 208 and 225, appendix A, section III.C.3 (Board); 12 CFR part 325, appendix A, section II.C.3 (FDIC); and 12 CFR 567.1 (definition of "qualifying mortgage loan") and 12 CFR 567.6(a)(1)(iii)(B) (50 percent risk weight) (OTS).

[27] This statutory risk weight applies to loans to builders secured by one-to-four family residential properties with substantial project equity for the construction of one-to-four family residences that have been pre-sold under firm contracts to purchasers who have obtained firm commitments for permanent qualifying mortgage loans and have made substantial earnest money deposits. See Resolution Trust Corporation Refinancing, Restructuring, and Improvement Act of 1991, Pub. L. No. 102-233, § 618(a), 105 Stat. 1761, 1789-91 (codified at 12 U.S.C. 1831n note (1991)).

[28] 12 CFR part 3 appendix A, section 3(3)(iv) (OCC); 12 CFR parts 208 and 225, appendix A, section III.C.3. (Board); 12 CFR part 325, appendix A, section II.C.3 (FDIC); and 12 CFR 567.1 (definition of "qualifying mortgage loan") (OTS).

issued mortgage-backed securities, including the appropriateness of assigning risk weights to these securities based on the risk weights of the underlying mortgages as determined under Table 3.

While the Agencies are not proposing to use LTV and borrower creditworthiness to risk weight mortgages, the Agencies continue to evaluate approaches that would consider borrower creditworthiness in risk weighting first lien mortgages. One such approach could use LTV and a measure of borrower creditworthiness to assign risk weights in a manner similar to that shown in Table 3A below. Table 3A would assign a lower risk weight to mortgages with a lower LTV that are underwritten to borrowers with a stronger credit history and a higher risk weight to mortgages with a higher LTV that are underwritten to borrowers with a weaker credit history.

Table 3A: Illustrative Risk-Weight Ranges for LTV and Credit History for 1-4 Family First Liens

First Lien Mortgages	**Illustrative Risk Weight Ranges**		
Loan-to-Value Ratios (in percent)	**Credit History Group 1** (in percent)	**Credit History Group 2** (in percent)	**Credit History Group 3** (in percent)
60 or less	20-35	20-35	20-35
Greater than 60 and less than or equal to 80	20-35	20-35	35-75
Greater than 80 and less than or equal to 90	20-50	35-75	75-150
Greater than 90 and less than or equal to 95	20-50	50-100	100-200
Greater than 95	35-75	50-100	150-200

Table 3A presents three broad categories of relative credit performance (credit history groups). The Agencies would determine the credit history groups using default odds. The default odds would be based upon credit reporting agencies' validation charts (also known as odds tables). A banking organization would determine a borrower's default odds by mapping the

borrower's credit score, as obtained from a credit reporting agency[29], to the credit reporting agency's validation chart. In order for a validation chart to qualify, it would be based on: (1) the same vendor and model as the credit scores used by the banking organization, (2) a nationally diverse group of credits, and (3) relevant default odds measured over no less than 18 months following the scoring date used in the validation chart. If the Agencies decide in the final rule to risk weight first lien mortgages based on LTV and borrower creditworthiness, the Agencies would generally determine a specific risk weight based on the ranges provided in Table 3A.

Question 9: While the Agencies are not proposing to use LTV and borrower creditworthiness to risk weight mortgages, the Agencies may decide to risk weight first lien mortgages based on LTV and borrower creditworthiness in the final rule. Accordingly, the Agencies continue to seek comment on an approach using LTV combined with credit scores for determining risk-based capital. More specifically, the Agencies seek comment on: operational aspects for assessing the use of default odds to determine creditworthiness qualifications to determine acceptable models for calculating the default odds; the negative performance criteria against which the default odds are determined (that is, 60-days past due, 90-days past due, etc.); regional disparity, especially for a banking organization whose borrowers are not geographically diverse; and how often credit scores should be updated. In addition, the Agencies seek comment on determining the proper credit history group for: an individual with multiple credit scores, a loan with multiple borrowers with different probabilities of default, an individual whose credit history was analyzed using inaccurate data, and individuals with insufficient credit history to calculate a probability of default.

ii. Calculation of LTV

The Agencies sought comment on whether LTV should be based on LTV at origination

[29]See 15 U.S.C. 1681a(f), which defines a credit reporting agency.

or should be periodically updated. Some commenters supported using LTV at origination only. These commenters stated that regularly updating and monitoring LTV would be unduly burdensome and costly. Other commenters said the Agencies should require periodic updates, especially during significant declines in housing values in a banking organization's service area. Some commenters said that banking organizations should be able to update LTV at their discretion. Certain commenters suggested that updates be based on periodic property appraisals and loan balance updates. However, a number of commenters expressed concern about the reliability of appraisals, especially in over-heated markets.

Commenters had varying opinions about how the Agencies should factor PMI into the LTV calculations. Most of the commenters that addressed the issue supported calculating LTV net of loan-level PMI coverage. However, some commenters suggested that the Agencies should also consider the risk mitigation benefits of pool-level PMI. A few commenters suggested considering PMI issued only by highly rated insurers. One commenter endorsed a Basel IA ANPR suggestion to create risk-weight floors for mortgages supported by loan-level PMI from highly rated insurers. Another commenter suggested considering PMI issued by non-affiliate insurers only.

In proposing the LTV calculation method, the Agencies aim to balance burden and costs against the benefits of a more risk sensitive risk-weighting system. The Agencies propose to calculate LTV at origination of the first mortgage as follows. First, the value of the property would be equal to the lower of the purchase price for the property or the value at origination. The value at origination must be based on an appraisal or evaluation of the property in conformance with the Agencies' appraisal regulations[30] and real estate lending guidelines.[31] The

[30] 12 CFR part 34 (OCC); 12 CFR part 208, subpart E and part 225, subpart G (Board); 12 CFR part 323, 12 CFR part 365 (FDIC); and 12 CFR part 564 (OTS).

value of the property could only be updated for risk-weight purposes when the borrower refinances its mortgage and the banking organization extends additional funds. Second, for loans that are positively amortizing, banking organizations may adjust the LTV quarterly to reflect any decrease in the principal balance. For loans that negatively amortize, banking organizations would be required to adjust the LTV quarterly to reflect the increase in principal balance and risk weight the loan based on the updated LTV. However, where property values in a banking organization's market subsequently experience a general decline in value, the Agencies continue to reserve their authority to require additional capital when warranted for supervisory reasons. The Agencies emphasize that the updating of LTV for regulatory capital purposes is not intended to replace good risk management practices at banking organizations for situations where more frequent updates of loan or property values might be appropriate.

Question 10: The Agencies seek comment on whether there are other circumstances under which LTV should be adjusted for risk-weight purposes.

The Agencies believe that the risk mitigating impact of loan-level PMI should be reflected in calculating the LTV. Loan-level PMI is insurance that protects a mortgage lender in the event of borrower default up to a predetermined portion of the value of a one-to-four family residential property provided that there is no pool-level cap. A pool-level cap would effectively reduce coverage to any amount less than the predetermined portion. PMI would be recognized only if the loan-level insurer is not affiliated with the banking organization and has long-term senior debt (without credit enhancement) externally rated at least the third highest investment grade by an NRSRO. The Agencies believe that pool-level PMI should not generally reduce the LTV, because pool-level PMI absorbs losses based on a portfolio basis and is not attributable to

[31] 12 CFR part 34 Subpart C.43 (OCC); 12 CFR part 208, subpart E and part 225, subpart G (Board); 12 CFR part 325, appendix A, section II.C.3 (FDIC);12 CFR 560.100 - 560.101 (OTS).

a given loan.

Question 11: The Agencies request comment on all aspects of PMI including, whether PMI providers must be non-affiliated companies of the banking organization. The Agencies also seek comment on the treatment of PMI in the calculation of LTV when the PMI provider is not an affiliate, but a portion of the mortgage insurance is reinsured by an affiliate of the banking organization.

iii. Non-Traditional Mortgage Products

The Basel IA ANPR sought comment on whether mortgages with non-traditional features pose unique risks that warrant higher risk-based capital requirements. Non-traditional loan features include the possibility of negative amortization of the loan balance, a borrower's option to make interest-only payments, and interest rate reset provisions that may result in significant payment shock to the borrower.

Commenters generally supported risk weighting mortgage loans with non-traditional features consistently with the risk weighting for traditional first lien mortgages. These commenters suggested that any additional risks posed by these mortgage products were the result of imprudent underwriting practices or the combining of risks, not risks inherent in the products. One commenter, however, supported higher capital requirements for all non-traditional mortgage loans. Other commenters supported additional capital for specific products, such as negative amortization loans.

The Agencies recognize the difficultly in providing a clear and consistent definition of higher-risk mortgage loans with non-traditional features. Thus, the Agencies generally propose to risk weight first lien mortgages with non-traditional features in the manner described above. Notwithstanding this proposed treatment, the Agencies recognize that certain underwriting

practices may increase the risk associated with a particular mortgage product. These practices may include underwriting of loans with less stringent income and asset verification requirements without offsetting mitigating factors; offering loans with very low introductory rates and short adjustment periods that may result in significant payment shock; and combining first lien loans with simultaneous junior lien loans that could result in an aggregate loan obligation with little borrower equity and the potential for a sizeable payment increase. The Agencies will continue to review banking organizations' lending practices on a case-by-case basis and may require additional capital or reserves in appropriate circumstances.

Loans with a negative amortization feature pose additional risks to a banking organization in the form of an unfunded commitment. Therefore, the Agencies propose to risk weight mortgage loans with negative amortization features consistent with the risk-based capital treatment for other unfunded commitments (for example, lines of credit). Under the proposed approach, the unfunded portion of the maximum negative amortization amount would be risk weighted separately from the funded portion of the loan. The funded portion of the loan would be risk weighted according to the risk weights for first-lien mortgages, and the unfunded portion of the maximum negative amortization amount would be risk weighted as a commitment based on the LTV for the maximum contractual loan amount.

Therefore, banking organizations would need to calculate two LTVs for a loan with a negative amortization feature for risk-based capital purposes: the LTV for the funded commitment and the LTV for the unfunded commitment. To demonstrate how loans with negative amortization features would be risk weighted, assume that a property is valued at $100,000 and the banking organization grants a first-lien loan for $81,000 that includes a negative amortization feature with a 10 percent cap. The funded amount of $81,000 results in an

81 percent LTV, which is risk weighted at 50 percent based on Table 3. In addition, the off-balance sheet unfunded commitment of $8,100 would receive a 50 percent credit conversion factor (CCF) resulting in an on-balance sheet credit equivalent amount of $4,050. The combined LTV of the funded and unfunded commitment would be 89.1 percent, hence $4,050 would receive a 75 percent risk weight based on Table 3. The total risk-weighted assets for the first-lien mortgage with negative amortization feature would equal the risk-weighted assets for the funded amount plus the risk-weighted assets for the unfunded amount.

That loan would be risk weighted at origination as follows**:**

Table 4: Example of Proposed Risk Based Capital Calculation for Mortgages with Negative Amortization Features

Funded Risk-Weighted Assets Calculation	
1) Amount to Risk Weight	$81,000
2) Funded LTV = Funded Loan Amount / Property Value = $81,000 / $100,000	81%
3) Risk weight based on Table 3	50%
4) RW Assets for Funded Loan Amount $81,000 x .50 =	$40,500
Unfunded Risk-Weighted Assets Calculation	
1) Amount to risk weight = Unfunded maximum amount * CCF = $8,100 x .50 =	$4,050
2) Unfunded LTV = Funded Loan Amount + Unfunded loan amount / Property Value = $81,000 +$8,100 / $100,000 =	89.1%
3) Risk Weight Based on Table 3	75%

4) RW Assets for Unfunded Amount = $4,050 x .75	$3,038
Total Risk-Weighted Assets for a Loan with Negative Amortizing Features	
RW Assets for Funded Amount + RW for Unfunded Amount = $40,500 + $3,038 = (Note: the funded and unfunded amount of the loan will change over time once the loan begins to negatively amortize)	$43,538

The Agencies believe that this approach would result in a risk-based capital charge that more accurately reflects the risk of mortgage loans with negative amortization features. Question 12: The Agencies seek comment on the proposed risk-based capital treatment for all mortgage loans with non-traditional features and, in particular the proposed approach for mortgage loans with negative amortization features. The Agencies also seek comment on whether the maximum contractual amount is the appropriate measure of the unfunded exposure to loans with negative amortization features. The Agencies seek comment on whether the unfunded commitment for a reverse mortgage should be subject to a similar risk-based capital charge.

iv. Junior Lien One-to-Four Family Residential Mortgages

The Basel IA ANPR discussed the existing treatment for home equity lines of credit (HELOCs) and other junior lien mortgages.[32] If a banking organization holds both a first and a junior lien, and no other party holds an intervening lien, the Agencies' existing capital rules

[32] The unfunded portion of a HELOC that is a commitment for more than one year and that is not unconditionally cancelable is converted to an on-balance sheet asset using a 50 percent CCF. That amount plus the funded portion of the HELOC are added together to determine the amount of the HELOC that is combined with the first lien position and then risk weighted at either 50 percent or 100 percent. See generally, 12 CFR part 3 appendix A, section (b)(2) and (a)(3)(iii) (OCC); 12 CFR parts 208 and 225, appendix A, section III.C.3 and 12 CFR parts 208 and 225, appendix A, section III.D.2 (Board); 12 CFR part 325, appendix A, section II.D.2.b. (FDIC); and 12 CFR 567.6(a)(2)(ii)(B) (OTS).

require these loans to be combined to determine the LTV and then risk weighted as a first lien mortgage. The Basel IA ANPR indicated that the Agencies intended to continue this approach.

Currently, stand-alone junior lien mortgages (a stand-alone junior lien mortgage is one where an institution holds a second or more junior lien without holding all of the more senior liens) receive a 100 percent risk weight. The Basel IA ANPR indicated that the Agencies were considering retaining this risk weight for stand-alone junior lien mortgages where the LTV (computed by combining the loan amounts for the junior lien and all senior liens) does not exceed 90 percent. However, for stand-alone junior lien mortgages where the LTV of the combined liens exceeds 90 percent, the Agencies suggested that a risk weight higher than 100 percent might be appropriate in recognition of the elevated credit risk associated with these exposures.

Many commenters opposed this approach and suggested that a more risk-sensitive approach, similar to that proposed for first lien mortgages, would be more appropriate because not all stand-alone junior lien mortgages are riskier than first lien mortgages. Other commenters stated that the risk-based capital treatment of first and junior lien mortgages, regardless of whether the same banking organization holds both, should be consistent. In addition, many commented that it would be illogical and unjustifiable to impose higher risk weights (for example, 150 percent) for secured mortgage loans than for unsecured retail loans (for example, 100 percent).

Consistent with the existing risk-based capital rules, the Agencies propose that a banking organization that holds both the first and junior lien mortgages on a one-to-four family residential property, where there is no intervening lien, would assign the combined loans to the appropriate risk-weight category in Table 3 above, based on the loans' combined LTV. A

banking organization that holds both the first and any subsequent liens may update the property value for calculation of the combined LTV of the senior loans and the junior lien if the organization obtains an appraisal or evaluation of the collateral in conformance with the Agencies' appraisal regulations and related guidelines at the origination of the junior lien mortgage.

For a stand-alone junior lien mortgage, the Agencies propose that a banking organization use the combined LTV of that loan and all senior loans to determine the appropriate risk weight for the junior lien. Using the combined LTV, a banking organization would risk weight the stand-alone junior lien based on Table 5.

Table 5: Proposed LTV and Risk Weights for 1-4 Family Junior Liens

Combined Loan-to-Value Ratios (in percent)	**Risk Weight** (in percent)
60 or less	75
Greater than 60 and less than or equal to 90	100
Greater than 90	150

The combined LTV for the funded portion of stand-alone junior liens where the first lien can negatively amortize would be calculated using the maximum contractual loan amount under the terms of the first lien mortgage plus the funded portion of the junior lien. The combined LTV for the unfunded portion of all junior liens where the first lien can negatively amortize would be calculated using the maximum contractual loan amount under the terms of the first lien mortgage plus the funded unfunded portions of the junior lien.

The Agencies propose that banking organizations will be required to hold capital for both the funded and unfunded portion of a HELOC. Banking organizations that hold a HELOC where there is no intervening lien would assign the first lien and funded portion of the HELOC to the appropriate risk weight category in Table 3 above, based on the loans' combined LTV using the

senior loans and the funded portion of the HELOC. The unfunded portion of the HELOC would be subject to the appropriate CCF[33] and risk weighted, using Table 3, based on the combined LTV, (senior loans plus the funded and unfunded portions of the HELOC).

For stand-alone HELOCs, the funded and unfunded portion of the stand-alone HELOC would be risk weighted based on Table 5. The funded portion of a HELOC would receive a risk weight based on the combined LTV of all senior loans and funded portion of the HELOC. The unfunded portion of the HELOC would be subject to the appropriate CCF and risk weighted, using Table 5, based on the combined LTV of all senior loans and the funded portion of the HELOC and the unfunded portion of the HELOC.

Question 13: The Agencies request comment on the appropriateness of the proposed risk-based capital treatment for HELOCs including the burden of adjusting LTV as the borrower utilizes the HELOC.

While the Agencies are not proposing in this NPR to use LTV and borrower creditworthiness, they also continue to evaluate approaches that would consider borrower creditworthiness in risk weighting junior lien mortgages. The Agencies believe that greater risk sensitivity can be achieved by evaluating not only LTV but also borrower creditworthiness. If the Agencies decide in the final rule to risk weight junior lien mortgages based on LTV and a measure of borrower creditworthiness, the Agencies would generally determine a specific risk weight based on the ranges provided in Table 5A.

Question 14: Accordingly, the Agencies seek further comment on all aspects of the use of LTV and borrower creditworthiness to determine the risk weight for a junior lien mortgage.

[33] The unfunded portion of a HELOC that is a commitment for more than one year and that is not unconditionally cancelable is converted to an on-balance sheet asset using a 50 percent CCF. If the unfunded portion of the HELOC is a commitment for less than a year or is unconditionally cancelable it is converted to an on-balance sheet credit equivalent using a 0 percent CCF.

Table 5A: Illustrative Risk-Weight Ranges for LTV and Credit History

For Junior Lien 1-4 Family Mortgages

Junior Liens/HELOCs	**Illustrative Risk Weight Ranges**		
Loan-to-Value Ratios (in percent)	**Credit History Group 1** (in percent)	**Credit History Group 2** (in percent)	**Credit History Group 3** (in percent)
60 or less	20 -50	75 - 150	150-200
Greater than 60 and less than or equal to 80	35 - 50	75 - 150	150-200
Greater than 80 and less than or equal to 90	35 - 75	75 - 200	200
Greater than 90 and less than or equal to 95	35 - 75	75 - 200	200
Greater than 95	35 - 75	75 - 200	200

v. Transitional Rule

Some commenters raised concerns about the cost and burden associated with recoding existing loans to conform to a new system. To minimize burden while moving toward a more risk-sensitive approach, the Agencies propose to allow banking organizations that choose to apply the proposed rule an option to continue to risk weight existing mortgage loans using the existing risk-based capital rules. The option would apply only to those loans that the banking organization owned at the time it chose to apply the proposed rules. The banking organization would be required to apply the transitional provision to all of its existing mortgage loans. A banking organization may not use this transitional treatment if it previously used Tables 3 or 5 to risk weight these existing loans.

E. Short-Term Commitments

Under the Agencies' existing risk-based capital rules, commitments with an original maturity of one year or less (short-term commitments) and commitments that are unconditionally

cancelable[34] are generally converted to an on-balance sheet credit equivalent amount using a zero percent CCF. Accordingly, banking organizations extending short-term commitments or unconditionally cancelable commitments are not required to maintain risk-based capital against the credit risk inherent in these exposures. Short-term commitments that are eligible liquidity facilities that support asset-backed commercial paper (ABCP), however, are converted to on-balance sheet assets using a 10 percent CCF. Commitments with an original maturity of more than one year (long-term commitments), including eligible long-term liquidity facilities that support ABCP, are converted to on-balance sheet credit equivalent amounts using a 50 percent CCF.

In the Basel IA ANPR, the Agencies noted that they were considering amending the risk-based capital requirements for short-term commitments. Even though commitments with an original maturity of one year or less expose banking organizations to a lower degree of credit risk than longer-term commitments, some credit risk exists. Thus, the Agencies suggested applying a 10 percent CCF to short-term commitments. The resulting credit equivalent amount would be risk-weighted according to the rating of the facility or the underlying asset(s) or the obligor, after considering any collateral and guarantees. The Agencies noted that they planned to retain the zero percent CCF for commitments that are unconditionally cancelable. The Agencies also sought comment on an alternative approach that would apply a single CCF (for example, 20 percent) to all commitments, both short- and long-term.

Almost universally, commenters agreed that unconditionally cancelable commitments should not receive a capital charge. However, commenters' recommendations varied about how

[34] An unconditionally cancelable commitment is one that can be canceled for any reason at any time without prior notice. In the case of a home equity line of credit, the banking organization is deemed able to unconditionally cancel the commitment if it can, at its option, prohibit additional extensions of credit, reduce the line, and terminate the commitment to the full extend permitted by relevant Federal law.

to approach other short- and long-term commitments. Some commenters suggested that all commitments, except unconditionally cancelable commitments, should receive a 20 percent CCF, regardless of maturity. These commenters argued that this simple approach would ease burden and counterbalance new complexities within the Basel IA ANPR.

Conversely, several commenters suggested that the capital treatment should reflect the fact that short-term commitments are less risky than long-term commitments. Of these commenters, a few argued that short-term commitments should not receive any capital charge. A few others supported the Basel IA ANPR suggestion to apply a 10 percent CCF to short-term commitments and 50 percent CCF to long-term commitments. One commenter suggested using a 20 percent CCF for short-term commitments and a 50 percent CCF for long-term commitments.

In the Agencies' view, banking organizations that provide short-term commitments that are not unconditionally cancelable are exposed to credit risk that the existing risk-based capital rules do not adequately address. The Agencies also recognize that short-term commitments generally expose banking organizations to a lower degree of credit risk than long-term commitments, thereby justifying a CCF that is lower than the 50 percent CCF currently assigned to long-term commitments. Thus, the Agencies are proposing to assign a 10 percent CCF to short-term commitments. The resulting credit equivalent amount would then be risk-weighted according to the rating of the facility, the underlying assets, or the obligor, after considering any applicable collateral and guarantees. Commitments that are unconditionally cancelable would retain a zero percent CCF.

Finally, the Agencies are not proposing to apply a CCF to commitments to originate one-to-four family residential mortgage loans that are provided in the ordinary course of business.

The Agencies believe these types of commitments present only minimal credit risk because of their short durations, the significant number that expire before being funded, and the large percentage of originations that are held for resale. In addition, commitments on held-for-sale mortgages are treated as derivatives and are accounted for at fair value on the balance sheet of the issuer, and therefore already receive a capital charge. Given these mitigating factors, the Agencies do not wish to impose the burden of determining risk weights by LTV during the short commitment period.

Question 15: The Agencies continue to seek comments on an alternative approach that would apply a single CCF of 20 percent to all commitments, both short- and long-term (that are not unconditionally cancelable), and the advantages and disadvantages of such an approach.

F. Assess a Risk-Based Capital Charge for Early Amortization

The Agencies' existing risk-based capital rules do not assess a capital charge for risks associated with early amortization of securitizations of revolving credits (for example, credit card receivables). When assets are securitized, the extent to which the selling or sponsoring entity transfers the risks associated with the assets depends on the structure of the securitization and the nature of the underlying assets. Early amortization provisions[35] in securitizations of revolving retail credit facilities increase the likelihood that investors will be repaid before being subject to any risk of significant credit losses. These provisions raise two concerns about the risks to banking organizations that sponsor securitizations with early amortization provisions: (1) the payment allocation formula can result in the subordination of the seller's interest in the securitized assets during early amortization, and (2) an early amortization event can increase a

[35] An early amortization provision means a provision in the documentation governing a securitization that, when triggered, causes investors in the securitization exposures to be repaid before the original stated maturity of the securitization exposures, unless the provision is solely triggered by events not directly related to the performance of the underlying exposures or the originating banking organization (such as material changes in tax laws or regulations).

banking organization's capital and liquidity needs in order to finance new draws on the revolving credit facilities.

In recognition of the risks associated with these structures, the Agencies have proposed a capital charge on securitizations of revolving credit exposures with early amortization provisions in prior rulemakings. On March 8, 2000, the Agencies published a proposed rule on recourse and direct credit substitutes.[36] In that proposal, the Agencies proposed to apply a fixed CCF of 20 percent to the amount of assets under management in all revolving securitizations that contained early amortization features.[37] The preamble to the final Recourse Rule[38] reiterated the concerns with early amortization, indicating that the risks associated with securitization, including those posed by an early amortization feature, are not fully captured in the Agencies' capital rules. While the Agencies did not impose a risk-based capital charge for early amortization provisions in the final Recourse Rule, they indicated that they would revisit the issue at some point in the future.[39]

In the Basel IA ANPR, the Agencies suggested two approaches to address these risks. One option was to apply a flat CCF to off-balance sheet receivables in revolving securitizations with early amortization provisions. Alternatively, the Agencies suggested using a risk-sensitive methodology based on excess spread[40] compression. Under this methodology, the risk-based capital charge would increase as excess spread decreased and approached the early amortization

[36] 65 FR 12320 (March 8, 2000).
[37] Id. at 12330–12331.
[38] 66 FR 59614, 59619 (November 29, 2001).
[39] In October 2003, the Agencies issued another proposed rule that included a risk-based capital charge for early amortization. See 68 FR 56568, 56571–56573 (October 1, 2003). This proposal was based upon the Basel Committee's third consultative paper issued April 2003. When the Agencies finalized other unrelated aspects of this proposed rule in July 2004, they did not implement the early amortization proposal. The Agencies determined that the change was inappropriate because the capital treatment of retail credit, including securitizations of revolving credit, was subject to change as the Basel framework proceeded through the U.S. rulemaking process. 69 FR 44908, 44912–44913 (July 28, 2004).
[40] Excess spread means gross finance charge collections (including market interchange fees) and other income received by a trust or the special purpose entity (SPE) minus interest paid to investors in the securitization exposures, servicing fees, charge-offs, and other similar trust or SPE expenses.

trigger point.

Most commenters that addressed this issue opposed the application of any capital charge on the investors' interest in credit card securitizations. Of the few that supported such a charge, one recommended that the rules apply a flat CCF to securitizations with early amortization provisions, and four supported the approach based on excess spread.

The Agencies are proposing to apply an approach based on excess spread to all revolving securitizations of credits with early-amortization features. This capital charge would be assessed against the investors' interest (that is, the total amount of securities issued by a trust or special purpose entity to investors, which is the portion of the securitization that is not on the banking organization's balance sheet) and would be imposed only in the event that the excess spread has declined to a predetermined percentage of the trapping point. The capital required would increase as the level of excess spread approaches the early amortization trigger. The Agencies are proposing to compare the three-month average excess spread against the point at which the securitization trust would be required to trap excess spread in a spread or reserve account as a basis for the capital charge. To determine the excess spread trapping point and the appropriate CCF, a banking organization would divide the level of excess spread by the spread trapping point as described below. In securitizations that do not require excess spread to be trapped, or that specify a trapping point based primarily on performance measures other than the three-month average excess spread, the excess spread trapping point would be set for purposes of this proposed rule at 4.5 percent.

To calculate the securitization's excess spread trapping point ratio, a banking organization must first calculate the annualized three month ratio for excess spread as follows:

a. For each of the three months, divide the month's excess spread by the outstanding principal balance of the underlying pool of exposures at the end of each month.

b. Calculate the average ratio for the three months and convert the resulting ratio to a compound annual rate.

Then a banking organization must divide the annualized three month ratio for excess spread by the excess spread trapping point that is specified in the documentation for the securitization. Finally, a banking organization must apply the appropriate CCF from Table 6 to the amount of investors' interest. The resulting on-balance sheet credit equivalent amount would be assigned to the risk weight category appropriate to the securitized assets.

Table 6: Early Amortization Credit Conversion Factors

Excess Spread Trapping Point Ratio	**CCF** (in percent)
133.33 percent of trapping point or more	0
Less than 133.33 percent to 100 percent of trapping point	5
Less than 100 percent to 75 percent of trapping point	15
Less than 75 percent to 50 percent of trapping point	50
Less than 50 percent of trapping point	100

Question 16: The Agencies solicit comment on the appropriateness of the 4.5 percent excess spread trapping point and on other types and levels of early amortization triggers used in securitizations of revolving exposures that should be considered, especially for HELOC securitizations. The Agencies also seek comment on whether a flat 10 percent CCF is a more appropriate capital charge for revolving securitizations with early amortization features.

G. Remove the 50 Percent Limit on the Risk Weight for Derivatives

Currently, the Agencies' risk-based capital rules permit banks to apply a maximum 50 percent risk weight to the credit equivalent amount of certain derivative contracts. The risk weight assigned to derivatives contracts was limited to 50 percent when the derivatives

counterparty credit risk rule was finalized in 1995 because most derivative counterparties were highly rated and were generally financial institutions.[41] At the time, the Agencies noted that they intended to monitor the quality of credits in the interest rate and exchange rate markets to determine whether some transactions might merit a 100 percent risk weight.

As the market for derivatives has developed, the types of counterparties acceptable to participants have expanded to include counterparties that the Agencies believe should receive a risk weight greater than 50 percent. Although the Basel IA ANPR did not discuss the limit on the risk weight for derivatives contracts, the Agencies have determined that it is appropriate to propose removing the 50 percent risk weight limit that applies to certain derivative contracts. In this proposed rule, the risk weight assigned to the credit equivalent amount of a derivative contract would be the risk weight assigned to the counterparty after consideration of any collateral or guarantees.

H. Small Loans to Businesses

The Agencies' existing risk-based capital rules generally assign business loans to the 100 percent risk weight category unless the credit risk is mitigated by an acceptable guarantee or collateral. Banking organizations and other industry participants have criticized the lack of sensitivity in the measurement of credit risk associated with these exposures and maintained that the current risk-based capital charge is greater than warranted for high quality loans to businesses.

In the Basel IA ANPR, the Agencies noted that they were considering a lower risk weight for certain business loans under $1 million on a consolidated basis to a single borrower (small loans to businesses). One alternative discussed in the Basel IA ANPR would allow small loans to businesses to be eligible for a lower risk weight if certain requirements were satisfied. These

[41] 60 FR 46169-46185 (September 5, 1995).

requirements would include, for example, full amortization over a period of seven years or less, performance according to the contractual provisions of the loan agreement, and full protection by collateral. The banking organization would also have to originate the loans according to its underwriting policies (or purchase loans that have been underwritten in a manner consistent with the banking organization's underwriting policies), which would have to include an acceptable assessment of the collateral and the borrower's financial condition and ability to repay the debt. The Agencies sought comment on whether this potential change would improve the risk sensitivity of the risk-based capital rules without unduly increasing complexity and burden.

The Agencies also suggested an alternative approach that would assess risk-based capital requirements for small loans to businesses based on a credit assessment of the principals of the business and their ability to service the debt. This alternative could be applied in those cases where the principals personally guarantee the loan. The Agencies sought comment on any alternative approaches for improving the risk sensitivity of the risk-based capital treatment for small loans to businesses, including the use of credit assessments, LTV, collateral, guarantees, or other methods for stratifying credit risk.

Most commenters supported a lower risk weight for small loans to businesses. However, it was apparent from the comments that there is no universal set of risk drivers used to measure credit risk for these loans. In addition, there was little agreement among commenters about how credit risk for these loans should be measured without generating undue burden.

One commenter asked the Agencies to create a small-business risk-based capital model that takes into account various risk drivers, including financing leverage, use of funds, loss modeling, and lending shelf and securitization. Another commenter recommended measuring credit risk based on results obtained by the Fair Isaac Small Business Scoring Service, which the

commenter claimed allows businesses to assess the creditworthiness of the principals of a small business and of the ability of the small business to make repayment on credit obligations up to $750,000.

Another commenter suggested that small loans to businesses that are collateralized should be risk weighted according to the LTV using the ratio of the amount of the loan to the value of eligible collateral. This commenter suggested that non-collateralized loans should be risk-weighted according to several factors, including credit assessments of personal guarantors, loan terms, size of the loan, amortization schedule, and past history of the borrower. Other commenters offered similar suggestions that would use risk measures such as credit assessments and debt-to-income ratios.

Several commenters suggested that the dollar threshold for receiving a lower risk weight was too low. A few commenters suggested increasing the threshold to $2 million. One commenter suggested setting the threshold at $5 million and indexing it to inflation.

Although the Agencies are not making a specific proposal in this NPR, they are exploring options for permitting certain small loans to businesses that meet certain criteria to qualify for a 75 percent risk weight. The Agencies believe that the application of the 75 percent risk weight to loans to businesses should be limited to situations where the banking organization's consolidated business credit exposure to the individual or company is $1 million or less.

Second, the Agencies believe that to qualify for the lower risk weight, these loans should be personally guaranteed by the owner or owners of the business and that the loans should be fully collateralized by the assets of the business. The Agencies believe that these requirements provide prudential safeguards to ensure that the banking organization is in the position to minimize losses in the event of default.

Third, the Agencies are considering requiring that qualifying loans fully amortize over a period of no more than seven years. The full amortization requirement encourages conservative cash management practices by the borrower and ensures that the banking organization can monitor the continued ability of the business to service the debt. The Agencies have chosen a seven-year limitation to coincide with the maturity structure of many loans used to finance equipment purchases.

The Agencies are also considering criteria for short-term loans that do not amortize, such as working capital loans and other revolving lines of credit. Under one alternative, the Agencies would allow loans or draws from a revolving line of credit that matures within 18 months to forgo the amortization requirement to the extent that the loan is to be repaid from the anticipated proceeds of a previously established financial transaction and such proceeds are pledged for the repayment of the loan.

Fourth, the Agencies are considering requiring that the loans be (1) prudently underwritten in a manner that justifies the assessment of a lower-than-100 percent risk weight and (2) performing, that is, the loan payments must be current. Thus, consistent with prudential standards required for the underwriting of any small loans to businesses, the Agencies would require that a banking organization establish standards for assessing the quality and sufficiency of pledged collateral, the financial condition of the borrower, the financial condition of any guarantors to the loan, and the ability of the business to meet certain debt service coverage criteria. The Agencies would also set requirements for an acceptable debt service coverage ratio, that is, the ratio of net operating income divided by total loan payments or net operating cash flow divided by debt service cost. The Agencies are considering a minimum debt service coverage ratio of 1.3.

Finally, the Agencies are analyzing the need for additional qualifying criteria. Among other criteria, the Agencies might require that the loans have not been restructured to prevent a past due occurrence and that none of the proceeds of the loans are used to service any other outstanding loan obligation.

Question 17: The Agencies seek comment on this or other approaches that might improve the risk sensitivity of the existing risk-based capital rules for small loans to businesses.

I. Multifamily Residential Mortgages, Other Retail Exposures, Loans 90 Days or More Past Due or In Nonaccrual, and Commercial Real Estate (CRE) Exposures

In the Basel IA ANPR, the Agencies sought comment on the risk-based capital treatment for multifamily residential mortgages, other retail exposures, loans 90 days or more past due or in nonaccrual, and commercial real estate exposures. After considering the comments that addressed the Agencies' approaches to the risk-based capital treatment for these exposures, the Agencies have decided that any increase in risk sensitivity is outweighed by the additional burden that would result from the suggested approaches. Consequently, the Agencies are not proposing any changes in this NPR with respect to these exposures. The Agencies will continue to examine these issues and may address the risk-based capital treatment for these exposures at some future time.

Question 18: The Agencies remain interested in industry comments on any methods that would increase the risk sensitivity of the risk-based capital requirements for other retail exposures, particularly through the use of credit assessments, such as the borrower's credit score or ability to service debt. The Agencies are particularly interested in whether and how credit assessments might be applied consistently and uniformly in the determination of risk weights without creating undue burden.

J. Other Issues Raised by Commenters

Although the issue was not addressed in the Basel IA ANPR, several commenters suggested that the Agencies should conduct a study of the potential effects of any proposed revisions to the Agencies' existing risk-based capital rules. They asserted that such a study would help the Agencies better understand the potential costs and benefits of the potential revisions, and help compare the revisions to the Basel II framework.

The Agencies intend to analyze the potential impact of these proposed changes, as well as any changes to the proposals that may result from the public comment process. The Agencies may make changes to these proposals if warranted based on this impact analysis.

III. Possible Alternatives for Basel II Banking Organizations

As noted in the "Background" section, on September 25, 2006, the Agencies issued the Basel II NPR. The Basel II advanced capital adequacy framework proposed in the Basel II NPR is highly complex and is directed primarily at banking organizations with total consolidated assets of $250 billion or more, or total consolidated on-balance sheet foreign exposure of $10 billion or more, and other banks that opt in to the Basel II framework – referred to as "Basel II banking organizations." In the Basel II NPR, the Agencies requested comment on whether Basel II banking organizations should be permitted to use other credit and operational risk approaches similar to those provided under Basel II.

The Agencies seek comment on all aspects of the following questions and seek the perspectives of banking organizations of different sizes and complexity.

Question 19: To what extent should the Agencies consider allowing Basel II banking organizations the option to calculate their risk based capital requirements using approaches other than the Advanced Internal Ratings Based (A-IRB) approach for credit risk and the Advanced

Measurement Approach (AMA) for operational risk? What would be the appropriate length of time for such an option?

Question 20: If Basel II banking organizations are provided the option to use alternatives to the advanced approaches, would either this Basel IA proposal or the standardized approach in Basel II be a suitable basis for a regulatory capital framework for credit risk for those organizations? What modifications would make either of these proposals more appropriate for use by large complex banking organizations? For example, what approaches should be considered for derivatives and other capital markets transactions, unsettled trades, equity exposures, and other significant risks and exposures typical of Basel II banking organizations?

Question 21: The risk weights in this Basel IA proposal were designed with the assumption that there would be no accompanying capital charge for operational risk. Basel II, however, requires banking organizations to calculate capital requirements for exposure to both credit risk and operational risk. If the Agencies were to proceed with a rulemaking for a U.S. version of a standardized approach for credit risk, should operational risk be addressed using one of the three methods set forth in Basel II?

Question 22: What additional requirements should the Agencies consider to encourage Basel II banking organizations to enhance their risk management practices or their financial disclosures, if they are provided the option to use alternatives to the advanced approaches of the Basel II NPR?

IV. Regulatory Analysis

Regulatory Flexibility Act Analysis

Pursuant to section 605(b) of the Regulatory Flexibility Act, 5 U.S.C. 605(b) (RFA), the regulatory flexibility analysis otherwise required under section 604 of the RFA is not required if

an agency certifies that the rule will not have a significant economic impact on a substantial number of small entities (defined for purposes of the RFA to include banking organizations with assets less than or equal to $165 million) and publishes its certification and a short, explanatory statement in the Federal Register along with its rule. Pursuant to section 605(b) of the RFA, the Agencies certify that this proposed rule will not have a significant economic impact on a substantial number of small entities. Accordingly, a regulatory flexibility analysis is not needed. The amendments to the Agencies' regulations described above are elective. They will apply only to banking organizations that opt to take advantage of the proposed revisions to the existing domestic risk-based capital framework and that will not be required to use the advanced approaches contained in the Basel II proposal.[42] The Agencies believe that banking organizations that elect to adopt these proposals will generally be able to do so with data they currently use as part of their credit approval and portfolio management processes. Banking organizations not exercising this option would remain subject to the current capital framework. The proposal does not impose any new mandatory requirements or burdens. Moreover, industry groups representing small banking organizations that commented on the Basel IA ANPR noted that small banking organizations typically hold more capital than is required by the capital rules and would prefer to remain under the existing risk-based capital framework. For these reasons, the proposal will not result in a significant economic impact on a substantial number of small entities.

OCC Executive Order 12866 Determination

Executive Order 12866 requires Federal agencies to prepare a regulatory impact analysis for agency actions that are found to be "significant regulatory actions." "Significant regulatory actions" include, among other things, rulemakings that "have an annual effect on the economy of

[42] 71 FR 55830 (September 25, 2006).

$100 million or more or adversely affect in a material way the economy, a sector of the economy, productivity, competition, jobs, the environment, public health or safety, or State, local, or tribal governments or communities."[43] Regulatory actions that satisfy one or more of these criteria are referred to as "economically significant regulatory actions."

The OCC anticipates that the proposed rule will meet the $100 million criterion and therefore is an economically significant regulatory action. In conducting the regulatory analysis for an economically significant regulatory action, Executive Order 12866 requires each Federal agency to provide to the Administrator of the Office of Management and Budget's (OMB) Office of Information and Regulatory Affairs (OIRA):

- The text of the draft regulatory action, together with a reasonably detailed description of the need for the regulatory action and an explanation of how the regulatory action will meet that need;
- An assessment of the potential costs and benefits of the regulatory action, including an explanation of the manner in which the regulatory action is consistent with a statutory mandate and, to the extent permitted by law, promotes the President's priorities and avoids undue interference with State, local, and tribal governments in the exercise of their governmental functions;
- An assessment, including the underlying analysis, of benefits anticipated from the regulatory action (such as, but not limited to, the promotion of the efficient functioning of the economy and private markets, the enhancement of health and safety, the protection of the natural environment, and the elimination or reduction of discrimination or bias)

[43] Executive Order 12866 (September 30, 1993), 58 FR 51735 (October 4, 1993), as amended by Executive Order 13258, 67 FR 9385 (February 28, 2002). For the complete text of the definition of "significant regulatory action," see E.O. 12866 at section 3(f). A "regulatory action" is "any substantive action by an agency (normally published in the Federal Register) that promulgates or is expected to lead to the promulgation of a final rule or regulation, including notices of inquiry, advance notices of proposed rulemaking, and notices of proposed rulemaking." E.O. 12866 at section 3(e).

together with, to the extent feasible, a quantification of those benefits;

- An assessment, including the underlying analysis, of costs anticipated from the regulatory action (such as, but not limited to, the direct cost both to the government in administering the regulation and to businesses and others in complying with the regulation, and any adverse effects on the efficient functioning of the economy, private markets (including productivity, employment, and competitiveness), health, safety, and the natural environment), together with, to the extent feasible, a quantification of those costs; and
- An assessment, including the underlying analysis, of costs and benefits of potentially effective and reasonably feasible alternatives to the planned regulation, identified by the agencies or the public (including improving the current regulation and reasonably viable nonregulatory actions), and an explanation why the planned regulatory action is preferable to the identified potential alternatives.

Set forth below is a summary of the OCC's regulatory impact analysis, which can be found in its entirety at http://www.occ.treas.gov/law/basel.htm under the link of "Regulatory Impact Analysis for Risk-Based Capital Guidelines: Domestic Capital Modifications (Basel IA), Office of the Comptroller of the Currency, International and Economic Affairs (2006)."

[INSERT EXECUTIVE SUMMARY OF OCC ECONOMIC ANALYSIS].

OTS Executive Order 12866 Determination

[INSERT EXECUTIVE SUMMARY OF OTS ECONOMIC ANALYSIS]

OCC Executive Order 13132 Determination

The OCC has determined that this proposed rule does not have any Federalism implications, as required by Executive Order 13132.

Paperwork Reduction Act

[TO BE ADDED}

OCC and OTS Unfunded Mandates Reform Act of 1995 Determination

Section 202 of the Unfunded Mandates Reform Act of 1995, Public Law 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. The OCC and OTS each has determined that this proposed rule will not result in expenditures by State, local, and tribal governments, or by the private sector, of $100 million or more. Accordingly, neither the OCC nor the OTS has prepared a budgetary impact statement or specifically addressed the regulatory alternatives considered.

Solicitation of Comments on Use of Plain Language

Section 722 of the GLBA requires the Federal banking agencies to use plain language in all proposed and final rules published after January 1, 2000. The Federal banking agencies invite comment on how to make this proposed rule easier to understand. For example:

- Have we organized the material to suit your needs? If not, how could this material be better organized?
- Are the requirements in the rule clearly stated? If not, how could the rule be more clearly stated?
- Do the regulations contain technical language or jargon that is not clear? If so, which language requires clarification?

- Would a different format (grouping and order of sections, use of headings, paragraphing) make the regulation easier to understand? If so, what changes to the format would make the regulation easier to understand?
- Would more, but shorter, sections be better? If so, which sections should be changed?
- What else could we do to make the regulation easier to understand?

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, Mortgages, Reporting and recordkeeping requirements, Securities.

12 CFR Part 225

Administrative practice and procedure, Banks, Banking, 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.

12 CFR Part 567

Capital, Reporting and recordkeeping requirements, Savings associations.