FEDERAL RESERVE SYSTEM

12 CFR Part 252

[Regulation YY; Docket No. R–1534]

RIN 7100–AE 48

Single-Counterparty Credit Limits for Large Banking Organizations

AGENCY: Board of Governors of the Federal Reserve System (Board).

ACTION: Notice of proposed rulemaking.

SUMMARY: The Board is inviting comment on proposed rules that would establish single-counterparty credit limits for domestic and foreign bank holding companies with $50 billion or more in total consolidated assets. The proposed rules would implement section 165(e) of the Dodd-Frank Wall Street Reform and Consumer Protection Act, which requires the Board to impose limits on the amount of credit exposure that such a domestic or foreign bank holding company can have to an unaffiliated company in order to reduce the risks arising from the company's failure. The proposed rules, which build on earlier proposed rules by the Board to establish single-counterparty credit limits for large domestic and foreign banking organizations, would increase in stringency based on the systemic importance of the firms to which they apply.

DATES: Comments should be received by June 3, 2016.

ADDRESSES: You may submit comments, identified by Docket No. R–1534 and RIN No. 7100 AE–48, 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.
- *Email: regs.comments@federalreserve.gov.* Include the docket number in the subject line of the message.
- *Fax:* (202) 452–3819 or (202) 452–3102.
- *Mail:* Robert deV. Frierson, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue NW., Washington, DC 20551.

All public comments will be made available on the Board's Web site 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 3515, 1801 K Street (between 18th and 19th Streets NW.) Washington, DC 20006 between 9:00 a.m. and 5:00 p.m. on weekdays.

FOR FURTHER INFORMATION CONTACT: Jordan Bleicher, Senior Supervisory Financial Analyst, (202) 973–6123, Division of Banking Supervision and Regulation; or Laurie Schaffer, Associate General Counsel, (202) 452–2272, Benjamin McDonough, Special Counsel, (202) 452–2036, Pam Nardolilli, Senior Counsel, (202) 452–3289, or Lucy Chang, Attorney, (202) 475–6331, Legal Division, Board of Governors of the Federal Reserve System, 20th and C Streets NW., Washington, DC 20551. For the hearing impaired only, Telecommunications Device for the Deaf (TDD) users may contact (202) 263–4869.

SUPPLEMENTARY INFORMATION:

Table of Contents

Background

General Background

During the 2007–2008 financial crisis, some of the largest financial firms in the world collapsed or experienced material financial distress. Counterparties of failing firms were placed under severe strain when the failing firm could not meet its financial obligations, in some cases resulting in the counterparties' inability to meet their own financial obligations. Similarly, weakened financial firms came under increased stress when counterparties with large exposures to the firm suddenly attempted to reduce those exposures.

The effect of a large financial institution's failure or near collapse is amplified by the mutual interconnectedness of large, systemically important firms—that is, the degree to which they extend each other credit and serve as counterparties to one another. As demonstrated during the crisis, financial distress at a banking organization may materially raise the likelihood of distress at other firms given the network of contractual obligations throughout the financial system. Accordingly, a large banking organization's systemic impact is likely to be directly related to its interconnectedness vis-à-vis other financial institutions and the financial sector as a whole. This interconnectedness of financial firms also creates the potential for an increase in the likelihood of distress at non-financial firms that are dependent upon financial firms for funding.

The financial crisis also revealed inadequacies in the U.S. regulatory approach to credit exposure limits, which limited only some of the interconnectedness among large financial companies. For example, certain commercial banks were subject to single-borrower lending and investment limits. However, these limits often excluded credit exposures generated by derivatives and some securities financing transactions, and did not apply at the consolidated holding company level.[1]

Section 165(e) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) authorizes the Board to establish single-counterparty credit limits for bank holding companies with total consolidated assets of $50 billion or more (covered companies) and foreign banking organizations with total consolidated assets of $50 billion or more, and any U.S. intermediate holding company (covered entities), in order to limit the risks that the failure of any individual firm could pose to a covered company.[2] This section prohibits covered companies and covered entities from having credit exposure to any unaffiliated company that exceeds 25 percent of the capital stock and surplus of the covered company, or such lower amount as the Board may determine by regulation to be necessary to mitigate risks to the financial stability of the United States.[3]

[1] Section 610 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) amends the term ''loans and extensions of credit'' for purposes of the lending limits applicable to national banks to include any credit exposure arising from a derivative transaction, repurchase agreement, reverse repurchase agreement, securities lending transaction, or securities borrowing transaction. *See* Dodd-Frank Act, Public Law 111–203, 610, 124 Stat. 1376, 1611 (2010), codified at 12 U.S.C. 84(b). As discussed in more detail below, these types of transactions also are made subject to the single-counterparty credit limits of section 165(e). 12 U.S.C. 5365(e)(3).

[2] *See* 12 U.S.C. 5365(e)(1).

[3] 12 U.S.C. 5365(e)(2).

Credit exposure to a company is defined in section 165(e) of the Dodd-Frank Act to mean all extensions of credit to the company, including loans, deposits, and lines of credit; all repurchase agreements, reverse repurchase agreements, and securities borrowing and lending transactions with the company (to the extent that such transactions create credit exposure for the covered company); all guarantees, acceptances, and letters of credit (including endorsement or standby letters of credit) issued on behalf of the company; all purchases of, or investments in, securities issued by the company; counterparty credit exposure to the company in connection with derivative transactions between the covered company and the company; and any other similar transaction that the Board, by regulation, determines to be a credit exposure for purposes of section 165.[4]

Section 165(e) also grants the Board authority to issue such regulations and orders, including definitions consistent with section 165(e), as may be necessary to administer and carry out that section. In addition, it authorizes the Board to exempt transactions, in whole or in part, from the definition of the term ''credit exposure,'' if the Board finds that the exemption is in the public interest and consistent with the purposes of section 165(e).[5] Finally, section 165(e) authorizes the Board to establish single-counterparty credit limits for nonbank financial companies designated by the Financial Stability Oversight Council (FSOC) for supervision by the Board. The draft proposed rules would not at this time apply to any such nonbank financial company. The Board intends to apply similar requirements to these companies separately by rule or order at a later time.

The proposed framework of credit exposure limits for covered companies is similar to existing limits for depository institutions, including the investment securities limits and the lending limits imposed on certain depository institutions.[6] A national bank generally is limited, subject to certain exceptions, in the total amount of investment securities of any one obligor that it may purchase for its own account to no more than 10 percent of its capital stock and surplus.[7] In addition, a national bank's total outstanding loans and extensions of credit to one borrower may not exceed 15 percent of the bank's capital stock and surplus, plus an additional 10 percent of the bank's capital stock and surplus, if the amount that exceeds the bank's 15 percent general limit is fully secured by readily-marketable collateral.[8]

The requirements in section 165(e) operate as a separate and independent limit from the investment securities limits and lending limits in the National Bank Act and Federal Reserve Act, and a covered company or covered entity must comply with all of the limits that are applicable to it and its subsidiaries. A covered company would be required to ensure that it does not exceed the single-counterparty credit limits when all the credit exposures of the organization are consolidated. Because the proposed rules would impose limits on credit transactions by a covered company or covered entity on a consolidated basis, including its subsidiary depository institutions, the proposed rules may affect the amount of loans and extensions of credit that would otherwise be consistent with a subsidiary depository institution's lending limits.

The Board invited public comment on proposed rules to implement section 165(e) for domestic banking organizations in December 2011 and for foreign banking organizations in December 2012.[9] The Board is re-proposing rules to implement section 165(e) in order to take account of (1) the large volume of comments received on the original 165(e) proposed rules from banks, trade associations, public interest groups, and others; (2) the revised lending limits rules applicable to national banks; [10] (3) the introduction by the Basel Committee on Banking Supervision (BCBS) of a large exposures standard (LE Standard), which establishes an international standard for the maximum amount of credit exposure that an internationally active bank is permitted to have to a single counterparty; [11] and (4) the results of quantitative impact studies and related analysis conducted by Board staff to help gauge the impact of the original 165(e) proposed rules and these revised rules.

Summary of Comments on the 2011 and 2012 Proposals

The Board received 48 comments, representing approximately 60 parties, on the 2011 proposal on section 165(e) as it relates to domestic firms and 35 comments, representing over 45 organizations, on the 2012 proposed rule as it relates to foreign banking organizations. The comments were received from a wide range of individuals, banking organizations, industry and trade groups representing banking, insurance, and the broader financial services industry, and public interest groups. Board staff also met with industry representatives and government representatives to discuss issues relating to the proposed rules.

Some commenters expressed support for the broader goals of the proposed rules to limit single-counterparty concentrations at large financial companies. Numerous commenters expressed concerns, however, about various aspects of the proposed rules. The Board received comments on all aspects of the proposed rules, and the Board has taken into consideration these comments in these revised proposed rules for section 165(e).

In the 2011 proposed rule, the Board proposed to limit the aggregate net credit exposure of a covered company to a single unaffiliated counterparty to no more than 25 percent of the consolidated capital stock and surplus of the covered company. The Board further proposed to limit the aggregate net credit exposure of U.S. bank holding companies with over $500 billion in assets to any other unaffiliated bank holding company of similar size, or to a nonbank financial company designated by the FSOC for supervision by the Board, to 10 percent of the capital stock and surplus of the covered company.

Several commenters questioned the Board's basis for lowering the 25 percent statutory limit to 10 percent. These commenters generally questioned the financial stability need for the lower limit and questioned whether the 10 percent limit would have disruptive effects, such as reducing market liquidity, decreasing loan capacity, and driving financial services to the shadow banking sector. Several commenters questioned the Board's basis for selecting a $500 billion asset threshold as the cutoff for the lower 25 percent statutory credit limit. Commenters representing the insurance industry criticized the proposed standard because it did not take into account the unique features of the insurance business. The Board also received

[4] *See* 12 U.S.C. 5365(e)(3).

[5] *See* 12 U.S.C. 5365(e)(5)–(6).

[6] *See, e.g.,* 12 U.S.C. 24(7); 12 U.S.C. 84; 12 CFR 1 and 32; *see also* 12 U.S.C. 335 (applying the provisions of 12 U.S.C. 24(7) to state member banks).

[7] *See* 12 U.S.C. 24(7); 12 CFR 1.

[8] *See* 12 U.S.C. 84; 12 CFR 32.3. State-chartered banks, as well as state and federally-chartered savings associations, also are subject to lending limits imposed by relevant state and federal law.

[9] *http://www.federalreserve.gov/newsevents/press/bcreg/20111220a.htm; http://www.federalreserve.gov/newsevents/press/bcreg/20121214a.htm.*

[10] *See* 78 FR 37930 (June 25, 2013).

[11] *http://www.bis.org/press/p140415.htm.*

several comments that supported imposing the more stringent limits on single-counterparty credit exposures between very large organizations.

Some commenters on the 2011 proposed rule urged the Board to base single-counterparty credit limits on a narrower definition of capital. For example, one commenter noted that a central finding of the financial crisis was that only common equity was reliably loss absorbing, and further observed that the Basel III capital standard reflects this through its redefinition of capital instruments. This commenter also argued that there are advantages to coordinating regulatory capital definitions around a limited number of capital definitions that include only instruments that are reliably loss absorbing.

In its 2011 proposed rule, the Board proposed to exempt credit exposures that were direct claims on, and the portions of claims that were directly and fully guaranteed as to principal and interest by, the United States and its agencies. Many commenters supported expanding this exemption to include creditworthy non-U.S. sovereigns. Several commenters noted that sovereign entities generally are not regarded as ''companies,'' and the statute covers exposures to companies. Others argued there is no rationale for distinguishing between U.S. and other highly-rated sovereign exposures and that limiting the amount of exposure that a covered company can have to a highly-rated sovereign may increase systemic risk by limiting the company's ability to invest in or accept as collateral instruments issued by such sovereigns. Commenters suggested that exposures to those sovereigns that are assigned a low risk-weight under the Basel Capital rules should be exempt.

Commenters questioned the Board's approach to measuring the exposures resulting from derivative transactions. Under the 2011 proposed rule, a covered company generally would have been required to calculate credit exposure to a derivatives counterparty using the Current Exposure Method (CEM). Commenters argued that CEM is insufficiently risk-sensitive and that it overstates the realistic economic exposure of a derivative transaction. Commenters attributed this issue in significant part to the fact that CEM limits the extent to which netting benefits are taken into account in calculating counterparty exposures.

Some commenters also criticized the Board's proposed approach to measuring exposures from securities financing transactions.[12] These commenters argued that the collateral volatility haircuts included in the 2011 proposed rule do not recognize the risk-mitigating value of positive correlations between securities on loan and securities received as collateral. These commenters also pointed out that under the Board's risk-based capital rules, collateral volatility haircuts for securities lending and repurchase transactions reflect a five-day liquidation period, rather than the ten-day period used in the proposed 165(e) rule.

Many of the comments received concerning the proposed rule for foreign banking organizations were similar to those filed with respect to the domestic proposed rule, especially regarding the 2012 proposed rule's treatment of foreign sovereign instruments. Some commenters argued that, in light of the BCBS's development of the LE Standard that would apply to a foreign banking organization on a consolidated basis, it was unnecessary for the Board to develop single-counterparty credit limits for a foreign banking organization's combined U.S. operations. Some commenters also expressed concerns related to the definition of the relevant capital base for their organizations. For example, some foreign banking organizations that expected to form intermediate holding companies (IHCs) to hold their U.S. subsidiaries were concerned that their relevant capital base would be restricted to the capital of the IHC, and not the relevant consolidated capital level of their entire company.

After a review of these comments, the Board has modified the proposed rules in a number of key respects. The Board welcomes comments on all aspects of the proposed rules, including on the various questions and alternatives discussed below.

Proposed Rule for Domestic Bank Holding Companies

Overview of Proposed Rule for Domestic Bank Holding Companies

Under the proposed rule to implement section 165(e) of the Dodd-Frank Act, the aggregate net credit exposure of a bank holding company with total consolidated assets of $50 billion or more (covered company) to a single counterparty would be subject to one of three increasingly stringent credit exposure limits. The first category of limits would apply to covered companies that have less than $250 billion in total consolidated assets and less than $10 billion in on-balance-sheet foreign exposures. Covered companies that have less than $250 billion in total consolidated assets and less than $10 billion in on-balance sheet foreign exposures would be prohibited from having aggregate net credit exposure to an unaffiliated counterparty in excess of 25 percent of the covered company's total capital stock and surplus, defined under the rule as the covered company's total regulatory capital plus allowance for loan and lease losses (ALLL).

The second category of exposure limits would prohibit any covered company with $250 billion or more in total consolidated assets or $10 billion or more in total on-balance-sheet foreign exposures, but which is not a global systemically important banking organization, from having aggregate net credit exposure to an unaffiliated counterparty in excess of 25 percent of the covered company's tier 1 capital.

The third category of exposure limits would prohibit any covered company that is a global systemically important banking organization (major covered company) from having aggregate net credit exposure in excess of 15 percent of the major covered company's tier 1 capital to a major counterparty, and 25 percent of the major covered company's tier 1 capital to any other counterparty. A ''major counterparty'' would be defined as a global systemically important banking organization or a nonbank financial company supervised by the Board. This framework would be consistent with the requirement in section 165(a)(1)(B) of the Dodd-Frank Act that the enhanced standards established by the Board under section 165 increase in stringency based on factors such as the nature, scope, size, scale, concentration, interconnectedness, and mix of the activities of the company.[13] The credit exposure limits are summarized in Table 1.

[12] ''Securities financing transactions'' include repurchase agreements, reverse repurchase agreements, securities lending transactions, and securities borrowing transactions.

[13] 12 U.S.C. 5323, 5365(e).

TABLE 1—SINGLE-COUNTERPARTY CREDIT LIMITS APPLICABLE TO COVERED COMPANIES

Category of covered company	Applicable credit exposure limit
Covered companies that have less than $250 billion in total consolidated assets and less than $10 billion in on-balance-sheet foreign exposures.	Aggregate net credit exposure to a counterparty cannot exceed 25 percent of a covered company's total regulatory capital plus ALLL.
Covered companies that have $250 billion or more in total consolidated assets or $10 billion or more in on-balance-sheet foreign exposures, but are not major covered companies.	Aggregate net credit exposure to a counterparty cannot exceed 25 percent of a covered company's tier 1 capital.
Major covered companies	Aggregate net credit exposure to a *major counterparty* cannot exceed 15 percent of a major covered company's tier 1 capital. Aggregate net credit exposure to *other counterparties* cannot exceed 25 percent of a major covered company's tier 1 capital.

The limits of the proposed rule would apply to the credit exposures of a covered company on a consolidated basis, including any subsidiaries, to any unaffiliated counterparty. A ''subsidiary'' of a covered company would mean a company that is directly or indirectly controlled by the specified company for purposes of the Bank Holding Company Act of 1956, 12 U.S.C. 1841 *et seq.*[14] If an investment fund or vehicle is not controlled by a covered company, the exposures of such fund or vehicle to its counterparties would not be aggregated with those of the covered company for purposes of the proposed single-counterparty credit limits applicable to that covered company.

A bank holding company should be able to monitor and control its credit exposures on a consolidated basis, including the credit exposures of its subsidiaries. Applying the single-counterparty credit limits in the proposed rule to bank holding companies on a consolidated basis, which would include the credit exposures of their subsidiaries, would help to avoid evasion of the rule's purposes.

Question 1: As noted, the proposed rule would apply the single-counterparty credit limits to covered companies on a consolidated basis and could, therefore, impact the level of credit exposures of subsidiaries of these covered companies, including depository institutions. Is application on a consolidated basis appropriate?

Question 2: Should the definition of a ''subsidiary'' of a covered company for purposes of single-counterparty credit limits be based on the definition in the Bank Holding Company Act of 1956? Should a ''subsidiary'' instead be defined as any entity that a covered company (1) owns, controls, or holds with power to vote 25 percent or more of a class of voting securities; (2) owns or controls 25 percent or more of the total equity; or (3) consolidates for financial reporting purposes?

Question 3: Should funds or vehicles that a covered company sponsors or advises be expressly included as part of the covered company for purposes of the proposed rule? Should the proposed rule's definition of ''subsidiary'' be expanded to include any investment fund or vehicle advised or sponsored by a covered company? Should the proposed rule's definition of ''subsidiary'' be expanded to include any other entity?

The proposed rule would establish limits on the credit exposure of a covered company to a single ''counterparty.'' [15] A counterparty would be defined to include natural persons (including the person's immediate family); a U.S. State (including all of its agencies, instrumentalities, and political subdivisions); and certain foreign sovereign entities (including their agencies, instrumentalities, and political subdivisions). The Board is proposing to include individuals and certain governmental entities within the definition of a ''counterparty'' because credit exposures to such entities create risks to the covered company that are similar to those created by large exposures to companies. The severe distress or failure of an individual, U.S. state or municipality, or sovereign entity could have effects on a covered company that are comparable to those caused by the failure of a financial firm or nonfinancial corporation to which the covered company has a large credit exposure. With respect to sovereign entities, these risks are most acute in the case of sovereigns that present greater credit risk. Therefore, the proposed rule would subject credit exposures to individuals, U.S. states and municipalities, and foreign sovereign governments that do not receive a zero percent risk weight under the Board's Standardized Approach risk-based capital rules in Regulation Q to the credit exposure framework in the same manner as credit exposures to companies.[16]

The Board proposes to extend the single-counterparty credit limits to individuals, U.S. states, and certain foreign sovereigns using two authorities. Under section 165(b)(1)(b) of the Dodd-Frank Act, the Board may impose such additional enhanced prudential standards as the Board of Governors determines are appropriate.[17] In addition, under section 5(b) of the Bank Holding Company Act, the Board may to issue such regulations as may be necessary to enable it to administer and carry out the purposes of this chapter and prevent evasions thereof.[18] Such purposes include examining the financial, operational, and other risks within the bank holding company system that may pose a threat to (1) the safety and soundness of the bank holding company or of any depository institution subsidiary of the bank holding company; or (2) the stability of the financial system of the United States.[19] The proposed rule would help to promote the safety and soundness of a covered company and mitigate risks to financial stability by limiting a covered company's maximum credit exposure to an individual, U.S. state, or foreign sovereign, and thereby reducing the risk that the failure of such individual or entity could cause the failure or material financial distress of a covered company.

For purposes of the proposed credit exposure limits, a covered company's exposures to a ''counterparty'' would include not only exposures to that particular entity but also exposures to any person with respect to which the counterparty (1) owns, controls, or holds with power to vote 25 percent or more of a class of voting securities; (2) owns or controls 25 percent or more of

[14] *See* proposed rule § 252.71(cc); *see also* section 252.2(g) of the Board's Regulation YY (12 CFR 252.2(g)).

[15] *See* proposed rule § 252.71(e).

[16] *See* 12 CFR part 217, subpart D.

[17] 12 U.S.C. 5363(b)(1)(B).

[18] 12 U.S.C. 1844(b).

[19] 12 U.S.C. 1844(c)(2)(A)(i)(II).

the total equity; or (3) consolidates for financial reporting purposes. To the extent that one or more of these conditions are met with respect to a company's relationship to an investment fund or vehicle, exposures to such fund or vehicle would need to be aggregated with that counterparty.

Question 4: Under what circumstances should funds or vehicles that a counterparty sponsors or advises be expressly included as part of the counterparty for purposes of the proposed rule?

Further, in cases where total exposures to a single counterparty exceed five percent of the covered company's eligible capital base (*i.e.,* total regulatory capital plus ALLL or tier 1 capital), the covered company would need to add to exposures to that counterparty all exposures to other counterparties that are ''economically interdependent'' with the first counterparty. The purpose of this proposed requirement is to limit a covered company's overall credit exposure to two or more counterparties where the underlying risk of one counterparty's financial distress or failure would cause the financial distress or failure of another counterparty. In particular, under the proposed rule, two counterparties would be considered economically interdependent when it is the case that, if one of the counterparties were to experience financial problems, the other counterparty would be likely to experience financial problems as a result. In determining whether two entities are economically interdependent, a covered company would be required to take into account (1) whether 50 percent of one counterparty's gross receipts or gross expenditures are derived from transactions with the other counterparty; (2) whether one counterparty has fully or partly guaranteed the exposure of the other counterparty, or is liable by other means, and the exposure is significant enough that the guarantor is likely to default if a claim occurs; (3) whether a significant part of one counterparty's production or output is sold to the other counterparty, which cannot easily be replaced by other customers; (4) whether one counterparty has made a loan to the other counterparty and is relying on repayment of that loan in order to satisfy its obligations to the covered company, and the first counterparty does not have another source of income that it can use to satisfy its obligations to the covered company; (5) whether it is likely that financial distress of one counterparty would cause difficulties for the other counterparty in terms of full and timely repayment of liabilities; and (6) when both counterparties rely on the same source for the majority of their funding and, in the event of the common provider's default, an alternative provider cannot be found.[20]

Two entities that are economically interdependent would be expected to default on their exposures in a highly correlated manner, and therefore they would be treated as a single counterparty for purposes of the proposed rule. At the same time, there may be cases in which the burdens of investigating economic interdependence would outweigh its credit risk mitigating benefits to the covered company. For this reason, a covered company would only be required to assess whether counterparties are economically interdependent if the sum of the covered company's exposures to one individual counterparty exceeds five percent of the covered company's capital stock and surplus, in the case of a covered company that does not have $250 billion or more in total consolidated assets or $10 billion or more in total on-balance-sheet foreign exposures, and tier 1 capital, in the case of a covered company with $250 billion or more in total consolidated assets or $10 billion or more in total on-balance-sheet foreign exposures.

In addition, under the proposed rule, a covered company would be required to add to exposures of an unaffiliated counterparty all exposures to other counterparties that are connected by certain control relationships, such as (i) the presence of voting agreements; (ii) the ability of one counterparty to influence significantly the appointment or dismissal of another counterparty's administrative, management or supervisory body, or the fact that a majority of members have been appointed solely as a result of the exercise of the first entity's voting rights; and (iii) the ability of one counterparty to significantly influence senior management or to exercise a controlling influence over the management or policies of another counterparty.[21] As with cases where two companies are economically interdependent, in cases where a counterparty is subject to some degree of control by another counterparty, a covered company's overall aggregate credit risk with respect to the two counterparties may be understated if such control relationships are not identified and their credit exposures added together for purposes of the proposed rule.

Example: A covered company has credit exposures to both a bank and a fund that is sponsored by the bank. The bank does not (1) own, control, or hold with power to vote 25 percent or more of a class of voting securities of the fund; (2) own or control 25 percent or more of the total equity of the fund; or (3) consolidate the fund for financial reporting purposes. Thus, the covered company generally would not be required to aggregate its exposures to the bank and the fund. The bank does, however, have the ability to appoint a majority of the directors of the fund. Under the proposed rule, a covered company would be required to add its credit exposures to the fund to the covered company's credit exposures to the bank for purposes of determining whether the covered company is in compliance with the proposed rule.

Question 5: Should covered companies be required to aggregate exposures to entities that are economically interdependent? Are the criteria for determining whether entities are economically interdependent sufficiently clear, and if not, how should the criteria be further clarified? Should covered companies only be required to identify entities as economically interdependent when exposure to one of the entities exceeds five percent of the covered company's capital stock and surplus, in the case of a covered company that does not have $250 billion or more in total consolidated assets or $10 billion or more in total on-balance-sheet foreign exposures, and tier 1 capital, in the case of a covered company with $250 billion or more in total consolidated assets or $10 billion or more in total on-balance-sheet foreign exposures? Should only covered companies with $250 billion or more in total consolidated assets or $10 billion or more in total on-balance-sheet foreign exposures be required to identify entities as economically interdependent? What other threshold(s) would be appropriate and why?

Question 6: What operational or other challenges, if any, would covered companies face in identifying companies that are economically interdependent? Will covered companies have access to all of the information needed to complete the analysis of economic interdependence? Is this type of information collected by covered companies in the ordinary course of business as part of underwriting or other, similar processes?

Question 7: Should covered companies be required to aggregate exposures to entities that are connected by certain control relationships? Should

[20] *See* proposed rule § 252.76(a).

[21] *See* proposed rule § 252.76(b).

covered companies only be required to aggregate exposures to entities that are connected by certain control relationships if the exposure exceeds five percent of the covered company's capital stock and surplus, in the case of a covered company that does not have $250 billion or more in total consolidated assets or $10 billion or more in total on-balance-sheet foreign exposures, and tier 1 capital, in the case of a covered company with $250 billion or more in total consolidated assets or $10 billion or more in total on-balance-sheet foreign exposures? Should only covered companies with $250 billion or more in total consolidated assets or $10 billion or more in total on-balance-sheet foreign exposures be required to aggregate exposures to entities that are connected by certain control relationships? Are the criteria for determining whether entities are connected by control relationships sufficiently clear, and if not, how could the criteria be further clarified? Are there additional criteria that the Board should consider?

Section 165(e) of the Dodd-Frank Act directs the Board to impose single-counterparty credit limits based on the ''capital stock and surplus'' of a covered company, or ''such lower amount as the Board may determine by regulation to be necessary to mitigate risks to the financial stability of the United States.'' [22] Under the proposed rule, ''capital stock and surplus'' of a covered company would be defined as the sum of the company's total regulatory capital as calculated under the capital adequacy guidelines applicable to that bank holding company under Regulation Q (12 CFR part 217) and the balance of the bank holding company's ALLL not included in tier 2 capital under the capital adequacy guidelines applicable to that bank holding company under Regulation Q (12 CFR part 217).[23] This definition of capital stock and surplus is conceptually similar to the definition of the same term in the Board's Regulations O and W and the OCC's national bank lending limit regulation.[24]

As indicated, for those covered companies with $250 billion or more in total consolidated assets or $10 billion or more in total on-balance-sheet foreign exposure, the proposed credit limits would be calculated by reference to those companies' tier 1 capital as defined under Regulation Q, rather than their total regulatory capital plus ALLL.[25] A key financial stability benefit of single-counterparty credit limits is that such limits help reduce the likelihood that the failure of one financial institution will lead to the failure of other financial institutions. By reducing the likelihood of multiple simultaneous failures arising from interconnectedness, single-counterparty credit limits reduce the probability of future financial crises and the social costs that would be associated with such crises. For this benefit to be realized, single-counterparty credit limits for firms whose failure is more likely to have an adverse impact on financial stability need to be based on a measure of capital that is available to absorb losses on a going-concern basis.

Total regulatory capital plus ALLL includes capital elements that do not absorb losses on a going-concern basis. For example, total regulatory capital includes a covered company's subordinated debt, which is senior in the creditor hierarchy to equity and therefore only takes losses once a company's equity has been wiped out. In contrast, a company's tier 1 capital consists only of equity claims on the company, such as common equity and certain preferred shares. By definition, these equity claims are available to absorb losses on a going-concern basis. Therefore, in order to limit the aggregate net credit exposure that a covered company with $250 billion or more in total consolidated assets or $10 billion or more in total on-balance-sheet foreign exposures can have to a single counterparty relative to the covered company's ability to absorb losses on a going-concern basis, single-counterparty credit limits applicable to such companies should be based on their tier 1 capital. Basing single-counterparty credit limits for such companies on tier 1 capital also is consistent with the direction given in section 165(a)(1)(B) of the Dodd-Frank Act to impose enhanced prudential standards that increase in stringency based on the systemic footprint of the firms to which they apply.[26]

Basing single-counterparty credit limits for covered companies with total consolidated assets of $250 billion or more, or $10 billion or more in on-balance-sheet foreign exposures on tier 1 capital would be consistent with lessons learned during the financial crisis of 2007–2009. During the crisis, counterparties and other creditors of distressed financial institutions discounted lower-quality regulatory capital instruments issued by such institutions, such as trust preferred shares, hybrid capital instruments, and other term instruments. Instead, market participants focused on a financial institution's common equity capital and other simple, perpetual-maturity instruments that now qualify as tier 1 regulatory capital. For this reason, the Board's revised capital framework introduced a new definition of common equity tier 1 capital, restricted the set of instruments that qualify as additional tier 1 capital, and raised the tier 1 capital regulatory minimum from 4 to 6 percent.[27] In contrast, the Board's revised capital framework left the total regulatory capital minimum requirement unchanged from its pre-crisis calibration of 8 percent.

Thus, basing single-counterparty credit limits for such covered companies on tier 1 capital would be consistent with the post-crisis focus on higher-quality forms of capital and, based on the experience in the crisis whereby market participants significantly discounted the value of capital instruments such as subordinate debt that count in total regulatory capital, would provide a more reliable capital base for the credit limits. In addition, the analysis that follows suggests that using a narrower definition of capital for such covered companies could help to mitigate risks to U.S. financial stability.

The marginal impact of basing single-counterparty credit limits on tier 1 capital for firms with $250 billion or more in total assets, or $10 billion or more in on-balance-sheet foreign exposures, appears to be limited. As of September 30, 2015, tier 1 capital represented approximately 82 percent of the total regulatory capital plus ALLL for these firms. Further, the quantitative impact study Board staff conducted to help gauge the likely effects of the proposed requirements suggests that using tier 1 capital as the eligible capital base for bank holding companies with $250 billion or more in total consolidated assets or $10 billion or more in total on-balance-sheet foreign exposures likely would increase the total amount of excess exposure among U.S. bank holding companies by approximately $30 billion. This incremental amount of excess credit exposure could be largely eliminated by firms through compression of derivatives, collection of additional collateral from counterparties, greater use of central clearing, and modest rebalancing of portfolios among counterparties.

[22] 12 U.S.C. 5365(e)(2).

[23] *See* proposed rule § 252.71(d).

[24] *See* 12 CFR 215.3(i), 12 CFR 223.3(d); *see also* 12 CFR 32.2(b).

[25] *See* 12 CFR 217.2; 12 CFR 217.20.

[26] 12 U.S.C. 5365(a)(1)(B).

[27] *See* 12 CFR part 217.

Question 8: Are the proposed definitions relating to capital stock and surplus and tier 1 capital clear? Should the single-counterparty credit limits applicable to covered companies with $250 billion or more in total consolidated assets or $10 billion or more in total on-balance-sheet foreign exposures be based on a different capital base than that used for other firms?

Credit Exposure Limits

Section 252.72 of the proposed rule contains the key quantitative limitations on credit exposure of a covered company to a single counterparty.[28] First, the general limit in proposed section 252.72 provides that no covered company may have aggregate net credit exposure to any unaffiliated counterparty in excess of 25 percent of the capital stock and surplus or tier 1 capital, as appropriate, of the covered company.[29] Second, proposed section 252.72 provides that no ''major covered company,'' defined as a covered company that is a U.S. global systemically important banking organization, may have aggregate net credit exposure to a major counterparty in excess of 15 percent of the major covered company's tier 1 capital.[30] ''Aggregate net credit exposure'' would be defined in this section to mean the sum of all net credit exposures of a covered company to a single counterparty.[31] As described in detail below, sections 252.73 and 252.74 of the proposed rule describe how a covered company would calculate gross and net credit exposure in order to arrive at the aggregate net credit exposure relevant to the single-counterparty credit limits in section 252.72.[32]

A ''major counterparty'' would be defined as (1) any major covered company and all of its subsidiaries, collectively; (2) any foreign banking organization and all of its subsidiaries, collectively, that would be considered a global systemically important foreign banking organization; and (3) any nonbank financial company supervised by the Board.[33]

The Board's proposed rule regarding the single-counterparty credit limits that should apply to credit exposures of a major covered company to a major counterparty reflects the financial stability consequences associated with such credit extensions. A credit extension between a major covered company and a major counterparty is expected to result in a heightened degree of credit risk to the major covered company relative to the case in which a major covered company extends credit to a counterparty that is not a major counterparty. The heightened credit risk arises because major covered companies and major counterparties are often engaged in common business lines and often have common counterparties and common funding sources. This creates a significant degree of commonality in their economic performance. In particular, factors that would likely cause the distress of a major counterparty would also likely be expected to simultaneously adversely affect a major covered company that has extended credit to the major counterparty. As a result, such credit extensions would be expected to present more credit risk, and greater potential for financial instability, than a credit extension made by a major covered company to a counterparty that is not a major counterparty.

In a white paper that has been released in conjunction with these proposed rules, Board staff has analyzed data on the default correlation between systemically important financial institutions (SIFIs) as well as data on the default correlation between SIFIs and a sample of non-SIFI companies.[34] The analysis supports the view that the correlation between SIFIs, and hence the correlation between major covered companies and major counterparties, is measurably higher than the correlation between SIFIs and other companies. This finding further supports the view that credit extensions between SIFIs, and hence by a major covered company to a major counterparty, present a higher degree of risk and the potential for greater financial instability than credit extensions of a major covered company to a non-major counterparty.

Because credit extensions of a major covered company to a major counterparty present a heightened degree of credit risk and a greater potential for heightened financial instability, the Board is proposing to set a more stringent single-counterparty credit limit for credit extensions between a major covered company and a major counterparty of 15 percent rather than the statutory limit of 25 percent. The more stringent credit limit of 15 percent is informed by the results of a credit risk model that is described in detail in the white paper. More specifically, data on correlations, as described above, is used to calibrate a credit risk model. The credit risk model is then used to set the single-counterparty credit limit between SIFIs such that the amount of credit risk that a SIFI is permitted to incur through extensions of credit to another SIFI is no greater than the amount of credit risk that the SIFI would be permitted to incur through extensions of credit to a non-SIFI under the 25 percent limit applicable to such exposures. The resulting calibrated model produces inter-SIFI single-counterparty credit limits that are in line with the proposed limit of 15 percent.

An additional consideration that is not considered explicitly in the context of the white paper's credit risk model, but which should influence the calibration of the credit limit between major covered companies and major counterparties, is the relative difference in adverse consequences arising from multiple SIFI defaults relative to the default of a SIFI and non-SIFI counterparty. The financial stability consequences of multiple SIFI defaults caused by the default of a SIFI borrower and the resulting default of a SIFI lender are likely substantially greater than the adverse consequences that would result from the default of a single SIFI lender and a single non-SIFI borrower. As a result, there is a compelling rationale to require that credit risk posed by inter-SIFI credit extensions be materially smaller than that posed by credit extensions between a SIFI lender and non-SIFI borrower. This consideration suggests that an appropriate inter-SIFI single-counterparty credit limit would be even lower than the 15 percent limit suggested by the calibrated credit risk model that is presented in the white paper.

Accordingly, the more stringent 15 percent single-counterparty credit limit on credit exposures of a major covered company to a major counterparty should help to mitigate risks to U.S. financial stability. The Board seeks comment on the analytical rationale that has been presented for a tighter single-counterparty credit limit for exposures of a major covered company to a major counterparty. The Board also invites comment on the data, analysis, and economic model that is used in the white paper to support the proposed more stringent limit. Commenters are encouraged to provide any specific

[28] *See* proposed rule § 252.72.

[29] *See* proposed rule §§ 252.72(a)–(b).

[30] *See* proposed rule § 252.72(c).

[31] *See* proposed rule § 252.71(b).

[32] *See* proposed rule §§ 252.73–252.74.

[33] *See* proposed rule § 252.72(v). The Financial Stability Board maintains and periodically publishes a list of entities that have the characteristics of a global systemically important banking organization: *http://www.fsb.org/.*

[34] *See Calibrating the Single-Counterparty Credit Limit between Systemically Important Financial Institutions.* For purposes of the white paper, SIFIs include global systemically important banking organizations and nonbank financial companies designated by FSOC for supervision by the Board.

analyses that could be used to support an alternative view on the appropriate level of the single-counterparty credit limit between major covered companies and major counterparties.

Question 9: Should more stringent credit exposure limits apply to credit exposures of a major covered company to a major counterparty than would apply to other credit exposures?

Question 10: Are the proposed definitions of a ''major covered company'' and a ''major counterparty'' appropriate? What alternative definitions should the Board consider?

Question 11: Should more stringent credit exposure limits apply to exposures of major covered companies to a nonbank financial company that has been designated by FSOC for Board supervision? Should more stringent limits also apply to exposures of a major covered company to other entities that have been designated as global systemically important financial institutions by the Financial Stability Board (e.g., global systemically important insurance companies)? If so, what limits should apply?

Question 12: What other limits or modifications to the proposed limits on aggregate net credit exposure should the Board consider? For example, should the Board consider developing aggregate exposure limits to certain categories of firms (e.g., a limit on the aggregate amount of credit exposure that a major covered company can have to all major counterparties)? How should the Board identify any such categories and the applicable exposure thresholds?

Gross Credit Exposure

As noted, the proposed rule would impose limits on a covered company's aggregate net credit exposure, rather than aggregate gross credit exposure, to a counterparty. The key difference between these two amounts is that a company's net credit exposure would take into account any available credit risk mitigants, such as collateral, guarantees, credit or equity derivatives, and other hedges, provided the credit risk mitigants meet certain requirements in the rule, as discussed more fully below. For example, if a covered company had $100 in gross credit exposure to a counterparty with respect to a particular credit transaction, and the counterparty pledged collateral with an adjusted market value of $50, the full amount of which qualified as ''eligible collateral'' under the rule, the covered company's net credit exposure to the counterparty on the transaction would be $50.

In order to calculate its aggregate net credit exposure to a counterparty, a covered company first would calculate its gross credit exposure to the counterparty on each credit transaction in accordance with certain valuation and other requirements under the rule. Second, the covered company would reduce its gross credit exposure amount based on eligible credit risk mitigants to determine its net credit exposure for each credit transaction with the counterparty. Third and finally, the covered company would sum all of its net credit exposures to the counterparty to calculate the covered company's aggregate net credit exposure to the counterparty. It is this final amount, the aggregate net credit exposure, that would be subject to a credit exposure limit under the rule.

With respect to a credit exposure involving eligible collateral or an eligible protection provider, the proposed rule would apply a ''risk-shifting'' approach. In general, any reduction in the exposure amount to the original counterparty relating to the eligible collateral or eligible protection provider would result in a dollar-for-dollar increase in exposure to the eligible collateral issuer or eligible protection provider (as applicable). For example, in the case discussed above where a covered company had $100 in gross credit exposure to a counterparty and the counterparty pledged collateral with an adjusted market value of $50, the covered company would have net credit exposure to the counterparty on the transaction of $50 and net credit exposure to the issuer of the collateral of $50.

However, in cases where a covered company hedges its exposure to an entity that is not a ''financial entity'' (a non-financial entity) using an eligible credit or equity derivative, and the underlying exposure is subject to the Board's market risk capital rule (12 CFR part 217, subpart F), the covered company would calculate its exposure to the eligible protection provider using methodologies that it is permitted to use under the Board's risk-based capital rules. For these purposes, a ''financial entity'' would include regulated U.S. financial institutions, such as insurance companies, broker-dealers, banks, thrifts, and futures commission merchants, as well as foreign banking organizations and a non-U.S.-based securities firm or a non-U.S.-based insurance company subject to consolidated supervision and regulation comparable to that imposed on U.S. depository institutions, securities broker-dealers, or insurance companies.[35] ''Financial entities'' would also include companies whose primary business includes the management of financial assets, lending, factoring, leasing, provision of credit enhancements, securitization, investments, financial custody, central counterparty services, proprietary trading, insurance, and other financial services.[36]

Question 13: Is the definition of a ''financial entity'' sufficiently clear? If not, what further guidance should be provided?

Section 252.73 of the proposed rule explains in detail how a covered company would calculate its ''gross credit exposure'' with respect to a counterparty. Gross credit exposure would be defined to mean, with respect to any credit transaction, the credit exposure of the covered company to the counterparty before adjusting for the effect of any qualifying master netting agreements, eligible collateral, eligible guarantees, eligible credit derivatives and eligible equity derivatives, and other eligible hedges (*i.e.,* a short position in the counterparty's debt or equity securities).[37] Consistent with the statutory definition of credit exposure, the proposed rule defines ''credit transaction'' to mean, with respect to a counterparty, any (i) extension of credit to the counterparty, including loans, deposits, and lines of credit, but excluding advised or other uncommitted lines of credit; (ii) repurchase or reverse repurchase agreement with the counterparty; (iii) securities lending or securities borrowing transaction with the counterparty; (iv) guarantee, acceptance, or letter of credit (including any confirmed letter of credit or standby letter of credit) issued on behalf of the counterparty; (v) purchase of, or investment in, securities issued by the counterparty; (vi) credit exposure to the counterparty in connection with a derivative transaction between the covered company and the counterparty; (vii) credit exposure to the counterparty in connection with a credit derivative or equity derivative transaction between the covered company and a third party, the reference asset of which is an obligation or equity security issued by the counterparty; [38] and (viii) any transaction that is the functional equivalent of the above, and any similar transaction that the Board determines to

[35] *See* proposed rule § 252.71(q).

[36] *Id.*

[37] *See* proposed rule § 252.71(r). Section 252.74 of the proposed rule explains how these adjustments are made.

[38] ''Credit derivative'' and ''equity derivative'' are defined in sections 252.71(g) and (p) of the proposed rule, respectively.

be a credit transaction for purposes of this subpart.[39]

Section 252.73 describes how the gross credit exposure of a covered company to a counterparty should be calculated for each type of credit transaction described above.[40] In general, the methodologies contained in the proposed rule are similar to those used to calculate credit exposure under the standardized risk-based capital rules for bank holding companies.[41] More specifically, section 252.73(a) of the proposed rule provides that, for purposes of calculating gross credit exposure:

(1) The value of loans by a covered company to a counterparty (and leases in which the covered company is the lessor and the counterparty is the lessee) would be equal to the amount owed by the counterparty to the covered company under the transaction;

(2) The value of debt securities held by the covered company that are issued by the counterparty would be equal to the market value of the securities (in the case of trading and available-for-sale securities) or the amortized purchase price of the securities (in the case of securities that are held to maturity);

(3) The value of equity securities held by the covered company that are issued by the counterparty would be equal to the market value of such securities;

(4) The value of repurchase agreements would be equal to the adjusted market value of the securities transferred by the covered company to the counterparty;

(5) The value of reverse repurchase agreements would be equal to the amount of cash transferred by the covered company to the counterparty;

(6) The value of securities borrowing transactions would be equal to the sum of the amount of cash collateral transferred by the covered company to the counterparty and the adjusted market value of the securities collateral transferred to the counterparty;

(7) The value of securities lending transactions would be equal to the adjusted market value of the securities lent by the covered company to the counterparty;

(8) Committed credit lines extended by a covered company to the counterparty would be valued at the face amount of the credit line;

(9) Guarantees and letters of credit issued by a covered company on behalf of the counterparty would be equal to the maximum potential loss to the covered company on the transaction;

(10) Derivative transactions between the covered company and the counterparty not subject to a qualifying master netting agreement would be valued in an amount equal to the sum of the current exposure of the derivatives contract and the potential future exposure of the derivatives contract, calculated using methodologies that the covered company is permitted to use under Regulation Q (12 CFR part 217, subparts D and E);

(11) Derivative transactions between the covered company and the counterparty subject to a qualifying master netting agreement would be valued in an amount equal to the exposure at default amount calculated using methodologies that the covered company is permitted to use under subpart E of Regulation Q (12 CFR part 217); and

(12) Credit or equity derivative transactions between the covered company and a third party where the covered company is the protection provider and the reference asset is an obligation or equity security of the counterparty, would be valued in an amount equal to the maximum potential loss to the covered company on the transaction.

Under the proposed rule, trading and available-for-sale debt securities held by the covered company, as well as equity securities, would be valued for purposes of single-counterparty credit limits based on their market value. This approach would require a covered company to revalue upwards the amount of an investment in such securities when the market value of the securities increases. In these circumstances, the re-valuation would reflect the covered company's greater financial exposure to the counterparty and would reduce the covered company's ability to engage in additional transactions with the counterparty. In circumstances where the market value of the securities falls, however, a covered company under the proposal would revalue downwards its exposure to the issuer of the securities. This reflects the fact that, just as an increase in the value of a security results in greater exposure to the issuer of that security, a decrease in the value of the security leaves a firm with less exposure to that issuer.

Question 14: Should the Board provide further guidance regarding the calculation of the ''market value'' of a debt or equity security, particularly for securities that are illiquid or otherwise hard-to-value? If so, what guidance should be provided?

In the context of repurchase agreements, securities borrowing transactions, and securities lending transactions, the ''adjusted market value'' of a security would mean the sum of (i) the market value of the security and (ii) the market value of the security multiplied by the product of (a) the collateral haircut set forth in Table 1 to section 217.132 of the Board's Regulation Q (12 CFR 217.132) that is applicable to the security and (b) the square root of ½.[42] The purpose of adjusting the value of a security in this manner is to capture the market volatility (and associated potential increase in counterparty credit exposure) of the securities transferred or lent by the covered company in these transactions. Multiplying the values in Table 1 to section 217.132 of the Board's Regulation Q by the square root of ½ would align with the requirements in the Board's risk-based capital rules, which assume a 5-day liquidation period for ''repo-style'' transactions,[43] rather than the 10-day liquidation period that is assumed for other transactions. With respect to derivative transactions between a covered company and a counterparty that are not subject to a qualifying master netting agreement, the gross credit exposure of a covered company to the counterparty would be valued as the sum of the current exposure and the potential future exposure of the contract.[44] With respect to derivative transactions between a covered company and a counterparty that are subject to a qualifying master netting agreement, the proposed rule would require covered companies to calculate gross credit exposure to a counterparty as the amount that would be calculated using any methodologies that the covered company is permitted to use under the Board's risk-based capital rules (12 CFR part 217, subpart D and E).[45] This approach would allow certain covered companies to calculate counterparty exposures for derivatives transactions subject to a qualifying master netting agreement using the internal model method in the Board's Regulation Q (12 CFR part 217, subpart E). The Board is

[39] *See* proposed rule § 252.71(h). The definition of ''credit transaction'' in the proposed rule is similar to the definition of ''credit exposure'' in section 165(e) of the Dodd-Frank Act. *See* 12 U.S.C. 5365(e)(3).

[40] *See* proposed rule § 252.73(a)(1)–(12).

[41] 12 CFR part 217, subpart D.

[42] *See* proposed rule § 252.71(a).

[43] A ''repo-style'' transaction is a repurchase or reverse repurchase transaction, or a securities borrowing or lending transaction, that meets certain criteria. *See* 12 CFR 217.2.

[44] *See* proposed rule § 252.73(a)(10). ''Qualifying master netting agreement'' is defined in section 252.71(z) of the proposed rule in a manner consistent with the Board's advanced risk-based capital rules for bank holding companies.

[45] *See* proposed rule § 252.73(a)(11).

proposing this approach, rather than proposing to require all covered companies to use CEM because of concerns that CEM may not take fully into account correlations and netting relationships, and therefore, under certain circumstances, may overstate counterparty credit risk.

The Board notes, however, that the BCBS has recently finalized a revised standardized approach (SA–CCR) for measuring credit exposure to a derivatives counterparty.[46] The Board expects to consider the benefits of incorporating SA–CCR in the single-counterparty credit limit rule at such time as the Board considers the benefits of SA–CCR for risk-based capital purposes.

With respect to derivative transactions between a covered company and a third party, where the covered company is the protection provider and the reference asset is an obligation or equity security of the counterparty, the credit exposure of the covered company to the counterparty would be equal to the maximum potential loss to the covered company on the transaction.[47]

With respect to cleared and uncleared derivatives, the amount of initial margin and excess variation margin (*i.e.,* variation margin in excess of that needed to secure the mark-to-market value of a derivative) posted to a bilateral or central counterparty would be treated as credit exposure to the counterparty unless the margin is held in a segregated account at a third party custodian.

Section 252.73(c) of the proposed rule includes the statutory attribution rule, which provides that a covered company must treat a transaction with any person as a credit exposure to a counterparty to the extent the proceeds of the transaction are used for the benefit of, or transferred to, that counterparty.[48] This attribution rule seeks to prevent firms from evading the single-counterparty credit limits by using intermediaries and thereby avoiding a direct credit transaction with a particular counterparty. It is the Board's intention to avoid interpreting the attribution rule in a manner that would impose undue burden on covered companies by requiring firms to monitor and trace the proceeds of transactions made in the ordinary course of business. In general, credit exposures resulting from transactions made in the ordinary course of business will not be subject to the attribution rule.

Question 15: The Board invites comment on all aspects of the proposed approaches for calculating gross credit exposures.

Question 16: With respect to derivative transactions, the Board invites comment on the proposed reliance on the methodologies covered companies are permitted to use under the risk-based capital rules. Should covered companies instead be required to use CEM? Should the single-counterparty credit limits rule ultimately require use of SA–CCR or a similar standardized approach to measure a covered company's credit exposure to derivatives counterparties?

Question 17: With respect to credit or equity derivative transactions between the covered company and a third party, where the covered company is the protection provider and the reference asset is an obligation or equity security of the counterparty, is it sufficiently clear how a covered company would calculate its ''maximum potential loss''? What additional guidance, if any, should the Board provide?

Question 18: With respect to credit derivatives, equity derivatives, guarantees, and letters of credit, are there cases in which ''maximum potential loss to the covered company'' arising from the transaction is indeterminate? How should single-counterparty credit limits apply in those instances?

Question 19: The Board invites comment on ways to apply the statutory attribution rule in a manner that would be consistent with the goal of preventing evasion of the single-counterparty credit limits without imposing undue burden on covered companies. Is additional regulatory clarity around the attribution rule necessary? What is the potential cost or burden of applying the attribution rule as proposed?

Net Credit Exposure

As noted, the proposed rule would impose limits on a covered company's net credit exposure to a counterparty. ''Net credit exposure'' would be defined to mean, with respect to any credit transaction, the gross credit exposure of a covered company calculated under section 252.73, as adjusted in accordance with section 252.74.[49] Section 252.74 of the proposed rule explains how a covered company would convert gross credit exposure amounts to net credit exposure amounts by taking into account eligible collateral, eligible guarantees, eligible credit and equity derivatives, other eligible hedges (for example, a short position in the counterparty's debt or equity securities), and for securities financing transactions, the effect also of bilateral netting agreements.[50]

Calculation of Net Credit Exposure for Securities Financing Transactions

With respect to any repurchase transaction, reverse repurchase transaction, securities lending transaction, and securities borrowing transaction with a counterparty that is subject to a bilateral netting agreement with that counterparty and that meets the definition of ''repo-style transaction'' in section 217.2 of the Board's Regulation Q (12 CFR 217.2), a covered company's net credit exposure to a counterparty generally would be equal to the exposure at default amount calculated under section 217.37(c)(2) of the Board's Regulation Q (12 CFR 217.37(c)(2)), applying standardized supervisory haircuts as provided in 12 CFR 217.37(c)(3)(iii).[51] A covered company would not be permitted to apply its own internal estimates for haircuts. Further, in calculating its net credit exposure to a counterparty as a result of such transactions, a covered company would be required to disregard any collateral received from that counterparty that does not meet the definition of ''eligible collateral'' in § 252.71(k).

The proposal would also require a covered company to recognize a credit exposure to any issuer of eligible collateral that is used to reduce the covered company's gross credit exposure from a transaction described in the preceding paragraph. The amount of credit exposure that a covered company would be required to recognize to an issuer of such collateral would be equal to the market value of the collateral minus the standardized supervisory haircuts provided in 12 CFR 217.37(c)(2)(ii). However, in no event would the amount of credit exposure that a covered company is required to recognize to such a collateral issuer be in excess of its gross credit exposure to the counterparty on the original credit transaction.

Some commenters on the 2011 section 165(e) proposed rule objected to the

[46] See *http://www.bis.org/publ/bcbs279.htm.*

[47] *See* proposed rule § 252.73(a)(12). ''Credit derivative'' is defined in § 252.71(g) of the proposed rule, and ''equity derivative'' is defined in § 252.71(p) of the proposed rule. ''Derivative transaction'' is defined in § 252.71(j) of the proposed rule in the same manner as it is defined in the National Bank Act, as amended by section 610 of the Dodd-Frank Act. *See* 12 U.S.C. 84(b)(3).

[48] *See* proposed rule § 252.73(c); *see also* 12 U.S.C. 5365(e)(4).

[49] *See* proposed rule § 252.71(x).

[50] *See* proposed rule § 252.74.

[51] Pursuant to 12 CFR 217.37(c)(3)(iii), a bank that is engaged in a repo-style transaction may multiply the standardized supervisory haircuts that would otherwise apply pursuant to Table 1 to § 217.37 of the Board's Regulation Q by the square root of ½.

proposed methodology for netting securities financing transactions as overly conservative. The commenters generally argued that the proposed approach implied unrealistic assumptions about correlations among securities that a covered company transfers to its counterparty and received from that counterparty. For example, if a covered company loans equity securities to a counterparty and receives equity securities from the counterparty as collateral, the proposed methodology implied that, upon the counterparty's default, the value of the equities transferred to the counterparty would increase in value while the value of the equities received would decrease in value.

In developing this proposed rule, the Board considered several alternatives to address these concerns. First, the Board considered allowing covered firms only to apply valuation adjustments to one side of a securities financing transaction where the securities transferred and received from a counterparty are of the same asset class. For example, if a covered company loans equity securities to a counterparty and receives equity securities from the counterparty as collateral, the covered company could be permitted to apply valuation adjustments only to the value of the equity securities that have been transferred to the counterparty. This would be a relatively simple way of taking account of the fact that securities in the same asset class tend to be somewhat positively correlated.

Second, the Board considered a methodology similar to the one recently proposed by the BCBS in its second consultative document on potential revisions to the standardized approach to credit risk.[52] Under the formula proposed by the Basel Committee, an entity's exposure for repo-style transactions would be equal to 40 percent of its ''net exposure'' from the transaction plus 60 percent of its ''gross exposure'' divided by the square root of the number of security issues in the netting set. In this formula, the ''net exposure'' term is intended to reflect the effect of netting long positions and short positions because the volatility haircuts that would apply to long positions would be allowed to offset those that apply to short positions. Although volatility haircuts would not offset when calculating gross exposure, gross exposure would reflect the effect of diversification by dividing the gross exposure amount by the square root of the number of exposures.

Third, the Board considered allowing credit exposure from repo-style transactions to be measured using standardized correlation matrices. Under this approach, securities would be divided into a handful of asset classes (for example, sovereign securities, corporate and municipal debt, and equities). Based on distinctions between asset classes, specific assumptions about correlations within portfolios of securities transferred to or received from a counterparty, as well as assumptions about correlations across portfolios of securities transferred and received, would be provided. These standardized correlation assumptions, together with standardized volatility haircuts for the relevant securities, would serve as inputs into a formula that would yield an estimate of a covered company's credit exposure to its counterparty. Again, this could provide a more accurate way of taking into account correlations among securities.

The first alternative would permit a covered company to apply valuation adjustments to only one side of a securities financing transaction where the securities transferred and received from a counterparty are of the same asset class. While this approach is meant to reflect the fact that securities in the same asset class are generally positively correlated, some securities in the same asset class may also be negative correlated. In addition, assumptions about asset correlations based on observations during normal times may break down during periods of extreme market turbulence, when large credit exposures of financial institutions to their counterparties could pose the greatest risk to financial stability. The second and third alternatives would increase the complexity of the framework and potentially make the framework susceptible to arbitrage. For the foregoing reasons, the proposed rule does not include these alternatives.

Question 20: Should the Board consider alternative approaches to measuring the net credit exposure from securities financing transactions? What are the advantages and disadvantages of such alternative measurement approaches relative to the proposed approach?

Collateral

Section 252.74(c) of the proposed rule describes how eligible collateral would be taken into account in the calculation of net credit exposure.[53] ''Eligible collateral'' would be defined to include cash on deposit with a covered company (including cash held for the covered company by a third-party custodian or trustee); debt securities (other than mortgage- or asset-backed securities [54]) that are bank-eligible investments and that have an investment grade rating; equity securities that are publicly traded; or convertible bonds that are publicly traded.[55] For any of these asset types to count as eligible collateral for a credit transaction, the covered company generally would be required to have a perfected, first priority security interest in the collateral or the legal equivalent thereof, if outside of the United States. This list of eligible collateral would be similar to the list of eligible collateral in Regulation Q.[56]

In computing its net credit exposure to a counterparty with respect to a credit transaction, a covered company would be required to reduce its gross credit exposure on the transaction by the adjusted market value of any eligible collateral.[57] Other than in the context of repo-style transactions, the ''adjusted market value'' of eligible collateral would be defined in section 252.71(a) of the proposed rule to mean the fair market value of the eligible collateral after application of the applicable haircut specified in Table 1 to section 217.132 of the Board's Regulation Q for that type of eligible collateral.[58]

The net credit exposure of a covered company to a counterparty on a credit transaction is the gross credit exposure of the covered company on the transaction minus the adjusted market value of any eligible collateral related to the transaction.[59] In addition, under the

[52] *http://www.bis.org/bcbs/publ/d347.pdf.*

[53] *See* proposed rule § 252.74(c).

[54] The proposed rule generally would exclude mortgage-backed securities and other asset-backed securities from the definition of ''eligible collateral'' because of concerns that those securities may be more likely than other securities to become illiquid and lose value during periods of financial instability. However, asset-backed securities guaranteed by a U.S. government sponsored entity, such as Ginnie Mae, Fannie Mae, or Freddie Mac, would qualify as eligible collateral under the proposed rule.

[55] *See* proposed rule § 252.71(k); *see also* 12 CFR 252.2(p) (defining ''publicly traded'').

[56] *See* 12 CFR 217.2.

[57] *See* proposed rule § 252.74(c).

[58] Table 1 to section 217.132 of the Board's Regulation Q (12 CFR 217.132) provides haircuts for multiple collateral types, including some types that do not meet the proposed definition of ''eligible collateral.'' Notwithstanding the inclusion of those collateral types in the reference table, a company cannot reduce its gross credit exposure for a transaction with a counterparty based on the adjusted market value of collateral that does not meet the definition of ''eligible collateral.''

[59] The Board is proposing to treat eligible collateral as a gross credit exposure to the collateral issuer under the Board's authority under section 165(e) to determine that any other similar transaction is a credit exposure. *See* 12 U.S.C. 5365(e)(3)(F).

proposed rule, a covered company generally must recognize a credit exposure to the collateral issuer in an amount equal to the adjusted market value of the collateral. As such, the amount of credit exposure to the original counterparty and the issuer of the eligible collateral would fluctuate over time based on the adjusted market value of the eligible collateral. Collateral that previously met the definition of eligible collateral under the proposed rule but over time ceases to do so would no longer be eligible to reduce gross credit exposure.

In effect, the proposed treatment of eligible collateral would require a covered company to shift its credit exposure from the original counterparty to the issuer of such collateral. This approach would help to promote a covered company's careful monitoring of its direct and indirect credit exposures. So as not to discourage overcollateralization, however, a covered company's maximum credit exposure to the collateral issuer would be limited to the credit exposure to the original counterparty.[60]

A covered company would continue to have credit exposure to the original counterparty to the extent that the adjusted market value of the eligible collateral does not equal the full amount of the credit exposure to the original counterparty.

Example: A covered company (Company A) makes a $1,000 loan to a counterparty (Company B), creating $1,000 of gross credit exposure to that counterparty, and the counterparty provides eligible collateral issued by a third party (Company C) that has an adjusted market value of $700 on day 1. Company A would be required to reduce its credit exposure to Company B by the adjusted market value of the eligible collateral. As a result, on day 1, Company A would have gross credit exposure of $700 to Company C and $300 net credit exposure to Company B.

As noted, the amount of credit exposure to the original counterparty and the issuer of the eligible collateral will fluctuate over time based on movements in the adjusted market value of the eligible collateral. If the adjusted market value of the eligible collateral decreased to $400 on day 2 in the previous example, on day 2 Company A's net credit exposure to Company B would increase to $600, and its gross credit exposure to Company C would decrease to $400. By contrast, if on day 3 the adjusted market value of the eligible collateral increased to $800, on day 3 Company A's net credit exposure to Company B would decrease to $200, and its gross credit exposure to Company C would increase to $800. In each case, the covered company's total credit exposure would be capped at the original amount of the exposure created by the loan or $1,000—even if the adjusted market value of the eligible collateral exceeded $1,000.

Finally, in cases where eligible collateral is issued by an issuer covered by one of the exemptions in section 252.76 of the proposed rule or that is excluded from the proposed definition of a ''counterparty,'' the requirement to recognize an exposure to the collateral issuer would have no effect.

Example: A covered company makes a $1,000 loan to a counterparty and that counterparty has pledged as collateral U.S. government bonds with an adjusted market value of $1,000. In this case, the covered company would not have any net credit exposure to the original counterparty because the value of loan and the adjusted market value of the U.S. government bonds are equal. Although the covered company would have $1,000 of exposure to the U.S. government, single-counterparty credit limits would not apply to that exposure because U.S. government bonds are excluded from the single-counterparty credit limits of the proposed rule.

Question 21: Should the list of eligible collateral be broadened or narrowed? What items should be added or deleted?

Question 22: Should covered companies have the option of whether to reduce their gross credit exposures by recognizing eligible collateral in some or all cases? If so, should covered companies nevertheless have to recognize gross credit exposures to the issuers of the eligible collateral? Are there situations in which full shifting of exposures would not be appropriate?

Question 23: Are the market volatility haircuts in Table 1 to section 217.132 of the Board's Regulation Q (12 CFR 217.132) appropriate for the valuation of eligible collateral for purposes of this rule? Should these haircuts be calibrated differently for purposes of this rule?

Eligible Guarantees

Section 252.74(d) of the proposed rule describes how to reflect eligible guarantees in calculations of net credit exposure to a counterparty.[61] Eligible guarantees would be defined as guarantees that meet certain conditions, including having been written by an eligible protection provider.[62] The definition of ''eligible protection provider'' would be the same as the definition of ''eligible guarantor'' in section 217.2 of Regulation Q. As such, an eligible protection provider would include a sovereign, the Bank for International Settlements, the International Monetary Fund, the European Central Bank, the European Commission, a Federal Home Loan Bank, the Federal Agricultural Mortgage Corporation (Farmer Mac), a multilateral development bank (MDB), a depository institution, a bank holding company, a savings and loan holding company, a credit union, a foreign bank, or a qualifying central counterparty. An eligible protection provider also would include any entity, other than a special purpose entity, (i) that at the time the guarantee is issued or anytime thereafter, has issued and maintains outstanding an unsecured debt security without credit enhancement that is investment grade, (ii) whose creditworthiness is not positively correlated with the credit risk of the exposures for which it has provided guarantees, and (iii) that is not an insurance company engaged predominantly in the business of providing credit protection (such as a monoline bond insurer or re-insurer).

In calculating its net credit exposure to the counterparty, a covered company would be required to reduce its gross credit exposure to the counterparty by the amount of any eligible guarantee from an eligible protection provider.[63] The covered company would then have to include the amount of the eligible guarantee when calculating its gross credit exposure to the eligible protection provider.[64] Also, as is the case with eligible collateral, a covered company's gross credit exposure to an eligible protection provider (with respect to an eligible guarantee) could not exceed its gross credit exposure to the original counterparty on the credit transaction prior to the recognition of the eligible guarantee.[65] Accordingly, the exposure to the eligible protection provider would be capped at the amount of the credit exposure to the original counterparty even if the amount of the eligible guarantee is larger than the original exposure. A covered company would continue to have credit exposure to the original counterparty to the extent that the eligible guarantee does not equal the full amount of the credit exposure to the original counterparty.

Example: A covered company makes a $1,000 loan to an unaffiliated counterparty and obtains a $700 eligible guarantee on the loan from an eligible protection provider.

[60] *See* proposed rule § 252.74(c)(2).

[61] *See* proposed rule § 252.74(d).

[62] *See* proposed rule § 252.71(n) for the definition of ''eligible guarantee'' and for a description of the requirements of an eligible guarantee.

[63] *See* proposed rule § 252.74(d).

[64] *See* proposed rule §§ 252.74(d)(1)–(2).

[65] *See* proposed rule § 252.74(d)(2).

The covered company would have gross credit exposure of $700 to the protection provider as a result of the eligible guarantee and $300 net credit exposure to the original counterparty.

Example: A covered company makes a $1,000 loan to an unaffiliated counterparty and obtains a $1,500 eligible guarantee from an eligible protection provider. The covered company would have $1,000 gross credit exposure to the protection provider (capped at the amount of the exposure to the unaffiliated counterparty), but the covered company would have no net credit exposure to the original counterparty as a result of the eligible guarantee.

As with eligible collateral, a covered company would be required to reduce its gross exposure to a counterparty by the amount of an eligible guarantee in order to ensure that concentrations in exposures to guarantors are captured by the risk-shifting approach. This requirement is meant to limit the ability of a covered company to extend loans or other forms of credit to a large number of high risk borrowers that are guaranteed by a single guarantor.

Question 24: Should the definition of eligible guarantee or eligible protection provider be expanded or narrowed? Are there any additional or alternative requirements the Board should place on eligible protection providers to ensure their capacity to perform on their guarantee obligations?

Question 25: Under what circumstances, if any, should covered companies have the option of whether (1) to fully shift exposures to eligible protection providers in the case of eligible guarantees or (2) divide an exposure between the original counterparty and the eligible protection provider in some manner? If so, should covered companies nevertheless have to recognize gross credit exposures to the issuers of the eligible collateral? Are there situations in which full shifting of exposures would not be appropriate?

Eligible Credit and Equity Derivative Hedges

Section 252.74(e) sets forth the proposed treatment of eligible credit and equity derivatives in the case where the covered company is the protection purchaser.[66] In the case where a covered company is a protection purchaser, such derivatives can be used to mitigate gross credit exposure. A covered company may only recognize credit and equity derivative hedges that qualify as eligible credit and equity derivative hedges for purposes of calculating net credit exposure under the proposed rule.[67] These derivatives would be required to meet certain criteria, including having been written by an eligible protection provider.[68] An eligible credit derivative hedge would need to be simple in form, meaning a single-name or standard, non-tranched index credit derivative. An eligible equity derivative hedge must be in the form of an equity-linked total return swap and would not include other, more complex forms of equity derivatives, such as purchased equity-linked options.

The proposed treatment of eligible credit and equity derivatives would be similar to the proposed treatment of eligible guarantees. A covered company would be required to reduce its gross credit exposure to a counterparty by the notional amount of any eligible credit or equity derivative hedge that references the counterparty if the covered company obtains the derivative from an eligible protection provider.[69] In these circumstances, the covered company generally would be required to include the notional amount of the eligible credit or equity derivative hedge in calculating its gross credit exposure to the eligible protection provider.[70] As is the case for eligible collateral and eligible guarantees, the gross exposure to the eligible protection provider would in no event be greater than it was to the original counterparty prior to recognition of the eligible credit or equity derivative.[71]

For eligible credit and equity derivatives that are used to hedge covered positions subject to the Board's market risk rule (12 CFR part 217, subpart F), the approach would be the same as that explained above, except in the case of credit derivatives where the counterparty on the hedged transaction is not a financial entity. In this case, a covered company would be required to reduce its gross credit exposure to the counterparty on the hedged transaction by the notional amount of the eligible credit derivative that references the counterparty if the covered company obtains the derivative from an eligible protection provider. In addition, the covered company would be required to recognize a credit exposure to the eligible protection provider that is measured using methodologies that the covered company is authorized to use under the Board's risk-based capital rules (12 CFR part 217, subparts D and E), rather than the notional amount.[72]

Example: A covered company holds a $1,000 bond issued by a non-financial entity (for example, a commercial firm or sovereign) that is a covered position subject to the Board's market risk rule, and the covered company purchases an eligible credit derivative in a notional amount of $800 from Protection Provider X, which is an eligible protection provider, to hedge its exposure to the non-financial entity. The covered company would continue to have $200 in net credit exposure to the non-financial entity. In addition, the covered company would treat Protection Provider X as a counterparty, and would measure its exposure to Protection Provider X using any methodology that the covered company is permitted to use under Regulation Q to calculate its risk-based capital requirements.

Example: A covered company holds as a covered position subject to the Board's market risk rule a $1,000 bond issued by a financial entity (for example, a banking organization), and the covered company purchases an eligible credit derivative in a notional amount of $800 from Protection Provider X, which is an eligible protection provider, to hedge its exposure to the financial entity. The covered company would continue to have credit exposure of $200 to the underlying financial entity. In addition, the covered company would now treat Protection Provider X as a counterparty, and would have an $800 credit exposure to Protection Provider X.

As with eligible collateral and eligible guarantees, a covered company would be required to reduce its gross exposure to a counterparty by the amount of an eligible equity or credit derivative, and to recognize an exposure to an eligible protection provider, in order to ensure that concentrations in exposures to eligible protection providers are captured in the regime. However, many commenters on the 2011 proposed rule argued that requiring a full notional shifting of risk in the context of credit derivatives was overly conservative, since a covered company would only experience losses in cases where both the original counterparty and the protection provider default. As such, these commenters recommended allowing covered companies to measure exposures from credit derivative hedges using the methodologies permitted for derivatives more generally.

[66] *See* proposed rule § 252.74(e).

[67] By contrast, in section 252.73(a)(12) of the proposed rule, where the covered company is the protection provider, *any* credit or equity derivative written by the covered company is included in the calculation of the covered company's gross credit exposure to the reference obligor.

[68] *See* proposed rule §§ 252.71(*l*) and (m) defining ''eligible credit derivative'' and ''eligible equity derivative,'' respectively. ''Eligible protection provider'' is defined in § 252.71(o) of the proposed rule. The same types of organizations that are eligible protection providers for the purposes of eligible guarantees are eligible protection providers for purposes of eligible credit and equity derivatives.

[69] *See* proposed rule § 252.74(e).

[70] *See* proposed rule §§ 252.74(e)(1)–(2).

[71] *See* proposed rule § 252.74(e)(2)(i).

[72] At such time as the Board may consider incorporation of SA–CCR into the U.S. risk-based capital rules, the Board may consider requiring SA–CCR to be used for this purpose as well.

The proposed rule includes this modification for credit derivatives that are used to hedge covered positions subject to the market risk rule, where the credit derivative is used to hedge an exposure to an entity that is not a financial entity. The proposed rule would require full notional risk-shifting for credit derivatives used to hedge exposures to financial entities because most protection providers are financial entities, and when both the protection provider and the reference entity are financial entities, the probability of correlated defaults generally is substantially greater than when protection is sold on non-financial reference entities.

In cases where a covered company is required to shift its credit exposure from the counterparty to an eligible protection provider pursuant to section 252.74(e), the covered company would be permitted to exclude the relevant equity or credit derivative when calculating its gross exposure to the eligible protection provider under sections 252.74(a)(10) and 252.94(a)(11). This is to avoid requiring covered companies to double count the same exposures.

Question 26: Should the proposed definitions of eligible credit derivative or eligible equity derivative be expanded or narrowed? In particular, are there more complex forms of derivatives that should be eligible hedges?

Question 27: Under what circumstances, if any, should covered companies be permitted not to recognize an eligible credit or equity derivative hedge, or to apportion the exposure between the original counterparty and the eligible protection provider?

Question 28: To the extent that covered companies will be required to shift exposures to protection providers in the case of eligible credit or equity derivative hedges, would the proposed approach result in recognition of the proper amount of exposure by a covered company to an eligible protection provider? If not, what modifications should the Board consider?

Other Eligible Hedges

Under the proposed rule, a covered company would be allowed to reduce its credit exposure to a counterparty by the face amount of a short sale of the counterparty's debt or equity securities, provided that the instrument in which the covered company has a short position is junior to, or *pari passu* with, the instrument in which the covered company has the long position.[73] This restriction on the set of short positions permitted to offset long positions would help to ensure that any loss arising from the covered company's long exposure is offset by a gain in the covered company's short exposure.

Example: A covered company holds $100 of bonds issued by Company X. If the covered company sells short $100 of equity shares issued by Company X, the covered company would not have any net credit exposure to Company X. Similarly, the covered company would not have any net credit exposure to Company X if it sells short $100 of Company X's debt obligations, provided that those obligations are junior to, or *pari passu* with, the Company X bonds that the covered company holds.

Question 29: Should the Board permit short positions to offset long positions only if the short position is in an instrument that is junior to, or pari passu with, the instrument that gives rise to the firm's long exposure?

Question 30: Should the Board place any additional requirements, including maturity match requirements, on short positions that are eligible to offset long positions? To the extent that there is a maturity mismatch between the positions, should the value of the short position be subject to application of the maturity mismatch adjustment approach of § 217.36(d) of the Board's Regulation Q?

Treatment of Maturity Mismatches

The above discussion of credit risk mitigation techniques (collateral, guarantees, equity and credit derivatives, and offsetting short positions) assumes that the residual maturity of the credit risk mitigant is greater than or equal to that of the underlying exposure. If the residual maturity of the credit risk mitigant is less than that of the underlying exposure, the credit risk mitigant would only be recognized under the proposed rule if the credit risk mitigant's original maturity is equal to or greater than one year and its residual maturity is not less than three months from the current date. In that case, the reduction in the underlying exposure would be adjusted based on the same approach that is used in the Board's Regulation Q (12 CFR part 217) to address a maturity mismatch.[74]

With respect to the amount of exposure that a covered company would need to recognize to the issuer of eligible collateral or to an eligible protection provider in cases of maturity mismatch, such amount generally would be equal to the amount by which the relevant form of credit risk mitigation has reduced the exposure to the original counterparty. However, in the case of credit and equity derivatives used to hedge exposures subject to the Board's market risk rule (12 CFR 217, subpart F) that are to counterparties that are non-financial entities, the covered company would be permitted to recognize a credit exposure with regard to the eligible protection provider measured using methodologies that the covered company is authorized to use under the Board's risk-based capital rules, including CEM for all covered companies and approaches that rely on internal models for companies subject to the Board's advanced approaches risk-based capital rules (12 CFR 217, subparts D and E).

Example: A covered company makes a loan to a counterparty and hedges the resulting exposure by obtaining an eligible guarantee from an eligible protection provider. If the residual maturity of the guarantee is less than that of the loan, the covered company would adjust the value assigned to the guarantee using the formula in the Board's Regulation Q (12 CFR part 217). The covered company would then reduce its gross credit exposure to the underlying counterparty by the adjusted value of the guarantee and would set its exposure to the eligible guarantor equal to the adjusted value of the guarantee.

Example: A covered company holds bonds issued by a non-financial entity that are subject to the Board's market risk rule, and hedges the exposure using an eligible credit derivative obtained from an eligible protection provider. If the residual maturity of the eligible credit derivative is less than that of the bonds, the covered company would reduce its exposure to the issuer of the bonds by the adjusted value of the credit derivative using the formula in the Board's Regulation Q. The covered company would measure its exposure to the eligible protection provider using methodologies that the covered company is permitted to use under the Board's risk-based capital rules (12 CFR part 217, subparts D and E), without any specific adjustment to reflect the maturity mismatch between the bonds and the credit derivative.

Question 31: The Board invites comment on the proposed treatment of maturity mismatches in the context of credit risk mitigation.

Unused Credit Lines

Section 252.74(g) of the proposed rule addresses the treatment of any unused portion of certain extensions of credit. In computing its net credit exposure to a counterparty for a credit line or revolving credit facility, a covered company would be permitted to reduce

[73] *See* proposed rule § 252.74(f).

[74] A credit risk mitigant would be adjusted using the formula $Pa = P \times (t - 0.25)/(T - 0.25)$, where Pa is the value of the credit protection adjusted for maturity mismatch; P is the credit protection adjusted for any haircuts; t is the lesser of (1) T or (2) the residual maturity of the credit protection, expressed in years; and T is the lesser of (1) 5 or (2) the residual maturity of the exposure, expressed in years. *See* 12 CFR 217.36(d).

its gross credit exposure by the amount of the unused portion of the credit extension to the extent that the covered company does not have any legal obligation to advance additional funds under the facility until the counterparty provides collateral that qualifies under the credit line or revolving credit facility equal to or greater than the entire used portion of the facility.[75] To qualify for this reduction, the contract governing the extension of credit would be required to specify that any used portion of the credit extension must be fully secured at all times by collateral that is either (i) cash; (ii) obligations of the United States or its agencies; (iii) obligations directly and fully guaranteed as to principal and interest by, the Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation, but only while operating under the conservatorship or receivership of the Federal Housing Finance Agency; or (iv) any additional obligations issued by a U.S. government sponsored entity, as determined by the Board.[76]

Question 32: What alternative approaches should the Board consider concerning the unused portion of certain credit facilities?

Credit Transactions Involving Exempt and Excluded Persons

Section 252.74(h)[77] provides that, if a covered company has reduced its credit exposure to a counterparty that would be exempt under the proposed rule by obtaining eligible collateral from that entity, or by obtaining an eligible guarantee or an eligible credit or equity derivative from an eligible protection provider, the covered company must recognize an exposure to the collateral issuer or eligible protection provider to the same extent as if the underlying exposure were to an entity that is not exempt. Similarly, if a covered company has reduced its exposure to an entity that is excluded from the definition of a ''counterparty'' (*e.g.,* the U.S. government or a foreign sovereign entity that receives a zero percent risk weight under Regulation Q) by obtaining eligible collateral from that entity, or by obtaining an eligible guarantee or an eligible credit or equity derivative from an eligible protection provider, the covered company must recognize an exposure to the collateral issuer or eligible protection provider to the same extent as if the underlying exposure were to an entity that is not excluded from the definition of a counterparty.

Example: A covered company has purchased a credit derivative from an eligible protection provider to hedge the credit risk on a portfolio of U.S. government bonds. The covered company would need to recognize an exposure to the credit protection provider equal to the full notional of the credit derivative (if the bonds are subject to the Board's risk-based capital rules in 12 CFR part 217, subparts D and E) or to the counterparty credit risk measurements obtained by using methodologies that the covered company is permitted to use under the market risk capital rules (if the bonds are subject to the Board's market risk rule in 12 CFR part 217, subpart F).

Question 33: If a covered company has an exempted credit exposure but either (1) receives non-exempt eligible collateral in support of the exempted transaction or (2) obtains a non-exempt eligible guarantee or eligible credit or equity derivative referencing the exempted credit exposure from an eligible protection provider, should the covered company be required to recognize an exposure to the issuer(s) of the collateral or eligible protection provider even though the original credit exposure was exempt? Should the Board consider any alternative treatment in such situations?

Exposures to Funds and Securitizations

Special considerations arise in connection with measuring credit exposure of a covered company to a securitization fund, investment fund or other special purpose vehicle (collectively, SPVs). In some cases, a covered company's failure to recognize an exposure to the issuers of the underlying assets held by an SPV may understate the covered company's credit exposure to those issuers. In other cases, a covered company's credit exposure to the issuers of the underlying assets held by an SPV may be insignificant and, in such cases, requiring a covered company to recognize an exposure to each issuer of underlying assets for every SPV in which a covered company invests could be unduly burdensome.

Under the proposed rule, covered companies that have $250 billion or more in total consolidated assets or $10 billion or more in total on-balance-sheet foreign exposures would be required to analyze their credit exposure to the issuers of the underlying assets in an SPV in which the covered company invests or to which the covered company otherwise has credit exposure. If a covered company cannot demonstrate that its exposure to the issuer of each underlying asset held by an SPV is less than 0.25 percent of the covered company's tier 1 capital (considering only exposures that arise from the SPV), the covered company would be required to apply a ''look-through approach'' and recognize an exposure to each issuer of the assets held by the SPV.[78] Conversely, if a covered company with $250 billion or more in total consolidated assets or $10 billion or more in total on-balance-sheet foreign exposures can demonstrate that its exposure to each underlying asset in an SPV is less than 0.25 percent of the covered company's tier 1 capital (considering only exposures that arise from the SPV), the covered company would be allowed to recognize an exposure solely to the SPV and not to the underlying assets.[79] The proposed 0.25 percent threshold for requiring the use of the look-through approach is intended to strike a balance between the goals of limiting a covered company's exposures to underlying assets in an SPV and avoiding excessive burden. If a covered company with $250 billion or more in total consolidated assets or $10 billion or more in total on-balance-sheet foreign exposures would be required to apply the look-through approach, but is unable to identify an issuer of assets underlying an SPV, the covered company would be required to attribute the exposure to a single ''unknown counterparty.'' The covered company would then be required to aggregate all exposures to an unknown counterparty as if they related to a single counterparty.

The application of the look-through approach would depend on the nature of the investment of the covered company in the SPV. Where all investors in an SPV are *pari passu,* the covered company would calculate its exposure to an issuer of assets held by the SPV as an amount equal to the covered company's pro rata share in the SPV multiplied by the value of the SPV's underlying assets issued by that issuer.

Example: An SPV holds $10 of bonds issued by Company A and $20 of bonds issued by Company B. Assuming that all investors in the SPV are *pari passu* and that a covered company's pro rata share in the SPV is 50 percent, a covered company (with $250 billion or more in total consolidated assets or $10 billion or more in total on-balance-sheet foreign exposures) would need

[75] *See* proposed rule § 252.74(g).

[76] *Id.*

[77] *See* proposed rule § 252.74(h).

[78] *See* proposed rule § 252.75. The calculation of a covered company's exposure to an issuer of assets held by an SPV is discussed in more detail in the following paragraphs.

[79] A covered company's exposure to each underlying asset in an SPV necessarily would be less than 0.25 percent of the covered company's eligible capital base where the covered company's entire investment in the SPV is less than 0.25 percent of the covered company's eligible capital base.

to recognize a $5 exposure to Company A (*i.e.,* 50 percent of $10) and a $10 exposure to Company B (*i.e.,* 50 percent of $20) if the look-through approach is required.

If all investors in an SPV are not *pari passu,* a covered company that is required to use the look-through approach would measure its exposure to an issuer of assets held by the SPV for each tranche in the SPV in which the covered company invests. The covered company would do this using a two-step process. First, the covered company would assume that the total exposure to an issuer of assets held by the SPV among all investors in a given SPV tranche is equal to the lesser of the value of the tranche and the value of the assets issued by the issuer that are held by the SPV. Second, the covered company would multiply this exposure amount by the percentage of the SPV tranche that the covered company holds.

Example: An SPV holds $10 of bonds issued by Company A. The SPV has issued $4 of junior notes and $6 of senior notes to the SPV's investors. A covered company with $250 billion or more in total consolidated assets or $10 billion or more in total on-balance-sheet foreign exposures holds 50 percent of the junior notes and 50 percent of the senior notes. With respect to the junior tranche of the SPV, the lesser of the value of the tranche (*i.e.,* $4) and the value of the underlying assets issued by Company A (*i.e.,* $10) is $4. With respect to the senior tranche of the SPV, the lesser of the value of the tranche (*i.e.,* $6) and the value of the underlying assets issued by Company A (*i.e.,* $10) is $6. Because the covered company has $250 billion or more in total consolidated assets or $10 billion or more in total on-balance-sheet foreign exposures and its pro rata share of each tranche is 50 percent, it would need to recognize $2 of exposure to Company A because of its investment in the junior tranche (*i.e.,* 50 percent of $4), and $3 of exposure to Company A because of its investment in the senior tranche (*i.e.,* 50 percent of $6), assuming the look-through approach is required.

In addition, a covered company with $250 billion or more in total consolidated assets or $10 billion or more in total on-balance-sheet foreign exposures would be required to identify third parties whose failure or distress would likely result in a loss in the value of the covered company's investment in the SPV. For example, the value of an investment by the covered company in an SPV might be reliant on various forms of credit support provided by a financial institution to the SPV. The failure or distress of the credit support provider would then lead to loss in the value of the investment of the covered company in the SPV. Other examples of third parties whose failure or distress could potentially lead to a loss in the value of the covered company's investment in the SPV are originators of assets held by the SPV, liquidity providers to the SPV, and (potentially) fund managers. In such cases, the covered company would be required to recognize an exposure to the relevant third party that is equal to the value of the covered company's investment in the SPV. This requirement would be in addition to the requirements described above to recognize an exposure to the SPV and, if needed, to the issuers of assets held by the SPV.

These proposed requirements for covered companies with $250 billion or more in total consolidated assets or $10 billion or more in total on-balance-sheet foreign exposures would be appropriate in light of the larger systemic footprint of those firms, and is consistent with the direction in section 165(a)(1)(B) of the Dodd-Frank Act to tailor enhanced prudential standards based on factors such as the nature, scope, size, scale, concentration, interconnectedness, and mix of the activities of the company to which the standards apply.[80]

Question 34: Is the proposed treatment of a covered company that has less than $250 billion or more in total consolidated assets and less than $10 billion or more in total on-balance-sheet foreign exposures with respect to its exposures related to SPVs appropriate? What alternatives should the Board consider?

Question 35: Is the proposed treatment of a covered company with $250 billion or more in total consolidated assets or $10 billion or more in total on-balance-sheet foreign exposures with respect to its exposures related to SPVs appropriate? Are there situations in which the proposed treatment would result in recognition of inappropriate amounts of credit exposure concerning an SPV? What alternative approaches should the Board consider?

Question 36: Is the proposed treatment of exposures related to SPVs sufficiently clear? Would further clarification or simplification be appropriate? What modifications should the Board consider? For example, should the Board modify the approach such that a covered company would only be required to use the look-through approach with respect to particular underlying exposures rather than all underlying exposures in the event that the covered company is able to demonstrate that its credit exposure to some of the underlying assets in an SPV is less than 0.25 percent of the covered company's tier 1 capital but not able to make this demonstration with respect to all the underlying assets?

Exemptions

Under the proposal, single-counterparty credit limits would not apply to exposures to the U.S. government or a foreign sovereign entity that receives a zero percent risk weight under Regulation Q because such entities are not included in the definition of a ''counterparty.'' Section 252.77 of the proposed rule sets forth additional exemptions from the single-counterparty credit limits.[81] Section 165(e)(6) of the Dodd-Frank Act states that the Board may, by regulation or order, exempt transactions, in whole or in part, from the definition of the term ''credit exposure'' for purposes of this subsection, if the Board finds that the exemption is in the public interest and is consistent with the purposes of this subsection.[82]

The first exemption from the proposed rule would be for direct claims on, and the portions of claims that are directly and fully guaranteed as to principal and interest by, the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation, while these entities are operating under the conservatorship or receivership of the Federal Housing Finance Agency.[83] This proposed exemption reflects a policy decision that credit exposures to these government-sponsored entities should not be subject to a regulatory limit for so long as the entities are in the conservatorship or receivership of the U.S. government. This approach is consistent with the approach that the Board used in its risk retention rules.[84] As determined by the Board, obligations issued by another U.S. government sponsored entity would also be exempt. The Board requests comment on whether these exemptions are appropriate.

The second exemption from the proposed rule would be for intraday credit exposure to a counterparty.[85] This exemption would help minimize the impact of the rule on the payment and settlement of financial transactions.

The third exemption from the proposed rule would be for trade exposures to a central counterparty that meet the definition of a qualified central counterparty under Regulation Q (QCCPs).[86] These exposures would

[80] 12 U.S.C. 5365(a)(1)(B).

[81] *See* proposed rule § 252.77.

[82] *See* 12 U.S.C. 5365(e)(6).

[83] *See* proposed rule § 252.77(a)(1).

[84] *See* 12 CFR 244.8.

[85] *See* proposed rule § 252.77(a)(2).

[86] *See* proposed rule § 252.71(y); *see also* 12 CFR 217.2.

include potential future exposure arising from transactions cleared by a QCCP and pre-funded default fund contributions.[87] The proposed rule would exempt these exposures to QCCPs from single-counterparty credit limits because of the concern that application of single-counterparty credit limits to these exposures would require firms to spread activity across a greater number of CCPs, which could lead to a reduction in multilateral netting benefits.[88]

The fourth exemption category would implement section 165(e)(6) of the Dodd-Frank Act and provide a catch-all category to exempt any transaction which the Board determines to be in the public interest and consistent with the purposes of section 165(e).[89]

Section 252.77(b) of the proposed rule would implement section 165(e)(6) of the Dodd-Frank Act, which provides a statutory exemption for credit exposures to the Federal Home Loan Banks.

Question 37: Should all trade exposures to QCCPs be exempt from the proposed rules? Is the definition of ''QCCP'' sufficiently clear? Should the Board consider exempting any different or additional exposures to QCCPs? Would additional clarification on these issues be appropriate?

Question 38: Should the Board exempt any additional credit exposures from the limitations of the proposed rule? If so, please explain why.

Compliance

Under section 252.78(a) of the proposed rule, covered companies with less than $250 billion in total consolidated assets and less than $10 billion in total on-balance-sheet foreign exposures would be required to demonstrate compliance with the requirements of the proposed rule as of the end of each calendar quarter.[90] These companies would, however, need to have systems in place that would allow them to calculate compliance on a daily basis and would be required to calculate compliance on a more frequent basis than quarterly if directed to do so by the Board. A covered company with $250 billion or more in total consolidated assets or $10 billion or more in total on-balance-sheet foreign exposures would be required to comply with the requirements of the proposed rule on a daily basis as of the end of each business day. Such covered companies also would be required to submit a monthly compliance report to the Board.[91]

Section 252.78(c) of the proposed rule would address the consequences if a covered company fails to comply with the credit exposure limits.[92] This section states that if a covered company is not in compliance with respect to a counterparty due to a decrease in the covered company's capital, the merger of a covered company with another covered company, or the merger of two unaffiliated counterparties of the covered company, the covered company would not be subject to enforcement actions with respect to such noncompliance for a period of 90 days (or such shorter or longer period determined by the Board to be appropriate to maintain the safety and soundness of the covered company or financial stability), so long as the company uses reasonable efforts to return to compliance with the proposed rule during this period. The covered company would be prohibited from engaging in any additional credit transactions with such a counterparty in contravention of this rule during the non-compliance period, except in cases where the Board determines that such additional credit transactions are necessary or appropriate to preserve the safety and soundness of the covered company or financial stability.[93] In granting approval for any such special temporary exceptions, the Board may impose supervisory oversight and reporting measures that it determines are appropriate to monitor compliance with the foregoing standards.[94]

The Board plans to develop reporting forms for covered companies to use to report credit exposures to their counterparties as those credit exposures would be measured under section 165(e). In addition, section 165(d)(2) of the Dodd-Frank Act directs the Board to require bank holding companies with $50 billion or more in total consolidated assets and nonbank financial companies that are supervised by the Board to prepare period exposure reports.[95] The Board anticipates that 165(d)(2) credit exposure reporting obligations will be informed by the requirements of the 165(e) framework and by any forms that are developed for covered companies to use in reporting their 165(e) exposures.

Question 39: Should the rule provide a cure period for covered companies that fall out of compliance? Under what circumstances should such a cure period be provided, and how long should such a period be?

Question 40: If a cure period is provided, would it be appropriate to generally prohibit additional credit transactions with the affected counterparty during the cure period? Are there additional situations in which additional credit transactions with the affected counterparty would be appropriate? What additional modifications or clarifications should the Board consider with respect to any cure period?

Timing

Under the proposed rule, covered companies with total consolidated assets of less than $250 billion in total consolidated assets and less than $10 billion or more in total on-balance-sheet foreign exposures would be required to comply initially with the proposed rules two years from the effective date of the proposed rules, unless that time is extended by the Board in writing.[96] Covered companies that have $250 billion or more in total consolidated assets or $10 billion or more in total on-balance-sheet foreign exposures would be required to comply initially with the proposed rules one year from the effective date of the rule, unless that time is extended by the Board in writing.[97]

Any company that becomes a covered company after the effective date of the rule would be required to comply with the requirements of the rule beginning on the first day of the fifth calendar quarter after it becomes a covered company, unless that time is accelerated or extended by the Board in writing.[98]

Question 41: Should the Board consider a longer or shorter phase-in period for all or a subset of covered companies? Is a shorter phase-in period for covered companies with $250 billion or more in total consolidated exposures, or $10 billion or more in total on-balance-sheet foreign exposures, compared to firms below these thresholds, appropriate?

Proposed Rule for Foreign Banking Organizations

Background

In February 2014, the Board adopted a final rule establishing enhanced

[87] As initial margin and excess variation margin posted to the QCCP and held in a segregated account by a third party custodian are not subject to counterparty risk, these amounts would not be considered credit exposures under the proposed rule.

[88] *See* proposed rule § 252.77(a)(3).

[89] *See* 12 U.S.C. 5365(e)(6); proposed rule § 252.76(a)(4).

[90] *See* proposed rule § 252.78(a).

[91] *See* proposed rule § 252.78(a).

[92] *See* proposed rule § 252.78(c).

[93] *Id.*

[94] *See* proposed rule § 252.78(d).

[95] 12 U.S.C. 5365(d)(2).

[96] *See* proposed rule § 252.70(g)(1).

[97] *See* proposed rule § 252.70(g)(2).

[98] *See* proposed rule § 252.70(h).

prudential standards for foreign banking organizations with U.S. banking operations and total consolidated assets of $50 billion or more.[99] Under that rule, a foreign banking organization with U.S. non-branch assets of $50 billion or more will be required to form an intermediate holding company (U.S. intermediate holding company) to hold its interests in U.S. bank and nonbank subsidiaries.[100] A foreign banking organization's U.S. intermediate holding company will be subject to enhanced prudential standards on a consolidated basis, including risk-based and leverage capital requirements, liquidity requirements, and risk management standards. Certain enhanced prudential standards also will apply to a foreign banking organization's ''combined U.S. operations,'' which would include a foreign banking organization's U.S. branches and agencies as well as U.S. subsidiaries.

Like the enhanced prudential standards for foreign banking organizations that the Board previously has adopted, the single-counterparty credit limits in this proposed rule would apply to a foreign banking organization with U.S. banking operations and $50 billion or more in total consolidated assets, and to the U.S. intermediate holding company of such a foreign banking organization.

Overview of the Proposed Rule for Foreign Banking Organizations

Similar to the proposed rule to implement section 165(e) of the Dodd-Frank Act for domestic companies, the aggregate net credit exposure of a foreign banking organization or U.S. intermediate holding company with total consolidated assets of $50 billion or more (each a covered entity) to a single counterparty would be subject to one of three increasingly stringent credit exposure limits. Credit exposure limits as applied to foreign banking organizations, as opposed to intermediate holding companies, would only apply with respect to credit exposures of that foreign banking organization's combined U.S. operations (*i.e.,* any U.S. intermediate holding company, including its subsidiaries, plus any U.S. branches or agencies of the foreign banking organization), although the foreign banking organization's total consolidated assets on a worldwide basis would determine whether the credit exposure limits apply.

The first category of limits would apply to covered entities that have less than $250 billion in total consolidated assets and less than $10 billion in on-balance-sheet foreign exposures. Covered entities that have less than $250 billion in total consolidated assets and less than $10 billion in on-balance sheet foreign exposures would be prohibited from having aggregate net credit exposure to an unaffiliated counterparty in excess of 25 percent of the covered entity's total capital stock and surplus, defined under the rule as (1) in the case of a U.S. intermediate holding company, the sum of the U.S. intermediate holding company's total regulatory capital, as calculated under the risk-based capital adequacy guidelines applicable to that U.S. intermediate holding company, plus the balance of the ALLL of the U.S. intermediate holding company not included in tier 2 capital under the capital adequacy guidelines, and (2) in the case of a foreign banking organization, the total regulatory capital of the foreign banking organization on a consolidated basis, as determined in accordance with section 252.171(d) of the proposed rule.[101] The different definition of ''capital stock and surplus'' with respect to a foreign banking organization reflects differences in international accounting standards.

The second category of exposure limits would prohibit any covered entity with $250 billion or more in total consolidated assets or $10 billion or more in total on-balance-sheet foreign exposures, but less than $500 billion in total consolidated assets, from having aggregate net credit exposure to an unaffiliated counterparty in excess of 25 percent of the covered entity's tier 1 capital. For the same reasons as described above with respect to the portion of the proposed rule applicable to covered companies, the proposed single-counterparty credit limits applicable to a covered entity, including both a foreign banking organization and any U.S. intermediate holding company, with $250 billion or more in total consolidated assets or $10 billion or more in total on-balance-sheet foreign exposures would be based on tier 1 capital.

The third category of exposure limits would prohibit any covered entity with total consolidated assets of $500 billion or more (major foreign banking organization or major U.S. intermediate holding company) from having aggregate net credit exposure in excess of 15 percent of the tier 1 capital of the major foreign banking organization or major U.S. intermediate holding company to a major counterparty, and 25 percent of the tier 1 capital of the major foreign banking organization or major U.S. intermediate holding company to any other counterparty. A ''major counterparty'' would be defined as a global systemically important banking organization or a nonbank financial company supervised by the Board. This framework would be consistent with the requirement in section 165(a)(1)(B) of the Dodd-Frank Act that the enhanced standards established by the Board under section 165 increase in stringency based on factors such as the nature, scope, size, scale, concentration, interconnectedness, and mix of the activities of the company.[102] The credit exposure limits are summarized in Table 2.

TABLE 2—SINGLE-COUNTERPARTY CREDIT LIMITS APPLICABLE TO COVERED ENTITIES

Category of covered entities	Applicable credit exposure limit
U.S. intermediate holding companies or foreign banking organizations with less than $250 billion in total consolidated assets and less than $10 billion in on-balance-sheet foreign exposures..	Aggregate net credit exposure of a U.S. intermediate holding company cannot exceed 25 percent of the U.S. intermediate holding company's total regulatory capital plus the balance of its ALLL not included in tier 2 capital under the capital adequacy guidelines in 12 CFR part 252. Aggregate net credit exposure of a foreign banking organization, with respect to its U.S. combined operations, to a counterparty cannot exceed 25 percent of the foreign banking organization's total regulatory capital on a consolidated basis.

[99] *See* 79 FR 17240 (Mar. 27, 2014).

[100] A foreign banking organization's intermediate holding company is not required to hold the foreign banking organization's interest in any company held under section 2(h)(2) of the Bank Holding Company Act, 12 U.S.C. 1841(h)(2).

[101] *See* 12 CFR part 252, subpart L.

[102] 12 U.S.C. 5323, 5365(e).

TABLE 2—SINGLE-COUNTERPARTY CREDIT LIMITS APPLICABLE TO COVERED ENTITIES—Continued

Category of covered entities	Applicable credit exposure limit
U.S. intermediate holding companies or foreign banking organizations with $250 billion or more in total consolidated assets or $10 billion or more in on-balance-sheet foreign exposures..	Aggregate net credit exposure of a U.S. intermediate holding company to a counterparty cannot exceed 25 percent of the U.S. intermediate holding company's tier 1 capital. Aggregate net credit exposure of a foreign banking organization, with respect to its U.S. combined operations, to a counterparty cannot exceed 25 percent of the foreign banking organization's worldwide tier 1 capital.
Major U.S. intermediate holding companies and major foreign banking organizations..	Aggregate net credit exposure of a major U.S. intermediate holding company or, with respect to its combined U.S. operations, of a foreign banking organization to a *major counterparty* cannot exceed 15 percent of the covered entity's tier 1 capital. Aggregate net credit exposure of a major U.S. intermediate holding company or, with respect to its combined U.S. operations, of a foreign banking organization to *other counterparties* cannot exceed 25 percent of the covered entity's tier 1 capital.

Question 42: Should the Board apply these single-counterparty credit limits to all foreign banking organizations that have $50 billion or more in total consolidated assets, regardless of the size of these organizations' combined operations in the United States? Is this application appropriate?

The more stringent limit for major U.S. intermediate holding companies and, with respect to their combined U.S. operations, major foreign banking organizations would be consistent with the Board's discretion under the Dodd-Frank Act to impose such lower single-counterparty credit limits as the Board may determine by regulation to be necessary to mitigate risks to the financial stability of the United States, as well as with the standard in section 165(a)(1)(B) of the Dodd-Frank Act that the Board establish enhanced prudential standards that increase in stringency based on the systemic footprint of the firms to which they apply. The rationale for proposing to apply a 15 percent limit to such exposures is set out in more detail in the discussion in the **SUPPLEMENTARY INFORMATION** concerning the credit exposure limits of the domestic proposed rule.

The proposed approach to identifying a major U.S. intermediate holding company and major foreign banking organization is based only on size, and the Board recognizes that size is only a rough proxy for the systemic footprint of a company. By contrast, the domestic proposed rule would only subject a U.S. banking organization to a 15 percent limit on its exposures to major counterparties if that U.S. banking organization has been identified as a global systemically important banking organization under Method 1 of the Board's G–SIB surcharge rule.[103] These determinations are based on multiple factors, including size, complexity, interconnectedness, cross-border exposure, and substitutability. Imposing stricter limits on exposures of the combined U.S. operations of major foreign banking organizations or major U.S. intermediate holding companies to their respective major counterparties based on a simple asset threshold may not take into account nuances that might be captured by other approaches.

Question 43: Should the Board adopt a different approach in determining which foreign banking organizations, with respect to their combined U.S. operations, and U.S. intermediate holding companies should be treated as major foreign banking organizations or major U.S. intermediate holding companies?

Question 44: Should the Board adopt a different approach to the definition of a ''major counterparty''?

In determining whether a U.S. intermediate holding company complies with these limits, exposures of the U.S. intermediate holding company itself and its subsidiaries would need to be taken into account. Exposures of a foreign banking organization's combined U.S. operations would include exposures of any branch or agency of the foreign banking organization; exposures of the U.S. subsidiaries of the foreign banking organization, including any U.S. intermediate holding company; and any subsidiaries of such subsidiaries (other than any companies held under section 2(h)(2) of the Bank Holding Company Act of 1956).[104] ''Subsidiary'' would be defined in the same manner as under the proposed requirements for domestic covered companies: any company that a parent company directly or indirectly controls for purposes of the Bank Holding Company Act of 1956.[105] For purposes of the proposed rule applicable to covered entities, the definitions of subsidiary, counterparty, and related terms and the economic interdependence, control relationship, and attribution requirements would be the same as under the portions of the proposed rule applicable to covered companies.

Although the major components of the proposed single-counterparty credit limits for foreign banking organizations would be the same as the proposed requirements for domestic covered companies, there are also some differences between the proposed rules. For example, as discussed in more detail below, the proposed single-counterparty credit limits would not apply to exposures of a U.S. intermediate holding company or a foreign banking organization's combined U.S. operations to the foreign banking organization's home country sovereign, regardless of the risk weight assigned to that sovereign under the Board's Regulation Q (12 CFR part 217).

Question 45: As noted, the proposed rule would apply the single-counterparty credit limits to covered entities on a consolidated basis and could, therefore, impact the level of credit exposures of subsidiaries of these covered entities, including depository institutions. Is application on a consolidated basis appropriate?

Question 46: What challenges, if any, would a foreign banking organization face in implementing the requirement that all subsidiaries of the U.S. intermediate holding company and the combined U.S. operations be subject to the proposed single-counterparty credit limit?

[103] 12 CFR 217.402.

[104] 12 U.S.C. 1841(h)(2).

[105] 12 U.S.C. 1841 *et seq.; see* proposed rule § 252.171(dd).

Question 47: What other alternatives to the proposed capital bases should the Board consider in applying single-counterparty credit limits to U.S. intermediate holding companies and the combined U.S. operations of foreign banking organizations?

Question 48: Should tier 1 capital be used as the capital base in applying single-counterparty credit limits to U.S. intermediate holding companies and the combined U.S. operations of foreign banking organizations with $250 billion or more in total consolidated assets, or $10 billion or more in total on-balance-sheet foreign exposures?

Question 49: Should single-counterparty credit limits apply to a foreign banking organization's combined U.S. operations, or is application of single-counterparty credit limits to a foreign banking organization's combined U.S. operations unnecessary in light of the Basel Committee's adoption of a Large Exposures standard?

Gross Credit Exposure

The proposed valuation rules for measuring gross credit exposure to a counterparty would be the same as those set forth in the proposed rule for domestic bank holding companies, other than the proposed valuation rules for derivatives exposures of U.S. branches and agencies that are subject to a qualifying master netting agreement. When calculating a U.S. branch or agency's gross credit exposure to a counterparty for a derivative contract that is subject to a qualifying master netting agreement, a foreign banking organization could choose either to use the exposure at default calculation set forth in the Board's advanced approaches capital rules (12 CFR 217.132(c)) provided that the collateral recognition rules of the proposed rule would apply, or use the gross valuation methodology for derivatives not subject to a qualified master netting agreements.[106] Under this approach, a foreign banking organization would be able to rely on a qualified master netting agreement to which the U.S. branch or agency is subject that covers exposures of the foreign banking organization outside of the U.S. branch and agency network.

Question 50: Is the proposed treatment of derivatives exposures of U.S. branches and agencies that are subject to a qualifying master netting agreement appropriate? What alternatives should the Board consider?

Question 51: Should there be any other differences between the treatment of derivative exposures of a foreign banking organization's combined U.S. operations or U.S. intermediate holding company and the treatment derivative exposures of U.S. covered companies?

Question 52: Should the rule provide a separate process that allows foreign banking organizations to receive Board approval to use internal models to value derivative transactions solely for the purpose of complying with this rule?

Net Credit Exposure

The proposed rule describes how a covered entity would convert gross credit exposure amounts to net credit exposure amounts by taking into account eligible collateral, eligible guarantees, eligible credit and equity derivatives, other eligible hedges (that is, a short position in the counterparty's debt or equity securities), and for securities financing transactions, the effect also of bilateral netting agreements. The proposed treatment described below is generally consistent with the proposed treatment for domestic bank holding companies. However, the definition of ''eligible collateral'' for covered entities would exclude debt or equity securities (including convertible bonds) issued by an affiliate of the U.S. intermediate holding company or the combined U.S. operations of a foreign banking organization, and the definition of ''eligible protection provider'' would exclude the foreign banking organization or any affiliate thereof.[107]

Question 53: Does the proposed approach to the calculation of net credit exposure pose particular concerns for U.S. intermediate holding companies or foreign banking organizations, with respect to their U.S. operations?

Exposures to Funds and Securitizations

The proposed rule's treatment for a covered entity's exposures to funds and securitizations would be the same as the proposed treatment for a domestic covered company's exposures to such entities.[108]

Question 54: Does the proposed treatment of exposures related to SPVs pose particular concerns for foreign banking organizations, with respect to its combined U.S. operations, or U.S. intermediate holding companies?

Exemptions

As noted, section 165(e)(6) of the Dodd-Frank Act permits the Board to exempt transactions from the definition of the term ''credit exposure'' for purposes of this subsection, if the Board finds that the exemption is in the public interest and is consistent with the purposes of this subsection. The proposed rule would provide the same exemptions for the credit exposures of covered entities as the proposed rule provides for credit exposures of domestic covered companies.[109] In addition, the proposed rule would include an additional exemption for a foreign banking organization's exposures to its home country sovereign, notwithstanding the risk weight assigned to that sovereign entity under the Board's Regulation Q (12 CFR part 217).[110] This exemption would recognize that a foreign banking organization's U.S. operations may have exposures to its home country sovereign entity that are required by home country laws or are necessary to facilitate the normal course of business for the consolidated company. This proposed exemption would be in the public interest and consistent with the treatment of credit exposures of covered companies to the U.S. government.

Question 55: Would additional exemptions for foreign banking organizations or the U.S. intermediate holding companies of foreign banking organizations be appropriate? Why or why not?

Compliance

Under the proposed rule, an U.S. intermediate holding company or the combined U.S. operations of a foreign banking organization with less than $250 billion in total consolidated assets, and less than $10 billion in total on-balance-sheet foreign exposures, would be required to comply with the requirements of the proposed rule as of the end of each quarter.[111] Other intermediate holding companies and foreign banking organizations would be required to comply with the proposed rule on a daily basis as of the end of each business day and submit a monthly compliance report demonstrating its daily compliance.[112] A foreign banking organization would be required to ensure the compliance of its U.S. intermediate holding company and its combined U.S. operations. If either the U.S. intermediate holding company or the combined U.S. operations were not in compliance with respect to a counterparty, both of the U.S. intermediate holding company and the combined U.S. operations would be prohibited from engaging in any additional credit transactions with such

[106] *See* proposed rule § 252.173(a)(11).

[107] *See* proposed rule § 252.171(k).

[108] *See* proposed rule § 252.175.

[109] *See* proposed rule § 252.177(a).

[110] *See* proposed rule § 252.177(a)(4).

[111] *See* proposed rule § 252.178(a).

[112] *Id.*

a counterparty, except in cases when the Board determines that such additional credit transactions are necessary or appropriate to preserve the safety and soundness of the foreign banking organization or financial stability.[113] In considering special temporary exceptions, the Board could impose supervisory oversight and reporting measures that it determines are appropriate to monitor compliance with the foregoing standards.[114]

Question 56: Should the rule provide a cure period for covered entities that are not compliant? Under what circumstances should such a cure period be provided, and how long should such a period be?

Question 57: If a cure period is provided, would it be appropriate to generally prohibit additional credit transactions with the affected counterparty during the cure period? Are there additional situations in which additional credit transactions with the affected counterparty would be appropriate? What additional modifications or clarifications should the Board consider with respect to any cure period?

Question 58: Should the Board consider any temporary exceptions particularly for foreign banking organizations or the U.S. intermediate holding companies of foreign banking organizations? In what situations would a temporary exception be appropriate?

Timing

The proposed rule is designed to be less stringent for those foreign banking organizations and U.S. intermediate holding companies whose failure or distress would be less likely to pose a risk to U.S. financial stability. Foreign banking organizations and U.S. intermediate holding companies with less than $250 billion in total consolidated assets and less than $10 billion in total on-balance-sheet foreign assets would be required to comply initially with the proposed rule two years from the effective date of the proposed rule, unless that time is extended by the Board in writing.[115] Foreign banking organizations and U.S. intermediate holding companies with $250 billion or more in total consolidated assets or $10 billion or more in total on-balance-sheet foreign assets would be required to comply initially with the proposed rule one year from the effective date of the rule, unless that time is extended by the Board in writing.[116] Any company that becomes a covered company after the effective date of the rule would be required to comply with the requirements of the rule beginning on the first day of the fifth calendar quarter after it becomes a covered entity, unless that time is accelerated or extended by the Board in writing.[117]

Regulatory Analysis

Paperwork Reduction Act

Certain provisions of the proposed rules contain ''collection of information'' requirements within the meaning of the Paperwork Reduction Act (PRA) of 1995 (44 U.S.C. 3501 through 3521). The Board has reviewed the reporting requirements in sections 252.78(a) and 252.178(a) of the proposed rules under the authority delegated to the Board by Office of Management and Budget (OMB). The Board will address these requirements in a separate notice, such as when the Board proposes reporting forms for companies subject to these rules to use to report credit exposures to their counterparties as those credit exposures would be measured under the proposed rules.

Solicitation of Comments on the Use of Plain Language

Section 722 of the Gramm-Leach Bliley Act (Pub. L. 106–102, 113 Stat. 1338, 1471, 12 U.S.C. 4809) requires the Federal banking agencies to use plain language in all proposed and final rules published after January 1, 2000. The Board has sought to present the proposed rules in a simple and straightforward manner, and invites comment on the use of plain language. For example:

- Have the agencies organized the material to suit your needs? If not, how could they present the proposed rules more clearly?
- Are the requirements in the proposed rules clearly stated? If not, how could the proposed rules 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 would achieve that?
- Is the section format adequate? If not, which of the sections should be changed and how?
- What other changes can the Board incorporate to make the regulation easier to understand?

Regulatory Flexibility Act Analysis

In accordance with section 3(a) of the Regulatory Flexibility Act[118] (RFA), the Board is publishing an initial regulatory flexibility analysis of the proposed rules. The RFA requires an agency either to provide an initial regulatory flexibility analysis with a proposed rule for which a general notice of proposed rulemaking is required or to certify that the proposed rule will not have a significant economic impact on a substantial number of small entities. Based on its analysis and for the reasons stated below, the Board believes that these proposed rules will not have a significant economic impact on a substantial number of small entities. Nevertheless, the Board is publishing an initial regulatory flexibility analysis. A final regulatory flexibility analysis will be conducted after comments received during the public comment period have been considered.

In accordance with section 165 of the Dodd-Frank Act, the Board is proposing to amend Regulation YY to establish single-counterparty credit limits for bank holding companies, foreign banking organizations, and U.S. intermediate holding companies with total consolidated assets of $50 billion or more in order to limit the risks that the failure of any individual firm could pose to those organizations.[119]

Under regulations issued by the Small Business Administration (SBA), a ''small entity'' includes a depository institution, bank holding company, or savings and loan holding company with assets of $550 million or less (small banking organizations).[120] As discussed in the **SUPPLEMENTARY INFORMATION**, the proposed rules generally would apply to bank holding companies, foreign banking organizations, and U.S. intermediate holding companies with total consolidated assets of $50 billion or more. Companies that are subject to the proposed rule have consolidated assets that substantially exceed the $550 million asset threshold at which a banking entity is considered a ''small entity'' under SBA regulations. Because the proposed rules would not apply to any company with assets of $550 million or less, if adopted in final form, the proposed rules would not apply to any ''small entity'' for purposes of the RFA. The Board does not believe that the proposed rules duplicate, overlap, or

[113] *See* proposed rule § 252.178(c).

[114] *See* proposed rule § 252.178(d).

[115] *See* proposed rule §§ 252.170(c)(1)(i) and 252.170(c)(2)(i).

[116] *See* proposed rule §§ 252.170(c)(1)(ii) and 252.170(c)(2)(ii).

[117] *See* proposed rule § 252.170(d).

[118] 5 U.S.C. 601 *et seq.*

[119] *See* 12 U.S.C. 5365(e).

[120] *See* 13 CFR 121.201.

conflict with any other Federal rules. In light of the foregoing, the Board does not believe that the proposed rules, if adopted in final form, would have a significant economic impact on a substantial number of small entities supervised. Nonetheless, the Board seeks comment on whether the proposed rules would impose undue burdens on, or have unintended consequences for, small organizations, and whether there are ways such potential burdens or consequences could be minimized in a manner consistent with section 165(e) of the Dodd-Frank Act.

List of Subjects in 12 CFR Part 252

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

Authority and Issuance

For the reasons stated in the preamble, the Board of Governors of the Federal Reserve System proposes to amend 12 CFR part 252 as follows:

PART 252—ENHANCED PRUDENTIAL STANDARDS (REGULATION YY)

■ 1. The authority citation for part 252 continues to read as follows:

Authority: 12 U.S.C. 321–338a, 1467a(g), 1818, 1831p–1, 1844(b), 1844(c), 5361, 5365, 5366.

■ 2. Add subpart H to read as follows:

Subpart H—Single-Counterparty Credit Limits

Sec.
252.70 Applicability.
252.71 Definitions.
252.72 Credit exposure limits.
252.73 Gross credit exposure.
252.74 Net credit exposure.
252.75 Investments in and exposures to securitization vehicles, investment funds, and other special purpose vehicles.
252.76 Aggregation of exposures to more than one counterparty due to economic interdependence or control relationships.
252.77 Exemptions.
252.78 Compliance.

§ 252.70 Applicability.

(a) *In general.* A covered company is subject to the general credit exposure limit set forth in § 252.72(a).

(b) *Covered companies with $250 billion or more in total consolidated assets or $10 billion or more in total on-balance-sheet foreign exposures.* A covered company with $250 billion or more in total consolidated assets or $10 billion or more in total on-balance-sheet foreign exposures is subject to the credit exposure limit set forth in § 252.72(b).

(c) *Major covered companies.* A major covered company is subject to the credit exposure limit set forth in § 252.72(c).

(d) *Total consolidated assets.* For purposes of this section, total consolidated assets are determined based on:

(1) The average of the bank holding company's total consolidated assets in the four most recent consecutive quarters as reported quarterly on the FR Y–9C; or

(2) If the bank holding company has not filed an FR Y–9C for each of the most recent four quarters, the average of the bank holding company's total consolidated assets in the most recent consecutive quarters as reported quarterly on the bank holding company's FR Y–9Cs.

(e) *Cessation of requirements.* Once a covered company meets the requirements described in paragraphs (a) or (b) of this section, the company shall remain a covered company for purposes of this subpart unless and until the company has less than $50 billion in total consolidated assets as determined based on each of the bank holding company's four most recent FR Y–9Cs.

(1) A bank holding company that has ceased to be a major covered company for purposes of paragraph (c) of this section shall no longer be subject to the requirements of § 252.70(c) beginning on the first day of the calendar quarter following the reporting date on which it ceased to be a major covered company.

(2) Nothing in paragraph (c) of this section shall preclude a company from becoming a covered company pursuant to paragraphs (a) or (b) of this section.

(f) *Measurement date.* For purposes of this section, total consolidated assets are measured on the last day of the quarter used in calculation of the average.

(g) *Initial applicability.*

(1) A covered company that is subject to this subpart under paragraph (a) of this section as of [INSERT EFFECTIVE DATE], must comply with the requirements of this subpart, including § 252.72(a), beginning on [INSERT DATE TWO YEARS FROM EFFECTIVE DATE], unless that time is extended by the Board in writing.

(2) A covered company that is subject to this subpart under paragraph (b) of this section as of [INSERT EFFECTIVE DATE], must comply with the requirements of this subpart, including §§ 252.72(b)–(c), as applicable, beginning on [INSERT DATE ONE YEAR FROM EFFECTIVE DATE], unless that time is extended by the Board in writing.

(3) A company that becomes a covered company subject to this subpart under paragraphs (a), (b), or (c) of this section after the effective date of this part will be subject to the requirements of this subpart in accordance with paragraph (h) of this section.

(h) *Ongoing applicability.* Except as provided in paragraph (g)(1) or (g)(2) of this section, a covered company that is subject to this subpart under paragraphs (a), (b), or (c) of this section must comply with the requirements of §§ 252.72(a)–(c), as applicable, beginning on the first day of the fifth calendar quarter after it becomes a covered company, unless that time is accelerated or extended by the Board in writing.

§ 252.71 Definitions.

For purposes of this subpart:

(a) *Adjusted market value* means:

(1) With respect to the value of securities transferred by the covered company to a counterparty, the sum of:

(i) The market value of the securities; and

(ii) The product of the market value of the securities multiplied by the applicable collateral haircut in Table 1 to § 217.132 of the Board's Regulation Q (12 CFR 217.132); and

(2) With respect to eligible collateral received by the covered company from a counterparty:

(i) The market value of the securities; minus

(ii) The market value of the securities multiplied by the applicable collateral haircut in Table 1 to § 217.132 of the Board's Regulation Q (12 CFR 217.132).

(3) Prior to calculating the adjusted market value pursuant to paragraphs (1) and (2) of this section, with regard to a transaction that meets the definition of ''repo-style transaction'' in § 217.2 the Board's Regulation Q (12 CFR 217.2), the covered company would first multiply the applicable collateral haircuts in Table 1 to § 217.132 of the Board's Regulation Q (12 CFR 217.132) by the square root of ½.

(b) *Aggregate net credit exposure* means the sum of all net credit exposures of a covered company to a single counterparty.

(c) *Bank-eligible investments* means investment securities that a national bank is permitted to purchase, sell, deal in, underwrite, and hold under 12 U.S.C. 24 (Seventh) and 12 CFR part 1.

(d) *Capital stock and surplus* means, with respect to a bank holding company, the sum of the following amounts in each case as reported by the bank holding company on the most recent FR Y–9C report:

(1) The company's tier 1 and tier 2 capital, as calculated under the capital

adequacy guidelines applicable to that bank holding company under the Board's Regulation Q (12 CFR part 217); and

(2) The balance of the allowance for loan and lease losses of the bank holding company not included in its tier 2 capital under the capital adequacy guidelines applicable to that bank holding company under the Board's Regulation Q (12 CFR part 217).

(e) *Counterparty* means:

(1) With respect to a natural person, the person, and members of the person's immediate family;

(2) With respect to a company, the company and all persons that that counterparty

(i) Owns, controls, or holds with power to vote 25 percent or more of a class of voting securities of the person;

(ii) Owns or controls 25 percent or more of the total equity of the person; or

(iii) Consolidates for financial reporting purposes, as described in § 252.72(d), collectively;

(3) With respect to a State, the State and all of its agencies, instrumentalities, and political subdivisions (including any municipalities) collectively;

(4) With respect to a foreign sovereign entity that is not assigned a zero percent risk weight under the standardized approach in the Board's Regulation Q (12 CFR part 217, subpart D), the foreign sovereign entity and all of its agencies and instrumentalities (but not including any political subdivision), collectively; and

(5) With respect to a political subdivision of a foreign sovereign entity such as states, provinces, and municipalities, any political subdivision of a foreign sovereign entity and all of such political subdivision's agencies and instrumentalities, collectively.

(f) *Covered company* means any bank holding company (other than a foreign banking organization that is subject to subpart Q of the Board's Regulation YY), that has $50 billion or more in total consolidated assets, calculated pursuant to § 252.70(d), and all of its subsidiaries.

(g) *Credit derivative* has the same meaning as in § 217.2 of the Board's Regulation Q (12 CFR 217.2).

(h) *Credit transaction* means, with respect to a counterparty:

(1) Any extension of credit to the counterparty, including loans, deposits, and lines of credit, but excluding uncommitted lines of credit;

(2) Any repurchase transaction or reverse repurchase transaction with the counterparty;

(3) Any securities lending or securities borrowing transaction with the counterparty;

(4) Any guarantee, acceptance, or letter of credit (including any endorsement, confirmed letter of credit, or standby letter of credit) issued on behalf of the counterparty;

(5) Any purchase of, or investment in, securities issued by the counterparty;

(6) Any credit exposure to the counterparty in connection with a derivative transaction between the covered company and the counterparty;

(7) Any credit exposure to the counterparty in connection with a credit derivative or equity derivative transaction between the covered company and a third party, the reference asset of which is an obligation or equity security of the counterparty; and

(8) Any transaction that is the functional equivalent of the above, and any other similar transaction that the Board, by regulation, determines to be a credit transaction for purposes of this subpart.

(i) *Depository institution* has the same meaning as in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813(c)).

(j) *Derivative transaction* means any transaction that is a contract, agreement, swap, warrant, note, or option that is based, in whole or in part, on the value of, any interest in, or any quantitative measure or the occurrence of any event relating to, one or more commodities, securities, currencies, interest or other rates, indices, or other assets.

(k) *Eligible collateral* means collateral in which the covered company has a perfected, first priority security interest or the legal equivalent thereof, if outside of the United States (with the exception of cash on deposit and notwithstanding the prior security interest of any custodial agent) and is in the form of:

(1) Cash on deposit with the covered company (including cash held for the covered company by a third-party custodian or trustee);

(2) Debt securities (other than mortgage- or asset-backed securities and resecuritization securities, unless those securities are issued by a U.S. government-sponsored enterprise) that are bank-eligible investments and that are investment grade;

(3) Equity securities that are publicly traded; or

(4) Convertible bonds that are publicly traded.

(l) *Eligible credit derivative* means a single-name credit derivative or a standard, non-tranched index credit derivative, provided that:

(1) The derivative contract is subject to an eligible guarantee and has been confirmed by the protection purchaser and the protection provider;

(2) Any assignment of the derivative contract has been confirmed by all relevant parties;

(3) If the credit derivative is a credit default swap, the derivative contract includes the following credit events:

(i) Failure to pay any amount due under the terms of the reference exposure, subject to any applicable minimal payment threshold that is consistent with standard market practice and with a grace period, if any, that is in line with the grace period of the reference exposure; and

(ii) Receivership, insolvency, liquidation, conservatorship, or inability of the reference exposure issuer to pay its debts, or its failure or admission in writing of its inability generally to pay its debts as they become due and similar events;

(4) The terms and conditions dictating the manner in which the derivative contract is to be settled are incorporated into the contract;

(5) If the contract allows for cash settlement, the contract incorporates a robust valuation process to estimate loss reliably and specifies a reasonable period for obtaining post-credit event valuations of the reference exposure;

(6) If the contract requires the protection purchaser to transfer an exposure to the protection provider at settlement, the terms of at least one of the exposures that is permitted to be transferred under the contract provides that any required consent to transfer may not be unreasonably withheld; and

(7) If the credit derivative is a credit default swap, the contract clearly identifies the parties responsible for determining whether a credit event has occurred, specifies that this determination is not the sole responsibility of the protection provider, and gives the protection purchaser the right to notify the protection provider of the occurrence of a credit event.

(m) *Eligible equity derivative* means an equity derivative, provided that:

(1) The derivative contract has been confirmed by the counterparties;

(2) Any assignment of the derivative contract has been confirmed by all relevant parties; and

(3) The terms and conditions dictating the manner in which the derivative contract is to be settled are incorporated into the contract.

(n) *Eligible guarantee* has the same meaning as in § 217.2 of the Board's Regulation Q (12 CFR 217.2) that is provided by an eligible protection provider.

(o) *Eligible protection provider* has the same meaning as ''eligible guarantor'' in

§ 217.2 of the Board's Regulation Q (12 CFR 217.2).

(p) *Equity derivative* has the same meaning as ''equity derivative contract'' in § 217.2 of the Board's Regulation Q (12 CFR 217.2).

(q) *Financial entity* means:

(1) A depository institution;

(2) A bank holding company;

(3) A savings and loan holding company (as defined in 12 U.S.C. 1467a);

(4) A securities broker or dealer registered with the U.S. Securities and Exchange Commission under the Securities Exchange Act of 1934 (15 U.S.C. 78o *et seq.*);

(5) An insurance company that is subject to the supervision by a State insurance regulator;

(6) A foreign banking organization;

(7) A non-U.S.-based securities firm or a non-U.S.-based insurance company that is subject to consolidated supervision and regulation comparable to that applicable to U.S. depository institutions, securities broker-dealers, or insurance companies;

(8) A central counterparty; and

(9) A legal entity whose main business includes the management of financial assets, lending, factoring, leasing, provision of credit enhancements, securitization, investments, financial custody, proprietary trading, and other financial services.

(r) *Gross credit exposure* means, with respect to any credit transaction, the credit exposure of the covered company before adjusting, pursuant to section 252.74, for the effect of any qualifying master netting agreement, eligible collateral, eligible guarantee, eligible credit derivative, eligible equity derivative, other eligible hedge, and any unused portion of certain extensions of credit.

(s) *Immediate family* means the spouse of an individual, the individual's minor children, and any of the individual's children (including adults) residing in the individual's home.

(t) *Intraday credit exposure* means credit exposure of a covered company to a counterparty that by its terms is to be repaid, sold, or terminated by the end of its business day in the United States.

(u) *Investment grade* has the same meaning as in § 217.2 of the Board's Regulation Q (12 CFR 217.2).

(v) *Major counterparty* means any:

(1) Major covered company and all of its subsidiaries, collectively;

(2) Any foreign banking organization (and all of its subsidiaries, collectively) that meets one of the following conditions:

(i) The foreign banking organization has the characteristics of a global systemically important banking organization under the assessment methodology and the higher loss absorbency requirement for global systemically important banks issued by the Basel Committee on Banking Supervision, as updated from time to time; or

(ii) The Board, using information reported by the foreign banking organization or its U.S. subsidiaries, information that is publicly available, and confidential supervisory information, determines:

(A) That the foreign banking organization would be a global systemically important banking organization under the global methodology;

(B) That the foreign banking organization, if it were subject to the Board's Regulation Q, would be identified as a global systemically important bank holding company under § 217.402 of the Board's Regulation Q; or

(C) That the U.S. intermediate holding company, if it were subject to the Board's Regulation Q, would be identified as a global systemically important bank holding company.

(iii) A foreign banking organization that prepares or reports for any purpose the indicator amounts necessary to determine whether the foreign banking organization is a global systemically important banking organization under the assessment methodology and the higher loss absorbency requirement for global systemically important banks issued by the Basel Committee on Banking Supervision, as updated from time to time, must use the data to determine whether the foreign banking organization has the characteristics of a global systemically important banking organization under the global methodology; and

(3) Any nonbank financial company supervised by the Board.

(w) *Major covered company* means any U.S. bank holding company identified as a global systemically important bank holding company pursuant to 12 CFR 217.402, and all of its subsidiaries.

(x) *Net credit exposure* means, with respect to any credit transaction, the gross credit exposure of a covered company calculated under § 252.73, as adjusted in accordance with § 252.74.

(y) *Qualifying central counterparty* has the same meaning as in § 217.2 of the Board's Regulation Q (12 CFR 217.2).

(z) *Qualifying master netting agreement* has the same meaning as in § 217.2 of the Board's Regulation Q (12 CFR 217.2).

(aa) *Short sale* means any sale of a security which the seller does not own or any sale which is consummated by the delivery of a security borrowed by, or for the account of, the seller.

(bb) *Sovereign entity* means a central national government (including the U.S. government) or an agency, department, ministry, or central bank, but not including any political governmental subdivision such as a state, province, or municipality.

(cc) *Subsidiary* of a specified company means a company that is directly or indirectly controlled by the specified company.

(dd) *Tier 1 capital* means common equity tier 1 capital and additional tier 1 capital, as defined in the Board's Regulation Q (12 CFR part 217).

§ 252.72 Credit exposure limits.

(a) *General limit on aggregate net credit exposure.* No covered company shall have an aggregate net credit exposure to any unaffiliated counterparty that exceeds 25 percent of the consolidated capital stock and surplus of the covered company.

(b) *Limit on aggregate net credit exposure for covered companies with $250 billion or more in total consolidated assets or $10 billion or more in total on-balance-sheet foreign exposures.* No covered company that has $250 billion or more in total consolidated assets or $10 billion or more in total on-balance-sheet foreign exposures shall have an aggregate net credit exposure to any unaffiliated counterparty that exceeds 25 percent of the covered company's tier 1 capital.

(c) *Limit on aggregate net credit exposure of major covered companies to major counterparties.* No major covered company shall have aggregate net credit exposure to any unaffiliated major counterparty that exceeds 15 percent of the tier 1 capital of the major covered company.

(d) For purposes of this subpart, a counterparty and major counterparty shall include any person that the counterparty or major counterparty

(1) Owns, controls, or holds with power to vote 25 percent or more of a class of voting securities of the person;

(2) Owns or controls 25 percent or more of the total equity of the person; or

(3) Consolidates for financial reporting purposes.

§ 252.73 Gross credit exposure.

(a) *Calculation of gross credit exposure.* Except as provided in paragraph (b), the amount of gross credit exposure of a covered company to a counterparty with respect to a credit transactions is, in the case of:

(1) Loans by a covered company to the counterparty and leases in which the covered company is the lessor and the counterparty is the lessee, equal to the amount owed by the counterparty to the covered company under the transaction.

(2) Debt securities held by the covered company that are issued by the counterparty, equal to:

(i) The market value of the securities, for trading and available-for-sale securities; and

(ii) The amortized purchase price of the securities, for securities held to maturity.

(3) Equity securities held by the covered company that are issued by the counterparty, equal to the market value.

(4) Repurchase transactions, equal to the adjusted market value of securities transferred by the covered company to the counterparty.

(5) Reverse repurchase transactions, equal to the amount of cash transferred by the covered company to the counterparty.

(6) Securities borrowing transactions, equal to:

(i) The amount of cash collateral transferred by the covered company to the counterparty; plus

(ii) The adjusted market value of securities collateral transferred by the covered company to the counterparty.

(7) Securities lending transactions, equal to the adjusted market value of securities lent by the covered company to the counterparty.

(8) Committed credit lines extended by a covered company to a counterparty, equal to the face amount of the credit line.

(9) Guarantees and letters of credit issued by a covered company on behalf of a counterparty, equal to the maximum potential loss to the covered company on the transaction.

(10) Derivative transactions between the covered company and the counterparty not subject to a qualifying master netting agreement:

(i) Valued at an amount equal to the sum of

(A) The current exposure of the derivatives contract equal to the greater of the mark-to-market value of the derivative contract or zero; and

(B) The potential future exposure of the derivatives contract, calculated by multiplying the notional principal amount of the derivative contract by the applicable conversion factor in Table 2 to § 217.132 of the Board's Regulation Q (12 CFR 217.132); and

(ii) In cases where a covered company is required to recognize an exposure to an eligible protection provider pursuant to § 252.74(e), the covered company must exclude the relevant derivative transaction when calculating its gross exposure to the original counterparty under this section.

(11) Derivative transactions between the covered company and the counterparty subject to a qualifying master netting agreement:

(i) The derivative transaction shall be valued using any of the methods that the covered company is authorized to use under the Board's Regulation Q (12 CFR part 217, subparts D and E) to value such transactions; and

(ii) In cases where a covered company is required to recognize an exposure to an eligible protection provider pursuant to § 252.74(e), the covered company must exclude the relevant derivative transaction when calculating its gross exposure to the original counterparty under this section.

(12) Credit or equity derivative transactions between the covered company and a third party where the covered company is the protection provider and the reference asset is an obligation or equity security of the counterparty, equal to the maximum potential loss to the covered company on the transaction.

(b) *Investments in and Exposures to Securitization Vehicles, Investment Funds, and Other Special Purpose Vehicles.* A covered company that has $250 billion or more in total consolidated assets or $10 billion or more in total on-balance-sheet foreign exposures shall calculate its gross credit exposure for investments in and exposures to a securitization vehicle, investment fund, and other special purpose vehicle pursuant to § 252.75.

(c) *Attribution rule.* A covered company must treat any credit transaction with any person as a credit transaction with a counterparty, to the extent that the proceeds of the transaction are used for the benefit of, or transferred to, that counterparty.

§ 252.74 Net Credit Exposure.

(a) *In general.* For purposes of this subpart, a covered company shall calculate its net credit exposure to a counterparty by adjusting its gross credit exposure to that counterparty in accordance with the rules set forth in this section.

(b) *Calculation of net credit exposure for repurchase transactions, reverse repurchase transactions, securities lending transactions, and securities borrowing transactions.* With respect to any repurchase transaction, reverse repurchase transaction, securities lending transaction, and securities borrowing transaction with a counterparty that is subject to a bilateral netting agreement with that counterparty and that meets the definition of ''repo-style transaction'' in § 217.2 of the Board's Regulation Q (12 CFR 217.2), a covered company's net credit exposure to a counterparty shall be equal to the exposure at default amount calculated under § 217.37(c)(2) of the Board's Regulation Q (12 CFR 217.37(c)(2)); provided that:

(1) The covered company shall apply the standardized supervisory haircuts as provided in 12 CFR 217.37(c)(3)(iii) of the Board's Regulation (12 CFR 217.37(c)(3)(iii), and is not permitted to use its own internal estimates for haircuts;

(2) The covered company shall, in calculating its net credit exposure to a counterparty as a result of the transactions described in paragraph (b) of this section, disregard any collateral received from that counterparty that does not meet the definition of ''eligible collateral'' in § 252.71(k); and

(3) The covered company shall include the adjusted market value of any eligible collateral, as further adjusted by the application of the maturity mismatch adjustment approach of § 217.36(d) of the Board's Regulation Q (12 CFR 217.36(d)), if applicable, when calculating its gross credit exposure to the collateral issuer, including in instances where the underlying repurchase transaction, reverse repurchase transaction, securities lending transaction, or securities borrowing transaction would not be subject to the credit limits of § 272.72.

(c) *Eligible collateral.*

(1) In computing its net credit exposure to a counterparty for any credit transaction other than transactions described in paragraph (b) of this section, a covered company must reduce its gross credit exposure on the transaction by:

(i) The adjusted market value of any eligible collateral, in cases where the eligible collateral has the same or greater maturity as the credit transactions; or

(ii) The adjusted market value of any eligible collateral, as further adjusted by application of the maturity mismatch adjustment approach of § 217.36(d) of the Board's Regulation Q (12 CFR 217.36(d)), if the eligible collateral has an original maturity equal to or greater than one year and a residual maturity of not less than three months, in cases where the eligible collateral has a shorter maturity than the credit transaction.

(2) A covered company that reduces its gross credit exposure to a counterparty as required under paragraph (c)(1) of this section must

include the adjusted market value of the eligible collateral, as further adjusted by the application of the maturity mismatch adjustment approach of § 217.36(d) of the Board's Regulation Q (12 CFR 217.36(d)), if applicable, when calculating its gross credit exposure to the collateral issuer, including in instances where the underlying credit transaction would not be subject to the credit limits of § 272.72. Notwithstanding the foregoing, in no event will the covered company's gross credit exposure to the issuer of collateral be in excess of its gross credit exposure to the counterparty on the credit transaction.

(d) *Eligible guarantees.*

(1) In calculating net credit exposure to a counterparty for any credit transaction, a covered company must reduce its gross credit exposure to the counterparty by any eligible guarantees from an eligible protection provider that covers the transaction by:

(i) The amount of any eligible guarantees from an eligible protection provider that covers the transaction, in cases where the eligible guarantee has the same or greater maturity as the credit transaction; or

(ii) The amount of any eligible guarantees from an eligible protection provider that covers the transaction as further adjusted by application of the maturity mismatch adjustment approach of § 217.36(d) of the Board's Regulation Q (12 CFR 217.36(d)), if the eligible guarantees have an original maturity equal to or greater than one year and a residual maturity of not less than three months, in cases where the eligible guarantee has a shorter maturity than the credit transaction.

(2) A covered company that reduces its gross credit exposure to a counterparty as required under paragraph (d)(1) must include the amount of eligible guarantees when calculating its gross credit exposure to the eligible protection provider, including in instances where the underlying credit transaction would not be subject to the credit limits of § 272.72. Notwithstanding the foregoing, in no event will the covered company's gross credit exposure to an eligible protection provider with respect to an eligible guarantee be in excess of its gross credit exposure to the counterparty on the credit transaction prior to recognition of the eligible guarantee.

(e) *Eligible credit and equity derivatives.* (1) In calculating net credit exposure to a counterparty for a credit transaction, a covered company must reduce its gross credit exposure to the counterparty by:

(i) The notional amount of any eligible credit or equity derivative from an eligible protection provider, in cases where the eligible credit or equity derivative has a maturity that is the same or greater than the maturity of the credit transaction; or

(ii) The notional amount of any eligible credit or equity derivative from an eligible protection provider, as further adjusted by application of the maturity mismatch adjustment approach of § 217.36(d) of the Board's Regulation Q (12 CFR 217.36(d)), if the eligible credit or equity derivative has an original maturity equal to or greater than one year and a residual maturity of not less than three months, in cases where the eligible credit or equity derivative has a shorter maturity than the credit transaction.

(2)(i) In general, a covered company that reduces its gross credit exposure to a counterparty as provided under paragraph (e)(1) must include the notional amount of the eligible credit or equity derivative from an eligible protection provider, as further adjusted by the application of the maturity mismatch adjustment approach of § 217.36(d) of the Board's Regulation Q (12 CFR 217.36(d)), as applicable, when calculating its gross credit exposure to the eligible protection provider, including in instances where the underlying credit transaction would not be subject to the credit limits of § 272.72. Notwithstanding the foregoing, in no event will the covered company's gross credit exposure to an eligible protection provider with respect to an eligible credit or equity derivative be in excess of its gross credit exposure to that counterparty on the credit transaction prior to recognition of the eligible credit or equity derivative; and

(ii) In cases where the eligible credit or equity derivative is used to hedge covered positions and available-for-sale exposures that are subject to the Board's market risk rule (12 CFR part 217, subpart F) and the counterparty on the hedged transaction is not a financial entity, the amount of credit exposure that a company must recognize to the eligible protection provider is the amount that would be calculated pursuant to § 252.73(a), including in instances where the underlying credit transaction would not be subject to the credit limits of § 272.72.

(f) *Other eligible hedges.* In calculating net credit exposure to a counterparty for a credit transaction, a covered company may reduce its gross credit exposure to the counterparty by the face amount of a short sale of the counterparty's debt or equity security, provided that:

(1) The instrument in which the covered company has a short position is junior to, or *pari passu* with, the instrument in which the covered company has the long position; and

(2) The instrument in which the covered company has a short position and the instrument in which the covered company has the long position are either both treated as trading or available-for-sale exposures or both treated as held-to-maturity exposures.

(g) *Unused portion of certain extensions of credit.* (1) In computing its net credit exposure to a counterparty for a credit line or revolving credit facility, a covered company may reduce its gross credit exposure by the amount of the unused portion of the credit extension to the extent that the covered company does not have any legal obligation to advance additional funds under the extension of credit, until the counterparty provides the amount of adjusted market value of collateral required with respect to the entire used portion of the extension of credit.

(2) To qualify for this reduction, the credit contract must specify that any used portion of the credit extension must be fully secured by collateral that is:

(i) Cash;

(ii) Obligations of the United States or its agencies; or

(iii) Obligations directly and fully guaranteed as to principal and interest by, the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation, while operating under the conservatorship or receivership of the Federal Housing Finance Agency, and any additional obligations issued by a U.S. government-sponsored enterprise as determined by the Board.

(h) *Credit transactions involving exempt and excluded persons.* If a covered company has a credit transaction with any person that is exempt from this subpart under § 252.75, or is otherwise excluded from this subpart, and the covered company has reduced its credit exposure on the credit transaction with that person by obtaining collateral from that person or a guarantee or credit or equity derivative from an eligible protection provider, the covered company shall calculate its credit exposure to the issuer of the collateral or protection provider, as applicable, in accordance with the rules set forth in this section to the same extent as if the credit transaction with the person were subject to the requirements in this subpart, including § 252.72.

§ 252.75 Investments in and exposures to securitization vehicles, investment funds, and other special purpose vehicles.

(a) *In general.* (1) This section applies only to covered companies with $250 billion or more in total consolidated assets or $10 billion or more in on-balance-sheet foreign exposures, subject to paragraph (d) of this section.

(2)(i) If a covered company can satisfy the requirements of paragraph (a)(3) of this section, a covered company must calculate its gross credit exposure to each securitization vehicle, investment fund, and other special purpose vehicle in which it invests pursuant to § 252.73(a), and the covered company is not required to calculate its gross credit exposure to each issuer of assets held by a securitization vehicle, investment fund, or other special purpose vehicle.

(ii) If a covered company cannot satisfy the requirements of paragraph (a)(3), the covered company must calculate its gross credit exposure to each issuer of assets held by a securitization vehicle, investment fund, or other special purpose vehicle using the look-through approach in paragraph (b) of this section.

(3) A covered company is not required to calculate its gross credit exposure to each issuer of assets held by a securitization vehicle, investment fund, or other special purpose vehicle, as applicable, if the covered company can demonstrate that its gross credit exposure to each issuer, considering only the credit exposures to that issuer arising from the covered company's investment in a particular securitization vehicle, investment fund, or other special purpose vehicle, is less than 0.25 percent of the covered company's:

(i) Capital stock and surplus in the case of a covered company subject to the credit exposure limit of § 252.72(a); or

(ii) Tier 1 capital in the case of a covered company subject to the credit exposure limit of § 252.72(b).

(b) *Look-through Approach.* (1) A covered company that cannot satisfy the requirements of paragraph (a)(3) must calculate its gross credit exposure, for purposes of § 252.73(a), to each issuer of assets held by a securitization vehicle, investment fund, or other special purpose vehicle pursuant to paragraph (b)(3).

(2) If a covered company that cannot satisfy the requirements of paragraph (a)(3) of this section is unable to identify each issuer of assets held by a securitization vehicle, investment fund, or other special purpose vehicle, the covered company, for purposes of paragraph (b)(3) of this section, must attribute the gross credit exposure to a single unknown counterparty, and the limits of § 252.72 shall apply to that counterparty as a single counterparty.

(3) A covered company that is required to calculate its gross credit exposure to an issuer of assets held by a securitization vehicle, investment fund, or other special purpose vehicle pursuant to paragraph (b)(1) of this section, or to an unknown counterparty pursuant to paragraph (b)(2) of this section, must calculate the gross credit exposure as follows:

(i) Where all investors in the securitization vehicle, investment fund, or other special purpose vehicle rank *pari passu,* the gross credit exposure is equal to the covered company's pro rata share multiplied by the value of the assets attributed to the issuer or the unknown counterparty, as applicable, that are held within the structure; and

(ii) Where all investors in the securitization vehicle, investment fund, or other special purpose vehicle do not rank *pari passu,* the gross credit exposure is equal to:

(A) The lower of the value of the tranche in which the covered company has invested, calculated pursuant to § 252.73(a), and the value of each asset attributed to the issuer or the unknown counterparty, as applicable, that are held by the securitization vehicle, investment fund, or other special purpose vehicle; multiplied by

(B) The pro rata share of the covered company's investment in the tranche.

(c) *Exposures to Third Parties.* (1) Notwithstanding any other requirement in this section, a covered company must recognize, for purposes of this subpart, a gross credit exposure to each third party that has a contractual or other business relationship with a securitization vehicle, investment fund, or other special purpose vehicle, such as a fund manager or protection provider to such securitization vehicle, investment fund, or other special purpose vehicle, whose failure or material financial distress would cause a loss in the value of the covered company's investment in or exposure to the securitization vehicle, investment fund, or other special purpose vehicle.

(2) For purposes of § 252.72, with respect to a covered company's gross credit exposure to a third party that a covered company must recognize pursuant to paragraph (c)(1) of this section, the covered company shall recognize an exposure to the third party in an amount equal to the covered company's gross credit exposure to the associated securitization vehicle, investment fund, or other special purpose vehicle, in addition to the covered company's gross credit exposure to the associated securitization vehicle, investment fund, or other special purpose vehicle.

(d) Notwithstanding paragraph (a)(1) of this section, in order to avoid evasion of this subpart, the Board may determine, after notice to the covered company and opportunity for hearing, that a covered company with less than $250 billion in total consolidated assets and less than $10 billion in total on-balance-sheet foreign exposures must apply the look-through approach or recognize exposures to third parties that have a contractual or other business relationship for purposes of this subpart.

§ 252.76 Aggregation of exposures to more than one counterparty due to economic interdependence or control relationships.

(a) *Aggregation of Exposures to More than One Counterparty due to Economic Interdependence.* (1)(i) If a covered company has an aggregate net credit exposure to any unaffiliated counterparty that exceeds 5 percent of the consolidated capital stock and surplus of the covered company, or 5 percent of its tier 1 capital in the case of a covered company with $250 billion or more in total consolidated assets or $10 billion or more in total foreign exposures, the covered company shall analyze its relationship with the unaffiliated counterparty under paragraph (a)(2) of this section to determine whether the unaffiliated counterparty is economically interdependent with one or more other unaffiliated counterparties of the covered company.

(ii) For purposes of this paragraph, two counterparties are economically interdependent if the failure, default, insolvency, or material financial distress of one counterparty would cause the failure, default, insolvency, or material financial distress of the other counterparty, taking into account the factors in paragraph (a)(2) of this section.

(iii) If a covered company or the Board determines pursuant to paragraph (a)(2) or (a)(3) of this section, as applicable, that one or more other unaffiliated counterparties of a covered company are economically dependent, the covered company shall aggregate its net credit exposure to the unaffiliated counterparties for all purposes under this subpart, including but not limited to, § 252.72.

(2) In making a determination as to whether any two counterparties are economically interdependent, a covered company shall consider the following factors:

(i) Whether 50 percent or more of one counterparty's gross revenue or gross expenditures are derived from transactions with the other counterparty;

(ii) Whether one counterparty (counterparty A) has fully or partly guaranteed the credit exposure of the other counterparty (counterparty B), or is liable by other means, and the credit exposure is significant enough that counterparty B is likely to default if presented with a claim relating to the guarantee or liability;

(iii) Whether 25 percent or more of one counterparty's production or output is sold to the other counterparty, which cannot easily be replaced by other customers;

(iv) Whether the expected source of funds to repay any credit exposure between the counterparties is the same and at least one of the counterparties does not have another source of income from which the extension of credit may be fully repaid;

(v) Whether the financial distress of one counterparty (counterparty A) is likely to impair the ability of the other counterparty (counterparty B) to fully and timely repay counterparty B's liabilities;

(vi) Whether one counterparty (counterparty A) has made a loan to the other counterparty (counterparty B) and is relying on repayment of that loan in order to satisfy its obligations to the covered company, and counterparty A does not have another source of income that it can use to satisfy its obligations to the covered company; and

(vii) Any other indicia of interdependence that the covered company determines to be relevant to this analysis.

(3) In order to avoid evasion of this subpart, the Board may determine, after notice to the covered company and opportunity for hearing, that one or more unaffiliated counterparties of a covered company are economically dependent for purposes of this subpart. In making any such determination, the Board shall consider the factors in paragraph (a)(2) of this section as well as any other indicia of economic interdependence that the Board determines to be relevant.

(b) *Aggregation of exposures to more than one counterparty due to certain control relationships.* (1) A covered company shall assess whether counterparties are connected by control relationships due to the following factors:

(i) The presence of voting agreements;

(ii) Ability of one counterparty to significantly influence the appointment or dismissal of another counterparty's administrative, management or governing body, or the fact that a majority of members of such body have been appointed solely as a result of the exercise of the first counterparty's voting rights; and

(iii) Ability of one counterparty to exercise a controlling influence over the management or policies of another counterparty.

(2) If a covered company or the Board determines pursuant to paragraph (b)(1) or (b)(3) of this section that one or more other unaffiliated counterparties of a covered company are connected by control relationships, the covered company shall aggregate its net credit exposure to the unaffiliated counterparties for all purposes under this subpart, including but not limited to, § 252.72.

(3) In order to avoid evasion of this subpart, the Board may determine, after notice to the covered company and opportunity for hearing, that one or more unaffiliated counterparties of a covered company are connected by control relationships for purposes of this subpart. In making any such determination, the Board shall consider the factors in paragraph (b)(1) of this section as well as any other control relationships that the Board determines to be relevant.

§ 252.77 Exemptions.

(a) *Exempted exposure categories.* The following categories of credit transactions are exempt from the limits on credit exposure under this subpart:

(1) Direct claims on, and the portions of claims that are directly and fully guaranteed as to principal and interest by, the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation, only while operating under the conservatorship or receivership of the Federal Housing Finance Agency, and any additional obligations issued by a U.S. government-sponsored entity as determined by the Board.

(2) Intraday credit exposure to a counterparty.

(3) Trade exposures to a qualifying central counterparty related to the covered company's clearing activity, including potential future exposure arising from transactions cleared by the qualifying central counterparty and pre-funded default fund contributions.

(4) Any transaction that the Board exempts if the Board finds that such exemption is in the public interest and is consistent with the purpose of this section.

(b) *Exemption for Federal Home Loan Banks.* For purposes of this subpart, a covered company does not include any Federal Home Loan Bank.

(c) *Additional Exemptions by the Board.* The Board may, by regulation or order, exempt transactions, in whole or in part, from the definition of the term ''credit exposure,'' if the Board finds that the exemption is in the public interest and is consistent with the purpose of § 165(e) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. 5365(e)).

§ 252.78 Compliance.

(a) *Scope of compliance.* A covered company with $250 billion or more in total consolidated assets or $10 billion or more in total on-balance-sheet foreign exposures must comply with the requirements of this section on a daily basis at the end of each business day and submit on a monthly basis a report demonstrating its daily compliance. A covered company with less than $250 billion in total consolidated assets and less than $10 billion in total on-balance-sheet foreign exposures must comply with the requirements of this section on a quarterly basis and submit on a quarterly basis a report demonstrating its quarterly compliance, unless the Board determines and notifies that company that more frequent compliance and reporting is required.

(b) *Qualifying Master Netting Agreement.* A covered company must establish and maintain procedures that meet or exceed the requirements of § 217.3(d) of the Board's Regulation Q (12 CFR 217.3(d)) to monitor possible changes in relevant law and to ensure that the agreement continues to satisfy the requirements of a qualifying master netting agreement.

(c) *Noncompliance.* Except as otherwise provided in this section, if a covered company is not in compliance with this subpart with respect to a counterparty solely due to the circumstances listed in paragraphs (c)(1)–(4) of this section, the covered company will not be subject to enforcement actions for a period of 90 days (or such other period determined by the Board to be appropriate to preserve the safety and soundness of the covered company or U.S. financial stability) if the company uses reasonable efforts to return to compliance with this subpart during this period. The covered company may not engage in any additional credit transactions with such a counterparty in contravention of this rule during the compliance period, except in cases where the Board determines that such credit transactions are necessary or appropriate to preserve the safety and soundness of the covered company or U.S. financial stability. In

granting approval for such a special temporary credit exposure limit, the Board will consider the following:

(1) A decrease in the covered company's capital stock and surplus;

(2) The merger of the covered company with another covered company;

(3) A merger of two unaffiliated counterparties; or

(4) Any other circumstance the Board determines is appropriate.

(d) *Other measures.* The Board may impose supervisory oversight and reporting measures that it determines are appropriate to monitor compliance with this subpart.

■ 3. Add subpart Q to read as follows:

Subpart Q—Single-Counterparty Credit Limits

Sec.

§ 252.170 Applicability.

(a) *Foreign banking organizations with total consolidated assets of $50 billion or more.*

(1) *In general.* A foreign banking organization with total consolidated assets of $50 billion or more is subject to the general credit exposure limit set forth in § 252.173(a).

(2) *Foreign banking organizations with $250 billion or more in total consolidated assets or $10 billion or more in total on-balance-sheet foreign exposures.* A foreign banking organization with $250 billion or more in total consolidated assets or $10 billion or more in total on-balance-sheet foreign exposures is subject to the credit exposure limit set forth in § 252.172(b).

(3) *Major foreign banking organizations.* A foreign banking organization with total consolidated assets of $500 billion or more is subject to the credit exposure limit set forth in § 252.172(c).

(4) *Total consolidated assets.* For purposes of this section, total consolidated assets are determined based on:

(i) The average of the foreign banking organization's total consolidated assets in the four most recent consecutive quarters as reported quarterly on the FR Y–7Q; or

(ii) If the foreign banking organization has not filed the FR Y–7Q for each of the four most recent consecutive quarters, the average of the foreign banking organization's total consolidated assets in the most recent consecutive quarters as reported quarterly on the foreign banking organization's FR Y–7Qs; or

(iii) If the foreign banking organization has not yet filed an FR Y–7Q, as determined under applicable accounting standards.

(5) *Cessation of requirements.* A foreign banking organization will remain subject to the requirements of this subpart, including § 252.172(a) and, as applicable, the credit exposure limits of §§ 252.172(b) and (c), unless and until total assets are less than $50 billion (with respect to the requirements in paragraphs (a) and (b)) or $500 billion (with respect to the requirement in paragraph (c)) for each of the four most recent consecutive calendar quarters, either as reported on the foreign banking organization's FR Y–7Q or as determined under applicable accounting standards, to the extent the foreign banking organization has not yet filed an FR Y–7Q.

(i) Nothing in paragraph (a)(3) shall preclude a company from becoming a covered company pursuant to paragraphs (a)(1) or (a)(2) of this section.

(6) *Measurement date.* For purposes of this section, total consolidated assets are measured on the last day of the quarter used in calculation of the average.

(b) *U.S. intermediate holding companies.*

(1) *In general.* A U.S. intermediate holding company is subject to the general credit exposure limit set forth in § 252.172(a).

(2) *U.S. intermediate holding companies with $250 billion or more in total consolidated assets or $10 billion or more in total on-balance-sheet foreign exposures.* A U.S intermediate holding company with $250 billion or more in total consolidated assets or $10 billion or more in total on-balance-sheet foreign exposures is subject to the credit exposure limit set forth in § 252.172(b).

(3) *Major U.S. intermediate holding companies.* A U.S. intermediate holding company that has total consolidated assets of $500 billion or more is subject to the credit exposure limit set forth in § 252.172(c)..

(4) *Total consolidated assets.* For purposes of this paragraph, total consolidated assets are determined based on:

(i) The average of the total consolidated assets for the four most recent consecutive quarters as reported by the U.S. intermediate holding company on its FR Y–9C, or

(ii) If the U.S. intermediate holding company has not filed the FR Y–9C for each of the four most recent consecutive quarters, for the most recent quarter or consecutive quarters as reported on the FR Y–9C, or

(iii) If the U.S. intermediate holding company has not yet filed an FR Y–9C, as determined under applicable accounting standards.

(5) *Cessation of requirements.* A major U.S. intermediate holding company will remain subject to the requirements of this subpart, including § 252.172(a) and, as applicable, the credit exposure limits set forth in §§ 252.172(b) and (c), unless and until total assets are less than $50 billion (with respect to the requirements in paragraphs (a) or (b) of this section) or $500 billion (with respect to the requirement in paragraph (c) of this section) for each of the four most recent consecutive calendar quarters either as reported on its FR Y–9C or as determined under applicable accounting standards, to the extent the foreign banking organization has not yet filed an FR Y–9C.

(i) Nothing in paragraph (b)(3) shall preclude a company from becoming a covered company pursuant to paragraphs (b)(1) or (b)(2) of this section.

(5) *Measurement date.* For purposes of this section, total consolidated assets are measured on the last day of the quarter used in calculation of the average.

(c) *Initial applicability.*

(1) *Foreign banking organizations.* (i) A foreign banking organization that is subject to this subpart under paragraph (a)(1) of this section as of [INSERT EFFECTIVE DATE], must comply with the requirements of this subpart beginning on [INSERT DATE TWO YEARS FROM EFFECTIVE DATE], unless that time is extended by the Board in writing.

(ii) A foreign banking organization that is subject to this subpart under paragraphs (a)(2) or (3) of this section as of [INSERT EFFECTIVE DATE], must comply with the requirements of this subpart, as applicable, beginning on [INSERT DATE ONE YEAR FROM EFFECTIVE DATE].

(2) *U.S. intermediate holding companies.* (i) A U.S. intermediate holding company that is subject to the requirements of this subpart under paragraph (b)(1) of this section as of [INSERT EFFECTIVE DATE], must comply with the requirements of this

subpart beginning on [INSERT DATE TWO YEARS FROM EFFECTIVE DATE], unless that time is extended by the Board in writing.

(ii) A U.S. intermediate holding company that is subject to this subpart under paragraphs (b)(2) or (3) of this section as of [INSERT EFFECTIVE DATE], must comply with the requirements of this subpart, including §§ 252.172(b)–(c), beginning on [INSERT DATE ONE YEAR FROM EFFECTIVE DATE].

(3) A foreign banking organization or U.S. intermediate holding company that becomes subject to the requirements of this subpart after the effective date of the subpart will be subject to the requirements of this subpart in accordance with paragraph (d) of this section.

(d) *Ongoing applicability.*

(1) *Foreign banking organizations.* Except as provided in paragraphs (c)(1) or (c)(2) of this section, a foreign banking organization that becomes subject to the requirements of this subpart after [INSERT EFFECTIVE DATE], must comply with the requirements of this subpart, as applicable, beginning on the first day of the fifth calendar quarter after it becomes subject to those requirements, unless that time is accelerated or extended by the Board in writing.

(2) *U.S. intermediate holding companies.* Except as provided in paragraph (c)(2) of this section, a U.S. intermediate holding company that becomes subject to the requirements of this subpart after [INSERT EFFECTIVE DATE], must comply with the requirements of this subpart, as applicable, on the later of:

(i) The first day of the fifth calendar quarter after it becomes subject to those requirements, or

(ii) The date on which the U.S. intermediate holding company is required to be established, unless that time is accelerated or extended by the Board in writing.

§ 252.171 Definitions.

For purposes of this subpart:

(a) *Adjusted market value* means:

(1) With respect to the value of securities transferred by the covered company to a counterparty, the sum of:

(i) Market value of the securities and

(ii) The product of the market value of the securities multiplied by the applicable collateral haircut in Table 1 to § 217.132 of the Board's Regulation Q (12 CFR 217.132); and

(2) With respect to eligible collateral received by the covered company from a counterparty:

(i) The market value of the securities minus

(ii) The market value of the securities multiplied by the applicable collateral haircut in Table 1 to § 217.132 of the Board's Regulation Q (12 CFR 217.132).

(3) Prior to calculating the adjusted market value pursuant to paragraphs (1) and (2) of this section, with regard to a transaction that meets the definition of ''repo-style transaction'' in § 217.2 the Board's Regulation Q (12 CFR 217.2), the covered company would first multiply the applicable collateral haircuts in Table 1 to § 217.132 of the Board's Regulation Q (12 CFR 217.132) by the square root of ½.

(b) *Aggregate net credit exposure* means the sum of all net credit exposures of a covered entity to a single counterparty.

(c) *Bank-eligible investments* means investment securities that a national bank is permitted to purchase, sell, deal in, underwrite, and hold under 12 U.S.C. 24 (Seventh) and 12 CFR part 1.

(d) *Capital stock and surplus* means:

(1) With respect to a U.S. intermediate holding company, the sum of the following amounts in each case as reported by a U.S. intermediate holding company on the most recent FR Y–9C:

(i) The tier 1 and tier 2 capital of the U.S. intermediate holding company, as calculated under the capital adequacy guidelines applicable to that U.S. intermediate holding company under subpart O of the Board's Regulation YY (12 CFR part 252); and

(ii) The excess allowance for loan and lease losses of the U.S. intermediate holding company not included in tier 2 capital under the capital adequacy guidelines applicable to that U.S. intermediate holding company under subpart O of the Board's Regulation YY (12 CFR part 252); and

(2) With respect to a foreign banking organization, the total regulatory capital as reported on the foreign banking organization's most recent FR Y–7Q or other reporting form specified by the Board.

(e) *Counterparty* means:

(1) With respect to a natural person, the person, and members of the person's immediate family;

(2) With respect to a company, the company and all persons that that counterparty

(i) Owns, controls, or holds with power to vote 25 percent or more of a class of voting securities of the person;

(ii) Owns or controls 25 percent or more of the total equity of the person; or

(iii) Consolidates for financial reporting purposes, as described in § 252.172(d), collectively;

(3) With respect to a State, the State and all of its agencies, instrumentalities, and political subdivisions (including any municipalities) collectively;

(4) With respect to a foreign sovereign entity that is not assigned a zero percent risk weight under the standardized approach in the Board's Regulation Q (12 CFR part 217, subpart D), the foreign sovereign entity and all of its agencies and instrumentalities (but not including any political subdivision), collectively; and

(5) With respect to a political subdivision of a foreign sovereign entity such as states, provinces, and municipalities, any political subdivisions of a foreign sovereign entity and all such political subdivision's agencies and instrumentalities, collectively.

(f) *Covered entity* means:

(1) Any entity that is part of the combined U.S. operations of a foreign banking organization with total consolidated assets of $50 billion or more, calculated pursuant to § 252.170(a), and all of its subsidiaries; and

(2) Any U.S. intermediate holding company of a foreign banking organization with total consolidated assets of $50 billion or more, calculated pursuant to § 252.170(b), and all of its subsidiaries.

(g) *Credit derivative* has the same meaning as in § 217.2 of the Board's Regulation Q (12 CFR 217.2).

(h) *Credit transaction* means:

(1) Any extension of credit, including loans, deposits, and lines of credit, but excluding uncommitted lines of credit;

(2) Any repurchase transaction or reverse repurchase transaction;

(3) Any securities lending or securities borrowing transaction;

(4) Any guarantee, acceptance, or letter of credit (including any endorsement, confirmed letter of credit, or standby letter of credit) issued on behalf of a counterparty;

(5) Any purchase of, or investment in, securities issued by a counterparty;

(6) Any credit exposure to the counterparty in connection with a derivative transaction between the covered company and the counterparty;

(7) Any credit exposure to the counterparty in connection with a credit derivative or equity derivative transaction between the covered company and a third party, the reference asset of which is an obligation or equity security of the counterparty; and

(8) Any transaction that is the functional equivalent of the above, and any other similar transaction that the Board, by regulation, determines to be a credit transaction for purposes of this subpart.

(i) *Depository institution* has the same meaning as in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813(c)).

(j) *Derivative transaction* means any transaction that is a contract, agreement, swap, warrant, note, or option that is based, in whole or in part, on the value of, any interest in, or any quantitative measure or the occurrence of any event relating to, one or more commodities, securities, currencies, interest or other rates, indices, or other assets.

(k) *Eligible collateral* means collateral in which a U.S. intermediate holding company or any part of the foreign banking organization's combined U.S. operations has a perfected, first priority security interest or the legal equivalent thereof, if outside of the United States (with the exception of cash on deposit and notwithstanding the prior security interest of any custodial agent) and is in the form of:

(1) Cash on deposit with the U.S. intermediate holding company or any part of the U.S. operations, the U.S. branch, or the U.S. agency (including cash held for the foreign banking organization or U.S. intermediate holding company by a third-party custodian or trustee);

(2) Debt securities (other than mortgage- or asset-backed securities and resecuritization securities, unless those securities are issued by a U.S. government-sponsored enterprise) that are bank-eligible investments and that are investment grade;

(3) Equity securities that are publicly traded; or

(4) Convertible bonds that are publicly traded; and

(5) Does not include any debt or equity securities (including convertible bonds), issued by an affiliate of the U.S. intermediate holding company or by any part of the foreign banking organization's combined U.S. operations.

(l) *Eligible credit derivative* means a single-name credit derivative or a standard, non-tranched index credit derivative, provided that:

(1) The derivative contract is subject to an eligible guarantee and has been confirmed by the protection purchaser and the protection provider;

(2) Any assignment of the derivative contract has been confirmed by all relevant parties;

(3) If the credit derivative is a credit default swap, the derivative contract includes the following credit events:

(i) Failure to pay any amount due under the terms of the reference exposure, subject to any applicable minimal payment threshold that is consistent with standard market practice and with a grace period that is closely in line with the grace period of the reference exposure; and

(ii) Receivership, insolvency, liquidation, conservatorship, or inability of the reference exposure issuer to pay its debts, or its failure or admission in writing of its inability generally to pay its debts as they become due and similar events;

(4) The terms and conditions dictating the manner in which the derivative contract is to be settled are incorporated into the contract;

(5) If the contract allows for cash settlement, the contract incorporates a robust valuation process to estimate loss reliably and specifies a reasonable period for obtaining post-credit event valuations of the reference exposure;

(6) If the contract requires the protection purchaser to transfer an exposure to the protection provider at settlement, the terms of at least one of the exposures that is permitted to be transferred under the contract provides that any required consent to transfer may not be unreasonably withheld; and

(7) If the credit derivative is a credit default swap, the contract clearly identifies the parties responsible for determining whether a credit event has occurred, specifies that this determination is not the sole responsibility of the protection provider, and gives the protection purchaser the right to notify the protection provider of the occurrence of a credit event.

(m) *Eligible equity derivative* means an equity-linked total return swap, provided that:

(1) The derivative contract has been confirmed by the counterparties;

(2) Any assignment of the derivative contract has been confirmed by all relevant parties; and

(3) The terms and conditions dictating the manner in which the derivative contract is to be settled are incorporated into the contract.

(n) *Eligible guarantee* has the same meaning as in § 217.2 of the Board's Regulation Q (12 CFR 217.2) that is provided by an eligible protection provider.

(o) *Eligible protection provider* has the same meaning as ''eligible guarantor'' in § 217.2 of the Board's Regulation Q (12 CFR 217.2), but does not include the foreign banking organization or any entity that is an affiliate of either the U.S. intermediate holding company or of any part of the foreign banking organization's combined U.S. operations.

(p) *Equity derivative* has the same meaning as ''equity derivative contract'' in § 217.2 of the Board's Regulation Q (12 CFR 217.2).

(q) *Financial entity* means:

(1) A depository institution;

(2) A bank holding company;

(3) A savings and loan holding company (as defined in 12 U.S.C. 1467a);

(4) A securities broker or dealer registered with the U.S. Securities and Exchange Commission under the Securities Exchange Act of 1934 (15 U.S.C. 78o *et seq.*);

(5) An insurance company that is subject to the supervision by a State insurance regulator;

(6) A foreign banking organization;

(7) A non-U.S.-based securities firm or a non-U.S.-based insurance company that is subject to consolidated supervision and regulation comparable to that imposed on U.S. depository institutions, securities broker-dealers, or insurance companies;

(8) A central counterparty; and

(9) A legal entity whose main business includes the management of financial assets, lending, factoring, leasing, provision of credit enhancements, securitization, investments, financial custody, proprietary trading, and other financial services.

(r) *Gross credit exposure* means, with respect to any credit transaction, the credit exposure of the covered company before adjusting, pursuant to section 252.174, for the effect of any qualifying master netting agreement, eligible collateral, eligible guarantee, eligible credit derivative, eligible equity derivative, other eligible hedge, and any unused portion of certain extensions of credit.

(s) *Immediate family* means the spouse of an individual, the individual's minor children, and any of the individual's children (including adults) residing in the individual's home.

(t) *Intraday credit exposure* means credit exposure of the U.S. intermediate holding company or any part of the combined U.S. operations to a counterparty that by its terms is to be repaid, sold, or terminated by the end of its business day in the United States.

(u) *Investment grade* has the same meaning as in § 217.2 of the Board's Regulation Q (12 CFR 217.2).

(v) *Major counterparty* means:

(1) A U.S. company identified as a global systemically important bank holding company pursuant to 12 CFR 217.402;

(2) Any foreign banking organization (and all of its subsidiaries, collectively) that meets one of the following conditions:

(i) The foreign banking organization has the characteristics of a global

systemically important banking organization under the assessment methodology and the higher loss absorbency requirement for global systemically important banks issued by the Basel Committee on Banking Supervision, as updated from time to time; or

(ii) The Board, using information reported by the foreign banking organization or its U.S. subsidiaries, information that is publicly available, and confidential supervisory information, determines:

(A) That the foreign banking organization would be a global systemically important banking organization under the global methodology;

(B) That the foreign banking organization, if it were subject to the Board's Regulation Q, would be identified as a global systemically important bank holding company under § 217.402 of the Board's Regulation Q; or

(C) That the U.S. intermediate holding company, if it were subject to the Board's Regulation Q, would be identified as a global systemically important bank holding company.

(iii) A foreign banking organization that prepares or reports for any purpose the indicator amounts necessary to determine whether the foreign banking organization is a global systemically important banking organization under the assessment methodology and the higher loss absorbency requirement for global systemically important banks issued by the Basel Committee on Banking Supervision, as updated from time to time, must use the data to determine whether the foreign banking organization has the characteristics of a global systemically important banking organization under the global methodology; and

(3) Any nonbank financial company supervised by the Board.

(w) *Major foreign banking organization* means any foreign banking organization that has total consolidated assets of $500 billion or more, calculated pursuant to § 252.170(a)(4).

(x) *Major U.S. intermediate holding company* means a U.S. intermediate holding company that has total consolidated assets of $500 billion or more, calculated pursuant to § 252.170(b)(3).

(y) *Net credit exposure* means, with respect to any credit transaction, the gross credit exposure of a covered company calculated under § 252.173, as adjusted in accordance with § 252.174.

(z) *Qualifying central counterparty* has the same meaning as in § 217.2 of the Board's Regulation Q (12 CFR 217.2).

(aa) *Qualifying master netting agreement* has the same meaning as in § 217.2 of the Board's Regulation Q (12 CFR 217.2).

(bb) *Short sale* means any sale of a security which the seller does not own or any sale which is consummated by the delivery of a security borrowed by, or for the account of, the seller.

(cc) *Sovereign entity* means a central national government (including the U.S. government) or an agency, department, ministry, or central bank, but not including any political governmental subdivision such as a state, province, or municipality.

(dd) *Subsidiary* of a specified company means a company that is directly or indirectly controlled by the specified company.

(ee) *Tier 1 capital* means common equity tier 1 capital and additional tier 1 capital, as defined in subpart O of the Board's Regulation YY (12 CFR part 252).

§ 252.172 Credit exposure limits.

(a) *General limit on aggregate net credit exposure.*

(1) No U.S. intermediate holding company shall have an aggregate net credit exposure to any unaffiliated counterparty in excess of 25 percent of the consolidated capital stock and surplus of the U.S. intermediate holding company.

(2) No foreign banking organization may permit its combined U.S. operations, including, but not limited to, any U.S. intermediate holding company and any subsidiary of any U.S. intermediate holding company, to have an aggregate net credit exposure to any unaffiliated counterparty in excess of 25 percent of the consolidated capital stock and surplus of the foreign banking organization.

(b) *Limit on aggregate net credit exposure for U.S. intermediate holding companies and foreign banking organizations with $250 billion or more in total consolidated assets or $10 billion or more in total on-balance-sheet foreign exposures.*

(1) No U.S. intermediate holding company that has $250 billion or more in total consolidated assets or $10 billion or more in total on-balance-sheet foreign exposures shall have an aggregate net credit exposure to any unaffiliated counterparty that exceeds 25 percent of the tier 1 capital of the U.S. intermediate holding company.

(2) No foreign banking organization that has $250 billion or more in total consolidated assets or $10 billion or more in total on-balance-sheet foreign exposures shall permit its combined U.S. operations, including, but not limited to, any U.S. intermediate holding company and any subsidiary of any U.S. intermediate holding company, to have an aggregate net credit exposure to any unaffiliated counterparty in excess of 25 percent of the tier 1 capital of the foreign banking organization.

(c) *Major U.S. intermediate holding company and major foreign banking organization limits on aggregate net credit exposure to each other.*

(1) No U.S. intermediate holding company shall have an aggregate net credit exposure to any unaffiliated major counterparty in excess of 15 percent of the tier 1 capital of the U.S. intermediate holding company.

(2) No major foreign banking organization may permit its combined U.S. operations to have an aggregate net credit exposure to any unaffiliated major counterparty in excess of 15 percent of the tier 1 capital of the major foreign banking organization.

(d) For purposes of this subpart, a counterparty and major counterparty shall include any person that the counterparty or major counterparty:

(1) owns, controls, or holds with power to vote 25 percent or more of a class of voting securities of the person;

(2) owns or controls 25 percent or more of the total equity of the person; or

(3) consolidates for financial reporting purposes.

§ 252.173 Gross credit exposure.

(a) *Calculation of gross credit exposure for U.S. intermediate holding companies and foreign banking organizations.* Except as provided in paragraph (b) of this section, the amount of gross credit exposure of a U.S. intermediate holding company or, with respect to any part of its combined U.S. operations, a foreign banking organization (each a covered entity), to a counterparty is, in the case of:

(1) Loans by a covered entity to a counterparty and leases in which a covered entity is the lessor and a counterparty is the lessee, an amount equal to the amount owed by the counterparty to the covered entity under the transaction.

(2) Debt securities held by a covered entity that is issued by the counterparty, equal to:

(i) The market value, for trading and available-for-sale securities; and

(ii) The amortized purchase price, for securities held to maturity.

(3) Equity securities held by a covered entity that is issued by the counterparty, equal to the market value.

(4) Repurchase transactions, equal to the adjusted market value of securities

transferred by a covered entity to the counterparty.

(5) Reverse repurchase transactions, equal to the amount of cash transferred by the covered company to the counterparty.

(6) Securities borrowing transactions, equal to:

(i) The amount of cash collateral transferred by the covered entity to the counterparty; plus

(ii) The adjusted market value of securities collateral transferred by the covered entity to the counterparty.

(7) Securities lending transactions, equal to the adjusted market value of securities lent by the covered entity to the counterparty.

(8) Committed credit lines extended by a covered entity to a counterparty, equal to the face amount of the credit line.

(9) Guarantees and letters of credit issued by a covered entity on behalf of a counterparty, equal to the maximum potential loss to the covered entity on the transaction.

(10) Derivative transactions between the covered entity and the counterparty that is not subject to a qualifying master netting agreement:

(i) The derivative transaction shall be valued at an amount equal to the sum of:

(A) The current exposure of the derivatives contract equal to the greater of the mark-to-market value of the derivative contract or zero; and

(B) The potential future exposure of the derivatives contract, calculated by multiplying the notional principal amount of the derivative contract by the applicable conversion factor in Table 2 to § 217.132 of the Board's Regulation Q (12 CFR 217.132).

(ii) In cases where a covered entity is required to recognize an exposure to an eligible protection provider pursuant to section 252.174(e), the covered entity must exclude the relevant derivative transaction when calculating its gross exposure to the original counterparty under this section.

(11) Derivative transactions:

(i) Between a U.S. intermediate holding company and a counterparty that is subject to a qualifying master netting agreement:

(A) The derivative transaction shall be valued using any of the methods that the U.S. intermediate holding company is authorized to use under the Board's Regulation Q (12 CFR part 217, subparts D and E) to value such transactions (provided that the rules governing the recognition of collateral set forth in this subpart shall apply).

(B) In cases where the U.S. intermediate holding company is required to recognize an exposure to an eligible protection provider pursuant to section 252.174(e), the U.S. intermediate holding company must exclude the relevant derivative transaction when calculating its gross exposure to the original counterparty under this section.

(ii) Between an entity within the combined U.S. operations of a foreign banking organization and a counterparty that is subject to a qualifying master netting agreement between an entity within the combined U.S. operations and the counterparty:

(A) The derivative transaction shall be valued at an amount equal to either (1) the exposure at default amount calculated under any of the methods that the covered company is authorized to use under the Board's Regulation Q (12 CFR part 217, subparts D and E) to value such transactions (provided that the rules governing the recognition of collateral set forth in this subpart shall apply); or (2) the gross credit exposure amount calculated under § 252.173(a)(10) of this subpart.

(B) In cases where, the foreign banking organization is required to recognize an exposure to an eligible protection provider pursuant to § 252.174(e), the foreign banking organization must exclude the relevant derivative transaction when calculating its gross exposure to the original counterparty under this section.

(12) Credit or equity derivative transactions between the covered entity and a third party where the covered entity is the protection provider and the reference asset is an obligation or equity security of the counterparty, equal to the maximum potential loss to the covered entity on the transaction.

(b) *Investments in and Exposures to Securitization Vehicles, Investment Funds, and Other Special Purpose Vehicles.* A U.S. intermediate holding company or a foreign banking organization that has $250 billion or more in total consolidated assets or $10 billion or more in total on-balance-sheet foreign exposures shall calculate its gross credit exposure for investments in and exposures to a securitization vehicle, investment fund, and other special purpose vehicle pursuant to § 252.175.

(c) *Attribution rule.* A U.S. intermediate holding company or, with respect to its combined U.S. operations, a foreign banking organization must treat any credit transaction with any person as a credit transaction with a counterparty, to the extent that the proceeds of the transaction are used for the benefit of, or transferred to, that counterparty.

§ 252.174 Net credit exposure.

(a) *In general.* For purposes of this subpart, a U.S. intermediate holding company, or with respect to its combined U.S. operations, a foreign banking organization, shall calculate its net credit exposure to a counterparty by adjusting its gross credit exposure to that counterparty in accordance with the rules set forth in this section.

(b) *Calculation of net credit exposure for repurchase transactions, reverse repurchase transactions, securities lending transactions, and securities borrowing transactions.* With respect to any repurchase transaction, reverse repurchase transaction, securities lending transaction, and securities borrowing transaction with a counterparty that is subject to a bilateral netting agreement with that counterparty and that meets the definition of ''repo-style transaction'' in section 217.2 of the Board's Regulation Q (12 CFR 217.2), the net credit exposure of a U.S. intermediate holding company or, with respect to its combined U.S. operations, a foreign banking organization to a counterparty shall be equal to the exposure at default amount calculated under § 217.37(c)(2) of the Board's Regulation Q (12 CFR 217.37(c)(2)); provided that:

(1) The U.S. intermediate holding company or, with respect to its combined U.S. operations, a foreign banking organization shall apply the standardized supervisory haircuts as provided in 12 CFR 217.37(c)(3)(iii) of the Board's Regulation (12 CFR 217.37(c)(3)(iii), and is not permitted to use its own internal estimates for haircuts;

(2) The U.S. intermediate holding company or, with respect to its combined U.S. operations, a foreign banking organization shall, in calculating its net credit exposure to a counterparty as a result of the transactions described in paragraph (b), disregard any collateral received from that counterparty that does not meet the definition of ''eligible collateral'' in § 252.171(k); and

(3) The U.S. intermediate holding company or, with respect to its combined U.S. operations, a foreign banking organization shall include the adjusted market value of any eligible collateral, as further adjusted by the application of the maturity mismatch adjustment approach of § 217.36(d) of the Board's Regulation Q (12 CFR 217.36(d)), if applicable, when calculating its gross credit exposure to the collateral issuer, including in instances where the underlying repurchase transaction, reverse repurchase transaction, securities

lending transaction, or securities borrowing transaction would not be subject to the credit limits of § 272.172.

(c) *Eligible collateral.*

(1) In computing its net credit exposure to a counterparty for any credit transaction other than transactions described in paragraph (b) of this section, a U.S. intermediate holding company or, with respect to its combined U.S. operations, a foreign banking organization must reduce its gross credit exposure on the transaction by:

(i) The adjusted market value of any eligible collateral, in cases where the eligible collateral has the same or greater maturity as the credit transactions; or

(ii) The adjusted market value of any eligible collateral, as further adjusted by application of the maturity mismatch adjustment approach of § 217.36(d) of the Board's Regulation Q (12 CFR 217.36(d)), but only if the eligible collateral has an original maturity equal to or greater than one year and a residual maturity of not less than three months, in cases where the eligible collateral has a shorter maturity than the credit transaction.

(2) A U.S. intermediate holding company or, with respect to its combined U.S. operations, a foreign banking organization that reduces its gross credit exposure to a counterparty as required under paragraph (c)(1) must include the adjusted market value of the eligible collateral, as further adjusted by the application of the maturity mismatch adjustment approach of § 217.36(d) of the Board's Regulation Q (12 CFR 217.36(d)), if applicable, when calculating its gross credit exposure to the collateral issuer, including in instances where the underlying credit transaction would not be subject to the credit limits of § 272.172. Notwithstanding the foregoing, in no event will the gross credit exposure of the U.S. intermediate holding company or, with respect to its combined U.S. operations, of the foreign banking organization to the issuer of collateral be in excess of its gross credit exposure to the counterparty on the credit transaction.

(d) *Eligible guarantees.*

(1) In calculating net credit exposure to a counterparty for any credit transaction, a U.S. intermediate holding company or, with respect to its combined U.S. operations, a foreign banking organization must reduce its gross credit exposure to the counterparty by any eligible guarantees from an eligible protection provider that covers the transaction by:

(i) The amount of any eligible guarantees from an eligible protection provider that covers the transaction, in cases where the eligible guarantee has the same or greater maturity as the credit transaction; or

(ii) The amount of any eligible guarantees from an eligible protection provider that covers the transaction as further adjusted by application of the maturity mismatch adjustment approach of § 217.36(d) of the Board's Regulation Q (12 CFR 217.36(d)), if the eligible guarantees have an original maturity equal to or greater than one year and a residual maturity of not less than three months, in cases where the eligible guarantee has a shorter maturity than the credit transaction.

(2) A U.S. intermediate holding company or, with respect to its combined U.S. operations, a foreign banking organization that reduces its gross credit exposure to a counterparty as required under paragraph (d)(1) must include the amount of eligible guarantees when calculating its gross credit exposure to the eligible protection provider, including in instances where the underlying credit transaction would not be subject to the credit limits of § 272.172. Notwithstanding the foregoing, in no event will the gross credit exposure of the U.S. intermediate holding company or, with respect to its combined U.S. operations, of the foreign banking organization to an eligible protection provider with respect to an eligible guarantee be in excess of its gross credit exposure to the counterparty on the credit transaction prior to recognition of the eligible guarantee.

(e) *Eligible credit and equity derivatives.*

(1) In calculating net credit exposure to a counterparty for a credit transaction, a U.S. intermediate holding company or, with respect to its combined U.S. operations, a foreign banking organization must reduce its gross credit exposure to the counterparty by:

(i) The notional amount of any eligible credit or equity derivative from an eligible protection provider, in cases where the eligible credit or equity derivative has a maturity that is the same or greater than the maturity of the credit transaction; or

(ii) The notional amount of any eligible credit or equity derivative from an eligible protection provider, as further adjusted by application of the maturity mismatch adjustment approach of § 217.36(d) of the Board's Regulation Q (12 CFR 217.36(d)), but only if the eligible credit or equity derivative has an original maturity equal to or greater than one year and a residual maturity of not less than three months, in cases where the eligible credit or equity derivative has a shorter maturity than the credit transaction.

(2)(i) In general, a U.S. intermediate holding company or, with respect to its combined U.S. operations, a foreign banking organization that reduces its gross credit exposure to a counterparty as provided under paragraph (e)(1) must include the notional amount of the eligible credit or equity derivative from an eligible protection provider, as further adjusted by the application of the maturity mismatch adjustment approach of § 217.36(d) of the Board's Regulation Q (12 CFR 217.36(d)), as applicable, when calculating its gross credit exposure to the eligible protection provider, including in instances where the underlying credit transaction would not be subject to the credit limits of § 272.172. Notwithstanding the foregoing, in no event will the gross credit exposure of the U.S. intermediate holding company or, with respect to its combined U.S. operations, of the foreign banking organization to an eligible provider with respect to an eligible credit or equity derivative be in excess of its gross credit exposure to that counterparty on the credit transaction prior to recognition of the eligible credit or equity derivative; and

(ii) In cases where the eligible credit or equity derivative is used to hedge covered positions and available-for-sale exposures that are subject to the Board's market risk rule (12 CFR part 217, subpart F) and the counterparty on the hedged transaction is not a financial entity, the amount of credit exposure that a company must recognize to the eligible protection provider is the amount that would be calculated pursuant to § 252.173(a), including in instances where the underlying credit transaction would not be subject to the credit limits of § 272.172.

(f) *Other eligible hedges.* In calculating net credit exposure to a counterparty for a credit transaction, a U.S. intermediate holding company or, with respect to its combined U.S. operations, a foreign banking organization may reduce its gross credit exposure to the counterparty by the face amount of a short sale of the counterparty's debt or equity security, provided that:

(1) The instrument in which the covered company has a short position is junior to, or *pari passu* with, the instrument in which the covered company has the long position; and

(2) The instrument in which the covered company has a short position and the instrument in which the

covered company has the long position are either both treated as trading or available-for-sale exposures or both treated as held-to-maturity exposures.

(g) *Unused portion of certain extensions of credit.*

(1) In computing its net credit exposure to a counterparty for a credit line or revolving credit facility, a U.S. intermediate holding company or, with respect to its combined U.S. operations, a foreign banking organization may reduce its gross credit exposure by the amount of the unused portion of the credit extension to the extent that the U.S. intermediate holding company or any part of the combined U.S. operations of the foreign banking organization does not have any legal obligation to advance additional funds under the extension of credit, until the counterparty provides the amount of adjusted market value of collateral of the type described in paragraph (g)(2) of this section in the amount (calculated in accordance with § 252.171 of this subpart) required with respect to the entire used portion of the extension of credit.

(2) To qualify for this reduction, the credit contract must specify that any used portion of the credit extension must be fully secured by collateral that is:

(i) Cash;

(ii) Obligations of the United States or its agencies;

(iii) Obligations directly and fully guaranteed as to principal and interest by, the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation, while operating under the conservatorship or receivership of the Federal Housing Finance Agency, and any additional obligations issued by a U.S. government-sponsored enterprise as determined by the Board; or

(iv) Obligations of the foreign banking organization's home country sovereign entity.

(h) *Credit transactions involving exempt and excluded persons.* If a U.S. intermediate holding company or, with respect to its combined U.S. operations, a foreign banking organization has a credit transaction with any person, exposures to which are exempt from this subpart under § 252.175 or otherwise excluded from the limits in this subpart, and the U.S. intermediate holding company or foreign banking organization has reduced its credit exposure on the credit transaction with that person by obtaining collateral from that person or a guarantee or credit or equity derivative from an eligible protection provider, the U.S. intermediate holding company or foreign banking organization shall calculate its credit exposure to the issuer of the collateral or protection provider, as applicable, in accordance with the rules set forth in this section to the same extent as if the credit transaction with the person were subject to the requirements in this subpart, including § 252.172.

§ 252.175 Investments in and exposures to securitization vehicles, investment funds, and other special purpose vehicles.

(a) *In general.* (1) This section applies only to covered entities with $250 billion or more in total consolidated assets or $10 billion or more in on-balance-sheet foreign exposures, subject to paragraph (d) of this section.

(2)(i) If a covered entity can satisfy the requirements of paragraph (a)(3), a covered company must calculate its gross credit exposure to each securitization vehicle, investment fund, and other special purpose vehicle in which it invests pursuant to § 252.173(a), and the covered entity is not required to calculate its gross credit exposure to each issuer of assets held by a securitization vehicle, investment fund, or other special purpose vehicle.

(ii) If a covered entity cannot satisfy the requirements of paragraph (a)(3), the covered entity must calculate its gross credit exposure to each issuer of assets held by a securitization vehicle, investment fund, or other special purpose vehicle using the look-through approach in paragraph (b) of this section.

(2) A covered entity is not required to calculate its gross credit exposure to each issuer of assets held by a securitization vehicle, investment fund, or other special purpose vehicle, as applicable, if the covered entity can demonstrate that its gross credit exposure to each such issuer, considering only the credit exposures to that issuer arising from the covered entity's investment in a particular securitization vehicle, investment fund, or other special purpose vehicle, is less than 0.25 percent of the covered entity's:

(i) Capital stock and surplus in the case of a covered entity subject to the credit exposure limit of § 252.172(a); or

(ii) Tier 1 capital in the case of a covered company subject to the credit exposure limit of § 252.172(b).

(b) *Look-Through Approach.* (1) A covered entity that cannot satisfy the requirements of paragraph (a)(3) must calculate its gross credit exposure, for purposes of § 252.173(a), to each issuer of assets held by a securitization vehicle, investment fund, or other special purpose vehicle, pursuant to paragraph (b)(3) of this section.

(2) If a covered entity that cannot satisfy the requirements of paragraph (a)(3) is unable to identify each issuer of assets held by a securitization vehicle, investment fund, or other special purpose vehicle, the covered entity, for purposes of paragraph (b)(3) of this section, must attribute the gross credit exposure to a single unknown counterparty, and the limits of § 252.172 shall apply to that counterparty as a single counterparty.

(3) A covered entity that is required to calculate its gross credit exposure to an issuer of assets held by a securitization vehicle, investment fund, or other special purpose vehicle pursuant to paragraph (b)(1), or to an unknown counterparty pursuant to paragraph (b)(2), must calculate the gross credit exposure as follows:

(i) Where all investors in the securitization vehicle, investment fund, or other special purpose vehicle rank *pari passu,* the gross credit exposure is equal to the covered entity's pro rata share multiplied by the value of the assets attributed to the issuer or the unknown counterparty, as applicable, that are held within the structure; and

(ii) Where all investors in the securitization vehicle, investment fund, or other special purpose vehicle do not rank *pari passu,* the gross credit exposure is equal to:

(A) The lower of the value of the tranche in which the covered entity has invested, calculated pursuant to § 252.173(a), and the value of each asset attributed to the issuer or the unknown counterparty, as applicable, that are held by the securitization vehicle, investment fund, or other special purpose vehicle; multiplied by

(B) The pro rata share of the covered entity's investment in the tranche.

(c) *Exposures to Third Parties.* (1) Notwithstanding any other requirement in this section, a covered entity must recognize, for purposes of this subpart, a gross credit exposure to each third party that has a contractual or other business relationship with a securitization vehicle, investment fund, or other special purpose vehicle, such as a fund manager or protection provider, whose failure or material financial distress would cause a loss in the value of the covered entity's investment in or exposure to the securitization vehicle, investment fund, or other special purpose vehicle.

(2) For purposes of § 252.172, with respect to a covered entity's gross credit exposure to a third party that a covered entity must recognize pursuant to paragraph (c)(1), the covered entity shall

recognize an exposure to the third party in an amount equal to the covered entity's gross credit exposure to the associated securitization vehicle, investment fund, or other special purpose vehicle, in addition to the covered entity's gross credit exposure to the associated securitization vehicle, investment fund, or other special purpose vehicle.

(d) Notwithstanding paragraph (a)(1) of this section, in order to avoid evasion of this subpart, the Board may determine, after notice to the covered entity and opportunity for hearing, that a covered entity with less than $250 billion in total consolidated assets and less than $10 billion in total on-balance-sheet foreign exposures must apply the look-through approach or recognize exposures to third parties that have a contractual or other business relationship for purposes of this subpart.

§ 252.176 Aggregation of exposures to more than one counterparty due to economic interdependence or control relationships.

(a) *Aggregation of Exposures to More than One Counterparty due to Economic Interdependence.*

(1)(i) If a U.S. intermediate holding company or, with respect to its combined U.S. operations, a foreign banking organization that has less than $250 billion in total consolidated assets and less than $10 billion in total on-balance-sheet foreign exposures has an aggregate net credit exposure to any unaffiliated counterparty that exceeds 5 percent of the consolidated capital stock and surplus of the covered company, or 5 percent of its tier 1 capital in the case of a U.S. intermediate holding company with $250 billion or more in total consolidated assets or $10 billion or more in total on-balance-sheet foreign exposures, the U.S. intermediate holding company or, with respect to its combined U.S. operations, the foreign banking organization shall analyze its relationship with the unaffiliated counterparty under paragraph (a)(2) of this section to determine whether the unaffiliated counterparty is economically interdependent with one or more other unaffiliated counterparties of the covered company.

(ii) For purposes of this paragraph, two counterparties are economically interdependent if the failure, default, insolvency, or material financial distress of one counterparty would cause the failure, default, insolvency, or material financial distress of the other counterparty, taking into account the factors in paragraph (a)(2) of this section.

(iii) If a U.S. intermediate holding company or, with respect to its combined U.S. operations, a foreign banking organization or the Board determines pursuant to paragraph (a)(2) or (a)(3) of this section, as applicable, that one or more other unaffiliated counterparties of a U.S. intermediate holding company or, with respect to its combined U.S. operations, of a foreign banking organization are economically dependent, the U.S. intermediate holding company or, with respect to its combined U.S. operations, the foreign banking organization shall aggregate its net credit exposure to the unaffiliated counterparties for all purposes under this subpart, including but not limited to § 252.172.

(2) In making a determination as to whether any two counterparties are economically interdependent, a U.S. intermediate holding company or, with respect to its combined U.S. operations, a foreign banking organization shall consider the following factors:

(i) Whether 50 percent or more of one counterparty's gross revenue or gross expenditures are derived from transactions with the other counterparty;

(ii) Whether one counterparty (counterparty A) has fully or partly guaranteed the credit exposure of the other counterparty (counterparty B), or is liable by other means, and the credit exposure is significant enough that counterparty B is likely to default if presented with a claim relating to the guarantee or liability;

(iii) Whether 25 percent or more of one counterparty's production or output is sold to the other counterparty, which cannot easily be replaced by other customers;

(iv) Whether the expected source of funds to repay any credit exposure between the counterparties is the same and at least one of the counterparties does not have another source of income from which the extension of credit may be fully repaid;

(v) Whether the financial distress of one counterparty (counterparty A) is likely to impair the ability of the other counterparty (counterparty B) to fully and timely repay counterparty B's liabilities;

(vi) Whether one counterparty (counterparty A) has made a loan to the other counterparty (counterparty B) and is relying on repayment of that loan in order to satisfy its obligations to the covered company, and counterparty A does not have another source of income that it can use to satisfy its obligations to the covered company; and

(vii) Any other indicia of interdependence that the covered company determines to be relevant to this analysis.

(3) In order to avoid evasion of this section, the Board may determine, after notice to the company and opportunity for hearing, that one or more unaffiliated counterparties of a U.S. intermediate holding company or, with respect to its combined U.S. operations, of a foreign banking organization are economically dependent for purposes of this subpart. In making any such determination, the Board shall consider the factors in paragraph (a)(2) of this section as well as any other indicia of economic interdependence that the Board determines to be relevant.

(b) *Aggregation of exposures to more than one counterparty due to certain control relationships.*

(1) A U.S. intermediate holding company or, with respect to its combined U.S. operations, a foreign banking organization shall assess whether counterparties are connected by control relationships due to the following factors:

(i) The presence of voting agreements;

(ii) Ability of one counterparty to significantly influence the appointment or dismissal of another counterparty's administrative, management or governing body, or the fact that a majority of members of such body have been appointed solely as a result of the exercise of the first counterparty's voting rights; and

(iii) Ability of one counterparty to exercise a controlling influence over the management or policies of another counterparty.

(2) If a U.S. intermediate holding company or, with respect to its combined U.S. operations, a foreign banking organization or the Board determines pursuant to paragraph (b)(1) or (b)(3) of this section that one or more other unaffiliated counterparties of the U.S. intermediate holding company or, with respect to its combined U.S. operations, of the foreign banking organization are connected by control relationships, the U.S. intermediate holding company or, with respect to its combined U.S. operations, the foreign banking organization shall aggregate its net credit exposure to the unaffiliated counterparties for all purposes under this subpart, including but not limited to, § 252.172.

(3) In order to avoid evasion of this section, the Board may determine, after notice to the company and opportunity for hearing, that one or more unaffiliated counterparties of a U.S. intermediate holding company or, with respect to its combined U.S. operations, of a foreign banking organization are connected by control relationships for

purposes of this subpart. In making any such determination, the Board shall consider the factors in paragraph (b)(1) of this section as well as any other control relationships that the Board determines to be relevant.

§ 252.177 Exemptions.

(a) *Exempted exposure categories.* The following categories of credit transactions are exempt from the limits on credit exposure under this subpart:

(1) Direct claims on, and the portions of claims that are directly and fully guaranteed as to principal and interest by, the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation, only while operating under the conservatorship or receivership of the Federal Housing Finance Agency, and any additional obligations issued by a U.S. government-sponsored entity as determined by the Board.

(2) Intraday credit exposure to a counterparty.

(3) Trade exposures to a qualifying central counterparty related to the covered entity's clearing activity, including potential future exposure arising from transactions cleared by the qualifying central counterparty and pre-funded default fund contributions.

(4) Direct claims on, and the portions of claims that are directly and fully guaranteed as to principal and interest by, the foreign banking organization's home country sovereign entity, notwithstanding the risk weight assigned to that sovereign entity under the Board's Regulation Q (12 CFR part 217).

(5) Any transaction that the Board exempts if the Board finds that such exemption is in the public interest and consistent with the purpose of this section.

(b) *Additional Exemptions by the Board.* The Board may, by regulation or order, exempt transactions, in whole or in part, from the definition of the term ''credit exposure,'' if the Board finds that the exemption is in the public interest and is consistent with the purpose of § 165(e) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. 5365(e)).

§ 252.178 Compliance.

(a) *Scope of compliance.* A foreign banking organization or U.S. intermediate holding company with $250 billion or more in total consolidated assets or $10 billion or more in total on-balance-sheet foreign exposures must ensure its compliance with the requirements of this section on a daily basis at the end of each business day and submit to the Board on a monthly basis a report demonstrating its daily compliance. A foreign banking organization or U.S. intermediate holding company with less than $250 billion in total consolidated assets or $10 billion in total on-balance-sheet foreign exposures must comply with the requirements of this section on a quarterly basis and submit on a quarterly basis a report demonstrating its quarterly compliance, unless the Board determines and notifies that company that more frequent compliance and reporting is required.

(b) *Qualifying Master Netting Agreement.* A foreign banking organization must ensure that its U.S. intermediate holding company and combined U.S. operations establish and maintain procedures that meet or exceed the requirements of § 217.3(d) of the Board's Regulation Q (12 CFR 217.3(d)) to monitor possible changes in relevant law and to ensure that the agreement continues to satisfy the requirements of a qualifying master netting agreement.

(c) *Noncompliance.* Except as otherwise provided in this section, either the U.S. intermediate holding company or the foreign banking organization is not in compliance with this subpart solely due to the circumstances listed in §§ 252.178(c)(1)–(4) below, the covered entity will not be subject to enforcement actions for a period of 90 days (or such other period determined by the Board to be appropriate to preserve the safety and soundness of the covered company or U.S. financial stability) if the covered entity uses reasonable efforts to return to compliance with this subpart during this period. Neither the U.S. intermediate holding company nor the combined U.S. operations may engage in any additional credit transactions with such a counterparty in contravention of this subpart, unless the Board determines that such credit transactions are necessary or appropriate to preserve the safety and soundness of the foreign banking organization or U.S. financial stability. In considering this determination, the Board will consider whether any of the following circumstances exist:

(1) A decrease in the U.S. intermediate holding company's or foreign banking organization's capital stock and surplus;

(2) The merger of the U.S. intermediate holding company or foreign banking organization with a bank holding company with total consolidated assets of $50 billion or more, a nonbank financial company supervised by the Board, a foreign banking organization, or U.S. intermediate holding company;

(3) A merger of two unaffiliated counterparties; or

(4) Any other circumstance the Board determines is appropriate.

(d) *Other measures.* The Board may impose supervisory oversight and reporting measures that it determines are appropriate to monitor compliance with this subpart.

By order of the Board of Governors of the Federal Reserve System, March 4, 2016.

Robert deV. Frierson,

Secretary of the Board.

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