

Credit Rating Alternatives

Federal Banking Agencies Issue Proposed Rules Regarding Alternatives to Credit Ratings for Bank Capital and Other Regulatory Purposes

SUMMARY

The Federal banking agencies have recently issued three notices of proposed rulemaking (and applicable related guidance) in connection with the implementation of Section 939A of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “*Dodd-Frank Act*”). Section 939A generally requires that all Federal agencies remove from their regulations references to and requirements of reliance on credit ratings and replace them with appropriate alternatives for evaluating creditworthiness.

Market Risk Capital NPR:

The Office of the Comptroller of the Currency (the “*OCC*”), the Board of Governors of the Federal Reserve System (the “*Federal Reserve*”) and the Federal Deposit Insurance Corporation (the “*FDIC*” and, together with the Federal Reserve and the OCC, the “*agencies*”) issued a joint notice of proposed rulemaking (the “*Market Risk Capital NPR*”) concerning their market risk capital rules applicable to certain U.S. banking organizations with significant trading operations by proposing standards of creditworthiness to be used in place of credit ratings when calculating the specific risk capital requirements for covered debt and securitization positions, including the following:

- **Sovereigns.** Specific risk-weighting factors for debt issued by sovereigns would generally be based on the Country Risk Classification (“*CRC*”) established for the relevant sovereign by the Organization for Economic Co-operation and Development (the “*OECD*”). Exposures to the U.S. government and its agencies would receive a specific risk-weighting factor of zero percent.
- **Certain Supranational Entities and Multilateral Development Banks.** Debt exposures to the Bank for International Settlements, the European Central Bank, the European Commission and the International Monetary Fund would receive a zero percent specific risk-weighting factor. Debt exposures to certain specified multilateral development banks (“*MDBs*”) also would receive a zero percent specific risk-weighting factor as would exposures to any other multilateral lending institution or regional development bank in which the U.S. government is a shareholder or contributing member.

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- **Government Sponsored Entities (“GSEs”).** Specific risk-weighting factors for debt positions in GSEs, including the Federal National Mortgage Association (“*Fannie Mae*”) and the Federal Home Loan Mortgage Corporation (“*Freddie Mac*”), would vary from 0.25 to 1.6 percent, based on maturity. Equity exposures (including GSE preferred stock) would be assigned a specific risk-weighting factor of 8.0 percent.
- **Depository Institutions, Foreign Banks and Credit Unions.** Specific risk-weighting factors for debt exposures to depository institutions, foreign banks and credit unions would range from 0.25 to 12.0 percent depending on the CRC of the country of incorporation of the relevant issuer. Depository institutions, foreign banks and credit unions incorporated in countries with no CRC would be assigned a specific risk-weighting factor of 8.0 percent.
- **Public Sector Entities (“PSEs”).** Specific risk-weighting factors for PSE exposures would range from 0.25 to 12.0 percent depending on the CRC of the PSE’s home country, as well as whether the exposure is a general obligation or revenue obligation. PSE’s in countries with no CRC would receive a specific risk-weighting factor of 8.0 percent.
- **Corporate Debt.** Positions in publicly traded nonfinancial companies would be assigned a specific risk-weighting factor based on an indicator-based methodology that requires banks to determine the leverage, cash flow and stock price volatility of the applicable company (based on publicly available financial data) and, in certain cases where the stock price volatility and leverage of the public company is sufficiently low, the remaining maturity of the position. Positions in non-publicly traded companies and financial companies would receive a specific risk-weighting factor of 8.0 percent.
- **Securitizations.** Specific risk-weighting factors would be calculated using a simplified version of the Basel II advanced-approaches supervisory formula approach. The simplified formula has several inputs, including (i) a weighted-average capital requirement based on the underlying exposures of the securitization, (ii) the position’s level of subordination and relative size within the securitization and (iii) the level of losses actually experienced on the underlying exposures. This approach would apply a 100 percent specific risk-weighting factor to securitization positions that absorb losses up to the amount of capital that is required for the underlying exposures under the agencies’ general risk-based capital rules if they were held directly by the relevant bank.

The agencies have indicated that similar methodologies to those proposed in the Market Risk Capital NPR may be incorporated into their risk-based capital rules more generally.

The Market Risk Capital NPR also considers, and requests comments on, several alternatives to the methodologies described above, including the methodologies proposed for determining the specific risk-weighting factors for corporate debt and securitizations.

Comments are due by February 3, 2012.

Investment Securities NPRs:

The OCC issued a notice of proposed rulemaking that would remove references to credit ratings from various OCC regulations, including the definition of “investment grade” in 12 C.F.R., part 1 (which is used, in part, to determine whether a national bank is permitted to hold particular securities). The proposed rule would provide that a security would be “investment grade” (and therefore generally eligible for purchase by a national bank if other provisions are satisfied) if the issuer of the security has an “adequate capacity” to meet financial commitments under the instrument for the projected life of the assets or exposures, thereby removing references to credit ratings from these regulations. In determining whether an issuer

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satisfies this standard, banks would be permitted to consult external credit ratings, although a bank must supplement external ratings with due diligence processes and analyses appropriate for the bank's risk profile and for the size and complexity of the instrument.

The OCC also issued related guidance to clarify steps national banks should ordinarily take to demonstrate that they have verified their investments meet the credit quality standards set forth in the OCC's proposed rule, steps to be taken in connection with the purchase of investment securities and ongoing reviews of investment portfolios. The FDIC issued a similar notice of proposed rulemaking (such notice of proposed rulemaking, together with the OCC's notice of proposed rulemaking described above, the "*Investment Securities NPRs*") and related guidance with respect to savings associations.

Comments on the OCC's Investment Securities NPR and the FDIC's Investment Securities NPR are due by December 29, 2011 and February 13, 2012, respectively.

BACKGROUND

Section 939A the Dodd-Frank Act requires Federal agencies, by not later than July 21, 2011, to review their regulations that require an assessment of credit-worthiness of a security or money market instrument and "any references or requirements in such regulations regarding credit ratings". Section 939A goes on to require Federal agencies to replace any references to credit ratings with an appropriate alternate standard of creditworthiness, but it does not specify a date by which such replacement must occur. In August of 2010, the OCC, the Federal Reserve, the FDIC and the then existing Office of Thrift Supervision released a joint advance notice of proposed rulemaking seeking comment on the feasibility of certain proposed alternatives to the use of credit agency ratings in the respective agencies' risk-based capital guidelines as mandated by Section 939A. The OCC also issued a similar advanced notice in connection with its investment securities regulations.¹ The Market Risk Capital NPR and Investment Securities NPRs generally acknowledge the comments received in connection with the August 2010 advanced notices and now propose concrete alternatives to the use of credit ratings.

The Market Risk Capital NPR amends and supplements an earlier notice of proposed rulemaking released in January 2011 (the "*January NPR*").² The January NPR proposed modifications to the agencies' market risk capital ("*MRC*") rules currently in effect (which apply to certain banking organizations with significant trading operations)³ to implement various revisions to the market risk framework adopted by the Basel Committee on Banking Supervision (the "*BCBS*")⁴ between April 2005 and June 2010.⁵ The January NPR, however, did not include the methodologies adopted by the BCBS for calculating the standard specific risk capital requirements for certain debt and securitization positions, because these methodologies relied on credit ratings.

Specific risk under the current MRC rules⁶ relates to changes in the market value of a position from factors other than general market movements (for example, the declaration of bankruptcy by the issuer of

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a debt instrument). By contrast, general market risk relates to changes that affect the value of all positions in a bank's trading account, such as changes in interest rates. Under the MRC rules, a bank may use an internal model to measure specific risk if it has demonstrated to its supervisor that the model adequately measures the specific risk of its debt and equity positions. If it is not permitted to use a model, it must calculate its specific risk capital requirement or "add-on" using a standardized method.

In order to determine the amount of capital required for a given position (subject to the MRC rules), the specific risk-weighting factor for a given position (for example, a sovereign debt security held in the trading book) is first multiplied by the value of that position (as determined under applicable market risk rules). This figure is then converted into a market risk equivalent asset by multiplying it by 12.5 and added to the denominator of a bank's risk-based capital ratios. For example, a specific risk-weighting factor of (i) 0.25 percent equates to a risk-weighting of 3.125 percent (that is, 0.25 percent times 12.5), (ii) 8 percent equates to a risk-weighting of 100 percent, (iii) 12 percent equates to a risk weighting of 150 percent and (iv) 100 percent equates to a risk-weighting of 1250 percent (or approximately equivalent to a dollar-for-dollar deduction from capital in the numerator of the capital ratios).

MARKET RISK CAPITAL NPR

The Market Risk Capital NPR generally sets forth the following methodologies for calculating the specific risk "add-on" for debt and securitization positions that replace the BCBS's use of credit ratings for that purpose.

A. SOVEREIGN DEBT POSITIONS

The current MRC Rules base the risk-weighting factors for sovereign debt positions on membership in the OECD, with exposures to sovereign entities that are OECD members receiving a zero percent specific risk-weighting factor and exposures to non-OECD members receiving an 8.0 percent risk-weighting factor. The BCBS market risk framework would apply a specific risk-weighting factor based on the sovereign's external credit rating; sovereigns that were highly rated would also be subject to a more granular charge based on the remaining maturity of the position.

Under the Market Risk Capital NPR, a bank⁷ would determine its specific risk-weighting factors for sovereign debt positions based on the sovereign entity's CRC as established by the OECD.⁸ The CRC methodology classifies countries into categories based on the OECD's country risk assessment model ("CRAM"), which produces a quantitative assessment of country credit risk as well as a qualitative assessment of CRAM results that is meant to incorporate political risk and other factors not captured by the CRAM. These components are combined and countries are assigned to one of eight categories (0-7), with countries assigned to category zero having the lowest risk assessment and those in category 7 having the highest. The proposed specific risk-weighting factors for sovereign debt positions are set forth in Table 1 of *Annex A* hereto.

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Certain exceptions apply to this general methodology:

- A lower specific risk-weighting factor may be assigned to a position if (i) the position is denominated in the sovereign entity's currency, (ii) the bank has at least an equivalent amount of liabilities in that currency and (iii) the sovereign entity permits banks under its jurisdiction to assign the lower specific risk-weighting factor to the same exposures.
- Exposures to the U.S. government and its agencies always would be treated as having a CRC of 0, and thus would receive a specific risk-weighting factor of zero percent.
- If a sovereign defaulted on any exposure during the previous five years, a specific risk-weighting factor of 12.0 percent would apply. This provision generally would be triggered by noncompliance by the sovereign with its debt obligations or the sovereign's failure to service an existing obligation according to its original contractual terms, as evidence by failure to pay principal and interest timely and fully, arrearages or a restructuring.

The Market Rule NPR states that the use of the OECD's CRC methodology instead of private credit ratings is justified by the fact that the OECD "is not subject to conflicts of interest" as it "is not a commercial entity that produces credit assessments for fee-paying clients".

The Market Risk Capital NPR also asks for comments concerning how well the proposed CRC methodology reflects the relative risk of sovereign debt exposures generally as well as two additional "market-based" alternative approaches. One method relies on credit default swap ("CDS") spreads to assign specific risk-weighting factors, with higher CDS spreads resulting in assignments of higher risk-weighting factors. The assumption is that CDS spreads reflect market expectations of default risk. The agencies suggest that such an approach could be used in combination with the CRC approach outlined above by taking the higher of the specific risk-weighting factors determined based on each of the respective approaches. A similar approach using sovereign bond spreads was also considered, although the agencies note that, because sovereign bonds are often denominated in the currency of the country, yields on those bonds would reflect factors other than credit risk, such as the sovereign's inflation rate.

B. CERTAIN SUPRA-NATIONAL ENTITIES AND MDBS

Under the current MRC rules, exposures to certain supranational entities and MDBs are assigned specific risk-weighting factors ranging from 0.25 to 1.6 percent, depending on their remaining maturity. The BCBS market risk framework did not alter this treatment.

Under the Market Risk Capital NPR, debt exposures to the Bank for International Settlements, the European Central Bank, the European Commission and the International Monetary Fund would receive a zero percent specific risk-weighting factor. Debt exposures to certain other specified MDBs⁹ would also receive a zero percent specific risk-weighting factor as would exposures to any other multilateral lending institution or regional development bank in which the U.S. government is a shareholder or contributing member, or which the bank's primary Federal supervisor determines poses comparable credit risk. Debt exposures to regional development banks and other multilateral lending institutions not meeting these

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requirements generally would be subject to the methodologies governing corporate debt positions described below.

C. GOVERNMENT SPONSORED ENTITIES

The Market Risk Capital NPR defines a GSE to include any entity established or chartered by the U.S. government to serve public purposes specified by the U.S. Congress, but the obligations of which are not explicitly guaranteed by the full faith and credit of the U.S. Government. Currently these include Freddie Mac, Fannie Mae, the Farm Credit System and the Federal Home Loan Bank System.

As under the current MRC rules, specific risk-weighting factors for GSE debt exposures would vary from 0.25 to 1.6 percent, based on maturity. GSE equity exposures (such as Fannie Mae and Freddie Mac preferred stock) would be assigned a specific risk-weighting factor of 8.0 percent.

D. DEPOSITORY INSTITUTIONS, FOREIGN BANKS AND CREDIT UNIONS

The current MRC rules generally assign specific risk-weighting factors ranging from 0.25 to 1.6 percent, depending on the remaining maturity of the position, to bank debt exposures if the investee bank is incorporated in an OECD country. A debt exposure to a bank that is not incorporated in an OECD country may receive a similar specific risk-weighting factor if certain conditions are met, including the presence of an investment grade credit rating or an assessment of comparable credit quality by the investor. Credit ratings are also used for such exposures under the BCBS market risk framework.

Under the Market Risk Capital NPR, debt exposures to depository institutions, foreign banks or credit unions would receive specific risk-weighting factors based on the CRC of the entity's country of incorporation, rather than whether the sovereign is an OECD country. For exposures to banks in certain low-risk countries, specific risk-weighting factors would also vary based on the remaining maturity of the position. The proposed specific risk-weighting factors for depository institution, foreign bank and credit union debt positions are set forth in Table 2 of *Annex A* hereto.

In addition, consistent with the agencies' general risk-based capital rules, a debt position in a depository institution or foreign bank that is includable in the investee entity's regulatory capital but not subject to deduction as a reciprocal holding would receive a specific risk-weighting factor of at least 8.0 percent.

The agencies seek comment on how well the proposed methodology assigns specific risk weighting factors that are commensurate with the relative risk of these exposures.

E. PUBLIC SECTOR ENTITIES

Under the current MRC rules, general obligations of states and other political subdivisions of OECD countries are assigned specific risk-weighting factors ranging from 0.25 to 1.6 percent, based on maturity. Revenue obligations of states and other political subdivisions of OECD countries may receive similar treatment only if certain conditions are met, including the presence of an investment grade credit rating or

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an assessment of comparable credit quality by the investor. The BCBS market risk framework similarly incorporates credit ratings in the assignment of specific risk-weighting factors.

The Market Risk Rule defines a PSE as a state, local authority or other governmental subdivision below the sovereign entity level. This definition would exclude government-owned commercial companies engaging in activities involving trade, commerce or profit, which generally are conducted in the private sector.

Under the Market Risk Capital NPR, specific risk-weighting factors for PSE exposures would be based on the CRC of the PSE's country of incorporation, as well as whether the exposure is a general obligation or revenue obligation, as set forth in Tables 3 and 4 of *Annex A* hereto. The specific risk-weighting factor for exposures to PSEs in lower-risk countries would vary based on the remaining maturity of the position.

Consistent with past agency practice, the Market Risk Capital NPR would permit a banking organization to assign a lower specific risk-weighting factor to a foreign PSE exposure if the PSE's home country permits banks under its jurisdiction to assign a lower specific risk-weighting factor to the exposure, although this factor may not be lower than the lowest factor assigned to that PSE's home sovereign.

The agencies seek comment on how well the proposed methodology assigns specific risk-weighting factors to PSE exposures in a consistent manner and in a way that is commensurate with the relative risk of these exposures.

F. CORPORATE DEBT POSITIONS

1. Non-Financial, Publicly Traded Corporate Entities

Under the current MRC rules, the specific risk-weighting factor for covered corporate debt positions is a function of the type of obligor, the credit rating of the obligor and the remaining maturity of the exposure, ranging from 0.25 to 8.0 percent based, in part, on whether the instrument was rated investment grade and the remaining term to maturity.¹⁰

The BCBS market risk framework made several changes to the existing MRC framework, including creating a specific risk-weighting factor of 12.0 percent for debt positions rated more than two categories below investment grade.¹¹

Under the Market Risk Capital NPR, an "indicator-based methodology" would be used to assign a specific risk-weighting factor to corporate debt positions that are exposures to a publicly traded, non-"financial institution".¹² As an alternative to such indicator-based methodology proposed in the Market Risk Capital NPR, a bank would be given the option of assigning a flat 8.0 percent specific risk-weighting factor to all of its corporate debt positions. The Market Risk Capital NPR's indicator-based methodology would require a bank to calculate, on a quarterly basis: (i) leverage, measured by the ratio of total liabilities ("debt")¹³ to the market value of assets of the applicable public company,¹⁴ (ii) cash flow, measured as the

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ratio of earnings before interest expense, taxes, depreciation and amortization (“*EBITDA*”)¹⁵ to a market value of assets and (iii) stock price volatility, measured as the standard deviation of the corporate obligor’s monthly stock price as of the last trading day of each month over the immediate preceding 12 months. Banks would use publicly available financial data to calculate the value of each of the three indicators. After calculating the indicators, a bank would assign the debt position to a specific risk-weighting factor using the below table.

Specific Risk-weighting Factors for Non-Financial Publicly Traded Corporate Debt Positions

		Specific Risk-weighting Factor (in percent)		
EBITDA-to-assets ratio	Stock market Volatility measure	Debt-to-assets ratio less than 0.2	Debt-to-assets ratio between 0.2 and 0.5	Debt-to-assets ratio greater than 0.5
Greater than zero	less than 0.1	(See immediately following table)	8.0	8.0
	between 0.1 and 0.15	8.0	8.0	8.0
	greater than 0.15	8.0	8.0	12.0
Less than zero	less than 0.1	8.0	8.0	8.0
	between 0.1 and 0.15	8.0	8.0	12.0
	greater than 0.15	12.0	12.0	12.0

Specific Risk-weighting Factors Non-financial Publicly Traded Company Debt Positions

Remaining Contractual Maturity	Specific Risk-weighting Factor (in percent)
Residual term to final maturity 6 months or less	0.25
Residual term to final maturity greater than 6 months and up to and including 24 months	1.0
Residual term to final maturity exceeding 24 months	1.6

According to the agencies, the three risk buckets (0.25 to 1.6 percent, 8.0 percent and 12.0 percent) into which the methodology categorizes exposures to non-financial institution public companies roughly approximate credit ratings of AAA to A, BBB to BB and below BB, respectively.

The agencies request comment on what operational challenges banks would face in implementing this approach and how well this methodology captures credit risk for purposes of assigning risk-based capital requirements of the relevant covered debt positions.

2. Non-Financial, Publicly Traded Corporate Entities and Private Companies

For the time being, the Market Risk Capital NPR provides that all corporate debt positions issued by financial institutions (other than depository institutions, foreign banks or credit unions) would be assigned a specific risk-weighting factor of 8.0 percent. The agencies indicate that they are continuing to work on developing alternative methodologies to the use of credit ratings for financial institution debt positions. Corporate debt positions that are exposures to companies that do not meet the definition of “publicly traded”¹⁶ would also receive an 8.0 percent specific risk-weighting factor.¹⁷

3. Possible Alternatives

The agencies are seeking comments on other potential approaches for corporate debt securities, including a bond spread methodology and a methodology based on the Investment Securities NPR’s revised definition of “investment grade”.

G. SECURITIZATION POSITIONS

Under the current MRC rules, if a bank does not model specific risk under the agencies’ advanced internal ratings-based and advanced measurement approaches applicable to certain large internationally active bank holding companies,¹⁸ it must determine a specific risk capital add-on for each securitization position subject to the rule using a standardized method. The standardized method requires a bank to multiply the absolute value of the current market value of each net long and net short position in a securitization position by the appropriate specific risk-weighting factor (which range from zero to 8.0 percent based on the credit rating and remaining contractual maturity of the position). Unrated securitization positions receive a specific risk-weighting factor of 8.0 percent.

Under the BCBS market risk framework and the January NPR, a bank is not permitted to model specific risk for securitization and re-securitization positions, other than certain correlation trading positions. Instead, pursuant to the BCBS market risk framework, certain specific risk-weighting factors ranging from 1.6 percent to a full deduction from capital for securitization exposures and from 3.2 percent to a full deduction from capital for re-securitization exposures are assigned based on the applicable long-term or short-term credit rating assigned to the instrument in question.

Under the Market Risk Capital NPR, the agencies have developed a simplified version of the Basel II supervisory formula approach (“SFA”) to assign risk-weighting factors to securitization positions and re-securitization positions.¹⁹ Under the U.S. risk-based capital rules, the SFA is available only to banks that have been approved to use the agencies’ internal ratings-based and advanced measurement approaches. The approach in the Market Risk Capital NPR is referred to as the simplified SFA (“SSFA”). Although the SSFA is based on the SFA, a bank does not need to be approved to use the SFA to use the SSFA methodology. If a bank does not use the SSFA, a securitization would be subject to a specific risk-weighting factor of 100 percent, which is roughly equivalent to a 1250 percent risk weight.

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The SSFA applies a 100 percent specific risk-weighting factor to securitization positions that absorb losses up to the amount of capital that would be required for the underlying exposures under the agencies' general risk-based capital rules had those exposures been held directly by a bank. To illustrate this rule, the Market Risk Capital NPR provides an example of a securitization position that is backed by a \$100 pool of auto loans. If the loans in this pool were otherwise subject to a 100 percent risk weight under the agencies' general risk-based capital rules, then the total risk-based capital requirement would be \$8 (assuming an 8 percent capital requirement). Under the SSFA, securitization positions that would absorb up to the first \$8 of loss in the securitization would be assigned a specific risk-weighting factor of 100 percent. For the remaining securitization tranches (which absorb losses beyond the first \$8), the SSFA would apply capital requirements that would decrease as seniority of the positions increases subject to a supervisory floor (discussed below).

Under the Market Risk Capital NPR, the SSFA specific risk-weighting factor for a position would depend on the following inputs:

- K_G , which is the weighted-average capital requirement of the underlying exposures calculated using the agencies' general risk-based capital rules.
- Parameter A, which is the attachment point of the position and represents the threshold at which credit losses would first be allocated to the position. Parameter A is a ratio, expressed as a decimal value between zero and one, of the dollar amount of the securitization positions that are subordinated to the position to the dollar amount of the entire pool of underlying assets.
- Parameter D, which is the detachment point of the position and represents the threshold at which credit losses allocated to the position would result in a total loss to the investor in the position. This parameter equals the value of Parameter A plus the ratio of the dollar amount of the securitization positions that are *pari passu* with the position to the dollar amount of the underlying exposures.
- A supervisory calibration parameter, p . For securitization positions that are not re-securitization positions, this parameter is 0.5; for re-securitization positions, it is 1.5.
- Cumulative losses on the underlying pool of exposures, which affect the level of the specific risk-weighting factor floor.

A bank may use the SSFA for a particular securitization position only if it has the information to assign each of the parameters for the position. If it does not, the bank must apply a specific risk-weighting factor of 100 percent (effectively a dollar-for-dollar deduction from capital for the position). The agencies note that under the SSFA, at the inception of a securitization, the overall capital charge of holding every tranche of a securitization would be greater than if the bank held the underlying assets themselves. This is deliberate in order to "reduce the ability of banks to engage in regulatory capital arbitrage through the use of securitization."

The SSFA specific risk-weighting factor for the portion of a securitization position not subject to the 100 percent specific risk-weighting factor applied to the junior most portion of the transaction (that is, a

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securitization position that absorbs losses up to the amount of capital that would be required for the underlying exposures under the agencies’ general risk-based capital rules) is quantitative and formulaic:

SSFA Formula

$$K_{SSFA} = \frac{e^{a \cdot u} - e^{a \cdot l}}{a(u - l)}$$

where

$$a = \frac{-1}{p \cdot K_G}$$

$$u = D - K_G$$

$$l = A - K_G$$

$e = 2.71828$ (the base of the natural logarithms)

is equal to the greater of

- (i) K_{SSFA} multiplied by 100 and expressed as a percent; and
- (ii) The supervisory minimum specific risk-weighting factor assigned to the tranche based on cumulative losses (as set forth in the table below).

As noted above, the agencies propose to include a supervisory “floor” that will increase as cumulative losses on the pool increase over time as follows:

Supervisory Minimum Specific Risk-weighting Factor Floors for Securitization Exposures

Cumulative Losses of Principal on Originally Issued Securities as a Percent of K_G at Origination		Specific Risk-weighting Factor (in percent)
Greater than:	Less than or equal to:	
0	50	1.6
50	100	8.0
100	150	52.0
150	n/a	100.0

This floor will increase the capital requirements for securitization exposures as underlying pool quality exhibits credit deterioration. The Market Risk Capital NPR indicates that the supervisory floor was imposed because, under the current MRC rules, many senior securitization positions require limited amounts of capital even if their external ratings are substantially downgraded.

As acknowledged by the agencies, under certain circumstances, the SSFA may produce a higher specific risk-weighting factor for a securitization position than what would be generated under the BCBS market risk framework’s ratings-based approach. The SSFA does not take into consideration many forms of credit enhancements, such as excess spread, that credit rating agencies may recognize. As a result, the

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agencies indicate that the SSFA will result in a 100 percent specific risk-weighting factor for all securitization positions that detach at or below K_G .

To achieve a better alignment of the specific risk-weighting factors assigned by the SSFA with those assigned by the ratings-based approach, the agencies seek comment on a proposal to alter certain parameters in the SSFA, for example, by introducing a scaling factor to adjust the SSFA based on the type or quality of assets underlying a securitization. Such a scaling factor could reduce the overall impact of the 100 percent specific risk-weighting factors for securitization positions that detach at or below an 8 percent K_G .

In addition, the agencies seek comment on other alternative and/or complementary approaches to the SSFA, including: using a concentration ratio approach,²⁰ a credit spread approach²¹ and a third party vendor approach.²²

The agencies expect to publish a final MRC rule after consideration of comments on both the Market Risk Capital NPR and the January NPR.

INVESTMENT SECURITIES NPRS

A. OCC INVESTMENT SECURITIES NPR

The OCC's Investment Securities NPR addresses the regulations of the OCC, other than those that establish regulatory capital requirements, that currently reference credit ratings and proposes alternatives to replace credit ratings in those provisions. The OCC also released related guidance that explains the due diligence national banks and Federal savings associations should conduct when purchasing investment securities, and reiterates supervisory expectations for purchased securities.

Definition of investment grade. The OCC NPR would amend 12 C.F.R., parts 1 and 16 to provide that a security would be "investment grade" if the issuer of the security has an adequate capacity to meet financial commitments under the security for the projected life of the assets or exposures. This "adequate capacity" standard would replace language in Sections 1.2 and 16.2 of the OCC's regulations that currently references rating agencies. According to the related OCC guidance, an issuer has an adequate capacity to meet financial commitments if the risk of default by the obligor is low and the full and timely repayment of principal and interest is expected.²³ In determining whether an issuer satisfies this adequate capacity standard, the OCC Investment Securities NPR indicates that consulting external credit ratings is permitted, although a national bank must supplement external ratings with due diligence processes and analyses appropriate for its risk profile and for the size and complexity of the instrument. It is therefore possible that a security rated in one of the top four categories by a rating agency may not satisfy the proposed revised investment grade standard. The Investment Securities NPR does not, however, elaborate on whether the converse holds true – that is, whether securities not rated in one of the top four categories could satisfy the proposed revised investment grade standard.

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Additional changes. The OCC is also proposing to make the following changes to regulations in 12 C.F.R., parts 1, 16 and 160:

- The OCC proposes to amend 12 C.F.R. § 1.3(e)(2), which limits a national bank's purchase of covered small business related securities to 25 percent of the bank's capital and surplus unless the securities are rated in the two highest investment grade ratings categories, by simply eliminating the 25 percent limit. National banks still would only be able to purchase securities satisfying the statutory creditworthiness standard set forth in the definition of small business-related securities in Section 3(a)(53)(A) of the Securities Exchange Act of 1934 (the "Exchange Act"), which itself references credit ratings issued by the rating agencies. This ratings-based requirement is mandated by the Dodd-Frank Act to be removed by July 21, 2012 and replaced with an alternative standard by the SEC.
- 12 C.F.R. § 1.2(m)(2) and (3) of the OCC's regulations include references to credit ratings and reference the definition of "mortgage-related security" in Section 3(a)(41) of the Exchange Act, which includes a requirement that the security be rated in the top two investment grade categories by a rating agency. As with the definition of "small business-related securities", the Dodd-Frank Act requires this reference to credit ratings be removed by July 21, 2012 and requires the SEC to develop an alternative. The OCC proposes deleting the explicit references to credit ratings although these provisions would continue to refer to the definition of mortgage-related security.
- Savings associations generally are prohibited by statute from investing in corporate debt securities unless they are rated "investment grade" by a rating agency.²⁴ The Dodd-Frank Act provides that on July 21, 2012 this statutory requirement will be replaced by standards of creditworthiness established by the FDIC (which are set forth in FDIC Investment Securities NPR and described below).²⁵ The OCC is proposing to define "investment grade" as it is used in part 160 to refer to 12 U.S.C. § 1831e, which generally provides that savings associations are prohibited from investing in corporate debt securities unless they are rated "investment grade" by a rating agency. Thus, "investment grade" would continue to reference rating-based requirements until the FDIC replaces it as mandated by the Dodd-Frank Act.
- 12 C.F.R. § 160.40(a)(1)(ii) generally provides that Federal savings associations may invest in commercial paper only if it is rated in the highest two investment grade categories or guaranteed by a company with such a rating. In addition, 12 C.F.R. § 160.93(d)(5)(i) provides a less restrictive lending limitation for commercial paper that is rated in the highest ratings category, and 12 C.F.R. § 160.93(d)(5)(ii) provides a lending limitation for corporate debt securities rated in the two highest ratings categories. The OCC Investment Securities NPR proposes removing these references to credit ratings. Instead, Federal savings associations would be permitted to invest in commercial paper if they meet the standards set forth in 12 U.S.C. § 1831(d)(1), which limits savings associations to purchasing corporate debt securities that are investment grade, but will after July 21, 2012 include a new creditworthiness standard established by the FDIC.
- At present, Federal savings associations may hold state or municipal revenue bonds that have ratings in one of the four highest investment grade ratings categories from one issuer up to a limit of 10 percent of total capital without prior OCC approval. Under the Investment Securities NPR, this provision would apply to state or municipal revenue bonds if the issuer has an adequate capacity to meet financial commitments under the security for the projected life of the asset or exposure. An issuer would be considered to have "adequate capacity to meet financial commitments" if the risk of default by the obligor is low and the full and timely repayment of principal and interest is expected.

Due Diligence Requirements. To be eligible for purchase under 12 C.F.R., part 1, certain securities that do not otherwise meet other tests set forth therein must satisfy the "investment grade" standard. Investments are considered "investment grade" if they meet the regulatory standard for credit quality. To

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meet this standard, as noted above, a national bank must be able to determine that there is a low risk of default by the obligor and the full and timely repayment of principal and interest is expected over the expected life of the investment. Federal savings associations must meet the same standard when purchasing certain municipal revenue bonds and corporate debt securities pursuant to 12 C.F.R. § 160.24. In addition, they must meet the standards in 12 U.S.C. § 1831e when purchasing corporate debt securities (as discussed below).

The related guidance provides that the OCC expects national banks and Federal savings associations to conduct an “appropriate” level of due diligence to determine whether an investment security is an appropriate investment. This diligence may include consideration of internal analyses, third party research and analytics (including external credit ratings) and internal risk ratings, among other things. The amount of due diligence that should be performed depends on factors including the security’s credit quality, the complexity of the structure and the size of the investment. The OCC guidance provides that the more complex a security’s structure is, the more credit-related diligence that an institution should perform. Management should ensure they understand the security’s structure and how the security will perform in different default environments and “should be particularly diligent when purchasing structured securities”.²⁶ Such guidance provides a list of “appropriate” factors to consider when determining whether a security is a permissible investment.²⁷

The OCC guidance emphasizes that national banks and Federal savings associations must have an appropriate risk management framework in place for the level of risk in their investment portfolios in order to comply with safe and sound practices. In addition, institutions are expected to identify and measure investment risks periodically after purchase. Risk measurement should be obtained from sources independent of sellers or counterparties and should be periodically validated.

The OCC requested comment on several aspects of the guidance including whether it should differentiate based on size and scope of operations for national banks and Federal savings associations for purposes of the due diligence requirements.

B. FDIC INVESTMENT SECURITIES NPR

Section 28(d)(1) of the Federal Deposit Insurance Act (the “*FDIA*”) generally prohibits Federal and state savings associations from acquiring or retaining, either directly or through a financial subsidiary, a corporate debt security that is not “investment grade.” Under Section 28(d)(4) of the *FDIA*, a corporate debt security is not “investment grade” unless it is rated in one of the four highest ratings categories by a rating agency at the time of acquisition. The definition of “investment grade” in Section 362.11(b)(1) of the FDIC’s regulations is consistent with this definition. Section 939(a)(2) of the Dodd-Frank Act amends Section 28(d) by removing references to credit ratings and inserting in their place “standards of creditworthiness established by the [FDIC]”.

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The FDIC's Investment Securities NPR would amend Sections 362.09, 362.10 and 362.11(b)(1) of subpart C²⁸ of the FDIC's regulations by deleting the definition of corporate debt securities not of investment grade and replacing the investment grade standard with a requirement that prior to acquiring a corporate debt security, and periodically thereafter, a Federal or state savings association²⁹ must determine that the issuer has adequate capacity to meet all financial commitments under the security for the projected life of the investment. Similar to the OCC's Investment Securities NPR's "adequate capacity" standard, an issuer would satisfy this requirement if the savings association appropriately determines that the obligor presents low default risk and is likely to make timely payments of principal and interest.³⁰ To make this determination, savings associations would be permitted to consider external credit assessments, although they must supplement these assessments with due diligence processes and analyses that are appropriate for the size and complexity of the investment. The FDIC requested comment on all aspects of the creditworthiness standard set forth in the FDIC NPR.

Subject to certain limited exceptions, the substance of the FDIC guidance, both as to what diligence is required prior to purchase and what ongoing obligations savings associations have with respect to their corporate debt investments, is generally the same as, and appears to have been based in large part on, the OCC guidance.

CONCLUDING OBSERVATIONS

The rules embodied in the Market Risk Capital NPR are quite complicated, and rigorous empirical analysis will likely be required to determine fully the ultimate impact of such rules on bank capital requirements. While the agencies have stated they believe that the capital requirements under the proposed methodologies generally would be comparable to those produced under the BCBS market risk framework, the Market Risk Capital NPR did not publish empirical analysis regarding the comparability of its requirements and those of the BCBS market risk framework. Lack of comparability would, of course, raise competitive equality concerns. Even if the amount of capital required under the Market Risk Capital NPR and the BCBS market risk framework is broadly comparable, the presence of a different methodology for assessing capital requirements in the U.S. may make achieving international harmonization of capital requirements more difficult. It should also be noted that, applying Section 171 of the Dodd-Frank Act, intermediate U.S. bank holding company subsidiaries of foreign banking organizations that otherwise meet the requirements for the application of the agencies' MRC rules will be required to use the U.S. methodology for market risk starting in 2015 while their non-U.S. parent will be required to use the BCBS version, including on a consolidated basis.

The agencies have indicated that similar methodologies to those proposed in the Market Risk Capital NPR are expected to be incorporated into the risk-based capital rules more generally. Thus, for example, the securitization provisions in the agencies' capital rules implementing the Basel I capital requirements as well as the advanced internal ratings based approach under Basel II³¹ will likely be reflective of these

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methodologies. In addition, any amendments to the existing general risk-based capital framework to implement, for example, the standardized approach of Basel II likely will also reflect similar methodologies. As a result, the proposed methodologies may ultimately have important implications not just for the relatively small group of banking organizations now subject to the MRC rules, but also potentially for a larger group of banking institutions.

Furthermore, it is not entirely clear whether by replacing rating agency judgment concerning sovereign risk with the CRC methodology authored by the OECD – an intergovernmental body – the Market Risk Capital NPR is not simply replacing one set of perceived biases by the rating agencies with potential biases towards understating sovereign risk by an organization ultimately made up of various national governments.

Finally, it remains to be determined how the Investment Securities NPRs and their diligence requirements will impact the operations of national banks and Federal savings associations as a practical matter. Depending on how these diligence standards are ultimately interpreted and implemented, they may impact such institutions' operations, including their ability to execute trades in a timely manner, potentially placing them at a disadvantage to non-depository institutions financial market participants that do not operate under similar constraints.

* * *

ENDNOTES

- ¹ For information regarding this advance notice of proposed rulemaking and related discussion, see Sullivan & Cromwell LLP, *Risk-Based Bank Capital Guidelines: Federal Banking Agencies Seek Comment on Alternatives to Credit Ratings in Risk-Based Capital Guidelines* (Aug. 31, 2010), available at <http://www.sullcrom.com/Risk-Based-Bank-Capital-Guidelines-08-31-2010/>.
- ² Agencies, *Risk-Based Capital Guidelines: Market Risk*, 76 F.R. 1890 (Jan. 11, 2011).
- ³ The agencies' MRC rules generally apply only to U.S. banks or bank holding companies with aggregate trading assets and trading liabilities equal to (i) 10 percent or more of total assets or (ii) \$1 billion or more.
- ⁴ The BCBS is a committee of banking supervisory authorities which was established by the central bank governors of the Group of Ten countries at the end of 1974.
- ⁵ The "BCBS market risk framework", as used in this memorandum, refers to the framework governing the assessment of capital charges for exposure to market risk primarily set forth in the following publications: BCBS, *International Convergence of Capital Measurement and Capital Standards: A Revised Framework* (June 2004), available at <http://www.bis.org/publ/bcbs107.pdf>; BCBS and International Organization of Securities Commissions, *The Application of Basel II to Trading Activities and the Treatment of Double Default Effects* (April 2005), available at <http://www.bis.org/publ/bcbs111.pdf>; BCBS, *Enhancements to the Basel II Framework* (July 2009), available at <http://www.bis.org/publ/bcbs157.pdf>; BCBS, *Revisions to the Basel II Market Risk Framework*, (July 2009), available at <http://www.bis.org/publ/bcbs158.pdf>; BCBS, *Guidelines for Computing Capital for Incremental Risk in the Trading Book* (July 2009), available at <http://www.bis.org/publ/bcbs159.pdf>; and BCBS, *Changes to the Revisions to the Basel II Market Risk Framework* (June 2010), available at <http://www.bis.org/press/p100618/annex.pdf>.
- ⁶ As used in this memorandum, the "current MRC rules" refers to the agencies' market risk capital rules at 12 C.F.R., part 3, Appendix B (OCC); 12 C.F.R., part 208, Appendix E and 12 C.F.R. part 225, Appendix E (Federal Reserve); and 12 C.F.R., part 325, Appendix C (FDIC). The "current MRC rules" does not refer to the amendments proposed in the January NPR.
- ⁷ A "bank", as used in this memorandum, refers to either a depository institution or depository institution holding company, as applicable.
- ⁸ See OECD, *Country Risk Classifications of the Participants to the Arrangement on Officially Supported Export Credits*, available at <http://www.oecd.org/dataoecd/47/29/3782900.pdf>.
- ⁹ These MDBs include the International Bank for Reconstruction and Development, the Multilateral Investment Guarantee Agency, the International Finance Corporation, the Inter-American Development Bank, the Asian Development Bank, the African Development Bank, the European Bank for Reconstruction and Development, the European Investment Bank, the European Investment Fund, the Nordic Investment Bank, the Caribbean Development Bank, the Islamic Development Bank and the Council of Europe Development Bank.
- ¹⁰ For more information regarding the specific risk-weighting factors for covered corporate debt positions under the agencies' MRC rules, see Table 5 of *Annex A* hereto.
- ¹¹ For more information regarding the specific risk-weighting factors for corporate debt positions under the BCBS market risk framework, see Table 6 of *Annex A* hereto.
- ¹² "Financial institutions" is defined for purposes of the Market Risk Capital NPR to include, among other entities, commodity pools (as defined in the Commodity Exchange Act), private funds (as defined in the Investment Advisors Act of 1940, except for certain limited exceptions), employee benefit plans (as defined in the Employee Retirement Income and Security Act of 1974), bank holding companies, depository institutions and foreign banks, any company predominantly engaged in activities that are (i) in the business of banking under Section 24(Seventh) of the National Bank Act or (ii) in activities that are financial in nature under Section 4(k) of the Bank

ENDNOTES (continued)

Holding Company Act of 1956 (collectively, “*financial activities*”), subject to certain limited exceptions for certain activities. For the purposes of the Market Risk Capital NPR, a company would be “predominantly engaged” in financial activities, if:

(i) 85 percent or more of the total consolidated annual gross revenues (as determined in accordance with applicable accounting standards) of the company in either of the two most recent calendar years were derived, directly or indirectly, by the company on a consolidated basis from financial activities; or

(ii) 85 percent or more of the company’s consolidated total assets (as determined in accordance with applicable accounting standards) as of the end of either of the two most recent calendar years were related to financial activities.

The agencies noted that, with this definition of “financial institution”, they attempted to achieve consistency with other similar definitions and requested comment on the proposed definition and in particular the appropriateness of the standard used to determine “predominantly engaged in financial activities”.

13 Debt would be based on liabilities reported as of the end of the most recent calendar quarter.

14 Assets would be measured as the sum of the product of the number of outstanding shares as of the end of the most recent calendar quarter and the entity’s stock price on the last trading day of the most recent calendar quarter, plus the measure of liabilities reported as of the end of the most recent calendar quarter.

15 The calculation of the EBITDA ratio would be determined using EBITDA for the four most recent calendar quarters. The EBITDA ratio would be calculated by dividing an entity’s cumulative earnings over the previous four quarters before interest expense taxes, depreciation and amortization by its equity market value plus total liabilities as reported as of the end of the most recent quarter.

16 “*Publicly traded*”, as defined in the Market Risk Capital NPR, means traded on (1) any exchange registered with the SEC as a national securities exchange or (2) any non-U.S.-based securities exchange that (i) is registered with, or approved by, a national securities regulatory authority and (ii) provides a liquid, two-way market for the instrument in question, meaning that there are enough independent bona fide offers to buy and sell so that a sales price reasonably related to the last sales price or current bona fide competitive bid and offer quotations can be determined promptly and a trade can be settled at such a price within five business days. See § 2 of the proposed rule.

17 See § 10(b)(2)(vi)(B)(3) of the proposed rule.

18 See, e.g., 12 C.F.R., part 225, Appendix G (Federal Reserve).

19 For purposes of the proposed rule, as under the January NPR, a “*securitization*” generally means a transaction in which (1) all or a portion of the credit risk of one or more underlying exposures is transferred to one or more third parties; (2) the credit risk associated with the underlying exposures has been separated into at least two tranches that reflect different levels of seniority; (3) performance of the securitization position depends upon the performance of the underlying exposures; (4) all or substantially all of the underlying exposures are financial exposures (such as loans, commitments, credit derivatives, guarantees, receivables, asset-backed securities, mortgage-backed securities, other debt securities or equity securities); (5) for non-synthetic securitizations, the underlying exposures are not owned by an operating company; (6) the underlying exposures are not owned by a small business investment company described in Section 302 of the Small Business Investment Act of 1958; (7) the underlying exposures are not owned by a firm, an investment in which qualifies as a community development investment under 12 U.S.C. § 24(Eleventh). In addition, the proposed rule provides that the relevant agency may determine that a transaction in which the underlying exposures are owned by an investment firm that exercises substantially unfettered control over the size and composition of its assets,

ENDNOTES (continued)

liabilities, and off-balance sheet exposures is not a securitization based on the transaction's leverage, risk profile or economic substance. A "re-securitization" means a securitization in which one or more of the underlying exposures is a securitization position. A "securitization position" means a covered position that is an on-balance sheet or off-balance sheet credit exposure that arises from a securitization (including a re-securitization); or an exposure that directly or indirectly references a securitization exposure. A "re-securitization position" means a covered position that is an on- or off-balance sheet exposure to a re-securitization; or an exposure that directly or indirectly references a re-securitization exposure.

20 Under the BCBS market risk framework, for securitization positions that do not meet the requirements for the Basel market risk framework's ratings-based approach, a bank may set the specific risk add-on for the securitization position equal to the absolute value of the market value of the effective notional amount of each net long or net short securitization position in the portfolio multiplied by 8 percent of the dollar-weighted average risk weight applicable to the underlying exposures and by a "concentration ratio". The concentration ratio equals the sum of the notional amounts of all tranches in the securitization divided by the sum of the notional amounts of the tranches junior to or *pari passu* with the tranche in which the position is held (including the amount of that tranche). If the concentration ratio is 12.5 or higher, the bank would have to apply a specific risk-weighting factor of 100 percent to the securitization position.

21 This methodology could set specific risk-weighting factors of a securitization position based on the spread between the rate of the position and the rate of a U.S. Treasury obligation of similar maturity and the movements of an index of securities, with the general idea being that a change in the spread of a securitization position should be interpreted differently depending on whether comparable market spreads were stable or volatile. The agencies requested comments on several aspects of this alternative including for which types of securitization this method is more or less feasible and the effectiveness of this method, compared with that of the SSFA, for assigning specific risk-weighting factors for securitization positions.

22 Under this approach (like the one used by the National Association of Insurance Commissioners for determining the regulatory capital requirements for certain securitization positions held by insurance companies), the agencies would retain one or more third-party vendors to assign risk-based capital requirements for securitization positions. Working with these vendors, the agencies would develop a uniform rating system that would evaluate individual securitization positions based on expected loss or probability of default.

23 The OCC guidance provides that securities with good to very strong credit quality will meet this standard.

24 12 U.S.C. § 1831e(d)(1).

25 Although the OCC now has primary responsibility for supervising Federal savings associations, the FDIC has amended 12 C.F.R. § 362.11(b)(1) by replacing the investment grade standard that is currently applicable to corporate debt securities investments of *state* savings associations, with a requirement applicable to *both* Federal and state savings associations that does not rely on credit ratings, as discussed in the following section of this memorandum. This expansion of authority in 12 C.F.R. § 362.11(b)(1) appears permissible under Section 28(d) of the FDIA (which, as noted above, prohibits both Federal and state savings associations from acquiring non-investment grade corporate debt securities) and to be a product of increased cooperation between the FDIC and the OCC on issues relating to savings associations.

26 76 FR 73779. For example, a national bank or Federal savings association, according to the OCC guidance, should be able to demonstrate an understanding of the effects on cash flows of a structured security assuming varying default levels in the underlying assets.

27 For example, factors that should be considered when assessing investments in corporate and revenue bonds include: whether the security's spread to U.S. Treasuries is consistent with bonds of similar credit quality; whether risk of default is low and consistent with bonds of similar credit

ENDNOTES (continued)

quality; and capacity to pay. The OCC guidance also provides several examples of factors that may be appropriate to consider when assessing a structured product, including: the position of the security in the cash flow waterfall; the quality of the underwriting of the underlying collateral; the structural subordination of the instrument and its adequacy given current underwriting standards; and the impact of collateral deterioration on tranche performance and potential credit losses under stress scenarios.

28 These provisions, respectively, regard the scope of subpart C (which pertains to the activities of insured state savings associations), contain definitions and set forth a prohibition on acquiring corporate debt securities that are not investment grade.

29 Section 362.11(b)(1) of the FDIC’s regulations currently only applies to insured *state* savings associations.

30 The OCC NPR’s adequate capacity standard requires national banks to determine that the “the full and timely repayment of principal and interest is expected” whereas the FDIC guidance, as noted, requires savings associations to determine that the issuer is “likely to make full and timely repayment of principal and interest.” It would appear that there is little substantive difference between these formulations.

31 “*Basel II*”, as used in this memorandum, refers to the BCBS’s Committee’s June 2006 comprehensive new accord titled *International Convergence of Capital Measurement and Capital Standards – A Revised Framework*.

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ANNEX A

TABLE 1: Proposed Specific Risk-Weighting Factors for Sovereign Debt Positions

Sovereign CRC	Specific Risk-Weighting Factor (in percent)	
0-1	0.0	
2-3	Residual term to final maturity in 6 months or less	0.25
	Residual term to final maturity greater than 6 and up to and including 24 months	1.0
	Residual term to final maturity exceeding 24 months	1.6
4-6	8.0	
7	12.0	
No CRC	8.0	

TABLE 2: Specific Risk-Weighting Factors for Depository Institution, Foreign Bank and Credit Union Debt Positions

CRC of Sovereign of Incorporation	Specific Risk-Weighting Factor (in percent)	
0-2	Residual term to final maturity in 6 months or less	0.25
	Residual term to final maturity greater than 6 and up to and including 24 months	1.0
	Residual term to final maturity exceeding 24 months	1.6
3	8.0	
4-7	12.0	
No CRC	8.0	

TABLE 3: Specific Risk-Weighting Factors for General Obligation Debt Positions in PSEs

Sovereign CRC Rating	General Obligation Claims Risk-Weighting Factor (in percent)	
0-2	Residual term to final maturity in 6 months or less	0.25
	Residual term to final maturity greater than 6 and up to and including 24 months	1.0
	Residual term to final maturity exceeding 24 months	1.6
3	8.0	
4-7	12.0	
No CRC	8.0	

TABLE 4: Specific Risk-Weighting Factors for Revenue Obligation Covered Positions in PSEs

Sovereign CRC Rating	Revenue Obligation Risk-Weighting Factor (in percent)	
0-1	Residual term to final maturity in 6 months or less	0.25
	Residual term to final maturity greater than 6 and up to and including 24 months	1.0
	Residual term to final maturity exceeding 24 months	1.6
2-3	8.0	
4-7	12.0	
No CRC	8.0	

TABLE 5: Specific Risk-weighting Factors for Covered Corporate Debt Positions Under the Agencies’ Market Risk Capital Rules

Category	Remaining Maturity (contractual)	Specific Risk-weighting Factor (in percent)
Qualifying ¹	6 months or less	0.25
Other ²	Over 6 months to 24 months	1.00
	Over 24 months	1.60
	N/A	8.00

TABLE 6: BCBS Market Risk Framework Specific Risk-weighting Factors for Corporate Debt Positions

External Credit Rating	Remaining Contractual Maturity	Specific Risk-weighting Factor (in percent)
Qualifying ³	6 months or less	0.25
	Residual term to final maturity greater than 6 and up to and including 24 months	1.00
	Residual term to final maturity exceeding 24 months	1.60
One category below investment grade to two categories below investment grade (for example, BB+ to B-), or equivalent based on a bank’s internal ratings.	--	8.00

¹ The “qualifying” category includes debt instruments that are: (1) rated investment grade by at least two nationally recognized credit rating services; (2) rated investment grade by one nationally recognized credit rating agency and not rated less than investment grade by any other credit rating agency; or (3) subject to supervisory review, unrated, but deemed to be of comparable investment quality by the bank and the issuer has instruments listed on a recognized stock exchange.

² The “other” category includes debt instruments that are not included in the government or qualifying categories.

³ Under the BCBS market risk framework, the qualifying category is generally comparable to the “qualifying” category under the current MRC rules and includes non-sovereign debt positions (i) rated investment grade by at least two credit rating agencies specified by national authority, (ii) rated investment grade by one credit rating agency and not rated less than investment grade by any other credit rating agency specified by national authority (subject to supervisory oversight); or (iii) unrated but deemed to be of comparable investment quality by the bank and the issuer has securities listed on a recognized stock exchange, subject to supervisory approval.

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External Credit Rating	Remaining Contractual Maturity	Specific Risk-weighting Factor (in percent)
More than two categories below investment grade, or equivalent based on a bank's internal ratings.	--	12.00
Unrated.	--	8.00