TO: The Chief Executive Officer of each financial institution and others concerned in the Eleventh Federal Reserve District

SUBJECT
Interim Rule and Request for Public Comment on Market Risk Rules

DETAILS

The Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation have issued an interim rule and requested public comment on an amendment to their market risk rules.

The amendment revises the capital treatment for cash collateral that is posted in connection with certain securities borrowing transactions. The interim rule, which becomes effective January 4, 2001, provides:

- more appropriately aligns the capital requirements for these transactions with the risk involved and
- provides a capital treatment for U.S. banking organizations that is more in line with the capital treatment applied to their domestic and foreign competitors.

The Board must receive comments by January 19, 2001. Please address comments to Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, 20th and C Streets, N.W., Washington, DC 20551. Also, you may mail comments electronically to regs.comments@federalreserve.gov. All comments should refer to Docket No. R-1087.

ATTACHMENT

A copy of the Board’s notice as it appears on pages 75856–59, Vol. 65, No. 234 of the Federal Register dated December 5, 2000, is attached.

MORE INFORMATION

For more information, please contact Dorsey Davis, Banking Supervision Department, (214) 922-6051. For additional copies of this Bank’s notice, contact the Public Affairs Department at (214) 922-5254 or access District Notices on our web site at http://www.dallasfed.org/banking/notices/index.html.
DEPARTMENT OF THE TREASURY
Office of the Comptroller of the Currency
12 CFR Part 3
[Docket No. 00–28]
RIN 1557–AB14

FEDERAL RESERVE SYSTEM
12 CFR Parts 208 and 225
[Regulation H and Y; Docket No. R–1087]

FEDERAL DEPOSIT INSURANCE CORPORATION
12 CFR Part 325
RIN 3064–AC46

Risk-Based Capital Guidelines; Market Risk Measure; Securities Borrowing Transactions

AGENCIES: Office of the Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve System (Board), and the Federal Deposit Insurance Corporation (FDIC) (collectively, the Agencies) are issuing an interim rule with request for comment that amends their market risk rules to revise the capital treatment for cash collateral that is posted in connection with certain securities borrowing transactions. The effect of the interim rule is to more appropriately align the capital requirements for these transactions with the risk involved and to provide a capital treatment for U.S. banking organizations that is more in line with the capital treatment applied to their domestic and foreign competitors.

DATES: This interim rule is effective January 4, 2001. U.S. banking organizations may apply the provisions of this interim rule beginning December 5, 2000. Comments must be received by January 19, 2001.

ADRESSES: Comments should be directed to:
OCC: Written comments may be submitted electronically to regs.comments@occ.treas.gov or by mail to Docket No. 00–28, Office of the Comptroller of the Currency, Public Information Room, 250 E Street, SW, Mail Stop 1–5, Washington, DC 20219.

FDIC: Written comments should be addressed to Robert E. Feldman, Executive Secretary, Attention: Comments/OES, Federal Deposit Insurance Corporation, 550 17th Street, NW, Washington, DC 20429. Comments may be hand delivered to the guard station at the rear of the 550 17th Street Building (located on F Street), on business days between 7 a.m. and 5 p.m. (Fax number: (202) 898–3838; Internet address: comments@fdic.gov). Comments may be inspected and photocopied in the FDIC Public Information Center Room 100, 801 17th Street, NW, Washington, DC, between 9 a.m. and 4:30 p.m. on business days.


Board: Norah Barger, Assistant Director (202)452–2402, or David Adkins, Supervisory Financial Analyst (202)452–5250, Division of Banking Supervision and Regulation. For the hearing impaired only, Telecommunication Device for the Deaf (TDD), Janice Simms (202)872–4984, Board of Governors of the Federal Reserve System, 20th and C Streets, NW, Washington, DC 20551.


SUPPLEMENTARY INFORMATION: Securities borrowing transactions were not specifically addressed in the July 1988 agreement entitled “International Convergence of Capital Measurement and Capital Standards” (Basel Accord), nor in the risk-based capital guidelines adopted by the Agencies in 1989.1 At that time, the involvement of U.S. banking organizations in corporate debt and equity securities trading activities was limited. However, in recent years, U.S. banking organizations have experienced a rapid growth of such activities, and it is recognized that securities borrowing transactions serve an important function in the operation of securities markets. Securities borrowings are used in conjunction with short sales, securities fails (securities sold but not made available for delivery on the settlement date), and option and arbitrage positions. Securities are also borrowed in order to pledge against public fund deposits. Securities borrowing enhances market efficiency and provides an important source of liquidity to the securities markets.

In a typical securities borrowing transaction, a party (for example, a banking organization) needing to borrow securities obtains the securities from a securities lender and posts collateral in the form of cash or highly marketable securities with the securities lender (or an agent acting on behalf of the securities lender) in an amount that fully covers the value of the securities borrowed plus an additional margin, usually ranging from two to five percent. In accordance with U.S. generally accepted accounting principles, cash collateral posted with the securities lender is treated as a receivable on the books of the securities borrower (that is, it is treated as a cash loan from the securities borrower to the securities lender, who is the obligor). Under the existing capital rules, the securities borrower must hold capital against the full amount of this receivable, i.e., the collateral posted. The borrowed securities generally remain on the balance sheet of the securities lender, and, therefore, no additional capital charge is incurred by...
the securities borrower. Where a
securities borrower posts collateral in
the form of securities that continue to be
carried on the borrower’s books, the
only capital charge incurred by the
borrower under the present guidelines is
that associated with a direct holding of
the securities.

The Agencies recognize that securities
borrowing is a long-established financial
activity that historically has resulted in
an exceedingly low level of losses.

Applying a standard 100 percent risk
weight to the full amount of the cash
collateral posted to support such
borrowings, the Agencies further
recognize, results in a capital charge
that is inordinately high, not only in
light of the risk involved in the
transactions, but also in comparison to
the capital required by other U.S. and
non-U.S. regulators of financial firms for
the same transactions. Further, under
the current capital rules, a banking
organization incurs no incremental
capital charge when it borrows
securities and posts securities to
collateralize the borrowing, even though
it is at risk for the amount by which the
collateral exceeds the value of the
securities borrowed.

The Agencies are issuing an interim
rule that better reflects the low risk of
securities borrowing and the posting of
cash collateral in connection with such
transactions and brings the capital
requirements for U.S. banking
organizations into better alignment with
the capital requirements of other U.S.
and non-U.S. regulators of financial
institutions.

Specifically, the Agencies are
adopting an interim rule that permits
banking organizations under the market
risk rules to exclude from risk-weighted assets receivables arising from the
posting of cash collateral associated
with securities borrowing transactions
to the extent such receivables are
collateralized by the market value of the
securities borrowed, subject to the
following conditions:

1. The transaction is based on
securities includable in the trading book
that are liquid and readily marketable;
2. The transaction is marked to market
daily;
3. The transaction is subject to daily
margin maintenance requirements, and;
4. The transaction is a securities
contract for the purposes of section 555
of the Bankruptcy Code (11 U.S.C. 555),
a qualified financial contract for the
purpose of section 11(e)(8) of the
Federal Deposit Insurance Act (12
U.S.C. 4821(e)(8)), or a netting contract
between or among financial institutions
for the purposes of sections 401–407 of
the Federal Deposit Insurance

Corporation Improvement Act of 1991
(12 U.S.C. 4401–4407), or the Board’s
Regulation EE (12 CFR Part 231).

Under this treatment, the amount of
the receivable created in connection
with the posting of cash collateral in a
securities borrowing transaction that
would be excluded from the securities
borrower’s adjusted risk-weighted assets
is limited to the portion that is
collateralized by the market value of the
securities borrowed. The
uncollateralized portion, which equals
the difference between the amount of
cash collateral that the securities
borrower posts in support of the
borrowing and the current market value
of the securities borrowed, would be
assigned to the risk weight appropriate
to the obligor.

The Agencies note that the Basel
Accord is currently under revision.

These revisions could result in a more
risk-sensitive treatment for securities
borrowing transactions. Accordingly,
banking organizations should be aware
that this capital treatment under the
market risk rules is subject to change
pending the outcome of the Basel
revisions, which may call for higher
capital charges for securities borrowing
and similar transactions.

The Agencies welcome comment on
all aspects of this interim rule. In
particular, the Agencies request
industry views on the capital treatment
of the posting of securities collateral
associated with securities borrowing
transactions. Under the current capital
rules and the interim rule, the posting
of securities collateral will continue to
not incur a capital charge even though
the securities borrower is at risk (as it
is where cash is posted as collateral) for
the amount by which the securities
collateral exceeds the value of the
securities borrowed.

The Agencies recognize that a strong case can be made for
achieving a greater consistency
between the treatment of the posting of
cash collateral and the posting of
securities collateral by requiring a
capital charge on the amount by which
the market value of the securities posted
collateral exceeds the market value of
securities borrowed. This could be
accomplished under the present capital
framework, for example, by requiring
the difference in the market value of the
securities posted as collateral and that
of the securities borrowed to be treated
as a securities lending transaction.

Under such a treatment, the difference
would be converted at 100 percent to an
on-balance sheet credit equivalent
amount and risk-weighted according to
the obligor’s financial institution. The
Agencies are specifically interested in
whether this revision to the calculation of the capital
requirement for securities borrowing
transactions should be limited only to
those banking organizations that have
implemented the market risk rules.

Under the interim rule, no reduction in
the capital requirement for these
securities borrowing transactions is
available to banking organizations that
have not implemented an approved
value-at-risk model. Accordingly,
comment is sought on whether the
capital treatment of securities borrowing
should be modified within the non-
trading portion of the risk-based capital
calculation.

**Regulatory Flexibility Act Analysis**

Pursuant to section 605(b) of the
Regulatory Flexibility Act, the Agencies
have determined that this interim rule
would not have a significant impact on
a substantial number of small entities in
accord with the spirit and purposes of
the Regulatory Flexibility Act (5 U.S.C.
601 et seq.). Accordingly, a regulatory
flexibility analysis is not required. The
interim rule would reduce regulatory
burden. The rule will only affect
banking organizations that operate
under the market risk rules which limits
the applicability of the rule to
organizations with significant trading
operations. The rule will reduce
regulatory burden for banking
organizations that engage in securities
borrowing transactions.

**Administrative Procedure Act**

Pursuant to section 553 of the
Administrative Procedure Act, 5 U.S.C.
553, the Agencies find good cause for
issuing this interim rule in advance of
the receipt of comments from interested
parties. Currently, U.S. banking
organizations are at a competitive
disadvantage versus certain foreign
organizations because of differing
capital treatment for securities
borrowing transactions. The Agencies
find that it is contrary to the public
interest for U.S. banking organizations
to be subject to more stringent rules
(resulting in higher regulatory capital
requirements) than direct competitor
institutions outside of the U.S. that have
capital charges determined from rules
that are consistent with the interim rule.

This rule relieves a restriction on
banking organizations and fosters
consistency among international
institutions prior to year-end, but does
not raise safety and soundness concerns.
The Agencies are seeking public comment on the interim rule.

**Paperwork Reduction Act**

The Agencies have determined that this interim rule does not involve a collection of information pursuant to the provisions of the Paperwork Reduction Act of 1995 (44 U.S.C. 3501 et seq.).

**OCC Unfunded Mandates Reform Act of 1995 Determinations**

Section 202 of the Unfunded Mandates Reform Act of 1995, Public Law 104–4 (Unfunded Mandates Act) requires that an agency prepare a budgetary impact statement before promulgating a rule that includes a Federal mandate that may result in expenditures by State, local, or tribal governments, or by the private sector of $100 million or more. Accordingly, the OCC has determined that this interim rule will not result in a Federal mandate that may result in any one year. If a budgetary impact statement is required, section 205 of the Unfunded Mandates Act also requires an agency to identify and consider a reasonable number of regulatory alternatives before promulgating a rule. As discussed in the preamble, this interim rule is limited to banking organizations subject to the market risk rules and to securities borrowing transactions collateralized with cash. The OCC, therefore, has determined that the interim rule will not result in expenditures by State, local, or tribal governments, or by the private sector of $100 million or more. Accordingly, the OCC has not prepared a budgetary impact statement or specifically addressed the regulatory alternatives considered.

**List of Subjects**

12 CFR Part 3
Administrative practice and procedure, Capital, National banks, Reporting and recordkeeping requirements, Risk.

12 CFR Part 208
Accounting, Agriculture, Banks, banking, Confidential business information, Crime, Currency, Federal Reserve System, Mortgages, Reporting and recordkeeping requirements, Securities.

12 CFR Part 225
Administrative practice and procedure, Banks, banking, Federal Reserve System, Holding companies, Reporting and recordkeeping requirements, Securities.

12 CFR Part 325
Administrative practice and procedure, Bank deposit insurance, Banks, banking, Capital adequacy, Reporting and recordkeeping requirements, Savings associations, State non-member banks.

**Department of Treasury**

**Office of the Comptroller of the Currency**

**12 CFR Chapter 1**

**Authority and Issuance**

For the reasons set out in the joint preamble, part 3 of chapter I of title 12 of the Code of Federal Regulations is amended as follows:

**PART 3—MINIMUM CAPITAL RATIOS; ISSUANCE OF DIRECTIVES**

1. The authority citation for part 3 continues to read as follows:


2. In appendix A to part 3, in section 3:
   a. Revise paragraph (a)(4) introductory text; and
   b. Add a new footnote 12a.

**Appendix A To Part 3—Risk-Based Capital Guidelines**

**Section 3. Risk Categories/Weights for On-Balance Sheet Assets and Off-Balance Sheet Items**

12 CFR Part 3
Administrative practice and procedure, Capital, National banks, Reporting and recordkeeping requirements, Savings associations, State non-member banks.

**Federal Reserve System**

**12 CFR Chapter 11**

**Authority and Issuance**

For the reasons set out in the joint preamble, part 208 of chapter II of title 12 of the Code of Federal Regulations is amended as set forth below:

**PART 208—MEMBERSHIP OF STATE BANKING INSTITUTIONS IN THE FEDERAL RESERVE SYSTEM (REGULATION H)**

1. The authority citation for part 208 continues to read as follows:


2. In appendix E to part 208, under section 3, paragraph (a)(1) is revised to read as follows:

**Appendix E to part 208—Capital Adequacy Guidelines for State Member Banks; Market Risk Measure**

**Section 3 Adjustments to the Risk-Based Capital Ratio Calculations**

(a) * * *
(1) Adjusted risk-weighted assets. Calculate adjusted risk-weighted assets, which equals
risk-weighted assets (as determined in accordance with appendix A of this part), excluding the risk-weighted amounts of all
covered positions (except foreign exchange positions outside the trading account and
over-the-counter derivative positions)7 and receivables arising from the posting of cash
collateral that is associated with securities borrowing transactions to the extent the
receivables are collateralized by the market value of the borrowed securities, provided
that the following conditions are met:

(i) The transaction is based on securities includable in the trading book that are liquid
and readily marketable,

(ii) The transaction is marked to market daily,

(iii) The transaction is subject to daily
margin maintenance requirements,

(iv) The transaction is a securities contract
for the purposes of section 555 of the
Bankruptcy Code (11 U.S.C. 555), a qualified
financial contract for the purposes of section
11(e)(8) of the Federal Deposit Insurance Act
(12 U.S.C. 1821(e)(8)), or a netting contract
between or among financial institutions for
the purposes of sections 401–407 of the
Federal Deposit Insurance Corporation
4407), or the Board’s Regulation EE (12 CFR
part 231).

* * * * *

7 Foreign exchange positions outside the
trading account and all over-the-counter
derivative positions, whether or not in the
trading account, must be included in the
adjusted risk weighted assets as determined
in appendix A of this part.

* * * * *

PART 225—BANK HOLDING
COMPANIES AND CHANGE IN BANK
CONTROL (REGULATION Y)

1. The authority citation for part 225
continues to read as follows:

Authority: 12 U.S.C. 1817(j)(13), 1818,
1828(o), 1831i, 1831p±1, 1843(c), 1844(b),
1972(a), 3106, 3108, 3310, 3311±3351, 3907,

2. In appendix E to part 225, under
section 3, paragraph (a)(1) is revised to read as follows:

Appendix E to Part 225—Capital
Adequacy Guidelines for Bank Holding
Companies; Market Risk Measure

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Section 3. Adjustments to the Risk-Based
Capital Ratio Calculations

(a) * * * *

(1) Adjusted risk-weighted assets. Calculate
adjusted risk-weighted assets, which equals
risk-weighted assets (as determined in
accordance with appendix A of this part), excluding the risk-weighted amounts of all
covered positions (except foreign exchange positions outside the trading account and
over-the-counter derivative positions)7 and receivables arising from the posting of cash

DEPARTMENT OF THE TREASURY
Office of the Comptroller of the
Currency

12 CFR Part 8

[Docket No. 00–31]

RIN 1557–AB72

Assessment of Fees; National Banks;
District of Columbia Banks

AGENCY: Office of the Comptroller of the
Currency, Treasury.

ACTION: Final rule.

SUMMARY: The Office of the Comptroller
of the Currency (OCC) is amending the
assessment formula it uses to assess
independent trust banks. A trust bank is
considered independent for purposes of
this regulation if it specializes in trust
activities and is not affiliated with a