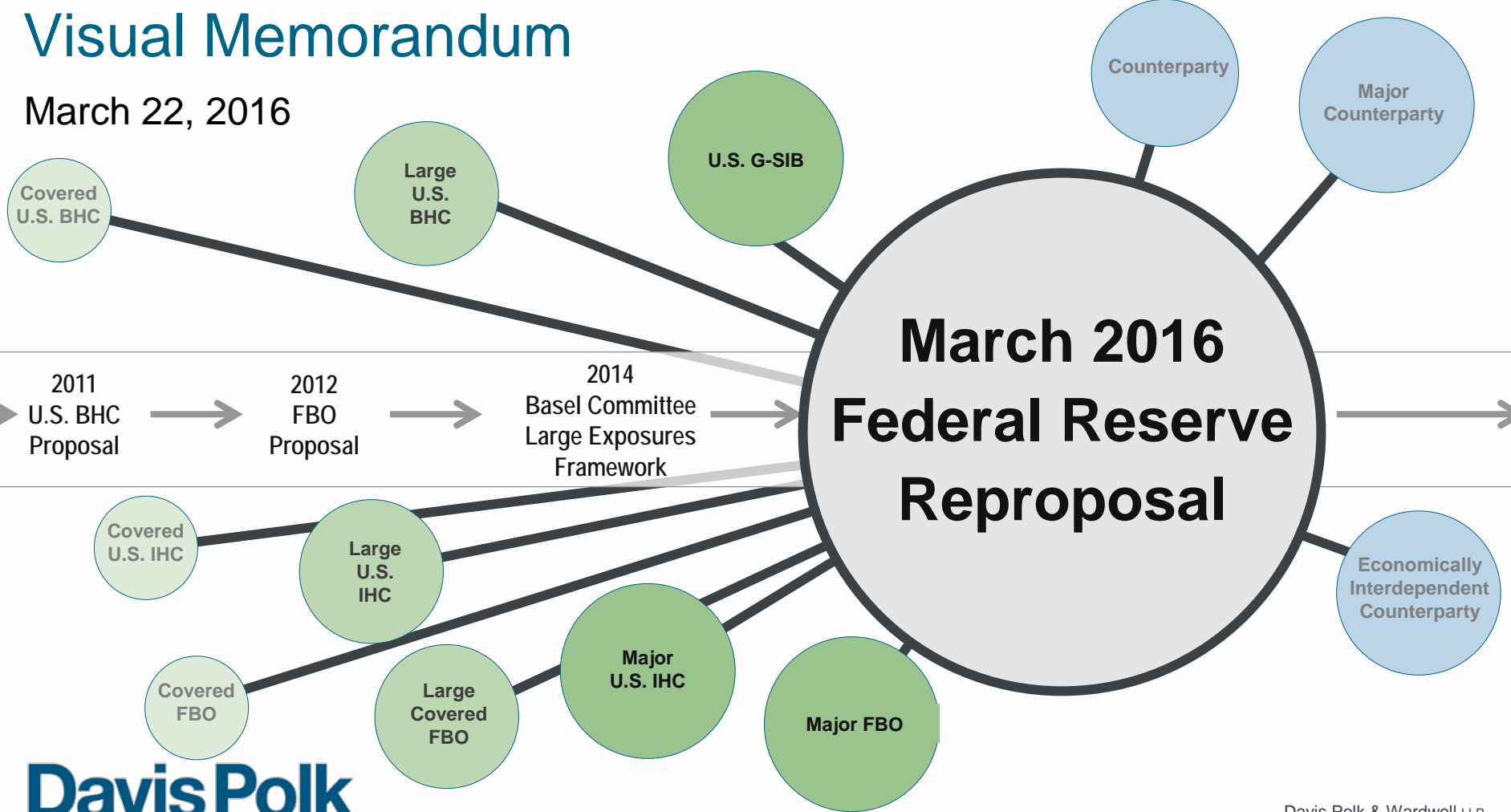


Single-Counterparty Credit Limits Proposed Rule


Visual Memorandum

March 22, 2016




Davis Polk & Wardwell LLP

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
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I. Introduction

- [Overview of Single-Counterparty Credit Limits Reproposal](#)
- [Key Changes from Prior SCCL Proposals](#)

Overview of Single-Counterparty Credit Limits Reproposal

- The Federal Reserve has repropoed rules that would establish single-counterparty credit limits (“**SCCL Reproposal**”) for certain U.S. bank holding companies (“**BHCs**”) and foreign banking organizations (“**FBOs**”) (collectively, “**covered companies**”).
 - The initial proposed rules were issued in December 2011 and December 2012.
- The SCCL Reproposal would impose the following limits on net credit exposures to unaffiliated counterparties:
 - **25% of capital stock and surplus** for U.S. BHCs, FBOs and U.S. intermediate holding companies (“**U.S. IHCs**”) of FBOs, in each case with \geq \$50 billion in total consolidated assets;
 - **25% of Tier 1 capital** for covered companies with \geq \$250 billion in total consolidated assets or \geq \$10 billion in on-balance sheet foreign exposures (the same quantitative thresholds for calculating risk-weighted assets using the advanced approaches under the U.S. Basel III capital rules); and
 - **15% of Tier 1 capital** for U.S. global systemically important bank holding companies and for FBOs and U.S. IHCs with \geq \$500 billion in total consolidated assets, with respect to their exposures to certain large counterparties.
- The limits for covered FBOs would apply to their combined U.S. operations (*i.e.*, U.S. branches, agencies, and subsidiaries, including U.S. IHCs).

According to the Federal Reserve, the SCCL Reproposal takes into account, among other things, the revised rules for **lending limits** for national banks issued by the Office of the Comptroller of the Currency (“**OCC**”) in 2013; the **large exposures framework** finalized by the Basel Committee on Banking Supervision (“**Basel Committee**”) in 2014; and **further analyses** by Federal Reserve staff.

Overview of Single-Counterparty Credit Limits Reproposal *(cont.)*


- Compliance would be required:
 - **One year** after the rule's effective date for covered companies with \geq \$250 billion in total consolidated assets or \geq \$10 billion in on-balance sheet foreign exposures, and
 - **Two years** after the effective date for smaller covered companies.
- The comment period for the SCCL Reproposal closes on **June 3, 2016**.

Key Changes from Prior SCCL Proposals

| Topic | Key Changes in the SCCL Reproposal from the Prior Proposals |
|---------------------------------|--|
| Scope of Covered Company | <ul style="list-style-type: none"> ▪ Introduction of a new third category of covered companies with ≥ \$250 billion in total consolidated assets or ≥ \$10 billion in on-balance sheet foreign exposures. ▪ Use of the broader Bank Holding Company Act of 1956 (“BHCA”) definition of control, which includes the direct or indirect exercise of a controlling influence over the management or policies of a company, to identify the subsidiaries of a covered company. |
| Scope of Counterparty | <ul style="list-style-type: none"> ▪ Expansion of the scope of counterparty as a result of additional requirements to aggregate exposures to counterparties that are connected by certain control relationships, including the BHCA “controlling influence” test, and, in certain cases, to unaffiliated counterparties that are “economically interdependent.” |
| Application of Limits | <ul style="list-style-type: none"> ▪ Narrower Tier 1 capital base (instead of capital stock and surplus) applies to covered companies with ≥ \$250 billion in total consolidated assets or ≥ \$10 billion in on-balance sheet foreign exposures and larger covered companies. |
| Foreign Sovereigns | <ul style="list-style-type: none"> ▪ Foreign sovereigns with a 0% risk weight under the Federal Reserve’s Basel III capital rules and their agencies (but not their political subdivisions) are excluded from the definition of “counterparty” and thus exposures to such sovereigns are not subject to the SCCL. ▪ In addition, for FBOs and their U.S. IHCs, exposures to an FBO’s home country sovereign entity, regardless of its Basel III risk weight, are exempt from the SCCL. |
| QCCPs | <ul style="list-style-type: none"> ▪ Trade exposures to qualifying central counterparties (“QCCPs”), including potential future exposure arising from cleared transactions and pre-funded default fund contributions, are exempt from the SCCL. |

Key Changes from Prior SCCL Proposals *(cont.)*


| Topic | Key Changes in the SCCL Reproposal from the Prior Proposals |
|---------------------------------|---|
| Derivatives | <ul style="list-style-type: none"> Exposures arising from derivatives transactions subject to qualifying master netting agreements may be calculated using any methodology that the covered company may use under the Federal Reserve's Basel III capital rules, including the current exposure method ("CEM") and, for companies subject to the advanced approaches, internal models. |
| Collateral | <ul style="list-style-type: none"> Requirement (vs. option) for covered companies to reduce their exposure to a counterparty based on eligible collateral or an eligible guarantee and recognize a commensurate increase in exposure to the collateral issuer or eligible protection provider. |
| Special Purpose Vehicles | <ul style="list-style-type: none"> Addition of a specific framework for measuring exposures to a securitization vehicle, investment fund or other special purpose vehicle (collectively, "SPVs"). Applies only to covered companies with \geq \$250 billion in total consolidated assets or \geq \$10 billion in on-balance sheet foreign exposures and larger covered companies. A "look-through approach" is required if a covered company cannot show that its exposure to each underlying asset held by the SPV is less than 0.25% of the covered company's Tier 1 capital. |
| Compliance | <ul style="list-style-type: none"> Quarterly (vs. daily) compliance and quarterly (vs. monthly) reporting required for covered companies with $<$ \$250 billion in total consolidated assets and $<$ \$10 billion in on-balance sheet foreign exposures. |

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II. Scope

- [Which Organizations Are Affected?](#)
- [Definition of Counterparty](#)
- [Definition of Major Counterparty](#)
- [Counterparty Aggregation Requirements](#)

Which Organizations Are Affected?

| | Defined Term* | Size | Institution Type | |
|---|-----------------------------|--|---|--|
|  Increasing strictness "Covered companies" | "Major Covered Companies" | n/a | A U.S. BHC identified as a global systemically important BHC under Method 1 of the Federal Reserve's G-SIB surcharge rule (" U.S. G-SIB ") | |
| | | ≥ \$500 billion in total consolidated assets | U.S. IHC (" major U.S. IHC ") FBO (" major FBO ") | |
| | | "Large Covered Companies" | ≥ \$250 billion in total consolidated assets <u>or</u> ≥ \$10 billion in on-balance sheet foreign exposures** | U.S. BHC (" large U.S. BHC ") U.S. IHC (" large U.S. IHC ") FBO (" large FBO ") |
| | "Smaller Covered Companies" | | ≥ \$50 billion in total consolidated assets | U.S. BHC (" covered U.S. BHC ") FBO (" covered FBO ") U.S. IHC (" covered U.S. IHC ") |

For an FBO, SCCL requirements apply to its **combined U.S. operations**, which include all U.S. branches and agencies of the FBO; its controlled U.S. subsidiaries, including any U.S. IHC; and any subsidiaries of such subsidiaries, **excluding** any companies held under section 2(h)(2) of the BHCA.

* Terms used for purposes of this memorandum. See note regarding defined terms on [next page](#).
 ** The Federal Reserve's Basel III capital rules specify the same quantitative thresholds to determine which depository institution holding companies must calculate their risk-weighted assets using the advanced approaches. U.S. IHCs are not subject to the advanced approaches unless they expressly opt in.

- Not Subject to SCCL
- A U.S. BHC with < \$50 billion in total consolidated assets
 - A U.S. IHC with < \$50 billion in total consolidated assets
 - A U.S. savings and loan holding company (not explicitly covered by the reference to a bank holding company, which is defined in 12 C.F.R. § 252.2(c))
 - A U.S. depository institution (depository institutions are subject to lending limits imposed by relevant federal or state law)
 - A bridge financial company or a bridge depository institution, as those terms are used in the resolution context
 - Federal Home Loan Banks

Nonbank SIFIs: The final rule does not apply to nonbank financial companies designated as systemically important by the Financial Stability Oversight Council. The Federal Reserve stated that it intends to apply similar requirements to such companies by separate rule or order.

Which Organizations Are Affected? *(cont.)*

Note on Defined Terms

- In the SCCL Reproposal, the following defined terms are used:
 - **“Covered company”**: any BHC (other than FBO) with ≥ \$50 billion in total consolidated assets and all of its subsidiaries.
 - **“Covered entity”**: (1) any entity that is part of the combined U.S. operations (which includes a U.S. branch or agency) of an FBO with ≥ \$50 billion in total consolidated assets and all of its subsidiaries, and (2) any U.S. IHC of an FBO with ≥ \$50 billion in total consolidated assets and all of its subsidiaries.
- In this memorandum, we use **“covered company”** to refer to any covered company or covered entity and **“Smaller Covered Company”** to refer to any covered company or covered entity with < \$250 billion in total consolidated assets and < \$10 billion in on-balance sheet foreign exposures.
- In this memorandum, we use **“Large Covered Company”** to refer to any covered company or FBO with ≥ \$250 billion in total consolidated assets or ≥ \$10 billion in on-balance sheet foreign exposures that is not a major covered company, major FBO or major U.S. IHC.
- In the SCCL Reproposal, the following defined terms are used:
 - **“Major covered company”**: any U.S. BHC identified as a global systemically important BHC pursuant to the Federal Reserve’s G-SIB surcharge rule and all of its subsidiaries.
 - **“Major FBO”**: any FBO with ≥ \$500 billion in total consolidated assets.
 - **“Major U.S. IHC”**: any U.S. IHC ≥ \$500 billion in total consolidated assets.
- In this memorandum, we use **“Major Covered Company”** to refer to any major covered company, major FBO or major U.S. IHC.

Which Organizations Are Affected? *(cont.)*

Calculation of Total Consolidated Assets

- **For any U.S. BHC or U.S. IHC:** Total consolidated assets are determined based on the average of total consolidated assets for the four most recent consecutive quarters as reported on Form FR Y-9C (or, if the U.S. BHC has not filed four quarters of FR Y-9Cs, the average for the most recent quarter(s) or, if a U.S. IHC has not yet filed an FR Y-9C, as determined under applicable accounting standards).
- **For any FBO:** Total consolidated assets are determined based on the average of total consolidated assets for the four most recent consecutive quarters as reported on Form FR Y-7Q (or, if the FBO has not filed four quarters of FR Y-7Qs, the average for the most recent quarter(s) or, if an FBO has not yet filed an FR Y-7Q, as determined under applicable accounting standards).

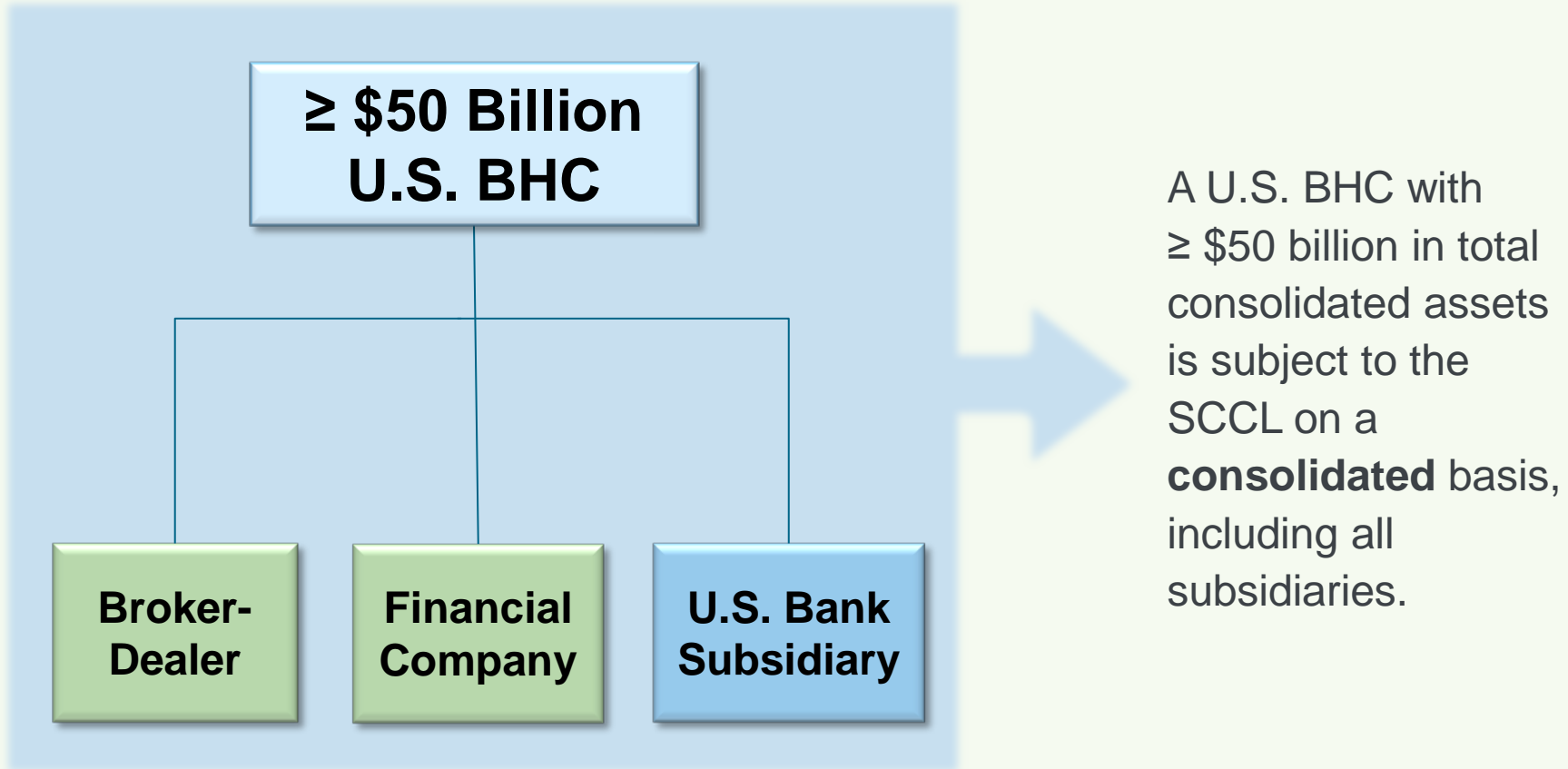
Which Organizations Are Affected? *(cont.)*

Subsidiaries of a Covered Company

- Under the SCCL Reproposal, the SCCL requirements apply to a covered company on a **consolidated basis**, including any subsidiaries.
 - A “**subsidiary**” of a covered company means any company that is directly or indirectly controlled by the covered company for the purposes of the BHCA.
 - Under the BHCA definition, **control** exists where a covered company:
 - 1) Directly or indirectly or acting through one or more other persons owns, controls, or has the power to vote **25%** or more of any class of voting securities of the other company;
 - 2) Controls in any manner the election of a **majority** of the directors or trustees of the other company;
or
 - 3) Directly or indirectly exercises a **controlling influence** over the management or policies of the other company, as determined by the Federal Reserve after notice and opportunity for hearing.
 - The controlling influence prong is a facts-and-circumstances test that results in **investment funds** or similar vehicles being considered subsidiaries of a covered company under certain circumstances.
- The aggregation requirement for counterparties connected by certain control relationships (see [pages 21-22](#)) effectively aligns the definition of covered company with the definition of counterparty, subject to the additional aggregation requirement for economic interdependence (see [pages 23-24](#)).

Which Organizations Are Affected? (cont.)

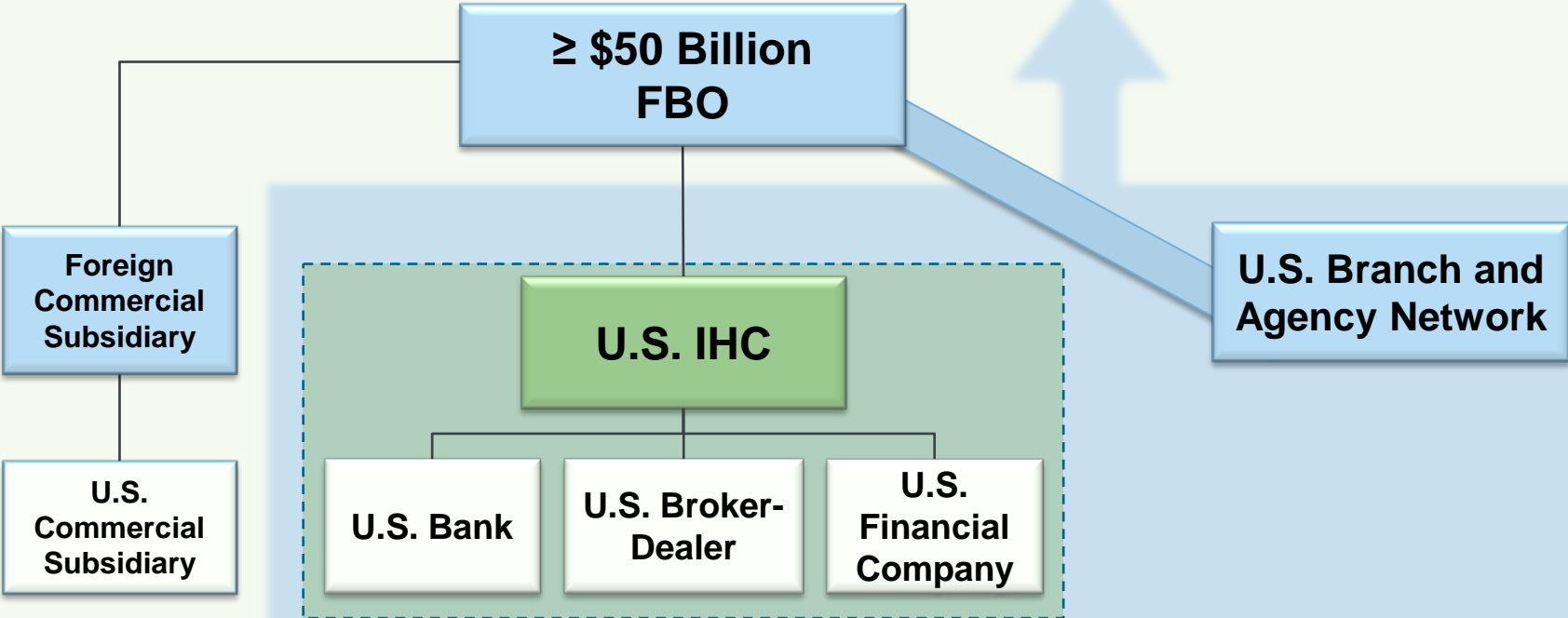
≥ \$50 Billion U.S. BHCs



Which Organizations Are Affected? (cont.)

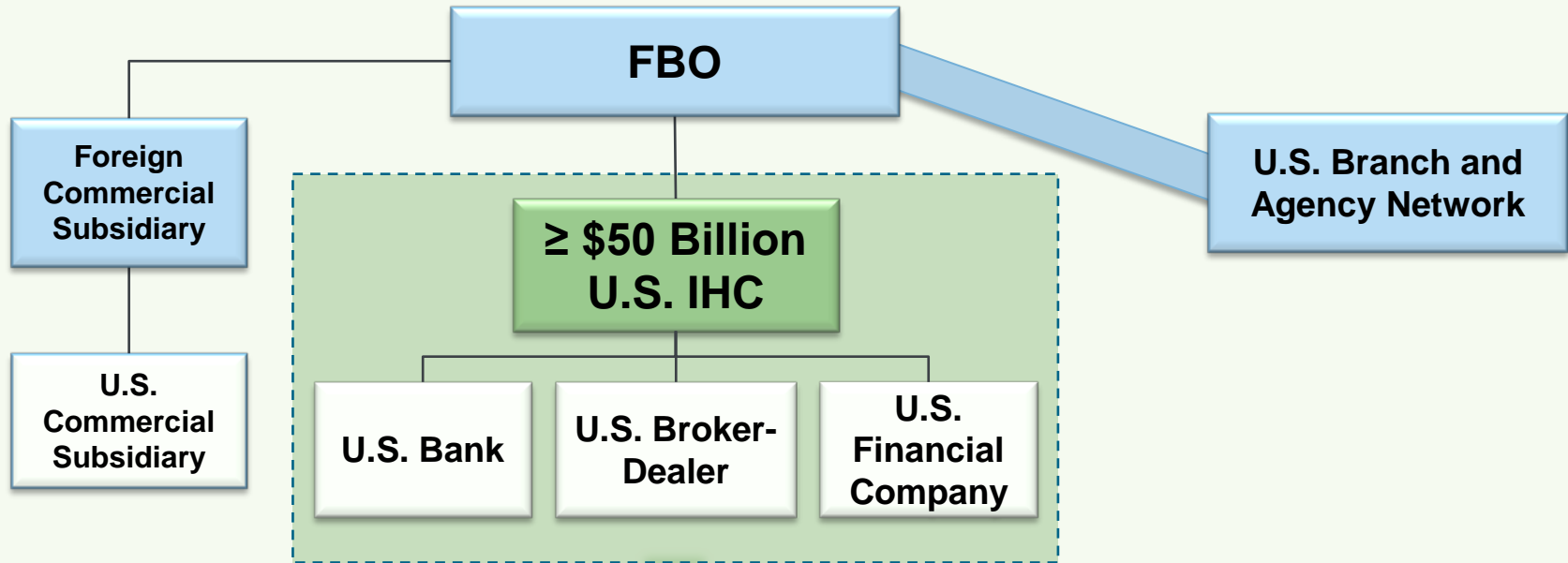
≥ \$50 Billion FBOs

An FBO with ≥ \$50 billion in total consolidated assets is subject to the SCCL with respect to its **combined U.S. operations.**



Which Organizations Are Affected? *(cont.)*

≥ \$50 Billion U.S. IHCs



A U.S. IHC with ≥ \$50 billion in total consolidated assets is subject to the SCCL on a **consolidated** basis, including all subsidiaries.

Definition of Counterparty

| Type of Entity | Scope of the Counterparty |
|-------------------------------|--|
| Natural Person | <ul style="list-style-type: none"> The person and members of the person's immediate family (<i>i.e.</i>, the individual's spouse, the individual's minor children, and any of the individual's children, including adults, residing in the individual's home) |
| Company | <ul style="list-style-type: none"> The company and all persons that the company: <ul style="list-style-type: none"> owns, controls, or holds with power to vote 25% or more of a class of voting securities of the person; owns or controls 25% or more of the total equity of the person; or consolidates for financial reporting purposes, collectively |
| U.S. State | <ul style="list-style-type: none"> The state and all of its agencies, instrumentalities, and political subdivisions (including any municipalities), collectively |
| Foreign Sovereign | <ul style="list-style-type: none"> Any foreign sovereign entity that is <u>not</u> assigned a 0% risk weight under the standardized approach in the Federal Reserve's Basel III capital rules and all of its agencies and instrumentalities (but not including any political subdivision), collectively |
| Foreign Political Subdivision | <ul style="list-style-type: none"> A political subdivision (<i>e.g.</i>, a state, province, or municipality) of any foreign sovereign entity and all of such political subdivision's agencies and instrumentalities, collectively |

Exclusions: The following are **excluded** from the definition of counterparty:

- The U.S. government;
- Foreign sovereigns with a 0% risk weight under the standardized approach in the Federal Reserve's Basel III capital rules; and
- Agencies, departments, ministries, and central banks of the foregoing (but not including political governmental subdivisions, such as a state, province, or municipality).

Exempt counterparties: In addition, exposures to the following counterparties are **exempt** from the SCCL (see [pages 31–32](#)):

- FNMA (Fannie Mae) and FHLMC (Freddie Mac), but only while under Federal Housing Finance Agency conservatorship or receivership;
- Trade exposures to a QCCP related to a covered company's clearing activity; and
- For FBOs and their U.S. IHCs, an FBO's home country sovereign entity, regardless of its Basel III risk weight.

Definition of Counterparty *(cont.)*

- The SCCL applies only to an **“unaffiliated” counterparty** of a covered company.
 - “Unaffiliated counterparty” is not defined in the SCCL Reproposal itself, but the general provisions (Subpart A) of Regulation YY define “affiliate” by reference to section 2(k) of the BHCA:
 - any company that controls, is controlled by, or is under common control with another company.
 - As a result, a counterparty for purposes of the SCCL is a company that does not control, is not controlled by, and is not under common control with the covered company.
- **Additional Aggregation:** The SCCL Reproposal effectively **expands** the scope of a counterparty by imposing additional aggregation requirements:
 - Exposures to counterparties connected by **certain control relationships** beyond those set out in the definition of counterparty, including the BHCA “controlling influence” test, must be aggregated. See [pages 21–22](#).
 - In certain cases, exposures to unaffiliated counterparties that are **“economically interdependent”** must be aggregated. See [pages 23–24](#).
- **Attribution Rule:** Any credit transaction with a person, the proceeds of which are used for the benefit of, or are transferred to a counterparty, must be **attributed to that counterparty**.
 - The Federal Reserve clarified that, in general, credit exposures resulting from transactions made in the **ordinary course of business** will **not** be subject to the attribution rule.

Definition of Major Counterparty

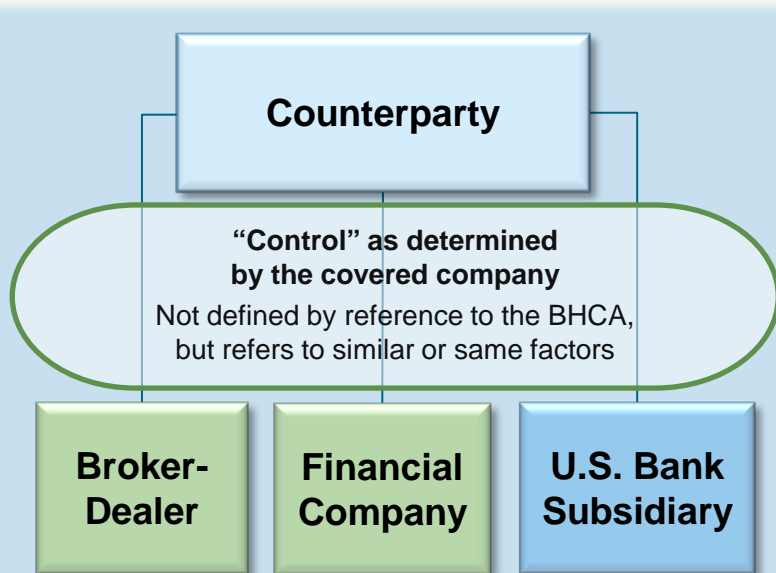
The SCCL Reproposal imposes **stricter limits** (15% rather than 25% of Tier 1 capital) on credit extensions between Major Covered Companies, on the one hand, and **major counterparties**, which are:

- A **U.S. G-SIB** and all of its subsidiaries, collectively;
- Any **FBO** (and all of its subsidiaries, collectively) that meets **one of the following conditions**:
 - 1) The FBO has the characteristics of a foreign G-SIB under the assessment methodology and the higher loss absorbency requirement for global systemically important banks issued by the Basel Committee, as updated from time to time (“**BCBS methodology**”);
 - An FBO that prepares or reports, for any purpose, the indicator amounts necessary to determine whether it is a foreign G-SIB under the BCBS methodology must use the data to determine whether it has the characteristics of a G-SIB under the BCBS methodology;
 - 2) The Federal Reserve, using information reported by the FBO or its U.S. subsidiaries, publicly available information and confidential supervisory information, determines that:
 - The FBO would be a foreign G-SIB under the BCBS methodology;
 - The FBO would be identified as a U.S. G-SIB under the Federal Reserve’s capital rules relating to G-SIB surcharges; **or**
 - The U.S. IHC would be identified as a U.S. G-SIB under the Federal Reserve’s capital rules relating to G-SIB surcharges; and
- Any **nonbank SIFI** supervised by the Federal Reserve.

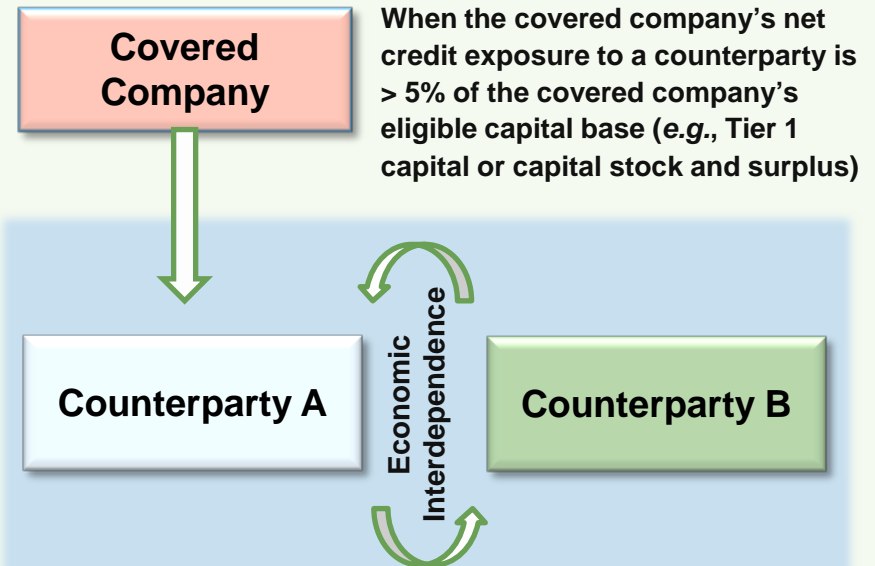
Counterparty Aggregation Requirements

In certain cases, a covered company's exposures to separate counterparties must be aggregated for purposes of the SCCL. These include (1) counterparties connected by control relationships ("**controlled counterparties**") and (2) unaffiliated counterparties that are economically interdependent with one another ("**economically interdependent counterparties**").

Controlled Counterparties (see [pages 21–22](#))



Economically Interdependent Counterparties (see [pages 23–24](#))



Counterparty Aggregation Requirements

Controlled Counterparties

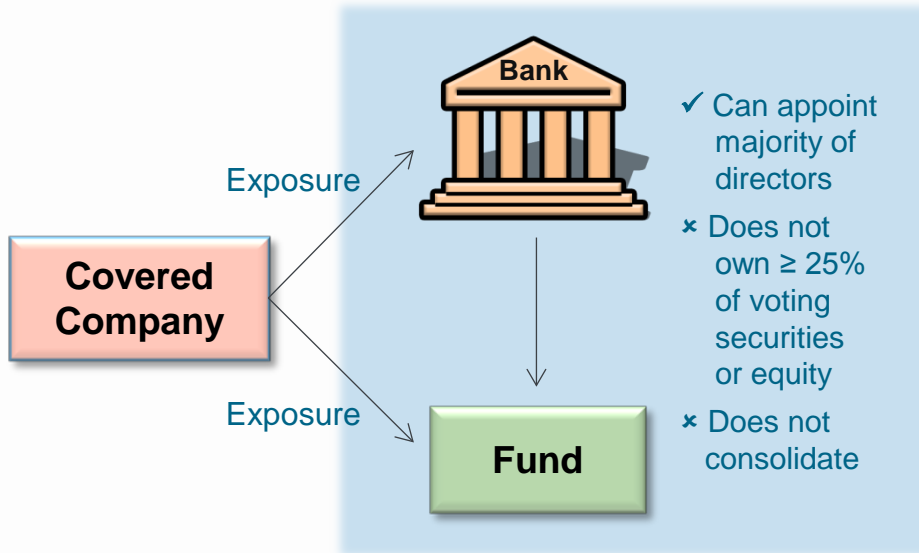
- A covered company **must assess** whether any of its counterparties are connected by control relationships, as described below, and **must aggregate** exposures of counterparties that it or the Federal Reserve determines are so connected.
 - These control relationships are **in addition** to those set out in the definition of counterparty, which includes all persons that the counterparty:
 - owns, controls, or holds with the power to vote 25% or more of a class of voting securities of the person;
 - owns or controls 25% or more of the total equity of the person; or
 - consolidates for financial reporting purposes.
 - There is **no net credit exposure threshold** (e.g., > 5%) for the control analysis.
- The additional control analysis must consider the following factors:
 - The presence of **voting agreements**;
 - The 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
 - The ability of one counterparty to **exercise a controlling influence** over the management or policies of another counterparty (this is effectively the same as the third prong of the BHCA definition of "control").
- To avoid evasion, the Federal Reserve may determine, after notice to the covered company and opportunity for hearing, that one or more counterparties are connected by control relationships, considering the factors above and **any other control relationships** that it determines to be relevant.

The Federal Reserve stated that "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."

Counterparty Aggregation Requirements

Controlled Counterparties (cont.)

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% or more of a class of voting securities of the fund; (2) own or control 25% or more of the total equity of the fund; or (3) consolidate the fund for financial reporting purposes. The bank does, however, have the ability to appoint a majority of the directors of the fund. Under the SCCL Reproposal, a covered company would be required to add its net credit exposures to the fund to its net credit exposures to the bank.



- ✗ owns, controls, or holds with power to vote 25% or more of a class of voting securities;
- ✗ owns or controls 25% or more of the total equity; or
- ✗ consolidates for financial reporting purposes.
- **The covered company determines that Counterparty A has a control relationship with Counterparty B due to following factors:**
 - ✗ The presence of voting agreements;
 - ✗ 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
 - ✗ Ability of one counterparty to exercise a controlling influence over the management or policies of another counterparty.

Counterparty Aggregation Requirements

Economically Interdependent Counterparties


- Where a covered company's net credit exposure to an unaffiliated counterparty **exceeds 5%** of the covered company's **eligible capital base** (see [pages 28–29](#)), the covered company **must analyze** whether the counterparty is **economically interdependent** with one or more unaffiliated counterparties of the covered company.
 - The covered company must take into account a **series of factors** (see [next page](#) for details) in making this analysis.
 - **Purpose of the 5% threshold:** “There may be cases in which the burdens of investigating economic interdependence would outweigh its credit risk mitigating benefits to the covered company.”
- If a **covered company** or the **Federal Reserve** determines that one or more unaffiliated counterparties of the covered company are economically interdependent, the covered company must **aggregate its net credit exposure to the unaffiliated counterparties** for all SCCL requirements.
 - To avoid evasion, the Federal Reserve may determine, after notice to the covered company and opportunity for hearing, that one or more unaffiliated counterparties are economically interdependent for purposes of the SCCL.

The Federal Reserve explained in the preamble that “[t]he 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. ... 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.”

Counterparty Aggregation Requirements

Economically Interdependent Counterparties (*cont.*)

- Two counterparties are **economically interdependent** if financial problems (*i.e.*, failure, default, insolvency, or material financial distress) of one counterparty would cause financial problems for the other counterparty, taking into account the following factors:
 - Whether **50% or more** of one counterparty's **gross revenue** or **gross expenditures** are derived from transactions with the other counterparty;
 - Whether one counterparty has **fully or partly guaranteed** the credit 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;
 - Whether **25% or more** of one counterparty's **production** or **output** is sold to the other counterparty, which cannot easily be replaced by other customers;
 - Whether the **expected source of funds** to repay any credit exposure between the counterparties is the same and at least one of the counterparties **has no other source** of income from which the extension of credit may be fully repaid;
 - Whether the **financial distress** of one counterparty is **likely to impair** the ability of the other counterparty to fully and timely repay its liabilities;
 - 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; and
 - **Any other indicia** of interdependence that the covered company determines to be relevant.
- These factors would clearly require fact-specific analyses of the nature of economic relationships between unaffiliated counterparties.

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III. Credit Exposure Limits

- [Overview](#)
- [Categories of Limits](#)
- [Eligible Capital Base](#)
- [Definition of Credit Transaction](#)
- [Exempt or Excluded Transactions](#)

Credit Exposure Limits Overview

For a covered company, with respect to an unaffiliated counterparty

Aggregate Net Credit Exposure

Eligible Capital Base

must be \leq relevant limit (15% or 25%)

A covered company's **aggregate net credit exposure** to a counterparty is calculated as follows:

Step 1: Calculate the **gross credit exposure** to the counterparty on each **credit transaction**. See [pages 33–43](#).

Step 2: **Reduce** the gross credit exposure amount based on eligible credit risk mitigants to determine the **net credit exposure** for each credit transaction with the counterparty. See [pages 44–67](#).

Step 3: **Sum** all net credit exposures to the counterparty, considering **additional aggregation requirements**. See [pages 20–24](#).

Eligible capital base is, depending on the type of covered company:

- capital stock and surplus (total regulatory capital plus balance of ALLL not already included in Tier 2 capital) **or**
- Tier 1 capital.

See [pages 28–29](#).

Relevant limit depends on the type and size of the covered company and counterparty. See [page 27](#).

Credit Exposure Limits

Categories of Limits

| Type of Institution | Limit of Aggregate Net Credit Exposure to Any: | |
|---|--|------------------------|
| | Major Counterparty | Other Counterparty |
| <ul style="list-style-type: none"> U.S. G-SIB Major U.S. IHC Major FBO | 15% of Tier 1 capital* | 25% of Tier 1 capital* |
| <ul style="list-style-type: none"> Large U.S. BHC Large U.S. IHC Large FBO | 25% of Tier 1 capital* | |
| <ul style="list-style-type: none"> Covered U.S. BHC Covered FBO Covered U.S. IHC <p>Each with < \$250 billion in total consolidated assets <u>and</u> < \$10 billion in on-balance sheet foreign exposures</p> | 25% of capital stock and surplus* | |
| Other institutions (e.g., a U.S. BHC with < \$50 billion in total consolidated assets, a U.S. depository institution) | N/A | |

The 15% limit is based on the Federal Reserve's analysis of default risk correlation between SIFIs and a credit risk model designed to limit credit risk between SIFIs to the equivalent credit risk a SIFI would incur to a non-SIFI under a 25% limit.

Credit Exposure Limits

Eligible Capital Base

| | Loss Absorbency | Covered U.S. BHCs / U.S. IHCs | Covered FBOs |
|----------------------------------|--|---|--|
| Capital Stock and Surplus | Includes capital elements that do not absorb losses on a going-concern basis – e.g., a covered company’s subordinated debt, which is senior in the creditor hierarchy to equity and therefore takes losses only once a company’s equity has been wiped out. | Total (Tier 1 + Tier 2) regulatory capital plus the balance of ALLL not included in Tier 2 capital. The Federal Reserve noted that this definition is “conceptually similar to the definition of [capital stock and surplus] in the Board’s Regulations O and W and the OCC’s national bank lending limit regulation.” | Total regulatory capital as reported on the most recent FR Y-7Q or other reporting form specified by the Federal Reserve. The Federal Reserve noted that the different definition of capital stock and surplus for FBOs reflects differences in international accounting standards. |

The Federal Reserve noted in the preamble: “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. ... 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 [*i.e.*, Tier 1 capital].”

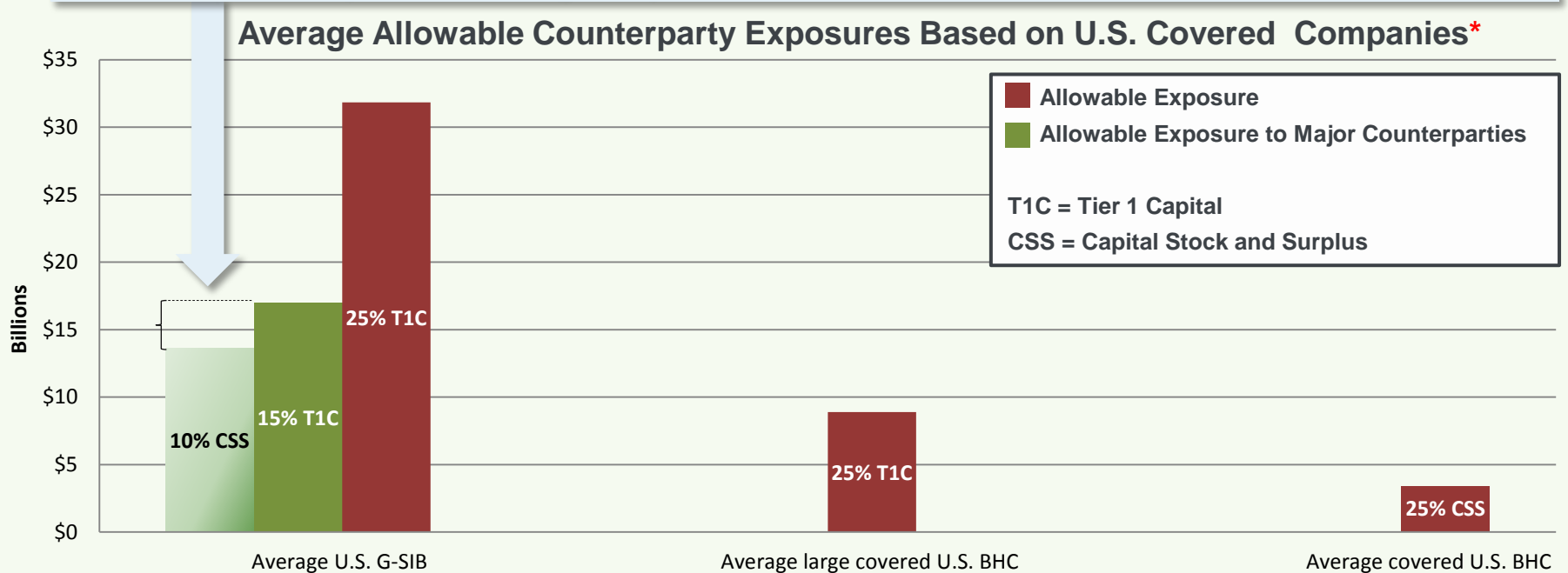
| | Loss Absorbency | Major and Large Covered Companies |
|-----------------------|--|--|
| Tier 1 Capital | Consists only of equity claims on the company (e.g., common equity and certain preferred shares), which are available to absorb losses on a going-concern basis . | Tier 1 capital (Common Equity Tier 1 + Additional Tier 1) |

Credit Exposure Limits

Eligible Capital Base *(cont.)*

- The following graph represents the absolute size of allowable single-counterparty exposures for the average U.S. G-SIB, large U.S. BHC and covered U.S. BHC.

Allowable exposure to major counterparties for a Majored Covered Company changed from 10% of capital stock and surplus in the initial proposals to 15% of Tier 1 capital in the SCCL Reproposal, leading to an average of \$3.4 billion in additional allowable exposure despite a narrower eligible capital base.



Credit Exposure Limits

Definition of Credit Transaction

- Gross credit exposure is calculated for any “**credit transaction.**”
- **Credit transaction** means, with respect to any counterparty, any:
 - **extension of credit** to the counterparty, including loans, deposits, and lines of credit, but excluding uncommitted lines of credit;
 - **repurchase or reverse repurchase** transaction with the counterparty;
 - **securities lending or securities borrowing** transaction with the counterparty;
 - **guarantee, acceptance, or letter of credit** (including any endorsement, confirmed letter of credit or standby letter of credit) issued on behalf of the counterparty;
 - **purchase of, or investment in, securities** issued by the counterparty;
 - with respect to derivative transactions, exposure to the counterparty in connection with a:
 - **derivative transaction** between the covered company and the counterparty;
 - **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;
 - any transaction that is the **functional equivalent** of the above; and
 - any **similar transaction** that the **Federal Reserve determines**, by regulation, to be a credit transaction for purposes of the SCCL.

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.

Credit derivative has the same meaning as in the Federal Reserve's Basel III capital rules: a financial contract executed under standard industry credit derivative documentation that allows one party (the protection purchaser) to transfer the credit risk of one or more exposures (reference exposure(s)) to another party (the protection provider) for a certain period of time.

Equity derivative has the same meaning as “equity derivative contract” in the Federal Reserve's Basel III capital rules: an equity-linked swap, purchased equity linked option, forward equity-linked contract, or any other instrument linked to equities that gives rise to similar counterparty credit risks.

Credit Exposure Limits

Exempt or Excluded Transactions


| Type of Exempt / Excluded Transaction | Rationale |
|--|---|
| Exposures to the U.S. government or a foreign sovereign entity with a 0% risk weight under the Federal Reserve's Basel III capital rules (and its respective agencies) | Excluded because such entities are not included in the definition of "counterparty." |
| Direct claims on, and the portions of claims that are directly and fully guaranteed as to principal and interest by, Fannie Mae and Freddie Mac, <u>only while operating under the conservatorship or receivership</u> of the Federal Housing Finance Agency, and any additional obligations issued by a U.S. GSE as determined by the Federal Reserve | According to the Federal Reserve, "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." |
| Intraday credit exposure to a counterparty (<i>i.e.</i> , an exposure that by its terms is to be repaid, sold or terminated by the end of its business day in the U.S.) | The Federal Reserve noted that "[t]his exemption would help minimize the impact of the rule on the payment and settlement of financial transactions." |

Credit Exposure Limits

Exempt or Excluded Transactions *(cont.)*

| Type of Exempt / Excluded Transaction | Rationale |
|---|---|
| Trade exposures to a QCCP (as defined in 12 C.F.R. § 217.2) related to the covered company's clearing activity, including potential future exposure arising from transactions cleared by the QCCP and pre-funded default fund contributions* | The Federal Reserve included this exemption 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." |
| For covered FBOs and U.S. IHCs, direct claims on, and the portions of claims that are directly and fully guaranteed as to principal and interest by, the FBO's home country sovereign entity, regardless of the risk weight assigned to that sovereign entity under the Federal Reserve's Basel III capital rules | According to the Federal Reserve, "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." |
| Any transaction that the Federal Reserve exempts if it finds that such exemption is in the public interest and consistent with the purpose of Section 165(e) of the Dodd-Frank Act. | Statutory authority for the Federal Reserve, by regulation or order, to exempt transactions, in whole or in part, from the SCCL. |

*The Federal Reserve noted that initial margin and excess variation margin posted to a QCCP and held in a segregated account by a third-party custodian are not subject to counterparty risk and thus would not be considered credit exposures under the SCCL Reproposal.

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IV. Gross Credit Exposure

- [Calculation of Gross Exposure](#)
- [Exposures to SPVs](#)
- [Exposures to Certain Third Parties of SPVs](#)

Gross Credit Exposure

Calculation of Gross Exposure

- Calculation of gross credit exposure depends on the category of on-balance sheet or off-balance sheet exposure.

| Exposure Type | Calculation of Gross Exposure |
|----------------------------------|--|
| Loans and leases | <ul style="list-style-type: none"> The amount owed by the counterparty to the covered company under the transaction |
| Debt securities | <ul style="list-style-type: none"> For trading and available-for-sale securities, the market value of the securities For securities held to maturity, the amortized purchase price of the securities |
| Equity securities | <ul style="list-style-type: none"> The market value of the securities |
| Committed credit lines | <ul style="list-style-type: none"> The face amount of the credit line |
| Guarantees and letters of credit | <ul style="list-style-type: none"> The maximum potential loss to the covered company on the transaction |

The **market value** approach is effectively **countercyclical**, requiring covered companies to revalue upwards the amount of an investment in such securities when the market value of the securities increases. This would limit the ability of the covered company to engage in additional transactions with the counterparty.

Gross Credit Exposure

Calculation of Gross Exposure (cont.)

| Exposure Type | Calculation of Gross Exposure |
|-----------------------------------|--|
| Repurchase transactions | <ul style="list-style-type: none"> The adjusted market value of the securities transferred by the covered company to the counterparty |
| Reverse repurchase transactions | <ul style="list-style-type: none"> The amount of cash transferred by the covered company to the counterparty |
| Securities borrowing transactions | <ul style="list-style-type: none"> The amount of cash collateral transferred by the covered company to the counterparty, plus The adjusted market value of securities collateral transferred by the covered company to the counterparty |
| Securities lending transactions | <ul style="list-style-type: none"> The adjusted market value of securities lent by the covered company to the counterparty |

Adjusted market value means:

$$MV + H_s \times \sqrt{1/2}$$

where

MV = the market value

H_s = the applicable standard supervisory market price volatility haircut provided by the Federal Reserve's Basel III capital rules (Table 1 of 12 C.F.R. § 217.132).

Multiplying the values in Table 1 by the square root of $1/2$ reflects the assumption of a **5-day liquidation period** for repo-style transactions (compared to a 10-day liquidation period for other collateralized transactions) under the Federal Reserve's Basel III capital rules.

Gross Credit Exposure

Calculation of Gross Exposure (cont.)

No double-counting: Where a covered company must recognize an exposure to an **eligible protection provider** (see [page 54](#)), the relevant derivative transaction must be **excluded** when calculating gross exposure to the original counterparty.

| Exposure Type | Calculation of Gross Exposure |
|--|---|
| <p>Derivative transactions <u>not</u> subject to a qualifying master netting agreement (defined on page 37)</p> | <ul style="list-style-type: none"> ▪ Effectively the CEM: <ul style="list-style-type: none"> ▪ The current exposure (equal to the greater of the mark-to-market value of the derivative contract and zero), plus ▪ The potential future exposure (PFE), calculated by multiplying the notional principal amount of the derivatives contract by the applicable conversion factor provided by the conversion factor matrix for OTC derivative contracts in the Federal Reserve’s Basel III capital rules (Table 2 to 12 C.F.R. § 217.132)* |
| <p>Derivative transactions subject to a qualifying master netting agreement</p> | <ul style="list-style-type: none"> ▪ For U.S. covered companies and U.S. IHCs, any of the methods that the covered company is authorized to use under the Federal Reserve’s Basel III capital rules (subject to the SCCL Reproposal’s rules governing collateral recognition) ▪ For a covered FBO’s combined U.S. operations, any of the methods that the covered FBO is authorized to use under the Federal Reserve’s Basel III capital rules or the gross credit exposure calculation for derivatives that are <u>not</u> subject to a qualifying master netting agreement |

For derivatives subject to a qualifying master netting agreement, covered companies subject to the **advanced approaches** may use the internal model method in the Federal Reserve’s Basel III capital rules, rather than the CEM.

The Federal Reserve stated that it would consider incorporating the **Basel Committee’s revised standardized approach** (“SA-CCR”) for measuring credit exposure to a derivatives counterparty.

- For collateralized OTC derivatives, the SA-CCR would require the exposure amount to be calculated in part as a function of the covered company’s replacement cost and a PFE add-on representing the potential change in value of the trades between the last exchange of collateral and replacement of the trades.

* Table 2 to 12 C.F.R. § 217.132 (advanced approaches) is substantially identical to Table 1 to 12 C.F.R. § 217.34 (standardized approach).

Gross Credit Exposure

Calculation of Gross Exposure (*cont.*)

Qualifying master netting agreement has the same meaning as in the Federal Reserve's Basel III capital rules, supplemented by a new operational requirement as part of the SCCL Reproposal's compliance requirements: a written, legally enforceable agreement provided that:

- 1) The agreement creates a **single legal obligation** for all individual transactions covered by the agreement **upon an event of default following any stay** permitted by paragraph (2) of this definition, including upon an event of receivership, conservatorship, insolvency, liquidation, or similar proceeding, of the counterparty;
- 2) The agreement provides the [covered company] the **right to accelerate, terminate, and close-out on a net basis all transactions** under the agreement and **to liquidate or set-off collateral** promptly upon an event of default, including upon an event of receivership, conservatorship, insolvency, liquidation, or similar proceeding, of the counterparty, provided that, in any such case, any exercise of rights under the agreement will not be stayed or avoided under applicable law in the relevant jurisdictions, **other than**:
 - (i) In receivership, conservatorship, or resolution under the Federal Deposit Insurance Act, Title II of the Dodd-Frank Act, or under any similar insolvency law applicable to GSEs, or laws of foreign jurisdictions that are substantially similar to the U.S. laws referenced in this paragraph (2)(i) in order to facilitate the orderly resolution of the defaulting counterparty; or
 - (ii) Where the agreement is subject by its terms to, or incorporates, any of the laws referenced in paragraph (2)(i) of this definition;
- 3) The agreement **does not contain a walkaway clause** (*i.e.*, a provision that permits a non-defaulting counterparty to make a lower payment than it otherwise would make under the agreement, or no payment at all, to a defaulter or the estate of a defaulter, even if the defaulter or the estate of the defaulter is a net creditor under the agreement); and
- 4) In order to recognize an agreement as a qualifying master netting agreement, a [covered company] must comply with the following **operational requirements** with respect to the agreement:
 - **Conduct sufficient legal review** to conclude with a well-founded basis (and maintain sufficient written documentation of that legal review) that the agreement meets the requirements of paragraph (2) above and, in the event of a legal challenge (including one resulting from default or from receivership, insolvency, liquidation, or similar proceeding), the relevant court and administrative authorities would find the agreement to be legal, valid, binding, and enforceable under the law of the relevant jurisdictions; and
 - **Establish and maintain written procedures to monitor possible changes in relevant law** and to ensure that the agreement continues to satisfy the requirements of the definition of qualifying master netting agreement. See [page 69](#).

Gross Credit Exposure

Calculation of Gross Exposure *(cont.)*

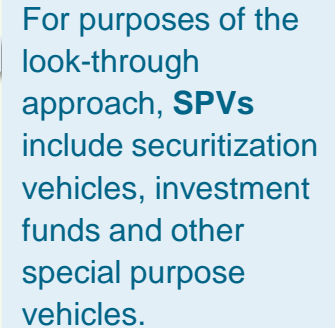
| Exposure Type | Calculation of Gross Exposure |
|--|---|
| Credit or equity derivative transactions between the covered company and a third party, where the covered company is the protection provider and the reference asset is the counterparty's obligation or equity security | <ul style="list-style-type: none">▪ The maximum potential loss to the covered company on the transaction |

- With respect to both cleared and uncleared derivatives, the amount of **initial margin** and **variation margin** in excess of that needed to secure the mark-to-market value of a derivative that is 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**.

Gross Credit Exposure

Exposures to SPVs

- Large and Major Covered Companies may be required to “**look through**” their investments in an **SPV**, which would increase their aggregate exposures to the issuers of the SPV’s underlying assets.
 - They must do so generally where exposure to **any issuer of each underlying asset** in an SPV is **≥ 0.25%** of the covered company’s Tier 1 capital.
 - See [pages 40–42](#) for further details.
- If a Large or Major Covered Company that must apply the look-through approach is **unable to identify** each issuer of assets held by an SPV, it must attribute the gross credit exposure to a **single unknown counterparty**, and the SCCL will apply to that counterparty as a single counterparty.
- The look-through approach generally would not apply to Smaller Covered Companies’ investments in SPVs.
 - However, the Federal Reserve may determine, after notice and opportunity for a hearing, that a covered company that is not a Large or Major Covered Company must comply with the look-through requirement.
 - To the extent that Smaller Covered Companies would be required to apply the look-through approach, the threshold would be 0.25% of their eligible capital base, which is capital stock and surplus rather than Tier 1 capital.

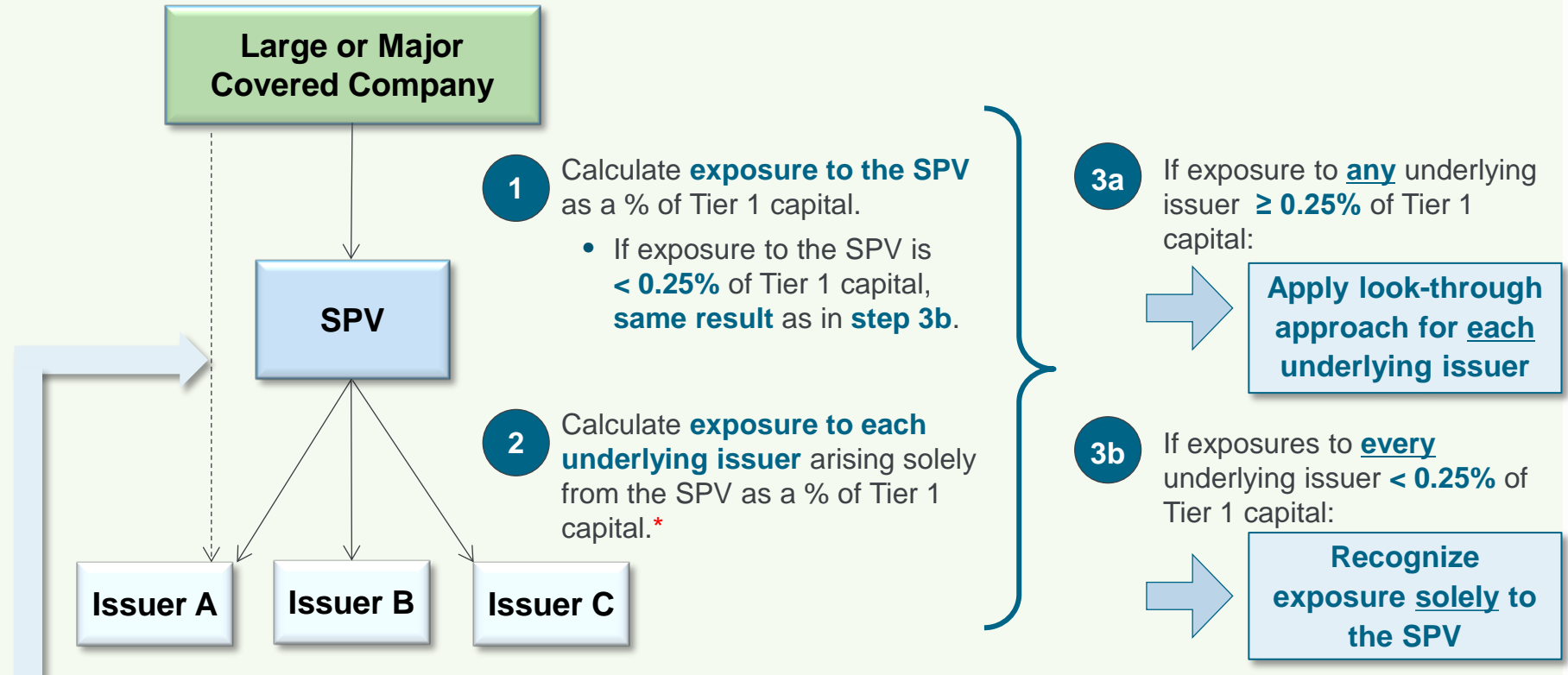


For purposes of the look-through approach, **SPVs** include securitization vehicles, investment funds and other special purpose vehicles.

Gross Credit Exposure

Exposures to SPVs (cont.)

- The look-through approach must be used unless it can be demonstrated that the exposure arising from the SPV to the issuer of **each underlying asset** in the SPV is **< 0.25%** of the covered company's **Tier 1 capital**.



Any direct exposures to the issuers of the underlying assets are not counted when determining whether the look-through approach is applied.

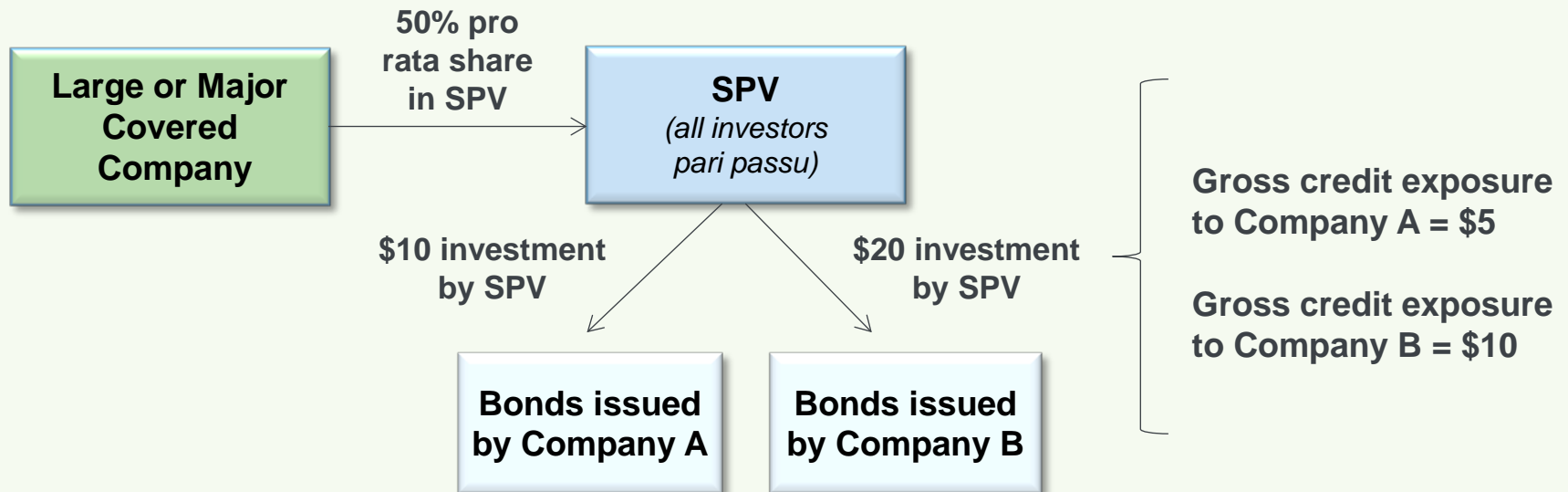
* Calculation of the exposure to each underlying issuer depends on whether each investor in the SPV is *pari passu* or not. See [pages 41–42](#).

Gross Credit Exposure

Exposures to SPVs (cont.)

- Investment in an SPV where all investors are *pari passu*: The application of the look-through approach depends on the nature of the Large or Major Covered Company's investment in the SPV. Where all investors in an SPV are *pari passu*, the Large or Major Covered Company must calculate its exposure to an issuer of assets held by the SPV as follows:

| | | | | |
|--|---|--|---|--|
| Gross credit exposure to underlying issuer | = | Large or Major Covered Company's pro rata share in SPV | × | Value of SPV's underlying assets issued by that issuer |
|--|---|--|---|--|

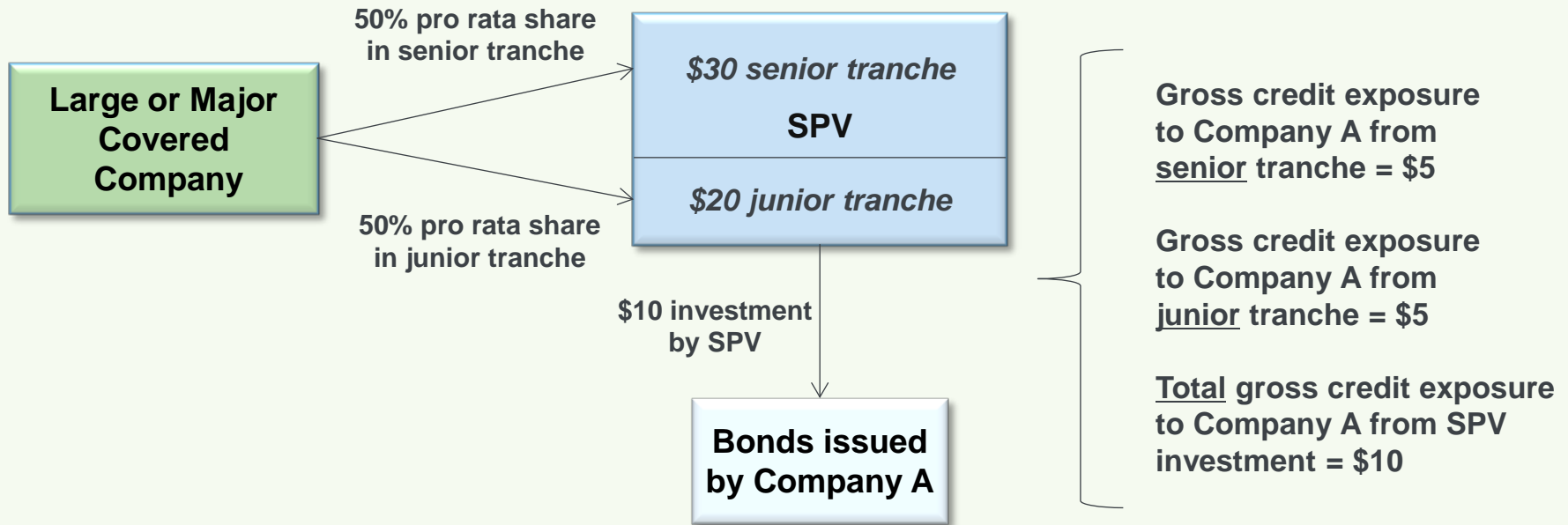


Gross Credit Exposure

Exposures to SPVs (cont.)

- Investment in an SPV where all investors are not *pari passu*: If all investors in an SPV are *not pari passu*, a Large or Major Covered Company that must use the look-through approach must measure its exposure to an issuer of assets held by the SPV for each tranche in the SPV in which it invests using the following formula:


| | | | | |
|--|---|--|---|--|
| Gross credit exposure to underlying issuer | = | Large or Major Covered Company's pro rata share in SPV tranche | × | Lesser of (i) value of tranche and (ii) value of assets issued by the issuer held by the SPV |
|--|---|--|---|--|



Gross Credit Exposure

Exposures to Certain Third Parties of SPVs

- In addition to the requirement to recognize a gross credit exposure to the SPV or to issuers of assets held by the SPV, as applicable, a Large or Major Covered Company **must recognize** a gross credit exposure to **each third party** that has a **contractual or other business relationship** with an SPV whose **failure or material financial stress** would likely cause a **loss in the value** of the covered company's investment in or exposure to the SPV.
- In such cases, the covered company must recognize an exposure to the relevant third party that is **equal** to the amount of the covered company's gross credit exposure to the SPV.
- Unlike the case for a guarantor or protection provider, this mechanism does not result in the risk-shifting of all or part of a single exposure, but is treated as the creation of an **additional** exposure.
- Examples of third parties that may trigger this requirement:
 - Third-party credit support providers to the SPV;
 - Originators of assets held by the SPV;
 - Liquidity providers to the SPV; and
 - The SPV's fund manager(s).
- The Federal Reserve may determine, after notice and opportunity for a hearing, that a covered company that is not a Large or Major Covered Company must comply with this requirement.

Click on an item to go to that page 

V. Net Credit Exposure

- [Securities Financing Transactions](#)
- [Eligible Collateral](#)
- [Eligible Guarantees](#)
- [Eligible Credit and Equity Derivatives as Risk Mitigants](#)
- [Other Eligible Hedges](#)
- [Unused Portions of Certain Extensions of Credit](#)
- [Credit Transactions Involving Exempt or Excluded Persons](#)
- [Exempt or Excluded Collateral Issuer or Eligible Protection Provider](#)

Net Credit Exposure

Securities Financing Transactions

- A covered company's net credit exposure with respect to a repurchase transaction, reverse repurchase transaction, securities lending transaction or securities borrowing transaction (collectively, "**securities financing transactions**") that is subject to a **bilateral netting agreement** with the counterparty and is a "**repo-style transaction**" as defined in the Federal Reserve's Basel III capital rules (see [page 47](#)) is equal to the **exposure amount** calculated under the capital rules' collateral haircut approach (12 C.F.R. § 217.37(c)(2)), applying the **standard supervisory haircuts** provided in Table 1 to 12 C.F.R. § 217.37.
 - As provided for under the capital rules, a covered company may multiply the standard supervisory haircuts by the square root of $\frac{1}{2}$ to reflect the assumption of a 5-day liquidation period for repo-style transactions.
 - A covered company may **not** apply its own **internal estimates** for the haircuts.
 - Collateral from the counterparty that does not qualify as "eligible collateral" (see [page 49](#)) must be disregarded.

Exposure amount =

$$\max\{0, [(\Sigma E - \Sigma C) + \Sigma(Es \times Hs) + \Sigma(E_{fx} + H_{fx})]\}$$

where

- ΣE = the value of the exposure, *i.e.*, the sum of the current fair values of all instruments and cash the covered company has lent, sold subject to repurchase, or posted as collateral to the counterparty under the transaction
- ΣC = the value of the collateral *i.e.*, the sum of the current fair values of all instruments and cash the covered company has borrowed, purchased subject to resale or taken as collateral from the counterparty under the transaction
- Es = the absolute value of the net position in a given instrument
- Hs = the appropriate market volatility haircut for the instrument
- E_{fx} = the absolute value of the net position of instruments and cash in a currency different from the settlement currency
- H_{fx} = the appropriate currency mismatch haircut between the currency referenced in E_{fx} and the settlement currency

For more details, please see Davis Polk's [U.S. Basel III Visual Memorandum](#).

Net Credit Exposure

Securities Financing Transactions (cont.)

- **Risk-shifting requirement:** A covered company **must include** the **adjusted market value** of any eligible collateral when calculating its gross credit exposure to the collateral issuer.
 - The covered company must apply a **maturity mismatch adjustment** where the eligible collateral has a shorter residual maturity than the transaction and the eligible collateral's original maturity is ≥ 1 year and its residual maturity is ≥ 3 months.
 - Consistent with the Federal Reserve's Basel III capital rules, if the eligible collateral has a shorter maturity than the transaction and its original maturity is < 1 year or its residual maturity is < 3 months, it cannot be used to reduce gross credit exposure.
 - The covered company's gross credit exposure to the collateral issuer for a particular securities financing transaction would be **capped** at the gross credit exposure to the counterparty on the transaction.
 - This shift in gross credit exposure must occur even when the securities financing transaction with the counterparty would not be subject to the SCCL.

The **maturity mismatch adjustment** is calculated as follows:

$$Pa = P \times (t - 0.25) / (T - 0.25)^*$$

- Pa = the value of the credit protection adjusted for maturity mismatch
- P = the credit protection adjusted for haircuts
- t = the lesser of (1) T and (2) the residual maturity of the credit protection, in years
- T = the lesser of (1) 5 and (2) the residual maturity of the exposure, in years

The Federal Reserve stated in the preamble that the purpose of the cap is **not to discourage overcollateralization**.

* This formula is stated in footnote 74 of the preamble and uses terms that are slightly different from those in 12 C.F.R. § 217.36(d).

Net Credit Exposure

Securities Financing Transactions *(cont.)*

Repo-style transaction has the same meaning as in the Federal Reserve’s Basel III capital rules: a **repurchase** or **reverse repurchase** transaction, or a **securities borrowing** or **securities lending** transaction, including a transaction in which the [covered company] acts as agent for a customer and indemnifies the customer against loss, **provided that**:

- 1) The transaction is based solely on **liquid** and **readily marketable** securities, cash, or gold;
- 2) The transaction is **marked-to-fair value daily** and **subject to daily margin maintenance requirements**;
- 3) (i) The transaction is a “**securities contract**” or “**repurchase agreement**” under section 555 or 559, respectively, of the Bankruptcy Code (11 U.S.C. 555 or 559), a qualified financial contract under section 11(e)(8) of the Federal Deposit Insurance Act, or a netting contract between or among financial institutions under sections 401-407 of the Federal Deposit Insurance Corporation Improvement Act or the Federal Reserve Board's Regulation EE (12 CFR part 231); or
(ii) If the transaction does **not** meet the criteria set forth in paragraph (3)(i) of this definition, then **either**:
 - (A) The transaction is executed under an agreement that provides the [covered company] the right to accelerate, terminate, and close-out the transaction on a net basis and to liquidate or set-off collateral promptly upon an event of default, including upon an event of receivership, insolvency, liquidation, or similar proceeding, of the counterparty, provided that, in any such case, any exercise of rights under the agreement will not be stayed or avoided under applicable law in the relevant jurisdictions, other than in receivership, conservatorship, or resolution under the Federal Deposit Insurance Act, Title II of the Dodd-Frank Act, or under any similar insolvency law applicable to GSEs, or laws of foreign jurisdictions that are substantially similar to the U.S. laws referenced in this paragraph (3)(ii)(a) in order to facilitate the orderly resolution of the defaulting counterparty; or
 - (B) The transaction is: (1) either overnight or unconditionally cancelable at any time by the [covered company]; and (2) executed under an agreement that provides the [covered company] the right to accelerate, terminate, and close-out the transaction on a net basis and to liquidate or set-off collateral promptly upon an event of counterparty default; and
- 4) In order to recognize an exposure as a repo-style transaction, a [covered company] must conduct **sufficient legal review** to conclude with a well-founded basis (and maintain sufficient written documentation of that legal review) that the agreement underlying the exposure meets the requirements of paragraph (3) above, and is legal, valid, binding, and enforceable under applicable law in the relevant jurisdictions.

Net Credit Exposure

Eligible Collateral

- A covered company **must reduce** its gross credit exposure to a counterparty with respect to a credit transaction (other than a securities financing transaction) as follows:
 - By the **adjusted market value** of any eligible collateral (defined on [page 49](#)) with the **same or greater** residual maturity as the credit transaction; or
 - By the **adjusted market value** of any eligible collateral with a **shorter** residual maturity than the credit transaction **plus** a **maturity mismatch adjustment** where the eligible collateral's original maturity is ≥ 1 year and its residual maturity is ≥ 3 months.
- If the eligible collateral has a shorter residual maturity than the credit transaction and its original maturity is < 1 year or its residual maturity is < 3 months, it **cannot** be used to reduce gross credit exposure.
- Collateral that once qualified as eligible collateral but over time ceases to do so can no longer be used to reduce gross credit exposure.
- **Risk-shifting requirement:** A covered company that reduces its gross credit exposure to a counterparty to account for eligible collateral **must** include the adjusted market value of the eligible collateral—subject to any applicable maturity mismatch adjustment—in calculating its gross credit exposure to the collateral issuer.
 - The covered company would have net credit exposure to the counterparty to the extent that the eligible collateral's adjusted market value does not equal the full amount of the gross credit exposure to the counterparty.
 - The covered company's gross credit exposure to the collateral issuer for a particular transaction would be **capped** at the gross credit exposure to the counterparty on the transaction prior to recognition of the eligible collateral.
 - This shift in exposure must occur even when the credit transaction with the counterparty would not be subject to the SCCL.

Net Credit Exposure

Eligible Collateral *(cont.)*

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

- Cash on deposit with the 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 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;
- Publicly traded equity securities; or
- Publicly traded convertible bonds; and
- For **covered FBOs and U.S. IHCs**, does **not** include debt or equity securities (including convertible bonds) issued by an affiliate of the U.S. IHC or by any part of the covered FBO's combined U.S. operations.
- “Eligible collateral” is narrower than “financial collateral” as defined in the Federal Reserve’s Basel III capital rules in that it excludes gold, money market fund shares and certain other mutual fund shares, and specifies a narrower range of debt securities and requires them to be “bank-eligible investments”.

Bank-eligible investments: 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 C.F.R. part 1.

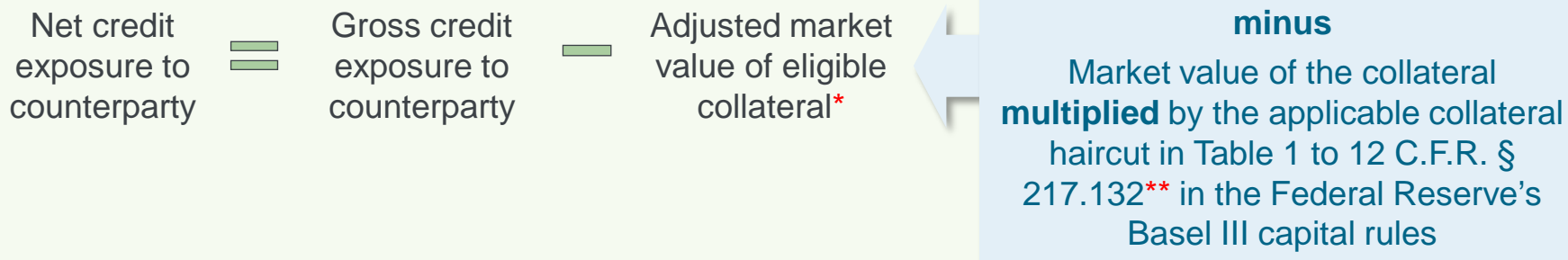
Investment grade has the same meaning as in the Federal Reserve’s Basel III capital rules: the entity to which the [covered company] is exposed through a loan or security, or the reference entity with respect to a credit derivative, has adequate capacity to meet financial commitments for the projected life of the asset or exposure.

- Such an entity or reference entity has adequate capacity to meet financial commitments if the risk of its default is low and the full and timely repayment of principal and interest is expected.

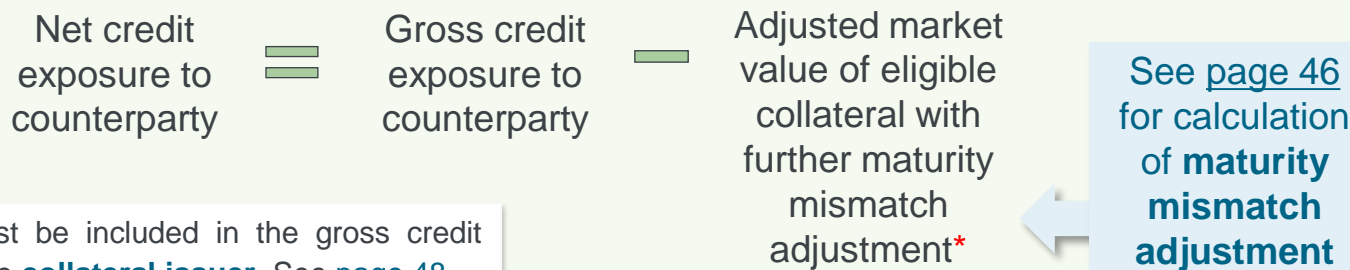
Net Credit Exposure

Eligible Collateral (cont.)

Credit transaction with eligible collateral that has the **same or greater maturity** as the transaction:



Credit transaction with eligible collateral that has a **shorter maturity** than the transaction and the collateral's **original maturity** is **≥ 1 year** and its **residual maturity** is **≥ 3 months**:



* Amount must be included in the gross credit exposure to the **collateral issuer**. See [page 48](#).

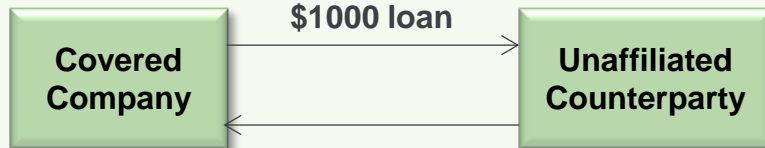
** Table 1 to 12 C.F.R. § 217.132 (advanced approaches) is identical to Table 1 to 12 C.F.R. § 217.37 (standardized approach) cited for securities financing transactions.

Net Credit Exposure

Eligible Collateral (cont.)

Example 1

Day 1

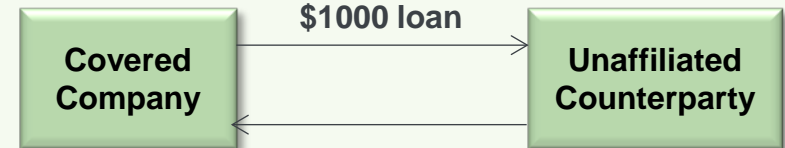


\$700 in publicly traded equity securities as collateral (adjusted market value)

Net credit exposure to counterparty = \$300

Gross credit exposure to collateral issuer = \$700

Day 180

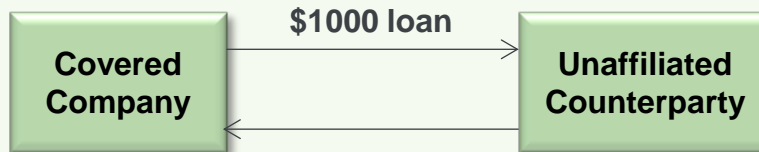


~~\$700~~ \$400 in publicly traded equity securities as collateral (adjusted market value)

Net credit exposure to counterparty = ~~\$300~~ \$600

Gross credit exposure to collateral issuer = ~~\$700~~ \$400

Example 2



\$1200 in publicly traded convertible bonds as collateral (adjusted market value)

Net credit exposure to counterparty = \$0

Gross credit exposure to collateral issuer = \$1000

Exposure is **capped** at the amount of the exposure to the counterparty prior to the recognition of eligible collateral.

Net Credit Exposure

Eligible Guarantees

- A covered company **must reduce** its gross credit exposure to a counterparty with respect to a credit transaction by the amount of any **eligible guarantee** (defined on [page 53](#)) from an **eligible protection provider** (defined on [page 54](#)) that covers the transaction as follows:
 - By the amount of any eligible guarantee with the **same or greater** residual maturity as the credit transaction; or
 - By the amount of any eligible guarantee with a **shorter** residual maturity than the credit transaction **plus** a **maturity mismatch adjustment** where the eligible guarantee's original maturity is ≥ 1 year and its residual maturity is ≥ 3 months.
- If the eligible guarantee has a shorter maturity than the credit transaction and its original maturity is < 1 year or its residual maturity is < 3 months, it **cannot** be used to reduce gross credit exposure.
- **Risk-shifting requirement:** A covered company that reduces its gross credit exposure to a counterparty to account for an eligible guarantee **must** include the amount of the eligible guarantee—subject to any applicable maturity mismatch adjustment—in calculating its gross credit exposure to the eligible protection provider.
 - The covered company would have net credit exposure to the counterparty to the extent that the amount of the eligible guarantee does not equal the full amount of the gross credit exposure to the counterparty.
 - The covered company's gross credit exposure to the eligible protection provider for a particular transaction would be **capped** at the gross credit exposure to the counterparty on the transaction prior to recognition of the eligible guarantee.
 - This shift in credit exposure must occur even when the credit transaction with the counterparty would not be subject to the SCCL.

Net Credit Exposure

Eligible Guarantees *(cont.)*

Eligible guarantee has the same meaning as in the Federal Reserve's Basel III capital rules, except for the requirement that it must be provided by an **eligible protection provider**: a written guarantee that:

- Is either (i) unconditional, or (ii) a contingent obligation of the U.S. government or its agencies, the enforceability of which is dependent upon some affirmative action on the part of the beneficiary of the guarantee or a third party (for example, meeting servicing requirements);
- Covers all or a pro rata portion of all contractual payments of the obligated party on the reference exposure;
- Gives the beneficiary a direct claim against the protection provider;
- Is not unilaterally cancelable by the protection provider for reasons other than breach of the contract by the beneficiary;
- Except for a guarantee by a sovereign, is legally enforceable against the protection provider in a jurisdiction where the protection provider has sufficient assets against which a judgment may be attached and enforced;
- Requires the protection provider to make payment to the beneficiary on the occurrence of a default (as defined in the guarantee) of the obligated party on the reference exposure in a timely manner without the beneficiary first having to take legal actions to pursue the obligor for payment;
- Does not increase the beneficiary's cost of credit protection on the guarantee in response to deterioration in the credit quality of the reference exposure;
- Is not provided by an affiliate of the [covered company], unless the affiliate is an insured depository institution, foreign bank, securities broker or dealer, or insurance company that (i) does not control the [covered company]; and (ii) is subject to consolidated supervision and regulation comparable to that imposed on depository institutions, U.S. securities broker-dealers, or U.S. insurance companies (as the case may be); and
- Is provided by an **eligible protection provider**.*

* Under the Federal Reserve's Basel III capital rules, the requirement for an eligible guarantee to be provided by an eligible guarantor does not apply to exposures under the advanced approaches other than securitization exposures.

Net Credit Exposure

Eligible Guarantees *(cont.)*

Eligible protection provider has the same meaning as “**eligible guarantor**” in the Federal Reserve’s Basel III capital rules:

- A sovereign;
- The Bank for International Settlements, the International Monetary Fund, the European Central Bank, the European Commission, a multilateral development bank;
- A Federal Home Loan Bank;
- Federal Agricultural Mortgage Corporation (Farmer Mac);
- A depository institution, a bank holding company, a savings and loan holding company, a credit union, a foreign bank, or a qualifying central counterparty; or
- An entity (other than a special purpose entity):
 - That, at the time the guarantee is issued or anytime thereafter, has issued and outstanding an unsecured debt security without credit enhancement that is investment grade;
 - Whose creditworthiness is not positively correlated with the credit risk of the exposures for which it has provided guarantees; and
 - That is not an insurance company engaged predominately in the business of providing credit protection (such as a monoline bond insurer or re-insurer)

Note: For **covered FBOs and U.S. IHCs**, eligible protection provider does **not** include the covered FBO or any entity that is an affiliate of either the U.S. IHC or any part of the covered FBO’s combined U.S. operations.

Net Credit Exposure

Eligible Guarantees (cont.)

Credit transaction with an eligible guarantee that has the **same or greater maturity** as the transaction:

$$\text{Net credit exposure to counterparty} = \text{Gross credit exposure to counterparty} - \text{Amount of eligible guarantee}^*$$

Credit transaction with an eligible guarantee that has a **shorter maturity** than the transaction and the guarantee's **original maturity** is **≥ 1 year** and its **residual maturity** is **≥ 3 months**:

$$\text{Net credit exposure to counterparty} = \text{Gross credit exposure to counterparty} - \text{Amount of eligible guarantee with further maturity mismatch adjustment}^*$$

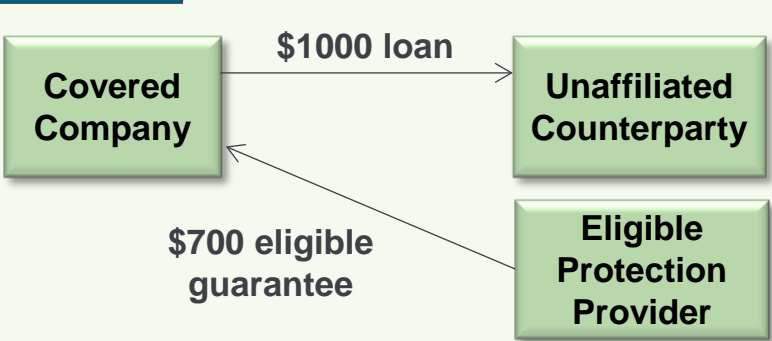
See [page 46](#) for calculation of **maturity mismatch adjustment**

* Amount must be included in the gross credit exposure to the **eligible protection provider**. See [page 52](#).

Net Credit Exposure

Eligible Guarantees (cont.)

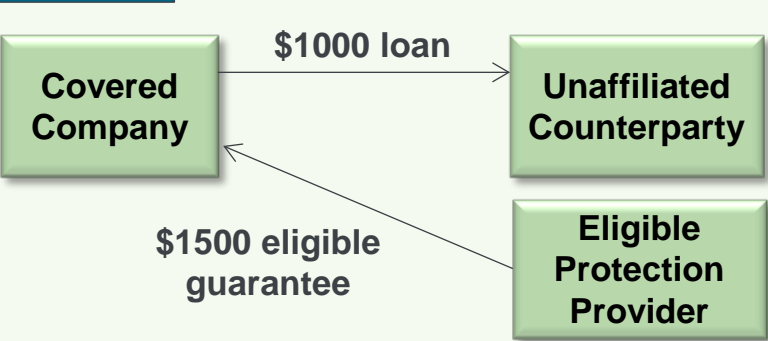
Example 1



Net credit exposure to counterparty = \$300

Gross credit exposure to eligible protection provider = \$700

Example 2



Net credit exposure to counterparty = \$0

Gross credit exposure to eligible protection provider = \$1000

Exposure is **capped** at the amount of the exposure to the counterparty prior to the recognition of eligible collateral.

Net Credit Exposure

Eligible Credit and Equity Derivatives as Risk Mitigants

- A covered company **must reduce** its gross credit exposure to a counterparty with respect to a credit transaction by the **notional amount** of any **eligible credit or equity derivative** (defined on [pages 59–60](#)) from an **eligible protection provider** (defined on [page 54](#)), where the eligible credit or equity derivative has a maturity that is the same or greater than the maturity of the credit transaction.
 - The covered company must apply a **maturity mismatch adjustment** where the eligible credit or equity derivative has a shorter maturity than the credit transaction and the derivative's original maturity is ≥ 1 year and its residual maturity is ≥ 3 months.
 - If the eligible credit or equity derivative has a shorter maturity than the credit transaction and its original maturity is < 1 year or its residual maturity is < 3 months, it **cannot** be used to reduce gross credit exposure.
- **Full notional risk-shifting requirement: Except** for eligible credit or equity derivatives used to hedge covered positions subject to the Federal Reserve's market risk rule where the counterparty to the original credit transaction is **not** a financial entity (defined on [page 60](#)), a covered company that reduces its gross credit exposure to a counterparty to account for an eligible credit or equity derivative must include the **notional amount** of the derivative—subject to any applicable maturity mismatch adjustment—in calculating its gross exposure to the eligible protection provider.
 - The covered company would have net credit exposure to the counterparty to the extent that the eligible credit or equity derivative's notional amount does not equal the full amount of the gross credit exposure to the counterparty.
 - The covered company's gross credit exposure to the eligible protection provider for a particular transaction would be **capped** at the gross credit exposure to the counterparty on the transaction prior to the recognition of the eligible credit or equity derivative.
 - This shift in credit exposure must occur even when the credit transaction with the counterparty would not be subject to the SCCL.

Net Credit Exposure

Eligible Credit and Equity Derivatives as Risk Mitigants (*cont.*)

- **Modified risk-shifting requirement for certain market risk exposures:**

- If the counterparty to the original credit transaction is **not a financial entity**, **and**
- The exposure is a **covered position*** that is subject to the Federal Reserve’s **market risk rule** (12 C.F.R. part 217, subpart F),

the amount of credit exposure to the eligible protection provider that the covered company must recognize is the amount that would be calculated in accordance with the provisions for calculating gross credit exposures for derivative transactions (*i.e.*, the CEM for derivatives not subject to a qualifying master netting agreement; any of the methods the covered company is authorized to use under the Federal Reserve’s Basel III capital rules for derivatives subject to a qualifying master netting agreement), **not** the full notional amount.

- **No double-counting of derivatives exposures:** In either case, the Federal Reserve clarified that, where a covered company is required to shift its net credit exposure to an eligible protection provider pursuant to these credit and equity derivatives positions, it may exclude the derivative when calculating its gross credit exposure to the eligible protection provider as a counterparty pursuant to Sections 252.73(a)(10) and (11) and 252.173(a)(10) and (11) of the SCCL Reproposal, as applicable.

* Sections 252.74(e)(2)(ii) and 252.174(e)(2)(ii) of the SCCL Reproposal also refer to “available-for-sale exposures” that are subject to the market risk rule. However, since the market risk rule does not specifically refer to such exposures and available-for-sale securities would need to be trading assets to be subject to the market risk rule, this reference appears to be redundant with “covered position”.

Net Credit Exposure

Eligible Credit and Equity Derivatives as Risk Mitigants *(cont.)*

Eligible credit derivative: a single-name credit derivative or a standard, non-tranched index derivative, provided that

- The derivative contract is subject to an eligible guarantee and has been confirmed by the protection purchaser and the protection provider;
- Any assignment of the derivative contract has been confirmed by all relevant parties;
- If the credit derivative is a credit default swap, the derivative contract includes the following credit events:
 - 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
 - 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;
- The terms and conditions dictating the manner in which the derivative contract is to be settled are incorporated into the contract;
- 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;
- 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**
- 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.

Net Credit Exposure

Eligible Credit and Equity Derivatives as Risk Mitigants *(cont.)*

Eligible equity derivative: an equity derivative, provided that

- The derivative contract has been confirmed by the counterparties;
- Any assignment of the derivative contract has been confirmed by all relevant parties; and
- The terms and conditions dictating the manner in which the derivative contract is to be settled are incorporated into the contract.

The Federal Reserve stated that 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.

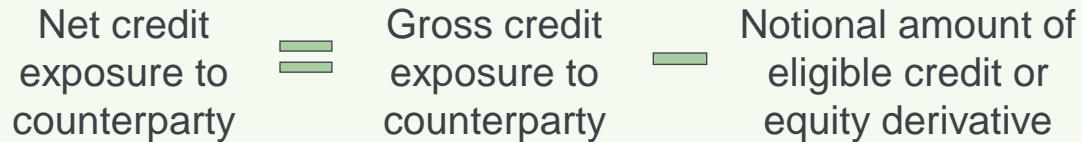
Financial entity includes:

- A depository institution;
- A bank holding company;
- A savings and loan holding company (as defined in 12 U.S.C. 1467a);
- 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.);
- An insurance company that is subject to the supervision by a state insurance regulator;
- A foreign banking organization;
- A non-U.S.-based securities firm or a non-U.S.-based insurance company subject to consolidated supervision and regulation comparable to that applicable to U.S. depository institutions, securities broker-dealers, or insurance companies;
- A central counterparty; and
- 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.

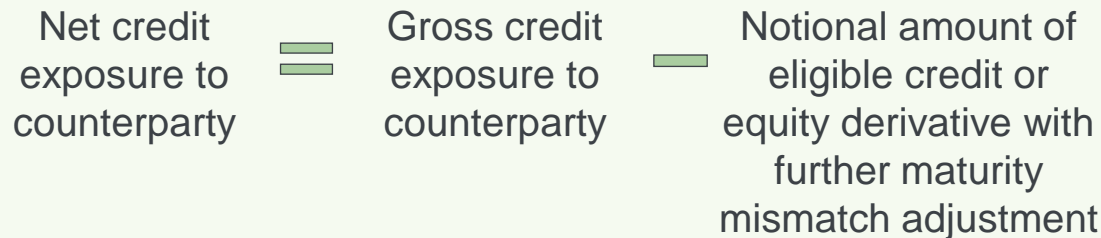
Net Credit Exposure

Eligible Credit and Equity Derivatives as Risk Mitigants *(cont.)*

Credit transaction with an eligible credit or equity derivative that has the **same or greater maturity** as the transaction:



Credit transaction with an eligible credit or equity derivative that has a **shorter maturity** than the transaction and the collateral's **original maturity** is ≥ 1 year and its **residual maturity** is ≥ 3 months:

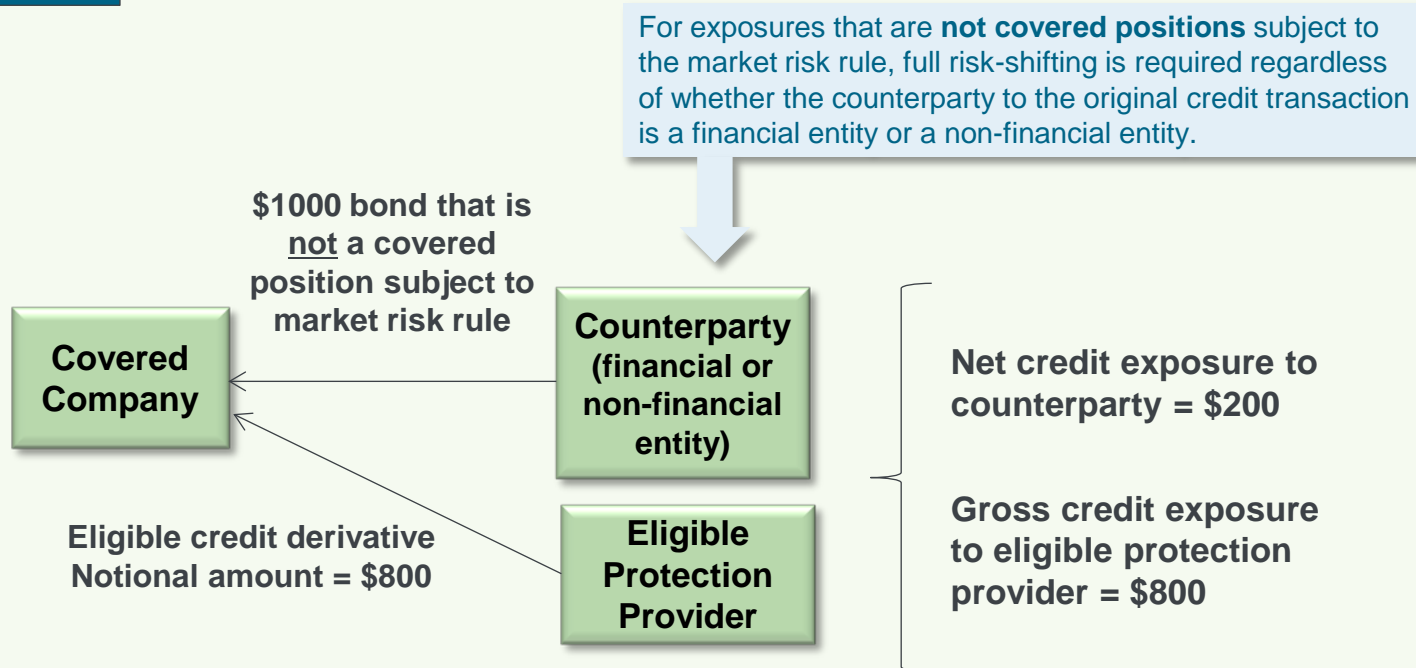


See [page 46](#) for calculation of **maturity mismatch adjustment**

Net Credit Exposure

Eligible Credit and Equity Derivatives as Risk Mitigants (cont.)

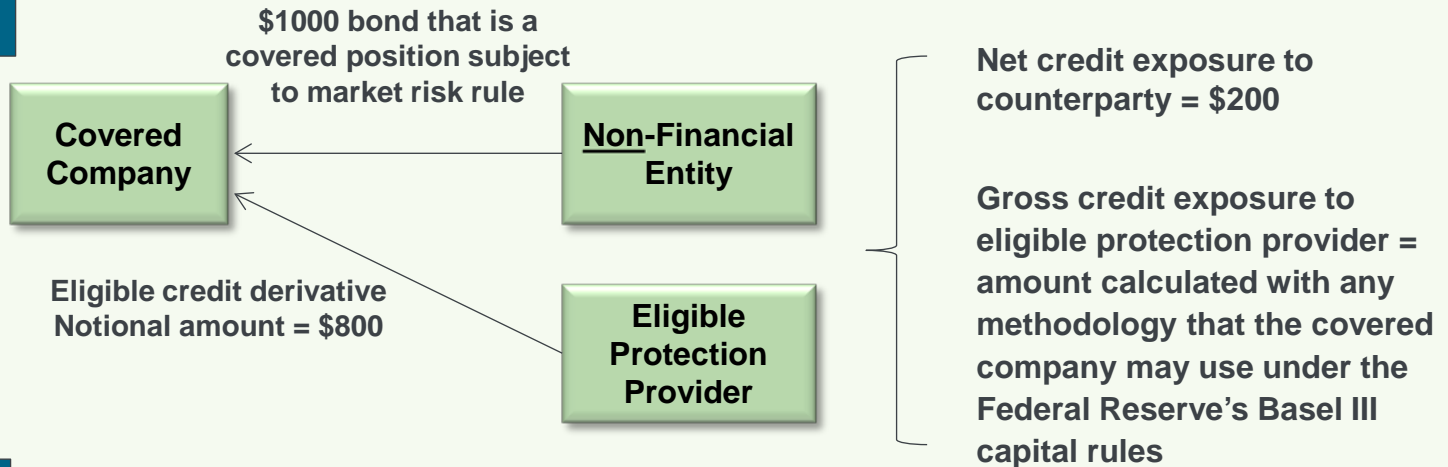
Example 1



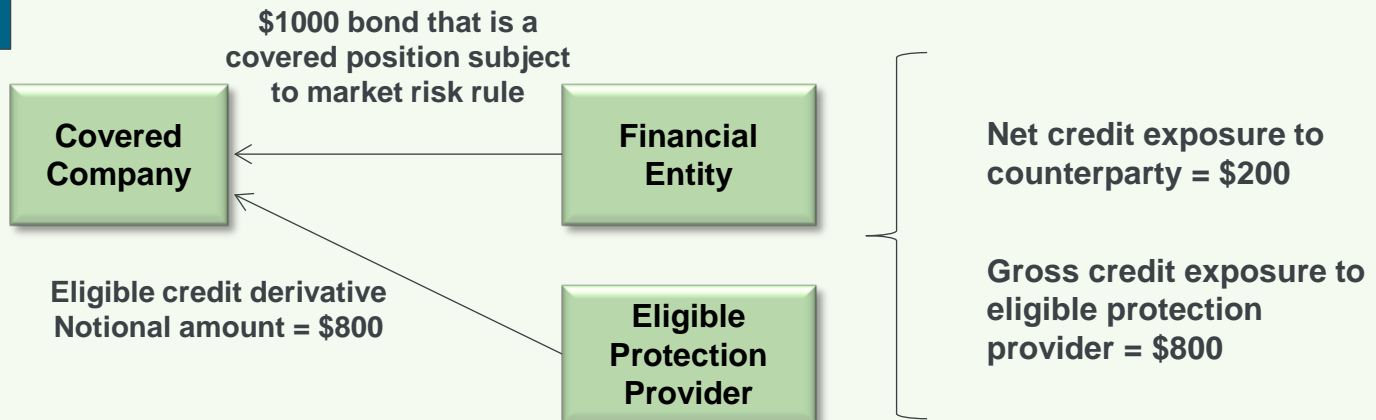
Net Credit Exposure

Eligible Credit and Equity Derivatives as Risk Mitigants (cont.)

Example 2



Example 3



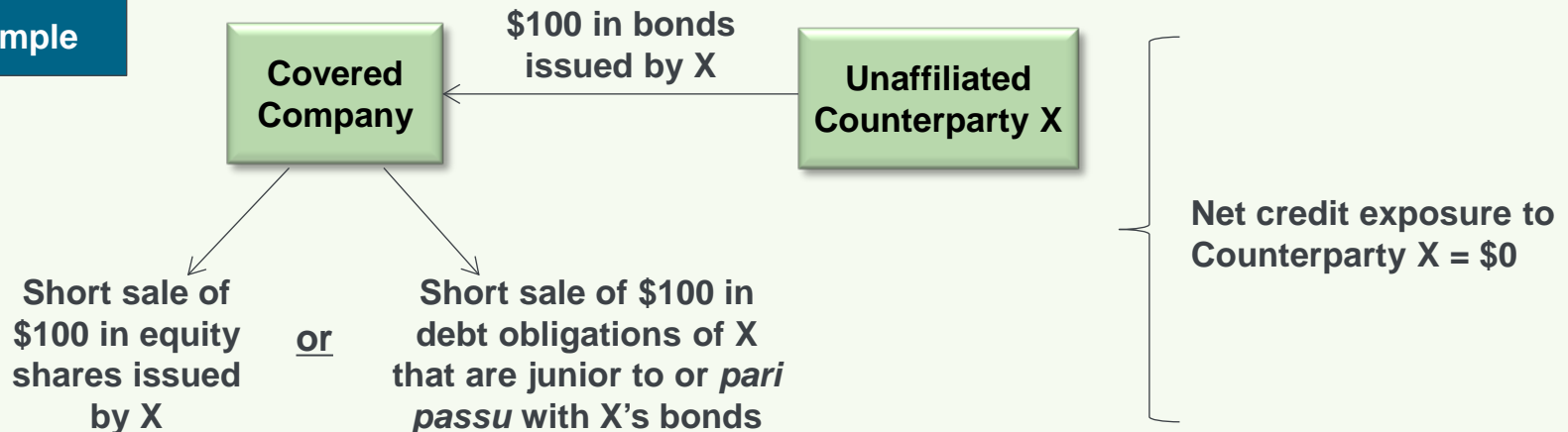
Net Credit Exposure

Other Eligible Hedges

- A covered company **may reduce** its gross credit exposure to a counterparty with respect to a credit transaction by the **face amount** of a **short sale** of the counterparty's debt or equity security, 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; and
 - 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.

Short sale: any sale of a security that the seller does not own or any sale that is consummated by the delivery of a security borrowed by, or for the account of, the seller.

Example



Example assumes consistent treatment of instruments held in short and long positions (*i.e.*, trading/available-for-sale or held-to-maturity).

Net Credit Exposure

Unused Portions of Certain Extensions of Credit

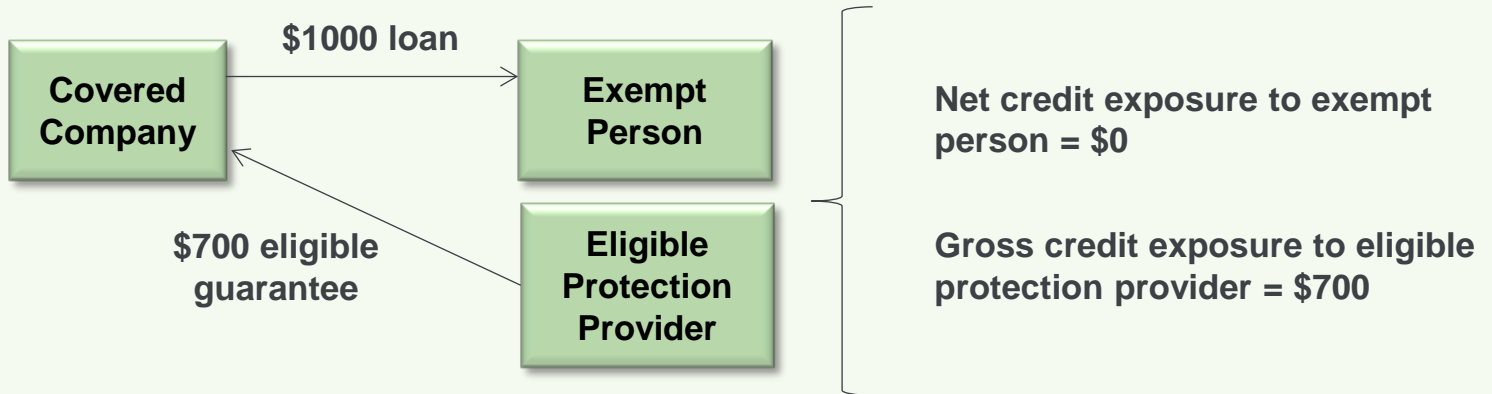
- A covered company **may reduce** its gross credit exposure to a counterparty with respect to a credit line or revolving credit facility by the amount of the **unused portion** of the credit extension to the extent that the covered company has **no legal obligation** to advance additional funds under 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.
- **Credit contract requirement:** In order for the covered company to use this reduction, the credit contract must specify that **any used portion** of the credit extension must be **fully secured** by collateral that is:
 - Cash;
 - Obligations of the United States or its agencies; or
 - Obligations directly and fully guaranteed as to principal and interest by Fannie Mae or Freddie Mac, 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 Federal Reserve.

Net Credit Exposure

Credit Transactions Involving Exempt and Excluded Persons

- Covered companies **must recognize** credit exposure with respect to certain **credit risk mitigants** for credit transactions that are otherwise not subject to the SCCL.
 - For a credit transaction with any person that is exempt from the SCCL or that is not considered a counterparty under the SCCL Reproposal, if the covered company **reduces** its credit exposure on the transaction by obtaining **collateral** from that person or a **guarantee** or a **credit or equity derivative** from an eligible protection provider, the covered company must calculate its credit exposure to the **issuer** of the collateral or the **protection provider** in accordance with the requirements for recognizing such exposure to the same extent as if the credit transaction with the counterparty were subject to the SCCL.

Example

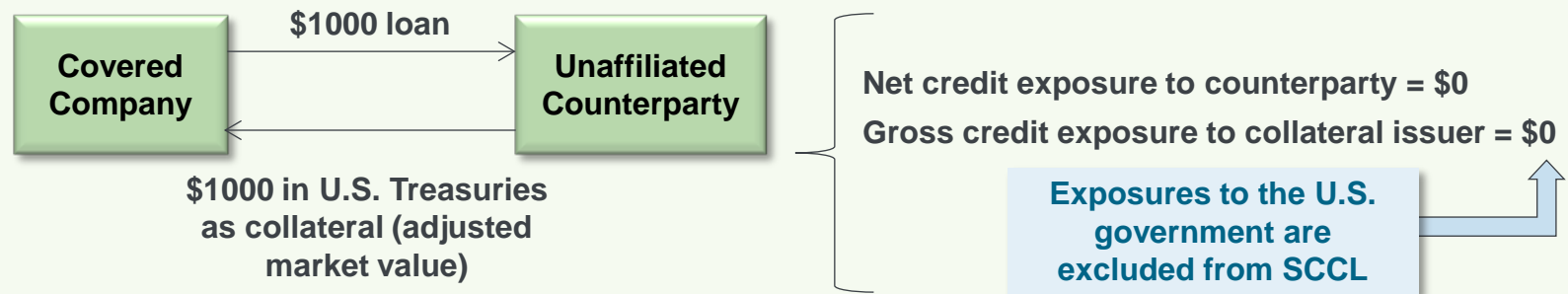


Net Credit Exposure

Exempt or Excluded Collateral Issuer or Eligible Protection Provider

- **No recognition:** There is no requirement to recognize a gross credit exposure to the collateral issuer if exposure to the issuer is exempt from the SCCL or the issuer is excluded from the definition of counterparty. See [page 17](#) and [pages 31–32](#).
 - This is true for any transaction in which there is otherwise a requirement to shift gross credit exposure to a collateral issuer or eligible protection provider:
 - Securities financing transactions
 - Eligible collateral
 - Eligible guarantees
 - Eligible credit and equity derivatives

Example



VI. Compliance Requirements

Compliance Requirements


| Covered Entities | Date | Compliance Requirement |
|--|---|---|
| General Compliance and Reporting | | |
| <ul style="list-style-type: none"> ▪ Majored Covered Companies ▪ Large Covered Companies | 1 year after the rule's effective date | <ul style="list-style-type: none"> ▪ Compliance with SCCL requirements daily, at the end of each business day ▪ Monthly report to the Federal Reserve demonstrating daily compliance <ul style="list-style-type: none"> • The Federal Reserve stated that it plans to develop forms for companies to report credit exposures as measured under section 165(e). |
| <ul style="list-style-type: none"> ▪ Smaller Covered Companies | 2 years after the rule's effective date | <ul style="list-style-type: none"> ▪ Compliance with SCCL requirements on quarterly basis ▪ Quarterly report to the Federal Reserve demonstrating quarterly compliance, unless the Federal Reserve determines that more frequent compliance and reporting are required <ul style="list-style-type: none"> • However, the Federal Reserve stated that these institutions would need to have systems in place that allow them to calculate compliance on a daily basis. |
| Procedures Regarding Qualifying Master Netting Agreements | | |
| <ul style="list-style-type: none"> ▪ Major Covered Companies ▪ Large Covered Companies | 1 year after the rule's effective date | <ul style="list-style-type: none"> ▪ Establish and maintain procedures that meet or exceed the operational requirements in the Federal Reserve's Basel III capital rules regarding qualifying master netting agreements (12 C.F.R. § 217.3(d)) to monitor possible changes in relevant law and ensure the agreement continues to satisfy the regulatory requirements |
| <ul style="list-style-type: none"> ▪ Smaller Covered Companies | 2 years after the rule's effective date | |

Compliance Requirements *(cont.)*

- **90-Day Cure Period:** If a covered company is not in compliance with the SCCL with respect to a counterparty due **solely** to certain circumstances (see chart below), the covered company would **not** be subject to enforcement actions for **90 days** (or such other period determined by the Federal Reserve).
 - During the 90-day period, the non-compliant company must:
 - Use **reasonable efforts** to return to compliance, and
 - **Not engage** in additional credit transactions with the counterparty in contravention of the SCCL, except if the Federal Reserve determines that they are necessary or appropriate for the safety and soundness of the covered company or U.S. financial stability, giving consideration to the circumstances listed in the chart below.
 - If either a U.S. IHC or the combined U.S. operations of a covered FBO are not in compliance, both the U.S. IHC and the combined U.S. operations are prohibited from additional credit transactions with the counterparty in contravention of the SCCL.
 - In granting approval for a special temporary credit exposure limit, the Federal Reserve will consider the following:

| Covered and Large U.S. BHCs, U.S. G-SIBs | Covered Large and Major U.S. IHCs and FBOs |
|--|--|
| 1) A decrease in the covered U.S. BHC's capital stock and surplus; 2) The merger of the covered U.S. BHC with another covered U.S. BHC; 3) A merger of two unaffiliated counterparties; or 4) Any other circumstance that the Federal Reserve determines is appropriate | 1) A decrease in the covered U.S. IHC's or FBO's capital stock and surplus; 2) The merger of the covered U.S. IHC or FBO with a covered BHC, a nonbank SIFI, an FBO, or a U.S. IHC; 3) A merger of two unaffiliated counterparties; or 4) Any other circumstance that the Federal Reserve determines is appropriate |

- **Other Compliance Measures:** The Federal Reserve may impose other supervisory oversight and reporting measures that it determines are appropriate to monitor compliance with the SCCL.

Click on an item to go to that page 

VII. Comparison to Other Lending Limits Regimes

- [Summary Comparison to Select Provisions of Basel Committee's Large Exposures Framework](#)
- [Summary Comparison to Select Provisions of OCC and New York State Lending Limits](#)

Summary Comparison to Select Provisions of Basel Committee's Large Exposures Framework

| Topic | Basel Committee's Large Exposures Framework (April 2014) | U.S. SCCL Reproposal (March 2016) |
|---------------------------------------|---|---|
| Scope and Level of Application | <ul style="list-style-type: none"> ▪ Internationally active banks ▪ Limits apply at the same level as risk-based capital requirements, <i>i.e.</i>, at every tier within a banking group | <ul style="list-style-type: none"> ▪ BHCs, FBOs (with respect to their combined U.S. operations), and U.S. IHCs, in each case with \geq \$50 billion in total consolidated assets ▪ Limits apply at the consolidated level only ▪ Depository institutions are subject to their own lending limits under existing laws and regulations |
| Timing | <ul style="list-style-type: none"> ▪ Full implementation by January 1, 2019 ▪ National supervisors may require reporting of large exposures before 2019 | <ul style="list-style-type: none"> ▪ Compliance required by one or two years after the final rule's effective date , depending on the size of the covered company |
| General Limit | <ul style="list-style-type: none"> ▪ 25% of the bank's Tier 1 capital | <ul style="list-style-type: none"> ▪ 25% of <u>Tier 1 capital</u> for covered companies with \geq \$250 billion in total consolidated assets or \geq \$10 billion in on-balance sheet foreign exposures ▪ 25% of <u>capital stock and surplus</u> for other covered companies |
| G-SIB Limit | <ul style="list-style-type: none"> ▪ 15% of Tier 1 capital for exposures <u>between</u> G-SIBs (as identified by the Basel Committee) ▪ Jurisdictions are encouraged to consider stricter limits for domestic systemically important banks and for exposures of smaller banks to G-SIBs | <ul style="list-style-type: none"> ▪ 15% of Tier 1 capital for exposures of U.S. G-SIBs and major FBOs and U.S. IHCs, on the one hand, to major counterparties on the other – <i>i.e.</i>, to U.S. G-SIBs, foreign G-SIBs, U.S. IHCs that would be considered U.S. G-SIBs, and nonbank SIFIs |

Summary Comparison to Select Provisions of Basel Committee's Large Exposures Framework *(cont.)*

| Topic | Basel Committee's Large Exposures Framework (April 2014) | U.S. SCCL Reproposal (March 2016) |
|----------------------------------|---|---|
| Large Exposures Reporting | <ul style="list-style-type: none"> ▪ A bank must report to its supervisor when its exposure to a counterparty reaches 10% of Tier 1 capital (before and after applying credit risk mitigants and including exempted exposures) ▪ Banks must report their 20 largest exposures | <ul style="list-style-type: none"> ▪ Not covered in the SCCL Reproposal ▪ Section 165(d)(2) of the Dodd-Frank Act requires the Federal Reserve to implement credit exposure reporting obligations for BHCs with ≥ \$50 billion in total consolidated assets and nonbank SIFIs |
| Compliance | <ul style="list-style-type: none"> ▪ Breaches must remain the exception, must be reported immediately to the supervisor and must be rapidly rectified | <ul style="list-style-type: none"> ▪ Daily compliance and monthly reporting for Large and Major Covered Companies; quarterly compliance and reporting for Smaller Covered Companies ▪ 90-day cure period for breaches in a limited set of cases <ul style="list-style-type: none"> ▪ The non-compliant company may not engage in additional credit transactions with the counterparty and must use reasonable efforts to return to compliance |
| Scope of Counterparty | <ul style="list-style-type: none"> ▪ All connected counterparties (natural or legal persons), as determined by “control relationships” and “economic interdependence” ▪ Automatic presumption of control with ownership of > 50% of voting rights ▪ > 5% total exposure to a counterparty triggers economic interdependence analysis | <ul style="list-style-type: none"> ▪ Counterparty is defined to include controlled subsidiaries <ul style="list-style-type: none"> ▪ Voting rights threshold for control is 25% ▪ Additional aggregation requirements for unaffiliated counterparties that are connected by broader control relationships or that are economically interdependent ▪ > 5% trigger for economic interdependence analysis ▪ Indicia of economic interdependence are similar to those in the Basel framework |

Summary Comparison to Select Provisions of Basel Committee's Large Exposures Framework *(cont.)*

| Topic | Basel Committee's Large Exposures Framework (April 2014) | U.S. SCCL Reproposal (March 2016) |
|--------------------|--|---|
| Attribution Rule | <ul style="list-style-type: none"> ▪ No | <ul style="list-style-type: none"> ▪ Yes (although the Federal Reserve stated that, in general, this would not apply to exposures resulting from transactions made in the ordinary course of business) |
| Sovereigns | <ul style="list-style-type: none"> ▪ Exemption for exposures to all sovereigns, their central banks and public-sector entities treated as sovereigns under the risk-based capital rules | <ul style="list-style-type: none"> ▪ SCCL does not apply to exposures to the U.S. government or to foreign sovereigns with a 0% risk weight under the Federal Reserve's Basel III capital rules ▪ For covered FBOs and U.S. IHCs, exposures to the home country sovereign are exempt |
| Intraday Exposures | <ul style="list-style-type: none"> ▪ All intraday exposures are exempt | <ul style="list-style-type: none"> ▪ All intraday exposures are exempt |
| QCCPs | <ul style="list-style-type: none"> ▪ Exposures relating to clearing activity are exempt; however, the Basel Committee is reviewing the appropriateness of a limit for such exposures | <ul style="list-style-type: none"> ▪ Exposures to QCCPs relating to clearing activity of the covered company are exempt |
| SPVs | <ul style="list-style-type: none"> ▪ Look-through approach required if the bank's exposure to an underlying asset is $\geq 0.25\%$ of the bank's eligible capital base, considering only exposures arising from the investment in the SPV <ul style="list-style-type: none"> ▪ <u>Partial</u> look-through is permitted ▪ Required recognition of exposure to third parties that present additional risk factors with respect to SPVs | <ul style="list-style-type: none"> ▪ 0.25% trigger for look-through approach, but partial look-through is <u>not</u> permitted ▪ Required recognition of exposure to third parties with certain business relationships with SPVs ▪ SPV framework applies only to Major and Large Covered Companies |

Summary Comparison to Select Provisions of Basel Committee's Large Exposures Framework *(cont.)*

| Topic | Basel Committee's Large Exposures Framework (April 2014) | U.S. SCCL Reproposal (March 2016) |
|---|--|---|
| Derivatives (other than securities financing transactions) | <ul style="list-style-type: none"> Valued as exposure at default amount calculated according to the SA-CCR | <ul style="list-style-type: none"> For derivatives subject to a qualifying master netting agreement, valued as exposure at default amount calculated using any methodology that the company may use under the Federal Reserve's Basel III capital rules (<i>i.e.</i>, CEM or internal model) For derivatives <u>not</u> subject to a qualifying master netting agreement, valued according to the CEM |
| Securities Financing Transactions ("SFTs") | <ul style="list-style-type: none"> Exposures to be valued using the Basel Committee's anticipated revised comprehensive approach and supervisory haircuts for measuring SFT exposures | <ul style="list-style-type: none"> For an SFT that is subject to a bilateral netting agreement with the counterparty and is a "repo-style transaction" as defined in the Federal Reserve's Basel III capital rules, exposure is valued as exposure at default, applying standardized supervisory haircuts |
| Recognition of Credit Risk Mitigants | <ul style="list-style-type: none"> A bank must recognize an eligible credit risk mitigant in calculating an exposure when it uses the mitigant to calculate risk-based capital requirements | <ul style="list-style-type: none"> A company <u>must</u> reduce gross exposure by eligible collateral, guarantees and credit and equity derivative hedges It <u>may</u> reduce gross exposure by certain short sales of the counterparty's debt or equity securities or unused portions of certain extensions of credit |

Summary Comparison to Select Provisions of Basel Committee's Large Exposures Framework *(cont.)*

| Topic | Basel Committee's Large Exposures Framework (April 2014) | U.S. SCCL Reproposal (March 2016) |
|--|---|--|
| Risk-Shifting | <ul style="list-style-type: none"> ▪ If exposure to the original counterparty is reduced due to an eligible credit risk mitigant, recognition of an exposure to the protection provider is required ▪ When the mitigant is a credit default swap and <u>either</u> the protection provider <u>or</u> the referenced entity is <u>not</u> a financial entity, the exposure to the protection provider is the counterparty credit risk exposure value calculated under the SA-CCR | <ul style="list-style-type: none"> ▪ If exposure to the original counterparty is reduced due to an eligible credit risk mitigant, recognition of an exposure to the provider of the mitigant is required, but is capped at the original exposure to the original counterparty ▪ Where the mitigant is an eligible credit or equity derivative, the original counterparty is <u>not</u> a financial entity and the exposure is a covered position subject to the Federal Reserve's market risk rule, the exposure to the protection provider is calculated using the CEM for derivatives not subject to a qualifying master netting agreement and any methodology that the company may use under the Federal Reserve's Basel III capital rules for derivatives subject to a qualifying master netting agreement, rather than the full notional amount |
| Maturity Mismatches for Credit Risk Mitigants | <ul style="list-style-type: none"> ▪ Treatment is generally consistent with the approach used for the particular credit risk mitigant in the risk-based capital framework ▪ Where there is a maturity mismatch, the mitigant is recognized only if its original maturity is ≥ 1 year and its residual maturity is not less than 3 months | <ul style="list-style-type: none"> ▪ Treatment is generally consistent with the approach used for the particular credit risk mitigant in the Federal Reserve's Basel III capital rules ▪ Same parameters for when a mitigant with a maturity mismatch can be recognized |

Summary Comparison to Select Provisions of OCC and New York State Lending Limits

| Topic | U.S. SCCL Reproposal | OCC Lending Limits | New York Lending Limits |
|--------------------------|--|---|---|
| Covered Entities | <ul style="list-style-type: none"> U.S. BHCs, U.S. IHCs and FBOs, each with ≥ \$50 billion in total consolidated assets, on a consolidated basis | <ul style="list-style-type: none"> National banks and their domestic operating subsidiaries Federal and state savings associations, their operating subsidiaries, and their service corporations consolidated under GAAP U.S. federal and state branches and agencies of foreign banks | <ul style="list-style-type: none"> New York-licensed banks and trust companies New York-licensed branches and agencies of foreign banks |
| Applicable Limits | <ul style="list-style-type: none"> 25% of capital stock and surplus for Smaller Covered Companies 25% of Tier 1 capital for Large and Major Covered Companies 15% of Tier 1 capital for Major Covered Companies with respect to their exposures to certain large counterparties | <ul style="list-style-type: none"> 15% of the institution's capital stock and surplus 25% of the institution's capital stock and surplus if the portion of loans and extensions of credit above the 15% limit is fully secured by readily marketable collateral 50% of the institution's capital stock and surplus for loans and extensions of credit to a "corporate group" (i.e., a person and all of its subsidiaries, where an entity is a subsidiary if the person owns > 50% of the entity's voting securities or interests) Other specified loans are subject to special lending limits | <ul style="list-style-type: none"> 15% of the institution's capital stock, surplus and undivided profits 25% of the institution's of the institution's capital stock, surplus and undivided profits if the portion of loans or extensions of credit above the 15% limit is fully secured by collateral with an ascertained market value or certain drafts or bills of exchange Other specified loans are subject to special lending limits |

Summary Comparison to Select Provisions of OCC and New York State Lending Limits *(cont.)*

| Topic | U.S. SCCL Reproposal | OCC Lending Limits | New York Lending Limits |
|------------------------------|---|--|--|
| Scope of Counterparty | <ul style="list-style-type: none"> ▪ Credit exposures to counterparties that are connected by certain control relationships or, in certain cases, counterparties that are “economically interdependent” must be aggregated ▪ Includes an attribution rule ▪ Includes a specific framework for measuring exposures to SPVs and requires recognition of gross credit exposure to certain third parties of SPVs | <ul style="list-style-type: none"> ▪ Loans and extensions of credit to one borrower must be attributed to another person if the proceeds are used for the “direct benefit” of the other person ▪ Loans to separate borrowers must be aggregated if a “common enterprise” exists among them (<i>e.g.</i>, if the borrowers are related through “common control” or have “substantial financial interdependence”) ▪ No specific requirements for SPVs | <ul style="list-style-type: none"> ▪ Loans to a company must include all loans “for the benefit of” the company ▪ No specific requirements for SPVs |
| U.S. Government | <ul style="list-style-type: none"> ▪ Credit exposures to the U.S. government and its agencies are not subject to the SCCL ▪ Credit transactions fully secured by U.S. government obligations are effectively exempt from the SCCL | <ul style="list-style-type: none"> ▪ Loans to, or guaranteed by, an agency of the U.S. government and loans fully secured by U.S. government obligations are not subject to the lending limits | <ul style="list-style-type: none"> ▪ Loans to, or guaranteed by, the U.S. government or certain of its agencies and loans fully secured by direct obligations of the U.S. government or such agencies are not subject to the lending limits |

Summary Comparison to Select Provisions of OCC and New York State Lending Limits *(cont.)*

| Topic | SCCL Reproposal | OCC Lending Limits | New York Lending Limits |
|---------------------------|--|--|---|
| States in the U.S. | <ul style="list-style-type: none"> ▪ Loans to, or guaranteed or secured by general obligations of, a U.S. state or its political subdivisions are not subject to the lending limits | <ul style="list-style-type: none"> ▪ Loans to, or guaranteed or secured by general obligations of, a U.S. state or its political subdivisions are not subject to the lending limits | <ul style="list-style-type: none"> ▪ Loans to, or guaranteed by, New York state, certain of its agencies, or its political subdivisions and loans fully secured by direct obligations of New York state, certain of its agencies, or its political subdivisions are not subject to the lending limits ▪ Limit of 25% of the institution's capital stock, surplus and undivided profits for loans to any state other than New York |
| Foreign Sovereigns | <ul style="list-style-type: none"> ▪ Exposures to foreign sovereigns with a 0% risk weight under the Federal Reserve's Basel III capital rules and their agencies are not subject to the SCCL ▪ For FBOs and their U.S. IHCs, exposures to an FBO's home country sovereign are not subject to the SCCL | <ul style="list-style-type: none"> ▪ Credit exposures arising from securities financing transactions in which the securities financed are Type I securities, which include qualified Canadian government obligations, are not subject to the lending limits | <ul style="list-style-type: none"> ▪ Limit of 25% of the institution's capital stock, surplus and undivided profits for loans to any foreign nation |

Summary Comparison to Select Provisions of OCC and New York State Lending Limits *(cont.)*

| Topic | SCCL Reproposal | OCC Lending Limits | New York Lending Limits |
|--|--|---|---|
| Central Counterparties | <ul style="list-style-type: none"> ▪ Trade exposures to QCCPs, including potential future exposure arising from cleared transactions and pre-funded default fund contributions, are not subject to the SCCL | <ul style="list-style-type: none"> ▪ Credit exposures to central counterparties arising from derivatives transactions, including the amount of initial margin posted and any contribution to a guaranty fund, are subject to the lending limits | <ul style="list-style-type: none"> ▪ Credit exposures arising from derivative transactions with a qualifying central counterparty that has been designated as a systemically important financial market utility by the Financial Stability Oversight Council are not subject to the lending limits |
| Securities Financing Transactions | <ul style="list-style-type: none"> ▪ Credit exposure for an SFT that is subject to a bilateral netting agreement and qualifies as a “repo-style transaction” is calculated as exposure at default, applying standardized supervisory haircuts | <ul style="list-style-type: none"> ▪ Credit exposure may be calculated by: <ul style="list-style-type: none"> • A regulator-approved internal model; • The “basic method”; or • The collateral haircut approach ▪ Credit exposures arising from securities financing transactions where the securities financed are Type I securities (i.e., certain government securities) are not subject to the lending limits | <ul style="list-style-type: none"> ▪ Not specifically addressed |

Summary Comparison to Select Provisions of OCC and New York State Lending Limits *(cont.)*

| Topic | SCCL Reproposal | OCC Lending Limits | New York Lending Limits |
|--------------------|--|---|--|
| Derivatives | <ul style="list-style-type: none"> ▪ Credit exposure is calculated by: <ul style="list-style-type: none"> • The CEM, for derivatives not subject to a qualifying master netting agreement; and • Any of the methods that the covered company may use under the Federal Reserve’s Basel III capital rules, for derivatives subject to a qualifying master netting agreement ▪ There are special rules for calculating credit exposure arising from certain credit and equity derivatives | <ul style="list-style-type: none"> ▪ Credit exposure for non-credit derivatives may be calculated by: <ul style="list-style-type: none"> • A regulator-approved internal model; • The conversion factor matrix method; or • The CEM ▪ There are special rules for calculating credit exposure arising from certain credit derivatives | <ul style="list-style-type: none"> ▪ Credit exposure is calculated as the sum of: <ul style="list-style-type: none"> • The exposure to the counterparty arising from non-credit derivative transactions; plus • The exposure to the counterparty arising from credit derivatives; plus • The exposure to the counterparty arising from credit derivatives where the counterparty is the obligor on a reference exposure ▪ A bank may also use an alternative method, such as an internal model, that is approved by the Superintendent of the Department of Financial Services ▪ A bank may take into account netting with respect to exposures covered by a qualifying master netting agreement ▪ There are special rules for calculating credit exposure arising from credit derivatives |

Summary Comparison to Select Provisions of OCC and New York State Lending Limits *(cont.)*

| Topic | SCCL Reproposal | OCC Lending Limits | New York Lending Limits |
|------------------------------|--|--|---|
| Credit Risk Mitigants | <ul style="list-style-type: none"> ▪ For most eligible credit risk mitigants, gross exposure to the counterparty must be reduced by the amount of the mitigant. Recognition of an exposure to the provider of the mitigant is required, but is capped at the original exposure to the original counterparty | <ul style="list-style-type: none"> ▪ Readily marketable collateral can extend the lending limit to 25% ▪ No requirement to recognize an exposure to the provider of a credit risk mitigant | <ul style="list-style-type: none"> ▪ In calculating credit exposure arising from derivative transactions, a bank may take into account: <ul style="list-style-type: none"> • readily marketable collateral held under an effective margining arrangement, and • hedging by an eligible credit derivative from an eligible protection provider |

What's Next?

Further Expected Proposed Rules

- **Regulation W Proposal:** Sections 23A and 23B of the Federal Reserve Act, which impose various restrictions on transactions between depository institutions and their affiliates, were amended by the Dodd-Frank Act to explicitly cover credit exposures arising from derivatives and securities financing transactions. However, Regulation W, the Federal Reserve's regulation implementing Sections 23A and 23B, has not yet been revised to take into account the Dodd-Frank amendments.
- **SA-CCR:** The Basel Committee finalized its standardized approach for measuring counterparty credit exposures in March 2014. The U.S. banking agencies have not yet proposed any corresponding revisions to the U.S. Basel III capital rules' standardized approach.
- **Other Prudential Rulemakings:** Among the enhanced prudential standards that remain to be finalized are the early remediation framework and credit exposure reporting requirements.

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