FEDERAL RESERVE SYSTEM

12 CFR Part 252

[Regulation YY; Docket No. R–1534]

RIN 7100–AE 48

Single-Counterparty Credit Limits for Bank Holding Companies and Foreign Banking Organizations

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

ACTION: Final rule.

SUMMARY: The Board is adopting a final rule (final rule) to establish single-counterparty credit limits for bank holding companies and foreign banking organizations with $250 billion or more in total consolidated assets, including any U.S. intermediate holding company of such a foreign banking organization with $50 billion or more in total consolidated assets, and any bank holding company identified as a global systemically important bank holding company under the Board's capital rules. The final rule implements section 165(e) of the Dodd-Frank Wall Street Reform and Consumer Protection Act, which requires the Board to impose limits on the amount of credit exposure that such a bank holding company or foreign banking organization can have to an unaffiliated company in order to reduce the risks arising from the company's failure.

DATES: The final rule is effective October 5, 2018.

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I. Introduction

A. Background

In March 2016, the Board invited public comment on a notice of proposed rulemaking (''proposal'' or ''proposed rule'') to establish single-counterparty credit limits for domestic and foreign bank holding companies with $50 billion or more in total consolidated assets.[1] The proposed rule would have implemented section 165(e) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), which requires the Board to establish limits on the amount of credit exposure that such a U.S. or foreign holding company can have to an unaffiliated company in order to reduce the risks arising from the company's failure. The March 2016 notice of proposed rulemaking followed earlier proposals to implement section 165(e) for U.S. and foreign banking organizations (FBOs).[2]

During the 2007–2009 financial crisis, some of the largest financial firms in the world collapsed or experienced material financial distress. Counterparties of failing firms were placed under severe strain when the failing firm could not meet its financial obligations, in some cases resulting in the counterparties' inability to meet their own financial obligations. Similarly, weakened financial firms came under increased stress when counterparties with large exposures to the firms suddenly attempted to reduce those exposures.

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

The financial crisis also revealed shortcomings in the U.S. regulatory approach to credit exposure limits, which limited only a portion of the interconnectedness among large financial companies. For example, certain commercial banks and U.S. branches and agencies of foreign banking organizations were subject to single-borrower lending and investment limits. However, these limits often excluded credit exposures generated by derivatives and some securities financing transactions, and the limits did not apply at the consolidated holding company level.[3]

As noted, section 165(e) of the Dodd-Frank Act (section 165(e)) requires the Board to establish single-counterparty credit limits (SCCL) for large U.S. and foreign bank holding companies and nonbank financial companies, in order to limit the risks that the failure of any

[1] *See* 81 FR 14328 (Mar. 16, 2016).

[2] 77 FR 594 (Jan. 5, 2012); 77 FR 76628 (Dec. 28, 2012).

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

individual firm could pose to these firms.[4] In particular, section 165(e) prohibits such firms from having credit exposure to any unaffiliated company that exceeds 25 percent of the capital stock and surplus of the firm.[5] The Board is authorized to establish a lower amount to mitigate the risks to the financial stability of the United States.[6]

Credit exposure to a company is defined in section 165(e) to mean all extensions of credit to the company, including loans, deposits, and lines of credit; all repurchase agreements, reverse repurchase agreements, and securities borrowing and lending transactions with the company (to the extent that such transactions create credit exposure for the company); all guarantees, acceptances, and letters of credit (including endorsement or standby letters of credit) issued on behalf of the company; all purchases of, or investments in, securities issued by the company; counterparty credit exposure to the company in connection with derivative transactions between the covered company and the company; and any other similar transaction that the Board, by regulation, determines to be a credit exposure for purposes of section 165(e).[7]

Section 165(e) authorizes the Board to issue such regulations and orders, including definitions consistent with section 165(e), as may be necessary to administer and carry out the section.[8] In addition, it authorizes the Board to exempt transactions, in whole or in part, from the definition of the term ''credit exposure,'' if the Board finds that the exemption is in the public interest and consistent with the purposes of section 165(e).[9]

The framework of SCCL established by the final rule is similar to and builds upon existing credit exposure limits for depository institutions, including the investment securities limits and the lending limits imposed on certain depository institutions by the National Bank Act and Federal Reserve Act.[10] A national bank generally is limited, subject to certain exceptions, in the total amount of investment securities of any one obligor that it may purchase for its own account to no more than 10 percent of its capital stock and surplus.[11] In addition, a national bank's total outstanding loans and extensions of credit to any one borrower may not exceed 15 percent of the bank's capital stock and surplus, plus an additional 10 percent of the bank's capital stock and surplus, if the amount that exceeds the bank's 15 percent general limit is fully secured by readily-marketable collateral.[12] U.S. branches of foreign banks are subject to similar limits, albeit measured against the capital stock and surplus of the top-tier parent foreign banking organization.[13]

The SCCL in section 165(e) operate separately and independently from the investment securities limits and lending limits in the National Bank Act and other statutes, and a covered company or covered foreign entity must comply with all of the limits that are applicable to it and its subsidiaries. Under the final rule, a covered company would be required to ensure that it meets the SCCL on a consolidated basis. Because of this, the final rule could affect the amount of a subsidiary depository institution's loans and extensions of credit, regardless of the subsidiary depository institution's applicable lending limits.

B. Notices of Proposed Rulemakings, General Summary of Comments, and Enactment of the Economic Growth, Regulatory Relief, and Consumer Protection Act

The Board received 48 comments, representing approximately 60 parties, on the 2011 proposal on section 165(e) relating to U.S. bank holding companies and 35 comments, representing over 45 organizations, on the 2012 proposed rule relating to FBOs.[14]

In March 2016, the Board re-proposed a rule to implement section 165(e)[15] in order to take account of (1) the large volume of comments received on the earlier proposed rules; (2) the revised lending limits rules applicable to national banks;[16] (3) the introduction by the Basel Committee on Banking Supervision (BCBS) of a large exposures standard (large exposure standard), which establishes an international standard for the maximum amount of credit exposure that an internationally active bank is permitted to have to a single counterparty;[17] and (4) the results of quantitative impact studies and related analysis conducted by Board staff to assess the impact of section 165(e).

The Board received approximately 30 comments in response to the 2016 proposed rule. Comments were received from a wide range of individuals, banking organizations, industry and trade groups representing banking, insurance, and the broader financial services industry, and public interest groups. Board staff also met with a number of commenters to discuss issues relating to the proposed rule, and summaries of these meetings may be found on the Board's public website.

Certain commenters expressed support for the broader goals of the proposed rule to limit single-counterparty concentrations at large financial companies. A number of commenters expressed concerns with particular aspects of the proposed rules.

The Board received a large number of comments on the scope of application of the proposal: How to define a ''covered company'' and a ''counterparty,'' terms that form the basis for the application of the credit exposure limits under the proposed rules. The proposal would have defined a covered company to include all of its subsidiaries. ''Subsidiary'' would have been defined to mean a company that is directly or indirectly controlled by that company for purposes of the Bank Holding Company Act of 1956 (BHC Act).[18] The proposal defined a counterparty to include a company and all entities with respect to which the company (1) owns or controls 25 percent or more of a class of voting securities; (2) owns or controls 25 percent or more of the total equity; or (3) consolidates for financial reporting purposes. Commenters urged the Board to adopt a financial consolidation standard to define a ''covered company'' and

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

[5] 12 U.S.C. 5365(e)(2).

[6] *See id.*

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

[8] *See* 12 U.S.C. 5365(e)(5).

[9] *See* 12 U.S.C. 5365(e)(6). Section 165(e) also authorizes the Board to establish single-counterparty credit limits for nonbank financial companies designated by the Financial Stability Oversight Council (FSOC) for supervision by the Board. The final rule does not at this time apply to any such nonbank financial company. The Board intends to consider whether to apply similar requirements to these companies separately by rule or order at a later time.

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

[11] *See* 12 U.S.C. 24(Seventh); 12 CFR 1.3.

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

[13] *See* 12 CFR 211.28.

[14] All of the comments are available on the Board's public website. A summary of comments received on the 2011 and 2012 proposal appears in the March 2016 re-proposal. *See* 81 FR at 14329–30.

[15] *See* 81 FR at 14328.

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

[17] Basel Committee on Banking Supervision, Supervisory framework for measuring and controlling large exposures (April 2014), *http://www.bis.org/press/p140415.htm.*

[18] *See* proposed rule § 252.71(cc). ''Control'' is defined in the Board's Regulation YY by reference to the BHC Act. *See* 12 CFR 252.2(g); *see also* 12 U.S.C. 1841 *et seq.* The BHC Act generally defines control to mean ownership or control of 25 percent or more of any class of voting securities; control in any manner over the election of a majority of the directors; or exercise of a controlling influence over management or policies. 12 U.S.C. 1841(a)(2).

''counterparty.'' Commenters contended that moving to a financial consolidation standard would capture true exposure risks and reduce the complexity and compliance costs of the final rule.

In addition, the proposal would have required a covered company to aggregate one or more counterparties that were economically interdependent with or tied to the counterparty through certain control relationships. A few commenters expressed support for this aspect of the proposal. The large majority of commenters, however, contended that these tests were highly subjective and could be costly and burdensome to implement in practice because the tests relied on information that might be difficult for a covered company to acquire from its counterparty. To mitigate these concerns, commenters requested that the Board adopt a threshold for counterparty exposures (for example, the control relationship test should only apply if a counterparty exposure exceeds 5 percent of the covered company's tier 1 capital). Certain commenters urged the Board to use a financial consolidation standard to define a counterparty and not to include any additional tests to aggregate one or more counterparties under the final rule.

Commenters also objected to the inclusion of a natural person together with members of the person's immediate family as a counterparty under the proposed rule. Commenters argued that the Board should exclude natural persons from the final rule's definition of counterparty, suggesting that it is unlikely that a natural person aggregated with members of its immediate family would ever approach the applicable SCCL and that collecting information for this test would be burdensome and unjustified on a cost-benefit basis. Commenters recommended that, at a minimum, the Board include a materiality threshold for exposures to a natural person to be subject to the requirements of the final rule and that the final rule provide a longer transition period for compliance with the requirements if natural persons are included in the final rule.

Certain commenters questioned whether the limit of 25 percent of tier 1 capital that would have applied to a large covered company (with $250 billion or more in total consolidated assets or $10 billion or more in on-balance-sheet foreign exposures) was authorized under the statute. Commenters also questioned the basis for the 15 percent of tier 1 capital limit for major covered companies' exposures to major counterparties. In particular, commenters expressed the view that this lower limit may not be necessary in light of other post-crisis financial regulatory reforms adopted by the Board. By contrast, some commenters argued that the proposal would continue to permit an excessively high level of exposure. These commenters argued the proposed limit of 15 percent of a major covered company's tier 1 capital for exposures of the largest financial institutions was too low and did not take into account the greater social costs of the failure of a systemically important institution as compared to a smaller institution.

A number of commenters expressed concern with the Board's approach to measuring exposures resulting from securities financing transactions, including securities lending transactions, securities borrowing transactions, repurchase agreements, and reverse repurchase agreements. Under the proposal, a covered company would have been required to measure credit exposure to a counterparty in a securities financing transaction as the value of any cash and securities transferred to that counterparty (adjusted upwards by a risk-based add-on) minus the value of any cash and securities received from that counterparty as collateral (adjusted downwards by a risk-based haircut). Commenters contended that the proposed rule's application of collateral volatility haircuts on both sides of the transaction did not recognize the risk-mitigating value of positive correlations between securities on loan and securities received as collateral. Commenters urged the Board to adopt a more risk-sensitive standardized approach to measuring securities financing transactions that has recently been finalized by the BCBS or afford securities financing transactions treatment similar to that provided for derivative transactions in the proposal (that is, use of any methodology permitted under the Board's capital rules), consistent with the large exposure standard.[19] Commenters noted that the significantly more risk-sensitive treatment of derivative transactions in the proposed rule would create an incentive for covered companies and their counterparties to engage in derivative transactions that replicate the economics of a securities financing transaction.

The proposal contained a section addressing how investments in and exposures to securitization vehicles, investment funds, and other special purpose vehicles would be treated. This section of the proposal specified the circumstances under which a covered company would be required to look through the vehicle to the underlying exposures. A number of commenters raised concerns about the breadth and scope of the look-through approach and requested additional clarity around these provisions. The commenters recommended that the Board limit the application of these provisions to only certain types of exposures (for example, investments in the securitization vehicle). Certain commenters also requested that the Board not require aggregation of any exposure to a third party connected to a securitization vehicle, investment fund, or other special purpose vehicle.

Commenters generally expressed support for certain of the exemptions and exclusions contained in the proposal, such as the exemption for trade exposures to qualifying central counterparties, the exclusion of certain sovereign issuers from the ''counterparty'' definition, and the exemption for intraday exposures. Some commenters requested additional exemptions in the final rule, including exemptions for short-dated exposures arising from traditional custody services. A few commenters requested that the Board maintain flexibility in the final rule to provide additional exemptions. The Federal Home Loan Banks urged the Board to exempt credit exposures to the Federal Home Loan Banks. Commenters also requested a longer initial compliance period.

A number of commenters asked the Board to consider the costs and benefits of the proposed rule. Commenters argued that certain aspects of the proposed rule would make it difficult to implement and that the Board should evaluate these aspects of the proposal on a cost-benefit basis.

As required under the Dodd-Frank Act at the time, the proposed rule would have applied the SCCL to any U.S. BHC or FBO with $50 billion or more in total consolidated assets. The narrower scope of application of the final rule reflects the passage of the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA).[20] Subject to an eighteen-month transition period, EGRRCPA recently amended section 165 of the Dodd-Frank Act to restrict the scope of application of most enhanced prudential standards (including SCCL) to U.S. global systemically important banking organizations (GSIBs) and to

[19] *See* Basel Committee on Banking Supervision, Basel III: Finalising post-crisis reforms (Dec. 2017), *https://www.bis.org/bcbs/publ/d424.pdf.*

[20] Public Law 115–174, section 401, 132 Stat. 1296 (2018).

U.S. bank holding companies (BHCs) and FBOs with $250 billion or more in total consolidated assets.[21] Under EGRRCPA, however, the Board may apply an SCCL or any other enhanced prudential standard to U.S. BHCs or FBOs with between $100 billion and $250 billion in total consolidated assets, if the Board makes certain safety and soundness or financial stability findings.

As described below in detail, the Board has modified the proposed rule in response to comments and in light of the enactment of EGRRCPA, while taking into account the need to limit the credit exposure of large financial firms.

C. Overview of the SCCL

Under the final rule, the aggregate net credit exposure of a U.S. GSIB (major covered company) and any bank holding company with total consolidated assets of $250 billion or more (collectively, covered companies) to a single counterparty is subject to one of two credit exposure limits that are tailored to the size and systemic footprint of the firm. As discussed below in more detail, the final rule does not apply to U.S. bank holding companies or FBOs with less than $250 billion in total consolidated assets.[22]

The first limit under the final rule prohibits any covered company that is not a major covered company from having aggregate net credit exposure to an unaffiliated counterparty in excess of 25 percent of its tier 1 capital.

The second limit prohibits any major covered company from having aggregate net credit exposure in excess of 15 percent of its tier 1 capital to a major counterparty and in excess of 25 percent of its tier 1 capital to any other counterparty. A ''major counterparty'' is defined as a global systemically important banking organization or a nonbank financial company supervised by the Board. This framework is consistent with the requirement in section 165(a)(1)(B) of the Dodd-Frank Act that the enhanced standards established by the Board under section 165 increase in stringency based on factors such as the nature, scope, size, scale, concentration, interconnectedness, and mix of the activities of the company.[23] The framework also is consistent with the authorization provided to the Board under section 165(e) to apply a lower limit to the extent necessary to mitigate risks to financial stability.[24] The SCCL applicable to covered companies in the final rule are summarized in Table 1.

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

Category of covered company	Applicable credit exposure limit
Covered companies that are not major covered companies.	Aggregate net credit exposure to a counterparty cannot exceed 25 percent of a covered company's tier 1 capital.
Major covered companies (U.S. GSIBs)	Aggregate net credit exposure to a *major counterparty* cannot exceed 15 percent of a major covered company's tier 1 capital. Aggregate net credit exposure to any *other counterparty* cannot exceed 25 percent of a major covered company's tier 1 capital.

As discussed below, tier 1 capital provides a superior capital base relative to capital stock and surplus as it has greater loss-absorbing capacity. In addition, the 15 percent of tier 1 capital limit is based on the heightened systemic risk presented by exposures between GSIBs.

In contrast to the proposal, the final rule applies only to FBOs with $250 billion or more in total global consolidated assets, and their subsidiary U.S. intermediate holding companies (IHCs) with total assets of $50 billion or more (together, ''covered foreign entities''). The proposal would have applied the SCCL to the combined U.S. operations of any FBO with $50 billion or more in total global consolidated assets and separately to any FBO's U.S. IHC with $50 billion or more in total consolidated assets. Unlike in the proposal, an FBO subject to the final rule can comply with the combined U.S. operations SCCL by certifying to the Board that it meets, on a consolidated basis, an SCCL established by its home country supervisor that is consistent with the large exposure standard. The SCCL for U.S. IHCs that are covered foreign entities are largely unchanged from the proposal and fall into three tailored tiers. These limits are summarized in Table 2 below.

TABLE 2—SINGLE-COUNTERPARTY CREDIT LIMITS APPLICABLE TO U.S. IHCS

Category of U.S. IHC	Applicable credit exposure limit
U.S. IHCs that have total consolidated assets of at least $50 billion but less than $250 billion.	Aggregate net credit exposure of the U.S. IHC to a counterparty cannot exceed 25 percent of the IHC's total regulatory capital plus the balance of its allowance for loan and lease losses (ALLL) not included in tier 2 capital under the capital adequacy guidelines in 12 CFR part 252.
U.S. IHCs that have $250 billion or more in total consolidated assets but are not major U.S. IHCs.	Aggregate net credit exposure of the U.S. IHC to a counterparty cannot exceed 25 percent of the IHC's tier 1 capital.

[21] EGRRCPA raised the asset thresholds for application of enhanced prudential standards under section 165 of the Dodd-Frank Act in two stages. Immediately on the date of enactment of EGRRCPA, bank holding companies with total consolidated assets less than $100 billion (other than any bank holding company that is a U.S. GSIB under the Board's capital rules) were no longer subject to section 165. Eighteen months after the date of enactment of EGRRCPA, bank holding companies with total consolidated assets less than $250 billion (other than any U.S. GSIB) will no longer be subject to section 165 of the Dodd-Frank Act, unless the Board determines, by order or regulation, to apply any enhanced prudential standard to such firms after making certain statutory findings. *See* section 401 of EGRRCPA.

[22] The final rule applies to a U.S. intermediate holding company (IHC) subsidiary of such an FBO that has $50 billion or more in total consolidated assets. In some cases, these U.S. intermediate holding companies also may be bank holding companies.

[23] 12 U.S.C. 5365(a)(1)(B); *see also* 12 U.S.C. 5365(a)(2)(A).

[24] 12 U.S.C. 5365(e); *see* Board of Governors of the Federal Reserve System, Calibrating the Single-Counterparty Credit Limit between Systemically Important Financial Institutions (Mar. 4, 2016), *https://www.federalreserve.gov/aboutthefed/boardmeetings/sccl-paper-20160304.pdf.*

TABLE 2—SINGLE-COUNTERPARTY CREDIT LIMITS APPLICABLE TO U.S. IHCS—Continued

Category of U.S. IHC	Applicable credit exposure limit
U.S. IHCs that have $500 billion or more in total consolidated assets (major U.S. IHCs).	Aggregate net credit exposure of a major U.S. IHC to a *major counterparty* cannot exceed 15 percent of the IHC's tier 1 capital. Aggregate net credit exposure of a major U.S. IHC to any *other counterparty* cannot exceed 25 percent of the IHC's tier 1 capital.

The SCCL in the final rule apply to the credit exposures of a covered company on a consolidated basis, including any subsidiaries, to any unaffiliated counterparty. As discussed below, subsidiary of a covered company under the final rule is defined to mean a company that is consolidated on the financial statements of the covered company.[25] A counterparty includes a company (including any consolidated affiliates of the company, as discussed below); a natural person (including the person's immediate family) where the exposure to the natural person exceeds 5 percent of the covered company's tier 1 capital; a U.S. state (including all of its agencies, instrumentalities, and political subdivisions); certain foreign sovereign entities (including their agencies and instrumentalities); and political subdivisions of foreign sovereign entities (including their agencies and instrumentalities).

As noted, the SCCL in the final rule apply to a covered company's aggregate net credit exposure, rather than aggregate gross credit exposure, to a counterparty. The key difference between gross credit exposure and net credit exposure is that a company's net credit exposure takes into account any available credit risk mitigants—for example, collateral, guarantees, credit or equity derivatives, and other hedges—provided the credit risk mitigants meet certain requirements in the rule, as discussed more fully below. To illustrate, if a covered company had $100 in gross credit exposure to a counterparty with respect to a particular credit transaction, and the counterparty pledged collateral with an adjusted market value of $50, the full amount of which qualified as ''eligible collateral'' under the final rule, the covered company's net credit exposure to the counterparty on the transaction would be $50, provided that the other $50 would be ''risk-shifted'' to the eligible collateral issuer, as described below.

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

The final rule applies a ''risk-shifting'' approach with respect to a credit exposure involving eligible collateral or an eligible guarantor. In general, any reduction in the exposure amount to the original counterparty relating to the eligible collateral or eligible guarantor would result in a dollar-for-dollar increase in exposure to the eligible collateral issuer or eligible guarantor (as applicable). For example, in the case discussed above where a covered company had $100 in gross credit exposure to a counterparty and the counterparty pledged collateral with an adjusted market value of $50, the covered company would have net credit exposure to the counterparty on the transaction of $50 and net credit exposure to the issuer of the collateral of $50. In no case, however, would risk-shifting result in credit exposure to a counterparty that is any larger than the credit exposure being mitigated. As a specific example, in the foregoing example, if the exposure was overcollateralized with $150 in collateral, the exposure to the issuer of the collateral would be capped at $100 while the exposure to the counterparty would be reduced to $0.

In cases where a covered company hedges its exposure to an entity that is not a ''financial entity'' (a non-financial entity) using an eligible credit or equity derivative, and the underlying exposure is subject to the Board's market risk capital rule (12 CFR part 217, subpart F), the covered company must calculate its exposure to the eligible guarantor using a methodology that it is permitted to use under the Board's risk-based capital rules. For these purposes, a ''financial entity'' includes regulated U.S. financial institutions, such as holding companies, insurance companies, broker-dealers, banks, thrifts, and futures commission merchants, as well as foreign banking organizations and non-U.S.-based securities firms and non-U.S.-based insurance companies subject to consolidated supervision and regulation comparable to that imposed on U.S. depository institutions, securities broker-dealers, or insurance companies.[26]

II. SCCL for Covered Companies

A. Key Terminology and Concepts

The terms ''covered company'' and ''counterparty'' form the basis for application of the SCCL in the final rule. The final rule contains modifications from the proposal to these and other definitions in response to concerns raised by commenters.

1. Covered Company and Counterparty

Under the proposal, ''covered company'' would have been defined to mean any bank holding company (other than a foreign banking organization that is subject to subpart Q of the Board's Regulation YY) that has $50 billion or more in total consolidated assets and all of its subsidiaries.[27] The term ''subsidiary'' of a specified company would have been defined under the proposal to mean a company that is directly or indirectly controlled by the specified company.[28] The applicable definition of ''control'' was defined by reference to section 2(a) of the BHC Act.[29]

In addition, the proposal would have defined ''counterparty'' to mean a natural person and members of the

[25] *See* final rule § 252.71(gg).

[26] *See* final rule § 252.71(r).

[27] *See* proposed rule § 252.71(f).

[28] *See* proposed rule § 252.71(cc).

[29] *See* section 252.2(g) of the Board's Regulation YY (12 CFR 252.2(g)). Control under the BHC Act is defined to mean a company (1) owns, controls, or has the power to vote 25 percent or more of any class of voting securities of another company; (2) controls in any manner the election of a majority of trustees of the other company; or (3) the Board determines, after notice and opportunity for hearing, that the company indirectly exercises a controlling influence over the management or policies of the other company. 12 U.S.C. 1841(a)(2).

person's immediate family; a state [30] including all of its agencies, instrumentalities, and political subdivisions (including municipalities); certain foreign sovereign entities and all of their agencies and instrumentalities; and political subdivisions of a foreign sovereign entity such as states, provinces, and municipalities.[31] Under the proposal, a counterparty also would have included any company and all persons that the counterparty (1) owns, controls, or holds with the power to vote 25 percent or more of a class of voting securities; (2) owns, controls, or holds 25 percent or more of the total equity; or (3) consolidates for financial reporting purposes.[32]

The definitions of ''covered company'' and ''counterparty'' were two of the most commented upon aspects of the proposal. A large number of commenters urged the Board to use financial consolidation for aggregating a covered company and its subsidiaries instead of BHC Act control. These commenters argued that a standard based on financial consolidation would bring within the scope of the final rule those exposures that actually put a covered company's capital at risk. Commenters contended that the financial reporting consolidation approach would more accurately capture true economic exposures of covered companies to their counterparties.

Commenters contended that basing the definition of ''covered company'' on control, as defined under the BHC Act, would introduce significant complexity into a covered company's management of its credit limits. This approach also would capture exposures that are not likely to be material to a covered company, including exposures of subsidiaries for which a covered company does not have operational control to actually monitor, measure, and conform credit exposures to the limits of the final rule. Commenters indicated that opportunities to use such a subsidiary to evade the final rule would be limited because a covered company would not exercise operational control of the subsidiary. Some commenters suggested that, to the extent evasion remains a concern, the final rule could include an explicit reservation of authority for the Board to address such concerns, and one commenter suggested the Board could use its supervisory authority to address any potential evasion of the final rule. Commenters also contended that using BHC Act control would impose significant compliance costs to capture risks that are not likely to be material to a covered company (*i.e.,* that compliance costs would exceed the limited incremental risk mitigation benefits).

Commenters also argued that using the BHC Act to define a ''covered company'' could result in some entities being included as part of both the covered company and the counterparty at the same time (*i.e.,* in the case of certain joint venture subsidiaries). Commenters argued that if financial consolidation is not used to define ''covered company,'' the final rule must clarify the treatment of joint ventures that could fall within the scope of being both a covered company and counterparty using BHC Act control. In the alternative to financial consolidation, these commenters suggested certain targeted modifications to the definition of covered company and counterparty to ensure that a joint venture that is controlled due to BHC Act control (for example, where the covered company owns 51 percent and the counterparty owns 49 percent) would not be considered both part of a covered company and of a counterparty under the final rule.

Commenters urged that, if the final rule does not adopt a financial consolidation standard to define subsidiaries of a covered company, the final rule should define subsidiaries of covered companies based on a simple percentage ownership test like the 2011 proposal and the counterparty definition (*i.e.,* ownership of 25 percent or more of the voting securities and ownership of 25 percent or more of the total equity). Under either this alternative or reference to BHC Act control, commenters requested categorical exemptions for funds or investments that are not consolidated for financial reporting purposes. In particular, commenters urged the Board to provide exemptions for registered investment companies and foreign public funds including during the seeding period; certain covered funds as defined in section 13 of the BHC Act, also known as the Volcker Rule, and implementing regulations, including during the seeding period; certain merchant banking portfolio companies; companies acquired in the ordinary course of collecting a debt previously contracted; small business investment companies and community development investments; and bank collective investment trusts.

Similar to the comments on the definition of covered company, a number of commenters urged the Board to define ''counterparty'' with respect to a company based on financial reporting consolidation and to eliminate the additional tests based on percentage ownership.[33] These commenters asserted that the 25 percent ownership tests added additional and unnecessary complexity to aggregating counterparty exposure and would be inconsistent with the large exposure standard. As with the definition of ''covered company,'' commenters argued that aggregation of connected counterparties based on financial consolidation would capture true connected exposure risks consistent with the purposes of section 165(e) of the Dodd-Frank Act. A few commenters also indicated that financial consolidation would address joint venture issues. Other commenters requested that particular entities not be treated as part of a counterparty for purposes of the final rule even if they would be consolidated with the counterparty, including a sponsored or advised registered fund (*e.g.,* during the seeding period) and special purpose vehicles.

To address the concerns raised by commenters and to reduce the burden of complying with the final rule, the Board has modified the definitions of ''covered company,'' ''counterparty,'' and ''subsidiary,'' and has added a new term ''affiliate.'' The purpose of these modifications is to apply a financial consolidation standard to define both the bank holding companies that are subject to the final rule and to define the counterparty exposures that are subject to the SCCL in the final rule. Under the final rule, a ''subsidiary'' is defined to include a company that is consolidated with the covered company under applicable accounting standards, and an ''affiliate'' is defined to include any subsidiary of the company and any other company that is consolidated with the company under applicable accounting standards.[34] For example, a subsidiary of a covered company under the final rule includes an insured depository institution that the covered

[30] ''State'' would have been defined by reference to the enhanced prudential standards to mean any state, commonwealth, territory, or possession of the United States, the District of Columbia, the Commonwealth of Puerto Rico, the Commonwealth of the Northern Mariana Islands, American Samoa, Guam, or the United States Virgin Islands. *See* 12 CFR 252.2(r).

[31] *See* proposed rule § 252.71(e).

[32] *See* proposed rule § 252.71(e)(2). The preamble to the proposal explained that, to the extent that one or more of these conditions are met with respect to a company's relationship to an investment fund or vehicle, exposures to such fund or vehicle would need to be aggregated with that counterparty. *See* 81 FR at 14,332.

[33] These commenters also contended that the economic interdependence and control tests to aggregate counterparty exposures should be eliminated as described further below.

[34] *See* final rule § 252.71(b) & (gg).

company consolidates for financial reporting purposes. Similarly, an affiliate of a counterparty under the final rule includes a parent company of the counterparty, as well as any other firm that is consolidated with the counterparty under applicable accounting standards. Applicable accounting standards can include U.S. Generally Accepted Accounting Principles, the International Financial Reporting Standards, or other similar standards. ''Subsidiary'' and ''affiliate'' would also include a company that is not subject to such principles or standards, if consolidation would have occurred if such principles or standards had applied.[35]

Using financial accounting standards for purposes of the final rule, rather than the control test in the BHC Act, should address many of the concerns raised by commenters and serve to reduce burden and complexity and mitigate costs of complying with the requirements of the final rule, without allowing evasion of the SCCL. Although consolidation tests under relevant accounting standards must also be applied on a case-by-case basis, like the proposed rule's control tests, the analysis already has been performed for companies that prepare their financial statements in accordance with relevant accounting standards. For companies that do not prepare these statements, industry participants should be more familiar with the relevant accounting standards and tests, and they will be less burdensome to apply. Additionally, the accounting consolidation standard typically results in consolidation at a higher level of ownership than the 25 percent voting interest standard that applies under the BHC Act control test, which is responsive to commenters' concerns that the proposed definitions were overly inclusive.

This change in the final rule should also address the concerns raised by commenters with respect to investment funds. Investment funds generally are not consolidated with the asset manager other than during the seeding period or other periods in which the manager holds an outsize portion of the fund's interest, although this may depend on the facts and circumstances. During these periods, when a covered company may own up to 100 percent of the ownership interest of an investment fund, the investment fund should be treated as a subsidiary. Similarly, merchant banking portfolio companies and companies held pursuant to debt previously contracted authorities would be treated as part of the covered company if consolidated with the covered company.

Joint ventures that are consolidated with the covered company are treated as part of a covered company even if a counterparty also has an investment in such joint venture. If a covered company invests in a minority-owned joint venture that is not consolidated, the final rule requires the covered company to treat that joint venture as a counterparty and recognize exposures to the joint venture.

The final rule also has adjusted the asset threshold for covered companies. As noted, EGRRCPA raised the threshold, from $50 billion to $250 billion in total consolidated assets, for the application of the SCCL and other enhanced prudential standards to a bank holding company in two stages.[36] EGRRCPA also provides the Board with 18 months to determine whether to apply the SCCL or other enhanced prudential standards to BHCs with between $100 billion and $250 billion in total consolidated assets. Accordingly, the final rule defines a ''covered company'' to mean any U.S. GSIB and any BHC (other than an FBO that is subject to the SCCL under subpart Q of Regulation YY) that has $250 billion or more in total consolidated assets. The Board is developing a comprehensive proposal on application of enhanced prudential standards to U.S. BHCs and FBOs with total consolidated assets of $100 billion but less than $250 billion. In connection with this proposal and other tailoring and implementation efforts related to EGRRCPA, the Board may make amendments to the SCCL framework in this final rule.

Additionally, the final rule maintains the economic interdependence and aggregation due to control relationships for covered companies as described below.[37] These additional tests require a covered company to aggregate counterparties in certain cases and further allow the Board to aggregate counterparties. Specifically, these tests provide for the aggregation of counterparties where the failure, default, insolvency, or material financial distress of one counterparty would cause the failure, default, insolvency, or material financial distress of the other counterparty or due to the presence of significant control relationships.

The final rule retains individuals and certain governmental entities within the definition of a ''counterparty,'' because credit exposures to such entities can create risks to the covered company that are similar to those created by large exposures to companies.[38] The severe distress or failure of an individual, U.S. state or municipality, sovereign entity, or political subdivision of a sovereign entity, could have effects on a covered company that are comparable to those caused by the failure of a financial firm or nonfinancial corporation to which the covered company has a large credit exposure. With respect to sovereign entities, these risks are most acute in the case of sovereigns that present greater credit risk. Therefore, the Board believes that it is appropriate to extend the SCCL to foreign sovereign entities that do not receive a zero percent risk weight under the standardized approach of the Board's risk-based capital rule in the same manner as credit exposures to companies.[39]

The Board is extending the SCCL to individuals, U.S. states and municipalities, and certain foreign sovereigns using two legal authorities. First, under section 165(b)(1)(B) of the Dodd-Frank Act, the Board may impose such additional enhanced prudential standards as the Board of Governors determines are appropriate.[40] Second, under section 5(b) of the BHC Act, the Board may issue such regulations as may be necessary to enable it to administer and carry out the purposes of this chapter and prevent evasions thereof.[41] Such purposes include examining the financial, operational, and other risks within the bank holding company system that may pose a threat to (1) the safety and soundness of the bank holding company or of any depository institution subsidiary of the bank holding company; or (2) the stability of the financial system of the United States.[42] The final rule would

[35] *Id.*

[36] This change took effect on the date of enactment of EGRRCPA for U.S. BHCs with total consolidated assets of less than $100 billion, and will take effect 18 months after enactment for all other firms. *See* section 401(d)(1) of EGRRCPA. Notwithstanding this change, the enhanced prudential standards required under section 165, including the SCCL, continue to apply to U.S. GSIBs, regardless of asset size. *See* section 401(f) of EGRRCPA. In addition and as noted, the Board may determine to apply the SCCL, or any other enhanced prudential standard, to U.S. BHCs or FBOs with between $100 billion and $250 billion in total consolidated assets, if the Board makes certain safety and soundness or financial stability findings.

[37] *See* final rule § 252.76.

[38] *See* final rule § 252.71(e); 12 U.S.C. 5365(b)(1)(B)(iv).

[39] *See* final rule § 252.71(e); 12 CFR part 217, subpart D. The final rule would not apply to exposures of a U.S. IHC or of the combined U.S. operations of an FBO to the FBO's home country sovereign entity, regardless of the risk weight assigned to that sovereign entity under the Board's capital rules (12 CFR part 217). *See* section III.D.4 infra.

[40] 12 U.S.C. 5365(b)(1)(B).

[41] 12 U.S.C. 1844.

[42] 12 U.S.C. 1844(c)(2).

help to promote the safety and soundness of a covered company and mitigate risks to financial stability by limiting a covered company's maximum credit exposure to an individual, U.S. state, foreign sovereign entity, or political subdivision of a foreign sovereign entity, and thereby reduce the risk that the failure of such individual or entity could cause the failure or material financial distress of a covered company.

i. Companies as Counterparties

To address the concerns raised by commenters and reduce burden on covered companies, the Board has modified the definition of ''counterparty'' with respect to a company. Under the final rule, a counterparty that is a company includes the company and all its affiliates.[43] As noted, the final rule applies a financial consolidation test with respect to the definition of counterparty to address concerns raised by commenters and to reduce the cost of complying with the final rule for the same reasons as described above with respect to covered company.

ii. Natural Persons as Counterparties

As noted, the proposal would have included in the definition of ''counterparty'' a natural person and members of the person's immediate family as a counterparty. Commenters urged the Board to exclude natural persons from the credit exposure limits of the final rule. These commenters argued that a natural person, even when aggregated with the person's immediate family, would be unlikely to approach 25 percent of a covered company's eligible capital base. Commenters argued that it would be impossible for such exposures to pose the types of systemic interconnectivity risks that the Dodd-Frank Act was meant to address and that section 165(e) prohibits a covered company from having credit exposure to an ''unaffiliated company,'' which indicates that Congress did not intend to cover exposures to natural persons. Further, commenters contended that collecting information that would be required to monitor exposures to natural persons aggregated with their immediate family and developing systems to monitor and track these relationships across millions of individual customers may not be possible and could not be justified on a cost-benefit basis. Commenters suggested that if exposure to a natural person is included in the final rule and required to be aggregated with immediate family members for purposes of the exposure limits under the final rule, a threshold of 5 percent of a covered company's eligible capital base should apply. Commenters pointed out that such a threshold would mitigate the need to engage in an analysis of every individual that might require aggregation and thereby reduce the burden of complying with the final rule.

The final rule continues to cover exposures to natural persons, together with members of the person's immediate family, as counterparties, subject to a threshold discussed below.[44] ''Immediate family'' is defined under the final rule in the same manner as under the proposal to mean the spouse of an individual, the individual's minor children, and any of the individual's children (including adults) residing in the individual's home.[45] To address concerns raised by commenters, the final rule only requires a covered company to aggregate a natural person with members of the person's immediate family if the exposure of the covered company to the natural person exceeds 5 percent of the company's tier 1 capital. This modification should reduce burden and address concerns raised by commenters.

iii. Governmental Entities as Counterparties

a. States

As noted, the proposal would have included a State, collectively with all of its agencies, instrumentalities and political subdivisions (including municipalities) as a counterparty.[46] Commenters argued that the proposal provided no basis for the aggregation of states and political subdivisions, ignored the different credit profiles that exist among a State and its subdivisions, and is at odds with historical default experience. As a result, certain commenters urged the Board to use the economic interdependence and control aggregation tests to determine if a covered company must aggregate its exposures to a State with exposures to its political subdivisions subject to a threshold of 5 percent or 10 percent of eligible capital.[47] These commenters argued that at a minimum, municipal revenue bonds, which are generally issued to finance public projects, should not be aggregated together with a State and its agencies, instrumentalities, and political subdivisions as these bonds are contractually supported by a specific stream of revenue derived from the relevant project, which is expressly recognized in Chapter 9 of the U.S. Bankruptcy Code.

The events that would render a State incapable of repaying a loan or bond would likely be highly correlated to the economic performance of the State and would have similar effects on the revenue streams underlying municipal revenue bonds. Accordingly, the final rule, like the proposal, treats a State and all of its agencies, instrumentalities, and political subdivisions (including any municipalities), collectively, as a counterparty.[48] In addition, the final rule requires that a covered company aggregate municipal revenue bonds with other types of municipal bonds, as well as exposures of the State and its agencies, instrumentalities, and other political subdivisions. Similarly, the Board has declined to adopt a 5 percent threshold for aggregating States with their agencies, instrumentalities, and political subdivisions. The Board believes that a covered company should limits its exposure to such entities to no more than 25 percent of its tier 1 capital given the high likelihood of correlation in the economic performance of these entities.

b. Foreign Sovereigns

The proposal would have included as a counterparty, a foreign sovereign entity and all of its agencies and instrumentalities (not including any political subdivision) that is not assigned a zero percent risk weight under the standardized approach in the Board's capital rules (12 CFR part 217, subpart D).[49] In addition, under the proposal, a covered company would have been required to treat a political subdivision of a foreign sovereign entity, together with its agencies and instrumentalities, as a single counterparty.[50]

A few commenters opposed the exemption for zero risk-weight sovereign exposures on the basis that such exposures can be risky. Other commenters urged that the carve-out for exposures to zero risk-weight foreign sovereign entities should be extended to their zero risk-weight public sector entities (PSEs), because they similarly pose little risk of default, and this

[43] *See* final rule § 252.71(e)(2).

[44] *See* final rule § 252.71(e).

[45] *See* final rule § 252.71(u).

[46] *See* 12 CFR 252.2(r).

[47] The economic interdependence and control aggregation tests are described further in Section II.F *infra.*

[48] *See* final rule § 252.71(e)(3).

[49] *See* proposed rule § 252.71(e)(4). ''Sovereign entity'' would have been defined under the proposal to mean a central national government or an agency, department, ministry, or central bank, but not including any political governmental subdivision such as a state, province or municipality. *See* proposed rule § 252.71(bb).

[50] *See* proposed rule § 252.71(e)(5).

treatment would align the treatment of such PSEs with the determination of risk weights under the risk-based capital rules.

Some commenters urged the Board not to aggregate foreign sovereign entities with their agencies and instrumentalities. These commenters recommended an approach that foreign sovereign entities only be aggregated with their agencies and instrumentalities if the entities meet the economic interdependence test, including the 5 percent of a covered company's eligible capital base threshold.

One commenter argued that the final rule should exempt exposures of foreign subsidiaries of covered companies to the respective sovereign entity of the jurisdiction in which such subsidiary is incorporated, regardless of the risk weight assigned to the sovereign entity. This commenter argued that foreign subsidiaries of covered companies need to retain these exposures as part of the transactions in a host country in order to manage their liquidity risk, to have access to intra-day liquidity facilities provided by central banks, and to have collateral to pledge at local central counterparties. Finally, this commenter urged the Board to treat each political subdivision of a foreign sovereign entity as a separate counterparty from any other political subdivision, as is the case for U.S. states, and urged that entities owned by a foreign government with their own revenue sources and without government guarantees should be treated as different counterparties since each poses its own credit risk characteristics.

The final rule retains the proposed approach to sovereign entities without modification. The final rule continues to include certain governmental entities within the definition of a ''counterparty'' because credit exposures to such entities create risks to the covered company that are similar to those created by large exposures to companies. The severe distress or failure of a sovereign entity could have effects on a covered company that are comparable to those caused by the failure of a financial firm or nonfinancial corporation to which the covered company has a large credit exposure. These risks are most acute in the case of sovereign entities that present greater credit risk, as evidenced by the risk weight that applies to the sovereign entity under the Board's capital rules.

In response to commenters who requested that the Board treat each political subdivision of a foreign sovereign entity as a separate counterparty from any other political subdivision, as is the case for the states of the U.S., the Board is confirming that each political subdivision of a foreign sovereign entity (together with any agencies and instrumentalities of the political subdivision, collectively) would be treated as a separate counterparty.[51] This treatment is appropriate because the events that would render a political subdivision incapable of repaying a loan or bond would likely be highly correlated to the economic performance of the agencies and instrumentalities within the political subdivision.

2. Major Company and Major Counterparty

The requirements of the proposal would have provided that no ''major covered company,'' defined as a covered company that is a U.S. global systemically important banking organization and all of its subsidiaries, could have aggregate net credit exposure to a major counterparty in excess of 15 percent of the major covered company's tier 1 capital.[52] A ''major counterparty'' was defined as (1) any major covered company and all of its subsidiaries, collectively; (2) any foreign banking organization and all of its subsidiaries, collectively, that would be considered a global systemically important foreign banking organization; and (3) any nonbank financial company supervised by the Board.[53]

Under the proposal, a foreign banking organization would have been considered to be a global systemically important foreign banking organization if (1) the foreign banking organization has the characteristics of a global systemically important banking organization under the global methodology; or (2) the Board, using any relevant information determines that the foreign banking organization would be a GSIB under the global methodology; that the top-tier foreign banking organization, if it were subject to the Board's capital rules would be identified as a GSIB; or that the U.S. IHC, if it were subject to the Board's capital rules, would be identified as a GSIB.

No comments were received on the definition of ''major covered company'' under the proposal. In terms of the identification of a ''major counterparty,'' commenters urged the Board to make this determination by reference to the annual FSB Report listing GSIBs identified by the BCBS.[54] Commenters indicated this approach to identifying major counterparties would harmonize with the BCBS approach and allow reliance upon and integration with pre-existing data sources.

The methodology in the Board's GSIB surcharge rule identifies the most systemically important U.S. banking organizations.[55] This methodology evaluates a banking organization's systemic importance on the basis of its size, interconnectedness, cross-jurisdictional activity, substitutability, and complexity. The firms that score highest on these attributes are classified as GSIBs. While the GSIB surcharge rule itself applies only to U.S bank holding companies, its methodology is equally well suited to evaluating the systemic importance of foreign banking organizations. Moreover, the method 1 methodology in the GSIB surcharge rule for identifying GSIBs is consistent with the methodology developed by the BCBS to identify GSIBs; foreign jurisdictions collect information from banking organizations in connection with that framework that parallels the information collected by the Board for purposes of the Board's GSIB surcharge rule.

Given that the global methodology and the method 1 methodology in the GSIB surcharge rule to identify GSIBs are virtually identical, the two methodologies should lead to the same outcomes, and the requirements in the final rule to identify whether a foreign banking organization is a GSIB should entail minimal additional burden for foreign banking organizations. Accordingly, the final rule generally adopts the same methodology as the proposal for determining whether a foreign banking organization and all of its subsidiaries, collectively, would be considered a global systemically important foreign banking organization, with minor changes to clarify that this determination applies at the top-tier foreign banking organization.[56]

The final rule applies certain notice requirements to foreign banking organizations subject to the final rule. First, each top-tier foreign banking organization that controls a U.S. IHC is required to submit to the Board by

[51] *See* final rule § 252.71(e)(5).

[52] *See* proposed rule § 252.72(c).

[53] *See* proposed rule § 252.71(v).

[54] The Financial Stability Board maintains and periodically publishes a list of entities that have the characteristics of a global systemically important banking organization on its website, *http://www.fsb.org.*

[55] *See* 12 CFR part 217, subpart H.

[56] ''Top-tier foreign banking organization,'' with respect to a foreign banking organization, means the top-tier foreign banking organization or, alternatively, a subsidiary of the top-tier foreign banking organization designated by the Board. 12 CFR 252.2(aa).

January 1 of each calendar year notice of whether the home country supervisor (or other appropriate home country regulatory authority) of the top-tier foreign banking organization of the U.S. IHC has adopted standards consistent with the global methodology. In addition, these firms are required to provide notice of whether the top-tier foreign banking organization prepares the indicators used by the global methodology to identify a banking organization as a global systemically important banking organization and, if it does, whether the top-tier foreign banking organization has determined that it has the characteristics of a global systemically important banking organization under the global methodology. This section also provides that a top-tier foreign banking organization, which controls a U.S. IHC and prepares or reports for any purpose the indicator amounts necessary to determine whether the top-tier foreign banking organization is a global systemically important banking organization under the global methodology, must use the data to determine whether the top-tier foreign banking organization has the characteristics of a global systemically important banking organization under the global methodology. These requirements mirror requirements in other Board regulations to identify foreign GSIBs, and an FBO is not expected to provide separate notice to the Board for purposes of the final rule if the FBO has already provided notice related to other regulatory requirements.[57]

3. Aggregate Net Credit Exposure

As noted, aggregate net credit exposure is the credit exposure amount to which the SCCL apply. The proposal would have defined aggregate net credit exposure to mean the sum of all net credit exposures of a covered company to a single counterparty. Under the proposal, ''covered company'' would have been defined to include all of the company's subsidiaries (that is, companies that were under common control of the covered company for purposes of section 2 of the BHC Act).[58] As noted, the definitions of ''covered company'' and ''subsidiary'' in the final rule have been revised to incorporate financial consolidation principles, and ''subsidiary'' is no longer part of the definition of ''covered company.''

Under the final rule, ''aggregate net credit exposure'' is defined to mean the sum of all net credit exposures of a covered company and its subsidiaries to a single counterparty as calculated under the final rule.[59] The purpose of this modification is to make clear that, notwithstanding the changes to the definition of ''covered company'' and ''subsidiary'' from the proposal to the final rule, a covered company must still aggregate exposures of its subsidiaries for purposes of the final rule.

4. Financial Entity

Under the proposal, a covered company would not have been required to include the notional amount of an eligible credit or equity derivative for a hedged transaction where the counterparty is not a financial entity. A ''financial entity'' would have included regulated U.S. financial institutions, such as insurance companies, broker-dealers, bank holding companies, banks, thrifts, and futures commission merchants, as well as foreign banking organizations and certain non-U.S.-based securities firms or non-U.S.-based insurance companies.[60] A ''financial entity'' also would have included a company whose primary business includes the management of financial assets, lending, factoring, leasing, provision of credit enhancements, securitization, investments, financial custody, central counterparty services, proprietary trading, insurance, and other financial services.[61]

In order to achieve additional clarity, the definition of ''financial entity'' in the final rule has been modified from the proposal to provide a list of discrete entities that would constitute financial entities for purposes of the final rule.[62] In developing this definition of ''financial entity,'' the Board sought to provide certainty and clarity to covered companies regarding the types of financial firms that would require notional amount treatment of eligible credit and equity derivatives and those that would not (that is, where the counterparty on the underlying hedged transaction is not a financial entity). The approach in the final rule is intended to strike a balance between the desire to capture all financial entities, without being overly broad and capturing commercial firms and sovereign entities.

5. Eligible Collateral

Under the proposal, ''eligible collateral'' would have been defined to include cash on deposit with a covered company (including cash held for the covered company by a third-party custodian or trustee); debt securities (other than mortgage- or asset-backed securities) that are bank-eligible investments and that have an investment grade rating; equity securities that are publicly traded; or convertible bonds that are publicly traded.[63] Section 252.74 of the proposal explained how eligible collateral would have been taken into account in the calculation of net credit exposure.[64]

A number of commenters argued that the list of ''eligible collateral'' should be consistent with the definition of ''financial collateral'' under the Board's regulatory capital rules and with the large exposure standard. In particular, these commenters requested that the final rule should include as ''eligible collateral'' gold, any long- or short-term debt securities that are not resecuritization exposures and that are investment grade (including mortgage- or asset-backed securities), and money market fund shares and other mutual fund shares if a price of such shares is publicly quoted daily.

As requested by certain commenters, the final rule makes clear that cash in a foreign currency or U.S. dollars is an acceptable form of eligible collateral and that cash held by a third-party custodian or trustee may be held inside or outside the United States. For any asset to count as eligible collateral under the final rule, as under the proposal, the covered company generally is required to have a perfected, first priority security interest in the collateral or the legal equivalent thereof, if outside of the United States.

In response to comments, the Board has added gold bullion to the list of eligible collateral. The Board has declined to add certain other types of collateral such as mortgage-backed securities (MBS) and shares in money market mutual funds (MMMF) as requested by commenters even though these collateral types are recognized as eligible collateral in the Board's capital rules. The Board has decided to limit the scope of eligible collateral to restrict those collateral types that would be likely to suffer from a bout of illiquidity and general market dislocation in a period of financial stress when a

[57] *See, e.g.,* 12 CFR 252.153(b)(4).

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

[59] *See* final rule § 252.71(c). ''Net credit exposure'' also is a defined term under the final rule. ''Net credit exposure'' is defined to mean, with respect to any credit transaction, the gross credit exposure of a covered company and all its subsidiaries calculated under § 252.73, as adjusted in accordance with § 252.74. *See* final rule § 252.71(aa).

[60] *See* proposed rule § 252.71(q).

[61] *Id.*

[62] 12 CFR 252.71(r).

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

[64] *See* proposed rule § 252.74.

covered company may need to monetize collateral quickly in the face of a large counterparty default. This stands in contrast to the purpose of collateral for capital purposes, which serves to offset losses that may arise in a variety of circumstances, not all of which coincide with the default of a significant counterparty or a period of financial distress. Unlike gold bullion, both MMMF and MBS have previously been subject to bouts of illiquidity and dislocation during periods of financial stress due to their complexity and lack of transparency. In light of these structural features of both MBS and MMMF, the final rule does not to recognize these collateral types as eligible collateral.

Accordingly, under the final rule, ''eligible collateral'' generally is defined in a similar manner as in the proposal to include cash in foreign currency or U.S. dollars on deposit with a covered company (including cash held for the covered company by a custodian or trustee that is not an affiliate of the covered company whether inside or outside the United States); debt securities (other than mortgage- or asset-backed securities) that are bank-eligible investments and that have an investment grade rating; equity securities that are publicly traded; convertible bonds that are publicly traded; or gold.[65] Like the proposal, the final rule generally excludes mortgage-backed securities and other asset-backed securities from the definition of ''eligible collateral'' because of concerns that those securities may be more likely than other securities to become illiquid and lose value during periods of financial instability. However, asset-backed securities guaranteed by a U.S. government-sponsored entity, such as Ginnie Mae, Fannie Mae, or Freddie Mac, qualify as eligible collateral under the final rule so long as the entity remains under U.S. government conservatorship. The final rule clarifies that eligible collateral does not include debt securities or equity securities issued by the covered company or its affiliate.

6. Credit Transaction

Consistent with the statutory definition of credit exposure, the proposed rule would have defined ''credit transaction'' to mean, with respect to a counterparty, any (i) extension of credit to the counterparty, including loans, deposits, and lines of credit, but excluding advised or other uncommitted lines of credit; (ii) repurchase or reverse repurchase agreement with the counterparty; (iii) securities lending or securities borrowing transaction with the counterparty; (iv) guarantee, acceptance, or letter of credit (including any confirmed letter of credit or standby letter of credit) issued on behalf of the counterparty; (v) purchase of, or investment in, securities issued by the counterparty; (vi) credit exposure to the counterparty in connection with a derivative transaction between the covered company and the counterparty; (vii) credit exposure to the counterparty in connection with a credit derivative or equity derivative transaction between the covered company and a third party, the reference asset of which is an obligation or equity security issued by the counterparty; [66] and (viii) any transaction that is the functional equivalent of the above, and any similar transaction that the Board determines to be a credit transaction for purposes of this subpart.[67]

One commenter urged the Board to exclude foreign demand deposits associated with custody services from the credit exposure calculation under the final rule. This commenter argued that cash deposits denominated in a foreign currency are often received from custody clients as a result of securities ownership and held in a demand deposit account with sub-custodian banks in jurisdictions where it does not self-custody.

The final rule retains the proposed definition of ''credit transaction'' without modification. The final rule does not exclude foreign demand deposits associated with custody services as requested by certain commenters. Section 165(e) explicitly provides that ''credit exposure'' means all extensions of credit including loans, deposits, and lines of credit. The Board may only grant exemptions that are in the public interest and consistent with the purposes of section 165(e) of the Dodd-Frank Act. In light of the plain language of the statute, the Board believes that if a covered company holds deposits at a counterparty, those deposits should be subject to the limits of the final rule and that an exclusion would not be appropriate in these circumstances. The final rule exempts intra-day exposures to minimize the impact of the proposal on payment and settlement transactions.

7. Other Terms

The final rule also defines a number of other terms, which are defined largely in the same manner as under the proposal. Additionally, there are certain newly defined terms that were not defined in the proposal but which should provide additional clarity regarding the application of the SCCL. These terms are discussed throughout the remainder of this preamble.

B. Credit Exposure Limits

Section 252.72 of the proposed rule would have contained the key SCCL.[68] As noted, a number of commenters argued that the use of tier 1 capital as the eligible capital base for covered companies was inconsistent with the statute, because section 165(e) defines the general SCCL limit by reference to a firm's ''capital stock and surplus.'' In addition, some commenters urged the Board to eliminate the 15 percent limit for major covered companies to major counterparties. These commenters expressed the view that before proceeding with the application of the lower 15 percent limit, the Federal Reserve should properly account for the probability of the default of a major covered company or major counterparty taking into account the impact of key components of regulatory reforms aimed specifically at addressing both the probability and impact of such a default. One commenter argued the more stringent limit could negatively impact job creation and the economy and was unnecessary in light of increased capital levels.

By contrast, other commenters expressed the view that the Board should use the flexibility granted by Congress under the statute to lower the credit exposure limits relative to the proposal. For instance, one commenter noted that a 25 percent limit would mean that a bank could expose 100 percent of its entire capital to four borrowers. These commenters expressed the view that the 15 percent limit between major covered companies and major counterparties was too high and did not take into account the greater costs of a failure of a global systemically importantant banking organization. These commenters argued that the economic damage created by multiple defaults of the largest firms would be catastrophic and that the credit exposure limit between such firms should be much lower than the 15 percent level proposed. One commenter,

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

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

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

[68] *See* proposed rule § 252.72.

for example, recommended a credit exposure limit of 5 percent of tier 1 capital. A few commenters expressed the view that the final rule should use gross credit exposure rather than net credit exposure to establish the SCCL.

The Board has considered the comments received as well as changes to the final rule made in response to EGRRCPA. Section 252.72 of the final rule now contains two credit exposure limits that are tailored to the size and systemic footprint of the firm. No covered company may have an aggregate net credit exposure to any counterparty that exceeds 25 percent of the tier 1 capital of the covered company. In addition, no major covered company may have aggregate net credit exposure to any major counterparty that exceeds 15 percent of the tier 1 capital of the major covered company.

1. 25 Percent of Tier 1 Capital Limit

The Board continues to believe that the use of tier 1 capital is the appropriate measurement for the SCCL applicable to covered companies. Notwithstanding the arguments that the standard in SCCL established under section 165(e) is based on a company's ''capital stock and surplus,'' section 165(e) expressly authorizes the Board to establish a lower amount as necessary to mitigate the risks to the financial stability of the United States. Further, section 165 requires the Board to tailor enhanced prudential standards to increase in stringency based on certain factors (capital structure, riskiness, complexity, financial activities (including the financial activities of their subsidiaries), size, and other risk-related factors that the Board deems appropriate).[69]

As indicated, the SCCL in the final rule for covered companies are calculated by reference to tier 1 capital as defined under the Board's capital rules, rather than total regulatory capital plus ALLL.[70] A key financial stability benefit of the SCCL is that such limits help reduce the likelihood that the failure of one financial institution will lead to the failure of other financial institutions. By reducing the likelihood of multiple simultaneous failures arising from interconnectedness, the SCCL reduce the probability of future financial crises and the social costs that would be associated with such crises. For this benefit to be realized, SCCL for firms whose failure is more likely to have an adverse impact on financial stability should be based on a measure of capital that is available to absorb losses on a going-concern basis.

Total regulatory capital plus ALLL includes capital elements that do not absorb losses on a going-concern basis. For example, total regulatory capital includes a covered company's subordinated debt, which is senior in the creditor hierarchy to equity and therefore only takes losses once a company's equity has been wiped out. In contrast, a company's tier 1 capital consists only of equity claims on the company, such as common equity and certain preferred shares. By definition, these equity claims are available to absorb losses on a going-concern basis. Therefore, in order to limit the aggregate net credit exposure that a covered company can have to a single counterparty, the SCCL applicable to such companies should be based on their tier 1 capital. Basing single-counterparty credit limits for such companies on tier 1 capital also is consistent with the mandate in section 165(a)(1)(B) of the Dodd-Frank Act to tailor enhanced prudential standards such that they increase in stringency based on the systemic footprint of the firms to which they apply.[71]

Moreover, this approach would be consistent with lessons learned during the financial crisis of 2007–2009. During the crisis, counterparties and other creditors of distressed financial institutions discounted lower-quality regulatory capital instruments issued by such institutions, such as trust preferred shares, hybrid capital instruments, and other term instruments. Instead, market participants focused on a financial institution's common equity capital and other simple, perpetual-maturity instruments that now qualify as tier 1 regulatory capital. For this reason, the Board's revised capital framework introduced a new definition of common equity tier 1 capital, restricted the set of instruments that qualify as additional tier 1 capital, and raised the tier 1 capital regulatory minimum from four to six percent.[72] In contrast, the Board's revised capital framework left the total regulatory capital minimum requirement unchanged from its pre-crisis calibration of 8 percent.

Thus, basing single-counterparty credit limits for such covered companies on tier 1 capital would be consistent with the post-crisis focus on higher-quality forms of capital and would provide a more reliable capital base for the credit limits. In addition, the analysis that follows suggests that using a narrower definition of capital for covered companies should mitigate risks to U.S. financial stability.

The marginal impact of basing single-counterparty credit limits on tier 1 capital for firms with $250 billion or more in total assets appears to be limited. As of December 31, 2016, tier 1 capital represented approximately 84 percent of the total regulatory capital plus ALLL for these firms. Further, the quantitative impact study Board staff conducted to help gauge the likely effects of the proposed requirements suggests that using tier 1 capital as the eligible capital base for bank holding companies with $250 billion or more in total consolidated assets or $10 billion or more in total on-balance-sheet foreign exposures likely would increase the total amount of excess exposure among U.S. bank holding companies by approximately $30 billion. This incremental amount of excess credit exposure could be largely eliminated by firms through compression of derivatives, collection of additional collateral from counterparties, greater use of central clearing, and modest rebalancing of portfolios among counterparties. The revised treatment for calculating net credit exposure from securities financing transactions should also reduce this exposure. For all these reasons, the Board has determined that it is appropriate to apply a more stringent SCCL of 25 percent of tier 1 capital to covered companies to mitigate risks to the financial stability of the United States.[73]

2. 15 Percent of Tier 1 Capital Limit

The 15 percent of tier 1 capital limit that applies to credit exposures of a major covered company to a major counterparty reflects the financial stability consequences associated with such credit extensions. A credit extension between a major covered company and a major counterparty is expected to result in a heightened degree of credit risk to the major covered company relative to the case in which a major covered company extends credit to a counterparty that is not a major counterparty. The heightened credit risk arises because major covered companies and major counterparties are often engaged in common business lines and often have common counterparties and common funding sources. This creates a significant degree of commonality in their economic performance. In

[69] 12 U.S.C. 5365(a)(1)(B); 12 U.S.C. 5365(a)(2)(A).

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

[71] 12 U.S.C. 5365(a)(1)(B); 12 U.S.C. 5365(a)(2)(A).

[72] *See* 12 CFR part 217.

[73] *See* 12 U.S.C. 5365(e)(2). In contrast, the SCCL for a U.S. IHC with $50 billion or more in total consolidated assets but less than $250 billion in total consolidated assets are based on the U.S. IHC's total regulatory capital plus ALLL. *See* final rule § 252.172.

particular, factors that would likely cause the distress of a major counterparty would also likely be expected simultaneously to adversely affect a major covered company that has extended credit to the major counterparty. As a result, such credit extensions would be expected to present more credit risk and greater potential for financial instability than a credit extension made by a major covered company to a counterparty that is not a major counterparty.

In the white paper that was released in conjunction with the proposal, Board staff analyzed data on the default correlation between systemically important financial institutions (SIFIs) as well as data on the default correlation between SIFIs and a sample of non-SIFI companies.[74] The analysis supports the view that the correlation between SIFIs, and hence the correlation between major covered companies and major counterparties, is measurably higher than the correlation between SIFIs and other companies. This finding further supports the view that credit extensions between SIFIs, and hence by a major covered company to a major counterparty, present a higher degree of risk and the potential for greater financial instability than credit extensions of a major covered company to a non-major counterparty.

Some commenters contended that the credit limit on exposures to major counterparties should reflect a reduced probability of default of such major counterparties resulting from a range of post-crisis reforms. The Board disagrees with this approach. SCCL are, by their nature, simple and transparent limits that do not depend on the probability of default of any individual counterparty. As a specific example, the general 25 percent limit does not recognize any difference in the probability of default between counterparties. Moreover, the SCCL are designed to protect against counterparty default and hence explicitly assume the default of the counterparty in question regardless of the likelihood of such an event. Accordingly, it would be inconsistent with the general motivation for counterparty credit limits to differentiate based on perceived differences in credit quality.

Because credit extensions of a major covered company to a major counterparty present a heightened degree of credit risk and a greater potential for heightened financial instability and to mitigate risks to the financial stability of the United States, the Board has determined that it is appropriate to apply a more stringent SCCL for credit extensions between a major covered company and a major counterparty of 15 percent of tier 1 capital.[75] The more stringent credit limit of 15 percent of tier 1 capital is informed by the results of a credit risk model that is described in detail in the white paper. More specifically, data on correlations, as described above, is used to calibrate a credit risk model. The credit risk model is then used to set the single-counterparty credit limit between SIFIs such that the amount of credit risk that a SIFI is permitted to incur through extensions of credit to another SIFI is no greater than the amount of credit risk that the SIFI would be permitted to incur through extensions of credit to a non-SIFI under the 25 percent limit applicable to such exposures. The resulting calibrated model produces inter-SIFI single-counterparty credit limits that are in line with the proposed limit of 15 percent.

An additional factor that is not considered explicitly in the context of the white paper's credit risk model, but which should influence the calibration of the credit limit between major covered companies and major counterparties, is the relative difference in adverse consequences arising from multiple SIFI defaults relative to the default of a SIFI and non-SIFI counterparty. The financial stability consequences of multiple SIFI defaults caused by the default of a SIFI borrower and the resulting default of a SIFI lender are likely substantially greater than the adverse consequences that would result from the default of a single SIFI lender and a single non-SIFI borrower. As a result, there is a compelling rationale to require that credit risk posed by inter-SIFI credit extensions be materially smaller than that posed by credit extensions between a SIFI lender and non-SIFI borrower. This consideration suggests that an appropriate inter-SIFI single-counterparty credit limit would be even lower than the 15 percent limit suggested by the calibrated credit risk model that is presented in the white paper. The Board has considered the case for an even more stringent credit limit on such inter-SIFI exposures and has decided not to lower the limit so as not to unduly constrain the ability of large banking organizations to engage in transactions that are a necessary part of their business and banking models. Accordingly, the 15 percent of tier 1 capital single-counterparty credit limit on credit exposures of a major covered company to a major counterparty should help to mitigate risks to U.S. financial stability while also allowing large banking organizations to continue to transact with each other as needed on a commercial basis.

C. Gross Credit Exposure

Under the proposal, gross credit exposure would have been defined to mean, with respect to any credit transaction, the credit exposure of the covered company to the counterparty before adjusting for the effect of any qualifying master netting agreements, eligible collateral, eligible guarantees, eligible credit derivatives and eligible equity derivatives, other eligible hedges (*i.e.,* a short position in the counterparty's debt or equity securities), and any unused portion of certain extensions of credit.[76] No comments were received on the definition of ''gross credit exposure'' or ''credit transaction,'' and the final rule continues to define these terms in the same manner as the proposal.[77]

Section 252.73 of the proposal described how the gross credit exposure of a covered company to a counterparty would have been calculated for each type of credit transaction described above.[78] In general, the methodologies contained in the proposed rule are similar to those used to calculate credit exposure under the standardized risk-based capital rules for bank holding companies.[79]

Section 252.73 of the final rule describes how the gross credit exposure of a covered company to a counterparty should be calculated for each type of credit transaction. In general, the methodologies contained in the final rule are the same as those under the proposal, other than the calculation methodologies for certain derivative transactions and securities financing transactions, which have been modified to address comments received and are similar to those used to calculate credit exposure under the standardized risk-based capital rules for bank holding companies.[80]

[74] *See,* ''*Calibrating the Single-Counterparty Credit Limit between Systemically Important Financial Institutions,*'' May 4, 2016, *https://www.federalreserve.gov/aboutthefed/boardmeetings/sccl-paper-20160304.pdf.* For purposes of the white paper, SIFIs include global systemically important banking organizations and nonbank financial companies designated by FSOC for supervision by the Board.

[75] 12 U.S.C. 5365(e)(2).

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

[77] *See* final rule § 252.71(t) & (h).

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

[79] 12 CFR part 217, subpart D.

[80] *Id.*

1. Loans, Deposits, and Lines of Credit

Section 165(e) provides that credit exposure includes all extension of credit to a company, including loans, deposits, and lines of credit.[81] Consistent with the statutory definition of credit exposure, the proposed rule would have defined ''credit transaction'' to mean, with respect to a counterparty, any extension of credit to the counterparty, including loans, deposits, and lines of credit, but excluding advised or other uncommitted lines of credit. As noted, the proposal provided that the gross credit exposure for loans by a covered company to the counterparty and leases in which the covered company is the lessor and the counterparty is the lessee, would have been equal to the amount owed by the counterparty to the covered company under the transaction. The final rule retains this treatment.[82]

2. Debt and Equity Securities

Similar to the proposal, under the final rule, trading and available-for-sale debt securities held by the covered company, as well as equity securities, are valued for purposes of single-counterparty credit limits based on their market value. This approach requires a covered company to revalue upwards the amount of an investment in such securities when the market value of the securities increases. In these circumstances, the revaluation would reflect the covered company's greater financial exposure to the counterparty and would reduce the covered company's ability to engage in additional transactions with the counterparty. In circumstances where the market value of the securities falls, however, a covered company would revalue downwards its exposure to the issuer of the securities. This reflects the fact that, just as an increase in the value of a security results in greater exposure to the issuer of that security, a decrease in the value of the security leaves a firm with less exposure to that issuer.[83]

3. Securities Financing Transactions

The proposal addressed the valuation of a securities financing transaction that is subject to a bilateral netting agreement and meets the definition of a ''repo-style'' transaction in the section dealing with calculation of net credit exposure. To enhance clarity, the Board now addresses the valuation of securities financing transactions, including those subject to a bilateral netting agreement that meet the definition of ''repo-style'' transaction, in the gross credit exposure section of the final rule.

Under the proposal, exposure from such a transaction generally would have been equal to an exposure at default amount as modified based on certain standardized collateral haircuts.[84] A covered company would not have been permitted to apply its own internal estimates for haircuts. Further, in calculating its net credit exposure to a counterparty due to such transactions, a covered company would have been required to disregard any collateral received from that counterparty that is not eligible collateral.

The proposal also would have required a covered company to recognize a credit exposure to any issuer of eligible collateral provided in connection with the securities financing transaction. The amount of credit exposure to the issuer would have been equal to the market value of the collateral minus standardized supervisory haircuts. However, the amount of the credit exposure to the issuer of the collateral would have been capped at the gross credit exposure to the counterparty on the original credit transaction.

As noted, commenters objected to the proposed methodology for netting securities financing transactions as overly conservative and highly risk-insensitive. The commenters generally argued that the proposed approach implied unrealistic assumptions about correlations among securities that a covered company transfers to its counterparty and receives from that counterparty. For example, if a covered company loans equity securities to a counterparty and receives equity securities from the counterparty as collateral, the proposed methodology implied that, upon the counterparty's default, the value of the equities transferred to the counterparty would increase in value while the value of the equities received would decrease in value. These commenters urged the Board to permit a covered company to use any methodology permitted under the risk-based capital rules, consistent with the proposal's approach for measuring derivative exposures, including any revisions to the risk-based capital rules. Commenters argued that securities lending plays a critical role in the broader U.S. securities markets and flaws in the securities financing transaction measurement methodology that have the potential to cause covered companies to pull back from this activity as a result of a significant overstatement of risk could have real market consequences.

In response to comments, the final rule includes a modified approach to securities financing transactions. The methodology that would have applied to securities financing transactions under the proposal could have overstated exposure from some transactions. In addition, the more risk-sensitive treatment of derivatives relative to securities financing transactions under the proposal could have artificially incentivized firms to engage in derivatives that are economically equivalent to securities financing transactions. Accordingly, the final rule allows covered companies to use any method that the company is authorized to use under the Board's capital rules, including, in certain circumstances, internal models to measure exposure to securities financing transactions.[85]

4. Derivatives

The proposed SCCL rule drew a distinction between derivative transactions that were subject to a qualifying master netting agreement (QMNA) and derivatives that were not subject to such an agreement.[86] Derivative transactions between the covered company and the counterparty that were not subject to a QMNA would have been valued based on the current exposure of the derivatives contract and its potential future exposure.[87] Derivative transactions between the covered company and the counterparty subject to a QMNA would have been valued based on the exposure at default amount calculated using methodologies the covered company is permitted to use under subparts D and E of the Board's capital rules (12 CFR part 217).[88] This approach would have allowed certain covered companies to calculate counterparty exposures for certain derivatives transactions subject to a QMNA using internal models.

With respect to credit derivative transactions between a covered company and a third party, where the covered company is the protection provider and the reference asset is a debt investment in the counterparty, the credit exposure of the covered company to the counterparty is equal to the

[81] 12 U.S.C. 5365(e)(3)(A).

[82] *See* final rule § 252.73(a)(1).

[83] *See* final rule § 252.73(a)(2) and (3).

[84] *See* proposed rule § 252.73(a)(4)–(7) & 252.74(b).

[85] *See* § 252.73(a)(4) of the final rule. The Board may revisit the approach to securities financing transactions permitted under the capital rules in the future. *See, e.g.,* Basel Committee on Banking Supervision, Basel III: Finalising post-crisis reforms (Dec. 2017), *https://www.bis.org/bcbs/publ/d424.pdf.*

[86] ''Qualifying master netting agreement'' is defined in § 252.71(cc) of the final rule by reference to the Board's capital rules.

[87] *See* proposed rule § 252.73(a)(10).

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

maximum potential loss to the covered company on the transaction.[89]

While commenters generally supported the valuation of derivative transactions under the proposal, certain commenters recommended that the final rule measure the credit exposure amount for derivatives that are not subject to a QMNA in a manner consistent with the proposed rule's measurement of the credit exposure amount for derivatives that are subject to a QMNA—that is, by permitting measurement using internal model methodologies for measuring credit exposure amounts (IMM). These commenters argued that requiring a different approach would introduce unnecessary operational complexity by subjecting the same set of derivative transactions to two different credit exposure calculations depending on whether the derivatives are subject to a QMNA without any apparent prudential benefit. These commenters also expressed the view that allowing IMM with respect to derivatives that are not subject to a QMNA would maintain internal consistency within the final rule and be consistent with the risk-based capital rules more generally.

In response to comments, the Board has modified the proposed rule to allow a covered company to use any methodology that the covered company is authorized to use under the capital rules to value a derivatives transaction. Thus, to the extent that a covered company is authorized to use a particular approach, including an internal model, to value a derivatives transaction under the capital rules, the covered company is authorized to use the same approach to value the transaction under the final rule.

5. Collateral in Custody

The proposal explained that, with respect to cleared and uncleared derivatives, the amount of initial margin and excess variation margin (that is, variation margin in excess of that needed to secure the mark-to-market value of a derivative) posted to a bilateral or central counterparty would have been treated as credit exposure to the counterparty unless the margin is held in a segregated account at a third-party custodian. Certain commenters urged the Board to make clear that all collateral posted to counterparties and held in segregated accounts at third-party custodians would not be treated as credit exposure to the counterparty (*i.e.,* the custodian) and that this treatment be codified in the final rule. The Board notes that initial margin and excess variation margin that is posted to a bilateral or central counterparty and held in a segregated account by a third-party custodian are not subject to counterparty risk with respect to the third-party custodian. Therefore, a covered company is not required under the final rule to calculate gross credit exposure to a third party acting solely as a custodian with respect to collateral held in a segregated account with that custodian.

6. Investments in and Exposures to Securitization Vehicles, Investment Funds, and Other Special Purpose Vehicles That Are Not Subsidiaries

Under the proposal, a covered company with $250 billion in total consolidated assets or $10 billion in total on-balance-sheet foreign exposures would have calculated its gross credit exposure arising from investments in and exposures to securitization vehicles, investment funds, and other special purpose vehicles that are not subsidiaries of the covered company pursuant to § 252.75 of the proposed rule. The final rule, like the proposal, directs a covered company to calculate its gross credit exposure to such entities pursuant to § 252.75 of the final rule. A discussion of this valuation methodology, including comments received on the proposal's valuation methodology, follows in section II.E. *infra.*

7. Attribution Rule

Just as in the proposal, § 252.73(c) of the final rule includes the statutory attribution rule, which provides that a covered company must treat a transaction with any person as a credit exposure to a counterparty to the extent the proceeds of the transaction are used for the benefit of, or transferred to, that party.[90] This attribution rule seeks to prevent firms from evading the single-counterparty credit limits by using intermediaries and thereby avoiding a direct credit transaction with a particular counterparty. The attribution rule in the final rule is similar to that of the proposed rule, except that the final rule refers to a ''party'' rather than a ''counterparty'' to follow more closely the terms of section 165(e).

It is the Board's intention to avoid interpreting the attribution rule in a manner that would impose undue burden on covered companies by requiring firms to monitor and trace the proceeds of transactions made in the ordinary course of business. In general, credit exposures resulting from transactions made in the ordinary course of business will not be subject to the attribution rule.

D. Net Credit Exposure

Section 252.74 of the proposed rule explained how a covered company would have converted gross credit exposure amounts to net credit exposure amounts by taking into account eligible collateral, eligible guarantees, eligible credit and equity derivatives, other eligible hedges (for example, a short position in the counterparty's debt or equity securities), and for securities financing transactions, the effect also of bilateral netting agreements.[91] The key difference between these two amounts is that a company's net credit exposure would take into account any available credit risk mitigants, such as collateral, guarantees, credit or equity derivatives, and other hedges, provided the credit risk mitigants meet certain requirements in the rule, as discussed more fully below. For example, if a covered company had $100 in gross credit exposure to a counterparty with respect to a particular credit transaction, and the counterparty pledged collateral with an adjusted market value of $50, the full amount of which qualified as ''eligible collateral'' under the rule, the covered company's net credit exposure to the counterparty on the transaction would be $50.

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

[89] Under the proposal, this treatment would have applied to both equity derivatives and credit derivatives. *See* proposed rule § 252.73(a)(12). Under the final rule, a covered company that is the protection provider on an equity derivative will apply the same treatment as under the Board's capital rules. *See* final rule § 252.73(7)–(8). ''Credit derivative'' is defined in § 252.71(g) of the final rule, and ''equity derivative'' is defined in § 252.71(p) of the final rule. ''Derivative transaction'' is defined in § 252.71(j) of the final rule in the same manner as it is defined in the National Bank Act, as amended by section 610 of the Dodd-Frank Act. *See* 12 U.S.C. 84(b)(3).

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

[91] *See* proposed rule § 252.74.

aggregate net credit exposure, that would have been subject to the SCCL.

With respect to a credit exposure involving eligible collateral or an eligible guarantor,[92] the proposed rule would have applied a ''risk-shifting'' approach. In general, any reduction in the exposure amount to the original counterparty relating to the eligible collateral or eligible guarantor would result in a dollar-for-dollar increase in exposure to the eligible collateral issuer or eligible guarantor (as applicable). For example, in the case discussed above where a covered company had $100 in gross credit exposure to a counterparty and the counterparty pledged collateral with an adjusted market value of $50, the covered company would have net credit exposure to the counterparty on the transaction of $50 and net credit exposure to the issuer of the collateral of $50.

However, in cases where a covered company hedged its exposure to an entity that is not a ''financial entity'' (a non-financial entity) using an eligible credit or equity derivative, and the underlying exposure is subject to the Board's market risk capital rule (12 CFR part 217, subpart F), the covered company would have calculated its exposure to the eligible guarantor using methodologies that it is permitted to use under the Board's risk-based capital rules.[93] The final rule follows the same general approach to the calculation of net credit exposure as the proposal, with modifications as discussed below.

1. Collateral

Section 252.74(c) of the proposed rule describes how eligible collateral would have been taken into account in the calculation of net credit exposure.[94] Under the proposal, the net credit exposure of a covered company to a counterparty on a credit transaction would have been the gross credit exposure of the covered company on the transaction minus the adjusted market value of any eligible collateral related to the transaction. In addition, under the proposal, a covered company generally would have been required to recognize a credit exposure to the collateral issuer in an amount equal to the adjusted market value of the collateral.

Certain commenters argued that eligible margin loans should not be subject to the risk-shifting requirement under the final rule. These commenters contended that ''risk-shifting'' to the eligible collateral issuer in the case of margin lending accounts would introduce a significant and unnecessary operational burden as it would require a covered company to identify each collateral issuer and shift individually relatively small dollar amounts of such exposures to each collateral issuer for each of these small exposures.

The final rule does not exclude margin loans from the risk-shifting requirements. The final rule contains no *de minimis* risk-shifting exception for any specific loan type, and margin loans do not have any special characteristics that would justify special treatment for margin loans relative to other credit transactions.

In computing its net credit exposure to a counterparty with respect to a credit transaction under the proposed rule, a covered company would have been required to reduce its gross credit exposure on the transaction by the adjusted market value of any eligible collateral.[95] Other than in the context of repo-style transactions, the ''adjusted market value'' of eligible collateral would have been defined to mean the fair market value of the eligible collateral after the application of certain haircuts.[96]

The final rule follows the same general approach. The net credit exposure of a covered company to a counterparty on a credit transaction under the final rule is the gross credit exposure of the covered company on the transaction minus the adjusted market value of any eligible collateral related to the transaction.[97] In addition, under the final rule, a covered company generally must recognize a credit exposure to the collateral issuer in an amount equal to the adjusted market value of the collateral.

The final rule treats eligible collateral as a gross credit exposure to the collateral issuer under the Board's authority under section 165(e) to determine that any other similar transaction is a credit exposure.[98] This approach will help to promote a covered company's careful monitoring of its direct and indirect credit exposures. In order not to discourage overcollateralization, however, a covered company's maximum credit exposure to the collateral issuer is limited to the credit exposure to the original counterparty (unless the counterparty is exempt or excluded from the rule).[99] A covered company would continue to have credit exposure to the original counterparty to the extent that the adjusted market value of the eligible collateral does not equal the full amount of the credit exposure to the original counterparty.

The amount of credit exposure to the original counterparty and the issuer of the eligible collateral would fluctuate over time based on the adjusted market value of the eligible collateral. Collateral that previously met the definition of eligible collateral under the rule but over time ceases to do so would no longer be eligible to reduce gross credit exposure to the original counterparty. Covered companies will need to monitor the adjusted market value and eligibility of all collateral under the final rule. To the extent the adjusted market value of collateral has increased or declined, the covered company would need to adjust its exposures to the original counterparty and issuer of collateral as appropriate. To the extent that collateral no longer meets the definition of eligible collateral, the covered company would need to recognize an exposure to the original counterparty.

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

As noted, the amount of credit exposure to the original counterparty and the issuer of the eligible collateral will fluctuate over time based on movements in the adjusted market value of the eligible collateral. If the adjusted market value of the eligible collateral decreased to $400 on day 2 in the previous example, on day 2 Company A's net credit exposure to Company B would increase to $600, and its gross

[92] The proposal referred to an ''eligible protection provider'' instead of an ''eligible guarantor.'' For simplicity, the final rule refers to ''eligible guarantor,'' which is the term used in the Board's capital rules. The definition of ''eligible guarantor'' in the final rule is unchanged from the proposal. *See* final rule § 252.71(o).

[93] *See* proposed rule § 252.74(e)(2)(ii).

[94] *See* proposed rule §§ 252.71(k) & 252.74(c).

[95] *See* proposed rule § 252.74(c).

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

[97] As discussed below, the final rule treats eligible collateral as a gross credit exposure to the collateral issuer under the Board's authority under 12 U.S.C. 5365(e)(3)(F).

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

[99] *See* final rule § 252.74(b)(3).

credit exposure to Company C would decrease to $400. By contrast, if on day 3 the adjusted market value of the eligible collateral increased to $800, on day 3 Company A's net credit exposure to Company B would decrease to $200, and its gross credit exposure to Company C would increase to $800. In each case, the covered company's total credit exposure would be capped at the original amount of the exposure created by the loan or $1,000—even if the adjusted market value of the eligible collateral exceeded $1,000.

Finally, in cases where eligible collateral is issued by an issuer covered by one of the exemptions in § 252.77 of the final rule or that is excluded from the definition of ''counterparty,'' the requirement to recognize an exposure to the collateral issuer does not apply.[100]

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

2. Eligible Guarantees

Section 252.74(d) of the proposed rule described how to reflect eligible guarantees in calculations of net credit exposure to a counterparty.[101] Eligible guarantees would have been defined as guarantees that meet certain conditions, including having been written by an eligible protection provider.[102] The proposal would have defined ''eligible protection provider'' in the same way as ''eligible guarantor'' in § 217.2 of the Board's capital rules. As such, an eligible protection provider would have included a sovereign entity, the Bank for International Settlements, the International Monetary Fund, the European Central Bank, the European Commission, a Federal Home Loan Bank, the Federal Agricultural Mortgage Corporation (Farmer Mac), a multilateral development bank (MDB), a depository institution, a bank holding company, a savings and loan holding company, a credit union, a foreign bank, or a qualifying central counterparty. An eligible protection provider also would have included any entity, other than a special purpose entity, (i) that at the time the guarantee is issued or anytime thereafter, has issued and maintains outstanding an unsecured debt security without credit enhancement that is investment grade, (ii) whose creditworthiness is not positively correlated with the credit risk of the exposures for which it has provided guarantees, and (iii) that is not an insurance company engaged predominantly in the business of providing credit protection (such as a monoline bond insurer or re-insurer). No comments were received on this aspect of the proposal, and the final rule is substantively the same as the proposal with respect to the treatment of eligible guarantees. However, for simplicity, the final rule refers to ''eligible guarantor'' instead of ''eligible protection provider,'' as that is the term used in the Board's capital rules. The definition of ''eligible guarantor'' in the final rule is unchanged from the proposal.[103]

In calculating its net credit exposure to the counterparty under the final rule, as in the proposal, a covered company is required to reduce its gross credit exposure to the counterparty by the amount of any eligible guarantee from an eligible guarantor.[104] As with other types of eligible collateral, the covered company would then include the amount of the eligible guarantee when calculating its gross credit exposure to the eligible guarantor.[105] In addition, as with eligible collateral, a covered company's gross credit exposure to an eligible guarantor (with respect to an eligible guarantee) could not exceed its gross credit exposure to the original counterparty on the credit transaction prior to recognition of the eligible guarantee.[106] Accordingly, the exposure to the eligible guarantor would be capped at the amount of the credit exposure to the original counterparty, even if the amount of the eligible guarantee is larger than the original exposure. A covered company would continue to have credit exposure to the original counterparty to the extent that the eligible guarantee is for an amount less than the full amount of the credit exposure to the original counterparty.

Example: A covered company makes a $1,000 loan to an unaffiliated counterparty and obtains a $700 eligible guarantee on the loan from an eligible guarantor. The covered company has gross credit exposure of $700 to the protection provider as a result of the eligible guarantee and $300 net credit exposure to the original counterparty.

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

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

3. Eligible Credit and Equity Derivative Hedges

Under the proposal, a covered company would have been required to reduce its gross credit exposure to a counterparty by the notional amount of any eligible credit or equity derivative that references the counterparty if the covered company obtains the derivative from an eligible protection provider.[107] In these circumstances, the covered company generally would have been required to include the notional amount of the eligible credit or equity derivative hedge in calculating its gross credit exposure to the eligible protection provider.[108] However, in cases where the eligible credit or equity derivative was used to hedge covered positions subject to the Board's market risk rule (12 CFR part 217, subpart F) [109] and the counterparty on the hedged transaction was not a financial entity, the covered company would only have been required to recognize a credit exposure to the eligible protection provider using methodologies that the covered company is authorized to use under the Board's capital rules (12 CFR part 217, subparts D and E), rather than the notional amount. Under the proposal, an eligible protection provider would have been defined to have the same

[100] *See* final rule § 252.74(g)(1).

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

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

[103] *See* final rule § 252.71(o).

[104] *See* final rule § 252.74(c).

[105] *See id.*

[106] *See id.*

[107] *See* proposed rule § 252.74(e).

[108] *Id.*

[109] ''Covered position'' is defined in 12 CFR 217.202.

meaning as the definition of ''eligible guarantor'' in the Board's capital rules.[110]

One commenter expressed support for the notional amount transfer of exposure to the protection provider. This commenter, however, objected to the transfer of exposure to the protection provider using the Board's risk-based capital rules in the case where the hedged transaction is a non-financial entity. This commenter argued that this approach was effectively a loophole in the exposure calculation that would create incentives for a bank to transfer risks to third parties rather than developing a solid underwriting analysis of their counterparties.

Certain commenters objected to the treatment of equity derivatives under the proposal. These commenters argued that equity derivatives that are covered positions under the market risk rule should be calculated as part of a covered company's net long or net short position with respect to a given issuer in a manner more generally aligned with how exposure amounts are calculated for such positions under the market risk rule. Commenters contended that this approach, rather than the approach under the proposal to treat equity derivatives in a manner equivalent to instruments designed to offer credit protection, would be consistent with the applicable risk-based capital rules and the large exposure standard.

Some commenters argued that purchased credit and equity derivatives when calculating net exposure for covered positions in the trading book should not be subject to the requirement to be purchased from an eligible protection provider. These commenters argued that permitting only credit and equity derivatives purchased from eligible protection providers to reduce a gross exposure conflicts with the nature of trading book positions and impacts the utility of derivatives purchased from protection providers that do not meet the eligibility criteria. As such, these commenters requested that the rule allow risk-shifting to a protection provider that is not an ''eligible protection provider.''

More broadly, a few commenters expressed the view that credit default swaps should not be used to reduce the calculation of exposure, noting that the experience of American International Group during the crisis demonstrates how the credit default swap itself can be worthless and argued this could be a potential loophole in the final rule. For example, one commenter requested that any obligations of a counterparty to a covered company be recognized directly, regardless of whether the covered company has taken an offsetting position. This commenter generally opposed the netting of derivative positions. Another commenter urged that dollar-for-dollar risk shifting is appropriate but calculation of exposure based upon any method permitted in the risk-based capital rules where the reference asset obligor is not a financial entity would result in much less than dollar-for-dollar risk shifting since the risk-based capital rules do not require derivatives to be measured at their full notional value.

After considering the comments on the proposal, the Board has determined not to modify the treatment of eligible credit and equity derivatives in the manner suggested by commenters. The Board believes that the treatment in the final rule is reflective of the nature of credit and equity derivatives. Equity derivatives shift risk from underlying equities in the same manner as credit derivatives shift risk from underlying credit instruments. Moreover, there is no basis for a distinction between trading book and banking book products under a credit exposure regime.

Section 252.74(d) of the final rule sets forth the treatment of eligible credit and equity derivatives, in the case where the covered company is the protection purchaser.[111] In the case where a covered company is a protection purchaser, such derivatives can be used to mitigate gross credit exposure. A covered company may only recognize eligible credit and equity derivative hedges for purposes of calculating net credit exposure under the final rule. These derivatives are required to meet certain criteria, including having been written by an eligible guarantor.[112] An eligible credit derivative hedge is required to be simple in form, meaning a single-name or standard, non-tranched index credit derivative.

Where protection is obtained, a covered company must recognize exposure to an eligible guarantor.[113] Accordingly, under the final rule, a covered company is required to reduce its gross credit exposure to a counterparty by the notional amount of any eligible credit derivative hedge that references the counterparty if the covered company obtains the derivative from an eligible guarantor.[114] In these circumstances, the covered company generally will be required to include the notional amount of the eligible credit derivative hedge in calculating its gross credit exposure to the eligible guarantor.[115] Similarly, a covered company is required to shift its gross credit exposure from a counterparty to an eligible guarantor in any case where the covered company obtains an eligible equity derivative hedge that references the counterparty from such eligible guarantor. As is the case for eligible collateral and eligible guarantees, the gross exposure to the eligible guarantor would in no event be greater than it was to the original counterparty prior to recognition of the eligible credit or equity derivative.[116] In cases where a covered company is required to shift its credit exposure from the counterparty to an eligible guarantor under the final rule, the covered company is permitted to exclude the relevant equity or credit derivative when calculating its gross exposure to the eligible guarantor. This is to avoid requiring covered companies to double count the same exposures.

The Board also has determined not to make the changes requested by commenters to allow requiring risk-shifting to protection providers that do not meet the definition of ''eligible guarantor.'' Limiting exposures to a large protection provider is an important feature of the final rule. As with eligible collateral and eligible guarantees, a covered company is required to reduce its gross exposure to a counterparty by the amount of an eligible equity or credit derivative, and to recognize an exposure to an eligible guarantor, in order to ensure that concentrations in exposures to eligible guarantors are captured in the regime.

The Board believes that the quality and creditworthiness of the protection provider is an important consideration when assessing the likelihood that the purchased protection would be provided in the event of a large counterparty default. Moreover, the Board notes that many positions subject to the Board's market risk rule represent mark-to-market positions that are intended to hedge market movement on a day-to-day basis and are not always intended to hedge against extreme default events. Accordingly, there is no inconsistency in the final rule's

[110] *See* proposed rule § 252.71(o).

[111] *See* final rule § 252.74(d).

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

[113] As noted, the final rule replaces the term ''eligible protection provider'' with ''eligible guarantor,'' as that is the term used in the Board's capital rules. The definition of the term in the final rule is unchanged from the proposal.

[114] *See* final rule § 252.74(d).

[115] *See* final rule §§ 252.74(d)(1)–(2).

[116] *See* final rule § 252.74(d).

requirement that protection be purchased from an eligible guarantor.

For eligible credit and equity derivatives that are used to hedge covered positions subject to the Board's market risk rule (12 CFR part 217, subpart F),[117] the approach is the same as that explained above, except in the case of credit derivatives where the counterparty on the hedged transaction is not a financial entity.[118] In this case, a covered company is required to reduce its gross credit exposure to the counterparty on the hedged transaction by the notional amount of the eligible credit derivative that references the counterparty if the covered company obtains the derivative from an eligible guarantor. In addition, the covered company is required to recognize a credit exposure to the eligible guarantor that is measured using methodologies that the covered company is authorized to use under the Board's risk-based capital rules (12 CFR part 217, subparts D and E), rather than the notional amount.

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

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

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

4. Treatment of Maturity Mismatches

Under the proposal, if the residual maturity of a credit risk mitigant was less than that of the underlying exposure, the credit risk mitigant would only have been recognized if the credit risk mitigant's original maturity were equal to or greater than one year and its residual maturity were not less than three months from the current date.[119] In that case, the reduction in the underlying exposure would have been adjusted based on the same approach that is used in the Board's capital rules (12 CFR part 217) to address a maturity mismatch.

Commenters argued that credit and equity derivatives that are covered positions under the Board's market risk rule should not be subject to the maturity mismatch adjustments. These commenters argued that, in the trading book, maturity of purchased protection is less important as positions change frequently, are often not held to maturity, and additional extending protection can and would be purchased if necessary. Other commenters argued that no maturity mismatch should exist for securities financing transactions, consistent with the Board's capital rules.

The Board has determined not to make the changes to the proposal recommended by commenters. The SCCL are point-in-time measures of exposure and generally are not designed to respond to anticipated future actions but to reflect actual credit exposure at the time the exposure amount is measured. If the residual maturity of a credit risk mitigant is less than that of the underlying exposure, the credit risk mitigant is only recognized under the final rule if the credit risk mitigant's original maturity is equal to or greater than one year and its residual maturity is not less than three months from the current date.[120] In that case, the reduction in the underlying exposure would be adjusted based on the same approach that is used in the Board's capital rules (12 CFR part 217) to address a maturity mismatch.[121]

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

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

Example: A covered company holds bonds issued by a non-financial entity that are subject to the Board's market risk rule, and hedges the exposure using an eligible credit derivative obtained from an eligible guarantor. If the residual maturity of the eligible credit derivative were less than that of the bonds, the covered company would reduce its exposure to the issuer of the bonds by the adjusted value of the credit derivative using the formula in the Board's capital rules. The covered

[117] ''Covered position'' is defined in 12 CFR 217.202.

[118] The revised definition of ''financial entity'' is explained above.

[119] *See* proposed rule § 252.74(b)–(e).

[120] *See* final rule § 252.74(i).

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

company would measure its exposure to the eligible guarantor using methodologies that the covered company is permitted to use under the Board's capital rules (12 CFR part 217, subparts D and E), without any specific adjustment to reflect the maturity mismatch between the bonds and the credit derivative.

5. Treatment of Currency Mismatch

To provide additional clarity, the final rule includes a section regarding application of currency mismatch adjustments to certain credit risk mitigants—namely, eligible collateral, eligible guarantees, eligible equity derivatives, and eligible credit derivatives—in cases where the collateral or hedge is denominated in a different currency than the hedged exposure. As with several other aspects of the final rule, this treatment is consistent with the Board's capital rules. This section clarifies that a covered company that reduces its credit exposure to a counterparty under the final rule as a result of eligible collateral, an eligible guarantee, an eligible equity derivative, or an eligible credit derivative must apply the currency mismatch adjustment approach in the Board's capital rules, if applicable, when calculating the covered company's gross credit exposure to the issuer of eligible collateral or an eligible guarantor.[122] As noted, a covered company that reduces its credit exposure to a counterparty as a result of such credit risk mitigants must calculate its gross credit exposure to an issuer of eligible collateral or an eligible guarantor even in cases where the underlying credit transaction would not be subject the credit limits of the final rule.[123]

To provide additional clarity, the final rule includes a section regarding application of cross-currency haircuts to certain credit risk mitigants, including eligible credit and equity derivatives. This section clarifies that a covered company that reduces its credit exposure to a counterparty under the final rule must apply the currency mismatch adjustment approach in the Board's capital rules (12 CFR 217.36(f)), if applicable, when calculating the covered company's gross credit exposure to the eligible guarantor, including in instances where the underlying credit transaction would not be subject the credit limits of the final rule.[124]

6. Other Eligible Hedges

Under the proposal, a covered company would have been allowed to reduce its credit exposure to a counterparty by the face amount of a short sale of the counterparty's debt or equity securities, provided that the instrument in which the covered company has a short position was junior to, or *pari passu* with, the instrument in which the covered company has the long position.[125] This restriction on the set of short positions permitted to offset long positions would have helped to reduce the risk that any loss arising from the covered company's long exposure were not offset by a gain in the covered company's short exposure. No comments were received on this aspect of the proposal, and the final rule retains the approach from the proposal.[126]

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

7. Unused Credit Lines

Section 252.74(g) of the proposed rule addressed the calculation of the net credit exposure for any unused portion of certain extensions of credit. In computing its net credit exposure to a counterparty for a credit line or revolving credit facility, a covered company would have been permitted to reduce its gross credit exposure by the amount of the unused portion of the credit extension to the extent that the covered company did not have any legal obligation to advance additional funds under the facility until the counterparty provided the amount of adjusted market value of collateral that qualifies under the credit line or revolving credit facility with respect to the entire used portion of the facility.[127] To qualify for this reduction, the credit contract governing the extension of credit would have been required to specify that any used portion of the credit extension must be fully secured at all times by collateral that is either (i) cash; (ii) obligations of the United States or its agencies; (iii) obligations directly and fully guaranteed as to principal and interest by, the Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation, but only while operating under the conservatorship or receivership of the Federal Housing Finance Agency, or any additional obligations issued by a U.S. government-sponsored entity, as determined by the Board.[128]

Commenters urged the Board to permit the full list of eligible collateral to qualify for this provision. Commenters also requested that the Board allow covered companies to apply the same credit conversion factors (CCF) to unfunded, off-balance sheet commitments as under the Board's capital rules rather than the proposed uniform 100 percent CCF to all such commitments regardless of contractual provisions, to better reflect actual economic exposure.

Under the final rule, in calculating net credit exposure to a counterparty for a credit line or revolving credit facility, a covered company is permitted to reduce its gross credit exposure by the amount of the unused portion of the credit extension, to the extent that the covered company does not have any legal obligation to advance additional funds under the facility until the counterparty provides the amount of adjusted market value of eligible collateral that qualifies under the credit line or revolving credit facility with respect to the entire used portion of the facility.[129] In response to comments, this provision has been modified to make clear that any form of eligible collateral as defined in the final rule (and described above) can be used as collateral for this purpose. To ensure that the methodology is simple and transparent and reflects the true value of the exposure, the final rule does not, however, include credit conversion factors similar to the Board's capital rules.

8. Credit Transactions Involving Exempt and Excluded Persons

Under the proposed rule, if a covered company obtained eligible collateral from an entity that would have been exempt or excluded from the SCCL (*e.g.,* the U.S. government or a foreign sovereign entity that receives a zero percent risk weight under the Board's capital rules), or obtained an eligible guarantee or an eligible credit or equity derivative from an eligible protection provider on an exposure to an exempt

[122] *See* final rule § 252.74(h); *see also* 12 CFR 217.37(c)(3)(ii) (providing the currency mismatch adjustments relevant to eligible collateral); 12 CFR 217.36(f) (providing the currency mismatch adjustments relevant to eligible guarantees, eligible credit deriatives, and eligible equity derivatives).

[123] *See* final rule § 252.74(b)–(d).

[124] *See* final rule § 252.74(d) & (h).

[125] *See* proposed rule § 252.74(f).

[126] *See* final rule § 252.74(e).

[127] *See* proposed rule § 252.74(g).

[128] *Id.*

[129] *See* final rule § 252.74(f).

or excluded entity, the covered company would have been required to recognize an exposure to the collateral issuer or eligible protection provider to the same extent as if the underlying exposure were to an entity that is not exempt.[130] The Board did not receive comments on this aspect of the proposal, and the final rule follows the same approach to exempt and excluded entities as the proposal.[131]

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

E. Exposures to Securitization Funds, Investment Funds, or Other Special Purpose Vehicles

1. Look-Through Approach

Special considerations arise in connection with measuring credit exposures of a covered company to a securitization fund, investment fund, or other special purpose vehicle (collectively, ''SPVs''). Under the proposed rule, large covered companies would have been required to analyze their credit exposure to the issuers of the underlying assets in an SPV in which the large covered company invests or to which the large covered company otherwise has credit exposure.[132] If such company was able to demonstrate that its exposure to each underlying asset in an SPV were less than 0.25 percent of its tier 1 capital (considering only exposures that arise from the SPV), then the covered company would have been allowed to recognize an exposure solely to the SPV and not to the underlying assets.[133] Conversely, if a large covered company was not able to demonstrate that its exposure to the issuer of each underlying asset held by an SPV were less than 0.25 percent of the covered company's tier 1 capital, then the company would have been required to apply a ''look-through approach'' and recognize an exposure to each issuer of the assets held by the SPV that exceeded 0.25 percent of its tier 1 capital.[134] In the latter case, if a large covered company were required to apply the look-through approach, but was unable to identify an issuer of assets underlying an SPV, the covered company would have been required to attribute the exposure to a single ''unknown counterparty'' and aggregate all exposures to such unknown counterparties to a single counterparty.[135]

The application of the look-through approach would have depended on the nature of the investment of the covered company in the SPV. Where all investors in an SPV are *pari passu,* the covered company would have calculated its exposure to an issuer of assets held by the SPV as an amount equal to the covered company's pro rata share in the SPV multiplied by the value of the SPV's underlying assets issued by that issuer.[136] Otherwise, where the investors do not rank *pari passu,* then the exposure to an issuer would have been calculated as the lower of either the value of the tranche in which the covered company has invested or the value of each asset attributed to the issuer—then multiplied by the covered company's pro rata share.[137]

While one commenter expressed support for the look-through requirement, a number of commenters expressed the view that the look-through approach was overbroad, complex, and unworkable as proposed. Commenters requested a number of modifications related to the proposal's look-through approach. Commenters urged the Board to clarify the scope of the look-through requirement. In particular, commenters argued that the look-through approach should only apply to exposures arising from cash investments in a securitization vehicle, investment fund, or other SPV and synthetic positions, such as derivative contracts or other instruments, that mirror the economics of a cash investment that are held in the banking book and exposures arising from extensions of credit and liquidity facilities that mimic the risks of such cash investments and that exceed 0.25 percent of the large covered company's tier 1 capital. A few commenters urged clarification that the look-through approach would not extend to exposures resulting from the provision of traditional custody services to an investment fund client, including payment, settlement, and asset administration. Certain commenters expressed concerns that covered companies would have to attribute excessive exposures to a single unknown counterparty, which could chill investment in funds and vehicles. Commenters requested clarification as to whether the attribution to a single unknown counterparty was required for a covered company's entire exposure to a securitization vehicle or merely the portion that it is unable to link back to an individual issuer.

Certain commenters argued that the Board should adopt a more risk-based approach to the look-through requirement by only requiring the look-through to underlying assets for which the exposure value is at least 0.25 percent of the company's tier 1 capital (the partial look-through approach available under the large exposure standard). These commenters also requested that the look-through be undertaken at less frequent intervals (*e.g.,* monthly or when asset-level disclosures are publicly filed) and using the most recently available information. Some commenters urged the Board to eliminate the requirement that exposures be attributed to a single, unknown counterparty across all SPVs when a large covered company is unable to identify each issuer of assets.

Commenters requested that the final rule exempt from the look-through requirement exposures such as retail asset-backed securities (including those funds or vehicles backed by credit card receivables, auto-loans, and residential mortgages), pools of finance receivables in which the underlying assets are comprised of small business borrower receivables (such as equipment loans and leases, trade receivables, and loans to auto dealers), and commercial mortgage-backed securities. Commenters also argued that investment funds registered under the Investment Company Act of 1940 (or governed by similar legislation in other jurisdictions) should be exempt based on the stringent diversification requirements to which such funds are subject.[138] Commenters argued that it is unlikely that any of the underlying assets would materially contribute to a

[130] *See* proposed rule § 252.74(g).

[131] *See* final rule § 252.74(g). As noted, the final rule replaces the term ''eligible protection provider'' with ''eligible guarantor,'' as that is the term used in the Board's capital rules. The definition of the term in the final rule is unchanged from the proposal.

[132] *See* proposed rule § 252.75(a).

[133] *See* proposed rule § 252.75(a)(3). The Board notes that a covered company's exposure to each underlying asset in an SPV necessarily would be less than 0.25 percent of the covered company's tier 1 capital if the covered company's entire investment in the SPV is less than 0.25 percent of the covered company's tier 1 capital.

[134] *See* proposed rule § 252.75(a)(2).

[135] *See id.*

[136] *See* proposed rule § 252.75(b)(3)(i).

[137] *See* proposed rule § 252.75(b)(3)(ii).

[138] *See, e.g.,* 15 U.S.C. 80a–5(b)(1).

covered company's exposure to a given counterparty given the granular nature of such assets.

Some commenters recommended that the Board exclude exposures from the look-through requirement that are required under other legal standards, such as the risk retention rule, since these exposures cannot be sold down. Commenters contended that the significant practical challenges of complying with the proposal could result in covered companies not investing in SPVs which could have a negative effect on credit markets. For example, certain commenters argued that covered companies may not have access to information at the frequency and level of granularity required.

In order to address the concerns raised by commenters, the Board has narrowed the scope of the look-through approach and reduced the burden of its implementation. The final rule requires application of the look-through approach only to individual underlying assets for which the exposure value is at least 0.25 percent of the company's tier 1 capital, even in cases where the covered company cannot demonstrate that *each* underlying asset in an SPV is less than 0.25 percent of the covered company's tier 1 capital. This approach is referred to as the partial look-through in this **SUPPLEMENTARY INFORMATION**.[139]

The Board has not modified the look-through approach to exclude explicitly certain types of SPVs. However, certain information provided by commenters (*e.g.,* that some retail exposures are unlikely to have large underlying exposures) bears on the potential compliance burden of the look-through and partial look-through approaches. In particular, covered companies may be able to ascertain that an SPV does not contain any exposures greater than or equal to 0.25 percent of tier 1 capital based on characteristics of the SPV without having to measure each specific exposure within the SPV.

Finally, to address the concerns that covered companies may not have access to information at the frequency and level of granularity required, the final rule allows covered companies to rely in good faith on the most recent available information. In other words, covered companies are allowed to fill in any missing values to the best of their ability (*i.e.,* in a reasonable manner and based on the most recently available information).

Example: An SPV holds $10 of bonds issued by Company A, $10 of bonds issued by Company B, and $20 of bonds issued by Company C. Assume that all investors in the SPV are *pari passu* and that a covered company's pro rata share in the SPV is 50 percent. Assume further that the ratio of the covered company's pro rata investment in each bond (A, B, C) to its tier 1 capital is 0.26 percent, 0.26 percent, and 0.52 percent. The covered company needs to recognize a $5 exposure to Company A and Company B (*i.e.,* 50 percent of $10) and a $10 exposure to Company C (*i.e.,* 50 percent of $20).

The foregoing example considers a case in which all of the underlying investments are at least 0.25 percent of the covered company's tier 1 capital. The following example illustrates application of the partial look-through approach.

Example: An SPV holds $10 of bonds issued by Company A, $10 of bonds issued by Company B, and $20 of bonds issued by Company C. Assume that all investors in the SPV are *pari passu* and that a covered company's pro rata share in the SPV is 50 percent. Assume further that the ratio of the covered company's pro rata investment in each bond (A, B, C) to its tier 1 capital is 0.24 percent, 0.24 percent, and 0.48 percent. The covered company needs to recognize a $10 exposure to the SPV (*i.e.,* 50 percent of the $10 exposure to Company A plus 50 percent of the $10 exposure to Company B). Note that the covered company only recognizes the exposure to the SPV—and not individually to Companies A and B—because those two exposures are under 0.25 percent of tier 1 capital. Finally, the covered company must recognize a $10 exposure to Company C (*i.e.,* 50 percent of the $20 exposure to Company C), as the exposure to Company C is above 0.25 percent of tier 1 capital.

The previous two examples consider situations in which the covered company can identify the counterparty associated with each underlying investment in the SPV. In certain cases, a covered company may not be able to identify the counterparty in each underlying investment of the SPV. In such cases, the underlying investments must be allocated to an unknown counterparty if the pro rata size of the investment exceeds 0.25 percent of tier 1 capital, as demonstrated in the following example.[140]

Example: An SPV holds $10 of bonds issued by one unidentified company, $14 of bonds issued by another unidentified company, and $20 of bonds issued by a third unidentified company. Assume that all investors in the SPV are *pari passu* and that a covered company's pro rata share in the SPV is 50 percent. Assume further that the ratio of the covered company's pro rata investment in each bond (A, B, C) to its tier 1 capital is 0.24 percent, 0.34 percent, and 0.48 percent. A covered company would need to recognize a $5 exposure to the SPV (*i.e.,* 50 percent of the $10 exposure to the first unidentified company) and a $17 exposure to an unknown counterparty (*i.e.,* 50 percent of the $14 exposure to the second unidentified company and 50 percent of the $20 exposure to the third unidentified company).

Note that the example above applies both the partial look-through approach, as the exposure to the first unidentified company is allocated to the SPV since it represents less than 0.25 percent of tier 1 capital, and the unknown counterparty treatment since the exposures to the second and third unknown companies are allocated to a single unknown counterparty, as each pro rata investment in the second and third investment exceeds 0.25 percent of the covered company's tier 1 capital. Finally, note that the foregoing example only considers a single SPV and accordingly the effect of applying the unknown counterparty treatment is to allocate some portion of the underlying investments of the SPV to a single unknown counterparty. To the extent that a covered company cannot identify the counterparty associated with several underlying investments across several SPVs, all of these unidentified investments must be allocated to a single unknown counterparty to the extent that the pro rata size of each investment exceeded 0.25 percent of the covered company's tier 1 capital.

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

Example: An SPV holds $10 of bonds issued by Company A. The SPV has issued $4 of junior notes and $6 of senior notes to the SPV's investors. A covered company holds 50 percent of the junior notes and 50 percent of the

[139] *See* final rule § 252.75(b)(1).

[140] *See* final rule § 252.75(a)(3)(iii).

senior notes. With respect to the junior tranche of the SPV, the lesser of the value of the tranche (*i.e.,* $4) and the value of the underlying assets issued by Company A (*i.e.,* $10) is $4. With respect to the senior tranche of the SPV, the lesser of the value of the tranche (*i.e.,* $6) and the value of the underlying assets issued by Company A (*i.e.,* $10) is $6. Because the covered company's pro rata share of each tranche is 50 percent, it would need to recognize $2 of exposure to Company A because of its investment in the junior tranche (*i.e.,* 50 percent of $4), and $3 of exposure to Company A because of its investment in the senior tranche (*i.e.,* 50 percent of $6), assuming the look-through approach is required.

2. Aggregation of Exposures to Certain Third Parties

Under the proposal, a large covered company would have been required to recognize a gross credit exposure to each third party with a contractual or other business relationship with an SPV whose failure or material financial distress would cause a loss in the value of the covered company's investment in or exposure to the SPV.[141] A covered company would have been required to recognize gross credit exposure to such a third party in addition to the covered company's gross credit exposure to an SPV.

A number of commenters urged the Board to eliminate the third-party exposure requirement. Commenters argued that this requirement would have required a covered company to recognize additional exposures without a consideration of the actual amount of risk to which the covered company is exposed as a result of such exposures. Commenters contended that the requirement under the proposal referenced a ''loss'' to a covered company's investment in a securitization vehicle or investment fund without reference to the materiality of such an investment relative to the covered company. Moreover, commenters argued that the proposal did not limit in any manner the universe of third parties, which could make it impossible for a covered company to identify all relevant third parties. As an alternative to eliminating this requirement, commenters urged the Board to limit this requirement to third parties that provide credit support or liquidity facilities to an SPV and only apply the requirement where the large covered company's investment in the vehicle exceeds 0.25 percent of its tier 1 capital, consistent with the look-through requirement. Commenters further argued that this requirement should only be on a reasonable ''best efforts'' basis, because covered companies may lack access to information to comply with this requirement (*e.g.,* a covered company may not know the identity of currency or interest rate providers). Commenters noted that in any case this requirement would overstate exposures by requiring a covered company to recognize an exposure to two different parties: The SPV and the third-party credit provider to the SPV.

The Board has modified the final rule to address the concerns raised by commenters, thereby reducing burden on covered companies. First, the Board has narrowed the scope of the requirement. The proposed rule would have applied to third parties that have a contractual or other business relationship with an SPV.[142] Based on suggestions from commenters, the final rule applies solely to third parties that have a contractual obligation to provide credit or liquidity support to an SPV.[143]

Second, the final rule explicitly limits the exposure that a covered company has to attribute to a third party under this requirement. The proposed rule would have required a large covered company to recognize an exposure to the third party in an amount equal to the large covered company's exposure to the SPV.[144] The final rule caps the recognized exposure to the maximum contractual obligation of that third party to the SPV.[145] This should mitigate the concern that the requirement would have required a covered company to recognize additional exposures without consideration of the actual amount of risk to which the covered company is exposed.

Third, under the final rule, covered companies may rely in good faith on the most recent available information. In other words, covered companies are allowed to rely on a reasonable best effort in the event that they lack access to information to comply with this requirement.

F. Aggregation of Exposures to Connected Counterparties

The proposed rule would have required a covered company to aggregate counterparties based on tests of economic interdependence or due to certain control relationships.[146] In cases where the total exposures to a single counterparty exceeded five percent of the covered company's eligible capital base, the covered company would have had to aggregate exposures to that counterparty with its exposures to all other counterparties that are ''economically interdependent'' with the first counterparty.[147] The purpose of this proposed requirement was 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. For similar reasons, under the proposed rule, a covered company would have been required to aggregate exposures of an unaffiliated counterparty with its exposures to all other counterparties connected by control relationships.[148]

Commenters argued that it would be very difficult and burdensome for covered companies to obtain the information required under the proposed rule to aggregate their counterparties on the basis of the economic interdependence and control tests. Certain commenters argued that if the control relationship tests were retained in the final rule, it should apply only to exposures exceeding five percent of the eligible capital base, similar to the threshold under the proposal for the economic interdependence test. Commenters urged the Board to make clear that any determinations regarding economic interdependence and control relationships, if retained in the final rule, would be subject to a reasonable inquiry standard (that is, there should be good faith due diligence into the relationship between the counterparty and other potentially related entities). Commenters also requested that the Board make clear these tests applied only within, and not across, different categories of counterparties (that is, the tests would not be used to aggregate a natural person with a company or a company with a State).

1. Economic Interdependence

The Board has incorporated two key provisions into the economic interdependency assessment in the final rule to address the concerns raised by commenters and to reduce burden on covered companies.[149] First, the Board has revised the relevant factors to clarify when firms must aggregate exposures to counterparties. For instance, the proposed rule would have required a

[141] *See* proposed rule § 252.75(c).

[142] *See* proposed rule § 252.75(c)(1).

[143] *See* final rule § 252.75(c)(1).

[144] *See* proposed rule § 252.75(c)(2).

[145] *See* final rule § 252.75(c)(2).

[146] *See* proposed rule § 252.76.

[147] *See* proposed rule § 252.76(a).

[148] *See* proposed rule § 252.76(b).

[149] *See* final rule § 252.76(b).

covered company to consider whether a counterparty (counterparty A) has fully or partly guaranteed the credit exposure of another counterparty (counterparty B), or is liable by other means, and the credit exposure is *significant enough* that counterparty B is likely to default if presented with a claim relating to the guarantee or liability.[150] The final rule reframes this standard to make it more concrete and more formulaic: Whether one counterparty has fully or partly guaranteed the credit exposure of the other counterparty, or is liable by other means, *in an amount that is 50 percent or more* of the covered company's net credit exposure to the counterparty.[151]

Second, the final rule allows firms to request in writing a determination from the Board that two counterparties are not economically interdependent, even if one or more factors in the final rule are met.[152] Upon such a request, the Board may grant temporary relief to the covered company and not require the covered company to aggregate one counterparty with another counterparty provided that the counterparty could modify its business relationships, such as by reducing its reliance on the other counterparty, and provided that such relief is in the public interest and is consistent with the purpose of the final rule and section 165(e).[153]

In addition, as under the proposal, this economic interdependency assessment in the final rule is required only when exposure to a counterparty exceeds five percent of a covered company's tier 1 capital. The Board investigated the potential burden of the above requirement using supervisory data covering U.S. GSIBs and their largest credit counterparties from 2008 to 2017. Although the specific definition of credit exposure in the supervisory data did not match precisely the exposure calculation that will be required under the final rule, the analysis does provide general insight into the frequency of large credit exposures. Based on this data, credit exposures exceeding the five-percent threshold occurred only 20 times per year since 2012, for all firms combined.

Example: A covered company has a credit exposure to a bank that is equal to 4.5 percent of tier 1 capital. This covered company does not have to apply the economic interdependency test to the bank because the credit exposure does not exceed five percent of its tier 1 capital.

Example: A covered company has credit exposures to both a car manufacturer and a tire manufacturer. The exposure to the car manufacturer is equal to 5.5 percent of its tier 1 capital. The exposure to the tire manufacturer is 1.5 percent of its tier 1 capital. The tire manufacturer sells all of its output to the car manufacturer. This satisfies § 252.76(b)(2)(i) of the final rule, so the covered company has to aggregate the credit exposures to both counterparties, which yields a total credit exposure of 7.0 percent of its tier 1 capital. Notably, this example also satisfies § 252.76(b)(2)(iii) of the final rule.

Example: A covered company has credit exposures to a bank and an insurance company. The exposure to the bank is equal to 6.0 percent of its tier 1 capital, or $3 billion. The exposure to the insurance company is 1.0 percent of its tier 1 capital, or $1 billion. As part of its business, the insurance company guaranteed half of the bank's exposures to the covered company, *i.e.,* $1.5 billion. This partial guarantee of $1.5 billion is greater than 50 percent of the covered company's exposure to the insurance company, as $1.5 billion is greater than $0.5 billion. This threshold exceeds the standard in the final rule, which means the covered company must aggregate the exposures to the bank and the insurance company.

2. Control Relationships

Similar to the approach to economically interdependent counterparties, the Board has modified the control relationship tests in the final rule to address the concerns raised by commenters and to reduce burden. First, the control test in the final rule applies only when exposures exceed a threshold of five percent of tier 1 capital, similar to the economic interdependence standard. In practice, the likelihood of a counterparty exceeding this five percent threshold is unlikely.

Second, covered companies will be required to apply only two clear control tests, based on 25 percent voting control and majority control of the board of directors.[154]

Third and finally, the final rule allows covered companies to request a determination in writing from the Board that two counterparties are not under common control, even if one or more of the control factors are met.[155] Upon such a request, the Board may grant temporary relief to the covered company and not require the covered company to aggregate one counterparty with another counterparty provided that, taking into account the specific facts and circumstances, such indicia of control does not result in entities being connected by control relationships for purposes of the final rule, and provided that such relief is in the public interest and is consistent with the purpose of the final rule and section 165(e).[156]

Lastly, it should be noted that the final rule authorizes the Board to determine, after notice to the covered company and opportunity for hearing, that one or more counterparties of the covered company are economically interdependent or connected by control relationships for the purposes of this section, based on consideration of the factors in the final rule as well as related indicia.[157] Moreover, the Board can determine, after notice to the covered company and opportunity for hearing, that the exposures to two counterparties must be aggregated to prevent evasion of the final rule and section 165(e).[158]

Example: A covered company has a credit exposure to a bank that is equal to 4.5 percent of its tier 1 capital. This covered company does not have to apply the control test because the exposure level does not exceed five percent of its tier 1 capital.

Example: A covered company has credit exposures to both a bank and a fund that is sponsored by the bank. The exposure to the bank is equal to 6.5 percent of its tier 1 capital. The exposure to the fund is 2.0 percent of its tier 1 capital. The bank does not own, control, or hold the power to vote 25 percent or more of any class of voting securities of the fund; however, the bank does have the ability to appoint a majority of the directors of the fund. Under the final rule, this covered company is required to aggregate its credit exposures to the fund with its credit exposures to the bank, which yields 8.5 percent of its tier 1 capital.

G. Exemptions

Section 165(e)(6) of the Dodd-Frank Act states that the Board may, by regulation or order, exempt transactions, in whole or in part, from the definition of the term ''credit exposure'' for purposes of that subsection, if the Board

[150] *See* proposed rule § 252.76(a)(2)(ii) (emphasis added).

[151] *See* final rule § 252.76(b)(2)(ii) (emphasis added).

[152] *See* final rule § 252.76(b)(3).

[153] *See* final rule § 252.76(b)(3)(ii).

[154] *See* final rule § 252.76(c)(1). For purposes of the final rule, one counterparty (counterparty A) is deemed to control the other counterparty (counterparty B) if (i) counterparty A owns, controls, or holds with the power to vote 25 percent or more of any class of voting securities of counterparty B; or (ii) counterparty A controls in any manner the election of a majority of the directors, trustees, general partners (or individuals exercising similar functions) of counterparty B.

[155] *See* final rule § 252.76(c)(2)(i).

[156] *See* final rule § 252.76(c)(2)(ii).

[157] *See* final rule § 252.76(d).

[158] *See* final rule § 252.76(e).

finds that the exemption is in the public interest and is consistent with the purposes of that subsection.[159] The proposed rule would have included several exemptions for credit transactions from the SCCL, including (1) direct claims on, and portions of claims that are directly and fully guaranteed as to principal and interest by the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation, while these entities are operating under the conservatorship or receivership of the Federal Housing Finance Agency; (2) intraday credit exposure to a counterparty; and (3) trade exposures to a central counterparty that meets the definition of a qualifying central counterparty.[160] The proposal also would have exempted any Federal Home Loan Bank from the definition of covered company.[161]

Many commenters expressed support for the proposed exemptions to qualifying central counterparties and for intraday credit exposures to a counterparty. Certain commenters requested an additional exemption for short-dated exposures arising from the provision of traditional custody services or, in the alternative, the implementation of a five-day cure period for such exposures. A few commenters requested an express exemption for credit exposures to the Federal Home Loan Banks. One commenter urged the Board to include regulatory exemptive authority in the final rule that would provide explicit flexibility for tailoring the rule for a particular covered company based on the company's risk profile.

Certain commenters also requested exemptions for multilateral banks and certain supranational entities, including the Bank of International Settlements, the European Central Bank, the European Commission, the International Monetary Fund, and multilateral development banks that are assigned a zero percent risk weight under the Board's capital rules. One commenter argued it is inappropriate to exclude sovereign exposures to zero percent risk weight foreign sovereign entities, which can be risky. Other commenters urged that the exclusion for exposures to zero percent risk weight foreign sovereign entities be extended to their zero percent risk weight public sector entities. These commenters argued that these entities similarly pose little risk of default and such treatment would align with the determination of risk weights under the Board's risk-based capital rules. Certain commenters requested that the Board allow covered companies to exclude any credit exposures to a counterparty that are deducted from their tier 1 capital as credit exposure since the covered company has already reduced its regulatory capital by these amounts. The Board's capital rules require certain unconsolidated investments in financial institutions to be deducted once certain thresholds are reached.

In response to comments, the Board has decided not to allow covered companies to exclude exposures that have been deducted from capital for two reasons. First, the deduction only occurs after a certain threshold is reached and so the full amount of the exposure cannot be excluded as only part of the exposure is deducted from capital. Second, the deduction from capital serves better to reflect the actual loss absorbing capacity of a company's capital base. These deductions are intended to result in a more accurate measure of equity capital; accordingly, no corresponding adjustment to the value of the related credit exposure is required.

Section 252.77 of the final rule sets forth additional exemptions from the single-counterparty credit limits.[162] The Board has retained the exemptions from the proposal and added two additional exemptions.

The first exemption from the final rule is for direct claims on, and the portions of claims that are directly and fully guaranteed as to principal and interest by, the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation, while these entities are operating under the conservatorship or receivership of the Federal Housing Finance Agency. This 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.[163] This approach is consistent with the approach that the Board used in its risk retention rules.[164] As determined by the Board, obligations issued by other U.S. government-sponsored entities also would be exempt.

The second exemption from the final rule is for intraday credit exposure to a counterparty.[165] This exemption will help minimize the impact of the rule on the payment and settlement of financial transactions. The Board has declined to broaden this exemption as requested by commenters to ensure that the credit exposure measures accurately reflect actual credit exposures assumed by covered companies. Moreover, the operational and logistical difficulties that extend to measuring intraday credit extensions do not extend in the same manner to longer-term credit extensions.

The third exemption from the final rule is for trade exposures to a central counterparty that meets the definition of a qualifying central counterparty under the Board's capital rules (QCCP).[166] These exposures include potential future exposure arising from transactions cleared by a QCCP and pre-funded default fund contributions. The final rule exempts these exposures to QCCPs from single-counterparty credit limits because of the concern that application of single-counterparty credit limits to these exposures would require firms to spread activity across a greater number of CCPs, which could lead to a reduction in multilateral netting benefits.[167]

In response to comments, the final rule includes two new exemptions. The fourth exemption from the final rule is for any credit transaction with the Bank for International Settlements, the International Monetary Fund, or institutions that are members of the World Bank Group (namely, the International Bank for Reconstruction and Development, the International Finance Corporation, the International Development Association, the Multilateral Investment Guarantee Agency, and the International Centre for Settlement of Investment Disputes). Although the Bank for International Settlements is not itself a central bank of any sovereign entity, the membership of the Bank for International Settlements is comprised entirely of central banks of sovereign entities, which are generally not defined as counterparties in the final rule.[168] With respect to the other entities, the Board notes that the United States is a shareholder or contributing member of each of those entities, along with other sovereign entities. In light of

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

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

[161] *See* proposed rule § 252.77(b).

[162] *See* final rule § 252.77.

[163] *See* final rule § 252.77(a)(1).

[164] *See* 12 CFR 244.8.

[165] *See* final rule § 252.77(a)(2).

[166] *See* final rule § 252.77(a)(3). Qualifying central counterparty is defined to have the same meaning as in § 217.2 of the Board's risk-based capital rules. *See* final rule § 252.71(bb); *See also* 12 CFR 217.2.

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

[168] Central banks of sovereign entities would only be considered counterparties under the final rule if the central bank's foreign sovereign entity was not assigned a zero percent risk weight under the Board's capital rules. *See* final rule § 252.71(e).

the generally high-credit quality of these institutions and considering that each has a membership structure comprised of a significant proportion of sovereign entities or agencies with strong creditworthiness, the Board is of the view that this treatment is appropriate. The fifth exemption from the final rule is for any credit transaction with the European Commission or European Central Bank. These international organizations share many features of sovereign entities that have been excluded from the final SCCL rule, including the assignment of a zero percent risk weight under the Board's capital rules. The Board believes that these exemptions are in the public interest, given the public purpose of each of these entities, and given the low credit risk of these entities, are consistent with the purposes of section 165(e) and this final rule. Accordingly, for the reasons discussed above and in the proposal, the Board has determined that each of these exemptions is in the public interest and is consistent with the purpose of section 165(e).

The sixth exemption category implements section 165(e)(6) of the Dodd-Frank Act and provides a catch-all category to exempt any transaction which the Board determines to be in the public interest and consistent with the purposes of section 165(e).[169]

Section 252.77(b) of the final rule implements section 165(e)(6) of the Dodd-Frank Act, which provides a statutory exemption for the Federal Home Loan Banks. The Board views section 165(e)(6) as providing an exemption for Federal Home Loan Banks from the definition of covered company but as not providing an exemption for a covered company's credit exposure to the Federal Home Loan Banks. As such, a covered company's exposure to a Federal Home Loan Bank is subject to the SCCL in the final rule.

H. Compliance and Timing of Applicability

1. Scope of Compliance

Under the proposed rule, a covered company with $250 billion or more in total consolidated assets would have been required to comply with the requirements of the proposed rule on a daily basis. These covered companies also would have been required to submit a monthly compliance report to the Board.

Certain commenters requested clarification that the daily compliance requirement for a covered company should be based on the most recent information available with respect to counterparties, consistent with the company's internal risk management processes, and not on information that is updated on a daily basis. Other commenters believed that daily compliance constitutes a significant operational challenge, especially with respect to the look-through approach for SPVs. These commenters noted that the composition of SPVs is typically reported only on a monthly or less frequent basis. To address these concerns, the final rule allows covered companies to rely in good faith on the most recent available information about an SPV. For example, consistent with the final rule, a covered company may fill in values, in a reasonable manner, based on available information.

Similar to the proposal, under § 252.78(a) of the final rule, a covered company is required to comply with the requirements on a daily basis, as of the end of each business day.[170] To address commenters' concerns regarding the ability to access certain information (including information regarding SPVs), the final rule allows covered companies to rely in good faith on the most recent available information. In other words, covered companies are allowed to fill in missing values, in a reasonable manner, based on available information. In addition, under the final rule, a covered company must report its compliance to the Federal Reserve on a quarterly basis, as of the end of the quarter, rather than a monthly basis, unless the Board determines and notifies that company in writing that more frequent reporting is required.[171]

The Board has approved proposed forms, published elsewhere in this issue of the **Federal Register**, for covered companies to report credit exposures to their counterparties as those credit exposures would be measured under the final rule and section 165(e). The comment period on the proposed reporting expires on October 5, 2018.

2. Noncompliance

Section 252.78(c) of the proposed rule addressed the consequences if a covered company were to fail to comply with the credit exposure limits.[172] The proposed rule stated that, if a covered company were not in compliance with respect to a counterparty due to any of four factors—(1) a decrease in the covered company's capital stock and surplus; (2) the merger of the covered company with another covered company; (3) a merger of two unaffiliated counterparties; or (4) any other circumstance the Board determines is appropriate—then the covered company would not have been subject to enforcement actions with respect to such noncompliance for a period of 90 days,[173] so long as the company were to use reasonable efforts to return to compliance with the proposed rule during this period. The covered company would have been prohibited from engaging in any additional credit transactions with such a counterparty in contravention of this requirement during the noncompliance period, except in cases where the Board determined that such additional credit transactions were necessary or appropriate to preserve the safety and soundness of the covered company or financial stability.[174] In granting approval for any such special temporary exceptions, the Board could have imposed supervisory oversight and reporting measures that it determined would have been appropriate to monitor compliance with the foregoing standards.[175]

A number of commenters suggested broadening the cure period to mitigate potential disruptions to proper market activities. In particular, these commenters requested that the cure period be broadened to apply to any breach that is beyond the covered company's control and could be reasonably remediated within the 90-day period. Commenters also requested appropriate transition periods if an exposure or counterparty changes status or loses an exemption under the final rule (*e.g.,* if a sovereign's risk-weight increases or if a qualifying central counterparty loses its status). A few commenters suggested that any breaches of the proposal's credit exposure limits should be promptly reported to the Board.

To address the concerns of commenters, the final rule includes an additional factor for relief during a period of noncompliance: An unforeseen and abrupt change in the status of a counterparty as a result of which the covered company's credit exposure to the counterparty becomes limited by the requirements of this section.[176] Along with the proposed

[169] *See* 12 U.S.C. 5365(e)(6); final rule § 252.77(a)(6).

[170] *See* final rule § 252.78(a)(1).

[171] *See* final rule § 252.78(a)(2).

[172] *See* proposed rule § 252.78(c).

[173] This period could have been adjusted by the Board as appropriate to preserve the safety and soundness of the covered company or U.S. financial stability. *Id.*

[174] *Id.*

[175] *See* proposed rule § 252.78(d).

[176] *See* final rule § 252.78(c)(2). The factors are (i) a decrease in the covered company's capital stock and surplus; (ii) the merger of the covered company with another covered company; (iii) a merger of two

Continued

discretionary factor (''[a]ny other factor(s) the Board determines, in its discretion, is appropriate''),[177] this factor should sufficiently broaden the scope of the cure period to mitigate the risk of an enforcement action due to circumstances outside the control of the covered company.

3. Initial Applicability and Ongoing Applicability

Under the proposed rule, covered companies with $250 billion or more in total consolidated assets would have been required to comply one year from the effective date of the rule, unless that time were extended by the Board in writing.[178] In addition, under the proposed rule, any company that becomes a covered company after the effective date of the rule would have been required to comply with the requirements of the rule beginning on the first day of the fifth calendar quarter after it becomes a covered company, unless that time were accelerated or extended by the Board in writing.[179]

A number of commenters urged the Board to provide covered companies additional time to comply with the requirements of the final rule. Most of these commenters argued that two years from the date the applicable reporting form is finalized is the minimum amount of time covered companies would need to develop the infrastructure to comply with the requirements.[180] These commenters pointed out that compliance with the final rule would entail the deployment of significant resources and development of entirely new systems and procedures, which would depend on the final rule and the associated reporting requirements. Moreover, certain commenters argued that if retail exposures were not exempted from the scope of the final rule, then a minimum of three years from finalization of the applicable reporting form would be necessary for covered companies to develop and implement systems capable of tracking and calculating exposures to millions of individual customers, their intermediate family members, and any other entities a covered company may be required to aggregate.

The Board has simplified the final rule to address the concerns raised by commenters regarding the compliance period of the final rule. The final rule gives major covered companies (*i.e.,* GSIBs) until January 1, 2020, to comply,[181] and gives all other covered companies until July 1, 2020, to comply.[182]

III. Final Rule for Foreign Banking Organizations

A. Background

In February 2014, the Board adopted a final rule establishing enhanced prudential standards for FBOs with U.S. banking operations and total consolidated assets of $50 billion or more.[183] Under that rule, an FBO with U.S. non-branch assets of $50 billion or more is required to form a U.S. IHC to hold its interests in U.S. bank and nonbank subsidiaries.[184] An FBO's U.S. IHC is subject to enhanced prudential standards on a consolidated basis, including risk-based and leverage capital requirements, liquidity requirements, and risk management standards. Certain enhanced prudential standards also apply to an FBO's ''combined U.S. operations,'' which would include an FBO's U.S. branches and agencies, as well as its U.S. IHC and its subsidiaries.

As with covered companies, and consistent with the amendments to section 165(e) made by EGRRCPA, the single-counterparty credit limits in this final rule would apply to the U.S. operations of an FBO with $250 billion or more in total global consolidated assets. The single-counterparty credit limits also would apply to any U.S. IHC of such an FBO with $50 billion or more in total consolidated assets. However, the final rule makes clear that the SCCL applicable to the U.S. operations of an FBO would not apply if an FBO certifies to the Board that it meets large exposure or SCCL standards on a consolidated basis established by its home country supervisor that are consistent with the large exposure standard, unless the Board determines, in writing, after notice to the FBO, that compliance with the final rule is required.

B. Summary of Comments on Proposal for Foreign Banking Organizations

As noted, under the proposal, an FBO was subject to two SCCL: One for its IHC measured against the IHC's capital base and one for its combined U.S. operations (including U.S. branches) measured against the capital base of the entire FBO. With respect to an FBO's combined U.S. operations (rather than its U.S. IHC), the proposal would have applied SCCL with respect to exposures of any U.S. branch or agency of the foreign banking organization; exposures of the U.S. subsidiaries of the foreign banking organization, including any U.S. IHC; and all subsidiaries of such subsidiaries (other than any companies held under section 2(h)(2) of the BHC Act).[185] The U.S. IHC and the FBO itself, with respect to its combined U.S. operations, each would have been a ''covered entity'' under the proposal. A number of commenters argued that application of SCCL to those FBOs that are subject to comparable large exposure or single-counterparty credit limit regimes in their home country is inconsistent with the statutory mandate to give due regard to principles of national treatment and competitive equality.[186] These commenters also noted that certain provisions of the Dodd-Frank Act expressly provide for the recognition of comparable home country regulation.[187] These commenters argued that the development of the large exposure standard made it more likely that other jurisdictions would have comparable single-counterparty credit limit regimes to that of section 165(e) and its implementing regulation.

Commenters also argued that the proposal would have had a materially disproportionate and adverse effect on

unaffiliated counterparties; (iv) an unforeseen and abrupt change in the status of a counterparty as a result of which the covered company's credit exposure to the counterparty becomes limited by the requirements of this section; or (v) any other factor(s) the Board determines, in its discretion, is appropriate.

[177] This prong is § 252.78(c)(4) in the proposed rule and § 252.78(c)(2) in the final rule.

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

[179] *See* proposed rule § 252.70(h).

[180] Section 252.78(a) of the proposal would have required covered companies to comply with the requirements on a daily basis at the end of each business day and submit on a monthly basis a report demonstrating its daily compliance. The preamble to the proposal explained that the Board plans to develop reporting forms for covered companies to use to report credit exposures to their counterparties as those exposures would be measured under rules implementing section 165(e) of the Dodd-Frank Act. 81 FR at 14344 (Mar. 16, 2016).

[181] *See* final rule § 252.70(c)(1)(ii).

[182] *See* final rule § 252.70(c)(1)(i). A covered company that becomes subject to the final rule after its effective date is also given two years from the date on which it becomes a covered company to comply, unless that time is accelerated or extended by the Board in writing. *See* final rule § 252.70(c)(2). The Board may, for instance, exercise its discretion to apply the SCCL to a covered company in a period of less than two years if the Board determined that there was a rapid expansion of risk in that company.

[183] *See* Enhanced Prudential Standards for Bank Holding Companies and Foreign Banking Organizations, 79 FR 17240 (Mar. 27, 2014). The definition of ''foreign banking organization'' is the same as in section 211.21(o) of the Board's Regulation K (12 CFR 211.21(o)), provided that, if the top-tier foreign banking organization is incorporated in or organized under the laws of any State, the foreign banking organization shall not be treated as a foreign banking organization for purposes of this part. *See* 12 CFR 252.2(j).

[184] An FBO's U.S. IHC is not required to hold the FBO's interest in any company held under section 2(h)(2) of the BHC Act, 12 U.S.C. 1841(h)(2).

[185] 12 U.S.C. 1841(h)(2).

[186] *See* 12 U.S.C. 5365(b)(2).

[187] *See, e.g.,* 12 U.S.C. 5365(b)(2)(B).

FBOs relative to covered companies due to the scope of FBOs subject to the proposal and the existence of limits for both the combined U.S. operations of FBOs and the U.S. IHCs of FBOs. In particular, commenters expressed concern that the proposed rule would apply to all FBOs with $50 billion or more in total global consolidated assets, regardless of the size of their U.S. operations. As a result, these commenters contended that the proposal would subject FBOs to materially greater costs and burdens than their covered company counterparts (*e.g.,* by requiring FBOs to prepare, monitor, and keep records for limits at multiple levels of an FBO's U.S. operations).

Further, commenters expressed the view that the proposal potentially could interfere with the safety and soundness and enterprise-wide risk management of FBOs by applying multiple, redundant, and inconsistent regimes for calculating credit exposures. Commenters also expressed concerns with the noncompliance cross-trigger to FBOs (that is, the prohibition against either the U.S. IHC or the combined U.S. operations of an FBO engaging in additional credit transactions with a counterparty if either entity exceeds its SCCL) as discriminatory and unwarranted. Certain commenters urged that, before applying SCCL to only a portion of the FBO's operations, the Board be required to find that existing federal and state lending limits applicable to an FBO's U.S. branches and agencies and comparable home country SCCL currently applicable to FBOs are not sufficient and that a lower SCCL is necessary to mitigate risks to the financial stability of the United States.

In light of these concerns, some commenters recommended that the final rule apply to a U.S. IHC as if it were a covered company and that an FBO, with respect to their combined U.S. operations, be required to comply with a comparable home country SCCL regime consistent with the large exposure standard. These commenters noted that such an approach would comport with the Board's approach to implementing regulatory capital and stress testing components and meet the requirements of section 165 of the Dodd-Frank Act.

Commenters representing FBOs also expressed substantive concerns with many of the same issues as commenters representing covered companies, such as the definitions of ''covered company'' and ''counterparty,'' the look-through approach for SPVs, and the aggregation of counterparties based on the economic interdependence and control relationship tests. To address these concerns, the final rule for FBOs generally contains the same modifications as those described above for covered companies.

C. Overview of the Final Rule for Foreign Banking Organizations

As noted, the final rule retains both sets of proposed limits that would have applied to FBOs; however, also as noted, an FBO that is subject on a consolidated basis to a home country SCCL framework will be able to comply with the SCCL for its combined U.S. operations by certifying to the Board that the FBO complies with its home country SCCL framework. This modification should address, in large part, the concerns raised by commenters regarding the multiple limits applicable to FBOs under the proposal and mitigate the compliance costs of the final rule for FBOs subject to the requirements in the final rule.[188]

An FBO that cannot make such a certification would be subject to one of two credit exposure limits with respect to its U.S. operations that are tailored to the size and systemic footprint of the firm. Similar to the final rule's provisions for covered companies, the first category of limits applies to any entity that is part of the combined U.S. operations of an FBO with total consolidated assets that equal or exceed $250 billion.[189] These covered foreign entities would be prohibited from having aggregate net credit exposure to an unaffiliated counterparty in excess of 25 percent of the FBO's tier 1 capital.

The second category of limits prohibits any top-tier FBO that has the characteristics of a GSIB under the global methodology [190] (major FBO) from having aggregate net credit exposure in excess of 15 percent of the FBO's tier 1 capital to a major counterparty (a GSIB or a nonbank financial company supervised by the Board) and in excess of 25 percent of the FBO's tier 1 capital to any other counterparty. This standard is similar to the standard in the final rule for covered companies and consistent with the requirements in section 165(a)(1)(B) and section 165(e) of the Dodd-Frank Act, as discussed above.[191] The SCCL applicable to the combined U.S. operations of an FBO that cannot certify to the Board that it complies with a home country SCCL regime consistent with the large exposure standard are summarized in Table 3.

TABLE 3—SINGLE-COUNTERPARTY CREDIT LIMITS APPLICABLE TO THE COMBINED U.S. OPERATIONS OF FOREIGN BANKING ORGANIZATIONS

Category of covered foreign entity	Applicable credit exposure limit
Combined U.S. operations of FBOs with total consolidated assets that equal or exceed $250 billion but are not major FBOs.	Aggregate net credit exposure to a counterparty cannot exceed 25 percent of the FBO's tier 1 capital.
Major FBOs	Aggregate net credit exposure to a *major counterparty* cannot exceed 15 percent of the FBO's tier 1 capital. Aggregate net credit exposure to any *other counterparty* cannot exceed 25 percent of the FBO's tier 1 capital.

Under the final rule, as in the proposal, the SCCL for a U.S. IHC of such an FBO with total consolidated assets that equal or exceed $50 billion to a single counterparty falls into one of three tailored tiers. First, a U.S. IHC with total consolidated assets of at least $50 billion but less than $250 billion is prohibited from having aggregate net

[188] The U.S. IHC and the FBO itself, with respect to its combined U.S. operations, are each a ''covered foreign entity'' under the final rule. For improved clarity, the final rule uses the term ''covered foreign entity'' rather than the term ''covered entity'' that was used in the proposal.

[189] *See* final rule § 252.170(a)(2)(i).

[190] ''Global methodology'' is defined in the Board's Regulation YY as ''the assessment methodology and the higher loss absorbency requirement for global systemically important banks issued by the Basel Committee on Banking Supervision, as updated from time to time.'' 12 CFR 252.2(o).

[191] 12 U.S.C. 5365(a)(1)(B), (e); *See,* ''*Calibrating the Single-Counterparty Credit Limit between Systemically Important Financial Institutions,*'' May 4, 2016, *https://www.federalreserve.gov/aboutthefed/boardmeetings/sccl-paper-20160304.pdf.*

credit exposure to a single counterparty in excess of 25 percent of the company's total regulatory capital plus ALLL.[192] Second, a U.S. IHC with total consolidated assets of $250 billion or more but less than $500 billion is prohibited from having aggregate net credit exposure to a single counterparty in excess of 25 percent of the U.S. IHC's tier 1 capital. (This limit is based on tier 1 capital for the same reasons as described above with respect to the limit applied to covered companies.) Third, a U.S. IHC with $500 billion or more in total consolidated assets is prohibited from having aggregate net credit exposure to a major counterparty in excess of 15 percent of the U.S. IHC's tier 1 capital and faces a 25 percent of tier 1 capital limit for any other counterparty. (This 15 percent limit of tier 1 capital limit is premised on the same rationale as described above with respect to the 15 percent of tier 1 capital limit that applies to major covered companies.) Similar to the final rule applicable to covered companies, a ''major counterparty'' is defined as a U.S. or foreign GSIB or a nonbank financial company supervised by the Board. These limits are summarized in Table 2 above.

In determining whether a U.S. IHC complies with these limits, exposures of the U.S. IHC itself and its subsidiaries needs to be taken into account. Similar to the final rule's requirements for covered companies, ''subsidiary'' is defined as any company that is consolidated by the other company under applicable accounting standards.[193] Definitions of ''counterparty,'' ''affiliate,'' and other related terms in the final rule also are similar to the final rule applicable to covered companies. The attribution requirements and application of the economic interdependence and control relationship tests also are generally the same as under the portions of the final rule applicable to covered companies.[194]

The final rule includes modifications in response to concerns raised by commenters, including comments made to the proposal for covered companies. The Board's final rule applicable to covered companies and the final rule applicable to FBOs have been aligned to the extent such alignment is appropriate. For example, the definition of ''covered foreign entity'' has been revised in the final rule to refer to financial consolidation standards rather than concepts of BHC Act control as under the proposal, which also is consistent with the approach in the final rule for covered companies. Similarly, FBOs that are not GSIBs will have until July 1, 2020, to comply with its requirements, as is the case with similarly situated covered companies.

Although the major components of the SCCL for foreign banking organizations are the same as the requirements applicable to covered companies, there are some differences between these requirements. For example, as discussed in more detail below, the SCCL would not apply to exposures of a U.S. IHC or of the combined U.S. operations of an FBO to the FBO's home country sovereign entity, regardless of the risk weight assigned to that sovereign entity under the Board's capital rules (12 CFR part 217).

D. Key Terminology and Concepts

1. Major Counterparty, Major Foreign Banking Organization, and Major Intermediate Holding Company

Under the proposal, a ''major foreign banking organization'' would have been defined to mean any FBO with total consolidated assets of $500 billion or more. Similarly, a ''major U.S. intermediate holding company'' would have been defined to mean a U.S. IHC with total consolidated assets of $500 billion or more. Under the proposal, major foreign banking organizations and major U.S. IHCs would have been subject to the more stringent 15 percent of tier 1 capital limit with a major counterparty (defined to mean a U.S. GSIB, foreign GSIB, or nonbank financial company supervised by the Board).

Some commenters argued that major FBOs should be defined as GSIBs, in the same manner as ''major covered company'' would have been defined in the proposal for covered companies. These commenters noted that a GSIB determination is based on indicators that correlate to an institution's systemic importance rather than simply consideration of its size, and that basing the classification of FBOs and U.S. IHCs as ''major'' based on size alone would grossly overstate the systemic impact of these entities on the U.S. financial system. Some commenters suggested the Board define a major FBO as an FBO that meets the following criteria: (i) The FBO is a GSIB as determined by the Financial Stability Board; and (ii) the FBO is required to have an IHC for its U.S. operations. These commenters urged that major counterparties also be identified in this manner.

Similar to the definition of ''major covered company'' with respect to covered companies, the final rule generally defines ''major foreign banking organization'' as a covered FBO that has the characteristics of a GSIB under the global methodology.[195] This should address in large part commenters' concerns with respect to FBOs. As discussed above, a U.S. IHC with total consolidated assets of $500 billion or more would present significant risk because of both its size and the likelihood that such a U.S. IHC would have significant cross-border exposure.[196] Therefore, the Board believes that a total consolidated assets threshold of $500 billion or more provides a reasonable indication of a U.S. IHC's ability to impact U.S. financial stability while providing a bright-line threshold that aids administrability of the rule.

2. Eligible Guarantor

Under the proposal, ''eligible protection provider'' for FBOs would not have included the FBO or any entity that is an affiliate either of the U.S. IHC or of any part of the FBO's combined U.S. operations. Commenters argued that the exclusion of an FBO and its affiliates would hinder effective enterprise-wide risk management.

As noted, the final rule replaces the term ''eligible protection provider'' with ''eligible guarantor,'' as that is the term used in the Board's capital rules. The Board has decided not to extend the definition of eligible guarantor to the FBO or any entity that is an affiliate either of the U.S. IHC or of any part of the FBO's combined U.S. operations.[197] Extraterritorial application of the final rule is limited by excluding exposures of the FBO outside the U.S. IHC, or its combined U.S. operations, from the SCCL. Similarly, hedges that are initiated and booked by the FBO outside of the U.S. IHC or its combined U.S. operations are not subject to the SCCL.

[192] The final rule's definition of ''capital stock and surplus'' with respect to a foreign banking organization reflects differences in international accounting standards. *See* final rule § 252.171(e).

[193] *See* final rule § 252.171(gg). For a company that is not subject to applicable accounting standards, ''subsidiary'' includes a company that would have been consolidated if such principles or standards had applied.

[194] A U.S. IHC with total consolidated assets of $50 billion or more but less than $250 billion generally would not be required to apply the economic interdependence or control relationship tests. *See* final rule § 252.176(a).

[195] ''Global methodology'' is defined in the Board's Regulation YY as ''the assessment methodology and the higher loss absorbency requirement for global systemically important banks issued by the Basel Committee on Banking Supervision, as updated from time to time.'' 12 CFR 252.2(o).

[196] As of March 31, 2018, all U.S. IHCs had less than $500 billion in total consolidated assets.

[197] *See* final rule § 252.171(p).

Further, this approach preserves consistent treatment with the SCCL applicable to covered companies—since those covered companies are subject to SCCL on a consolidated basis, a hedge provided by one subsidiary to another subsidiary would not result in any reduction of credit exposure of the covered company. If the Board were to change the definition as requested, an FBO or U.S. IHC would be able to reduce its credit exposures in a way unavailable to covered companies. For these reasons, the Board has decided not to expand the definition of eligible guarantor as requested.

3. Eligible Collateral

The proposal would have excluded from ''eligible collateral'' debt and equity securities, including convertible bonds, issued by an affiliate of the U.S. IHC or by any part of the combined U.S. operations of the FBO. FBO commenters argued that this was discriminatory and noted that a similar restriction did not appear in the definition of eligible collateral for covered companies. In response to comments, the final rule applicable to covered companies clarifies that, with respect to application of the SCCL to covered companies, ''eligible collateral'' does not include debt securities or equity securities issued by the covered company or its affiliate.[198]

Some commenters also expressed concern with the limitation on eligible collateral that would have required a U.S. IHC or the combined U.S. operations of an FBO to have a perfected, first priority security interest in the collateral. Those commenters argued that this requirement could interfere with effective enterprise-wide risk management and urged recognition of collateral where a non-U.S. branch has a security interest if the collateral is held for the benefit of the combined U.S. operations of the FBO. The Board believes that covered foreign entities that operate in the United States should be subject to creditor protections that are consistent with U.S. law and, therefore, has not modified this requirement. Moreover, with respect to exposures within the United States and outside an FBO's U.S. IHC, an FBO that certifies that it complies on a consolidated basis to a home country SCCL regime consistent with the large exposure standard would be subject to its home country requirements, not the final rule, in which case a perfected, first priority security interest in collateral may not be required.

4. Counterparty

The final rule generally defines ''counterparty'' in the same manner as the final rule that applies to covered companies.[199] The Board received similar comments concerning the definition of ''counterparty'' in the proposed rule for FBOs as with the proposed rule for covered companies, and the definition has been modified in the final rule in the same manner and for the same reasons as the revised definition of ''counterparty'' in the final rule for covered companies, as discussed earlier.

One key difference between this definition in the final rule for FBOs and the final rule for covered companies is that, with respect to an FBO, the FBO's home country sovereign entity is not included as a counterparty, notwithstanding the risk weight assigned to that sovereign entity under the Board's Regulation Q (12 CFR part 217).[200] This difference recognizes that an FBO's U.S. IHC and combined U.S. operations may have exposures to the FBO's home country sovereign entity that are required by home country laws or are necessary to facilitate the normal course of business for the consolidated FBO. The proposal included an exemption to exclude these exposures; however, in light of the fact that these foreign sovereign entities would not be considered companies formally subject to the requirements of section 165(e) of the Dodd-Frank Act, the Board believes it is more appropriate simply to not include these entities as defined counterparties. ''Sovereign entity'' is defined in the final rule, as under the proposal, to mean a central national government (including the U.S. government) or an agency, department, ministry, or central bank, but not including any political subdivision such as a state, province or municipality.[201]

Certain commenters requested clarification or confirmation that the home country sovereign entity exemption includes a sovereign's agencies and instrumentalities. Since the definition of ''sovereign entity'' includes an agency, department, ministry or central bank, these entities would fall within the scope of the home country sovereign entity exemption. Some commenters requested that the final rule extend the scope of this exemption to include the sovereign's political subdivisions. These commenters urged that there is no reason to treat political subdivisions differently from sovereign agencies and instrumentalities. As noted, the Board's final rule applicable to covered companies includes a U.S. State (including all of its agencies, instrumentalities, and political subdivisions) as a separate counterparty because the severe distress or failure of a U.S. state or municipality could have effects on a covered company that are comparable to those caused by the failure of a financial firm or nonfinancial corporation to which the covered company has a large credit exposure. For the same reason, the Board includes as a separate counterparty political subdivisions of a foreign sovereign entity (including all of such political subdivision's agencies and instrumentalities), and the final rule does not extend the exclusion for exposures to an FBO's home country sovereign entity.

E. Credit Exposure Limits

Section 252.172 of the proposed rule contained the key quantitative limitations on credit exposure of a covered entity to a single counterparty.[202] As noted, consistent with the final rule applied to covered companies and the amendments to section 165(e) made by EGRRCPA, the final rule would apply SCCL to an FBO with U.S. banking operations and $250 billion or more in total global consolidated assets. The final rule seeks to limit further the burden on FBOs by generally permitting an FBO to comply with the SCCL for the combined U.S. operations of an FBO by certifying to the Board that the FBO meets large exposure or SCCL standards on a consolidated basis established by its home country supervisor that are consistent with the large exposure standard.[203] The final rule applies the SCCL to any U.S. IHC with $50 billion or more in total consolidated assets that is a subsidiary of an FBO with $250 billion or more in total global consolidated assets, consistent with the proposal and the Board's other enhanced prudential standards applicable to U.S. IHCs.[204]

A number of commenters argued that application of SCCL to foreign banking organizations subject to comparable large exposure or single-counterparty credit limit regimes in their home country is inconsistent with the statutory mandate to give due regard to

[198] *See* final rule § 252.171(*l*).

[199] *See* final rule §§ 252.71(e), 252.171(f).

[200] *See* final rule § 252.171(f).

[201] *See* final rule § 252.171(hh).

[202] *See* proposed rule § 252.172.

[203] An FBO that makes such a certification is required to provide to the Board reports relating to its compliance with the large exposure or SCCL standards of its home country supervisor concurrently with filing the FR Y–7Q or any successor report.

[204] *See also* section 401(g) of EGRRCPA.

the principle of national treatment and competitive equality.[205] These commenters noted that certain provisions of the Dodd-Frank Act expressly provide for the recognition of comparable home country regulation,[206] and contended that more jurisdictions are likely to have comparable single-counterparty credit limit regimes following development of the large exposure standard.

The principle of national treatment and equality of competitive opportunity generally means that FBOs operating in the United States should be treated no less favorably than similarly situated U.S. banking organizations and should generally be subject to the same restrictions and obligations in the United States as those that apply to the domestic operations of U.S. banking organizations. The final rule generally applies SCCL to FBOs in the same manner as to covered companies, consistent with the principle of national treatment and equality of competitive opportunity. In particular, the final rule uses the same total consolidated assets threshold of $250 billion or more for both covered companies and FBOs, and both covered companies and FBOs are designated as ''major covered companies'' and ''major foreign banking organizations'' based on whether those firms have certain characteristics of GSIBs.[207] The final rule's application of SCCL to U.S. IHCs is tailored such that U.S. IHCs of similar size to covered companies are subject to the same SCCL. Although the final rule for FBOs differs from the final rule for covered companies by applying SCCL to U.S. IHCs with total consolidated assets of at least $50 billion but less than $250 billion, the SCCL applicable to this category of companies is tailored relative to covered companies (a limit of 25 percent of capital stock and surplus rather than a limit of 25 percent of tier 1 capital). Furthermore, application of the SCCL to these U.S. IHCs promotes equality of competitive opportunity, since they represent one portion of a significantly larger banking organization.

In addition, the final rule also does not include as a counterparty the home country sovereign entity of an FBO, without regard to the risk weight that applies to the sovereign. This treatment is consistent with the exclusion of exposures to the U.S. government from the final rule. Finally, as noted, the final rule permits FBOs to comply with the SCCL for their combined U.S. operations by certifying to the Board that the FBO meets large exposure or SCCL standards on a consolidated basis established by its home country supervisor that are consistent with the large exposure standard. This option should avoid subjecting an FBO to duplicative SCCL standards. For all these reasons, the Board believes it is providing due regard to the principles of national treatment and equality of competitive opportunity in applying SCCL to FBOs through this final rule.[208]

As noted, the Board is developing a comprehensive proposal on application of enhanced prudential standards to FBOs with total consolidated assets of at least $100 billion but less than $250 billion, including any subsidiary U.S. IHC. In connection with this proposal and other tailoring and implementation efforts related to EGRRCPA, the Board may make amendments to the SCCL framework in this final rule.

F. Gross Credit Exposure

Under the proposed rule, a covered entity would have been permitted to calculate gross exposure to certain derivative transactions using any methodology that it is permitted to use under the Board's capital rules, including IMM. This treatment would have been the same as the proposed treatment of covered companies. FBO commenters expressed support for the proposal's flexibility in permitting use of IMM that have been approved for risk based-capital purposes to value exposures due to derivative transactions. However, commenters explained that an FBO would be unable to benefit from this treatment with respect to its U.S. IHC or its combined U.S. operations because there is currently no approval process in place for FBOs to seek approval to use IMM in the United States. As a result, these commenters indicated that an FBO would need to use the standardized methodology, which does not fully consider correlation between derivatives and any netting benefits, and thus may overstate the entity's exposures, in valuing exposures due to derivatives transactions of its U.S. IHC and its combined U.S. operations. Some commenters urged the Board to provide an avenue in the final rule for an FBO to obtain approval for its U.S. IHC and its combined U.S. operations to use IMM in calculating exposures due to derivatives transactions. In particular, these commenters argued that, to the extent FBOs are subject to rigorous approval processes to use IMM in their home countries, the Board should establish a process to recognize and defer to home country regulators' approval of IMM and thereby permit an FBO to use such methodologies in calculating exposures due to derivative transactions of its U.S. IHC or its combined U.S. operations, if desired. These commenters noted that this approach would be consistent with the statutory mandate to give due regard to comparable home country treatment.

Under the final rule, an FBO is authorized to measure its gross credit exposure to a counterparty on a derivatives transaction using the same valuation approaches as those set forth in the final rule applicable to covered companies. As noted, an FBO that is subject on a consolidated basis to a home country SCCL framework will be able to comply with the SCCL for its combined U.S. operations by certifying to the Board that the FBO complies with its home country SCCL framework. To the extent the FBO's home country SCCL framework permits the use of internal models to value derivative transactions, the FBO's certification to the Board that the FBO complies with the SCCL framework could be based, in part, on its measurement of derivatives transactions using such models. In the case of a U.S. IHC, the U.S. IHC is authorized under the final rule to value a derivative transaction using any approach, including internal models, that the U.S. IHC is authorized to use under the capital rules to value the derivatives transaction.

G. Net Credit Exposure

The final rule describes how a covered foreign entity would convert gross credit exposure amounts to net credit exposure amounts by taking into account eligible collateral, eligible guarantees, eligible credit and equity derivatives, and other eligible hedges (that is, a short position in the counterparty's debt or equity securities). An FBO generally would calculate its net credit exposure to a counterparty by adjusting its gross credit exposure to that counterparty in the same way as covered companies would adjust their gross credit exposures. However, the definition of ''eligible collateral'' for

[205] *See* 12 U.S.C. 5365(b)(2).

[206] *See, e.g.,* 12 U.S.C. 5365(b)(2)(B).

[207] As noted, a U.S. IHC with total consolidated assets of $500 billion or more would be considered a ''major U.S. intermediate holding company.'' Although this threshold is not identical to the standard applied to covered companies, the Board believes that an entity with that level of total consolidated assets would present significant risk because of both its size and the likelihood that such a U.S. IHC would have significant cross-border exposure. As a result, it is consistent with the principle of national treatment to subject such U.S. IHCs to the same SCCL as a major covered company.

[208] 12 U.S.C. 5365(b)(2).

covered foreign entities would exclude debt or equity securities (including convertible bonds) issued by an affiliate (rather than a subsidiary) of the U.S. IHC or the combined U.S. operations of a foreign banking organization. Referring to ''affiliate'' in the context of FBOs preserves consistent treatment with covered companies, who are subject to SCCL on a consolidated basis. As discussed above, the definition of ''eligible guarantor'' would exclude the foreign banking organization or any affiliate thereof, in order to preserve consistent treatment with covered companies.[209]

H. Exposures to SPVs and Aggregation of Exposures to Connected Counterparties

The final rule generally treats foreign covered entities in the same manner as covered companies with respect to exposures to SPVs and the application of the economic interdependence and control relationship tests.[210] This treatment includes modifications made in the final rule for covered companies in response to public comments for the same reasons discussed earlier in this **SUPPLEMENTARY INFORMATION**. Just as in the proposal, under the final rule for FBOs, U.S. IHCs with total consolidated assets of at least $50 billion but less than $250 billion generally are not required to apply the specialized SPV treatment of section 252.175 of the final rule. However, the final rule has been revised such that only a covered foreign entity or U.S. IHC with $250 billion or more in total consolidated assets is required to apply the economic interdependence and control relationship tests to aggregate connected counterparties, unless the Board determines it is necessary to apply these tests with respect to such a company to prevent evasion of the rule.

I. Exemptions

As with the proposal for covered companies, certain commenters also requested exemptions for multilateral banks and certain supranational entities, including the Bank of International Settlements, the European Central Bank, the European Commission, the International Monetary Fund, and multilateral development banks that are assigned a zero percent risk weight under the Board's capital rules.

As noted, section 165(e)(6) of the Dodd-Frank Act permits the Board to exempt transactions from the definition of the term ''credit exposure'' for purposes of this subsection, if the Board finds that the exemption is in the public interest and is consistent with the purposes of this subsection. The final rule provides the same exemptions for the credit exposures of covered foreign entities as those provided in the final rule for covered companies.[211]

J. Compliance

Under the proposed rule, a U.S. IHC and the combined U.S. operations of an FBO with less than $250 billion in total consolidated assets, and less than $10 billion in total on-balance-sheet foreign exposures, would have been required to comply with the requirements of the proposed rule as of the end of each quarter.[212] Other U.S. IHCs and FBOs would have been required to comply with the proposed rule on a daily basis as of the end of each business day and submit a monthly compliance report demonstrating its daily compliance.[213] The final rule, like the proposal, requires a U.S. IHC with total consolidated assets of at least $50 billion but less than $250 billion to comply with the requirements of the rule as of the end of each quarter, unless the Board determines and notifies the U.S. IHC in writing that more frequent compliance is required. Also like the proposal, the final rule requires an FBO (with respect to its combined U.S. operations) or U.S. IHC with total consolidated assets of $250 billion or more to comply with the requirements of the rule on a daily basis, as of the end of each business day. The final rule requires all covered foreign entities to report compliance on a quarterly basis.

Under the proposal, an FBO would have been required to ensure the compliance of its U.S. IHC and its combined U.S. operations. If either the U.S. IHC or the combined U.S. operations were not in compliance with respect to a counterparty, both the U.S. IHC and the combined U.S. operations would have been prohibited from engaging in any additional credit transactions with such a counterparty, except in cases when the Board determines that such additional credit transactions were necessary or appropriate to preserve the safety and soundness of the foreign banking organization or financial stability.[214] In considering special temporary exceptions, the Board could have imposed supervisory oversight and reporting measures that the Board determined were appropriate to monitor compliance with the foregoing standards.[215]

Commenters expressed concern with the fact that if either the U.S. IHC or the combined U.S. operations of an FBO were not in compliance, both the U.S. IHC and the combined U.S. operations would be prohibited from engaging in any additional credit transactions with such a counterparty (the ''cross-trigger''). Commenters contended there was no similar restriction on U.S. covered companies (for example, the breach of lending limits that apply to a national bank subsidiary would not restrict lending or additional exposures by other parts of the consolidated BHC). Commenters also noted that this provision would create incentives for FBOs to shift banking, lending, and derivatives activities to non-U.S. branches to avoid the potential curtailment of activities that could result from operation of the cross-trigger.

As noted, the final rule modifies the manner in which the SCCL apply to an FBO. In particular, an FBO that is subject on a consolidated basis to a home country SCCL framework will be able to comply with the SCCL for its combined U.S. operations by certifying to the Board that the FBO complies with its home country SCCL framework. If an FBO is able to make such a certification, the FBO would be viewed as compliant with the final rule with respect to its combined U.S. operations. As a result, any noncompliance by the FBO would be with respect to its IHC. This modification should help mitigate concerns raised by commenters regarding the cross-trigger.

K. Timing of Applicability

Under the proposal, FBOs and U.S. IHCs with less than $250 billion in total consolidated assets and less than $10 billion in total on-balance-sheet foreign assets would have been required to comply with the proposed rule two years from the effective date of the proposed rule, unless that time were extended by the Board in writing.[216] FBOs and U.S. IHCs with $250 billion or more in total consolidated assets or $10 billion or more in total on-balance-sheet foreign assets would have been required to comply with the proposed rule one year from the effective date of any final rule, unless that time were

[209] *See* final rule § 252.171(p).

[210] *See* final rule §§ 252.175–.176.

[211] *See* final rule § 252.177(a). As noted, the final rule retains the treatment for an FBO's exposures to a home country sovereign entity, but does so by modifying the definition of ''counterparty'' to exclude these entities. *See* section III.D.4 supra for additional discussion.

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

[213] *Id.*

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

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

[216] *See* proposed rule § 252.170(c)(1)(i), 252.170(c)(2)(i).

extended by the Board in writing.[217] The proposal would have required any company that became a covered company after the effective date of the final rule to comply with the requirements of the rule beginning on the first day of the fifth calendar quarter after it becomes a covered entity, unless that time were accelerated or extended by the Board in writing.[218]

Commenters argued that FBOs should have more time to comply with the final rule, for reasons similar to those provided by commenters concerning the proposal for covered companies. In particular, these commenters argued that the one-year compliance period might be insufficient for smaller organizations in light of the multiple and complex requirements on the combined U.S. operations of an FBO.

The Board has determined to permit all covered foreign entities that are not major FBOs or major U.S. IHCs until July 1, 2020, to comply with the final rule, while major FBOs and major U.S. IHCs have until January 1, 2020, to comply. This timing is similar to the final compliance period for covered companies. Also similar to the final rule for covered companies, the final rule requires a covered foreign entity that becomes a covered foreign entity after the effective date of the final rule to comply with the SCCL beginning on the first day of the ninth calendar quarter after it becomes a covered foreign entity, unless that time is accelerated or extended by the Board in writing.

IV. Impact Analysis

A quantitative impact study conducted by Board staff on the proposal concluded that banking firms would generally have been able to meet the proposed SCCL with modest adjustments. The study estimated that the total amount of covered companies' credit exposure in excess of the limits in the proposed rule would have been less than $100 billion, and that the overwhelming majority of this excess credit exposure would have been credit exposure of major covered companies to major counterparties. The final rule contains a number of recommended modifications that would reduce this estimated impact. In particular, the final rule would allow covered companies and U.S. IHCs to use internal models to measure exposures from securities financing transactions, which was one of the major sources of excess exposure. Moreover, the narrower scope of application of the final rule, including the narrower definitions of ''covered company'' and ''counterparty,'' would further reduce its impact. Finally, recent staff analysis shows that covered companies and U.S. IHCs have very few single-counterparty exposures above 5 percent of their tier 1 capital. Thus, they are unlikely to exceed the credit limits of the final rule. As a result, staff believes the final rule is unlikely to have a material impact on covered companies and U.S. IHCs.

Importantly, the final rule provides covered companies and U.S. IHCs with a compliance period of 18 to 24 months, which should allow firms sufficient time to construct an infrastructure for monitoring and reporting their credit exposures to the Federal Reserve and for conforming any excess credit exposures. Covered firms will have a number of relatively low-cost mechanisms for reducing any residual excess credit exposures, including shifting exposures to other less-concentrated counterparties, increasing margin requirements for some derivatives or securities financing transactions, or increasing use of derivative transactions that are cleared by qualifying central counterparties.

V. Regulatory Analysis

A. Paperwork Reduction Act

Certain provisions of the final rule contain ''collection of information'' requirements within the meaning of the Paperwork Reduction Act of 1995 (44 U.S.C. 3501 through 3521). The Board has reviewed the reporting requirements in §§ 252.78(a) and 252.178(a) of the final rule under the authority delegated to the Board by Office of Management and Budget. As noted, the Board is addressing these requirements in a separate notice published elsewhere in this issue of the **Federal Register**.

B. Regulatory Flexibility Act Analysis

The Regulatory Flexibility Act, 5 U.S.C. 601 *et seq.* (RFA), generally requires that an agency prepare and make available an initial regulatory flexibility analysis in connection with a notice of proposed rulemaking.

The Board solicited public comment on this rule in a notice of proposed rulemaking[219] and has since considered the potential impact of this rule on small entities in accordance with section 604 of the RFA. Based on the Board's analysis, and for the reasons stated below, the Board believes the final rule will not have a significant economic impact on a substantial number of small entities.

Under regulations issued by the Small Business Administration (SBA), a ''small entity'' includes a depository institution, bank holding company, or savings and loan holding company with assets of $550 million or less (small banking organizations).[220] As discussed in the **SUPPLEMENTARY INFORMATION**, the final rule generally would apply to bank holding companies and foreign banking organizations with total consolidated assets of $250 billion or more. Companies that are subject to the final rule have consolidated assets that substantially exceed the $550 million asset threshold at which a banking entity is considered a ''small entity'' under SBA regulations. Because the final rule does not apply to any company with assets of $550 million or less, the final rule would not apply to any ''small entity'' for purposes of the RFA. The Board does not believe that the final rule duplicates, overlaps, or conflicts with any other Federal rules. In light of the foregoing, the Board does not believe that the final rule would have a significant economic impact on a substantial number of small entities supervised.

1. *Statement of the need for, and objectives of the final rule.*

In accordance with section 165 of the Dodd-Frank Act, the Board is proposing to amend Regulation YY to establish SCCL for covered companies and covered foreign entities in order to limit the risks that the failure of any individual firm could pose to those organizations.[221] Section 165(e) requires the Board to implement the SCCL by regulation. The reasons and justification for the final rule are described above in more detail in this **SUPPLEMENTARY INFORMATION**.

2. *Summary of the significant issues raised by public comment on the Board's initial analysis, the Board's assessment of any such issues, and a result of such comments.*

The Board performed a regulatory flexibility analysis in connection with the final rule. Moreover, the final rule does not impact small entities as described below.

3. *Small entities affected by the final rule and compliance requirements.*

The provisions of the final rule apply to covered companies and covered foreign entities. Bank holding companies and foreign banking organizations that are subject to the proposed rule therefore substantially exceed the $550 million asset threshold at which a banking entity would qualify as a small banking organization.

[217] *See* proposed rule §§ 252.170(c)(1)(ii), 252.170(c)(2)(ii).

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

[219] 81 FR 14328 (Mar. 16, 2016).

[220] *See* 13 CFR 121.201.

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

4. *Significant alternatives to the final rule.*

In light of the foregoing, the Board does not believe that this final rule would have a significant negative economic impact on any small entities.

C. Solicitation of Comments on the Use of Plain Language

Section 722 of the Gramm-Leach Bliley Act of 1999 requires the Federal banking agencies to use plain language in all proposed and final rules published after January 1, 2000. The Board received no comments on these matters and believes that the final rule is written plainly and clearly.

List of Subjects in 12 CFR Part 252

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

Authority and Issuance

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

PART 252—ENHANCED PRUDENTIAL STANDARDS (REGULATION YY).

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

Authority: 12 U.S.C. 321–338a, 481–486, 1467a(g), 1818, 1828, 1831n, 1831o, 1831p–l, 1831w, 1835, 1844(b), 1844(c), 3904, 3906–3909, 4808, 5361, 5365, 5366, 5367, 5368, 5371.

■ 2. Add subpart H to read as follows:

Subpart H—Single-Counterparty Credit Limits

Sec.

252.70 Applicability and general provisions.
252.71 Definitions.
252.72 Credit exposure limits.
252.73 Gross credit exposure.
252.74 Net credit exposure.
252.75 Investments in and exposures to securitization vehicles, investment funds, and other special purpose vehicles that are not affiliates of the covered company.
252.76 Aggregation of exposures to more than one counterparty due to economic interdependence or control relationships.
252.77 Exemptions.
252.78 Compliance.

Subpart H—Single-Counterparty Credit Limits

§ 252.70 Applicability and general provisions.

(a) *In general.* (1) This subpart establishes single counterparty credit limits for a covered company.

(2) For purposes of this subpart:

(i) *Covered company* means

(A) Any bank holding company (other than a foreign banking organization that is subject to subpart Q of this part, including any U.S. intermediate holding company of such foreign banking organization) with total consolidated assets that equal or exceed $250 billion; and

(B) Any U.S. bank holding company identified as a global systemically important BHC pursuant to § 217.402 of the Board's Regulation Q (12 CFR 217.402).

(ii) *Major covered company* means any covered company that is a U.S. bank holding company identified as a global systemically important BHC pursuant to § 217.402 of the Board's Regulation Q (12 CFR 217.402).

(b) *Credit exposure limits.* (1) Section 252.72 establishes credit exposure limits for a covered company and a major covered company.

(2) A covered company is required to calculate its aggregate net credit exposure, gross credit exposure, and net credit exposure to a counterparty using the methods in this subpart.

(c) *Applicability of this subpart.* (1)(i) A company that is a covered company as of October 5, 2018, must comply with the requirements of this subpart, including but not limited to § 252.72, beginning on July 1, 2020, unless that time is extended by the Board in writing.

(ii) Notwithstanding paragraph (c)(1)(i) of this section, a company that is a major covered company as of October 5, 2018, must comply with the requirements of this subpart, including but not limited to § 252.72, beginning on January 1, 2020, unless that time is extended by the Board in writing.

(2) A covered company that becomes subject to this subpart after October 5, 2018 must comply with the requirements of this subpart beginning on the first day of the ninth calendar quarter after it becomes a covered company, unless that time is accelerated or extended by the Board in writing.

(d) *Cessation of requirements.* (1) Any company that becomes a covered company will remain subject to the requirements of this subpart unless and until its total consolidated assets fall below $250 billion for each of four consecutive quarters, as reported on the covered company's FR Y–9C, effective on the as-of date of the fourth consecutive FR Y–9C.

(2) A covered company that has ceased to be a major covered company for purposes of § 252.72(b) is no longer subject to the requirements of § 252.72(b) beginning on the first day of the calendar quarter following the reporting date on which it ceased to be a major covered company; provided that the covered company remains subject to the requirements of this subpart, unless it ceases to be a covered company pursuant to paragraph (d)(1) of this section.

§ 252.71 Definitions.

Unless defined in this section, terms that are set forth in § 252.2 of this part and used in this subpart have the definitions assigned in § 252.2. For purposes of this subpart:

(a) *Adjusted market value* means:

(1) With respect to the value of cash, securities, or other eligible collateral transferred by the covered company to a counterparty, the sum of:

(i) The market value of the cash, securities, or other eligible collateral; and

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

(2) With respect to cash, securities, or other eligible collateral received by the covered company from a counterparty:

(i) The market value of the cash, securities, or other eligible collateral; minus

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

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

(b) *Affiliate* means, with respect to a company:

(1) Any subsidiary of the company and any other company that is consolidated with the company under applicable accounting standards; or

(2) For a company that is not subject to principles or standards referenced in paragraph (b)(1) of this section, any subsidiary of the company and any other company that would be consolidated with the company, if consolidation would have occurred if such principles or standards had applied.

(c) *Aggregate net credit exposure* means the sum of all net credit exposures of a covered company and all

of its subsidiaries to a single counterparty as calculated under this subpart.

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

(e) *Counterparty* means, with respect to a credit transaction:

(1) With respect to a natural person, the natural person, and, if the credit exposure of the covered company to such natural person exceeds 5 percent of the covered company's tier 1 capital, the natural person and members of the person's immediate family collectively;

(2) With respect to any company that is not a subsidiary of the covered company, the company and its affiliates collectively;

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

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

(5) With respect to a political subdivision of a foreign sovereign entity such as a state, province, or municipality, any political subdivision of the foreign sovereign entity and all of such political subdivision's agencies and instrumentalities, collectively.[1]

(f) *Covered company* is defined in § 252.70(a)(2)(i) of this subpart.

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

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

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

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

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

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

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

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

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

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

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

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

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

(1) Cash on deposit with the covered company or a subsidiary of the covered company (including cash in foreign currency or U.S. dollars held for the covered company by a custodian or trustee, whether inside or outside of the United States);

(2) Debt securities (other than mortgage- or asset-backed securities and resecuritization securities, unless those securities are issued by a U.S. government-sponsored enterprise) that are bank-eligible investments and that are investment grade, except for any debt securities issued by the covered company or any subsidiary of the covered company;

(3) Equity securities that are publicly traded, except for any equity securities issued by the covered company or any subsidiary of the covered company;

(4) Convertible bonds that are publicly traded, except for any convertible bonds issued by the covered company or any subsidiary of the covered company; or

(5) Gold bullion.

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

(1) The contract meets the requirements of an eligible guarantee and has been confirmed by the protection purchaser and the protection provider;

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

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

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

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

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

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

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

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

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

(1) The derivative contract has been confirmed by all relevant parties;

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

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

[1] In addition, under § 252.76, under certain circumstances, a covered company is required to aggregate its net credit exposure to one or more counterparties for all purposes under this subpart.

(n) *Eligible guarantee* has the same meaning as in § 217.2 of the Board's Regulation Q (12 CFR 217.2).

(o) *Eligible guarantor* has the same meaning as in § 217.2 of the Board's Regulation Q (12 CFR 217.2).

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

(q) *Exempt counterparty* means an entity that is identified as exempt from the requirements of this subpart under § 252.77, or that is otherwise excluded from this subpart, including any sovereign entity assigned a zero percent risk weight under the standardized approach in the Board's Regulation Q (12 CFR part 217, subpart D).

(r) *Financial entity* means:

(1)(i) A bank holding company or an affiliate thereof; a savings and loan holding company as defined in section 10(n) of the Home Owners' Loan Act (12 U.S.C. 1467a(n)); a U.S. intermediate holding company established or designated for purposes of compliance with this part; or a nonbank financial company supervised by the Board;

(ii) A depository institution as defined in section 3(c) of the Federal Deposit Insurance Act (12 U.S.C. 1813(c)); an organization that is organized under the laws of a foreign country and that engages directly in the business of banking outside the United States; a federal credit union or state credit union as defined in section 2 of the Federal Credit Union Act (12 U.S.C. 1752(1) and (6)); a national association, state member bank, or state nonmember bank that is not a depository institution; an institution that functions solely in a trust or fiduciary capacity as described in section 2(c)(2)(D) of the Bank Holding Company Act (12 U.S.C. 1841(c)(2)(D)); an industrial loan company, an industrial bank, or other similar institution described in section 2(c)(2)(H) of the Bank Holding Company Act (12 U.S.C. 1841(c)(2)(H));

(iii) An entity that is state-licensed or registered as:

(A) A credit or lending entity, including a finance company; money lender; installment lender; consumer lender or lending company; mortgage lender, broker, or bank; motor vehicle title pledge lender; payday or deferred deposit lender; premium finance company; commercial finance or lending company; or commercial mortgage company; except entities registered or licensed solely on account of financing the entity's direct sales of goods or services to customers;

(B) A money services business, including a check casher; money transmitter; currency dealer or exchange; or money order or traveler's check issuer;

(iv) Any person registered with the Commodity Futures Trading Commission as a swap dealer or major swap participant pursuant to the Commodity Exchange Act of 1936 (7 U.S.C. 1 *et seq.*), or an entity that is registered with the U.S. Securities and Exchange Commission as a security-based swap dealer or a major security-based swap participant pursuant to the Securities Exchange Act of 1934 (15 U.S.C. 78a *et seq.*);

(v) A securities holding company as defined in section 618 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. 1850a); a broker or dealer as defined in sections 3(a)(4) and 3(a)(5) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(4)–(5)); an investment adviser as defined in section 202(a) of the Investment Advisers Act of 1940 (15 U.S.C. 80b–2(a)); an investment company registered with the U.S. Securities and Exchange Commission under the Investment Company Act of 1940 (15 U.S.C. 80a–1 *et seq.*); or a company that has elected to be regulated as a business development company pursuant to section 54(a) of the Investment Company Act of 1940 (15 U.S.C. 80a–53(a));

(vi) A private fund as defined in section 202(a) of the Investment Advisers Act of 1940 (15 U.S.C. 80b–2(a)); an entity that would be an investment company under section 3 of the Investment Company Act of 1940 (15 U.S.C. 80a–3) but for section 3(c)(5)(C); or an entity that is deemed not to be an investment company under section 3 of the Investment Company Act of 1940 pursuant to Investment Company Act Rule 3a–7 (17 CFR 270.3a–7) of the U.S. Securities and Exchange Commission;

(vii) A commodity pool, a commodity pool operator, or a commodity trading advisor as defined, respectively, in sections 1a(10), 1a(11), and 1a(12) of the Commodity Exchange Act of 1936 (7 U.S.C. 1a(10), 1a(11), and 1a(12)); a floor broker, a floor trader, or introducing broker as defined, respectively, in sections 1a(22), 1a(23) and 1a(31) of the Commodity Exchange Act of 1936 (7 U.S.C. 1a(22), 1a(23), and 1a(31)); or a futures commission merchant as defined in section 1a(28) of the Commodity Exchange Act of 1936 (7 U.S.C. 1a(28));

(viii) An employee benefit plan as defined in paragraphs (3) and (32) of section 3 of the Employee Retirement Income and Security Act of 1974 (29 U.S.C. 1002);

(ix) An entity that is organized as an insurance company, primarily engaged in writing insurance or reinsuring risks underwritten by insurance companies, or is subject to supervision as such by a State insurance regulator or foreign insurance regulator;

(x) Any designated financial market utility, as defined in section 803 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. 5462); and

(xi) An entity that would be a financial entity described in paragraphs (r)(1)(i) through (x) of this section, if it were organized under the laws of the United States or any State thereof; and

(2) Provided that, for purposes of this subpart, ''financial entity'' does not include any counterparty that is a foreign sovereign entity or multilateral development bank.

(s) *Foreign sovereign entity* means a sovereign entity other than the United States government and the entity's agencies, departments, ministries, and central bank collectively.

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

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

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

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

(x) *Major counterparty* means any counterparty that is or includes:

(1) A major covered company;

(2) A top-tier foreign banking organization that meets the requirements of § 252.172(c)(3) through (5); or

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

(y) *Major covered company* is defined in § 252.70(a)(2)(ii) of this subpart.

(z) *Multilateral development bank* has the same meaning as in § 217.2 of the Board's Regulation Q (12 CFR 217.2).

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

(bb) *Qualifying central counterparty* has the same meaning as in § 217.2 of

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

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

(dd) *Securities financing transaction* means any repurchase agreement, reverse repurchase agreement, securities borrowing transaction, or securities lending transaction.

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

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

(gg) *Subsidiary.* A company is a *subsidiary* of another company if:

(1) The company is consolidated by the other company under applicable accounting standards; or

(2) For a company that is not subject to principles or standards referenced in paragraph (gg)(1) of this definition, consolidation would have occurred if such principles or standards had applied.

(hh) *Tier 1 capital* means common equity tier 1 capital and additional tier 1 capital, as defined in the Board's Regulation Q (12 CFR part 217) and as reported by the bank holding company on the most recent FR Y–9C report on a consolidated basis.

(ii) *Total consolidated assets.* A company's total consolidated assets are determined based on:

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

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

§ 252.72 Credit exposure limits.

(a) *General limit on aggregate net credit exposure.* No covered company may have an aggregate net credit exposure to any counterparty that exceeds 25 percent of the tier 1 capital of the covered company.

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

§ 252.73 Gross credit exposure.

(a) *Calculation of gross credit exposure.* The amount of gross credit exposure of a covered company to a counterparty with respect to a credit transaction is, in the case of:

(1) A deposit of the covered company held by the counterparty, loan by a covered company to the counterparty, and lease in which the covered company is the lessor and the counterparty is the lessee, equal to the amount owed by the counterparty to the covered company under the transaction.

(2) A debt security or debt investment held by the covered company that is issued by the counterparty, equal to:

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

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

(3) An equity security held by the covered company that is issued by the counterparty, equity investment in a counterparty, and other direct investments in a counterparty, equal to the market value.

(4) A securities financing transaction must be valued using any of the methods that the covered company is authorized to use under the Board's Regulation Q (12 CFR part 217, subparts D and E) to value such transactions:

(i)(A) As calculated for each transaction, in the case of a securities financing transaction between the covered company and the counterparty that is not subject to a bilateral netting agreement or does not meet the definition of ''repo-style transaction'' in § 217.2 of the Board's Regulation Q (12 CFR 217.2); or

(B) As calculated for a netting set, in the case of a securities financing transaction between the covered company and the counterparty that is subject to a bilateral netting agreement with that counterparty and meets the definition of ''repo-style transaction'' in § 217.2 of the Board's Regulation Q (12 CFR 217.2);

(ii) For purposes of paragraph (a)(4)(i) of this section, the covered company must:

(A) Assign a value of zero to any security received from the counterparty that does not meet the definition of ''eligible collateral'' in § 252.71(k); and

(B) Include the value of securities that are eligible collateral received by the covered company from the counterparty (including any exempt counterparty), calculated in accordance with paragraphs (a)(4)(i) through (iv) of this section, when calculating its gross credit exposure to the issuer of those securities;

(iii) Notwithstanding paragraphs (a)(4)(i) and (ii) of this section and with respect to each credit transaction, a covered company's gross credit exposure to a collateral issuer under this paragraph (a)(4) is limited to the covered company's gross credit exposure to the counterparty on the credit transaction; and

(iv) In cases where the covered company receives eligible collateral from a counterparty in addition to the cash or securities received from that counterparty, the counterparty may reduce its gross credit exposure to that counterparty in accordance with § 252.74(b).

(5) A committed credit line extended by a covered company to a counterparty, equal to the face amount of the committed credit line.

(6) A guarantee or letter of credit issued by a covered company on behalf of a counterparty, equal to the maximum potential loss to the covered company on the transaction.

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

(i)(A) As calculated for each transaction, in the case of a derivative transaction between the covered company and the counterparty, including an equity derivative but excluding a credit derivative described in paragraph (a)(8) of this section, that is not subject to a qualifying master netting agreement; or

(B) As calculated for a netting set, in the case of a derivative transaction between the covered company and the counterparty, including an equity derivative but excluding a credit derivative described in paragraph (a)(8) of this section, that is subject to a qualifying master netting agreement.

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

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

(b) *Investments in and exposures to securitization vehicles, investment funds, and other special purpose vehicles that are not subsidiaries.* Notwithstanding paragraph (a) of this section, a covered company must calculate pursuant to § 252.75 its gross credit exposure due to any investment in the debt or equity of, and any credit derivative or equity derivative between the covered company and a third party where the covered company is the protection provider and the reference asset is an obligation or equity security of, or equity investment in, a securitization vehicle, investment fund, and other special purpose vehicle that is not a subsidiary of the covered company.

(c) *Attribution rule.* Notwithstanding any other requirement in this subpart, a covered company must treat any transaction with any natural person or entity as a credit transaction with another party, to the extent that the proceeds of the transaction are used for the benefit of, or transferred to, the other party.

§ 252.74 Net credit exposure.

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

(b) *Eligible collateral.* (1) In computing its net credit exposure to a counterparty for any credit transaction other than a securities financing transaction, a covered company must reduce its gross credit exposure on the transaction by the adjusted market value of any eligible collateral.

(2) A covered company that reduces its gross credit exposure to a counterparty as required under paragraph (b)(1) of this section must include the adjusted market value of the eligible collateral, when calculating its gross credit exposure to the collateral issuer.

(3) Notwithstanding paragraph (b)(2) of this section, a covered company's gross credit exposure to a collateral issuer under this paragraph (b) is limited to:

(i) Its gross credit exposure to the counterparty on the credit transaction, or

(ii) In the case of an exempt counterparty, the gross credit exposure that would have been attributable to that exempt counterparty on the credit transaction if valued in accordance with § 252.73(a).

(c) *Eligible guarantees.* (1) In calculating net credit exposure to a counterparty for any credit transaction, a covered company must reduce its gross credit exposure to the counterparty by the amount of any eligible guarantee from an eligible guarantor that covers the transaction.

(2) A covered company that reduces its gross credit exposure to a counterparty as required under paragraph (c)(1) of this section must include the amount of eligible guarantees when calculating its gross credit exposure to the eligible guarantor.

(3) Notwithstanding paragraph (c)(2) of this section, a covered company's gross credit exposure to an eligible guarantor with respect to an eligible guarantee under this paragraph (c) is limited to:

(i) Its gross credit exposure to the counterparty on the credit transaction prior to recognition of the eligible guarantee, or

(ii) In the case of an exempt counterparty, the gross credit exposure that would have been attributable to that exempt counterparty on the credit transaction prior to recognition of the eligible guarantee if valued in accordance with § 252.73(a).

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

(i) In the case of any eligible credit derivative from an eligible guarantor, the notional amount of the eligible credit derivative; or

(ii) In the case of any eligible equity derivative from an eligible guarantor, the gross credit exposure amount to the counterparty (calculated in accordance with § 252.73(a)(7)).

(2)(i) A covered company that reduces its gross credit exposure to a counterparty as provided under paragraph (d)(1) of this section must include, when calculating its net credit exposure to the eligible guarantor, including in instances where the underlying credit transaction would not be subject to the credit limits of § 252.72 (for example, due to an exempt counterparty), either

(A) In the case of any eligible credit derivative from an eligible guarantor, the notional amount of the eligible credit derivative; or

(B) In the case of any eligible equity derivative from an eligible guarantor, the gross credit exposure amount to the counterparty (calculated in accordance with § 252.73(a)(7)).

(ii) Notwithstanding paragraph (d)(2)(i) of this section, in cases where the eligible credit derivative or eligible equity derivative is used to hedge covered positions that are subject to the Board's market risk rule (12 CFR part 217, subpart F) and the counterparty on the hedged transaction is not a financial entity, the amount of credit exposure that a company must recognize to the eligible guarantor is the amount that would be calculated pursuant to § 252.73(a).

(3) Notwithstanding paragraph (d)(2) of this section, a covered company's gross credit exposure to an eligible guarantor with respect to an eligible credit derivative or an eligible equity derivative under this paragraph (d) is limited to:

(i) Its gross credit exposure to the counterparty on the credit transaction prior to recognition of the eligible credit derivative or the eligible equity derivative, or

(ii) In the case of an exempt counterparty, the gross credit exposure that would have been attributable to that exempt counterparty on the credit transaction prior to recognition of the eligible credit derivative or the eligible equity derivative if valued in accordance with § 252.73(a).

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

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

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

(f) *Unused portion of certain extensions of credit.* (1) In computing its net credit exposure to a counterparty for a committed credit line or revolving credit facility under this section, a covered company may reduce its gross credit exposure by the amount of the unused portion of the credit extension to the extent that the covered company does not have any legal obligation to advance additional funds under the extension of credit and the used portion of the credit extension has been fully secured by eligible collateral.

(2) To the extent that the used portion of a credit extension has been secured by eligible collateral, the covered company may reduce its gross credit exposure by the adjusted market value

of any eligible collateral received from the counterparty, even if the used portion has not been fully secured by eligible collateral.

(3) To qualify for the reduction in net credit exposure under this paragraph, the credit contract must specify that any used portion of the credit extension must be fully secured by the adjusted market value of any eligible collateral.

(g) *Credit transactions involving exempt counterparties.* (1) A covered company's credit transactions with an exempt counterparty are not subject to the requirements of this subpart, including but not limited to § 252.72.

(2) Notwithstanding paragraph (g)(1) of this section, in cases where a covered company has a credit transaction with an exempt counterparty and the covered company has obtained eligible collateral from that exempt counterparty or an eligible guarantee or eligible credit or equity derivative from an eligible guarantor, the covered company must include (for purposes of this subpart) such exposure to the issuer of such eligible collateral or the eligible guarantor, as calculated in accordance with the rules set forth in this section, when calculating its gross credit exposure to that issuer of eligible collateral or eligible guarantor.

(h) *Currency mismatch adjustments.* For purposes of calculating its net credit exposure to a counterparty under this section, a covered company must apply, as applicable:

(1) When reducing its gross credit exposure to a counterparty resulting from any credit transaction due to any eligible collateral and calculating its gross credit exposure to an issuer of eligible collateral, pursuant to paragraph (b) of this section, the currency mismatch adjustment approach of § 217.37(c)(3)(ii) of the Board's Regulation Q (12 CFR 217.37(c)(3)(ii)); and

(2) When reducing its gross credit exposure to a counterparty resulting from any credit transaction due to any eligible guarantee, eligible equity derivative, or eligible credit derivative from an eligible guarantor and calculating its gross credit exposure to an eligible guarantor, pursuant to paragraphs (c) and (d) of this section, the currency mismatch adjustment approach of § 217.36(f) of the Board's Regulation Q (12 CFR 217.36(f)).

(i) *Maturity mismatch adjustments.* For purposes of calculating its net credit exposure to a counterparty under this section, a covered company must apply, as applicable, the maturity mismatch adjustment approach of § 217.36(d) of the Board's Regulation Q (12 CFR 217.36(d)):

(1) When reducing its gross credit exposure to a counterparty resulting from any credit transaction due to any eligible collateral or any eligible guarantees, eligible equity derivatives, or eligible credit derivatives from an eligible guarantor, pursuant to paragraphs (b) through (d) of this section, and

(2) In calculating its gross credit exposure to an issuer of eligible collateral, pursuant to paragraph (b) of this section, or to an eligible guarantor, pursuant to paragraphs (c) and (d) of this section; provided that

(3) The eligible collateral, eligible guarantee, eligible equity derivative, or eligible credit derivative subject to paragraph (i)(1) of this section:

(i) Has a shorter maturity than the credit transaction;

(ii) Has an original maturity equal to or greater than one year;

(iii) Has a residual maturity of not less than three months; and

(iv) The adjustment approach is otherwise applicable.

§ 252.75 Investments in and exposures to securitization vehicles, investment funds, and other special purpose vehicles that are not subsidiaries of the covered company.

(a) *In general.* (1) For purposes of this section, the following definitions apply:

(i) *SPV* means a securitization vehicle, investment fund, or other special purpose vehicle that is not a subsidiary of the covered company.

(ii) *SPV exposure* means an investment in the debt or equity of an SPV, or a credit derivative or equity derivative between the covered company and a third party where the covered company is the protection provider and the reference asset is an obligation or equity security of, or equity investment in, an SPV.

(2)(i) A covered company must determine whether the amount of its gross credit exposure to an issuer of assets in an SPV, due to an SPV exposure, is equal to or greater than 0.25 percent of the covered company's tier 1 capital using one of the following two methods:

(A) The sum of all of the issuer's assets (with each asset valued in accordance with § 252.73(a)) in the SPV; or

(B) The application of the look-through approach described in paragraph (b) of this section.

(ii) With respect to the determination required under paragraph (a)(2)(i) of this section, a covered company must use the same method to calculate gross credit exposure to each issuer of assets in a particular SPV.

(iii) In making a determination under paragraph (a)(2)(i) of this section, the covered company must consider only the credit exposure to the issuer arising from the covered company's SPV exposure.

(iv) For purposes of this paragraph (a)(2), a covered company that is unable to identify each issuer of assets in an SPV must attribute to a single unknown counterparty the amount of its gross credit exposure to all unidentified issuers and calculate such gross credit exposure using one method in either paragraph (a)(2)(i)(A) or (a)(2)(i)(B) of this section.

(3)(i) If a covered company determines pursuant to paragraph (a)(2) of this section that the amount of its gross credit exposure to an issuer of assets in an SPV is less than 0.25 percent of the covered company's tier 1 capital, the amount of the covered company's gross credit exposure to that issuer may be attributed to either that issuer of assets or the SPV:

(A) If attributed to the issuer of assets, the issuer of assets must be identified as a counterparty, and the gross credit exposure calculated under paragraph (a)(2)(i)(A) of this section to that issuer of assets must be aggregated with any other gross credit exposures (valued in accordance with § 252.73) to that same counterparty; and

(B) If attributed to the SPV, the covered company's gross credit exposure is equal to the covered company's SPV exposure, valued in accordance with § 252.73(a).

(ii) If a covered company determines pursuant to paragraph (a)(2) of this section that the amount of its gross credit exposure to an issuer of assets in an SPV is equal to or greater than 0.25 percent of the covered company's tier 1 capital or the covered company is unable to determine that the amount of the gross credit exposure is less than 0.25 percent of the covered company's tier 1 capital:

(A) The covered company must calculate the amount of its gross credit exposure to the issuer of assets in the SPV using the look-through approach in paragraph (b) of this section;

(B) The issuer of assets in the SPV must be identified as a counterparty, and the gross credit exposure calculated in accordance with paragraph (b) must be aggregated with any other gross credit exposures (valued in accordance with § 252.73) to that same counterparty; and

(C) When applying the look-through approach in paragraph (b) of this section, a covered company that is unable to identify each issuer of assets in an SPV must attribute to a single unknown counterparty the amount of its gross credit exposure, calculated in

accordance with paragraph (b) of this section, to all unidentified issuers.

(iii) For purposes of this section, a covered company must aggregate all gross credit exposures to unknown counterparties for all SPVs as if the exposures related to a single unknown counterparty; this single unknown counterparty is subject to the limits of § 252.72 as if it were a single counterparty.

(b) *Look-through approach.* A covered company that is required to calculate the amount of its gross credit exposure with respect to an issuer of assets in accordance with this paragraph (b) must calculate the amount as follows:

(1) Where all investors in the SPV rank *pari passu,* the amount of the gross credit exposure to the issuer of assets is equal to the covered company's pro rata share of the SPV multiplied by the value of the underlying asset in the SPV, valued in accordance with § 252.73(a); and

(2) Where all investors in the SPV do not rank *pari passu,* the amount of the gross credit exposure to the issuer of assets is equal to:

(i) The pro rata share of the covered company's investment in the tranche of the SPV; multiplied by

(ii) The lesser of:

(A) The market value of the tranche in which the covered company has invested, except in the case of a debt security that is held to maturity, in which case the tranche must be valued at the amortized purchase price of the securities; and

(B) The value of each underlying asset attributed to the issuer in the SPV, each as calculated pursuant to § 252.73(a).

(c) *Exposures to third parties.* (1) Notwithstanding any other requirement in this section, a covered company must recognize, for purposes of this subpart, a gross credit exposure to each third party that has a contractual obligation to provide credit or liquidity support to an SPV whose failure or material financial distress would cause a loss in the value of the covered company's SPV exposure.

(2) The amount of any gross credit exposure that is required to be recognized to a third party under paragraph (c)(1) of this section is equal to the covered company's SPV exposure, up to the maximum contractual obligation of that third party to the SPV, valued in accordance with § 252.73(a). (This gross credit exposure is in addition to the covered company's gross credit exposure to the SPV or the issuers of assets of the SPV, calculated in accordance with paragraphs (a) and (b) of this section.)

(3) A covered company must aggregate the gross credit exposure to a third party recognized in accordance with paragraphs (c)(1) and (2) of this section with its other gross credit exposures to that third party (that are unrelated to the SPV) for purposes of compliance with the limits of § 252.72.

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

(a) *In general.* (1) If a covered company has an aggregate net credit exposure to any counterparty that exceeds 5 percent of its tier 1 capital, the covered company must assess its relationship with the counterparty under paragraph (b)(2) of this section to determine whether the counterparty is economically interdependent with one or more other counterparties of the covered company and under paragraph (c)(1) of this section to determine whether the counterparty is connected by a control relationship with one or more other counterparties.

(2) If, pursuant to an assessment required under paragraph (a)(1) of this section, the covered company determines that one or more of the factors of paragraph (b)(2) or (c)(1) of this section are met with respect to one or more counterparties, or the Board determines pursuant to paragraph (d) of this section that one or more other counterparties of a covered company are economically interdependent or that one or more other counterparties of a covered company are connected by a control relationship, the covered company must aggregate its net credit exposure to the counterparties for all purposes under this subpart, including, but not limited to, § 252.72.

(3) In connection with any request pursuant to paragraph (b)(3) or (c)(2) of this section, the Board may require the covered company to provide additional information.

(b) *Aggregation of exposures to more than one counterparty due to economic interdependence.* (1) For purposes of this paragraph, two counterparties are economically interdependent if the failure, default, insolvency, or material financial distress of one counterparty would cause the failure, default, insolvency, or material financial distress of the other counterparty, taking into account the factors in paragraph (b)(2) of this section.

(2) A covered company must assess whether the financial distress of one counterparty (counterparty A) would prevent the ability of the other counterparty (counterparty B) to fully and timely repay counterparty B's liabilities and whether the insolvency or default of counterparty A is likely to be associated with the insolvency or default of counterparty B and, therefore, these counterparties are economically interdependent, by evaluating the following:

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

(ii) Whether counterparty A has fully or partly guaranteed the credit exposure of counterparty B, or is liable by other means, in an amount that is 50 percent or more of the covered company's net credit exposure to counterparty A;

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

(iv) Whether the expected source of funds to repay the loans of both counterparties is the same and neither counterparty has another independent source of income from which the loans may be serviced and fully repaid; [1] and

(v) Whether two or more counterparties rely on the same source for the majority of their funding and, in the event of the common provider's default, an alternative provider cannot be found.

(3)(i) Notwithstanding paragraph (b)(2) of this section, if a covered company determines that one or more of the factors in paragraph (b)(2) is met, the covered company may request in writing a determination from the Board that those counterparties are not economically interdependent and that the covered company is not required to aggregate those counterparties.

(ii) Upon a request by a covered company pursuant to paragraph (b)(3) of this section, the Board may grant temporary relief to the covered company and not require the covered company to aggregate one counterparty with another counterparty provided that the counterparty could promptly modify its business relationships, such as by reducing its reliance on the other counterparty, to address any economic interdependence concerns, and provided that such relief is in the public interest and is consistent with the purpose of this subpart and 12 U.S.C. 5365(e).

(c) *Aggregation of exposures to more than one counterparty due to certain control relationships.* (1) For purposes of this subpart, one counterparty (counterparty A) is deemed to control the other counterparty (counterparty B) if:

[1] An employer will not be treated as a source of repayment under this paragraph because of wages and salaries paid to an employee.

(i) Counterparty A owns, controls, or holds with the power to vote 25 percent or more of any class of voting securities of counterparty B; or

(ii) Counterparty A controls in any manner the election of a majority of the directors, trustees, or general partners (or individuals exercising similar functions) of counterparty B.

(2)(i) Notwithstanding paragraph (c)(1) of this section, if a covered company determines that one or more of the factors in paragraph (c)(1) is met, the covered company may request in writing a determination from the Board that counterparty A does not control counterparty B and that the covered company is not required to aggregate those counterparties.

(ii) Upon a request by a covered company pursuant to paragraph (c)(2) of this section, the Board may grant temporary relief to the covered company and not require the covered company to aggregate counterparty A with counterparty B provided that, taking into account the specific facts and circumstances, such indicia of control does not result in the entities being connected by control relationships for purposes of this subpart, and provided that such relief is in the public interest and is consistent with the purpose of this subpart and 12 U.S.C. 5365(e).

(d) *Board determinations for aggregation of counterparties due to economic interdependence or control relationships.* The Board may determine, after notice to the covered company and opportunity for hearing, that one or more counterparties of a covered company are:

(i) Economically interdependent for purposes of this subpart, considering the factors in paragraph (b)(2) of this section, as well as any other indicia of economic interdependence that the Board determines in its discretion to be relevant; or

(ii) Connected by control relationships for purposes of this subpart, considering the factors in paragraph (c)(1) of this section and whether counterparty A:

(A) Controls the power to vote 25 percent or more of any class of voting securities of Counterparty B pursuant to a voting agreement;

(B) Has significant influence on the appointment or dismissal of counterparty B'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 counterparty A's voting rights; or

(C) Has the power to exercise a controlling influence over the management or policies of counterparty B.

(e) *Board determinations for aggregation of counterparties to prevent evasion.* Notwithstanding paragraphs (b) and (c) of this section, a covered company must aggregate its exposures to a counterparty with the covered company's exposures to another counterparty if the Board determines in writing after notice and opportunity for hearing, that the exposures to the two counterparties must be aggregated to prevent evasions of the purposes of this subpart, including, but not limited to § 252.76 and 12 U.S.C. 5365(e).

§ 252.77 Exemptions.

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

(1) Any direct claim on, and the portion of a claim that is directly and fully guaranteed as to principal and interest by, the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation, only while operating under the conservatorship or receivership of the Federal Housing Finance Agency, and any additional obligation issued by a U.S. government-sponsored entity as determined by the Board;

(2) Intraday credit exposure to a counterparty;

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

(4) Any credit transaction with the Bank for International Settlements, the International Monetary Fund, the International Bank for Reconstruction and Development, the International Finance Corporation, the International Development Association, the Multilateral Investment Guarantee Agency, or the International Centre for Settlement of Investment Disputes;

(5) Any credit transaction with the European Commission or the European Central Bank; and

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

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

(c) *Additional exemptions by the Board.* The Board may, by regulation or order, exempt transactions, in whole or in part, from the definition of the term ''credit exposure,'' if the Board finds that the exemption is in the public interest and is consistent with the purpose of 12 U.S.C. 5365(e).

§ 252.78 Compliance.

(a) *Scope of compliance.* (1) Using all available data, including any data required to be maintained or reported to the Federal Reserve under this subpart, a covered company must comply with the requirements of this subpart on a daily basis at the end of each business day.

(2) A covered company must report its compliance to the Federal Reserve as of the end of the quarter, unless the Board determines and notifies that company in writing that more frequent reporting is required.

(3) In reporting its compliance, a covered company must calculate and include in its gross credit exposure to an issuer of eligible collateral or eligible guarantor the amounts of eligible collateral, eligible guarantees, eligible equity derivatives, and eligible credit derivatives that were provided to the covered company in connection with credit transactions with exempt counterparties, valued in accordance with and as required by § 252.74(b) through (d) and (g).

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

(c) *Noncompliance.* (1) Except as otherwise provided in this section, if a covered company is not in compliance with this subpart with respect to a counterparty solely due to the circumstances listed in paragraphs (c)(2)(i) through (v) of this section, the covered company will not be subject to enforcement actions for a period of 90 days (or, with prior notice to the company, such shorter or longer period determined by the Board, in its sole discretion, to be appropriate to preserve the safety and soundness of the covered company or U.S. financial stability), if the covered company uses reasonable efforts to return to compliance with this subpart during this period. The covered company may not engage in any additional credit transactions with such a counterparty in contravention of this rule during the period of noncompliance, except as provided in paragraph (c)(2).

(2) A covered company may request a special temporary credit exposure limit exemption from the Board. The Board may grant approval for such exemption in cases where the Board determines that such credit transactions are necessary or appropriate to preserve the safety and soundness of the covered company or U.S. financial stability. In acting on a request for an exemption, the Board will consider the following:

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

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

(iii) A merger of two counterparties; or

(iv) An unforeseen and abrupt change in the status of a counterparty as a result of which the covered company's credit exposure to the counterparty becomes limited by the requirements of this section; or

(v) Any other factor(s) the Board determines, in its discretion, is appropriate.

(d) *Other measures.* The Board may impose supervisory oversight and additional reporting measures that it determines are appropriate to monitor compliance with this subpart. Covered companies must furnish, in the manner and form prescribed by the Board, such information to monitor compliance with this subpart and the limits therein as the Board may require.

■ 3. Add subpart Q to read as follows:

Subpart Q—Single-Counterparty Credit Limits

Sec.

252.170 Applicability and general provisions.
252.171 Definitions.
252.172 Credit exposure limits.
252.173 Gross credit exposure.
252.174 Net credit exposure.
252.175 Investments in and exposures to securitization vehicles, investment funds, and other special purpose vehicles that are not affiliates of the covered foreign entity.
252.176 Aggregation of exposures to more than one counterparty due to economic interdependence or control relationships.
252.177 Exemptions.
252.178 Compliance.

§ 252.170 Applicability and general provisions.

(a) *In general.* (1) This subpart establishes single counterparty credit limits for a covered foreign entity.

(2) For purposes of this subpart:

(i) *Covered foreign entity* means:

(A) A foreign banking organization with total consolidated assets that equal or exceed $250 billion with respect to its combined U.S. operations; and

(B) Any U.S. intermediate holding company of such a foreign banking organization with total consolidated assets that equal or exceed $50 billion, including a U.S. intermediate holding company that is a bank holding company.

(ii) *Major foreign banking organization* means a foreign banking organization that is a covered foreign entity and meets the requirements of § 252.172(c)(3) through (5).

(iii) *Major U.S. intermediate holding company* means any covered foreign entity that is a U.S. intermediate holding company and has total consolidated assets that equal or exceed $500 billion.

(b) *Credit exposure limits.* (1) Section 252.172 establishes credit exposure limits for covered foreign entities, major foreign banking organizations, and major U.S. intermediate holding companies.

(2) A covered foreign entity is required to calculate its aggregate net credit exposure, gross credit exposure, and net credit exposure to a counterparty using the methods in this subpart.

(c) *Applicability of this subpart*—(1) *Foreign banking organizations.* (i) A foreign banking organization that is a covered foreign entity as of October 5, 2018, must comply with the requirements of this subpart, including but not limited to § 252.172, beginning on July 1, 2020, unless that time is extended by the Board in writing.

(ii) Notwithstanding paragraph (c)(1)(i) of this section, a foreign banking organization that is a major foreign banking organization as of October 5, 2018, must comply with the requirements of this subpart, including but not limited to § 252.172, beginning on January 1, 2020, unless that time is extended by the Board in writing.

(iii) A foreign banking organization that becomes a covered foreign entity subject to this subpart after October 5, 2018 must comply with the requirements of this subpart beginning on the first day of the ninth calendar quarter after it becomes a covered foreign entity, unless that time is accelerated or extended by the Board in writing.

(2) *U.S. intermediate holding companies.* (i) A U.S. intermediate holding company that is a covered foreign entity but not a major U.S. intermediate holding company as of October 5, 2018, must comply with the requirements of this subpart, including but not limited to § 252.172, beginning on July 1, 2020, unless that time is extended by the Board in writing.

(ii) Notwithstanding paragraph (c)(2)(i) of this section, a U.S. intermediate holding company that is a major U.S. intermediate holding company as of October 5, 2018, must comply with the requirements of this subpart, including but not limited to § 252.172, beginning on January 1, 2020, unless that time is extended by the Board in writing.

(iii) A U.S. intermediate holding company that becomes a covered foreign entity subject to this subpart after October 5, 2018 must comply with the requirements of this subpart beginning on the first day of the ninth calendar quarter after it becomes a covered foreign entity, unless that time is accelerated or extended by the Board in writing.

(d) *Cessation of requirements*—(1) *Foreign banking organizations.* (i) Any foreign banking organization that becomes a covered foreign entity will remain subject to the requirements of this subpart unless and until its total consolidated assets fall below $250 billion for each of four consecutive quarters, as reported on the covered foreign entity's FR Y–7Q, effective on the as-of date of the fourth consecutive FR Y–7Q.

(ii) A foreign banking organization that is a covered foreign entity and that has ceased to be a major foreign banking organization for purposes of § 252.172(c) is no longer subject to the requirements of § 252.172(c) beginning on the first day of the calendar quarter following the reporting date on which it ceased to be a major foreign banking organization; provided that the foreign banking organization remains subject to the requirements of this subpart, unless it ceases to be a foreign banking organization that is a covered foreign entity pursuant to paragraph (d)(1)(i) of this section.

(2) *U.S. intermediate holding companies.* (i) Any U.S. intermediate holding company that becomes a covered foreign entity will remain subject to the requirements of this subpart unless and until its total consolidated assets fall below $50 billion for each of four consecutive quarters, as reported on the covered foreign entity's FR Y–9C, effective on the as-of date of the fourth consecutive FR Y–9C.

(ii) A U.S. intermediate holding company that is a covered foreign entity and that has ceased to be a major U.S. intermediate holding company for purposes of § 252.172(c) is no longer subject to the requirements of § 252.172(c) beginning on the first day of the calendar quarter following the reporting date on which it ceased to be

a major U.S. intermediate holding company; provided that the U.S. intermediate holding company remains subject to the requirements of this subpart, unless it ceases to be a U.S. intermediate holding company that is a covered foreign entity pursuant to paragraph (d)(2)(i) of this section.

§ 252.171 Definitions.

Unless defined in this section, terms that are set forth in § 252.2 of this part and used in this subpart have the definitions assigned in § 252.2. For purposes of this subpart:

(a) *Adjusted market value* means:

(1) With respect to the value of cash, securities, or other eligible collateral transferred by the covered foreign entity to a counterparty, the sum of:

(i) The market value of the cash, securities, or other eligible collateral; and

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

(2) With respect to cash, securities, or other eligible collateral received by the covered foreign entity from a counterparty:

(i) The market value of the cash, securities, or other eligible collateral; minus

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

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

(b) *Affiliate* means, with respect to a company:

(1) Any subsidiary of the company and any other company that is consolidated with the company under applicable accounting standards; or

(2) For a company that is not subject to principles or standards referenced in paragraph (b)(1) of this section, any subsidiary of the company and any other company that would be consolidated with the company, if consolidation would have occurred if such principles or standards had applied.

(c) *Aggregate net credit exposure* means the sum of all net credit exposures of a covered foreign entity and all of its subsidiaries to a single counterparty as calculated under this subpart.

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

(e) *Capital stock and surplus* means, with respect to a U.S. intermediate holding company, the sum of the following amounts in each case as reported by the U.S. intermediate holding company on the most recent FR Y–9C on a consolidated basis:

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

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

(f) *Counterparty* means with respect to a credit transaction:

(1) With respect to a natural person, the natural person, and, if the credit exposure of the covered foreign entity to such natural person exceeds 5 percent of its capital stock and surplus in the case of a U.S. intermediate holding company that is a covered foreign entity with total consolidated assets of less than $250 billion, or 5 percent of its tier 1 capital in the case of a foreign banking organization that is a covered foreign entity or a U.S. intermediate holding company with total consolidated assets that equal or exceed $250 billion, the natural person and members of the person's immediate family collectively;

(2) With respect to any company that is not an affiliate of the covered foreign entity, the company and its affiliates collectively;

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

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

(5) With respect to a political subdivision of a foreign sovereign entity such as a state, province, or municipality, any political subdivision of the foreign sovereign entity and all of such political subdivision's agencies and instrumentalities, collectively.[1]

(g) *Covered foreign entity* is defined in § 252.170(a)(2)(i) of this subpart.

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

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

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

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

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

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

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

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

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

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

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

(k) *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,

[1] In addition, under § 252.176, under certain circumstances, a covered foreign entity is required to aggregate its net credit exposure to one or more counterparties for all purposes under this subpart.

securities, currencies, interest or other rates, indices, or other assets.

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

(1) Cash on deposit with the covered foreign entity or an affiliate of the covered foreign entity (including cash in foreign currency or U.S. dollars held for the covered foreign entity by a custodian or trustee, whether inside or outside of the United States);

(2) Debt securities (other than mortgage- or asset-backed securities and resecuritization securities, unless those securities are issued by a U.S. government-sponsored enterprise) that are bank-eligible investments and that are investment grade, except for any debt securities issued by the covered foreign entity or any affiliate of the covered foreign entity;

(3) Equity securities that are publicly traded, except for any equity securities issued by the covered foreign entity or any affiliate of the covered foreign entity;

(4) Convertible bonds that are publicly traded, except for any convertible bonds issued by the covered foreign entity or any affiliate of the covered foreign entity; or

(5) Gold bullion.

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

(1) The contract meets the requirements of an eligible guarantee and has been confirmed by the protection purchaser and the protection provider;

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

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

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

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

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

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

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

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

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

(1) The derivative contract has been confirmed by all relevant parties;

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

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

(o) *Eligible guarantee* has the same meaning as in § 217.2 of the Board's Regulation Q (12 CFR 217.2).

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

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

(r) *Exempt counterparty* means an entity that is identified as exempt from the requirements of this subpart under § 252.177, or that is otherwise excluded from this subpart, including any sovereign entity assigned a zero percent risk weight under the standardized approach in the Board's Regulation Q (12 CFR part 217, subpart D).

(s) *Financial entity* means:

(1)(i) A bank holding company or an affiliate thereof; a savings and loan holding company as defined in section 10(n) of the Home Owners' Loan Act (12 U.S.C. 1467a(n)); a U.S. intermediate holding company established or designated for purposes of compliance with this part; or a nonbank financial company supervised by the Board;

(ii) A depository institution as defined in section 3(c) of the Federal Deposit Insurance Act (12 U.S.C. 1813(c)); an organization that is organized under the laws of a foreign country and that engages directly in the business of banking outside the United States; a federal credit union or state credit union as defined in section 2 of the Federal Credit Union Act (12 U.S.C. 1752(1) and (6)); a national association, state member bank, or state nonmember bank that is not a depository institution; an institution that functions solely in a trust or fiduciary capacity as described in section 2(c)(2)(D) of the Bank Holding Company Act (12 U.S.C. 1841(c)(2)(D)); an industrial loan company, an industrial bank, or other similar institution described in section 2(c)(2)(H) of the Bank Holding Company Act (12 U.S.C. 1841(c)(2)(H));

(iii) An entity that is state-licensed or registered as:

(A) A credit or lending entity, including a finance company; money lender; installment lender; consumer lender or lending company; mortgage lender, broker, or bank; motor vehicle title pledge lender; payday or deferred deposit lender; premium finance company; commercial finance or lending company; or commercial mortgage company; except entities registered or licensed solely on account of financing the entity's direct sales of goods or services to customers;

(B) A money services business, including a check casher; money transmitter; currency dealer or exchange; or money order or traveler's check issuer;

(iv) Any person registered with the Commodity Futures Trading Commission as a swap dealer or major swap participant pursuant to the Commodity Exchange Act of 1936 (7 U.S.C. 1 *et seq.*), or an entity that is registered with the U.S. Securities and Exchange Commission as a security-based swap dealer or a major security-based swap participant pursuant to the Securities Exchange Act of 1934 (15 U.S.C. 78a *et seq.*);

(v) A securities holding company as defined in section 618 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. 1850a); a broker or dealer as defined in sections 3(a)(4) and 3(a)(5) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(4)–(5)); an investment adviser as defined in section 202(a) of the

Investment Advisers Act of 1940 (15 U.S.C. 80b–2(a)); an investment company registered with the U.S. Securities and Exchange Commission under the Investment Company Act of 1940 (15 U.S.C. 80a–1 *et seq.*); or a company that has elected to be regulated as a business development company pursuant to section 54(a) of the Investment Company Act of 1940 (15 U.S.C. 80a–53(a));

(vi) A private fund as defined in section 202(a) of the Investment Advisers Act of 1940 (15 U.S.C. 80b–2(a)); an entity that would be an investment company under section 3 of the Investment Company Act of 1940 (15 U.S.C. 80a–3) but for section 3(c)(5)(C); or an entity that is deemed not to be an investment company under section 3 of the Investment Company Act of 1940 pursuant to Investment Company Act Rule 3a–7 (17 CFR 270.3a–7) of the U.S. Securities and Exchange Commission;

(vii) A commodity pool, a commodity pool operator, or a commodity trading advisor as defined, respectively, in sections 1a(10), 1a(11), and 1a(12) of the Commodity Exchange Act of 1936 (7 U.S.C. 1a(10), 1a(11), and 1a(12)); a floor broker, a floor trader, or introducing broker as defined, respectively, in sections 1a(22), 1a(23) and 1a(31) of the Commodity Exchange Act of 1936 (7 U.S.C. 1a(22), 1a(23), and 1a(31)); or a futures commission merchant as defined in section 1a(28) of the Commodity Exchange Act of 1936 (7 U.S.C. 1a(28));

(viii) An employee benefit plan as defined in paragraphs (3) and (32) of section 3 of the Employee Retirement Income and Security Act of 1974 (29 U.S.C. 1002);

(ix) An entity that is organized as an insurance company, primarily engaged in writing insurance or reinsuring risks underwritten by insurance companies, or is subject to supervision as such by a State insurance regulator or foreign insurance regulator;

(x) Any designated financial market utility, as defined in section 803 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. 5462); and

(xi) An entity that would be a financial entity described in paragraphs (s)(1)(i) through (x) of this section, if it were organized under the laws of the United States or any State thereof; and

(2) Provided that, for purposes of this subpart, ''financial entity'' does not include any counterparty that is a foreign sovereign entity or multilateral development bank.

(t) *Foreign sovereign entity* means a sovereign entity other than the United States government and the entity's agencies, departments, ministries, and central bank.

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

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

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

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

(y) *Major counterparty* means any counterparty that is or includes:

(1) A U.S. bank holding company identified as a global systemically important BHC pursuant to § 217.402 of the Board's Regulation Q (12 CFR 217.402);

(2) A top-tier foreign banking organization that meets the requirements of § 252.172(c)(3) through (5); or

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

(z) *Major foreign banking organization* is defined in § 252.170(a)(2)(ii) of this subpart.

(aa) *Major U.S. intermediate holding company* is defined in § 252.170(a)(2)(iii) of this subpart.

(bb) *Multilateral development bank* has the same meaning as in § 217.2 of the Board's Regulation Q (12 CFR 217.2).

(cc) *Net credit exposure* means, with respect to any credit transaction, the gross credit exposure of a covered foreign entity and all of its subsidiaries calculated under § 252.173, as adjusted in accordance with § 252.174.

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

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

(ff) *Securities financing transaction* means any repurchase agreement, reverse repurchase agreement, securities borrowing transaction, or securities lending transaction.

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

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

(ii) *Subsidiary.* A company is a *subsidiary* of another company if

(1) The company is consolidated by the other company under applicable accounting standards; or

(2) For a company that is not subject to principles or standards referenced in paragraph (ii)(1) of this definition, consolidation would have occurred if such principles or standards had applied.

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

(kk) *Tier 2 capital* means tier 2 capital as defined in subpart O of the Board's Regulation YY (12 CFR part 252, subpart O).

(ll) *Total consolidated assets.* (1) A foreign banking organization's *total consolidated assets* are determined based on:

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

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

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

(2) A U.S. intermediate holding company's *total consolidated assets* are determined based on:

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

(ii) If the U.S. intermediate holding company has not filed an FR Y–9C for each of the four most recent consecutive quarters, the average of the U.S. intermediate holding company's total consolidated assets, as reported on the company's FR Y–9C, for the most recent

quarter or consecutive quarters, as applicable; or

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

§ 252.172 Credit exposure limits.

(a) *General limit on aggregate net credit exposure.* No U.S. intermediate holding company that is a covered foreign entity may have an aggregate net credit exposure to any counterparty that exceeds 25 percent of the consolidated capital stock and surplus of the U.S. intermediate holding company.

(b) *Limit on aggregate net credit exposure for U.S. intermediate holding companies with total consolidated assets that equal or exceed $250 billion and foreign banking organizations that are covered foreign entities.* (1) No U.S. intermediate holding company with total consolidated assets that equal or exceed $250 billion that is a covered foreign entity may have an aggregate net credit exposure to any counterparty that exceeds 25 percent of the tier 1 capital of the U.S. intermediate holding company.

(2) No foreign banking organization that is a covered foreign entity may permit its combined U.S. operations to have aggregate net credit exposure to any counterparty that exceeds 25 percent of the tier 1 capital of the foreign banking organization.

(c) *Limit on aggregate net credit exposure of major U.S. intermediate holding companies and major foreign banking organizations to major counterparties.* (1) No major U.S. intermediate holding company may have aggregate net credit exposure to any major counterparty that exceeds 15 percent of the tier 1 capital of the major U.S. intermediate holding company.

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

(3) For purposes of this subpart, a top-tier foreign banking organization will be a major counterparty if it meets one of the following conditions:

(i) The top-tier foreign banking organization determines, pursuant to 12 CFR 252.153(b)(6), that the top-tier foreign banking organization has the characteristics of a global systemically important banking organization under the global methodology; or

(ii) The Board, using information available to the Board, determines:

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

(B) That the top-tier foreign banking organization, if it were subject to the Board's Regulation Q, would be identified as a global systemically important BHC under 12 CFR 217.402 of the Board's Regulation Q; or

(C) That the U.S. intermediate holding company, if it were subject to 12 CFR 217.402 of the Board's Regulation Q, would be identified as a global systemically important BHC.

(4) Each top-tier foreign banking organization that controls a U.S. intermediate holding company must submit to the Board by January 1 of each calendar year through the U.S. intermediate holding company:

(A) Notice of whether the home country supervisor (or other appropriate home country regulatory authority) of the top-tier foreign banking organization of the U.S. intermediate holding company has adopted standards consistent with the global methodology; and

(B) Notice of whether the top-tier foreign banking organization prepares or reports the indicators used by the global methodology to identify a banking organization as a global systemically important banking organization and, if it does, whether the top-tier foreign banking organization has determined that it has the characteristics of a global systemically important banking organization under the global methodology pursuant to 12 CFR 252.153(b)(6).

(5) A top-tier foreign banking organization that controls a U.S. intermediate holding company and prepares or reports for any purpose the indicator amounts necessary to determine whether the top-tier foreign banking organization is a global systemically important banking organization under the global methodology must use the data to determine whether the top-tier foreign banking organization has the characteristics of a global systemically important banking organization under the global methodology.

(d) *Foreign banking organizations subject on a consolidated basis to a large exposures or single-counterparty credit limit regime by its home-country supervisor.* (1) Notwithstanding paragraphs (a) through (c) of this section, a foreign banking organization that is a covered foreign entity is not required to comply with the requirements of this subpart with respect to limits on the aggregate net credit exposure of its combined U.S. operations if the foreign banking organization certifies to the Board that it meets large exposure standards on a consolidated basis established by its home-country supervisor that are consistent with the large exposures framework published by the Basel Committee on Banking Supervision (Basel Large Exposures Framework), unless the Board determines in writing, after notice to the foreign banking organization, that compliance with this subpart is required.

(i) For purposes of this paragraph, home-country large exposure standards that are consistent with the Basel Large Exposures Framework include single-counterparty credit limits and any restrictions set forth in ''Supervisory framework for measuring and controlling large exposures'' (2014) (Basel LE Standard), as implemented in accordance with the Basel LE Standard.

(ii) [Reserved]

(2) A foreign banking organization that is a covered foreign entity must provide to the Board reports relating to its compliance with the large exposure standards described in paragraph (d)(1) of this section concurrently with filing the FR Y–7Q or any successor report.

§ 252.173 Gross credit exposure.

(a) *Calculation of gross credit exposure.* The amount of gross credit exposure of a covered foreign entity to a counterparty with respect to a credit transaction is, in the case of:

(1) A deposit of the covered foreign entity held by the counterparty, loan by a covered foreign entity to the counterparty, and lease in which the covered foreign entity is the lessor and the counterparty is the lessee, equal to the amount owed by the counterparty to the covered foreign entity under the transaction.

(2) A debt security or debt investment held by the covered foreign entity that is issued by the counterparty, equal to:

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

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

(3) An equity security held by the covered foreign entity that is issued by the counterparty, equity investment in a counterparty, and other direct investments in a counterparty, equal to the market value.

(4) A securities financing transaction must be valued using any of the methods that the covered foreign entity is authorized to use under the Board's Regulation Q (12 CFR part 217, subparts D and E) to value such transactions:

(i)(A) As calculated for each transaction, in the case of a securities financing transaction between the covered foreign entity and the counterparty that is not subject to a bilateral netting agreement or does not meet the definition of ''repo-style transaction'' in § 217.2 of the Board's Regulation Q (12 CFR 217.2); or

(B) As calculated for a netting set, in the case of a securities financing transaction between the covered foreign entity and the counterparty that is subject to a bilateral netting agreement with that counterparty and meets the definition of ''repo-style transaction'' in § 217.2 of the Board's Regulation Q (12 CFR 217.2);

(ii) For purposes of paragraph (a)(4)(i) of this section, the covered foreign entity must:

(A) Assign a value of zero to any security received from the counterparty that does not meet the definition of ''eligible collateral'' in § 252.171(*l*); and

(B) Include the value of securities that are eligible collateral received by the covered foreign entity from the counterparty (including any exempt counterparty), calculated in accordance with paragraphs (a)(4)(i) through (iv) of this section, when calculating its gross credit exposure to the issuer of those securities;

(iii) Notwithstanding paragraph (a)(4)(i) and (ii) of this section and with respect to each credit transaction, a covered foreign entity's gross credit exposure to a collateral issuer under this paragraph (a)(4) is limited to the covered foreign entity's gross credit exposure to the counterparty on the credit transaction;

(iv) In cases where the covered foreign entity receives eligible collateral from a counterparty in addition to the cash or securities received from that counterparty, the counterparty may reduce its gross credit exposure to that counterparty in accordance with § 252.174(b).

(5) A committed credit line extended by a covered foreign entity to a counterparty, equal to the face amount of the committed credit line.

(6) A guarantee or letter of credit issued by a covered foreign entity on behalf of a counterparty, equal to the maximum potential loss to the covered foreign entity on the transaction.

(7) A derivative transaction must be valued using any of the methods that the covered foreign entity is authorized to use under the Board's Regulation Q (12 CFR part 217, subparts D and E) to value such transactions:

(i)(A) As calculated for each transaction, in the case of a derivative transaction between the covered foreign entity and the counterparty, including an equity derivative but excluding a credit derivative described in paragraph (a)(8) of this section, that is not subject to a qualifying master netting agreement; or

(B) As calculated for a netting set, in the case of a derivative transaction between the covered foreign entity and the counterparty, including an equity derivative but excluding a credit derivative described in paragraph (a)(8) of this section, that is subject to a qualifying master netting agreement.

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

(8) A credit derivative between the covered foreign entity and a third party where the covered foreign entity is the protection provider and the reference asset is an obligation or debt security of the counterparty, equal to the maximum potential loss to the covered foreign entity on the transaction.

(b) *Investments in and exposures to securitization vehicles, investment funds, and other special purpose vehicles that are not affiliates.* Notwithstanding paragraph (a) of this section.

(1) Unless the Board applies the requirements of § 252.175 to the transaction pursuant to § 252.175(d), a U.S. intermediate holding company that is a covered foreign entity but has less than $250 billion in total consolidated assets must:

(A) Calculate pursuant to § 252.173(a) its gross credit exposure due to any investment in the debt or equity of, and any credit derivative or equity derivative between the covered foreign entity and a third party where the covered foreign entity is the protection provider and the reference asset is an obligation or equity security of, or equity investment in, a securitization vehicle, investment fund, and other special purpose vehicle that is not an affiliate of the covered foreign entity; and

(B) Attribute that gross credit exposure to the securitization vehicle, investment fund, or other special purpose vehicle for purposes of this subpart.

(2) A foreign banking organization that is a covered foreign entity or a U.S. intermediate holding company with total consolidated assets that equal or exceed $250 billion must calculate pursuant to § 252.175 its gross credit exposure due to any investment in the debt or equity of, and any credit derivative or equity derivative between the covered foreign entity and a third party where the covered foreign entity is the protection provider and the reference asset is an obligation or equity security of, or equity investment in, a securitization vehicle, investment fund, and other special purpose vehicle that is not an affiliate of the covered foreign entity.

(c) *Attribution rule.* Notwithstanding paragraph (a) of this section, a covered foreign entity must treat any transaction with any natural person or entity as a credit transaction with another party, to the extent that the proceeds of the transaction are used for the benefit of, or transferred to, the other party.

§ 252.174 Net credit exposure.

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

(b) *Eligible collateral.* (1) In computing its net credit exposure to a counterparty for any credit transaction other than a securities financing transaction, a covered foreign entity must reduce its gross credit exposure on the transaction by the adjusted market value of any eligible collateral.

(2) A covered foreign entity that reduces its gross credit exposure to a counterparty as required under paragraph (b)(1) of this section must include the adjusted market value of the eligible collateral when calculating its gross credit exposure to the collateral issuer.

(3) Notwithstanding paragraph (b)(2) of this section, a covered foreign entity's gross credit exposure to a collateral issuer under this paragraph (b) is limited to:

(i) Its gross credit exposure to the counterparty on the credit transaction, or

(ii) In the case of an exempt counterparty, the gross credit exposure that would have been attributable to that exempt counterparty on the credit transaction if valued in accordance with § 252.173(a).

(c) *Eligible guarantees.* (1) In calculating net credit exposure to a counterparty for any credit transaction, a covered foreign entity must reduce its gross credit exposure to the counterparty by the amount of any eligible guarantee from an eligible guarantor that covers the transaction.

(2) A covered foreign entity that reduces its gross credit exposure to a counterparty as required under

paragraph (c)(1) of this section must include the amount of eligible guarantees when calculating its gross credit exposure to the eligible guarantor.

(3) Notwithstanding paragraph (c)(2) of this section, a covered foreign entity's gross credit exposure to an eligible guarantor with respect to an eligible guarantee under this paragraph (c) is limited to:

(i) Its gross credit exposure to the counterparty on the credit transaction prior to recognition of the eligible guarantee, or

(ii) In the case of an exempt counterparty, the gross credit exposure that would have been attributable to that exempt counterparty on the credit transaction prior to recognition of the eligible guarantee if valued in accordance with § 252.173(a).

(d) *Eligible credit and equity derivatives.* (1) In calculating net credit exposure to a counterparty for a credit transaction under this section, a covered foreign entity must reduce its gross credit exposure to the counterparty by:

(i) In the case of any eligible credit derivative from an eligible guarantor, the notional amount of the eligible credit derivative; or

(ii) In the case of any eligible equity derivative from an eligible guarantor, the gross credit exposure amount to the counterparty (calculated in accordance with § 252.173(a)(7)).

(2)(i) A covered foreign entity that reduces its gross credit exposure to a counterparty as provided under paragraph (d)(1) of this section must include, when calculating its net credit exposure to the eligible guarantor, including in instances where the underlying credit transaction would not be subject to the credit limits of § 252.172 (for example, due to an exempt counterparty), either

(A) In the case of any eligible credit derivative from an eligible guarantor, the notional amount of the eligible credit derivative; or

(B) In the case of any eligible equity derivative from an eligible guarantor, the gross credit exposure amount to the counterparty (calculated in accordance with § 252.173(a)(7)).

(ii) Notwithstanding paragraph (d)(2)(i) of this section, in cases where the eligible credit derivative or eligible equity derivative is used to hedge covered positions that are subject to the Board's market risk rule (12 CFR part 217, subpart F) and the counterparty on the hedged transaction is not a financial entity, the amount of credit exposure that a entity must recognize to the eligible guarantor is the amount that would be calculated pursuant to § 252.173(a).

(3) Notwithstanding paragraph (d)(2) of this section, a covered foreign entity's gross credit exposure to an eligible guarantor with respect to an eligible credit derivative or an eligible equity derivative under this paragraph (d) is limited to:

(i) Its gross credit exposure to the counterparty on the credit transaction prior to recognition of the eligible credit derivative or the eligible equity derivative, or

(ii) In the case of an exempt counterparty, the gross credit exposure that would have been attributable to that exempt counterparty on the credit transaction prior to recognition of the eligible credit derivative or the eligible equity derivative if valued in accordance with § 252.173(a).

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

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

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

(f) *Unused portion of certain extensions of credit.* (1) In computing its net credit exposure to a counterparty for a committed credit line or revolving credit facility under this section, a covered foreign entity may reduce its gross credit exposure by the amount of the unused portion of the credit extension to the extent that the covered foreign entity does not have any legal obligation to advance additional funds under the extension of credit and the used portion of the credit extension has been fully secured by eligible collateral.

(2) To the extent that the used portion of a credit extension has been secured by eligible collateral, the covered foreign entity may reduce its gross credit exposure by the adjusted market value of any eligible collateral received from the counterparty, even if the used portion has not been fully secured by eligible collateral.

(3) To qualify for the reduction in net credit exposure under this paragraph, the credit contract must specify that any used portion of the credit extension must be fully secured by the adjusted market value of any eligible collateral.

(g) *Credit transactions involving exempt counterparties.* (1) A covered foreign entity's credit transactions with an exempt counterparty are not subject to the requirements of this subpart, including but not limited to § 252.172.

(2) Notwithstanding paragraph (g)(1) of this section, in cases where a covered foreign entity has a credit transaction with an exempt counterparty and the covered foreign entity has obtained eligible collateral from that exempt counterparty or an eligible guarantee or eligible credit or equity derivative from an eligible guarantor, the covered foreign entity must include (for purposes of this subpart) such exposure to the issuer of such eligible collateral or the eligible guarantor, as calculated in accordance with the rules set forth in this section, when calculating its gross credit exposure to that issuer of eligible collateral or eligible guarantor.

(h) *Currency mismatch adjustments.* For purposes of calculating its net credit exposure to a counterparty under this section, a covered foreign entity must apply, as applicable:

(1) When reducing its gross credit exposure to a counterparty resulting from any credit transaction due to any eligible collateral and calculating its gross credit exposure to an issuer of eligible collateral, pursuant to paragraph (b) of this section, the currency mismatch adjustment approach of § 217.37(c)(3)(ii) of the Board's Regulation Q (12 CFR 217.37(c)(3)(ii)); and

(2) When reducing its gross credit exposure to a counterparty resulting from any credit transaction due to any eligible guarantee, eligible equity derivative, or eligible credit derivative from an eligible guarantor and calculating its gross credit exposure to an eligible guarantor, pursuant to paragraphs (c) and (d) of this section, the currency mismatch adjustment approach of § 217.36(f) of the Board's Regulation Q (12 CFR 217.36(f)).

(i) *Maturity mismatch adjustments.* For purposes of calculating its net credit exposure to a counterparty under this section, a covered foreign entity must apply, as applicable, the maturity mismatch adjustment approach of § 217.36(d) of the Board's Regulation Q (12 CFR 217.36(d)):

(1) When reducing its gross credit exposure to a counterparty resulting from any credit transaction due to any eligible collateral or any eligible guarantees, eligible equity derivatives, or eligible credit derivatives from an eligible guarantor, pursuant to

paragraphs (b) through (d) of this section, and

(2) In calculating its gross credit exposure to an issuer of eligible collateral, pursuant to paragraph (b) of this section, or to an eligible guarantor, pursuant to paragraphs (c) and (d) of this section; provided that

(3) The eligible collateral, eligible guarantee, eligible equity derivative, or eligible credit derivative subject to paragraph (i)(1) of this section:

(1) Has a shorter maturity than the credit transaction;

(2) Has an original maturity equal to or greater than one year;

(3) Has a residual maturity of not less than three months; and

(4) The adjustment approach is otherwise applicable.

§ 252.175 Investments in and exposures to securitization vehicles, investment funds, and other special purpose vehicles that are not affiliates of the covered foreign entity.

(a) *In general.* (1) This section applies only to a foreign banking organization that is a covered foreign entity or a U.S. intermediate holding company with total consolidated assets that equal or exceed $250 billion, provided that:

(i) In order to avoid evasion of this subpart, the Board may determine, after notice to the covered foreign entity and opportunity for hearing, that a U.S. intermediate holding company with less than $250 billion in total consolidated assets must apply either the approach in paragraph (a) of this section or the look-through approach in paragraph (b) of this section, or must recognize exposures to a third party that has a contractual obligation to provide credit or liquidity support to a securitization vehicle, investment fund, or other special purpose vehicle that is not an affiliate of the covered foreign entity, as provided in paragraph (c) of this section; and

(ii) For purposes of paragraph (a)(1)(i) of this section, the Board, in its discretion and as applicable, may allow a covered foreign entity to measure its capital base using the covered foreign entity's capital stock and surplus rather than its tier 1 capital.

(2) For purposes of this section, the following definitions apply:

(i) *SPV* means a securitization vehicle, investment fund, or other special purpose vehicle that is not an affiliate of the covered foreign entity.

(ii) *SPV exposure* means an investment in the debt or equity of an SPV or a credit derivative or equity derivative between the covered foreign entity and a third party where the covered foreign entity is the protection provider and the reference asset is an obligation or equity security of, or equity investment in, an SPV.

(3)(i) A covered foreign entity must determine whether the amount of its gross credit exposure to an issuer of assets in an SPV, due to an SPV exposure, is equal to or greater than 0.25 percent of the covered foreign entity's tier 1 capital using one of the following two methods:

(A) The sum of all of the issuer's assets (with each asset valued in accordance with § 252.173(a)) in the SPV; or

(B) The application of the look-through approach described in paragraph (b) of this section.

(ii) With respect to the determination required under paragraph (a)(3)(i) of this section, a covered foreign entity must use the same method to calculate gross credit exposure to each issuer of assets in a particular SPV.

(iii) In making a determination under paragraph (a)(3)(i) of this section, the covered foreign entity must consider only the credit exposure to the issuer arising from the covered foreign entity's SPV exposure.

(iv) For purposes of this paragraph (a)(3), a covered foreign entity that is unable to identify each issuer of assets in an SPV must attribute to a single unknown counterparty the amount of its gross credit exposure to all unidentified issuers and calculate such gross credit exposure using one method in either paragraph (a)(3)(i)(A) or (B) of this section.

(4)(i) If a covered foreign entity determines pursuant to paragraph (a)(3) of this section that the amount of its gross credit exposure to an issuer of assets in an SPV is less than 0.25 percent of the covered foreign entity's tier 1 capital, the amount of the covered foreign entity's gross credit exposure to that issuer may be attributed to either that issuer of assets or the SPV:

(A) If attributed to the issuer of assets, the issuer of assets must be identified as a counterparty, and the gross credit exposure calculated under paragraph (a)(3)(i)(A) of this section to that issuer of assets must be aggregated with any other gross credit exposures (valued in accordance with § 252.173) to that same counterparty; and

(B) If attributed to the SPV, the covered foreign entity's gross credit exposure is equal to the covered foreign entity's SPV exposure, valued in accordance with § 252.173(a).

(ii) If a covered foreign entity determines pursuant to paragraph (a)(3) of this section that the amount of its gross credit exposure to an issuer of assets in an SPV is equal to or greater than 0.25 percent of the covered foreign entity's tier 1 capital or the covered foreign entity is unable to determine that the amount of the gross credit exposure is less than 0.25 percent of the covered foreign entity's tier 1 capital:

(A) The covered foreign entity must calculate the amount of its gross credit exposure to the issuer of assets in the SPV using the look-through approach in paragraph (b) of this section;

(B) The issuer of assets in the SPV must be identified as a counterparty, and the gross credit exposure calculated in accordance with paragraph (b) must be aggregated with any other gross credit exposures (valued in accordance with § 252.173) to that same counterparty; and

(C) When applying the look-through approach in paragraph (b) of this section, a covered foreign entity that is unable to identify each issuer of assets in an SPV must attribute to a single unknown counterparty the amount of its gross credit exposure, calculated in accordance with paragraph (b) of this section, to all unidentified issuers.

(iii) For purposes of this section, a covered foreign entity must aggregate all gross credit exposures to unknown counterparties for all SPVs as if the exposures related to a single unknown counterparty; this single unknown counterparty is subject to the limits of § 252.172 as if it were a single counterparty.

(b) *Look-through approach.* A covered foreign entity that is required to calculate the amount of its gross credit exposure with respect to an issuer of assets in accordance with this paragraph (b) must calculate the amount as follows:

(1) Where all investors in the SPV rank *pari passu,* the amount of the gross credit exposure to the issuer of assets is equal to the covered foreign entity's pro rata share of the SPV multiplied by the value of the underlying asset in the SPV, valued in accordance with § 252.173(a); and

(2) Where all investors in the SPV do not rank *pari passu,* the amount of the gross credit exposure to the issuer of assets is equal to:

(i) The pro rata share of the covered foreign entity's investment in the tranche of the SPV; multiplied by

(ii) The lesser of:

(A) The market value of the tranche in which the covered foreign entity has invested, except in the case of a debt security that is held to maturity, in which case the tranche must be valued at the amortized purchase price of the securities; and

(B) The value of each underlying asset attributed to the issuer in the SPV, each as calculated pursuant to § 252.173(a).

(c) *Exposures to third parties.* (1) Notwithstanding any other requirement in this section, a covered foreign entity must recognize, for purposes of this subpart, a gross credit exposure to each third party that has a contractual obligation to provide credit or liquidity support to an SPV whose failure or material financial distress would cause a loss in the value of the covered foreign entity's SPV exposure.

(2) The amount of any gross credit exposure that is required to be recognized to a third party under paragraph (c)(1) of this section is equal to the covered foreign entity's SPV exposure, up to the maximum contractual obligation of that third party to the SPV, valued in accordance with § 252.173(a). (This gross credit exposure is in addition to the covered foreign entity's gross credit exposure to the SPV or the issuers of assets of the SPV, calculated in accordance with paragraphs (a) and (b) of this section.)

(3) A covered foreign entity must aggregate the gross credit exposure to a third party recognized in accordance with paragraphs (c)(1) and (2) of this section with its other gross credit exposures to that third party (that are unrelated to the SPV) for purposes of compliance with the limits of § 252.172.

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

(a) *In general.* (1)(i) Paragraphs (a)(2) through (d) of this section apply only to a foreign banking organization that is a covered foreign entity or a U.S. intermediate holding company with total consolidated assets that equal or exceed $250 billion.

(ii) Paragraph (e) of this section applies to all covered foreign entities.

(2)(i) If a covered foreign entity has an aggregate net credit exposure to any counterparty that exceeds 5 percent of its tier 1 capital, the covered foreign entity must assess its relationship with the counterparty under paragraph (b)(2) of this section to determine whether the counterparty is economically interdependent with one or more other counterparties of the covered foreign entity and under paragraph (c)(1) of this section to determine whether the counterparty is connected by a control relationship with one or more other counterparties.

(ii) If, pursuant to an assessment required under paragraph (a)(2)(i) of this section, the covered foreign entity determines that one or more of the factors of paragraph (b)(2) or (c)(1) of this section are met with respect to one or more counterparties, or the Board determines pursuant to paragraph (d) of this section that one or more other counterparties of a covered foreign entity are economically interdependent or that one or more other counterparties of a covered foreign entity are connected by a control relationship, the covered foreign entity must aggregate its net credit exposure to the counterparties for all purposes under this subpart, including, but not limited to, § 252.172.

(iii) In connection with any request pursuant to paragraph (b)(3) or (c)(2) of this section, the Board may require the covered foreign entity to provide additional information.

(b) *Aggregation of exposures to more than one counterparty due to economic interdependence.* (1) For purposes of this paragraph, two counterparties are economically interdependent if the failure, default, insolvency, or material financial distress of one counterparty would cause the failure, default, insolvency, or material financial distress of the other counterparty, taking into account the factors in paragraph (b)(2) of this section.

(2) A covered foreign entity must assess whether the financial distress of one counterparty (counterparty A) would prevent the ability of the other counterparty (counterparty B) to fully and timely repay counterparty B's liabilities and whether the insolvency or default of counterparty A is likely to be associated with the insolvency or default of counterparty B and, therefore, these counterparties are economically interdependent, by evaluating the following:

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

(ii) Whether counterparty A has fully or partly guaranteed the credit exposure of counterparty B, or is liable by other means, in an amount that is 50 percent or more of the covered foreign entity's net credit exposure to counterparty A;

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

(iv) Whether the expected source of funds to repay the loans of both counterparties is the same and neither counterparty has another independent source of income from which the loans may be serviced and fully repaid; [1] and

(v) Whether two or more counterparties rely on the same source for the majority of their funding and, in the event of the common provider's default, an alternative provider cannot be found.

(3)(i) Notwithstanding paragraph (b)(2) of this section, if a covered foreign entity determines that one or more of the factors in paragraph (b)(2) is met, the covered foreign entity may request in writing a determination from the Board that those counterparties are not economically interdependent and that the covered foreign entity is not required to aggregate those counterparties.

(ii) Upon a request by a covered foreign entity pursuant to paragraph (b)(3) of this section, the Board may grant temporary relief to the covered foreign entity and not require the covered foreign entity to aggregate one counterparty with another counterparty provided that the counterparty could promptly modify its business relationships, such as by reducing its reliance on the other counterparty, to address any economic interdependence concerns, and provided that such relief is in the public interest and is consistent with the purpose of this subpart and 12 U.S.C. 5365(e).

(c) *Aggregation of exposures to more than one counterparty due to certain control relationships.* (1) For purposes of this subpart, one counterparty (counterparty A) is deemed to control the other counterparty (counterparty B) if:

(i) Counterparty A owns, controls, or holds with the power to vote 25 percent or more of any class of voting securities of counterparty B; or

(ii) Counterparty A controls in any manner the election of a majority of the directors, trustees, or general partners (or individuals exercising similar functions) of counterparty B.

(2)(i) Notwithstanding paragraph (c)(1) of this section, if a covered foreign entity determines that one or more of the factors in paragraph (c)(1) is met, the covered foreign entity may request in writing a determination from the Board that counterparty A does not control counterparty B and that the covered foreign entity is not required to aggregate those counterparties.

(ii) Upon a request by a covered foreign entity pursuant to paragraph (c)(2) of this section, the Board may grant temporary relief to the covered foreign entity and not require the covered foreign entity to aggregate counterparty A with counterparty B provided that, taking into account the specific facts and circumstances, such indicia of control does not result in the entities being connected by control relationships for purposes of this

[1] An employer will not be treated as a source of repayment under this paragraph because of wages and salaries paid to an employee.

subpart, and provided that such relief is in the public interest and is consistent with the purpose of this subpart and 12 U.S.C. 5365(e).

(d) *Board determinations for aggregation of counterparties due to economic interdependence or control relationships.* The Board may determine, after notice to the covered foreign entity and opportunity for hearing, that one or more counterparties of a covered foreign entity are:

(1) Economically interdependent for purposes of this subpart, considering the factors in paragraph (b)(2) of this section, as well as any other indicia of economic interdependence that the Board determines in its discretion to be relevant; or

(2) Connected by control relationships for purpose of this subpart, considering the factors in paragraph (c)(1) of this section and whether counterparty A:

(i) Controls the power to vote 25 percent or more of any class of voting securities of Counterparty B pursuant to a voting agreement;

(ii) Has significant influence on the appointment or dismissal of counterparty B'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 counterparty A's voting rights; or

(iii) Has the power to exercise a controlling influence over the management or policies of counterparty B.

(e) *Board determinations for aggregation of counterparties to prevent evasion.* Notwithstanding paragraphs (b) and (c) of this section, a covered foreign entity must aggregate its exposures to a counterparty with the covered foreign entity's exposures to another counterparty if the Board determines in writing after notice and opportunity for hearing, that the exposures to the two counterparties must be aggregated to prevent evasions of the purposes of this subpart, including, but not limited to § 252.176 and 12 U.S.C. 5365(e).

§ 252.177 Exemptions.

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

(1) Any direct claim on, and the portion of a claim that is directly and fully guaranteed as to principal and interest by, the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation, only while operating under the conservatorship or receivership of the Federal Housing Finance Agency, and any additional obligation issued by a U.S. government-sponsored entity as determined by the Board;

(2) Intraday credit exposure to a counterparty;

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

(4) Any credit transaction with the Bank for International Settlements, the International Monetary Fund, the International Bank for Reconstruction and Development, the International Finance Corporation, the International Development Association, the Multilateral Investment Guarantee Agency, or the International Centre for Settlement of Investment Disputes;

(5) Any credit transaction with the European Commission or the European Central Bank; and

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

(b) *Additional exemptions by the Board.* The Board may, by regulation or order, exempt transactions, in whole or in part, from the definition of the term ''credit exposure,'' if the Board finds that the exemption is in the public interest and is consistent with the purpose of 12 U.S.C. 5365(e).

§ 252.178 Compliance.

(a) *Scope of compliance.* (1) Using all available data, including any data required to be maintained or reported to the Federal Reserve under this subpart, a foreign banking organization that is a covered foreign entity or a U.S. intermediate holding company with total consolidated assets that equal or exceed $250 billion must comply with the requirements of this subpart on a daily basis at the end of each business day.

(2) Using all available data, including any data required to be maintained or reported to the Federal Reserve under this subpart, a U.S. intermediate holding company with less than $250 billion in total consolidated assets must comply with the requirements of this subpart on a quarterly basis, unless the Board determines and notifies the entity in writing that more frequent compliance is required.

(3) A covered foreign entity must report its compliance to the Federal Reserve as of the end of the quarter, unless the Board determines and notifies that entity in writing that more frequent reporting is required.

(4) In reporting its compliance, a covered foreign entity must calculate and include in its gross credit exposure to an issuer of eligible collateral or eligible guarantor the amounts of eligible collateral, eligible guarantees, eligible equity derivatives, and eligible credit derivatives that were provided to the covered foreign entity in connection with credit transactions with exempt counterparties, valued in accordance with and as required by § 252.174(b) through (d) and (g).

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

(c) *Noncompliance.* (1) Except as otherwise provided in this section, if a covered foreign entity is not in compliance with this subpart with respect to a counterparty solely due to the circumstances listed in paragraphs (c)(2)(i) through (v) of this section, the covered foreign entity will not be subject to enforcement actions for a period of 90 days (or, with prior notice to the foreign entity, such shorter or longer period determined by the Board, in its sole discretion, to be appropriate to preserve the safety and soundness of the covered foreign entity or U.S. financial stability), if the covered foreign entity uses reasonable efforts to return to compliance with this subpart during this period. The covered foreign entity may not engage in any additional credit transactions with such a counterparty in contravention of this rule during the period of noncompliance, except as provided in paragraph (c)(2) of this section.

(2) A covered foreign entity may request a special temporary credit exposure limit exemption from the Board. The Board may grant approval for such exemption in cases where the Board determines that such credit transactions are necessary or appropriate to preserve the safety and soundness of the covered foreign entity or U.S. financial stability. In acting on a request for an exemption, the Board will consider the following:

(i) A decrease in the covered foreign entity's capital stock and surplus;

(ii) The merger of the covered foreign entity with another covered foreign entity;

(iii) A merger of two counterparties; or

(iv) An unforeseen and abrupt change in the status of a counterparty as a result of which the covered foreign entity's credit exposure to the counterparty becomes limited by the requirements of this section; or

(v) Any other factor(s) the Board determines, in its discretion, is appropriate.

(d) *Other measures.* The Board may impose supervisory oversight and additional reporting measures that it determines are appropriate to monitor compliance with this subpart. Covered foreign entities must furnish, in the manner and form prescribed by the Board, such information to monitor compliance with this subpart and the limits therein as the Board may require.

By order of the Board of Governors of the Federal Reserve System, July 24, 2018.

Yao-Chin Chao,

Assistant Secretary of the Board.

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