

The Agencies invite the submission of empirical evidence regarding the (relative or absolute) asset correlations characterizing portfolios of ADC loans, as well as comments regarding the circumstances under which such loans would appropriately be categorized as HVCRE.

The Agencies also invite comment on the appropriateness of exempting from the high-asset-correlation category ADC loans with substantial equity or that are pre-sold or sufficiently pre-leased. The Agencies invite comment on what standard should be used in determining whether a property is sufficiently pre-leased when prevailing occupancy rates are unusually low.

The Agencies invite comment on whether high-asset-correlation treatment for one- to four-family residential construction loans is appropriate, or whether they should be included in the low-asset-correlation category. In cases where loans finance the construction of a subdivision or other group of houses, some of which are pre-sold while others are not, the Agencies invite comment regarding how the "pre-sold" exception should be interpreted.

The Agencies invite comment on the competitive impact of treating defined classes of CRE differently. What are commenters' views on an alternative approach where there is only one risk weight function for all CRE? If a single risk weight function for all CRE is considered, what would be the appropriate asset correlation to employ?

#### Lease Financings

Under the wholesale A-IRB framework, some lease financings require special consideration. A distinction is made for leases that expose the lessor to residual value risk, namely the risk of the fair value of the assets declining below the banking organization's estimate of residual risk at lease inception. If a banking organization has exposure to residual value risk, it would assign a 100 percent risk weight to the residual value amount and determine a risk-weighted asset equivalent for the lease's remaining net investment (net of residual value amount) using the same methodology as for any other wholesale exposure. The sum of these components would be the risk-weighted asset amount for a particular lease. Where a banking organization does not have exposure to residual value risk, the lease's net investment would be subject to a capital charge using the same methodology applied to any other wholesale exposure.

This approach would be used regardless of accounting classification as a direct finance, operating or leveraged lease. For leveraged leases, when the banking organization is the equity participant it would net the balance of the non-recourse debt against the discounted lease payment stream prior

to applying the risk weight. If the banking organization is the debt participant, the exposure would be treated as any other wholesale exposure.

The Agencies are seeking comment on the wholesale A-IRB capital formulas and the resulting capital requirements. Would this approach provide a meaningful and appropriate increase in risk sensitivity in the sense that the results are consistent with alternative assessments of the credit risks associated with such exposures or the capital needed to support them? If not, where are there material inconsistencies?

Does the proposed A-IRB maturity adjustment appropriately address the risk differences between loans with differing maturities?

#### Retail Exposures: Definitions and Inputs

The second major exposure category in the A-IRB framework is the retail exposure category. This category encompasses the vast majority of credit exposures to individual consumers. The Agencies also are considering whether certain SME exposures should be eligible for retail A-IRB treatment. The retail exposure category has three distinct sub-categories: (1) Residential mortgages (and related exposures); (2) qualifying revolving exposures (QREs); and (3) other retail exposures. There are separate A-IRB capital formulas for each of these three sub-categories to reflect different levels of associated risk.

The Agencies propose that the residential mortgage exposure sub-category be defined to include loans secured by first or subsequent liens on one-to four-family residential properties, including term loans and revolving lines of credit secured by home equity. There would be no upper limit on the size of the exposure that could be included in the residential mortgage exposure sub-category, but the borrower would have to be an individual and the banking organization should generally manage the exposure as part of a pool of similar exposures. Residential mortgage exposures that are individually internally rated and managed similarly to commercial exposures, rather than managed and internally rated as pools, would be treated under the wholesale A-IRB framework.

The second sub-category of retail exposures is qualifying revolving exposures (QREs). The Agencies propose to define QREs as exposures to individuals that are revolving, unsecured, uncommitted, less than \$100,000, and managed as part of a pool of similar exposures. In practice, QREs will include primarily exposures where customers' outstanding borrowings are permitted to fluctuate based on their

own decisions to borrow and repay, up to a limit established by the banking organization. Most credit card exposures to individuals and overdraft lines on individual checking accounts would be QREs.

The third sub-category of retail exposures, other retail exposures, includes two types of exposures. First, it encompasses all exposures to individuals for non-business purposes that are generally managed as part of a pool of similar exposures and that do not meet the conditions for inclusion in the first two sub-categories of retail exposures. The Agencies are not proposing to establish a fixed upper limit on the size of exposures to individuals that are eligible for the other retail treatment. In addition, the Agencies are proposing that the other retail sub-category include certain SME exposures that are managed on a pool basis similar to retail exposures. These exposures could be to a company or to an individual. The Agencies are considering an individual borrower exposure threshold of \$1 million for such exposures. For the purpose of assessing compliance with the individual borrower exposure threshold, the banking organization would aggregate all exposures to a particular borrower on a fully consolidated basis. Credit card accounts with balances between \$100,000 and \$1 million would be considered other retail exposures rather than QRE, even if the accounts are extended to or guaranteed by an individual and used exclusively for small business purposes.

The Agencies are interested in comment on whether the proposed \$1 million threshold provides the appropriate dividing line between those SME exposures that banking organizations should be allowed to treat on a pooled basis under the retail A-IRB framework and those SME exposures that should be rated individually and treated under the wholesale A-IRB framework.

One of the most significant differences between the wholesale and retail A-IRB categories is that the risk inputs for retail exposures do not have to be assigned at the level of an individual exposure. The Agencies recognize that banking organizations typically manage retail exposures on a portfolio or pool basis, where each portfolio or pool contains exposures with similar risk characteristics. Therefore, a key characteristic of the retail A-IRB framework is that the risk inputs for retail exposures would be assigned to portfolios or pools of exposures rather than to individual exposures.

It is important to highlight that within each of the three sub-categories of retail