

section 2, paragraph (a) to read as follows:

Appendix B to Part 3—Risk-Based Capital Guidelines; Market Risk Adjustment

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Section 2. Definitions

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(a) * * * Liquidity facilities provided to asset-backed commercial paper programs in a bank's trading account are excluded from covered positions, and instead, are subject to the risk-based capital requirements as provided in appendix A of this part.

Dated: September 4, 2003.

John D. Hawke,

Comptroller of the Currency.

FEDERAL RESERVE SYSTEM

12 CFR Chapter II

Authority and Issuance

For the reasons set forth in the joint preamble, the Board of Governors of the Federal Reserve System proposes to amend parts 208 and 225 of chapter II of title 12 of the Code of Federal Regulations as follows:

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

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

Authority: 12 U.S.C. 24, 36, 92a, 93a, 248(a), 248(c), 321–338a, 371d, 461, 481–486, 601, 611, 1814, 1816, 1818, 1820(d)(9), 1823(j), 1828(o), 1831, 1831o, 1831p–1, 1831r–1, 1831w, 1831x, 1835a, 1882, 2901–2907, 3105, 3310, 3331–3351, and 3906–3909; 15 U.S.C. 78b, 78l(b), 78l(g), 78l(i), 78o–4(c)(5), 78q, 78q–1, and 78w; 31 U.S.C. 5318; 42 U.S.C. 4012a, 4104a, 4104b, 4106, and 4128.

2. In Appendix A to part 208, the following amendments are proposed:

- a. Section II.A.1.c. is revised.
- b. In section III.B.3—
 - i. Paragraph a., *Definitions*, is revised.
 - ii. Paragraph g., *Limitations on risk-based capital requirements*, is redesignated as paragraph h.
 - iii. A new paragraph g., *Early amortization triggers*, is added.
 - iv. A new paragraph iv., is added to the redesignated paragraph h.
- c. Section III.B.6. is revised.
- d. In section III.D—
 - i. The last sentence of the introductory paragraph is removed.
 - ii. In paragraph 2., *Items with a 50 percent conversion factor*, the third undesignated paragraph is revised, the fourth undesignated paragraph is removed, and the five remaining undesignated paragraphs are designated as 2.a. through 2.c.

iii. In paragraph 3, *Items with a 20 percent conversion factor*, the first undesignated paragraph is designated as 3.a. and a new paragraph 3.b. is added.

iv. The first sentence in paragraph 4., *Items with a zero percent conversion factor*, is revised.

v. Footnote 54 is removed and reserved.

e. Attachments IV, V, and VI are removed.

Appendix A to Part 208—Capital Adequacy Guidelines for State Member Banks: Risk-Based Measure

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II. * * *

A. * * *

1. * * *

c. *Minority interest in equity accounts of consolidated subsidiaries.* This element is included in Tier 1 because, as a general rule, it represents equity that is freely available to absorb losses in operating subsidiaries whose assets are included in a bank's risk-weighted asset base. While not subject to an explicit sublimit within Tier 1, banks are expected to avoid using minority interest in the equity accounts of consolidated subsidiaries as an avenue for introducing into their capital structures elements that might not otherwise qualify as Tier 1 capital or that would, in effect, result in an excessive reliance on preferred stock within Tier 1. Minority interests in small business investment companies, investment funds that hold nonfinancial equity investments (as defined in section II.B.5.b. of this appendix A), and subsidiaries engaged in nonfinancial activities, are not included in the bank's Tier 1 or total capital base if the bank's interest in the company or fund is held under one of the legal authorities listed in section II.B.5.b. In addition, minority interests in consolidated asset-backed commercial paper programs (as defined in section III.B.6. of this appendix) that are sponsored by a bank are not to be included in the bank's Tier 1 or total capital base when the bank excludes the consolidated assets of such programs from risk-weighted assets pursuant to section III.B.6. of this appendix.

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III. * * *

B. * * *

a. *Definitions*—i. *Credit derivative* means a contract that allows one party (the "protection purchaser") to transfer the credit risk of an asset or off-balance sheet credit exposure to another party (the "protection provider"). The value of a credit derivative is dependent, at least in part, on the credit performance of the "reference asset."

ii. *Credit-enhancing representations and warranties* means representations and warranties that are made or assumed in connection with a transfer of assets (including loan servicing assets) and that obligate the bank to protect investors from losses arising from credit risk in the assets transferred or the loans serviced. Credit-enhancing representations and warranties include promises to protect a party from losses resulting from the default or nonperformance of another party or from an

insufficiency in the value of the collateral. Credit-enhancing representations and warranties do not include:

1. Early default clauses and similar warranties that permit the return of, or premium refund clauses covering, 1–4 family residential first mortgage loans that qualify for a 50 percent risk weight for a period not to exceed 120 days from the date of transfer. These warranties may cover only those loans that were originated within 1 year of the date of transfer;

2. Premium refund clauses that cover assets guaranteed, in whole or in part, by the U.S. Government, a U.S. Government agency or a government-sponsored enterprise, provided the premium refund clauses are for a period not to exceed 120 days from the date of transfer; or

3. Warranties that permit the return of assets in instances of misrepresentation, fraud or incomplete documentation.

iii. *Direct credit substitute* means an arrangement in which a bank assumes, in form or in substance, credit risk associated with an on- or off-balance sheet credit exposure that was not previously owned by the bank (third-party asset) and the risk assumed by the bank exceeds the pro rata share of the bank's interest in the third-party asset. If the bank has no claim on the third-party asset, then the bank's assumption of any credit risk with respect to the third party asset is a direct credit substitute. Direct credit substitutes include, but are not limited to:

1. Financial standby letters of credit that support financial claims on a third party that exceed a bank's pro rata share of losses in the financial claim;

2. Guarantees, surety arrangements, credit derivatives, and similar instruments backing financial claims that exceed a bank's pro rata share in the financial claim;

3. Purchased subordinated interests or securities that absorb more than their pro rata share of losses from the underlying assets;

4. Credit derivative contracts under which the bank assumes more than its pro rata share of credit risk on a third party exposure;

5. Loans or lines of credit that provide credit enhancement for the financial obligations of an account party;

6. Purchased loan servicing assets if the servicer is responsible for credit losses or if the servicer makes or assumes credit-enhancing representations and warranties with respect to the loans serviced. Mortgage servicer cash advances that meet the conditions of section III.B.3.a.viii. of this appendix are not direct credit substitutes; and

7. Clean-up calls on third party assets. Clean-up calls that are 10 percent or less of the original pool balance that are exercisable at the option of the bank are not direct credit substitutes.

8. Liquidity facilities extended to ABCP programs that are not eligible liquidity facilities (as defined in section III.B.3.a. of this appendix).

iv. *Early amortization triggers* mean contractual requirements that, if triggered, would cause a securitization to begin repaying investors prior to the originally scheduled payment dates.

v. *Eligible liquidity facility* means a facility subject to a reasonable asset quality test at