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Statement of

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Chairman Johnson, Ranking Member Shelby, and members of the Committee, thank you for the opportunity to testify on the proposed interagency changes to the regulatory capital framework for U.S. banking organizations. In today's testimony, I will provide an overview of the proposed changes and the main themes arising from the public comment process, especially as they relate to community banking organizations and depository institution holding companies with insurance activities.

Overview of Proposed Changes

The recent financial crisis revealed that the amount of high-quality capital held by banking organizations in the United States was insufficient to absorb losses during periods of severe stress. The effects of having insufficient levels of capital were further magnified by the fact that some capital instruments did not absorb losses to the extent previously expected. While robust bank capital requirements alone cannot ensure the safety and soundness of the banking system, we believe they play a key role in protecting the banking system and financial stability more broadly.

As demonstrated during the recent financial crisis, banking organizations with strong capital positions are better equipped to absorb losses from unexpected sources. Furthermore, strong capital positions help to ensure that bank losses are borne by shareholders, rather than taxpayers. The June 2012 interagency proposal to amend the bank regulatory capital framework applies the lessons of the crisis, in part, by increasing the quantity and quality of capital held by banks.¹ For all banking organizations, the proposal would introduce a new common equity tier 1 capital requirement, raise existing minimum tier 1 capital requirements, and implement a capital conservation buffer to increase bank resiliency during times of stress. The proposal also updates

¹ See press release and proposal, www.federalreserve.gov/newsevents/press/bcreg/20120612a.htm.

and harmonizes the existing capital rules with a standardized approach for the calculation of risk-weighted assets, incorporating a more risk-sensitive treatment for certain asset classes to address weaknesses identified in the capital framework in recent years.

For large, internationally active organizations, the proposal would introduce a supplementary leverage ratio, a countercyclical capital buffer, and would effectively raise the capital requirement by updating aspects of the advanced approaches risk-based capital rule. These amendments, along with other recent regulatory capital enhancements, will require the large, systemically important banking organizations to hold significantly higher levels of capital relative to other institutions. Under the proposal, savings and loan holding companies would, for the first time, be subject to consolidated capital requirements, as required by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). With this proposal, U.S. bank capital requirements would reflect international Basel III agreements reached by the Basel Committee on Banking Supervision as well as relevant domestic legislative provisions, including sections 171 and 939A of the Dodd-Frank Act.

In developing this proposal, the Federal Reserve sought to strike the right balance between safety and soundness concerns and the regulatory burden associated with implementation, including the impact on community banking. It is important to note that numerous items in this proposal, and in other recent regulatory reforms, are focused on larger institutions and would not be applicable to community banking organizations. These items include the countercyclical capital buffer, the supplementary leverage ratio, enhanced disclosure requirements, the advanced approaches risk-based capital framework, stress testing requirements, the systemically important financial institution capital surcharge, and market risk capital reforms.

Impact

The Federal Reserve has assessed the impact of the changes proposed by this rulemaking on banking organizations and the broader financial system through domestic analyses and through its participation in cost-benefit analyses performed by the Basel Committee on Banking Supervision. The Macroeconomic Assessment Group, a working group of the Basel Committee, found that among internationally active banks, the stronger capital standards proposed under Basel III would significantly lower the probability of banking crises and their associated economic losses, while having only a modest negative effect on gross domestic product and the cost of credit.² Furthermore, these modest negative effects can be mitigated by the phase in of the standards over time, which is why we have included extensive transition periods for several aspects of the proposal. The Federal Reserve believes that the benefits of the proposed changes, in terms of the reduction of risk to the U.S. financial system and to the broader economy, outweigh the compliance costs to the financial industry and any costs to the macroeconomy.

In developing the proposal, each of the federal banking agencies prepared an impact analysis of the proposed requirements on banking organizations that currently meet the minimum regulatory capital requirements, based on each agency's own key assumptions using regulatory reporting data. The Federal Reserve's analysis and assumptions are included as an attachment to today's testimony.³ The overall conclusion of these analyses was that the vast majority of banking organizations would not be required to raise additional capital because they already meet, on a fully phased-in basis, the proposed higher minimum requirements. In addition,

² See "Assessing the macroeconomic impact of the transition to stronger capital and liquidity requirements" (August 2010), www.bis.org/publ/othp10.pdf; and "An assessment of the long-term economic impact of stronger capital and liquidity requirements" (August 2010), <http://www.bis.org/publ/bcbs173.pdf>.

³ See Attachment A - FRB Impact, Methodology, and Assumptions.

approximately 90 percent of community banking organizations already have sufficient capital to meet or exceed the proposed buffer, thus avoiding restrictions on capital distributions and certain executive bonus payments. While many of the largest banking organizations do not already meet the proposed new minimums and the buffer on a fully phased-in basis, they are generally making steady progress toward meeting these standards before they are phased in. However, the Federal Reserve is mindful that other burdens exist for banks, such as systems changes and other compliance costs, which were outside the scope of our analysis.

Public Comments on the Proposed Changes

The federal banking agencies released the proposed rulemaking in early June with an extended comment period ending on October 22, giving interested parties more than four months to comment on the proposal rather than the typical two- or three-month comment period. The agencies have received thousands of comment letters from the public, including banking organizations of all sizes, trade groups, academics, public interest advocates, and private individuals.⁴ Agency staffs are reviewing these letters carefully and will continue to do so in the coming weeks. Comments include general views on the proposal, including concerns regarding overall complexity and burden, as well as suggestions for specific policy changes and technical modifications aimed at better conforming the proposal to market practices.

The most common specific areas of concern noted by the financial industry, regardless of institution size, relate to the proposed treatments of accumulated other comprehensive income, otherwise known as AOCI, and residential mortgage exposures. The proposed treatment of AOCI would require unrealized gains and losses on available-for-sale securities to flow through to regulatory capital as opposed to the current treatment, which neutralizes such effects.

⁴ See comment letters, www.federalreserve.gov/apps/foia/ViewComments.aspx?doc_id=R-1442&doc_ver=1.

Commenters have expressed concern that this treatment would introduce capital volatility, due not only to credit risk but also to interest rate risk, and affect the composition of firms' securities holdings. The proposed treatment of AOCI is part of the Basel III Accord and is meant to better reflect an institution's actual loss-absorption capacity; however, we are analyzing commenters' concerns and will be assessing potential ways forward in this area as we finalize the rule.

In light of observed high loss rates for residential mortgages during the crisis, the agencies proposed a modified treatment aimed at better differentiating the risks of these exposures, which are generally assigned preferential risk weights under our current approach. Commenters have expressed concern that the operational burden and compliance costs of the proposed methodology for risk weighting residential mortgage exposures and the higher risk weights for certain types of mortgage products will increase costs to consumers and reduce their access to mortgage credit. The Federal Reserve, along with the other federal banking agencies, will take these and all comments received into consideration as we finalize the rule.

Community Banks

The Federal Reserve believes capital requirements that improve the quantity and quality of regulatory capital would benefit the resiliency of all banking organizations regardless of size. However, as we consider comments from industry participants and other interested parties regarding the proposed regulatory capital requirements, the Federal Reserve, along with the other federal banking agencies, will remain sensitive to concerns expressed by community banking organizations. The Board recognizes the vital role that community banking organizations play in the U.S. financial system. Community bankers typically have deep roots in their communities, allowing them to gain insights on their local economies and to forge strong relationships with

customers. As a result, they can provide relationship-based lending to small businesses, families, and others in their local communities in a manner that larger institutions would find difficult to duplicate.

When the agencies were developing these proposals, we recognized the need to carefully assess their impact on community banking organizations. While we conducted internal analysis to estimate the impact of the proposal (as discussed earlier), the Federal Reserve also recognized the importance of soliciting feedback directly from community banking organizations to understand more specifically the potential effects on their business activities. To facilitate review of the proposal, the agencies provided summaries of the requirements that were most relevant for community banking organizations, provided a tool to help smaller organizations estimate their capital levels under the proposal, and extended the comment period so that interested parties would have more time to assess the proposals and submit their comments. The Federal Reserve also engaged in substantial industry outreach to hear the views of community bankers and encourage submission of comments. For example, we held a series of “Ask the Fed” sessions aimed primarily at banking organizations supervised by the Federal Reserve that provided an overview of the proposals and gave bankers an opportunity to ask us questions. Following these sessions, which were attended by more than 3,000 bankers, we published a summary of answers to frequently asked questions in a new Federal Reserve publication for community bankers.⁵ Throughout the comment process, Board members and staff also met with various industry associations to clarify and discuss aspects of the proposal.

⁵ See “Community Banking Connections: A Supervision and Regulation Publication” (Third Quarter, 2012), www.communitybankingconnections.org/articles/2012/Q3/CBCQ32012.pdf.

Through outreach efforts and as part of the comment process, community banking organizations have expressed concerns about particular elements of the proposed requirements, indicating that they do not adequately take into account the community banking business model and that some aspects would have potential disproportionate effects on their organizations. In particular, they have asserted that the proposed treatment of AOCI would have more of an impact on community banks because they have fewer available strategies to address the resultant capital volatility relative to larger institutions. In addition, they have expressed concern that the relatively higher risk weights assigned to certain mortgage products would penalize loan products that community banking organizations typically provide their customers. We will be mindful of these comments when considering potential refinements to the proposal and will work to appropriately balance the benefits of a revised capital framework against its costs. As we work toward finalizing the rule, we will seek to further tailor the requirements as appropriate for community banking organizations.

Insurance Holding Companies

The proposal would apply consolidated risk-based capital requirements that measure the credit and market risk of all assets owned by a depository institution holding company and its subsidiaries, including assets held by insurance companies. In addition, the proposal would capture the risk of insurance underwriting activities included in the consolidated holding company capital requirements by requiring deduction of the minimum regulatory capital requirement of the relevant state regulator for insurance companies in the consolidated group. Currently, capital requirements for insurance companies are imposed by state insurance laws on

a legal entity basis and there are no state-based, consolidated capital requirements that cover the subsidiaries and non-insurance affiliates of insurance companies.

The proposed capital requirements have been criticized by savings and loan holding companies that are not currently subject to consolidated capital requirements and that have significant insurance activities. Before mentioning some of the concerns raised by the industry, I would like to provide some background regarding the policy rationale for this proposal. The proposed application of consolidated capital requirements to savings and loan holding companies is consistent with the Board's long-standing practice of applying consolidated minimum capital requirements to bank holding companies, including those that control functionally regulated subsidiary insurance companies. Importantly, such an approach eliminates incentives to engage in capital arbitrage by booking individual exposures in the legal entity in which they receive the most favorable capital requirement.

The proposed requirements are also consistent with the Collins Amendment in section 171 of the Dodd-Frank Act, which requires that the agencies establish consolidated minimum risk-based and leverage requirements for depository institution holding companies (bank holding companies and savings and loan holding companies) that are no less than the generally applicable risk-based capital and leverage requirements that apply to insured depository institutions under the prompt corrective action framework. At the same time, the proposal included provisions assigning specific risk weights to assets typically held by insurance companies but not depository institutions, namely policy loans and non-guaranteed separate accounts. These provisions were designed to appropriately risk weight assets particular to the insurance industry while at the same time ensuring that the proposals complied with section 171

of the Dodd-Frank Act and fulfilled the policy goals for consistent consolidated capital requirements previously described.

Through the comment process, depository institution holding companies with insurance activities raised overarching concerns that the proposed regulatory capital requirements, which have primarily been developed for banking organizations, are not suitable for the insurance business model. In particular, they assert that the proposal does not appropriately recognize the longer-term nature of their liabilities and their practice of matching asset and liability maturities. They also assert that the proposal would disproportionately affect longer term assets held by many insurance companies, thus causing them to fundamentally alter their business strategy. These holding companies also have requested a longer transition period to implement consolidated capital requirements for the first time. Currently, those savings and loan holding companies that are also insurance companies report financial statements to state insurance regulators according to Statutory Accounting Principles and would have to begin reporting under the Generally Accepted Accounting Principles to comply with consolidated regulatory capital requirements, a change they assert would be unreasonably costly.

The Federal Reserve takes these comments seriously and will consider them carefully in determining how to appropriately apply regulatory capital requirements to depository institution holding companies with significant insurance activities.

Timeline

Given the breadth of the proposed changes, many industry participants have expressed general concern that they may be subject to a final regulatory capital rule on January 1, 2013, as contemplated in the proposals, and that this would not provide sufficient time to understand the

rule or to make the necessary systems changes. Therefore, the agencies clarified on Friday that they do not expect to finalize the proposal by January 2013.⁶ We are working as quickly as possible to evaluate comments and issue a final rule that would provide the industry with appropriate transition periods to come into compliance.

Thank you. I would be pleased to take your questions.

⁶ See "Agencies Provide Guidance on Regulatory Capital Rulemakings," www.federalreserve.gov/newsevents/press/bcreg/20121109a.htm.

Top-tier BHCs that meet tier 1 minimums under the current and proposed rule
Data as of March 31, 2012

Current rules (Basel I)		>= \$500m and < \$10b		>\$10 b		Total	
BHC total asset size	877	78	78	955	955		
Total # top-tier BHCs	859	77	77	936	936		
Number of BHCs that meet 4% tier 1 minimum today	98%	99%	99%	98%	98%		
Avg \$ amount of tier 1 in excess of minimum (\$000s)	\$111,428	\$10,479,898					
Avg multiple of tier 1 held / tier 1 required	3.8	3.6					
Proposed rule (Basel III)		>= \$500m and < \$10b		>\$10 b		Total	
BHC total asset size	877	78	78	955	955		
Total # top-tier BHCs	810	74	74	884	884		
Number of BHCs that meet 6% tier 1 minimum as proposed	92%	95%	95%	93%	93%		
Average \$ amount of tier 1 in excess of minimum (\$000s)	\$71,715	\$5,658,259					
Average multiple of tier 1 held / tier 1 required	2.1	1.9					

Top-tier BHCs that do not meet tier 1 minimums under the current and proposed rule
Data as of March 31, 2012

Current rules (Basel I)		>= \$500m and < \$10b		>\$10 b		Total	
BHC total asset size	877	78	78	955	955		
Total # top-tier BHCs	18	1	1	19	19		
Number of BHCs that do not meet 4% tier 1 minimum today	2%	1%	1%	2%	2%		
Average \$ amount of tier 1 shortfall of minimum (\$000s)	-\$34,766	-\$497,448					
Aggregate \$ amount of tier 1 shortfall of minimum (\$000s)	-\$625,791	-\$497,448					
Proposed rule (Basel III)		>= \$500m and < \$10b		>\$10 b		Total	
BHC total asset size	877	78	78	955	955		
Total # top-tier BHCs	67	4	4	71	71		
Number of BHCs that do not meet 6% tier 1 minimum as proposed	8%	5%	5%	7%	7%		
Average \$ amount of tier 1 shortfall of minimum (\$000s)	-\$32,716	-\$688,217					
Aggregate \$ amount of tier 1 shortfall of minimum (\$000s)	-\$2,191,942	-\$2,752,868					
Proposed rule (Basel III) excluding those who fail tier 1 min today		>= \$500m and < \$10b		>\$10 b		Total	
BHC total asset size	877	78	78	955	955		
Total # top-tier BHCs	49	3	3	52	52		
Number of BHCs that do not meet 6% tier 1 minimum as proposed	6%	4%	4%	5%	5%		
Average \$ amount of tier 1 shortfall of minimum (\$000s)	-\$17,124	-\$309,260					
Aggregate \$ amount of tier 1 shortfall of minimum (\$000s)	-\$839,087	-\$927,781					
Common equity tier 1 (CET1)		>= \$500m and < \$10b		>\$10 b		Total	
Number of BHCs that do not meet 4.5% CET1 minimum as proposed	54	1	1	55	55		
% of total	6%	1%	1%	6%	6%		
Average \$ amount of CET1 4.5% shortfall of minimum (\$000s)	-\$15,355	-\$21,888					
Aggregate \$ amount of CET1 4.5% shortfall of minimum (\$000s)	-\$829,181	-\$21,888					
Number of BHCs that do not meet 7% CET1 minimum as proposed	150	8	8	158	158		
% of total	17%	10%	10%	17%	17%		
Average \$ amount of CET1 7% shortfall of minimum (\$000s)	-\$23,483	-\$752,523					
Aggregate \$ amount of CET1 7% shortfall of minimum (\$000s)	-\$3,522,450	-\$6,020,186					

Banks that meet tier 1 minimums under the current and proposed rule
Data as of March 31, 2012

<u>Current rules (Basel I)</u>		< \$10b	>=\$10b	Total
Bank total asset size		7,269	107	7,376
Total # banks		7,213	107	7,320
Number of banks that meet 4% tier 1 minimum today		99%	100%	99%
% of total				
Avg \$ amount of tier 1 in excess of minimum (\$000s)		\$30,110	\$6,055,069	
Avg multiple of tier 1 held / tier 1 required		5.7	4.1	
<u>Proposed rule (Basel III)</u>		< \$10b	>=\$10b	Total
Bank total asset size		7,269	107	7,376
Total # banks		7,094	106	7,200
Number of banks that meet 6% tier 1 minimum as proposed		98%	99%	98%
% of total				
Average \$ amount of tier 1 in excess of minimum (\$000s)		\$24,184	\$4,153,418	
Average multiple of tier 1 held / tier 1 required		3.7	2.4	

Banks that do not meet tier 1 minimums under the current and proposed rule
Data as of March 31, 2012

<u>Current rules (Basel I)</u>		< \$10b	>=\$10b	Total
Bank total asset size		7,269	107	7,376
Total # banks		56	0	56
Number of banks that do not meet 4% tier 1 minimum today		1%	0%	1%
% of total				
Average \$ amount of tier 1 shortfall of minimum (\$000s)		-\$2,344	\$0	
Aggregate \$ amount of tier 1 shortfall of minimum (\$000s)		-\$131,254	\$0	
<u>Proposed rule (Basel III)</u>		< \$10b	>=\$10b	Total
Bank total asset size		7,269	107	7,376
Total # banks		175	1	176
Number of banks that do not meet 6% tier 1 minimum as proposed		2%	1%	2%
% of total				
Average \$ amount of tier 1 shortfall of minimum (\$000s)		-\$5,303	-\$106,263	
Aggregate \$ amount of tier 1 shortfall of minimum (\$000s)		-\$928,108	-\$106,263	

Proposed rule (Basel III) excluding those who fail tier 1 min today

<u>Bank total asset size</u>		< \$10b	>=\$10b	Total
Bank total asset size		7,269	107	7,376
Total # banks				
Number of banks that do not meet 6% tier 1 minimum as proposed				
% of total				
Average \$ amount of tier 1 shortfall of minimum (\$000s)				
Aggregate \$ amount of tier 1 shortfall of minimum (\$000s)				
<u>Tier 1</u>		< \$10b	>=\$10b	Total
Bank total asset size		7,269	107	7,376
Total # banks				
Number of banks that do not meet 6% tier 1 minimum as proposed				
% of total				
Average \$ amount of tier 1 shortfall of minimum (\$000s)		119	1	120
Aggregate \$ amount of tier 1 shortfall of minimum (\$000s)		-\$4,273	-\$106,263	-\$106,263
<u>Common equity tier 1 (CET1)</u>		< \$10b	>=\$10b	Total
Bank total asset size		7,269	107	7,376
Total # banks				
Number of banks that do not meet 4.5% CET1 minimum as proposed				
% of total				
Average \$ amount of CET1 4.5% shortfall of minimum (\$000s)		59	0	59
Aggregate \$ amount of CET1 4.5% shortfall of minimum (\$000s)		-\$6,694	\$0	-\$6,694
<u>Number of banks that do not meet 7% CET1 minimum as proposed</u>		< \$10b	>=\$10b	Total
Bank total asset size		7,269	107	7,376
Total # banks				
Number of banks that do not meet 7% CET1 minimum as proposed		187	2	189
% of total		3%	2%	3%
Average \$ amount of CET1 7% shortfall of minimum (\$000s)		-\$6,206	-\$196,296	-\$196,296
Aggregate \$ amount of CET1 7% shortfall of minimum (\$000s)		-\$1,160,524	-\$392,592	-\$1,160,524

Impact Analysis Methodology for Basel 3 NPRs

- Staff conducted an analysis to assess the impact of the proposed changes to the definition of capital (Basel III NPR) and to risk-weighted assets (Standardized Approach NPR) for banks and top-tier bank holding companies using available data, as of March 31, 2012, from the commercial bank Call Reports and the holding company FR Y-9C reports. Because required data was not always available, staff made certain assumptions (listed below) to calculate the Basel III requirements.

Definition of capital (numerator of risk-based capital ratios)

- With respect to the regulatory deductions from capital, staff made assumptions regarding the amount of:
 - outstanding DTAs subject to full deduction and the amount subject to the threshold deductions;
 - investments in the capital of unconsolidated financial institutions subject to the threshold deductions; &
 - common equity tier 1 and tier 1 minority interest based on outstanding Class A minority interest.

Standardized approach risk-weighted assets (denominator of risk-based capital ratios)

- To estimate Basel III risk-weighted assets, staff used line items from the Call Report and Y-9C to estimate changes in the risk-weighted asset amount for residential mortgage exposures, high-volatility commercial real estate (HVCRE) exposures, past-due loans, and securitizations.
- The risk weight for HVCRE exposures (defined as construction, land development, and other land loans for this analysis; available on the regulatory reports) was increased from a risk-weight of 100% to 150%.
- Residential Mortgage Exposures
 - First-lien residential mortgage exposures as reported on the regulatory reports (currently risk weighted at 50%) were assumed to be category 1 exposures, while junior lien exposures, including home equity lines of credit, (currently risk-weighted at 100%) were assumed to be category 2 exposures.
 - To distribute residential mortgages across the proposed risk weights, which are based on LTV, an LTV distribution for firms' first and second lien mortgage portfolios was estimated using loan LTV data from industry databases (McDash and Corelogic) and then spread across the Category 1 risk weights (35% to 100%) and Category 2 risk weights (100% to 200%), as appropriate.
- Past-due loans (loans past due 90 days or more and nonaccrual loans, excluding residential mortgages and sovereign exposures), which currently are risk-weighted at 100%, were assigned to the 150% risk weight.
- For foreign sovereign exposures, used the public cross-border claims and the foreign-office claims on local residents in non-local currency from the FFIEC 009 report to find a distribution of foreign sovereign exposures by country, which was assumed to be representative across all institutions. Assigned risk weights by country: under Basel I, OECD countries received a zero percent risk weight, while all other countries received a 100% risk weight; under Basel III, assigned countries risk weights according to their CRC ratings. Applied country distribution, with associated risk weight, to foreign debt securities line items from the regulatory report.
- Securitization exposures
 - An interagency analysis was conducted using the simplified supervisory formula approach to calculate risk weights on tranches within 60 securitization transactions downloaded from an industry database (Intex) 15 deals each were selected for credit cards, autos, residential mortgages, and commercial mortgages.
 - To calculate average risk weights under Basel I, each tranche of the selected transactions was assigned a risk weight according to the general risk-based capital rules with certain assumptions. As a result, certain exposures were assigned risk weights according to the ratings-based approach, most mezzanine and junior positions were assumed to receive a 1,250% under the gross-up approach, and low-rated senior positions were assigned a 100% risk weight. To calculate average risk weights under Basel III, the SSFA was applied to each tranche of the selected transactions.
 - The current balance of each transaction was used to calculate a weighted average risk weight across each transaction type. These risk weights were then applied to each bank's value of summed items from the regulatory report for RMBS, CMBS, auto, and credit card.

I. Steps for estimating the numerator changes for the capital ratios under the Basel 3 proposal

Staff from an inter-agency work group used both qualitative measures (such as discussions with banks), as well as quantitative measures (such as QIS data) to create the assumptions used to estimate capital as proposed in the Basel 3 NPRs.

The assumptions include:

- 40% of a bank's deferred tax assets (DTAs) are used as a proxy for "carry-forward DTAs," which would be subject to full deduction
- 60% of DTAs are used as a proxy for "temporary differences DTAs," which would be subject to strict limits
- 80% of qualifying non-controlling (minority) interests in consolidated subsidiaries is used as a proxy for qualifying "common equity tier 1 minority interest"
- 20% of qualifying non-controlling (minority) interests in consolidated subsidiaries is used as a proxy for qualifying "tier 1 minority interest"
- 40% of investments in unconsolidated subsidiaries and associated companies is used as a proxy for "significant investments in unconsolidated financial institutions in the form of common stock"
- Regarding tier 1 deductions resulting from the corresponding deduction approach, trust preferred securities issued by financial institutions are used as a proxy for investments in the capital of unconsolidated financial institutions

1. Basel 3 Common equity tier 1 (CET1) calculation

The following items from the regulatory reports were used in the Basel 3 CET1 numerator calculations:

Item	Banks (Call Report)	BHCs (Y-9C)
Common stock	RCFD3230	BHCK3230
Surplus	RCFD3839	BHCK3240
Retained Earnings	RCFD3632	BHCK3247
AOCI	RCFDb530	BHCKb530
Other equity capital components	RCFDa130	BHCKa130
Qualifying non-controlling (minority) interests in consolidated subsidiaries	RCFDb589	BHCKG214
Goodwill	RCFDb590	BHCKb590
Cumulative change in fair value of all financial liabilities accounted for under a fair value option that is included in retained earnings and is attributable to changes in the bank's own creditworthiness	RCFDf264	BHCKf264
Purchased credit card relationships and nonmortgage servicing assets	RCFDb026	BHCKb026
Net deferred tax assets	RCFD2148	BHCK2148
Investments in unconsolidated subsidiaries and associated companies	RCFD2130	BHCK2130
Mortgage servicing assets	RCFDa590	BHCK6438

The Basel 3 CET1 base

The Basel 3 CET1 base used for the 10 and 15% threshold limitations described below is calculated by adding common stock, surplus, retained earnings, AOCI, other equity capital components, and 80% of qualifying non-controlling (minority) interests in consolidated subsidiaries (CET1 minority interest). Subtracted from that value is goodwill, the cumulative change in fair value of financial liabilities, the purchased credit card relationships and nonmortgage servicing assets, and the 40% of DTAs (“carry-forward DTAs”).

The 10 and 15% threshold limitations on MSAs, DTAs, and significant investments in unconsolidated subsidiaries in the form of common stock

The 10% potential deduction for MSAs, “temporary differences DTAs” and significant investments in unconsolidated financial institutions in the form of common stock is calculated using the CET1 base described above.

The 15% limitation for MSAs, “temporary differences DTAs” and significant investments in unconsolidated financial institutions in the form of common stock is equal to 17.65% of the Basel 3 CET1 base, less the sum of the 10% deductions described above.

Basel 3 CET1 capital calculation

Basel 3 CET1 is equal to the Basel 3 CET1 base, less deductions resulting from the 10% limitations, less deductions resulting from the 15% limitation described above.

2. Basel 3 Tier 1 capital calculation

The following items from the regulatory reports were used in the Basel 3 tier 1 numerator calculations:

Item	Banks (Call Report)	BHCs (Y-9C)
Perpetual preferred stock and related surplus	RCFD3838	BHCK3283
Non-qualifying perpetual preferred stock	RCFDb588	BHCKb588
Qualifying non-controlling (minority) interests in consolidated subsidiaries	RCFDb589	BHCKG214
Trust preferred securities issued by financial institutions (HTM fair value from HC-B)	RCFDg349	BHCKg349
Trust preferred securities issued by financial institutions (AFS fair value from HC-B)	RCFDg351	BHCKg351
Trust preferred securities issued by financial institutions (consolidated from HC-D)	RCFDg299	BHCKg299

Basel 3 tier 1 capital calculation

Basel 3 tier 1 capital is estimated to be equal to the Basel 3 CET1 base plus perpetual preferred stock and related surplus, plus tier 1 minority interest, less non-qualifying perpetual preferred stock and less any amount of investments in the capital of unconsolidated financial institutions above the 10% threshold limitation.

2. Basel 3 Tier 2 and total capital calculation

The following items from the regulatory reports were used in the Basel 3 tier 2 and total capital numerator calculations:

Item	Banks (Call Report)	BHCs (Y-9C)
Qualifying subordinated debt and redeemable preferred stock	RCFD5306	BHCKg217
Cumulative perpetual preferred stock includible in Tier 2 capital	RCFDb593	BHCKg218
Allowance for loan and lease losses includible in Tier 2 capital	RCFD5310	BHCK5310
Qualifying restricted core elements (other than cumulative perpetual preferred stock)		BHCKg215
Unrealized gains on AFS equity securities includable in Tier 2 capital	RCFD2221	BHCK2221
Other Tier 2 capital components	RCFDb594	BHCKb594

Basel 3 tier 2 capital calculation

Basel 3 tier 2 is calculated by adding qualifying subordinated debt and redeemable preferred stock, cumulative perpetual preferred stock includible in tier 2 capital, allowance for loan and lease losses includible in tier 2 capital, unrealized gains on available-for-sale securities includable in tier 2 capital, other tier 2 capital components, and qualifying restricted core elements (other than cumulative perpetual preferred stock), which is the value of the trust-preferred securities that were removed from tier 1 capital.

Basel 3 total capital calculation

Basel 3 total capital is calculated by adding tier 1 and tier 2 capital as described above.

II. Steps for estimating the denominator changes for the capital ratios under the Basel 3 proposal (standardized approach)

To determine the impact of the changes to risk-weighted assets under the standardized approach, staff used existing risk-weighted assets (less numerator deductions), and then added the Basel III “impact” for the following categories: foreign sovereign exposures, foreign DI exposures, high volatility commercial real estate (HVCRE), past-due loans, residential mortgage exposures, and securitization exposures.

1. “Base” risk-weighted assets and risk-weighted asset impact by category

The “base” (reported) risk-weighted asset value for each bank was first adjusted to reflect any of the capital deductions described in part I (numerator changes). Staff then estimated a change in risk-weighted assets for each category (foreign sovereign exposures, foreign DI exposures, HVCRE, past-due loans, residential mortgage exposures, and securitization exposures) by pulling line items for each category, and comparing the risk-weighted exposure amount under Basel I versus under Basel III.

A. Foreign Sovereign Exposures.

1) Sum line items RCFD 1742, RCFD 1744, and RCFD 2081 for each bank, finding one value, “sovereign amount” per bank.

2) Sum the exposure amounts from 009 Report line items FCEX C916 and C919 for each country. Find the % by country by dividing total for country over total exposures for all countries for FCEX C916 and C919. Will have one % for each country. This “distribution” will be used for all banks and bank holding companies.

For this analysis:

- Removed countries where there were no exposure values
- Removed lines that were regions or sums of countries (ie only included individual country data)

3) Find appropriate risk weight under Basel I and Basel III per country as outlined below:

Basel I (baseline)

4) Exposures to OECD member countries receive a zero percent risk weight, while exposures to all other countries receive a risk weight of 100 percent. Multiply applicable risk weight (zero or 100) by exposure amount per country. Sum the amounts per country, per bank to find risk-weighted exposure amount by asset size group.

Basel III

CRC Ratings	Risk Weight
0-1	0%
2	20%
3	50%
4-6	100%
7	150%
No CRC	100%

4) Use CRC table to find appropriate risk weight per country. Multiply risk weight by the distribution percentage found in step 2; then multiply by exposure amount per bank.

B. Foreign DI Exposures.

1) Pull line RCFD B532 for each bank as “foreign DI amount.”

2) Sum the exposure amounts from 009 Report line items FCEX C915 and C918 for each country. Find the % by country by dividing total for country over total exposures for all countries for FCEX C915 and C918. Will have one % for each country. This “distribution” will be used for all banks and bank holding companies.

3) Find appropriate risk weight under Basel I and Basel III per country as outlined below:

Basel I (baseline)

4) Foreign DI exposures to OECD member countries receive a 20 percent risk weight, while exposures to all other countries receive a risk weight of 100 percent. Multiply applicable risk weight (20 or 100) by exposure amount per country.

Basel III

4) Use CRC table below to find appropriate risk weight per country. Multiply risk weight by the distribution percentage found in step 2; then multiply by exposure amount per bank.

CRC of Sovereign Incorporation	Risk Weight (%)
0-1	20
2	50
3	100
4-7	150
No CRC	100

C. High Volatility Commercial Real Estate (HVCRE)

Steps for analysis:

1) Pull line item RCONf159 by bank as “HVCRE.”

Basel I

2) HVCRE under Basel I is 100% risk-weighted.

Basel III

2) HVCRE under Basel III is 150% risk-weighted.

D. Past-due loans

Steps for analysis:

1) Sum line items: rcfdf171 rcfdf170 rcfdf5461 rcfdf5460 rcfdf1256 rcfdf1255 rcfdf1253 rcfdf1252 rconc229 rconc237 rconc230 rconc239 rcfdf167 rcfdf1597 rcfdf5391 rcfdf5390 rcfdf5382 rcfdf5381 rcfdf5379 rcfdf5378 rcon3495 rcon3494 rconf183 rconf181 rconf180 rconf182 rcfdb574 rcfdb573 rcon5400 rcon5399 rcon3501 rcon3500 rcfdf1583 rcfdk215 rcfdk214 rcfdk217 rcfdk218 rcfdb577 rcfdb576 rcfdf3506 rcfdf3507 rconf177 rconf175 rcfdf168 rconf176 rconf174) as “Past Due Loans” per bank.

Basel I

2) Past Due loans under Basel I are 100% risk-weighted.

Basel III

2) Past Due loans under Basel III are 150% risk-weighted.

E. Residential Mortgage Exposures.

Steps for analysis:

1) Pull line item RCON 5367 (first liens) per bank as “RCON 5367.” Sum line items RCON 1797 and RCON 5368 (junior and revolving liens) for each bank as “RCON 1797+RCON 5368.”

Basel I

2) Multiply “RCON 5367” by 50% (RW); multiply “RCON 1797 +RCON 5368” by 100% (RW). Sum these values by bank to find the risk-weighted exposure amount for residential mortgages.

Basel III

2) Distribute “RCON 5367” according to table and multiply that amount by appropriate risk weight, per the table. Sum the values by bank. Note for this analysis, used the original LTV category (per ALH). Distributions for Category 1 and Category 2 loans are based on analysis from Paul Calem (document titled “ltv distributions.txt”).

Original LTV Category	80% of First liens are Category 1	Category 1 risk weight	20% of First liens are Category 2	Category 2 risk weight
<= 60	32.73	35%	4.02	100%
> 60 and <= 80	60.81	50%	18.04	100%
> 80 and <= 90	2.89	75%	26.44	100%
>90	3.58	100%	51.5	200%

3) Distribute “RCON 1797 +RCON 5368” according to table and multiply that amount by appropriate risk weight, per the table.

LTV Category	Percent of principal balance by category	Category 2 residential mortgage exposure risk weights
<= 60	22%	100%
> 60 and <= 80	40%	100%
> 80 and <= 90	24%	150%
> 90	14%	200%
Total	100%	

F. Securitization Exposures.

Approach: The New York RB and the Philadelphia RB provided a file of anonymized securitization data from large banking organizations across five product types (CLOs, non-agency RMBS, Credit Card, Auto, and CMBS) with the necessary data points including an external rating, attachment point and detachment points, and cumulative loss data. For each of these product types, risk weights were

calculated for 25 securities under the Baseline and the SSFA. The average risk weights under the Baseline and the SSFA for these securities were used as a proxy to estimate the impact.

1. For each product type, provide the weighted average for the Baseline RW and the SSFA risk weight.

Type	Baseline Ave RW (Basel I treatment)	SSFA Ave RW (Basel III treatment)
Credit Cards	109%	170.4%
Autos	52%	67%
CMBS	164%	239.5%
RMBS*	365%	445%

*to find Basel I risk weight for RMBS, using interagency-supplied securitization data:

- 1) Used "current" cycle date data only
- 2) anything with a detachment point of 100 (senior) got 100% risk weight, all else got 1250% as "B1 risk weight"
- 3) used current bal to find a weight per transaction
- 4) multiplied weight by B1 risk weight; summed risk weights to find one weighted average risk weight

2. Baseline reporting line items:

Type	Baseline Call Report Line Items	Baseline BHC Line Items
Credit Cards	RCFD B838, RCFD B841	BHCK B838, BHCK B841
Autos	RCFD B846, RCFD B849	BHCK B846, BHCK B849
CMBS	RCFD K146 RCFD K149, RCFD K154, RCFD K157	BHCK K146, BHCK K149, BHCK K154, BHCK K157
RMBS	RCFD G308, RCFD G311, RCFD G320, RCFD G323	BHCK G308, BHCK G311, BHCK G320, BHCK G323,

3. For each product type, aggregate and average the Call Report line items and apply the Baseline (Basel I) risk weights and SSFA risk weights (Basel 3).

3. Calculate impact and Basel III risk-weighted assets

For each category (foreign sovereign exposures, foreign DI exposures, HVCRE, past-due loans, residential mortgage exposures, and securitization exposures), multiplied the line items from the regulatory reports first by the risk weight for Basel I, which represented the risk-weighted assets under Basel I for that category. This step was replicated for Basel III by multiplying the line items from the regulatory reports by the risk weight for Basel III, which represented the risk-weighted assets under Basel III for that category.

The "impact" of Basel III was the Basel III amount per category less the Basel I amount per category, per bank, which represented the increase in risk-weighted assets for that category. The impact amount from each category was added to the "base risk-weighted assets" calculated in step 1 per bank. The sum of the

base risk-weighted assets plus the impacts of each category represented the Basel III risk-weighted asset amount.

4. Additional Notes:

- This analysis was replicated for banks and bank holding companies.
- For the bank holding company analysis, used only top-tier BHCs with more than \$500 million in total assets.
- Instances where tier 1, as reported in the Call Report or Y-9C was negative was left in the analysis, assuming that the reported figures were accurate.