
12 CFR Ch. II (1–1–14 Edition)

(a) Eligibility and operational criteria for double default treatment. A Board-regulated institution may recognize the credit risk mitigation benefits of a guarantee or credit derivative covering an exposure described in § 217.134(a)(1) by applying the double default treatment in this section if all the following criteria are satisfied:

(1) The hedged exposure is fully covered or covered on a pro rata basis by:
   (i) An eligible guarantee issued by an eligible double default guarantor; or
   (ii) An eligible credit derivative that meets the requirements of § 217.134(b)(2) and that is issued by an eligible double default guarantor.

(2) The guarantee or credit derivative is:
   (i) An uncollateralized guarantee or uncollateralized credit derivative (for example, a credit default swap) that provides protection with respect to a single reference obligor; or
   (ii) An nth-to-default credit derivative (subject to the requirements of § 217.142(m).

(3) The hedged exposure is a wholesale exposure (other than a sovereign exposure).

(4) The obligor of the hedged exposure is not:
   (i) An eligible double default guarantor or an affiliate of an eligible double default guarantor; or
   (ii) An affiliate of the guarantor.

(5) The Board-regulated institution does not recognize any credit risk mitigation benefits of the guarantee or credit derivative for the hedged exposure other than through application of the double default treatment as provided in this section.
Federal Reserve System § 217.135

(6) The Board-regulated institution has implemented a process (which has received the prior, written approval of the Board) to detect excessive correlation between the creditworthiness of the obligor of the hedged exposure and the protection provider. If excessive correlation is present, the Board-regulated institution may not use the double default treatment for the hedged exposure.

(b) Full coverage. If a transaction meets the criteria in paragraph (a) of this section and the protection amount (P) of the guarantee or credit derivative is at least equal to the EAD of the hedged exposure, the Board-regulated institution may determine its risk-weighted asset amount for the hedged exposure under paragraph (e) of this section.

(c) Partial coverage. If a transaction meets the criteria in paragraph (a) of this section and the protection amount (P) of the guarantee or credit derivative is less than the EAD of the hedged exposure, the Board-regulated institution must treat the hedged exposure as two separate exposures (protected and unprotected) in order to recognize double default treatment on the protected portion of the exposure:

(1) For the protected exposure, the Board-regulated institution must set EAD equal to P and calculate its risk-weighted asset amount as provided in paragraph (e) of this section; and

(2) For the unprotected exposure, the Board-regulated institution must set EAD equal to the EAD of the original exposure minus P and then calculate its risk-weighted asset amount as provided in § 217.131.

(d) Mismatches. For any hedged exposure to which a Board-regulated institution applies double default treatment under this part, the Board-regulated institution must make applicable adjustments to the protection amount as required in § 217.134(d), (e), and (f).

(e) The double default dollar risk-based capital requirement. The dollar risk-based capital requirement for a hedged exposure to which a Board-regulated institution has applied double default treatment is $K_{DD}$ multiplied by the EAD of the exposure. $K_{DD}$ is calculated according to the following formula:

$$K_{DD} = K_o \times (0.15 + 160 \times PD_x),$$

Where:

(1) PD$_x$ = PD of the protection provider.

(2) PD$_o$ = PD of the obligor of the hedged exposure.

(4) LGD$_x$ =

(i) The lower of the LGD of the hedged exposure (not adjusted to reflect the guarantee or credit derivative) and the LGD of the guarantee or credit derivative, if the guarantee or credit derivative provides the Board-regulated institution with the option to receive immediate payout on triggering the protection; or

(ii) The LGD of the guarantee or credit derivative, if the guarantee or credit derivative does not provide the Board-regulated institution with the option to receive immediate payout on triggering the protection; and

(5) $\rho_{oa}$ (asset value correlation of the obligor) is calculated according to the appropriate formula for (R) provided in Table 1 in § 217.131, with PD equal to PD$_o$.

(6) b (maturity adjustment coefficient) is calculated according to the formula for b provided in Table 1 in § 217.131, with PD equal to the lesser of PD$_o$ and PD$_x$; and

(7) M (maturity) is the effective maturity of the guarantee or credit derivative, which may not be less than one year or greater than five years.