must treat the exposure as an equity derivative with an adjusted carrying value determined as the sum of §217.151(b)(1) and (2).

(b) Adjusted carrying value. For purposes of this subpart, the adjusted carrying value of an equity exposure is:

(1) For the on-balance sheet component of an equity exposure, the Board-regulated institution’s carrying value of the exposure;

(2) For the off-balance sheet component of an equity exposure, the effective notional principal amount of the exposure, the size of which is equivalent to a hypothetical on-balance sheet position in the underlying equity instrument that would evidence the same change in fair value (measured in dollars) for a given small change in the price of the underlying equity instrument, minus the adjusted carrying value of the on-balance sheet component of the exposure as calculated in paragraph (b)(1) of this section.

(3) For unfunded equity commitments that are unconditional, the effective notional principal amount is the notional amount of the commitment. For unfunded equity commitments that are conditional, the effective notional principal amount is the Board-regulated institution’s best estimate of the amount that would be funded under economic downturn conditions.

§ 217.152 Simple risk weight approach (SRWA).

(a) General. Under the SRWA, a Board-regulated institution’s aggregate risk-weighted asset amount for its equity exposures is equal to the sum of the risk-weighted asset amounts for each of the Board-regulated institution’s individual equity exposures (other than equity exposures to an investment fund) as determined in this section and the risk-weighted asset amounts for each of the Board-regulated institution’s individual equity exposures to an investment fund as determined in §217.154.

(b) SRWA computation for individual equity exposures. A Board-regulated institution must determine the risk-weighted asset amount for an individual equity exposure (other than an equity exposure to an investment fund) by multiplying the adjusted carrying value of the equity exposure or the effective portion and ineffective portion of a hedge pair (as defined in paragraph (c) of this section) by the lowest applicable risk weight in this section.

(1) Zero percent risk weight equity exposures. An equity exposure to an entity whose credit exposures are exempt from the 0.03 percent PD floor in §217.131(d)(2) is assigned a zero percent risk weight.

(2) 20 percent risk weight equity exposures. An equity exposure to a Federal Home Loan Bank or the Federal Agricultural Mortgage Corporation (Farmer Mac) is assigned a 20 percent risk weight.

(3) 100 percent risk weight equity exposures. The following equity exposures are assigned a 100 percent risk weight:

(i) Community development equity exposures. (A) For state member banks and bank holding companies, an equity exposure that qualifies as a community development investment under 12 U.S.C. 24 (Eleventh), excluding equity exposures to an unconsolidated small business investment company and equity exposures held through a consolidated small business investment company described in section 302 of the Small Business Investment Act of 1958 (15 U.S.C. 682).

(B) For savings and loan holding companies, an equity exposure that is designed primarily to promote community welfare, including the welfare of low- and moderate-income communities or families, such as by providing services or employment, and excluding equity exposures to an unconsolidated small business investment company and equity exposures held through a small business investment company described in section 302 of the Small Business Investment Act of 1958 (15 U.S.C. 682).

(B) For savings and loan holding companies, an equity exposure that is designed primarily to promote community welfare, including the welfare of low- and moderate-income communities or families, such as by providing services or employment, and excluding equity exposures to an unconsolidated small business investment company and equity exposures held through a small business investment company described in section 302 of the Small Business Investment Act of 1958 (15 U.S.C. 682).

(ii) Effective portion of hedge pairs. The effective portion of a hedge pair.

(iii) Non-significant equity exposures. Equity exposures, excluding significant investments in the capital of an unconsolidated institution in the form of common stock and exposures to an investment firm that would meet the definition of a traditional securitization were it not for the Board’s application of paragraph (8) of that definition in
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250 percent risk weight equity exposures. Significant investments in the capital of unconsolidated financial institutions in the form of common stock that are not deducted from capital pursuant to §217.22(b)(4) are assigned a 250 percent risk weight.

(5) 300 percent risk weight equity exposures. A publicly traded equity exposure (other than an equity exposure described in paragraph (b)(6) of this section) that is not publicly traded is assigned a 400 percent risk weight.

(6) 400 percent risk weight equity exposures. An equity exposure (other than an equity exposure described in paragraph (b)(6) of this section) that is not publicly traded is assigned a 400 percent risk weight.

(7) 600 percent risk weight equity exposures. An equity exposure to an investment firm that:

(i) Would meet the definition of a traditional securitization were it not for the Board’s application of paragraph (8) of that definition in §217.2; and

(ii) Has greater than immaterial leverage is assigned a 600 percent risk weight.

(c) Hedge transactions—(1) Hedge pair. A hedge pair is two equity exposures that form an effective hedge so long as each equity exposure is publicly traded or has a return that is primarily based on a publicly traded equity exposure.

(2) Effective hedge. Two equity exposures form an effective hedge if the exposures either have the same remaining maturity or each has a remaining maturity of at least three months; the hedge relationship is formally documented in a prospective manner (that is, before the Board-regulated institution acquires at least one of the equity exposures); the documentation specifies the measure of effectiveness (E) the Board-regulated institution will use for the hedge relationship throughout the life of the transaction; and the hedge relationship has an E greater than or equal to 0.8. A Board-regulated institution must measure E at least quarterly and must use one of three alternative measures of E:

(i) Under the dollar-offset method of measuring effectiveness, the Board-regulated institution must determine the ratio of value change (RVC). The RVC is the ratio of the cumulative sum of the periodic changes in value of one equity exposure to the cumulative sum of
the periodic changes in the value of the other equity exposure. If RVC is positive, the hedge is not effective and E equals zero. If RVC is negative and greater than or equal to \(-1\) (that is, between zero and \(-1\)), then E equals the absolute value of RVC. If RVC is negative and less than \(-1\), then E equals 2 plus RVC.

(ii) Under the variability-reduction method of measuring effectiveness:

\[
E = 1 - \frac{\sum_{t=1}^{T} (X_t - X_{t-1})^2}{\sum_{t=1}^{T} (A_t - A_{t-1})^2}, \text{ where}
\]

(A) \(X_t = A_t - B_t\); 

(B) \(A_t = \) the value at time \(t\) of one exposure in a hedge pair; and 

(C) \(B_t = \) the value at time \(t\) of the other exposure in a hedge pair.

(iii) Under the regression method of measuring effectiveness, E equals the coefficient of determination of a regression in which the change in value of one exposure in a hedge pair is the dependent variable and the change in value of the other exposure in a hedge pair is the independent variable. However, if the estimated regression coefficient is positive, then the value of E is zero.

(3) The effective portion of a hedge pair is E multiplied by the greater of the adjusted carrying values of the equity exposures forming a hedge pair.

(4) The ineffective portion of a hedge pair is \(1-E\) multiplied by the greater of the adjusted carrying values of the equity exposures forming a hedge pair.


§ 217.153 Internal models approach (IMA).

(a) General. A Board-regulated institution may calculate its risk-weighted asset amount for equity exposures using the IMA by modeling publicly traded and non-publicly traded equity exposures (in accordance with paragraph (c) of this section) or by modeling only publicly traded equity exposures (in accordance with paragraphs (c) and (d) of this section).

(b) Qualifying criteria. To qualify to use the IMA to calculate risk-weighted assets for equity exposures, a Board-regulated institution must receive prior written approval from the Board. To receive such approval, the Board-regulated institution must demonstrate to the Board’s satisfaction that the Board-regulated institution meets the following criteria:

(1) The Board-regulated institution must have one or more models that:
   (i) Assess the potential decline in value of its modeled equity exposures;
   (ii) Are commensurate with the size, complexity, and composition of the Board-regulated institution’s modeled equity exposures; and
   (iii) Adequately capture both general market risk and idiosyncratic risk.

(2) The Board-regulated institution’s model must produce an estimate of potential losses for its modeled equity exposures that is no less than the estimate of potential losses produced by a VaR methodology employing a 99th