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DEPARTMENT OF TRANSPORTATION

Federal Aviation Administration

14 CFR Part 39

[Docket No. FAA-2005-22874; Directorate Identifier 2005-NM-173-AD; Amendment 39-14769; AD 2006-19-12]

RIN 2120-AA64

Airworthiness Directives; Boeing Model 777-200 and -300 Series Airplanes

AGENCY: Federal Aviation Administration (FAA), Department of Transportation (DOT).

ACTION: Final rule.

SUMMARY: The FAA is adopting a new airworthiness directive (AD) for certain Boeing Model 777-200 and -300 series airplanes. This AD requires inspecting the lower web of the aft fairing of engine struts for any discoloration and doing any related investigative and corrective action if necessary; inspecting the heat shield castings for any damage and doing any corrective action if necessary; installing gap cover strips; and replacing insulation blankets with new insulation blankets. This AD results from a report that several discolored fairing lower webs and some damaged/deteriorated insulation blankets were found in the aft fairings of engine struts. We are issuing this AD to prevent cracking of lower webs of the aft fairings, which could result in flammable hydraulic fluid leaking onto or near an ignition source, and possibly result in an uncontrollable fire in the engine strut area.

EFFECTIVE DATE: This AD becomes effective October 30, 2006.

The Director of the Federal Register approved the incorporation by reference of a certain publication listed in the AD as of October 30, 2006.

ADDRESSES: You may examine the AD docket on the Internet at [http://](http://dms.dot.gov)

dms.dot.gov or in person at the Docket Management Facility, U.S. Department of Transportation, 400 Seventh Street SW., Nassif Building, Room PL-401, Washington, DC.

Contact Boeing Commercial Airplanes, P.O. Box 3707, Seattle, Washington 98124-2207, for service information identified in this AD.

FOR FURTHER INFORMATION CONTACT:

Margaret Langsted, Aerospace Engineer, Propulsion Branch, ANM-140S, FAA, Seattle Aircraft Certification Office, 1601 Lind Avenue, SW., Renton, Washington 98057-3356; telephone (425) 917-6500; fax (425) 917-6590.

SUPPLEMENTARY INFORMATION:

Examining the Docket

You may examine the airworthiness directive (AD) docket on the Internet at <http://dms.dot.gov> or in person at the Docket Management Facility office between 9 a.m. and 5 p.m., Monday through Friday, except Federal holidays. The Docket Management Facility office (telephone (800) 647-5227) is located on the plaza level of the Nassif Building at the street address stated in the **ADDRESSES** section.

Discussion

The FAA issued a notice of proposed rulemaking (NPRM) to amend 14 CFR part 39 to include an AD that would apply to certain Boeing Model 777-200 and -300 series airplanes. That NPRM was published in the **Federal Register** on November 9, 2005 (70 FR 67952). That NPRM proposed to require inspecting the lower web of the aft fairing of engine struts for any discoloration and doing any related investigative and corrective action if necessary; inspecting the heat shield castings for any damage and doing any corrective action if necessary; installing gap cover strips; and replacing insulation blankets with new insulation blankets.

Comments

We provided the public the opportunity to participate in the development of this AD. We have considered the comments received.

Supportive Comment

One commenter, Boeing, concurs with the contents of the NPRM.

Request To Address Technical Discrepancies in the Service Bulletin

Continental Airlines (CAL) concurs with the intent of the NPRM to mandate Boeing Special Attention Service Bulletin 777-54-0021, dated June 23, 2005, in an effort to minimize heat damage to the pylon aft fairing. CAL noted some technical discrepancies that may create problems for the operators if Service Bulletin 777-54-0021 is mandated as-is. CAL specifically noted that, in the procedures given for performing an inspection of the lower web for heat damage, there are no International Annealed Copper Standard (IACS) values given to determine whether the condition of the web material is acceptable for continued service. CAL considers a conductivity of 44 percent of IACS value or less acceptable for service. CAL coordinated these issues with Boeing for corrective action, confirmed that the issues would be corrected in the next revision of the service bulletin, and agreed to validate Service Bulletin 777-54-0021 for Boeing. CAL recommends that we either defer this rulemaking action until Revision 1 of the service bulletin is released, or incorporate the corrections of these discrepancies within the AD. CAL also "would like to see verbiage in the ruling that will allow us to take credit" for work accomplished on airplanes changed as shown in the initial release of the service bulletin.

We agree that the initial release of Service Bulletin 777-54-0021 has discrepancies that could create problems for operators if required as-is. Since the NPRM was published, Boeing has issued Boeing Special Attention Service Bulletin 777-54-0021, Revision 1, dated March 16, 2006. Revision 1 of the service bulletin addresses the discrepancies noted by CAL. However, Revision 1 of the service bulletin recommends that the threshold criteria for the heat damage inspection be 42 percent or less of IACS, not the 44 percent proposed by CAL. We have determined that we will require a 42 percent threshold in accordance with that service bulletin. We also have determined that no more work is necessary for airplanes modified in accordance with the initial release of the service bulletin. We have revised paragraphs (f) and (g) of this AD to reference Revision 1 of the service bulletin and have added paragraph (h)

to this AD to allow credit for previously accomplished actions in accordance with the initial release of the service bulletin, provided that the IACS threshold used is 42 percent or less.

Request To Extend Compliance Times for Airplanes With Boeing Service Bulletin 777-54A0015 Incorporated

CAL requests that the AD make a distinction between affected GE-engine-powered airplanes with and without the incorporation of Boeing Service Bulletin 777-54A0015, Revision 1, dated March 15, 2002. CAL states that according to the information in Service Bulletin 777-54-0021, reports of discolored lower webs and deteriorated thermal blankets are all from airplanes that did not have Service Bulletin 777-54A0015 incorporated. CAL notes that Service Bulletin 777-54A0015 provides instructions to modify the cover plate of the Number 1 heat shield segment to block the through-flow of hot exhaust gas in the heat shield cavity, and replace the thermal insulation blankets to protect the area above from heat damage. CAL states that it incorporated these changes on all affected airplanes in its fleet between 2002 and 2003. CAL requests/recommends that we extend the compliance time from 12 months to 24 months for airplanes that have incorporated Service Bulletin 777-54A0015.

We do not agree to extend the compliance time. The incorporation of Service Bulletin 777-54A0015 on GE-engine-powered airplanes was intended to prevent elevated temperatures from the primary exhaust from passing into the strut aft fairing cavity through a gap between the strut aft fairing heat shield cover plate and the aft fairing lower web. The incorporation of Service Bulletin 777-54-0021, Revision 1, is intended to prevent the deterioration of new insulation blankets in the strut aft fairing. The insulation blankets, located on the bottom side of the fairing lower web and above the segmented heat shield, are used to reduce the temperature inside the strut aft fairing. Gaps in the segmented heat shield allow the engine's primary exhaust to enter the heat shield cavity. The flow path blockage provided by Service Bulletin 777-54A0015 is entirely separate from the blockage provided by Service Bulletin 777-54-0021, Revision 1. We consider these two design changes independent and do not agree with extending the compliance time for those airplanes having incorporated Service Bulletin 777-54A0015. We have not revised this AD in this regard.

Clarification of Service Bulletin's Inclusion of Nutplate Inspection

Service Bulletin 777-54-0021, Revision 1, includes in the general visual inspection for damage of the heat shield casting, a missing or loose nutplate as one criterion for damage. We consider this additional criterion a relieving action. Without the nutplate inspection in the general visual inspection for damage, a missing nutplate would be discovered during re-installation of the forward-most heat shield when fasteners would fail to be torqued to the correct torque value. Finding missing or loose nutplate(s) during the general visual inspection provides scheduling and economic benefits when compared to the cost of discovering missing nutplates after heat shield reinstallation.

Clarification of Additional Available Repair Method

Service Bulletin 777-54-0021, Revision 1, also provides more detailed repair instructions that may be used for repair of conditions found during the inspections. We have revised paragraph (g) of this AD to allow repair in accordance with the repair instructions provided by Service Bulletin 777-54-0021, Revision 1.

Conclusion

We have carefully reviewed the available data, including the comments received, and determined that air safety and the public interest require adopting the AD with the changes described previously. We have determined that these changes will neither increase the economic burden on any operator nor increase the scope of the AD.

Costs of Compliance

There are about 294 airplanes of the affected design in the worldwide fleet. This AD will affect about 72 airplanes of U.S. registry. The actions will take about 9 to 11 work hours per airplane, depending on engine manufacturer (configuration), at an average labor rate of \$65 per work hour. Required parts would cost about \$15,368 to \$16,179 per airplane. Based on these figures, the estimated cost of the AD for U.S. operators is \$1,148,616 to \$1,216,368, or \$15,953 to \$16,894 per airplane.

Authority for This Rulemaking

Title 49 of the United States Code specifies the FAA's authority to issue rules on aviation safety. Subtitle I, Section 106, describes the authority of the FAA Administrator. Subtitle VII, Aviation Programs, describes in more detail the scope of the Agency's authority.

We are issuing this rulemaking under the authority described in Subtitle VII, Part A, Subpart III, Section 44701, "General requirements." Under that section, Congress charges the FAA with promoting safe flight of civil aircraft in air commerce by prescribing regulations for practices, methods, and procedures the Administrator finds necessary for safety in air commerce. This regulation is within the scope of that authority because it addresses an unsafe condition that is likely to exist or develop on products identified in this rulemaking action.

Regulatory Findings

We have determined that this AD will not have federalism implications under Executive Order 13132. This AD will not have a substantial direct effect on the States, on the relationship between the national government and the States, or on the distribution of power and responsibilities among the various levels of government.

For the reasons discussed above, I certify that this AD:

- (1) Is not a "significant regulatory action" under Executive Order 12866;
- (2) Is not a "significant rule" under DOT Regulatory Policies and Procedures (44 FR 11034, February 26, 1979); and
- (3) Will not have a significant economic impact, positive or negative, on a substantial number of small entities under the criteria of the Regulatory Flexibility Act.

We prepared a regulatory evaluation of the estimated costs to comply with this AD and placed it in the AD docket. See the **ADDRESSES** section for a location to examine the regulatory evaluation.

List of Subjects in 14 CFR Part 39

Air transportation, Aircraft, Aviation safety, Incorporation by reference, Safety.

Adoption of the Amendment

- Accordingly, under the authority delegated to me by the Administrator, the FAA amends 14 CFR part 39 as follows:

PART 39—AIRWORTHINESS DIRECTIVES

- 1. The authority citation for part 39 continues to read as follows:

Authority: 49 U.S.C. 106(g), 40113, 44701.

§ 39.13 [Amended]

- 2. The Federal Aviation Administration (FAA) amends § 39.13 by adding the following new airworthiness directive (AD):

2006–19–12 Boeing: Amendment 39–14769.
Docket No. FAA–2005–22874;
Directorate Identifier 2005–NM–173–AD.

Effective Date

(a) This AD becomes effective October 30, 2006.

Affected ADs

(b) None.

Applicability

(c) This AD applies to Boeing Model 777–200 and –300 series airplanes, certificated in any category; as identified in Boeing Special Attention Service Bulletin 777–54–0021, Revision 1, dated March 16, 2006.

Unsafe Condition

(d) This AD results from a report that several discolored fairing lower webs and some damaged/deteriorated insulation blankets were found in the aft fairings of engine struts. We are issuing this AD to prevent cracking of lower webs of the aft fairings, which could result in flammable hydraulic fluid leaking onto or near an ignition source, and possibly result in an uncontrollable fire in the engine strut area.

Compliance

(e) You are responsible for having the actions required by this AD performed within the compliance times specified, unless the actions have already been done.

Inspection, Installation, and Replacement Actions

(f) Except as provided by paragraph (g) of this AD: Within 12 months after the effective date of this AD, do the actions specified in paragraphs (f)(1), (f)(2), (f)(3), and (f)(4) of this AD in accordance with the Accomplishment Instructions of Boeing Special Attention Service Bulletin 777–54–0021, Revision 1, dated March 16, 2006.

(1) Do a general visual inspection of the lower web of the aft fairing for any discoloration and do any related investigative action.

(2) Do a general visual inspection of the heat shield castings for any damage (crack(s), dent(s), gouge(s), warpage, fretting, or missing/loose nutplates).

(3) Install gap cover strips on the heat shield pans.

(4) Replace insulation blankets on the heat shield pans with new insulation blankets.

Repair Instructions

(g) If any damage, discoloration, heat damage, or crack is found during any inspection required by this AD: Before further flight, do all applicable corrective actions in accordance with a method approved by the Manager, Seattle Aircraft Certification Office (ACO), FAA, or in accordance with the Accomplishment Instructions of Boeing Special Attention Service Bulletin 777–54–0021, Revision 1, dated March 16, 2006.

Previously Accomplished Actions

(h) Actions done before the effective date of this AD in accordance with Boeing Special Attention Service Bulletin 777–54–0021, dated June 23, 2005, are acceptable for

compliance with the requirements of paragraph (f) of this AD, except where the service bulletin does not provide an International Annealed Copper Standard (ICAS) value for determining the results of the inspection for heat damage, the maximum acceptable ICAS value is 42 percent.

Alternative Methods of Compliance (AMOCs)

(i)(1) The Manager, Seattle ACO, FAA, has the authority to approve AMOCs for this AD, if requested in accordance with the procedures found in 14 CFR 39.19.

(2) Before using any AMOC approved in accordance with 14 CFR 39.19 on any airplane to which the AMOC applies, notify the appropriate principal inspector in the FAA Flight Standards Certificate Holding District Office.

(3) An AMOC that provides an acceptable level of safety may be used for any repair required by this AD, if it is approved by an Authorized Representative for the Boeing Commercial Airplanes Delegation Option Authorization Organization who has been authorized by the Manager, Seattle ACO, to make those findings. For a repair method to be approved, the repair must meet the certification basis of the airplane, and the approval must specifically refer to this AD.

Material Incorporated by Reference

(j) You must use Boeing Special Attention Service Bulletin 777–54–0021, Revision 1, dated March 16, 2006, to perform the actions that are required by this AD, unless the AD specifies otherwise. The Director of the Federal Register approved the incorporation by reference of this document in accordance with 5 U.S.C. 552(a) and 1 CFR part 51. Contact Boeing Commercial Airplanes, P.O. Box 3707, Seattle, Washington 98124–2207, for a copy of this service information. You may review copies at the Docket Management Facility, U.S. Department of Transportation, 400 Seventh Street SW., Room PL–401, Nassif Building, Washington, DC; on the Internet at <http://dms.dot.gov>; or at the National Archives and Records Administration (NARA). For information on the availability of this material at the NARA, call (202) 741–6030, or go to http://www.archives.gov/federal_register/code_of_federal_regulations/ibr_locations.html.

Issued in Renton, Washington, on September 13, 2006.

Kevin M. Mullin,

Acting Manager, Transport Airplane Directorate, Aircraft Certification Service.
[FR Doc. 06–8122 Filed 9–22–06; 8:45 am]

BILLING CODE 4910–13–P

DEPARTMENT OF HEALTH AND HUMAN SERVICES

Food and Drug Administration

21 CFR Parts 807, 868, 870, 872, 874, 876, 878, 880, 882, 884, 886, and 892

[Docket No. 2006N–0335]

Medical Devices; Reprocessed Single-Use Devices; Requirement for Submission of Validation Data

AGENCY: Food and Drug Administration, HHS.

ACTION: Direct final rule.

SUMMARY: The Food and Drug Administration (FDA or we) is amending certain classification regulations for reprocessed single-use devices (SUDs) whose exemption from premarket notification (510(k)) requirements have been terminated and other reprocessed SUDs already subject to premarket notification for which validation data, as specified under the Medical Device User Fee and Modernization Act of 2002 (MDUFMA), are necessary in a 510(k). Elsewhere in this issue of the **Federal Register**, we are publishing a companion proposed rule, under FDA's usual procedures for notice and comment, to provide a procedural framework to finalize the rule in the event we receive any significant adverse comment and withdraw the direct final rule. This action codifies actions taken in previous **Federal Register** notices in accordance with MDUFMA.

DATES: This rule is effective February 7, 2007. Submit written or electronic comments by December 11, 2006. If we receive no significant adverse comments within the specified comment period, we intend to publish a document confirming the effective date of the final rule in the **Federal Register** within 30 days after the comment period on this direct final rule ends. If we receive any timely significant adverse comment, we will withdraw this final rule in part or in whole by publication of a document in the **Federal Register** within 30 days after the comment period ends.

ADDRESSES: You may submit comments, identified by Docket No. 2006N–0335, by any of the following methods:
Electronic Submissions

Submit electronic comments in the following ways:

- Federal eRulemaking Portal: <http://www.regulations.gov>. Follow the instructions for submitting comments.
- Agency Web site: <http://www.fda.gov/dockets/comments>. Follow the instructions for submitting comments on the agency Web site.

Written Submissions

Submit written submissions in the following ways:

- FAX: 301-827-6870.
- Mail/Hand delivery/Courier [For paper, disk, or CD-ROM submissions]: Division of Dockets Management (HFA-305), Food and Drug Administration, 5630 Fishers Lane, rm. 1061, Rockville, MD 20852.

To ensure more timely processing of comments, FDA is no longer accepting comments submitted to the agency by e-mail. FDA encourages you to continue to submit electronic comments by using the Federal eRulemaking Portal or the agency Web site, as described in the *Electronic Submissions* portion of this paragraph.

Instructions: All submissions received must include the agency name and Docket No(s). and Regulatory Information Number (RIN) (if a RIN number has been assigned) for this rulemaking. All comments received may be posted without change to <http://www.fda.gov/ohrms/dockets/default.htm>, including any personal information provided. For additional information on submitting comments, see the "Comments" heading of the **SUPPLEMENTARY INFORMATION** section of this document.

Docket: For access to the docket to read background documents or comments received, go to <http://www.fda.gov/ohrms/dockets/default.htm> and insert the docket number(s), found in brackets in the heading of this document, into the "Search" box and follow the prompts and/or go to the Division of Dockets Management, 5630 Fishers Lane, rm. 1061, Rockville, MD 20852.

FOR FURTHER INFORMATION CONTACT: Heather S. Rosecrans, Center for Devices and Radiological Health (HFZ-404), Food and Drug Administration, 9200 Corporate Blvd., Rockville, MD 20850, 301-594-1190, ext. 143.

SUPPLEMENTARY INFORMATION:

I. What Is the Background of the Rule?

On October 26, 2002, MDUFMA (Public Law 107-250), amended the Federal Food, Drug, and Cosmetic Act (the act) by adding section 510(o) (21 U.S.C. 360(o)), which provided new regulatory requirements for reprocessed SUDs. According to this provision, in order to ensure that reprocessed SUDs are substantially equivalent to predicate devices, 510(k)s for certain reprocessed SUDs identified by FDA must include validation data. These required validation data include cleaning and sterilization data, and functional performance data demonstrating that

each SUD will remain substantially equivalent to its predicate device after the maximum number of times the device is reprocessed as intended by the person submitting the premarket notification.

Before enactment of the new law, a manufacturer of a reprocessed SUD was required to obtain premarket approval or premarket clearance for the device, unless the device was exempt from premarket submission requirements. Under MDUFMA, some previously exempt reprocessed SUDs are no longer exempt from premarket notification requirements. Manufacturers of these identified devices were required to submit 510(k)s that included validation data specified by FDA. Reprocessors of certain SUDs already subject to cleared 510(k)s were also required to submit the validation data specified by the agency.

A. Definitions

Under section 201(l)(2)(A) of the act (21 U.S.C. 321(l)(2)(A)), a reprocessed SUD is defined as an "original device that has previously been used on a patient and has been subjected to additional processing and manufacturing for the purpose of an additional single use on a patient. The subsequent processing and manufacture of a reprocessed single-use device shall result in a device that is reprocessed within the meaning of this definition." FDA is amending § 807.3 (21 CFR 807.3) by adding paragraph (t) to incorporate this definition into the regulations.

Reprocessed SUDs are divided into three groups: (1) Critical, (2) semicritical, and (3) noncritical. The first two categories are set forth in the act and all three reflect a categorization scheme recognized in the industry (Ref. 1). In the **Federal Register** of April 30, 2003 (68 FR 23139), FDA describes in more detail the development of this scheme and its use in the implementation of section 510(o) of the act. The act defines critical and semicritical reprocessed single use devices at section 201(mm) as amended by MDUFMA. FDA defined noncritical devices in the **Federal Register** of April 30, 2003. The definitions are as follows:

- A critical reprocessed SUD is intended to contact normally sterile tissue or body spaces during use.
- A semicritical reprocessed SUD is intended to contact intact mucous membranes and not penetrate normally sterile areas of the body.
- A noncritical reprocessed SUD is intended to make topical contact and not penetrate intact skin.

B. Critical and Semicritical Reprocessed SUDs Previously Exempt from Premarket Notification

MDUFMA required FDA to review the critical and semicritical reprocessed SUDs that were previously exempt from premarket notification requirements and determine which of these devices required premarket notification to ensure their substantial equivalence to predicate devices. Under MDUFMA, FDA was required to identify in a **Federal Register** notice those critical reprocessed SUDs whose exemption from premarket notification would be terminated and for which FDA determined that validation data, as specified under MDUFMA, was necessary in a 510(k). FDA published a list of these devices on April 30, 2003. According to the law, manufacturers of the devices whose exemptions from premarket notification were terminated were required to submit 510(k)s that included validation data regarding cleaning, sterilization, and functional performance, in addition to all the other required elements of a 510(k) identified in § 807.87 (21 CFR 807.87), within 15 months of publication of the notice or no longer market their devices.

In accordance with section 510(o) of the act, FDA must revise the list of devices subject to this requirement as appropriate. In the **Federal Register** of June 26, 2003 (68 FR 38071), FDA recategorized nine device types from semicritical to critical, and added nonelectric gastroenterology-urology biopsy forceps to the list of critical reprocessed SUDs whose exemption from premarket notification requirements was being terminated. In the **Federal Register** of September 29, 2005 (70 FR 56911), FDA announced that it was adding devices to the list of critical reprocessed SUDs whose 510(k) exemption is terminated and for which validation data is necessary.

By April 26, 2004, FDA was required to identify in a **Federal Register** notice those semicritical reprocessed SUDs whose exemption from premarket notification would be terminated and for which FDA determined that validation data, as specified under MDUFMA, was necessary in a 510(k). FDA published this list in the **Federal Register** of April 13, 2004 (69 FR 19433). As discussed previously in this document, manufacturers of the devices whose exemptions from premarket notification were terminated were required to submit 510(k)s that included validation data regarding cleaning, sterilization, and functional performance, in addition to all the other required elements of a 510(k) identified

in § 807.87, within 15 months of publication of the notice or no longer market their devices. In accordance with section 510(o) of the act, FDA must revise the list of devices subject to this requirement as appropriate.

C. Reprocessed SUDs Already Subject to Premarket Notification Requirements

MDUFMA also required FDA to review the types of reprocessed SUDs already subject to premarket notification requirements and to identify which of these devices required the submission of validation data to ensure their substantial equivalence to predicate devices. FDA published a list of these devices in the **Federal Register** of April 30, 2003. As described previously in this document, FDA must revise the list of devices subject to this requirement as appropriate. In the **Federal Register** of September 29, 2005, FDA announced that it was adding laparoscopic and endoscopic electrosurgical accessories to this list of reprocessed SUDs already subject to premarket notification.

For devices identified on this list that had already been cleared through the 510(k) process, manufacturers were required to submit validation data regarding cleaning, sterilization, and functional performance within 9 months of publication of the list or no longer market their devices.

For devices on this list that were not yet cleared through the 510(k) process, manufacturers were required to submit 510(k)s with validation data regarding cleaning, sterilization, and functional performance, in addition to all the other required elements identified in § 807.87.

II. What Does This Direct Final Rulemaking Do?

In this final rule, FDA is:

- Amending § 807.3 to add definitions for “single use device,” “reprocessed single use device (SUD)” and “validation data.” The definitions of single use device and reprocessed single use device reflect the definitions of those terms in section 201(l) of the act as amended by MDUFMA. The definition of validation data tracks the language used to describe validation data in section 510(o)(1)(A) of the act.

- Amending § 807.87 (Information required in a premarket notification submission) to reference the requirement (of section 510(o) of the act) to submit validation data for reprocessed SUDs in appropriate situations.

submission of validation data. If the revocation applies only to a subset within a generic type, FDA has revised the language accordingly.

- Amending the classification regulations for devices already subject to premarket notification that FDA has designated as requiring the submission of validation data. If the requirement to submit validation data applies only to a subset of the generic type, FDA has revised the regulation accordingly.

- Making minor corrections to the classification regulations, including amending the sections for affected class II devices to update the definition of class II from requiring “performance standards” to requiring “special controls” in order to provide a reasonable assurance of the safety and effectiveness of the device. This conforms these sections to the definition of class II at section 513(a)(1)(B) of the act (21 U.S.C. 360c(a)(1)(B)), as revised by the Safe Medical Devices Act of 1990 (SMDA) (Public Law 101-629).

FDA has made available previously a guidance document on the submission of validation data entitled “Medical Device User Fee and Modernization Act of 2002, Validation Data in Premarket Notification Submissions (510(k)s) for Reprocessed Single-Use Medical Devices” (June 1, 2004, 69 FR 30943). This guidance document may be accessed on the Internet at <http://www.fda.gov/cdrh/ode/guidance/1216.html>.

III. What are the Procedures for Issuing a Direct Final Rule?

In the **Federal Register** of November 21, 1997 (62 FR 62466), FDA announced the availability of the guidance document entitled “Guidance for FDA and Industry: Direct Final Rule Procedures” that described when and how FDA will employ direct final rulemaking. We believe that this rule is appropriate for direct final rulemaking because it is intended to make noncontroversial amendments and minor corrections to existing regulations. We anticipate no significant adverse comment.

Consistent with FDA’s procedures on direct final rulemaking, we are publishing elsewhere in this issue of the **Federal Register** a companion proposed rule that is identical to the direct final rule. The companion proposed rule provides a procedural framework within which the rule may be finalized in the event the direct final rule is withdrawn because of any significant adverse comment. The comment period for this direct final rule runs concurrently with the comment period of the companion proposed rule. Any comments received

in response to the companion proposed rule will also be considered as comments regarding this direct final rule.

If we receive any significant adverse comment, we intend to withdraw this final rule before its effective date by publication of a notice in the **Federal Register** within 30 days after the comment period ends. A significant adverse comment is defined as a comment that explains why the rule would be inappropriate, including challenges to the rule’s underlying premise or approach, or would be ineffective or unacceptable without change. In determining whether an adverse comment is significant and warrants terminating a direct final rulemaking, we will consider whether the comment raises an issue serious enough to warrant a substantive response in a notice-and-comment process in accordance with section 553 of the Administrative Procedure Act (APA) (5 U.S.C. 553). Comments that are frivolous, insubstantial, or outside the scope of the rule will not be considered significant or adverse under this procedure. For example, a comment recommending an additional change to the rule will not be considered a significant adverse comment, unless the comment states why the rule would be ineffective without the additional change. In addition, if a significant adverse comment applies to part of a rule and that part can be severed from the remainder of the rule, we may adopt as final those parts of the rule that are not the subject of a significant adverse comment.

If we withdraw the direct final rule, all comments received will be considered under the companion proposed rule in developing a final rule under the usual notice-and-comment procedures under the APA (5 U.S.C. 552a *et seq.*). If we receive no significant adverse comment during the specified comment period, we intend to publish a confirmation document in the **Federal Register** within 30 days after the comment period ends.

IV. What is the Legal Authority for This Rule?

This direct final rule is authorized by sections 201, 301, 501, 502, 510, 513, 515, 519, 520, 701, 704, 801, and 903 of the act and sections 264 and 271 of the Public Health Service Act (21 U.S.C. 321, 331, 351, 352, 360, 360c, 360e, 360i, 360j, 371, 374, 381, 393; 42 U.S.C. 264 and 271).

V. What is the Environmental Impact of This Rule?

We have determined under 21 CFR 25.30(h) and 25.34(a) that this action is of a type that does not individually or cumulatively have a significant effect on the human environment. Therefore, neither an environmental assessment nor an environmental impact statement is required.

VI. What is the Economic Impact of This Rule?

We have examined the impacts of the final rule under Executive Order 12866 and the Regulatory Flexibility Act (5 U.S.C. 601–612), and the Unfunded Mandates Reform Act of 1995 (Public Law 104–4). Executive Order 12866 directs agencies to assess all costs and benefits of available regulatory alternatives and, when regulation is necessary, to select regulatory approaches that maximize net benefits (including potential economic, environmental, public health and safety, and other advantages; distributive impacts; and equity). We believe that this direct final rule is not a significant regulatory action as defined by the Executive order.

The Regulatory Flexibility Act requires agencies to analyze regulatory options that would minimize any significant impact of a rule on small entities. Because this regulation only codifies in regulations existing statutory requirements, the agency certifies that the final rule will not have a significant economic impact on a substantial number of small entities.

Section 202(a) of the Unfunded Mandates Reform Act of 1995 requires that agencies prepare a written statement, which includes an assessment of anticipated costs and benefits, before proposing “any rule that includes any Federal mandate that may result in the expenditure by State, local, and tribal governments, in the aggregate, or by the private sector, of \$100,000,000 or more (adjusted annually for inflation) in any one year.” The current threshold after adjustment for inflation is \$118 million, using the most current (2004) Implicit Price Deflator for the Gross Domestic Product. We do not expect this final rule to result in any 1-year expenditure that would meet or exceed this amount.

VII. How Does the Paperwork Reduction Act of 1995 Apply to This Rule?

This final rule contains information collection provisions that are subject to review by the Office of Management and Budget (OMB) under the Paperwork

Reduction Act of 1995 (the PRA) (44 U.S.C. 3501–3520). The collections of information addressed in the direct final rule have been approved by OMB in accordance with the PRA under the regulations governing premarket notifications (21 CFR part 807, OMB control number 0910–0120).

VIII. What are the Federalism Impacts of This Rule?

We have analyzed this final rule in accordance with the principles set forth in Executive Order 13132. We have determined that the rule does not contain policies that have substantial direct effects on the States, on the relationship between the National Government and the States, or on the distribution of power and responsibilities among the various levels of government. Accordingly, we have concluded that the rule does not contain policies that have federalism implications as defined in the Executive order and, consequently, a federalism summary impact statement is not required.

IX. How Do You Submit Comments on This Rule?

Interested persons may submit to the Division of Dockets Management (see **ADDRESSES**) written or electronic comments regarding this direct final rule. Submit a single copy of electronic comments or two paper copies of any mailed comments, except that individuals may submit one paper copy. Comments are to be identified with the docket number found in brackets in the heading of this document. Received comments may be seen in the Division of Dockets Management between 9 a.m. and 4 p.m., Monday through Friday.

X. What Is the Reference for This Rule?

The following reference has been placed on display in the Division of Dockets Management (see **ADDRESSES**) and may be seen by interested persons between 9 a.m. and 4 p.m., Monday through Friday.

1. Spaulding, E. H., “The Role of Chemical Disinfection in the Prevention of Nonsocomial Infections.” Edited by P. S. Brachman and T. C. Eickoff, Proceedings of International Conference on Nonsocomial Infections, 1970, American Hospital Association, Chicago, 254–274, 1971.

List of Subjects

21 CFR Part 886

Confidential business information, Imports, Medical devices, Reporting and recordkeeping requirements.

21 CFR Parts 868, 870, 872, 874, 876, 878, 880, 882, and 884

Medical devices.

21 CFR Part 886

Medical devices, Ophthalmic goods and services.

21 CFR Part 892

Medical devices, Radiation protection, X-rays.

■ Therefore, under the Federal Food, Drug, and Cosmetic Act and under authority delegated to the Commissioner of Food and Drugs, 21 CFR parts 807, 868, 870, 872, 874, 876, 878, 880, 882, 884, 886, and 892 are amended as follows:

PART 807—ESTABLISHMENT REGISTRATION AND DEVICE LISTING FOR MANUFACTURERS AND INITIAL IMPORTERS OF DEVICES

■ 1. The authority citation for 21 CFR part 807 continues to read as follows:

Authority: 21 U.S.C. 321, 331, 351, 352, 360, 360c, 360e, 360i, 360j, 371, 374, 381, 393; 42 U.S.C. 264, 271.

■ 2. Section 807.3 is amended by adding new paragraphs (t), (u), and (v) to read as follows:

§ 807.3 Definitions.

* * * * *

(t) A single use device (SUD) means a device that is intended for one use or on a single patient during a single procedure.

(u) A reprocessed SUD is an original device that has previously been used on a patient and has been subjected to additional processing and manufacturing for the purpose of an additional single use on a patient. The subsequent processing and manufacture of a reprocessed SUD shall result in a device that is reprocessed within the meaning of this definition.

(v) Validation data for the purposes of this part means cleaning and sterilization data, and functional performance data demonstrating that an SUD will remain substantially equivalent to its predicate device after the maximum number of times the device is reprocessed as intended by the person submitting the premarket notification.

■ 3. Section 807.87 is amended by redesignating paragraphs (h), (i), (j), (k), and (l) as paragraphs (i), (j), (k), (l), and (m), respectively, and by adding new paragraph (h) to read as follows:

§ 807.87 Information required in a premarket notification submission.

* * * * *

(h) If the device is a reprocessed SUD that FDA has identified as requiring validation data, the premarket

notification submission must include validation data as defined in § 807.3(v).

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PART 868—ANESTHESIOLOGY DEVICES

- 4. The authority citation for 21 CFR part 868 continues to read as follows:

Authority: 21 U.S.C. 351, 360, 360c, 360e, 360j, 371.

- 5. Section 868.5150 is amended by revising paragraph (b) to read as follows:

§ 868.5150 Anesthesia conduction needle.

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(b) *Classification.* Class II (special controls). If the device is an anesthetic conduction needle (with/without introducer) or a short term spinal needle and it is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, a premarket notification submission for the device must include validation data as described in § 807.3(v).

- 6. Section 868.5730 is amended by revising paragraph (b) to read as follows:

§ 868.5730 Tracheal tube.

* * * * *

(b) *Classification.* Class II (special controls). If the device is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, a premarket notification submission for the device must include validation data as described in § 807.3(v).

- 7. Section 868.5905 is amended by revising paragraph (b) to read as follows:

§ 868.5905 Noncontinuous ventilator (IPPB).

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(b) *Classification.* Class II (special controls). If the device is a noncontinuous ventilator (respirator) mask that is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, a premarket notification submission for the device must include validation data as described in § 807.3(v).

- 8. Section 868.6810 is amended by revising paragraph (b) to read as follows:

§ 868.6810 Tracheobronchial suction catheter.

* * * * *

(b) *Classification.* Class I (general controls). The device is exempt from the premarket notification procedures in subpart E of part 807 of this chapter subject to the limitations in § 868.9. If the device is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, the exemption from premarket notification does not apply and the manufacturer must submit a

premarket notification that includes validation data as described in § 807.3(v).

PART 870—CARDIOVASCULAR DEVICES

- 9. The authority citation for 21 CFR part 870 continues to read as follows:

Authority: 21 U.S.C. 351, 360, 360c, 360e, 360j, 371.

- 10. Section 870.1200 is amended by revising paragraph (b) to read as follows:

§ 870.1200 Diagnostic intravascular catheter.

* * * * *

(b) *Classification.* Class II (special controls). If the device is an angiography catheter that is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, a premarket notification submission for the device must include validation data as described in § 807.3(v).

- 11. Section 870.1220 is amended by revising paragraph (b) to read as follows:

§ 870.1220 Electrode recording catheter or electrode recording probe.

* * * * *

(b) *Classification.* Class II (special controls). If the device is an electrode recording catheter or intracardiac mapping catheter that is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, a premarket notification submission for the device must include validation data as described in § 807.3(v).

- 12. Section 870.1230 is amended by revising paragraph (b) to read as follows:

§ 870.1230 Fiberoptic oximeter catheter.

* * * * *

(b) *Classification.* Class II (special controls). If the device is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, a premarket notification submission for the device must include validation data as described in § 807.3(v).

- 13. Section 870.1280 is amended by revising paragraph (b) to read as follows:

§ 870.1280 Steerable catheter.

* * * * *

(b) *Classification.* Class II (special controls). If the device is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, a premarket notification submission for the device must include validation data as described in § 807.3(v).

- 14. Section 870.1290 is amended by revising paragraph (b) to read as follows:

§ 870.1290 Steerable catheter control system.

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(b) *Classification.* Class II (special controls). If the device is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, a premarket notification submission for the device must include validation data as described in § 807.3(v).

- 15. Section 870.1330 is amended by revising paragraph (b) to read as follows:

§ 870.1330 Catheter guide wire.

* * * * *

(b) *Classification.* Class II (special controls). If the device is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, a premarket notification submission for the device must include validation data as described in § 807.3(v).

- 16. Section 870.1390 is amended by revising paragraph (b) to read as follows:

§ 870.1390 Trocar.

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(b) *Classification.* Class II (special controls). If the device is a cardiovascular trocar that is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, a premarket notification submission for the device must include validation data as described in § 807.3(v).

17. Section 870.1650 is amended by revising paragraph (b) to read as follows:

§ 870.1650 Angiographic injector and syringe.

* * * * *

(b) *Classification.* Class II (special controls). If the device is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, a premarket notification submission for the device must include validation data as described in § 807.3(v).

- 18. Section 870.1670 is amended by revising paragraph (b) to read as follows:

§ 870.1670 Syringe actuator for an injector.

* * * * *

(b) *Classification.* Class II (special controls). If the device is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, a premarket notification submission for the device must include validation data as described in § 807.3(v).

- 19. Section 870.2700 is amended by revising paragraph (b) to read as follows:

§ 870.2700 Oximeter.

* * * * *

(b) *Classification.* Class II (special controls). If the device is a tissue saturation oximeter or an oximeter and it is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, a premarket notification submission for the device must include

validation data as described in § 807.3(v).

■ 20. Section 870.3535 is amended by revising paragraph (b) to read as follows:

§ 870.3535 Intra-aortic balloon and control system.

* * * * *

(b) *Classification.* Class III (premarket approval). If the device is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, a premarket notification submission for the device must include validation data as described in § 807.3(v).

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■ 21. Section 870.4450 is amended by revising paragraph (b) to read as follows:

§ 870.4450 Vascular clamp.

* * * * *

(b) *Classification.* Class II (special controls). If the device is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, a premarket notification submission for the device must include validation data as described in § 807.3(v).

■ 22. Section 870.4500 is amended by revising paragraph (b) to read as follows:

§ 870.4500 Cardiovascular surgical instruments.

* * * * *

(b) *Classification.* Class I (general controls). The device is exempt from the premarket notification procedures in subpart E of part 807 of this chapter subject to the limitations in § 870.9. If the device is a noncompression heart stabilizer that is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, the exemption from premarket notification does not apply and the manufacturer must submit a premarket notification that includes validation data as described in § 807.3(v).

■ 23. Section 870.4885 is amended by revising paragraph (b) to read as follows:

§ 870.4885 External vein stripper.

* * * * *

(b) *Classification.* Class II (special controls). If the device is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, a premarket notification submission for the device must include validation data as described in § 807.3(v).

PART 872—DENTAL DEVICES

■ 24. The authority citation for 21 CFR part 872 continues to read as follows:

Authority: 21 U.S.C. 351, 360, 360c, 360e, 360j, 371.

■ 25. Section 872.3240 is amended by revising paragraph (b) to read as follows:

§ 872.3240 Dental bur.

* * * * *

(b) *Classification.* Class I (general controls). The device is exempt from the premarket notification procedures in subpart E of part 807 of this chapter subject to the limitations in § 872.9. If the device is a dental diamond coated bur that is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, the exemption from premarket notification does not apply and the manufacturer must submit a premarket notification submission that includes validation data as described in § 807.3(v).

■ 26. Section 872.4535 is amended by revising paragraph (b) to read as follows:

§ 872.4535 Dental diamond instrument.

* * * * *

(b) *Classification.* Class I (general controls). The device is exempt from the premarket notification procedures in subpart E of part 807 of this chapter subject to the limitations in § 872.9. If the device is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, the exemption from premarket notification does not apply and the manufacturer must submit a premarket notification that includes validation data as described in § 807.3(v).

■ 27. Section 872.4730 is amended by revising paragraph (b) to read as follows:

§ 872.4730 Dental injecting needle.

* * * * *

(b) *Classification.* Class I (general controls). The device is exempt from the premarket notification procedures in subpart E of part 807 of this chapter subject to the limitations in § 872.9. If the device is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, the exemption from premarket notification does not apply and the manufacturer must submit a premarket notification that includes validation data as described in § 807.3(v).

■ 28. Section 872.5410 is amended by revising paragraph (b) to read as follows:

§ 872.5410 Orthodontic appliance and accessories.

* * * * *

(b) *Classification.* Class I (general controls). The device is exempt from the premarket notification procedures in subpart E of part 807 of this chapter subject to the limitations in § 872.9. If the device is a orthodontic metal bracket that is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, the exemption from premarket notification does not apply and the manufacturer must submit a premarket

notification that includes validation data as described in § 807.3(v).

■ 29. Section 872.5470 is amended by revising paragraph (b) to read as follows:

§ 872.5470 Orthodontic plastic bracket.

* * * * *

(b) *Classification.* Class II (special controls). If the device is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, the exemption from premarket notification does not apply and the manufacturer must submit a premarket notification that includes validation data as described in § 807.3(v).

PART 874—EAR, NOSE, AND THROAT DEVICES

■ 30. The authority citation for 21 CFR part 874 continues to read as follows:

Authority: 21 U.S.C. 351, 360, 360c, 360e, 360j, 371.

■ 31. Section 874.4140 is amended by revising paragraph (b) to read as follows:

§ 874.4140 Ear, nose, and throat bur.

* * * * *

(b) *Classification.* Class I (general controls). The device is exempt from the premarket notification procedures in subpart E of part 807 of this chapter subject to the limitations in § 874.9. If the device is an ear, nose, and throat (ENT) high speed microdebrider or an ENT diamond coated bur and it is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, the exemption from premarket notification does not apply and the manufacturer must submit a premarket notification that includes validation data as described in § 807.3(v).

■ 32. Section 874.4420 is amended by revising paragraph (b) to read as follows:

§ 874.4420 Ear, nose, and throat manual surgical instrument.

* * * * *

(b) *Classification.* Class I (general controls). The device is exempt from the premarket notification procedures in subpart E of part 807 of this chapter subject to the limitations in § 874.9. If the device is a laryngeal, sinus, or tracheal trocar that is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, the exemption from premarket notification does not apply and the manufacturer must submit a premarket notification that includes validation data as described in § 807.3(v).

■ 33. Section 874.4680 is amended by revising paragraph (b) to read as follows:

§ 874.4680 Bronchoscope (flexible or rigid) and accessories.

* * * * *

(b) *Classification.* Class II (special controls). If the device is a bronchoscope (nonrigid) biopsy forceps that is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, a premarket notification submission for the device must include validation data as described in § 807.3(v).

PART 876—GASTROENTEROLOGY-UROLOGY DEVICES

■ 34. The authority citation for 21 CFR part 876 continues to read as follows:

Authority: 21 U.S.C. 351, 360, 360c, 360e, 360j, 360l, 371.

■ 35. Section 876.1075 is amended by revising paragraph (b) to read as follows:

§ 876.1075 Gastroenterology-urology biopsy instrument.

* * * * *

(b) *Classification.* (1) Class II (special controls). If the device is a gastroenterology-urology (G-U) biopsy needle and needle set or a biopsy instrument and it is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, a premarket notification submission for the device must include validation data as described in § 807.3(v).

(2) Class I (general controls) for the biopsy forceps cover and the non-electric biopsy forceps. The devices subject to this paragraph (b)(2) are exempt from the premarket notification procedures in subpart E of part 807 of this chapter subject to the limitations in § 876.9. If the device is a non-electric biopsy forceps that is a reprocessed SUD as defined in § 807.3(u) of this chapter, the exemption from premarket notification does not apply and the manufacturer must submit a premarket notification that includes validation data as described in § 807.3(v).

■ 36. Section 876.1500 is amended by revising paragraph (b) (1) to read as follows:

§ 876.1500 Endoscope and accessories.

* * * * *

(b) *Classification.* (1) Class II (special controls). If the device is an endoscopic needle, an endoilluminator, a general and plastic surgery laparoscope, or a spring-loaded pneumoperitoneum needle and it is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, a premarket notification submission for the device must include validation data as described in § 807.3(v).

* * * * *

■ 37. Section 876.4300 is amended by revising paragraph (b) to read as follows:

§ 876.4300 Endoscopic electrosurgical unit and accessories.

* * * * *

(b) *Classification.* Class II (special controls). If the device is an active urological electrosurgical electrode, a flexible suction coagulator electrode, an electric biopsy forceps, a flexible snare, or an endoscopic (with or without accessories) electrosurgical unit that is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, a premarket notification submission for the device must include validation data as described in § 807.3(v).

■ 38. Section 876.4680 is amended by revising paragraph (b) to read as follows:

§ 876.4680 Ureteral stone dislodger.

* * * * *

(b) *Classification.* Class II (special controls). The device is exempt from the premarket notification procedures in subpart E of part 807 of this chapter subject to the limitations in § 876.9. If the device is a flexible and basket stone dislodger that is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, a premarket notification submission for the device must include validation data as described in § 807.3(v).

■ 39. Section 876.5010 is amended by revising paragraph (b) to read as follows:

§ 876.5010 Biliary catheter and accessories.

* * * * *

(b) *Classification.* Class II (special controls). The device is exempt from the premarket notification procedures in subpart E of part 807 of this chapter subject to the limitations in § 876.9. If the device is a biliary catheter that is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, a premarket notification submission for the device must include validation data as described in § 807.3(v).

■ 40. Section 876.5540 is amended in paragraph (b) (3) to read as follows:

§ 876.5540 Blood access device and accessories.

* * * * *

(b) * * *
(3) Class II (special controls) for accessories for both the implanted and the nonimplanted blood access devices not listed in paragraph (b)(4) of this section. If the device is a single needle dialysis set (coaxial flow) or fistula needle and it is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, a premarket notification submission for the device must include

validation data as described in § 807.3(v).

* * * * *

■ 41. Section 876.5820 is amended by revising paragraph (b) (1) to read as follows:

§ 876.5820 Hemodialysis system and accessories.

* * * * *

(b) *Classification.* (1) Class II (special controls) (for hemodialysis systems and all accessories directly associated with the extracorporeal blood system and the dialysate delivery system). If the device is a single needle dialysis set with unidirectional pump that is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, a premarket notification submission for the device must include validation data as described in § 807.3(v).

* * * * *

PART 878—GENERAL AND PLASTIC SURGERY DEVICES

■ 42. The authority citation for 21 CFR part 878 continues to read as follows:

Authority: 21 U.S.C. 351, 360, 360c, 360e, 360j, 360l, 371.

■ 43. Section 878.4200 is amended by revising paragraph (b) to read as follows:

§ 878.4200 Introduction/drainage catheter and accessories.

* * * * *

(b) *Classification.* Class I (general controls). The device is exempt from the premarket notification procedures in subpart E of part 807 of this chapter subject to the limitations in § 878.9. If the device is a catheter needle that is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, the exemption from premarket notification does not apply and the manufacturer must submit a premarket notification that includes validation data as described in § 807.3(v).

■ 44. Section 878.4300 is amended by revising paragraph (b) to read as follows:

§ 878.4300 Implantable clip.

* * * * *

(b) *Classification.* Class II (special controls). If the device is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, a premarket notification submission for the device must include validation data as described in § 807.3(v).

■ 45. Section 878.4400 is amended by revising paragraph (b) to read as follows:

§ 878.4400 Electrosurgical cutting and coagulation device and accessories.

* * * * *

(b) *Classification*. Class II (special controls). If the device is an endoscopic or laparoscopic electrosurgical accessory that is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, a premarket notification submission for the device must include validation data as described in § 807.3(v).

■ 46. Section 878.4750 is amended by revising paragraph (b) to read as follows:

§ 878.4750 Implantable staple.

* * * * *

(b) *Classification*. Class II (special controls). If the device is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, a premarket notification submission for the device must include validation data as described in § 807.3(v).

■ 47. Section 878.4800 is amended by revising paragraph (b) to read as follows:

§ 878.4800 Manual surgical instrument for general use.

* * * * *

(b) *Classification*. Class I (general controls). The device is exempt from the premarket notification procedures in subpart E of part 807 of this chapter subject to the limitations in § 878.9. If the device is a percutaneous biopsy device, a gastroenterology-urology needle, a cardiovascular biopsy needle, or an aspiration and injection needle and it is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, the exemption from premarket notification does not apply and the manufacturer must submit a premarket notification that includes validation data as described in § 807.3(v).

PART 880—GENERAL HOSPITAL AND PERSONAL USE DEVICES

■ 48. The authority citation for 21 CFR part 880 continues to read as follows:

Authority: 21 U.S.C. 351, 360, 360c, 360e, 360j, 371.

■ 49. Section 880.5570 is amended by revising paragraph (b) to read as follows:

§ 880.5570 Hypodermic single lumen needle.

* * * * *

(b) *Classification*. Class II (special controls). If the device is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, a premarket notification submission for the device must include validation data as described in § 807.3(v).

■ 50. Section 880.5860 is amended by revising paragraph (b) to read as follows:

§ 880.5860 Piston syringe.

* * * * *

(b) *Classification*. Class II (special controls). If the device is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, a premarket notification submission for the device must include validation data as described in § 807.3(v).

PART 882—NEUROLOGICAL DEVICES

■ 51. The authority citation for 21 CFR part 882 continues to read as follows:

Authority: 21 U.S.C. 351, 360, 360c, 360e, 360j, 371.

■ 52. Section 882.4190 is amended by revising paragraph (b) to read as follows:

§ 882.4190 Clip forming/cutting instrument.

* * * * *

(b) *Classification*. Class I (general controls). The device is exempt from the premarket notification procedures in subpart E of part 807 of this chapter subject to the limitations in § 882.9. If the device is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, the exemption from premarket notification does not apply and the manufacturer must submit a premarket notification that includes validation data as described in § 807.3(v).

■ 53. Section 882.4300 is amended by revising paragraph (b) to read as follows:

§ 882.4300 Manual cranial drills, burrs, trephines, and accessories.

* * * * *

(b) *Classification*. Class II (special controls). If the device is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, a premarket notification submission for the device must include validation data as described in § 807.3(v).

■ 54. Section 882.4305 is amended by revising paragraph (b) to read as follows:

§ 882.4305 Powered compound cranial drills, burrs, trephines, and their accessories.

* * * * *

(b) *Classification*. Class II (special controls). If the device is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, a premarket notification submission for the device must include validation data as described in § 807.3(v).

■ 55. Section 882.4310 is amended by revising paragraph (b) to read as follows:

§ 882.4310 Powered simple cranial drills, burrs, trephines, and their accessories.

* * * * *

(b) *Classification*. Class II (special controls). If the device is a reprocessed single use device (SUD) as defined in

§ 807.3(u) of this chapter, a premarket notification submission for the device must include validation data as described in § 807.3(v).

PART 884—OBSTETRICAL AND GYNECOLOGICAL DEVICES

■ 56. The authority citation for 21 CFR part 884 continues to read as follows:

Authority: 21 U.S.C. 351, 360, 360c, 360e, 360j, 371.

■ 57. Section 884.1720 is amended by revising paragraph (b)(1) to read as follows:

§ 884.1720 Gynecologic laparoscope and accessories.

* * * * *

(b) (1) *Classification*. Class II (special controls). If the device is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, a premarket notification submission for the device must include validation data as described in § 807.3(v).

* * * * *

■ 58. Section 884.1730 is amended by revising paragraph (b)(2) to read as follows:

§ 884.1730 Laparoscopic insufflator.

* * * * *

(b) * * *
(2) Class I for tubing and tubing/filter kits which include accessory instruments that are not used to effect intra-abdominal insufflation (pneumoperitoneum). The devices subject to this paragraph (b)(2) are exempt from the premarket notification procedures in subpart E of part 807 of this chapter, subject to the limitations in § 884.9. If the device is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, the exemption from premarket notification does not apply and the manufacturer must submit a premarket notification that includes validation data as described in § 807.3(v).

■ 59. Section 884.4530 is amended by revising paragraph (b)(2) to read as follows:

§ 884.4530 Obstetric-gynecologic specialized manual instrument.

* * * * *

(b) * * *
(2) Class I for the amniotome, uterine curette, cervical dilator (fixed-size bougies), cerclage needle, intrauterine device (IUD) remover, uterine sound, and gynecological biopsy forceps. The devices subject to this paragraph (b)(2) are exempt from the premarket notification procedures in subpart E of part 807 of this chapter, subject to the limitations in § 884.9. If the device is a

gynecological biopsy forceps that is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, the exemption from premarket notification does not apply and the manufacturer must submit a premarket notification that includes validation data as described in § 807.3(v).

■ 60. Section 884.6100 is amended by revising paragraph (b) to read as follows:

§ 884.6100 Assisted reproduction needles.

* * * * *

(b) *Classification.* Class II (special controls) (mouse embryo assay information, endotoxin testing, sterilization validation, design specifications, labeling requirements, biocompatibility testing, and clinical testing). If the device is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, the exemption from premarket notification does not apply and the manufacturer must submit a premarket notification that includes validation data as described in § 807.3(v).

PART 886—OPHTHALMIC DEVICES

■ 61. The authority citation for 21 CFR part 886 continues to read as follows:

Authority: 21 U.S.C. 351, 360, 360c, 360e, 360j, 371.

■ 62. Section 886.4350 is amended by revising paragraph (b) to read as follows:

§ 886.4350 Manual ophthalmic surgical instrument.

* * * * *

(b) *Classification.* Class I (general controls). The device is exempt from the premarket notification procedures in subpart E of part 807 of this chapter, subject to the limitations in § 886.9. If the device is an ophthalmic knife that is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, the exemption from premarket notification does not apply and the manufacturer must submit a premarket notification that includes validation data as described in § 807.3(v).

■ 63. Section 886.4370 is amended by revising paragraph (b) to read as follows:

§ 886.4370 Keratome.

* * * * *

(b) *Classification.* Class I (general controls). If the device is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, a premarket notification submission for the device must include validation data as described in § 807.3(v).

■ 64. Section 886.4670 is amended by revising paragraph (b) to read as follows:

§ 886.4670 Phacofragmentation system.

* * * * *

(b) *Classification.* Class II (special controls). If the device is a phacoemulsification needle that is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, a premarket notification submission for the device must include validation data as described in § 807.3(v).

PART 892—RADIOLOGY DEVICES

■ 65. The authority citation for 21 CFR part 892 continues to read as follows:

Authority: 21 U.S.C. 351, 360, 360c, 360e, 360j, 371.

■ 66. Section 892.5730 is amended by revising paragraph (b) to read as follows:

§ 892.5730 Radionuclide brachytherapy source.

* * * * *

(b) *Classification.* Class II (special controls). If the device is an isotope needle that is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, a premarket notification submission for the device must include validation data as described in § 807.3(v).

Dated: September 6, 2006.

Jeffrey Shuren,

Assistant Commissioner for Policy.

[FR Doc. 06–8166 Filed 9–22–06; 8:45 am]

BILLING CODE 4160–01–S

DEPARTMENT OF HOMELAND SECURITY

Coast Guard

33 CFR Part 165

[COTP San Francisco Bay 06–022]

RIN 1625–AA00

Safety Zone; BART Transbay Tube Seismic Upgrade, San Francisco, CA

AGENCY: Coast Guard, DHS.

ACTION: Temporary final rule.

SUMMARY: The Coast Guard is establishing a moving temporary safety zone in the navigable waters of San Francisco Bay, California during vibro penetration testing for a seismic upgrade of the Bay Area Rapid Transit (BART) Transbay tube. The testing will require placement of a barge at test sites along the BART Transbay tube. The safety zone will surround the barge and move with the barge as it conducts the tests at seven sites along the BART Transbay tube. This safety zone is necessary to protect persons and vessels from hazards, injury, and damage associated

with the vibro penetration testing. Unauthorized persons or vessels are prohibited from entering into, transiting through, or remaining in the safety zone without permission of the Captain of the Port or his designated representative.

DATES: This rule is effective from September 25, 2006 through December 31, 2006.

ADDRESSES: Documents indicated in this preamble as being available in the docket are part of docket COTP San Francisco Bay 06–022 and are available for inspection or copying at the Waterways Safety Branch of Sector San Francisco, Yerba Buena Island, Bldg. 278, San Francisco, California, 94130, between 9 a.m. and 4 p.m., Monday through Friday, except Federal holidays.

FOR FURTHER INFORMATION CONTACT:

Ensign Erin Bastick, U.S. Coast Guard Sector San Francisco, at (415) 556–2950 or Sector San Francisco 24 hour Command Center at (415) 399–3547.

SUPPLEMENTARY INFORMATION:

Regulatory Information

We did not publish a notice of proposed rulemaking (NPRM) for this regulation. Under 5 U.S.C. 553(b)(B), the Coast Guard finds that good cause exists for not publishing an NPRM. The dates for the vibro penetration testing along the Transbay tube were not finalized and presented to the Coast Guard in time to draft and publish an NPRM. As such, the testing would commence before the rulemaking process could be completed. Any delay in implementing this rule is contrary to the public interest since immediate action is necessary in order to protect the maritime public from the hazards associated with the vibro penetration testing.

Under 5 U.S.C. 553(d)(3), the Coast Guard finds that good cause exists for making this rule effective less than 30 days after publication in the **Federal Register**. The dates for the vibro penetration testing along the Transbay tube were not finalized and presented to the Coast Guard in time to publish this rule 30 days prior to its effective date. As such, the testing would commence before the rulemaking process could be completed. Delay in the effective date of this rule would expose the mariners and waterways users to undue hazards associated with the vibro penetration testing.

Background and Purpose

Bay Area Rapid Transit has contracted Hayward Baker, Soletanche, Traylor, A Joint Venture, to conduct BART marine demonstration tests in support of their earthquake safety efforts. They will be

conducting vibro penetration tests for future seismic upgrade of the BART Transbay tube. The scope of work involves four primary activities carried out on the water. These activities include vibro penetration tests, vibro ground improvement, drilling, sampling and sonic borings.

The Joint Venture's work will involve outfitting the barge DOGBONE with a crane and vibratory densification equipment and locating it over the tube alignment to perform the ground improvement within the test areas. At times there will be an additional barge lashed to the barge DOGBONE for material handling. Approximately ten 5-foot tall tripods with acoustic transponders will be deployed on the bay bottom to determine specific test locations along the BART Transbay. At each specified location the crane suspended vibrator will be lowered into the bay floor and then proceed to densify the granular backfill placed around the tubes shortly after they were originally placed into position.

Discussion of Rule

This safety zone will encompass the navigable waters from the surface to the sea floor, located in the San Francisco Bay, encompassing a circular safety zone with a 750-foot radius extending from the Crane Barge DOGBONE. The Barge DOGBONE will transit and conduct testing along the BART Transbay tube between two points: 37°47'50.97" N Latitude by 122°23'17.01" W Longitude at the western extreme and 37°48'25.65" N Latitude by 122°21'03.59" W Longitude on the eastern extreme. This area between the two points will be used to maneuver and anchor the Barge DOGBONE as it conducts the vibro penetration tests from September 25, 2006 through December 31, 2006. The BART Project manager coordinated the test locations with the local Bar Pilots and the Vessel Traffic Service to ensure the testing would result in minimum impact to vessel traffic. This moving safety zone around the Barge DOGBONE is necessary to protect persons and vessels from hazards, injury, and damage associated with the vibro penetration testing.

U.S. Coast Guard personnel will enforce this safety zone. Other Federal, State, or local agencies may assist the Coast Guard, including the Coast Guard Auxiliary. Section 165.53 of Title 33, Code of Federal Regulations, prohibits any unauthorized person or vessel from entering or remaining in a safety zone. Vessels or persons violating this section may be subject to both criminal and civil penalties.

Regulatory Evaluation

This rule is not a "significant regulatory action" under section 3(f) of Executive Order 12866, Regulatory Planning and Review, and does not require an assessment of potential costs and benefits under section 6(a)(3) of that Order. The Office of Management and Budget has not reviewed it under that Order.

Although this rule restricts access to the waters encompassed by the safety zone, the effect of this rule will not be significant because the local waterway users have been contacted to ensure the closure will result in minimum impact. The entities most likely to be affected are pleasure craft engaged in recreational activities. Not only is the safety zone small in size, but there will be ample space to navigate around the safety zone as well.

Small Entities

Under the Regulatory Flexibility Act (5 U.S.C. 601–612), we have considered whether this rule would have a significant economic impact on a substantial number of small entities. The term "small entities" comprises small businesses, not-for-profit organizations that are independently owned and operated and are not dominant in their fields, and governmental jurisdictions with populations of less than 50,000.

The Coast Guard certifies under 5 U.S.C. 605(b) that this rule will not have a significant economic impact on a substantial number of small entities. This rule will affect the following entities, some of which may be small entities: the owners or operators of vessels intending to transit or anchor in a portion of the San Francisco Bay from September 25, 2006 through December 31, 2006.

We expect this rule may affect owners and operators of vessels, some of which may be small entities, intending to fish, sightsee, transit, or anchor in the waters affected by this safety zone. This safety zone will not have a significant economic impact on a substantial number of small entities for several reasons: small vessel traffic will be able to pass safely around the area and vessels engaged in recreational activities, sightseeing and commercial fishing have ample space outside of the safety zone to engage in these activities. The entities most likely to be affected are pleasure craft engaged in recreational activities and sightseeing.

Small entities and the maritime public will also be advised of this safety zone via public broadcast notice to mariners. In addition, vessels will be

able to pass through the zone on a case-by-case basis. Therefore, the economic impact of this waterway closure is not expected to be significant.

Assistance for Small Entities

Under section 213(a) of the Small Business Regulatory Enforcement Fairness Act of 1996 (Pub. L. 104–121), we offered to assist small entities in understanding the rule so that they could better evaluate its effects on them and participate in the rulemaking process.

Small businesses may send comments on the actions of Federal employees who enforce, or otherwise determine compliance with, Federal regulations to the Small Business and Agriculture Regulatory Enforcement Ombudsman and the Regional Small Business Regulatory Fairness Boards. The Ombudsman evaluates these actions annually and rates each agency's responsiveness to small business. If you wish to comment on actions by employees of the Coast Guard, call 1–888–REG–FAIR (1–888–734–3247).

Collection of Information

This rule calls for no new collection of information under the Paperwork Reduction Act of 1995 (44 U.S.C. 3501–3520).

Federalism

A rule has implications for federalism under Executive Order 13132, Federalism, if it has a substantial direct effect on State or local governments and would either preempt State law or impose a substantial direct cost of compliance on them. We have analyzed this rule under that Order and have determined that it does not have implications for federalism.

Unfunded Mandates Reform Act

The Unfunded Mandates Reform Act of 1995 (2 U.S.C. 1531–1538) requires Federal agencies to assess the effects of their discretionary regulatory actions. In particular, the Act addresses actions that may result in the expenditure by a State, local, or tribal government, in the aggregate, or by the private sector of \$100,000,000 or more in any one year. Though this rule will not result in such expenditure, we do discuss the effects of this rule elsewhere in this preamble.

Taking of Private Property

This rule will not affect a taking of private property or otherwise have taking implications under Executive Order 12630, Governmental Actions and Interference with Constitutionally Protected Property Rights.

Civil Justice Reform

This rule meets applicable standards in sections 3(a) and 3(b)(2) of Executive Order 12988, Civil Justice Reform, to minimize litigation, eliminate ambiguity, and reduce burden.

Protection of Children

We have analyzed this rule under Executive Order 13045, Protection of Children from Environmental Health Risks and Safety Risks. This rule is not an economically significant rule and does not create an environmental risk to health or risk to safety that may disproportionately affect children.

Indian Tribal Governments

This rule does not have tribal implications under Executive Order 13175, Consultation and Coordination with Indian Tribal Governments, because it does not have a substantial direct effect on one or more Indian tribes, on the relationship between the Federal Government and Indian tribes, or on the distribution of power and responsibilities between the Federal Government and Indian tribes.

Energy Effects

We have analyzed this rule under Executive Order 13211, Actions Concerning Regulations That Significantly Affect Energy Supply, Distribution, or Use. We have determined that it is not a "significant energy action" under that order because it is not a "significant regulatory action" under Executive Order 12866 and is not likely to have a significant adverse effect on the supply, distribution, or use of energy. The Administrator of the Office of Information and Regulatory Affairs has not designated it as a significant energy action. Therefore, it does not require a Statement of Energy Effects under Executive Order 13211.

Technical Standards

The National Technology Transfer and Advancement Act (NTTAA) (15 U.S.C. 272 note) directs agencies to use voluntary consensus standards in their regulatory activities unless the agency provides Congress, through the Office of Management and Budget, with an explanation of why using these standards would be inconsistent with applicable law or otherwise impractical. Voluntary consensus standards are technical standards (e.g., specifications of materials, performance, design, or operation; test methods; sampling procedures; and related management systems practices) that are developed or adopted by voluntary consensus standards bodies.

This rule does not use technical standards. Therefore, we did not consider the use of voluntary consensus standards.

Environment

We have analyzed this rule under Commandant Instruction M16475.ID and Department of Homeland Security Management Directive 5100.1, which guide the Coast Guard in complying with the National Environmental Policy Act of 1969 (NEPA) (42 U.S.C. 4321–4370f), and have concluded that there are no factors in this case that would limit the use of a categorical exclusion under section 2.B.2 of the Instruction. Therefore, this rule is categorically excluded, under figure 2–1, paragraph (34)(g), of the Instruction, from further environmental documentation. Paragraph (34)(g) is applicable because this rule establishes a safety zone.

A final "Environmental Analysis Check List" and a final "Categorical Exclusion Determination" will be available in the docket where indicated under **ADDRESSES**.

List of Subjects in 33 CFR Part 165

Harbors, Marine safety, Navigation (water), Reporting and recordkeeping requirements, Security measures, Waterways.

■ For the reasons discussed in the preamble, the Coast Guard amends 33 CFR part 165 as follows:

PART 165—REGULATED NAVIGATION AREAS AND LIMITED ACCESS AREAS

■ 1. The authority citation for part 165 continues to read as follows:

Authority: 33 U.S.C. 1226, 1231; 46 U.S.C. Chapter 701; 50 U.S.C. 191; 33 CFR 1.05–1(g), 6.04–1, 6.04–6, and 160.5; Pub. L. 107–295, 116 Stat. 2064; Department of Homeland Security Delegation No. 0170.1.

■ 2. Add § 165.T11–146, to read as follows:

§ 165.T11–110 Safety Zone; San Francisco Bay, California.

(a) *Location.* This safety zone will encompass the navigable waters from the surface to the sea floor, in the San Francisco Bay, and its limits will encompass a circular safety zone with a radius of 750-feet extending from and around the Crane Barge DOGBONE. This safety zone will move and continue to extend 750-feet from the Barge DOGBONE while it operates along the charted BART Transbay tube between the following two points: 37°47'50.97" N Latitude, by 122°23'17.01"W Longitude at the western extreme, and 37°48'25.65"N Latitude by

122°21'03.59"W Longitude at the eastern extreme.

(b) *Effective Dates.* This rule is effective from September 25, 2006 through December 31, 2006. If the need for the safety zone ends prior to the scheduled termination time, the Captain of the Port (COTP) will cease enforcement of the safety zone.

(c) *Regulations.* In accordance with the general regulations in § 165.23 of this part, entry into, transit through, or anchoring within this safety zone by all vessels and persons is prohibited, unless specifically authorized by the COTP San Francisco, or his designated representative.

(d) *Enforcement.* All persons and vessels shall comply with the instructions of the Coast Guard COTP or his designated representative. The COTP's designated representative can be comprised of commissioned, warrant, and petty officers of the Coast Guard onboard Coast Guard, Coast Guard Auxiliary, local, State, and Federal law enforcement vessels. Upon being hailed by U.S. Coast Guard patrol personnel by siren, radio, flashing light, or other means, the operator of a vessel shall proceed as directed.

The U.S. Coast Guard may be assisted in the patrol and enforcement of these two safety zones by local law enforcement as necessary.

Dated: September 8, 2006.

W.J. Uberti,

Captain, U.S. Coast Guard, Captain of the Port, San Francisco, California.

[FR Doc. 06–8132 Filed 9–22–06; 8:45 am]

BILLING CODE 4910–15–P

DEPARTMENT OF HOMELAND SECURITY

Coast Guard

33 CFR Part 165

[COTP Western Alaska 06–003]

RIN 1625–AA00

Safety Zone; Gulf of Alaska, Narrow Cape, Kodiak Island, AK

AGENCY: Coast Guard, DHS.

ACTION: Temporary final rule.

SUMMARY: The Coast Guard is establishing a temporary safety zone in the Gulf of Alaska, encompassing the navigable waters in the vicinity of Narrow Cape and Ugak Island. The zone is needed to protect persons and vessels operating in the vicinity of the safety zone during a rocket launch from the Alaska Aerospace Development Corporation, Narrow Cape, Kodiak

Island facility. Entry of vessels or persons into this zone is prohibited unless specifically authorized by the Commander, Seventeenth Coast Guard District, the Coast Guard Captain of the Port, Western Alaska, or their on-scene representative. The intended effect of this safety zone is to ensure the safety of human life and property during the rocket launch.

DATES: This temporary final rule is effective from 2 a.m. through 11:30 a.m., August 31, 2006 through September 30, 2006. The safety zones will be enforced each of these days from 2 a.m. through 11:30 a.m.

ADDRESSES: Documents indicated in this preamble as being available in the docket are available for inspection and copying at Coast Guard Marine Safety Detachment Kodiak, Kodiak, AK 99619. Normal Office hours are 7:30 a.m. to 4 p.m., Monday through Friday, except federal holidays.

FOR FURTHER INFORMATION CONTACT: LT Patrick Lee, Marine Safety Detachment, at (907) 486-5918.

SUPPLEMENTARY INFORMATION:

Regulatory Information

We did not publish a notice of proposed rulemaking (NPRM) for this regulation. Under 5 U.S.C. 553(b)(8), the Coast Guard finds that good cause exists for not publishing an NPRM. The process of scheduling a rocket launch is uncertain due to unforeseen delays such as weather that can cause cancellation of the launch. The Coast Guard attempts to publish a final rule as close to the expected launch date as possible, however, these attempts often prove futile due to frequent re-scheduling. The safety zone is necessary to protect spectators and transiting vessels from the potential hazards associated with the launch.

For similar reasons under 5 U.S.C. 553(d)(3), the Coast Guard finds that good cause exists for making this rule effective less than 30 days after publication in the **Federal Register**. Any delay encountered in this regulation's effective date would be unnecessary and contrary to public interest since immediate action is needed to protect human life and property from possible fallout from the rocket launch.

Background and Purpose

The Alaska Aerospace Development Corporation will launch an unmanned rocket from their facility at Narrow Cape, Kodiak Island, Alaska sometime between 6 a.m. and 11 a.m. during a five-day period between August 31, 2006 and September 30, 2006. The safety zone is necessary to protect

spectators and transiting vessels from the potential hazards associated with the launch. The duration of the safety zone period will allow time for proper surveillance to be conducted to ensure the public is clear of the hazard area prior to and immediately following the rocket launch. The Captain of the Port, Western Alaska will terminate the safety zone after rocket launch operations are complete.

Discussion of Rule

From the latest information received from the Alaska Aerospace Development Corporation, the launch window is scheduled for four (4) hours during a five-day period between August 31, 2006 and September 30, 2006. The size of the safety zone has been set to protect the public from potential hazards associated with the launch. The Pacific Range Support Team has identified a launch area exclusion zone from the area north of Narrow Cape to a point south of Ugak Island along the launch trajectory. The Captain of the Port, Western Alaska will enforce a single safety zone in support of their exclusion zone. The established safety zone includes the navigable waters in the vicinity of Narrow Cape and Ugak Island, within the boundaries defined by a line drawn from a point located at 57°29.8' North, 152°17.0' West, then southeast to a point located at 57°21.1' North, 152°11.2' West, then southwest to a point located at 57°19.9' North, 152°14.2' West, and then northwest to a point located at 57°25.4' North, 152°28.2' West, and then northeast to the point located at 57°29.8' North, 152°17.0' West. All coordinates reference Datum: NAD 1983.

The Coast Guard will announce via Broadcast Notice to Mariners the anticipated date and time of the launch and will grant general permission to enter the safety zone during those times in which the launch does not pose a hazard to mariners.

Regulatory Evaluation

This rule is not a "significant regulatory action" under section 3(f) of Executive Order 12866, Regulatory Planning and Review, and does not require an assessment of potential cost and benefits under section 6(a)(3) of that Order. The Office of Management and Budget has not reviewed it under that Order. It is not significant under the regulatory policies and procedures of the Department of Homeland Security (DHS) (44 FR 11040; February 26, 1979). The Coast Guard expects the economic impact of this rule to be so minimal that a full Regulatory Evaluation under paragraph 10(e) of the regulatory

policies and procedures of DHS is unnecessary. Because the hazardous situation is expected to last for approximately nine and a half (9.5) hours each day during the five-day launch window period, and because general permission to enter the safety zone will be given during non-hazardous times, the impact of this rule on commercial traffic should be minimal. Before the effective period, we will issue maritime advisories widely available to users of the affected portion of the Gulf of Alaska. We believe there will be minimal economic impact on commercial traffic.

Small Entities

Under the Regulatory Flexibility Act (5 U.S.C. 601-612), we have considered whether this rule would have significant economic impacts on a substantial number of small entities. The term "small entities" comprises small businesses, not-for-profit organizations that are independently owned and operated and are not dominant in their fields, and governmental jurisdictions with populations less than 50,000.

The Coast Guard certifies under 5 U.S.C. 605(b) that this rule will not have a significant economic impact on a substantial number of small entities.

This rule will affect the following entities, some of which may be small entities: The owners or operators of vessels intending to transit, anchor, or fish in a portion of the Gulf of Alaska from north of Narrow Cape to South of Ugak Island from 2 a.m. to 11:30 a.m. each day from August 31 until September 30, 2006 until rocket launch operations are complete. Because the hazardous situation is expected to last for approximately nine and a half (9.5) hours of each day during the five-day launch window period, and because general permission to enter the safety zone will be given during non-hazardous times, the impact of this rule on commercial and recreational traffic should be minimal. Before the effective period, we will issue maritime advisories widely available to users of the affected portion of the Gulf of Alaska. We believe there will be minimal impact to small entities.

Collection of Information

This rule calls for no new collection of information under the Paperwork Reduction Act of 1995 (44 U.S.C. 3501-3520).

Federalism

A rule has implications for federalism under Executive Order 13132, Federalism, if it has a substantial direct effect on State or local governments and

would either preempt State law or impose a substantial direct cost of compliance on them. We have analyzed this rule under that Order and have determined that this rule does not have implications for federalism.

Unfunded Mandates Reform Act

The Unfunded Mandates Reform Act of 1995 (2 U.S.C. 1531–1538) requires Federal agencies to assess the effects of their discretionary regulatory actions. In particular, the Act addresses actions that may result in the expenditure by a State, local, or tribal government, in the aggregate, or by the private sector of \$100,000,000 or more in any one year. Though this rule will not result in such an expenditure, we do discuss the effects of this rule elsewhere in this preamble.

Taking of Private Property

This rule will not effect a taking of private property or otherwise have taking implications under Executive Order 12630, Governmental Actions and Interference with Constitutionally Protected Property Rights.

Civil Justice Reform

This rule meets applicable standards in sections 3(a) and 3(b)(2) of Executive Order 12988, Civil Justice Reform, to minimize litigation, eliminate ambiguity, and reduce burden.

Protection of Children

We have analyzed this rule under Executive Order 13045, Protection of Children from Environmental Health Risks and Safety Risks. This rule is not economically significant and does not cause an environmental risk to health or risk to safety that may disproportionately affect children.

Indian Tribal Governments

This rule does not have tribal implications under Executive Order 13175, Consultation and Coordination with Indian Tribal Governments, because it would not have a substantial direct effect on one or more Indian tribes, on the relationship between the Federal Government and Indian tribes, or on the distribution of power and responsibilities between the Federal Government and Indian tribes. We invite your comments on how this proposed rule might impact tribal governments, even if that impact may not constitute a “tribal implication” under the Order.

Energy Effects

We have analyzed this rule under Executive Order 13211, Actions Concerning Regulations That

Significantly Affect Energy Supply, Distribution, or Use. We have determined that it is not a “significant energy action” under that order because it is not a “significant regulatory action” under Executive Order 12866 and is not likely to have a significant adverse effect on the supply, distribution, or use of energy. The Administrator of the Office of Information and Regulatory Affairs has not designated it as a significant energy action. Therefore, it does not require a Statement of Energy Effects under Executive Order 13211.

Technical Standards

The National Technology Transfer and Advancement Act (NTTAA) (15 U.S.C. 272 note) directs agencies to use voluntary consensus standards in their regulatory activities unless the agency provides Congress, through the Office of Management and Budget, with an explanation of why using these standards would be inconsistent with applicable law or otherwise impractical. Voluntary consensus standards are technical standards (e.g., specifications of materials, performance, design, or operation; test methods; sampling procedures; and related management systems practices) that are developed or adopted by voluntary consensus standards bodies.

This rule does not use technical standards. Therefore, we did not consider the use of voluntary consensus standards.

Environment

We have analyzed this rule under Commandant Instruction M16475.ID and Department of Homeland Security Management Directive 5100.1, which guide the Coast Guard in complying with the National Environmental Policy Act of 1969 (NEPA) (42 U.S.C. 4321–4370f), and have concluded that there are no factors in this case that would limit the use of a categorical exclusion under section 2.B.2 of the Instruction. Therefore, we believe that this rule should be categorically excluded, under figure 2–1, paragraph (34)(g) of the Instruction, from further environmental documentation because this rule establishes a safety zone. A final “Environmental Analysis Check List” and a final “Categorical Exclusion Determination” will be available in the docket where indicated under **ADDRESSES**.

List of Subjects in 33 CFR Part 165

Harbors, Marine safety, Navigation (water), Reporting and record keeping requirements, Security measures, Waterways.

■ For the reasons set out in the preamble, the Coast Guard amends 33 CFR part 165 as follows:

PART 165—REGULATED NAVIGATION AREAS AND LIMITED ACCESS AREAS

■ 1. The authority citation for Part 165 continues to read as follows:

Authority: 33 U.S.C. 1226, 1231; 46 U.S.C. Chapter 701; 50 U.S.C. 191, 195; 33 CFR 1.05–1(g), 6.04–1, 6.04–6, and 160.5; Pub. L. 107–295, 116 Stat. 2064; Department of Homeland Security Delegation No. 0170.1.

■ 2. Add § 165.T17–072 to read as follows:

§ 165.T17–072 Alaska Aerospace Development Corporation, Safety Zone; Gulf of Alaska, Narrow Cape, Kodiak Island, AK.

(a) *Location.* The established safety zone includes the navigable waters in the vicinity of Narrow Cape and Ugak Island, within the boundaries defined by a line drawn from a point located at 57°29.8” North, 152°17.0” West, then southeast to a point located at 57°21.1” North, 152°11.2’ West, then southwest to a point located at 57°19.9’ North, 152°14.2’ West, and then northwest to a point located at 57°25.4’ North, 152°28.2’ West, and then northeast to the point located at 57°29.8’ North, 152°17.0’ West. All coordinates reference Datum: NAD 1983.

(b) *Enforcement periods.* The safety zones in this section will be enforced from 2 a.m. to 11:30 a.m. during each day of a five-day launch window period from August 31, 2006 to September 30, 2006.

(c) *Regulations.* (1) The Duty Officer at Marine Safety Detachment, Kodiak, Alaska can be contacted at telephone number (907) 486–5918 or (907) 539–5841.

(2) The Captain of the Port may authorize and designate any Coast Guard commissioned, warrant, or petty officer to act on his behalf in enforcing the safety zone.

(3) The general regulations governing safety zones 1 contained in § 165.23 apply. No person or vessel may enter or remain in this safety zone without first obtaining permission from the Captain of the Port or his on-scene representative. The Captain of the Port, Western Alaska, on-scene representative may be contacted at Marine Safety Detachment Kodiak.

Dated: August 30, 2006.

M. R. DeVries,

Captain, U.S. Coast Guard, Captain of the Port, Western Alaska.

[FR Doc. 06–8138 Filed 9–22–06; 8:45 am]

BILLING CODE 4910–15–P

ENVIRONMENTAL PROTECTION AGENCY**40 CFR Part 300**

[FRL-8222-9]

National Oil and Hazardous Substances Pollution Contingency Plan; National Priorities List Update**AGENCY:** Environmental Protection Agency.**ACTION:** Notice of deletion of the Nineteenth (19th) Avenue Landfill Superfund Site from the National Priorities List.

SUMMARY: The Environmental Protection Agency (EPA) announces the deletion of the Nineteenth (19th) Avenue Landfill Site (Site), located in Phoenix, Maricopa County, Arizona, from the National Priorities List (NPL). The NPL is Appendix B of 40 CFR part 300 which is the National Oil and Hazardous Substances Pollution Contingency Plan (NCP), which EPA promulgated pursuant to Section 105 of the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) of 1980, as amended. EPA and the State of Arizona have determined that the Site poses no significant threat to public health or the environment and, therefore, no further remedial measures pursuant to CERCLA are appropriate.

DATES: *Effective Date:* September 25, 2006.

FOR FURTHER INFORMATION CONTACT: Nadia Hollan, Remedial Project Manager, Mail Code: SFD-8-2, U.S. EPA Region 9, 75 Hawthorne Street, San Francisco, California 94105-3901, hollan.nadia@epa.gov, (415) 972-3187 OR 1-800-231-3075 (message line), or William DePaul, Remedial Project Manager, Arizona Department of Environmental Quality, 1110 West Washington Street, Phoenix Arizona, 85007, depaul.william@azdeq.gov, (602) 771-4654.

SUPPLEMENTARY INFORMATION: The site to be deleted from the NPL is: Nineteenth (19th) Avenue Landfill Site, Phoenix, Maricopa County, Arizona.

A Notice of Intent to Delete for this Site was published in the **Federal Register** on August 14, 2006 (71 FR 46429). The closing date for comments on the Notice of Intent to Delete was September 13, 2006. Two written comments were received; therefore EPA has prepared a Responsiveness Summary (See Appendix 1 below). In addition, EPA received a request from a community group representative to extend the public comment period. This

is also addressed in the Responsiveness Summary. EPA has considered all public comments in its final decision to delete the Site from the NPL.

EPA identifies sites that appear to present a significant risk to public health, welfare, or the environment and it maintains the NPL as the list of those sites. Any site deleted from the NPL remains eligible for Fund-financed remedial actions in the unlikely event that conditions at the site warrant such action. Section 300.425(e)(3) of the NCP states that Fund-financed actions may be taken at sites deleted from the NPL. Deletion of a site from the NPL does not affect responsible party liability or impede agency efforts to recover costs associated with response efforts.

Appendix 1—Responsiveness Summary

The Responsiveness Summary has been prepared to provide responses to comments submitted to EPA during the 30-day public comment period regarding the Notice of Intent to Delete (71 FR 46429) for the 19th Avenue Landfill Superfund Site. The original comments are summarized below and available at <http://www.regulations.gov>, Docket ID No. EPA-HQ-SFUND-1983-0002, with the support materials under document type “public submissions”, and at the information repositories at the following addresses: Arizona Department of Environmental Quality Records Center, 1110 West Washington Street, Phoenix, Arizona 85007, (602) 771-4380 or 1 (800) 234-5677, ext. 771-4380, Hours: M-F 8:30 a.m.-4:30 p.m.; City of Phoenix Public Library, Government Documents Section, 1221 North Central Avenue, Phoenix, Arizona 85004, (602) 262-4636, Hours: M-Th 10 a.m.-9 p.m., Fr&Sa 10 a.m.-6 p.m., Su 12 p.m.-6 p.m.; and U.S. EPA Superfund Records Center, 95 Hawthorne Street, San Francisco, California 94105, (415) 536-2000, Hours: M-F 8 a.m.-5 p.m.

Summary of Comment #1, Letter from Stephen M. Brittle, President, Don't Waste Arizona, Inc. (DWAZ): The majority of the comments are concerns regarding the impact of the Site to groundwater contamination. Mr. Brittle stated that the delisting “will remove the appropriate protections that the Superfund program is supposed to provide”. Specifically, there is a concern that during the landfill cleanup in the 1990's barrels of hazardous waste were left in the landfill and could ultimately leak, impacting groundwater in the future. There is also a concern regarding “plumes of chemical contamination moving off the landfill site” and DWAZ believes it has received conflicting information regarding the

source of the contamination. It also appears to the group that EPA has allowed the plumes to migrate and fall below action levels rather than taking appropriate action to clean them up.

Response to Comment #1: The landfill contains a variety of contaminants which have the potential to leach into the groundwater. Since removing all of the landfill contamination was not feasible, the EPA and ADEQ selected the remedy to include leaving the refuse in place, preventing the landfill from eroding during flood seasons with levees and a soil cap, and controlling the soil gas produced with a landfill gas collection and treatment system. The landfill cap also reduces infiltration of rainwater, which will reduce the potential for leaching. Also as part of the remedy, the City of Phoenix is required to monitor groundwater at the landfill in perpetuity, and required to implement a “groundwater contingency plan” should any constituent *due to landfill contamination* exceed action levels. This plan involves follow-up sampling to confirm the results, and an evaluation of remedial alternatives for groundwater cleanup should the contamination pose a threat to human health and the environment. The deletion does not affect this requirement, nor does it prevent EPA or ADEQ from requiring cleanup of groundwater should there be an impact in the future. As explained later in this response, EPA acknowledges that there are elevated levels of contaminants in the groundwater at the landfill, however it has been determined that the landfill is not a source of this contamination based on the review of monitoring data that has been collected quarterly for almost 20 years.

Regarding the allegations of buried barrels, a letter was sent to ADEQ in August 1996, complaining that barrels were improperly handled. Potentially hazardous material was drained out of leaking drums, mixed with surrounding soil/debris, excavated and stored in roll-off containers, and then re-buried in the landfill. Therefore, the material was already taken out of the drums. The complaint gave rise to the question of whether the material was hazardous and whether it was handled appropriately, and this was investigated by ADEQ and EPA at the time. The conclusions of the investigation were provided by EPA to the complainant in February 1998.

Regarding groundwater contamination in the area, only three constituents have ever exceeded action levels on multiple occasions in the landfill monitoring well network: 1,1-dichloroethylene (1,1-DCE), vinyl chloride, and arsenic. There is a known plume of 1,1-DCE moving

under the landfill, however, EPA and ADEQ have determined that the 1,1-DCE plume is from an upgradient source, and that the 19th Avenue Landfill is not contributing (*Assessment of Upgradient 1,1-DCE for City of Phoenix 19th Avenue Landfill*, Dames & Moore, November 1998). Vinyl chloride was detected above the action level in one of the monitoring wells and was also from off-site sources unrelated to the landfill. Vinyl chloride has not been above the action level since 2002 (*19th Avenue Landfill Exceedence Report for Vinyl Chloride*, URS, June 2002, and *Response to Agency Comments to the June 2002 Report*, URS, April 2003). Arsenic has been detected above action levels in two of the on-site wells, however arsenic is below levels of concern outside the boundaries of the landfill. EPA and ADEQ determined that the source of the arsenic is not contamination from the landfill itself, but native arsenic present in the soils. The arsenic is being mobilized into groundwater over a small area due to the oxygen low conditions near the landfill. (*Exceedence Report for Arsenic at Monitoring Well I-4*, URS, December 2003, *Technical Memorandum of Arsenic Concentrations in Groundwater Monitor Wells*, Hugh Rieck, ADEQ, April 2004, and *Exceedence Report for Arsenic at Monitoring Well I-4*, URS, June 2006, reference arsenic report). Again, if in the future it is determined that groundwater is impacted by the landfill, the protections will remain in place to compel cleanup. The supporting information that is referenced above is available in the deletion docket and site repositories and can also be provided to DWAZ.

Summary of Comment #2, Request from Michael Pops, President, Concerned Residents of South Phoenix: Mr. Pops contacted EPA and ADEQ by telephone with a request to extend the public comment period. He believed the community outreach EPA conducted regarding the notice was inadequate and requested that EPA and ADEQ conduct an outreach campaign to fully inform the affected community of the proposed action. He also was concerned with future use of the Site, and that the community would be unable to provide input or ensure that redevelopment plans would be acceptable to the community.

Response to Comment #2: EPA decided not to extend the timeframe for comment on this action beyond the required 30 days. EPA believes there was adequate time for the community to raise significant concerns regarding the deletion, and that the deletion action itself will not impact the community's

ability to comment on issues regarding the Site. EPA had issued a fact sheet to the Site mailing list and published a notice in the local paper, *The Arizona Republic*. We will work with ADEQ and the City of Phoenix to update the Community Involvement Plan and add other local newspapers and community groups to the outreach strategy as suggested for future actions. The public will continue to have an opportunity to comment to ADEQ, the lead agency, on any actions or activities associated with the Site even after deletion, particularly during the statutory Five-Year Review process.

Regarding future development at the Site, any plans would still need to follow all the applicable criteria under CERCLA and the NCP, and be protective of human health and the environment. In addition, the City of Phoenix filed a Declaration of Environmental Use Restriction on the property title in July 2006, prohibiting residential use and ensuring a process by which no landowner will be allowed to interfere with the remedy.

Summary of Comment #3, Letter from Karen O'Regan, City of Phoenix, Environmental Programs: This comment is in "support and concurrence" with the deletion action, and an expression of the commitment the City has to ensuring the remedy will be maintained and the groundwater monitored. The City will work with ADEQ on any "viable reuse proposals".

Response to Comment #3: EPA appreciates the concurrence, and on-going commitment to ensure the remedy will be maintained. EPA encourages the City to consider community concerns regarding the Site in the future, particularly as associated with the issues expressed by the community during this public comment period, and any input that may be provided during additional community involvement activities.

List of Subjects in 40 CFR Part 300

Environmental protection, Air pollution control, Chemicals, Hazardous substances, Hazardous waste, Intergovernmental relations, Penalties, Reporting and recordkeeping requirements, Superfund, Water pollution control, Water supply.

Dated: September 18, 2006.

Laura Yoshii,

Acting Regional Administrator, Region 9.

■ For the reasons set out in this document, 40 CFR part 300 is amended as follows:

PART 300—[AMENDED]

■ 1. The authority citation for part 300 continues to read as follows:

Authority: 33 U.S.C. 1321(c)(2); 42 U.S.C. 9601–9657; E.O. 12777, 56 FR 54757, 3 CFR, 1991 Comp., p.351; E.O. 12580, 52 FR 2923, 3 CFR, 1987 Comp., p. 193.

Appendix B—[Amended]

■ 2. Table 1 of Appendix B to Part 300 is amended under [Arizona] ("AZ") by removing the entry for the Nineteenth Avenue Landfill site in Phoenix, Arizona.

[FR Doc. 06–8175 Filed 9–22–06; 8:45 am]

BILLING CODE 6560–50–P

DEPARTMENT OF HOMELAND SECURITY

Coast Guard

46 CFR Parts 4, 30, 31, 32, 52, 68, 71, 91, 107, 108, 109, 126, 147, 150, 153, 159, 160, 164, 176, and 197

49 CFR Part 450

[USCG–2006–25697]

RIN 1625–ZA10

Shipping and Transportation; Technical, Organizational, and Conforming Amendments

ACTION: Final rule.

SUMMARY: This rule makes non-substantive changes throughout Titles 46 and 49 of the Code of Federal Regulations. The purpose of this rule is to make conforming amendments and technical corrections to Coast Guard navigation and navigable water regulations. This rule will have no substantive effect on the regulated public.

DATES: This final rule is effective September 25, 2006.

ADDRESSES: Comments and material received from the public, as well as documents mentioned in this preamble as being available in the docket, are part of docket USCG–2006–25697 and are available for inspection or copying at the Docket Management Facility, U.S. Department of Transportation, room PL–401, 400 Seventh Street, SW., Washington, DC, between 9 a.m. and 5 p.m., Monday through Friday, except Federal holidays. You may also find this docket on the Internet at <http://dms.dot.gov>.

FOR FURTHER INFORMATION CONTACT: If you have questions on this rule, call Mr. Ray Davis, Coast Guard, telephone 202–

372–1461. If you have questions on viewing the docket, call Ms. Renee V. Wright, Program Manager, Docket Operations, telephone 202–493–0402.

SUPPLEMENTARY INFORMATION:

Regulatory History

We did not publish a notice of proposed rulemaking (NPRM) for this regulation. Under both 5 U.S.C. 553(b)(A) and (b)(B), the Coast Guard finds that this rule is exempt from notice and comment rulemaking requirements because these changes involve agency organization and practices, and good cause exists for not publishing an NPRM for all revisions in the rule because they are all non-substantive changes. This rule consists only of corrections and editorial, organizational, and conforming amendments. These changes will have no substantive effect on the public; therefore, it is unnecessary to publish an NPRM. Under 5 U.S.C. 553(d)(3), the Coast Guard finds that, for the same reasons, good cause exists for making this rule effective less than 30 days after publication in the **Federal Register**.

Background and Purpose

Each year Titles 46 and 49 of the Code of Federal Regulations are updated on October 1. This rule, which becomes effective September 25, 2006, makes other technical and editorial corrections throughout Titles 46 and 49. This rule does not create any substantive requirements.

Regulatory Evaluation

This rule is not a “significant regulatory action” under section 3(f) of Executive Order 12866, Regulatory Planning and Review, and does not require an assessment of potential costs and benefits under section 6(a)(3) of that Order. The Office of Management and Budget has not reviewed it under that Order. It is not “significant” under the regulatory policies and procedures of the Department of Homeland Security (DHS). We expect the economic impact of this rule to be so minimal that a full Regulatory Evaluation under the regulatory policies and procedures of DHS is unnecessary. As this rule involves internal agency practices and procedures and non-substantive changes, it will not impose any costs on the public.

Small Entities

Under the Regulatory Flexibility Act (5 U.S.C. 601–612), we have considered whether this rule would have a significant economic impact on a substantial number of small entities. The term “small entities” comprises

small businesses, not-for-profit organizations that are independently owned and operated and are not dominant in their fields, and governmental jurisdictions with populations of less than 50,000. This rule does not require a general NPRM and, therefore, is exempt from the requirements of the Regulatory Flexibility Act. Although this rule is exempt, we have reviewed it for potential economic impact on small entities.

Collection of Information

This rule calls for no new collection of information under the Paperwork Reduction Act of 1995 (44 U.S.C. 3501–3520).

Federalism

A rule has implications for federalism under Executive Order 13132, Federalism, if it has a substantial direct effect on State or local governments and would either preempt State law or impose a substantial direct cost of compliance on them. We have analyzed this rule under that Order and have determined that it does not have implications for federalism.

Unfunded Mandates Reform Act

The Unfunded Mandates Reform Act of 1995 (2 U.S.C. 1531–1538) requires Federal agencies to assess the effects of their discretionary regulatory actions. In particular, the Act addresses actions that may result in the expenditure by a State, local, or tribal government, in the aggregate, or by the private sector of \$100,000,000 or more in any one year. Though this rule will not result in an expenditure of this magnitude, we do discuss the effects of this rule elsewhere in this preamble.

Taking of Private Property

This rule will not effect a taking of private property or otherwise have taking implications under Executive Order 12630, Governmental Actions and Interference with Constitutionally Protected Property Rights.

Civil Justice Reform

This rule meets applicable standards in sections 3(a) and 3(b)(2) of Executive Order 12988, Civil Justice Reform, to minimize litigation, eliminate ambiguity, and reduce burden.

Protection of Children

We have analyzed this rule under Executive Order 13045, Protection of Children from Environmental Health Risks and Safety Risks. This rule is not an economically significant rule and does not create an environmental risk to

health or risk to safety that may disproportionately affect children.

Indian Tribal Governments

This rule does not have tribal implications under Executive Order 13175, Consultation and Coordination with Indian Tribal Governments, because it does not have a substantial direct effect on one or more Indian tribes, on the relationship between the Federal Government and Indian tribes, or on the distribution of power and responsibilities between the Federal Government and Indian tribes.

Energy Effects

We have analyzed this rule under Executive Order 13211, Actions Concerning Regulations That Significantly Affect Energy Supply, Distribution, or Use. We have determined that it is not a “significant energy action” under that order because it is not a “significant regulatory action” under Executive Order 12866 and is not likely to have a significant adverse effect on the supply, distribution, or use of energy. The Administrator of the Office of Information and Regulatory Affairs has not designated it as a significant energy action. Therefore, it does not require a Statement of Energy Effects under Executive Order 13211.

Technical Standards

The National Technology Transfer and Advancement Act (NTTAA) (15 U.S.C. 272 note) directs agencies to use voluntary consensus standards in their regulatory activities unless the agency provides Congress, through the Office of Management and Budget, with an explanation of why using these standards would be inconsistent with applicable law or otherwise impractical. Voluntary consensus standards are technical standards (e.g., specifications of materials, performance, design, or operation; test methods; sampling procedures; and related management systems practices) that are developed or adopted by voluntary consensus standards bodies. This rule does not use technical standards. Therefore, we did not consider the use of voluntary consensus standards.

Environment

We have analyzed this rule under Commandant Instruction M16475.1D, which guides the Coast Guard in complying with the National Environmental Policy Act of 1969 (NEPA)(42 U.S.C. 4321–4370f), and have concluded that there are no factors in this case that would limit the use of a categorical exclusion under section 2.B.2 of the Instruction. Therefore, this

rule is categorically excluded, under figure 2–1, paragraph (34)(a) and (b), of the Instruction from further environmental documentation because this rule involves editorial, procedural, and internal agency functions. A final “Environmental Analysis Check List” and a final “Categorical Exclusion Determination” are available in the docket where indicated under **ADDRESSES**.

List of Subjects

46 CFR Part 4

Administrative practice and procedure, Drug testing, Investigations, Marine safety, Nuclear vessels, Radiation protection, Reporting and recordkeeping requirements, Safety, Transportation.

46 CFR Part 30

Cargo vessels, Foreign relations, Hazardous materials transportation, Penalties, Reporting and recordkeeping requirements, Seamen.

46 CFR Part 31

Cargo vessels, Marine safety, Reporting and recordkeeping requirements.

46 CFR Part 32

Cargo vessels, Fire prevention, Marine safety, Navigation (water), Occupational safety and health, Reporting and recordkeeping requirements, Seamen.

46 CFR Part 52

Reporting and recordkeeping requirements, Vessels.

46 CFR Part 68

Oil pollution, Vessels.

46 CFR Part 71

Marine safety, Passenger vessels, Reporting and recordkeeping requirements.

46 CFR Part 91

Cargo vessels, Marine safety, Reporting and recordkeeping requirements.

46 CFR Part 107

Marine safety, Oil and gas exploration, Reporting and recordkeeping requirements, Vessels.

46 CFR Part 108

Fire prevention, Marine safety, Occupational safety and health, Oil and gas exploration, Vessels.

46 CFR Part 109

Marine safety, Occupational safety and health, Oil and gas exploration, Reporting and recordkeeping requirements, Vessels.

46 CFR Part 126

Cargo vessels, Marine safety, Reporting and recordkeeping requirements.

46 CFR Part 147

Hazardous materials transportation, Labeling, Marine safety, Packaging and containers, Reporting and recordkeeping requirements.

46 CFR Part 150

Hazardous materials transportation, Marine safety, Occupational safety and health, Reporting and recordkeeping requirements.

46 CFR Part 153

Administrative practice and procedure, Cargo vessels, Hazardous materials transportation, Marine safety, Reporting and recordkeeping requirements, Water pollution control.

46 CFR Part 159

Business and industry, Laboratories, Marine safety, Reporting and recordkeeping requirements.

46 CFR Part 160

Marine safety, Reporting and recordkeeping requirements.

46 CFR Part 164

Fire prevention, Marine safety, Reporting and recordkeeping requirements.

46 CFR Part 176

Fire prevention, Marine safety, Passenger vessels, Reporting and recordkeeping requirements.

46 CFR Part 197

Benzene, Diving, Marine safety, Occupational safety and health, Reporting and recordkeeping requirements, Vessels.

49 CFR Part 450

Freight, Packaging and containers, Reporting and recordkeeping requirements, Safety.

■ For the reasons listed in the preamble, the Coast Guard amends 46 CFR parts 4, 30, 31, 32, 52, 68, 71, 91, 107, 108, 109, 126, 147, 150, 153, 159, 160, 164, 176, and 197 and 49 CFR part 450:

TITLE 46—SHIPPING

PART 4—MARINE CASUALTIES AND INVESTIGATIONS

■ 1. The authority citation for part 4 continues to read as follows:

Authority: 33 U.S.C. 1231; 43 U.S.C. 1333; 46 U.S.C. 2103, 2303a, 2306, 6101, 6301, and 6305; 50 U.S.C. 198; Department of Homeland Security Delegation No. 0170.1.

Subpart 4.40 issued under 49 U.S.C. 1903(a)(1)(E).

■ 2. Revise the parenthetical at the end of § 4.04–3 to read as follows:

§ 4.04–3 Reports of lack of vessel communication.

* * * * *

(Information collection requirements approved by the Office of Management and Budget under control number 1625–0048)

■ 3. Revise the parenthetical at the end of § 4.04–5, to read as follows:

§ 4.04–5 Substance of reports.

* * * * *

(Information collection requirements approved by the Office of Management and Budget under control number 1625–0048)

PART 30—GENERAL PROVISIONS

■ 4. The authority citation for part 30 continues to read as follows:

Authority: 46 U.S.C. 2103, 3306, 3703; Pub. L. 103–206, 107 Stat. 2439; 49 U.S.C. 5103, 5106; Department of Homeland Security Delegation No. 0170.1; Section 30.01–2 also issued under the authority of 44 U.S.C. 3507; Section 30.01–05 also issued under the authority of Sec. 4109, Pub. L. 101–380, 104 Stat. 515.

§ 30.30–7 [Amended]

■ 5. In § 30.30–7, after the word “Telephone:”, remove the text “(202) 267–2978” and add, in its place, the text “(202) 372–1251”.

PART 31—INSPECTION AND CERTIFICATION

■ 6. The authority citation for part 31 continues to read as follows:

Authority: 33 U.S.C. 1321(j); 46 U.S.C. 2103, 3205, 3306, 3307, 3703; 46 U.S.C. Chapter 701; 49 U.S.C. 5103, 5106; E.O. 12234, 45 FR 58801, 3 CFR, 1980 Comp., p. 277; E.O. 12777, 56 FR 54757, 3 CFR, 1991 Comp., p. 351; Department of Homeland Security Delegation No. 0170.1. Section 31.10–21 also issued under the authority of Sect. 4109, Pub. L. 101–380, 104 Stat. 515.

§ 31.01–3 [Amended]

■ 7. In § 31.01–3(b), after the word “telephone”, remove the text “(202) 267–2988; or fax (202) 267–4816” and add, in its place, the text “(202) 372–1372; or fax (202) 372–1925”.

PART 32—SPECIAL EQUIPMENT, MACHINERY, AND HULL REQUIREMENTS

■ 8. The authority citation for part 32 continues to read as follows:

Authority: 46 U.S.C. 2103, 3306, 3703, 3719; E.O. 12234, 45 FR 58801, 3 CFR, 1980 Comp., p. 277; 49 CFR 1.46; Subpart 32.59 also issued under the authority of Sec. 4109, Pub. L. 101–380, 104 Stat. 515.

■ 9. In § 32.15–15(e), revise the fourth sentence to read as follows:

§ 32.15–15 Anchors, Chains, and Hawser-TB/ALL

* * * * *

(e) * * * Inquiries concerning classification society standards for anchoring systems should be directed to Commandant (G–PSE–3), 2100 Second Street, SW., Washington DC, 20593–0001; telephone (202) 372–1378 or fax (202) 372–1925. * * *

* * * * *

PART 52—POWER BOILERS

■ 10. The authority citation for part 52 continues to read as follows:

Authority: 46 U.S.C. 3306, 3307, 3703; E.O. 12234, 45 FR 58801, 3 CFR, 1980 Comp., p. 277; Department of Homeland Security Delegation No. 0170.1.

■ 11. Revise the parenthetical at the end of § 52.01–5 to read as follows:

§ 52.01–5 Plans.

* * * * *

(Approved by the Office of Management and Budget under control number 1625–0097)

PART 68—DOCUMENTATION OF VESSELS PURSUANT TO EXTRAORDINARY LEGISLATIVE GRANTS

■ 12. The authority citation for part 68 continues to read as follows:

Authority: 46 U.S.C. 2103; Pub. L. 107–296, 116 Stat. 2135; Department of Homeland Security Delegation No. 0170.1. Subpart 68.01 also issued under 46 U.S.C. App. 876; subpart 68.05 also issued under 46 U.S.C. 12106(d).

■ 13. Revise the parenthetical at the end of § 68.01–5 to read as follows:

§ 68.01–5 Qualification as an 883–1 corporation.

* * * * *

(Approved by the Office of Management and Budget under control number 1625–0027)

PART 71—INSPECTION AND CERTIFICATION

■ 14. The authority citation for part 71 continues to read as follows:

Authority: 33 U.S.C. 1321(j); 46 U.S.C. 2113, 3205, 3306, 3307; E.O. 12234, 45 FR 58801, 3 CFR, 1980 Comp., p. 277; E.O. 12777, 56 FR 54757, 3 CFR, 1991 Comp., p. 351; Department of Homeland Security Delegation No. 0170.1.

§ 71.15–5 [Amended]

■ 15. In § 71.15–5(b), after the word “telephone” remove the text “(202) 267–2988; or fax (202) 267–4816” and add, in its place, the text “(202) 372–1372; or fax (202) 372–1925”.

PART 91—INSPECTION AND CERTIFICATION

■ 16. The authority citation for part 91 continues to read as follows:

Authority: 33 U.S.C. 1321(j); 46 U.S.C. 3205, 3306, 3307; 46 U.S.C. Chapter 701; Executive Order 12234; 45 FR 58801; 3 CFR, 1980 Comp., p. 277; Executive Order 12777, 56 FR 54757, 3 CFR, 1991 Comp., p. 351; Department of Homeland Security Delegation No. 0170.1.

§ 91.15–5 [Amended]

■ 17. In § 91.15–5(b), after the word “telephone” remove the text “(202) 267–2988; or fax (202) 267–4816” and add, in its place, the text “(202) 372–1372; or fax (202) 372–1925”.

PART 107—INSPECTION AND CERTIFICATION

■ 18. The authority citation for part 107 continues to read as follows:

Authority: 43 U.S.C. 1333; 46 U.S.C. 3306, 3307; 46 U.S.C. 3316; Department of Homeland Security Delegation No. 0170.1; § 107.05 also issued under the authority of 44 U.S.C. 3507.

§ 107.205 [Amended]

■ 19. In § 107.205(a), after the word “telephone” remove the text “(202) 267–2988; or fax (202) 267–4816” and add, in its place, the text “(202) 372–1372; or fax (202) 372–1925”.

PART 108—DESIGN AND EQUIPMENT

■ 20. The authority citation for part 108 continues to read as follows:

Authority: 43 U.S.C. 1333; 46 U.S.C. 3102, 3306; Department of Homeland Security Delegation No. 0170.1.

§ 108.520 [Amended]

■ 21. In § 108.520(a), after the words “approved under approval series” remove the text “160.135” and add, in its place, the text “160.035”.

PART 109—OPERATIONS

■ 22. The authority citation for part 109 continues to read as follows:

Authority: 43 U.S.C. 1333; 46 U.S.C. 3306, 6101, 10104; Department of Homeland Security Delegation No. 0170.1.

■ 23. Revise the parenthetical at the end of § 109.121 to read as follows:

§ 109.121 Operating manual.

* * * * *

(Approved by the Office of Management and Budget under control number 1625–0038)

PART 126—INSPECTION AND CERTIFICATION

■ 24. The authority citation for part 126 continues to read as follows:

Authority: 33 U.S.C. 1321(j); 46 U.S.C. 3205, 3306, 3307; 46 U.S.C. Chapter 701; Executive Order 111735, 38 FR 21243, 3 CFR 1971–1975 Comp., p. 793; Department of Homeland Security Delegation No. 0170.1.

§ 126.235 [Amended]

■ 25. In § 126.235(b), after the words “available from” remove the text “Commandant (G–MSE), 2100 Second St., SW., Washington, DC 20593–0001; telephone (202) 267–6925; or fax (202) 267–4816.” and add, in its place, the text “Commandant (G–PSE–2), 2100 Second St., SW., Washington, DC 20593–0001; telephone (202) 372–1372; or fax (202) 372–1925.”

PART 147—HAZARDOUS SHIPS’ STORES

■ 26. The authority citation for part 147 continues to read as follows:

Authority: 46 U.S.C. 3306; E.O. 12234, 45 FR 58801, 3 CFR, 1980 Comp., p. 277; Department of Homeland Security Delegation No. 0170.1.

§ 147.5 [Amended]

■ 27. In § 147.5 text, after the words “telephone number is” remove the text “(202) 267–0214” and add, in its place, the text, “(202) 372–1401”.

PART 150—COMPATIBILITY OF CARGOES

■ 28. The authority citation for part 150 continues to read as follows:

Authority: 46 U.S.C. 3306, 3703; Department of Homeland Security Delegation No. 0170.1. Section 150.105 issued under 44 U.S.C. 3507; Department of Homeland Security Delegation No. 0170.1.

§ 150.140 [Amended]

■ 29. In § 150.140, after the text “(tel. no.” remove the text “(202) 267–1577” and add, in its place, the text “(202) 372–1425”.

Table 1 to Part 150 [Amended]

■ 30. In footnote 1. to Table I to part 150, after the word “Telephone”, remove the text “(202) 267–1577” and add, in its place, the text “(202) 372–1425”.

Table II to Part 150 [Amended]

■ 31. In footnote 1. to Table II to part 150, after the word “Telephone”, remove the text “(202) 267–1577” and add, in its place, the text “(202) 372–1425”.

PART 153—SHIPS CARRYING BULK LIQUID, LIQUEFIED GAS, OR COMPRESSED GAS HAZARDOUS MATERIALS

■ 32. The authority citation for part 153 continues to read as follows:

Authority: 46 U.S.C. 3703; Department of Homeland Security Delegation No. 0170.1. Section 153.40 issued under 49 U.S.C. 5103. Sections 153.470 through 153.491, 153.1100 through 153.1132, and 153.1600 through 153.1608 also issued under 33 U.S.C. 1903 (b).

§ 153.490 [Amended]

■ 33. In § 153.490(a)(1), after the words “OMB App. No.” remove the text “2115–0089” and add, in its place, the text “1625–0094”.

§ 153.1025 [Amended]

■ 34. In § 153.1025(c), after the text “telephone (“ remove the text “(202) 267–1217” and add, in its place, the text “(202) 372–1425”.

§ 153.1119 [Amended]

■ 35. In § 153.1119(c) introductory text, after the text “tel num;” remove the text “202–267–1217” and add, in its place, the text “202–372–1425”.

§ 153.1608 [Amended]

■ 36. In the Note at the end of § 153.1608, after the text “tel#” remove the text “202–267–1217” and add, in its place, the text “202–372–1425”.

PART 159—APPROVAL OF EQUIPMENT AND MATERIALS

■ 37. The authority citation for part 159 continues to read as follows:

Authority: 46 U.S.C. 3306, 3703; 49 CFR 1.45, 1.46; Section 159.001–9 also issued under the authority of 44 U.S.C. 3507.

■ 38. Revise § 159.001–5 to read as follows:

§ 159.001–5 Correspondence and applications.

Unless otherwise specified, all correspondence and applications in

connection with approval and testing of equipment and materials must be addressed to: Commandant (G–PSE–4), U.S. Coast Guard, 2100 Second Street, SW., Washington, DC 20593–0001, Telephone: (202) 372–1392, Facsimile: (202) 372–1924.

PART 160—LIFESAVING EQUIPMENT

■ 39. The authority citation for part 160 continues to read as follows:

Authority: 46 U.S.C. 2103, 3306, 3703 and 4302; E.O. 12234, 45 FR 58801, 3 CFR, 1980 Comp., p. 277; 49 CFR 1.46.

■ 40. In § 160.076–5 revise the definition of “Commandant” to read as follows:

§ 160.076–5 Definitions

* * * * *

Commandant means the Chief of the Lifesaving and Fire Safety Standards Division, Marine Safety and Environmental Protection. Address: Commandant (G–PSE–4), U.S. Coast Guard Headquarters, 2100 Second St., SW., Washington, DC 20593–0001; phone: 202–372–1392; facsimile: 202–372–1924.

* * * * *

PART 164—MATERIALS

■ 41. The authority citation for part 164 continues to read as follows:

Authority: 46 U.S.C. 3306, 3703, 4302; E.O. 12234, 45 FR 58801, 3 CFR, 1980 Comp., p. 277; 49 CFR 1.46.

§ 164.019–3 [Amended]

■ 42. In § 164.019–3, in the definition for “Commandant”, after the text “phone:” remove the text “202–267–1444” and add, in its place the text “202 372–1392”.

PART 176—INSPECTION AND CERTIFICATION

■ 43. The authority citation for part 176 continues to read as follows:

Authority: 33 U.S.C. 1321(j); 46 U.S.C. 2103, 3205, 3306, 3307; 49 U.S.C. App. 1804;

E.O. 11735, 38 FR 21243, 3 CFR, 1971–1975 Comp., p. 743; E.O. 12234, 45 FR 58801, 3 CFR, 1980 Comp., p. 277; Department of Homeland Security Delegation No. 0170.

§ 176.665 [Amended]

■ 44. In § 176.665(a), after the words “in compliance with” remove the text “§ 176.605” and add, in its place, the text “§ 176.600”.

PART 197—GENERAL PROVISIONS

■ 45. The authority citation for part 197 continues to read as follows:

Authority: 33 U.S.C. 1509; 43 U.S.C. 1333; 46 U.S.C. 3306, 3703, 6101; Department of Homeland Security Delegation No. 0170.1.

■ 46. Revise the parenthetical at the end of § 197.486 to read as follows:

§ 197.486 Retention of records after casualty.

* * * * *

(The reporting requirement in paragraph (a) was approved by OMB under control number 1625–0001)

TITLE 49—TRANSPORTATION

PART 450—GENERAL

■ 47. The authority citation for part 450 continues to read as follows:

Authority: Sec. 4, 91 Stat 1475 (46 U.S.C. 1503); Department of Homeland Security Delegation No. 0170.1.

§ 450.7 [Amended]

■ 48. Revise the parenthetical at the end of § 450.7 to read as follows:

§ 450.7 Marking.

* * * * *

(Approved by the Office of Management and Budget under OMB control number 1625–0024)

Dated: September 18, 2006.

Stefan G. Venckus,

Chief, Office of Regulations and Administrative Law, United States Coast Guard.

[FR Doc. 06–8133 Filed 9–22–06; 8:45 am]

BILLING CODE 4910–15–P

Proposed Rules

Federal Register

Vol. 71, No. 185

Monday, September 25, 2006

This section of the FEDERAL REGISTER contains notices to the public of the proposed issuance of rules and regulations. The purpose of these notices is to give interested persons an opportunity to participate in the rule making prior to the adoption of the final rules.

DEPARTMENT OF HEALTH AND HUMAN SERVICES

Food and Drug Administration

21 CFR Parts 807, 868, 870, 872, 874, 876, 878, 880, 882, 884, 886, and 892

[Docket No. 2006N-0335]

Medical Devices; Reprocessed Single-Use Devices; Requirement for Submission of Validation Data; Companion to Direct Final Rule

AGENCY: Food and Drug Administration, HHS.

ACTION: Proposed rule.

SUMMARY: The Food and Drug Administration (FDA or we) is proposing to amend certain classification regulations to reflect the termination of certain device exemptions and the requirement to submit validation data for specific reprocessed single-use devices (SUDs), as required by the Medical Device User Fee and Modernization Act of 2002 (MDUFMA). This proposed rule is a companion document to a direct final rule published elsewhere in this issue of the **Federal Register**. This proposed rule will provide a procedural framework to finalize the rule in the event we receive any significant adverse comment and withdraw the direct final rule. This proposed rule would codify actions taken in previous **Federal Register** notices in accordance with MDUFMA.

DATES: Submit written or electronic comments by December 11, 2006.

ADDRESSES: You may submit comments, identified by Docket No. 2006N-0335, by any of the following methods:

Electronic Submissions

Submit electronic comments in the following ways:

- Federal eRulemaking Portal: <http://www.regulations.gov>. Follow the instructions for submitting comments.
- Agency Web site: <http://www.fda.gov/dockets/ecomments>. Follow the instructions for submitting comments on the agency Web site.

Written Submissions

Submit written submissions in the following ways:

- FAX: 301-827-6870.
- Mail/Hand delivery/Courier [For paper, disk, or CD-ROM submissions]: Division of Dockets Management (HFA-305), Food and Drug Administration, 5630 Fishers Lane, rm. 1061, Rockville, MD 20852.

To ensure more timely processing of comments, FDA is no longer accepting comments submitted to the agency by e-mail. FDA encourages you to continue to submit electronic comments by using the Federal eRulemaking Portal or the agency Web site, as described in the *Electronic Submissions* portion of this paragraph.

Instructions: All submissions received must include the agency name and Docket No(s), and Regulatory Information Number (RIN) (if a RIN number has been assigned) for this rulemaking. All comments received may be posted without change to <http://www.fda.gov/ohrms/dockets/default.htm>, including any personal information provided. For additional information on submitting comments, see the "Comments" heading of the **SUPPLEMENTARY INFORMATION** section of this document.

Docket: For access to the docket to read background documents or comments received, go to <http://www.fda.gov/ohrms/dockets/default.htm> and insert the docket number(s), found in brackets in the heading of this document, into the "Search" box and follow the prompts and/or go to the Division of Dockets Management, 5630 Fishers Lane, rm. 1061, Rockville, MD 20852.

FOR FURTHER INFORMATION CONTACT: Heather S. Rosecrans, Center for Devices and Radiological Health (HFZ-404), Food and Drug Administration, 9200 Corporate Blvd., Rockville, MD 20850, 301-594-1190, ext. 143.

SUPPLEMENTARY INFORMATION:

I. Why Is This Rule Being Issued as a Companion Proposed Rule?

This proposed rule is a companion to the direct final rule that is published in the final rules section of this issue of the **Federal Register**. The direct final rule would amend certain classification regulations for reprocessed single-use devices (SUDs) whose exemption from premarket notification (510(k))

requirements have been terminated and other reprocessed SUDs already subject to premarket notification for which validation data, as specified under MDUFMA, are necessary in a 510(k). The direct final rule and this companion proposed rule are identical. We are publishing the direct final rule because we believe the rule contains noncontroversial changes and minor corrections to existing regulations, and we anticipate that it will receive no significant adverse comment. A detailed discussion of the rule is set forth in the preamble of the direct final rule. If no significant adverse comment is received in response to the direct final rule, no further action will be taken related to this proposed rule. Instead, we will publish a confirmation document within 30 days after the comment period ends confirming when the direct final rule will go into effect. You can find additional information about FDA's direct final rulemaking procedures in the guidance document entitled "Guidance for FDA and Industry: Direct Final Rule Procedures" (62 FR 62466, November 21, 1997). This guidance document may be accessed at <http://www.fda.gov/opacom/morechoices/industry/guidance.htm>.

If we receive any significant adverse comment regarding the direct final rule, we will withdraw the direct final rule within 30 days after the comment period ends and proceed to respond to all of the comments under this companion proposed rule using usual notice-and-comment rulemaking procedures under the Administrative Procedure Act (APA) (5 U.S.C. 552a *et seq*). The comment period for this companion proposed rule runs concurrently with the direct final rule's comment period. Any comments received under this companion proposed rule will also be considered as comments regarding the direct final rule. A significant adverse comment is defined as a comment that explains why the rule would be inappropriate, including challenges to the rule's underlying premise or approach, or would be ineffective or unacceptable without a change. In determining whether an adverse comment is significant and warrants terminating a direct final rulemaking, we will consider whether the comment raises an issue serious enough to warrant a substantive response in a notice-and-

comment process in accordance with section 553 of the APA (5 U.S.C. 553). Comments that are frivolous, insubstantial, or outside the scope of the rule will not be considered adverse under this procedure. For example, a comment recommending an additional change to the rule will not be considered a significant adverse comment, unless the comment states why the rule would be ineffective without the additional change. In addition, if a significant adverse comment applies to part of a rule and that part can be severed from the remainder of the rule, we may adopt as final those parts of the rule that are not the subject of a significant adverse comment.

II. What Is the Background of the Rule?

On October 26, 2002, MDUFMA (Public Law 107-250), amended the Federal Food, Drug, and Cosmetic Act (the act) by adding section 510(o) (21 U.S.C. 360(o)), which provided new regulatory requirements for reprocessed SUDs. The new provision requires validation data to be included in the premarket notification (510(k)) for certain reprocessed SUDs, to ensure that reprocessed SUDs are substantially equivalent to predicate devices. The validation data includes cleaning and sterilization data, and functional performance data demonstrating that each SUD will remain substantially equivalent to its predicate device after the maximum number of times the device is reprocessed.

Before enactment of the new law, a manufacturer of a reprocessed SUD was required to obtain premarket approval or premarket clearance for the device, unless the device was exempt from premarket submission requirements. Under MDUFMA, some previously exempt reprocessed SUDs are no longer exempt from premarket notification requirements. Manufacturers of these identified devices were required to submit 510(k)s that included validation data specified by FDA. Reprocessors of certain SUDs already subject to cleared 510(k)s were also required to submit the validation data specified by the agency.

A. Definitions

Under section 201(l)(2)(A) of the act (21 U.S.C. 321(l)(2)(A)), a reprocessed SUD is defined as an "original device that has previously been used on a patient and has been subjected to additional processing and manufacturing for the purpose of an additional single use on a patient. The subsequent processing and manufacture of a reprocessed single-use device shall result in a device that is reprocessed

within the meaning of this definition." FDA is amending § 807.3 (21 CFR 807.3) by adding paragraph (t) to incorporate this definition into the regulations.

Reprocessed SUDs are divided into three groups: (1) Critical, (2) semicritical, and (3) noncritical. The first two categories are set forth in the act and all three reflect a categorization scheme recognized in the industry (Ref. 1). In the **Federal Register** of April 30, 2003 (68 FR 23139), FDA describes in more detail the development of this scheme and its use in the implementation of section 510(o) of the act. The act defines critical and semicritical reprocessed single use devices at section 201(mm) as amended by MDUFMA. FDA defined noncritical devices in the **Federal Register** of April 30, 2003. The definitions are as follows:

- A critical reprocessed SUD is intended to contact normally sterile tissue or body spaces during use.
- A semicritical reprocessed SUD is intended to contact intact mucous membranes and not penetrate normally sterile areas of the body.
- A noncritical reprocessed SUD is intended to make topical contact and not penetrate intact skin.

B. Critical and Semicritical Reprocessed SUDs Previously Exempt from Premarket Notification

MDUFMA required FDA to review the critical and semicritical reprocessed SUDs that were previously exempt from premarket notification requirements and determine which of these devices required premarket notification to ensure their substantial equivalence to predicate devices. Under MDUFMA, FDA was required to identify in a **Federal Register** notice those critical reprocessed SUDs whose exemption from premarket notification would be terminated and for which FDA determined that validation data, as specified under MDUFMA, was necessary in a 510(k). FDA published a list of these devices on April 30, 2003. According to the law, manufacturers of the devices whose exemptions from premarket notification were terminated were required to submit 510(k)s that included validation data regarding cleaning, sterilization, and functional performance, in addition to all the other required elements of a 510(k) identified in § 807.87 (21 CFR 807.87), within 15 months of publication of the notice or no longer market their devices.

In accordance with section 510(o) of the act, FDA must revise the list of devices subject to this requirement as appropriate. In the **Federal Register** of June 26, 2003 (68 FR 38071), FDA recategorized nine device types from

semicritical to critical, and added nonelectric gastroenterology-urology biopsy forceps to the list of critical reprocessed SUDs whose exemption from premarket notification requirements was being terminated. In the **Federal Register** of September 29, 2005 (70 FR 56911), FDA announced that it was adding devices to the list of critical reprocessed SUDs whose 510(k) exemption is terminated and for which validation data is necessary.

By April 26, 2004, FDA was required to identify in a **Federal Register** notice those semicritical reprocessed SUDs whose exemption from premarket notification would be terminated and for which FDA determined that validation data, as specified under MDUFMA, was necessary in a 510(k). FDA published this list in the **Federal Register** of April 13, 2004 (69 FR 19433). As discussed previously in this document, manufacturers of the devices whose exemptions from premarket notification were terminated were required to submit 510(k)s that included validation data regarding cleaning, sterilization, and functional performance, in addition to all the other required elements of a 510(k) identified in § 807.87, within 15 months of publication of the notice or no longer market their devices. In accordance with section 510(o) of the act, FDA must revise the list of devices subject to this requirement as appropriate.

C. Reprocessed SUDs Already Subject to Premarket Notification Requirements

MDUFMA also required FDA to review the types of reprocessed SUDs already subject to premarket notification requirements and to identify which of these devices required the submission of validation data to ensure their substantial equivalence to predicate devices. FDA published a list of these devices in the **Federal Register** of April 30, 2003. As described previously in this document, FDA must revise the list of devices subject to this requirement as appropriate. In the **Federal Register** of September 29, 2005, FDA announced that it was adding laparoscopic and endoscopic electrosurgical accessories to this list of reprocessed SUDs already subject to premarket notification.

For devices identified on this list that had already been cleared through the 510(k) process, manufacturers were required to submit validation data regarding cleaning, sterilization, and functional performance within 9 months of publication of the list or no longer market their devices.

For devices on this list that were not yet cleared through the 510(k) process, manufacturers were required to submit

510(k)s with validation data regarding cleaning, sterilization, and functional performance, in addition to all the other required elements identified in § 807.87.

III. What Does This Proposed Rule Do?

As described previously in this document, we have already taken actions required under section 510(o) of the act. This proposed rule would codify these actions, including revocations of exemption from premarket notification for SUDs and the requirement to submit validation data, and add definitions based on the statute to 21 CFR part 807. The proposed rule does not make any substantive changes to existing requirements. We have included a detailed description of specific changes in the rule in the preamble to the direct final rule, published elsewhere in this issue of the **Federal Register**.

FDA has made available previously a guidance document on the submission of validation data entitled "Medical Device User Fee and Modernization Act of 2002, Validation Data in Premarket Notification Submissions (510(k)s) for Reprocessed Single-Use Medical Devices" (69 FR 30943, June 1, 2004). This guidance document may be accessed on the Internet at <http://www.fda.gov/cdrh/ode/guidance/1216.html>.

IV. What Is the Legal Authority for This Proposed Rule?

This proposed rule is authorized by sections 201, 301, 501, 502, 510, 513, 515, 519, 520, 701, 704, 801, and 903 of the act and sections 264 and 271 of the Public Health Service Act (21 U.S.C. 321, 331, 351, 352, 360, 360c, 360e, 360i, 360j, 371, 374, 381, 393; 42 U.S.C. 264 and 271).

V. What Is the Environmental Impact of This Proposed Rule?

We have determined under 21 CFR 25.30(h) and 25.34(a) that this action is of a type that does not individually or cumulatively have a significant effect on the human environment. Therefore, neither an environmental assessment nor an environmental impact statement is required.

VI. What Is the Economic Impact of This Proposed Rule?

We have examined the impacts of the rule under Executive Order 12866 and the Regulatory Flexibility Act (5 U.S.C. 601–612), and the Unfunded Mandates Reform Act of 1995 (Public Law 104–4). Executive Order 12866 directs agencies to assess all costs and benefits of available regulatory alternatives and, when regulation is necessary, to select

regulatory approaches that maximize net benefits (including potential economic, environmental, public health and safety, and other advantages; distributive impacts; and equity). We believe that this proposed rule is not a significant regulatory action as defined by the Executive order.

The Regulatory Flexibility Act requires agencies to analyze regulatory options that would minimize any significant impact of a rule on small entities. Because this proposed rule will not change any existing requirements or impose any new requirements, we certify that the proposed rule, if finalized, will not have a significant economic impact on a substantial number of small entities.

Section 202(a) of the Unfunded Mandates Reform Act of 1995 requires that agencies prepare a written statement, which includes an assessment of anticipated costs and benefits, before proposing "any rule that includes any Federal mandate that may result in the expenditure by State, local, and tribal governments, in the aggregate, or by the private sector, of \$100,000,000 or more (adjusted annually for inflation) in any one year." The current threshold after adjustment for inflation is \$118 million, using the most current (2004) Implicit Price Deflator for the Gross Domestic Product. FDA does not expect this proposed rule to result in any 1-year expenditure that would meet or exceed this amount.

VII. How Does the Paperwork Reduction Act of 1995 Apply to This Rule?

This proposed rule contains information collection provisions that are subject to review by the Office of Management and Budget (OMB) under the Paperwork Reduction Act of 1995 (the PRA) (44 U.S.C. 3501–3520). The collections of information addressed in the proposed rule have been approved by OMB in accordance with the PRA under the regulations governing premarket notifications (21 CFR part 807, OMB control number 0910–0120).

VIII. What Are the Federalism Impacts of This Proposed Rule?

We have analyzed this proposed rule in accordance with the principles set forth in Executive Order 13132. We have determined that the rule does not contain policies that have substantial direct effects on the States, on the relationship between the National Government and the States, or on the distribution of power and responsibilities among the various levels of government. Accordingly, we have concluded that the rule does not

contain policies that have federalism implications as defined in the Executive order and, consequently, a federalism summary impact statement is not required.

IX. How Do You Submit Comments on This Proposed Rule?

Interested persons may submit to the Division of Dockets Management (see **ADDRESSES**) written or electronic comments regarding this proposed rule. Submit a single copy of electronic comments or two paper copies of any mailed comments, except that individuals may submit one paper copy. Comments are to be identified with the docket number found in brackets in the heading of this document. Received comments may be seen in the Division of Dockets Management between 9 a.m. and 4 p.m., Monday through Friday.

X. What Is the Reference for This Rule?

The following reference has been placed on display in the Division of Dockets Management (see **ADDRESSES**) and may be seen by interested persons between 9 a.m. and 4 p.m., Monday through Friday.

1. Spaulding, E. H., "The Role of Chemical Disinfection in the Prevention of Nonsocomial Infections." Edited by P. S. Brachman and T. C. Eickoff, Proceedings of International Conference on Nonsocomial Infections, 1970, American Hospital Association, Chicago, 254–274, 1971.

List of Subjects

21 CFR Part 807

Confidential business information, Imports, Medical devices, Reporting and recordkeeping requirements.

21 CFR Parts 868, 870, 872, 874, 876, 878, 880, 882, and 884

Medical devices.

21 CFR Part 886

Medical devices, Ophthalmic goods and services.

21 CFR Part 892

Medical devices, Radiation protection, X-rays.

Therefore, under the Federal Food, Drug, and Cosmetic Act and under authority delegated to the Commissioner of Food and Drugs, it is proposed that 21 CFR parts 807, 868, 870, 872, 874, 876, 878, 880, 882, 884, 886, and 892 be amended as follows:

PART 807—ESTABLISHMENT REGISTRATION AND DEVICE LISTING FOR MANUFACTURERS AND INITIAL IMPORTERS OF DEVICES

1. The authority citation for 21 CFR part 807 continues to read as follows:

Authority: 21 U.S.C. 321, 331, 351, 352, 360, 360c, 360e, 360i, 360j, 371, 374, 381, 393; 42 U.S.C. 264, 271

2. Section 807.3 is amended by adding new paragraphs (t), (u), and (v) to read as follows:

§ 807.3 Definitions.

* * * * *

(t) A single use device (SUD) means a device that is intended for one use or on a single patient during a single procedure.

(u) A reprocessed SUD is an original device that has previously been used on a patient and has been subjected to additional processing and manufacturing for the purpose of an additional single use on a patient. The subsequent processing and manufacture of a reprocessed SUD shall result in a device that is reprocessed within the meaning of this definition.

(v) Validation data for the purposes of this part means cleaning and sterilization data, and functional performance data demonstrating that an SUD will remain substantially equivalent to its predicate device after the maximum number of times the device is reprocessed as intended by the person submitting the premarket notification.

3. Section 807.87 is amended by redesignating paragraphs (h), (i), (j), (k), and (l) as paragraphs (i), (j), (k), (l), and (m), respectively, and by adding new paragraph (h) to read as follows:

§ 807.87 Information required in a premarket notification submission.

* * * * *

(h) If the device is a reprocessed SUD that FDA has identified as requiring validation data, the premarket notification submission must include validation data as defined in § 807.3(v).

* * * * *

PART 868—ANESTHESIOLOGY DEVICES

4. The authority citation for 21 CFR part 868 continues to read as follows:

Authority: 21 U.S.C. 351, 360, 360c, 360e, 360j, 371.

5. Section 868.5150 is amended by revising paragraph (b) to read as follows:

§ 868.5150 Anesthesia conduction needle.

* * * * *

(b) *Classification.* Class II (special controls). If the device is an anesthetic conduction needle (with/without introducer) or a short term spinal needle and it is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, a premarket notification submission for the device must include

validation data as described in § 807.3(v).

6. Section 868.5730 is amended by revising paragraph (b) to read as follows:

§ 868.5730 Tracheal tube.

* * * * *

(b) *Classification.* Class II (special controls). If the device is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, a premarket notification submission for the device must include validation data as described in § 807.3(v).

7. Section 868.5905 is amended by revising paragraph (b) to read as follows:

§ 868.5905 Noncontinuous ventilator (IPPB).

* * * * *

(b) *Classification.* Class II (special controls). If the device is a noncontinuous ventilator (respirator) mask that is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, a premarket notification submission for the device must include validation data as described in § 807.3(v).

8. Section 868.6810 is amended by revising paragraph (b) to read as follows:

§ 868.6810 Tracheobronchial suction catheter.

* * * * *

(b) *Classification.* Class I (general controls). The device is exempt from the premarket notification procedures in subpart E of part 807 of this chapter subject to the limitations in § 868.9. If the device is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, the exemption from premarket notification does not apply and the manufacturer must submit a premarket notification that includes validation data as described in § 807.3(v).

PART 870—CARDIOVASCULAR DEVICES

9. The authority citation for 21 CFR part 870 continues to read as follows:

Authority: 21 U.S.C. 351, 360, 360c, 360e, 360j, 371.

10. Section 870.1200 is amended by revising paragraph (b) to read as follows:

§ 870.1200 Diagnostic intravascular catheter.

* * * * *

(b) *Classification.* Class II (special controls). If the device is an angiography catheter that is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, a premarket notification submission for the device must include validation data as described in § 807.3(v).

11. Section 870.1220 is amended by revising paragraph (b) to read as follows:

§ 870.1220 Electrode recording catheter or electrode recording probe.

* * * * *

(b) *Classification.* Class II (special controls). If the device is an electrode recording catheter or intracardiac mapping catheter that is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, a premarket notification submission for the device must include validation data as described in § 807.3(v).

12. Section 870.1230 is amended by revising paragraph (b) to read as follows:

§ 870.1230 Fiberoptic oximeter catheter.

* * * * *

(b) *Classification.* Class II (special controls). If the device is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, a premarket notification submission for the device must include validation data as described in § 807.3(v).

13. Section 870.1280 is amended by revising paragraph (b) to read as follows:

§ 870.1280 Steerable catheter.

* * * * *

(b) *Classification.* Class II (special controls). If the device is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, a premarket notification submission for the device must include validation data as described in § 807.3(v).

14. Section 870.1290 is amended by revising paragraph (b) to read as follows:

§ 870.1290 Steerable catheter control system.

* * * * *

(b) *Classification.* Class II (special controls). If the device is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, a premarket notification submission for the device must include validation data as described in § 807.3(v).

15. Section 870.1330 is amended by revising paragraph (b) to read as follows:

§ 870.1330 Catheter guide wire.

* * * * *

(b) *Classification.* Class II (special controls). If the device is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, a premarket notification submission for the device must include validation data as described in § 807.3(v).

16. Section 870.1390 is amended by revising paragraph (b) to read as follows:

§ 870.1390 Trocar.

* * * * *

(b) *Classification.* Class II (special controls). If the device is a

cardiovascular trocar that is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, a premarket notification submission for the device must include validation data as described in § 807.3(v).

17. Section 870.1650 is amended by revising paragraph (b) to read as follows:

§ 870.1650 Angiographic injector and syringe.

* * * * *

(b) *Classification.* Class II (special controls). If the device is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, a premarket notification submission for the device must include validation data as described in § 807.3(v).

18. Section 870.1670 is amended by revising paragraph (b) to read as follows:

§ 870.1670 Syringe actuator for an injector.

* * * * *

(b) *Classification.* Class II (special controls). If the device is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, a premarket notification submission for the device must include validation data as described in § 807.3(v).

19. Section 870.2700 is amended by revising paragraph (b) to read as follows:

§ 870.2700 Oximeter.

* * * * *

(b) *Classification.* Class II (special controls). If the device is a tissue saturation oximeter or an oximeter and it is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, a premarket notification submission for the device must include validation data as described in § 807.3(v).

20. Section 870.3535 is amended by revising paragraph (b) to read as follows:

§ 870.3535 Intra-aortic balloon and control system.

* * * * *

(b) *Classification.* Class III (premarket approval). If the device is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, a premarket notification submission for the device must include validation data as described in § 807.3(v).

* * * * *

21. Section 870.4450 is amended by revising paragraph (b) to read as follows:

§ 870.4450 Vascular clamp.

* * * * *

(b) *Classification.* Class II (special controls). If the device is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, a premarket notification submission for the device

must include validation data as described in § 807.3(v).

22. Section 870.4500 is amended by revising paragraph (b) to read as follows:

§ 870.4500 Cardiovascular surgical instruments.

* * * * *

(b) *Classification.* Class I (general controls). The device is exempt from the premarket notification procedures in subpart E of part 807 of this chapter subject to the limitations in § 870.9. If the device is a noncompression heart stabilizer that is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, the exemption from premarket notification does not apply and the manufacturer must submit a premarket notification that includes validation data as described in § 807.3(v).

23. Section 870.4885 is amended by revising paragraph (b) to read as follows:

§ 870.4885 External vein stripper.

* * * * *

(b) *Classification.* Class II (special controls). If the device is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, a premarket notification submission for the device must include validation data as described in § 807.3(v).

PART 872—DENTAL DEVICES

24. The authority citation for 21 CFR part 872 continues to read as follows:

Authority: 21 U.S.C. 351, 360, 360c, 360e, 360j, 371.

25. Section 872.3240 is amended by revising paragraph (b) to read as follows:

§ 872.3240 Dental bur.

* * * * *

(b) *Classification.* Class I (general controls). The device is exempt from the premarket notification procedures in subpart E of part 807 of this chapter subject to the limitations in § 872.9. If the device is a dental diamond coated bur that is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, the exemption from premarket notification does not apply and the manufacturer must submit a premarket notification submission that includes validation data as described in § 807.3(v).

26. Section 872.4535 is amended by revising paragraph (b) to read as follows:

§ 872.4535 Dental diamond instrument.

* * * * *

(b) *Classification.* Class I (general controls). The device is exempt from the premarket notification procedures in subpart E of part 807 of this chapter subject to the limitations in § 872.9. If

the device is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, the exemption from premarket notification does not apply and the manufacturer must submit a premarket notification that includes validation data as described in § 807.3(v).

27. Section 872.4730 is amended by revising paragraph (b) to read as follows:

§ 872.4730 Dental injecting needle.

* * * * *

(b) *Classification.* Class I (general controls). The device is exempt from the premarket notification procedures in subpart E of part 807 of this chapter subject to the limitations in § 872.9. If the device is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, the exemption from premarket notification does not apply and the manufacturer must submit a premarket notification that includes validation data as described in § 807.3(v).

28. Section 872.5410 is amended by revising paragraph (b) to read as follows:

§ 872.5410 Orthodontic appliance and accessories.

* * * * *

(b) *Classification.* Class I (general controls). The device is exempt from the premarket notification procedures in subpart E of part 807 of this chapter subject to the limitations in § 872.9. If the device is an orthodontic metal bracket that is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, the exemption from premarket notification does not apply and the manufacturer must submit a premarket notification that includes validation data as described in § 807.3(v).

29. Section 872.5470 is amended by revising paragraph (b) to read as follows:

§ 872.5470 Orthodontic plastic bracket.

* * * * *

(b) *Classification.* Class II (special controls). If the device is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, the exemption from premarket notification does not apply and the manufacturer must submit a premarket notification that includes validation data as described in § 807.3(v).

PART 874—EAR, NOSE, AND THROAT DEVICES

30. The authority citation for 21 CFR part 874 continues to read as follows:

Authority: 21 U.S.C. 351, 360, 360c, 360e, 360j, 371.

31. Section 874.4140 is amended by revising paragraph (b) to read as follows:

§ 874.4140 Ear, nose, and throat bur.

* * * * *

(b) *Classification.* Class I (general controls). The device is exempt from the premarket notification procedures in subpart E of part 807 of this chapter subject to the limitations in § 874.9. If the device is an ear, nose, and throat (ENT) high speed microdebrider or an ENT diamond coated bur and it is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, the exemption from premarket notification does not apply and the manufacturer must submit a premarket notification that includes validation data as described in § 807.3(v).

32. Section 874.4420 is amended by revising paragraph (b) to read as follows:

§ 874.4420 Ear, nose, and throat manual surgical instrument.

* * * * *

(b) *Classification.* Class I (general controls). The device is exempt from the premarket notification procedures in subpart E of part 807 of this chapter subject to the limitations in § 874.9. If the device is a laryngeal, sinus, or tracheal trocar that is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, the exemption from premarket notification does not apply and the manufacturer must submit a premarket notification that includes validation data as described in § 807.3(v).

33. Section 874.4680 is amended by revising paragraph (b) to read as follows:

§ 874.4680 Bronchoscope (flexible or rigid) and accessories.

* * * * *

(b) *Classification.* Class II (special controls). If the device is a bronchoscope (nonrigid) biopsy forceps that is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, a premarket notification submission for the device must include validation data as described in § 807.3(v).

PART 876—GASTROENTEROLOGY-UROLOGY DEVICES

34. The authority citation for 21 CFR part 876 continues to read as follows:

Authority: 21 U.S.C. 351, 360, 360c, 360e, 360j, 360l, 371.

35. Section 876.1075 is amended by revising paragraph (b) to read as follows:

§ 876.1075 Gastroenterology-urology biopsy instrument.

* * * * *

(b) *Classification.* (1) Class II (special controls). If the device is a gastroenterology-urology (G-U) biopsy needle and needle set or a biopsy

instrument and it is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, a premarket notification submission for the device must include validation data as described in § 807.3(v).

(2) Class I (general controls) for the biopsy forceps cover and the non-electric biopsy forceps. The devices subject to this paragraph (b)(2) are exempt from the premarket notification procedures in subpart E of part 807 of this chapter subject to the limitations in § 876.9. If the device is a non-electric biopsy forceps that is a reprocessed SUD as defined in § 807.3(u) of this chapter, the exemption from premarket notification does not apply and the manufacturer must submit a premarket notification that includes validation data as described in § 807.3(v).

36. Section 876.1500 is amended by revising paragraph (b)(1) to read as follows:

§ 876.1500 Endoscope and accessories.

* * * * *

(b) *Classification.* (1) Class II (special controls). If the device is an endoscopic needle, an endoilluminator, a general and plastic surgery laparoscope, or a spring-loaded pneumoperitoneum needle and it is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, a premarket notification submission for the device must include validation data as described in § 807.3(v).

* * * * *

37. Section 876.4300 is amended by revising paragraph (b) to read as follows:

§ 876.4300 Endoscopic electrosurgical unit and accessories.

* * * * *

(b) *Classification.* Class II (special controls). If the device is an active urological electrosurgical electrode, a flexible suction coagulator electrode, an electric biopsy forceps, a flexible snare, or an endoscopic (with or without accessories) electrosurgical unit that is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, a premarket notification submission for the device must include validation data as described in § 807.3(v).

38. Section 876.4680 is amended by revising paragraph (b) to read as follows:

§ 876.4680 Ureteral stone dislodger.

* * * * *

(b) *Classification.* Class II (special controls). The device is exempt from the premarket notification procedures in subpart E of part 807 of this chapter subject to the limitations in § 876.9. If the device is a flexible and basket stone dislodger that is a reprocessed single

use device (SUD) as defined in § 807.3(u) of this chapter, a premarket notification submission for the device must include validation data as described in § 807.3(v).

39. Section 876.5010 is amended by revising paragraph (b) to read as follows:

§ 876.5010 Biliary catheter and accessories.

* * * * *

(b) *Classification.* Class II (special controls). The device is exempt from the premarket notification procedures in subpart E of part 807 of this chapter subject to the limitations in § 876.9. If the device is a biliary catheter that is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, a premarket notification submission for the device must include validation data as described in § 807.3(v).

40. Section 876.5540 is amended in paragraph (b)(3) to read as follows:

§ 876.5540 Blood access device and accessories.

* * * * *

(b) * * *

(3) Class II (special controls) for accessories for both the implanted and the nonimplanted blood access devices not listed in paragraph (b)(4) of this section. If the device is a single needle dialysis set (coaxial flow) or fistula needle and it is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, a premarket notification submission for the device must include validation data as described in § 807.3(v).

* * * * *

41. Section 876.5820 is amended by revising paragraph (b)(1) to read as follows:

§ 876.5820 Hemodialysis system and accessories.

* * * * *

(b) *Classification.* (1) Class II (special controls) for hemodialysis systems and all accessories directly associated with the extracorporeal blood system and the dialysate delivery system. If the device is a single needle dialysis set with unidirectional pump that is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, a premarket notification submission for the device must include validation data as described in § 807.3(v).

* * * * *

PART 878—GENERAL AND PLASTIC SURGERY DEVICES

42. The authority citation for 21 CFR part 878 continues to read as follows:

Authority: 21 U.S.C. 351, 360, 360c, 360e, 360j, 360l, 371.

43. Section 878.4200 is amended by revising paragraph (b) to read as follows:

§ 878.4200 Introduction/drainage catheter and accessories.

* * * * *

(b) *Classification*. Class I (general controls). The device is exempt from the premarket notification procedures in subpart E of part 807 of this chapter subject to the limitations in § 878.9. If the device is a catheter needle that is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, the exemption from premarket notification does not apply and the manufacturer must submit a premarket notification that includes validation data as described in § 807.3(v).

44. Section 878.4300 is amended by revising paragraph (b) to read as follows:

§ 878.4300 Implantable clip.

* * * * *

(b) *Classification*. Class II (special controls). If the device is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, a premarket notification submission for the device must include validation data as described in § 807.3(v).

45. Section 878.4400 is amended by revising paragraph (b) to read as follows:

§ 878.4400 Electrosurgical cutting and coagulation device and accessories.

* * * * *

(b) *Classification*. Class II (special controls). If the device is an endoscopic or laparoscopic electrosurgical accessory that is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, a premarket notification submission for the device must include validation data as described in § 807.3(v).

46. Section 878.4750 is amended by revising paragraph (b) to read as follows:

§ 878.4750 Implantable staple.

* * * * *

(b) *Classification*. Class II (special controls). If the device is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, a premarket notification submission for the device must include validation data as described in § 807.3(v).

47. Section 878.4800 is amended by revising paragraph (b) to read as follows:

§ 878.4800 Manual surgical instrument for general use.

* * * * *

(b) *Classification*. Class I (general controls). The device is exempt from the premarket notification procedures in subpart E of part 807 of this chapter subject to the limitations in § 878.9. If the device is a percutaneous biopsy

device, a gastroenterology-urology needle, a cardiovascular biopsy needle, or an aspiration and injection needle and it is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, the exemption from premarket notification does not apply and the manufacturer must submit a premarket notification that includes validation data as described in § 807.3(v).

PART 880—GENERAL HOSPITAL AND PERSONAL USE DEVICES

48. The authority citation for 21 CFR part 880 continues to read as follows:

Authority: 21 U.S.C. 351, 360, 360c, 360e, 360j, 371.

49. Section 880.5570 is amended by revising paragraph (b) to read as follows:

§ 880.5570 Hypodermic single lumen needle.

* * * * *

(b) *Classification*. Class II (special controls). If the device is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, a premarket notification submission for the device must include validation data as described in § 807.3(v).

50. Section 880.5860 is amended by revising paragraph (b) to read as follows:

§ 880.5860 Piston syringe.

* * * * *

(b) *Classification*. Class II (special controls). If the device is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, a premarket notification submission for the device must include validation data as described in § 807.3(v).

PART 882—NEUROLOGICAL DEVICES

51. The authority citation for 21 CFR part 882 continues to read as follows:

Authority: 21 U.S.C. 351, 360, 360c, 360e, 360j, 371.

52. Section 882.4190 is amended by revising paragraph (b) to read as follows:

§ 882.4190 Clip forming/cutting instrument.

* * * * *

(b) *Classification*. Class I (general controls). The device is exempt from the premarket notification procedures in subpart E of part 807 of this chapter subject to the limitations in § 882.9. If the device is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, the exemption from premarket notification does not apply and the manufacturer must submit a premarket notification that includes validation data as described in § 807.3(v).

53. Section 882.4300 is amended by revising paragraph (b) to read as follows:

§ 882.4300 Manual cranial drills, burrs, trephines, and accessories.

* * * * *

(b) *Classification*. Class II (special controls). If the device is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, a premarket notification submission for the device must include validation data as described in § 807.3(v).

54. Section 882.4305 is amended by revising paragraph (b) to read as follows:

§ 882.4305 Powered compound cranial drills, burrs, trephines, and their accessories.

* * * * *

(b) *Classification*. Class II (special controls). If the device is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, a premarket notification submission for the device must include validation data as described in § 807.3(v).

55. Section 882.4310 is amended by revising paragraph (b) to read as follows:

§ 882.4310 Powered simple cranial drills, burrs, trephines, and their accessories.

* * * * *

(b) *Classification*. Class II (special controls). If the device is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, a premarket notification submission for the device must include validation data as described in § 807.3(v).

PART 884—OBSTETRICAL AND GYNECOLOGICAL DEVICES

56. The authority citation for 21 CFR part 884 continues to read as follows:

Authority: 21 U.S.C. 351, 360, 360c, 360e, 360j, 371.

57. Section 884.1720 is amended by revising paragraph (b)(1) to read as follows:

§ 884.1720 Gynecologic laparoscope and accessories.

* * * * *

(b) (1) *Classification*. Class II (special controls). If the device is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, a premarket notification submission for the device must include validation data as described in § 807.3(v).

* * * * *

58. Section 884.1730 is amended by revising paragraph (b)(2) to read as follows:

§ 884.1730 Laparoscopic insufflator.

* * * * *

(b) * * *

(2) Class I for tubing and tubing/filter kits which include accessory instruments that are not used to effect intra-abdominal insufflation (pneumoperitoneum). The devices subject to this paragraph (b)(2) are exempt from the premarket notification procedures in subpart E of part 807 of this chapter, subject to the limitations in § 884.9. If the device is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, the exemption from premarket notification does not apply and the manufacturer must submit a premarket notification that includes validation data as described in § 807.3(v).

59. Section 884.4530 is amended by revising paragraph (b)(2) to read as follows:

§ 884.4530 Obstetric-gynecologic specialized manual instrument.

* * * * *

(b) * * *

(2) Class I for the amniotome, uterine curette, cervical dilator (fixed-size bougies), cerclage needle, intrauterine device (IUD) remover, uterine sound, and gynecological biopsy forceps. The devices subject to this paragraph (b)(2) are exempt from the premarket notification procedures in subpart E of part 807 of this chapter, subject to the limitations in § 884.9. If the device is a gynecological biopsy forceps that is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, the exemption from premarket notification does not apply and the manufacturer must submit a premarket notification that includes validation data as described in § 807.3(v).

60. Section 884.6100 is amended by revising paragraph (b) to read as follows:

§ 884.6100 Assisted reproduction needles.

* * * * *

(b) *Classification.* Class II (special controls) (mouse embryo assay information, endotoxin testing, sterilization validation, design specifications, labeling requirements, biocompatibility testing, and clinical testing). If the device is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, the exemption from premarket notification does not apply and the manufacturer must submit a premarket notification that includes validation data as described in § 807.3(v).

PART 886—OPHTHALMIC DEVICES

61. The authority citation for 21 CFR part 886 continues to read as follows:

Authority: 21 U.S.C. 351, 360, 360c, 360e, 360j, 371.

62. Section 886.4350 is amended by revising paragraph (b) to read as follows:

§ 886.4350 Manual ophthalmic surgical instrument.

* * * * *

(b) *Classification.* Class I (general controls). The device is exempt from the premarket notification procedures in subpart E of part 807 of this chapter, subject to the limitations in § 886.9. If the device is an ophthalmic knife that is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, the exemption from premarket notification does not apply and the manufacturer must submit a premarket notification that includes validation data as described in § 807.3(v).

63. Section 886.4370 is amended by revising paragraph (b) to read as follows:

§ 886.4370 Keratome.

* * * * *

(b) *Classification.* Class I (general controls). If the device is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, a premarket notification submission for the device must include validation data as described in § 807.3(v).

64. Section 886.4670 is amended by revising paragraph (b) to read as follows:

§ 886.4670 Phacofragmentation system.

* * * * *

(b) *Classification.* Class II (special controls). If the device is a phacoemulsification needle that is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, a premarket notification submission for the device must include validation data as described in § 807.3(v).

PART 892—RADIOLOGY DEVICES

65. The authority citation for 21 CFR part 892 continues to read as follows:

Authority: 21 U.S.C. 351, 360, 360c, 360e, 360j, 371.

66. Section 892.5730 is amended by revising paragraph (b) to read as follows:

§ 892.5730 Radionuclide brachytherapy source.

* * * * *

(b) *Classification.* Class II (special controls). If the device is an isotope needle that is a reprocessed single use device (SUD) as defined in § 807.3(u) of this chapter, a premarket notification submission for the device must include validation data as described in § 807.3(v).

Dated: September 6, 2006.

Jeffrey Shuren,

Assistant Commissioner for Policy.

[FR Doc. 06–8165 Filed 9–22–06; 8:45 am]

BILLING CODE 4160–01–S

DEPARTMENT OF HOMELAND SECURITY

Coast Guard

33 CFR Part 165

[COTP San Francisco Bay 06–036]

RIN 1625–AA00

Safety Zone; Red Bull Air Show Practice, San Francisco Bay, CA

AGENCY: Coast Guard, DHS.

ACTION: Notice of proposed rulemaking.

SUMMARY: The Coast Guard proposes a safety zone to be used to keep spectator vessels out of the path and away from the area directly below participating aircraft during the fleet week air show practice in order to ensure the safety of event participants and spectators.

DATES: Comments and related material must reach the Coast Guard on or before October 10, 2006.

ADDRESSES: You may mail comments and related material to the Waterways Safety Branch, U.S. Coast Guard Sector San Francisco, 1 Yerba Buena Island, San Francisco, California 94130. The Waterways Safety Branch maintains the public docket for this rulemaking. Comments and material received from the public, as well as documents indicated in this preamble as being available in the docket, will become part of this docket and will be available for inspection or copying at the Waterways Safety Branch between 9 a.m. and 4 p.m., Monday through Friday, except Federal holidays.

FOR FURTHER INFORMATION CONTACT:

Ensign Erin Bastick, U.S. Coast Guard Sector San Francisco, at (415) 556–2950 or Sector San Francisco 24 hour Command Center at (415) 399–3547.

SUPPLEMENTARY INFORMATION:

Request for Comments

We encourage you to participate in this rulemaking by submitting comments and related material. If you do so, please include your name and address, identify the docket number for this rulemaking (COTP San Francisco Bay 06–036), indicate the specific section of this document to which each comment applies, and give the reason for each comment. Please submit all comments and related material in an unbound format, no larger than 8½ by 11 inches, suitable for copying. If you would like to know they reached us, please enclose a stamped, self-addressed postcard or envelope. We will consider all comments and material received during the comment period. We may

change this proposed rule in view of them.

Public Meeting

We do not now plan to hold a public meeting. But you may submit a request for a meeting by writing to the Waterways Safety Branch at the address under **ADDRESSES** explaining why one would be beneficial. If we determine that one would aid this rulemaking, we will hold one at a time and place announced by a separate notice in the **Federal Register**.

Background and Purpose

On October 1, 1993, the Coast Guard published a final rule (58 FR 51242) modifying the regulations in 33 CFR 100.1105, that establish regulated areas to ensure the safe execution of the San Francisco Bay Navy Fleet Week Parade of Ships and Air Show Demonstration. The U.S. Navy and City of San Francisco are sponsoring the Annual Fleet Week Parade of Navy Ships and Air Show Demonstration to be held October 5 thru October 8, 2006. The Red Bull practice will be held on October 4, 2006 from 10 a.m. through 2 p.m., in order to allow sufficient time to practice prior to the scheduled Fleet Week Air Show Demonstration.

Due to the safety concerns associated with the air show practice demonstration, this safety zone is necessary to provide for the safety of event participants, spectator craft, and other vessels transiting the event area.

Discussion of Proposed Rule

The safety zone will include all navigable waters, from the surface to the seafloor, encompassed by connecting the following points to form an approximate square security zone, beginning at 37°48'29.50" N, 122°26'34.08" W, thence 37° 48'29.32" N, 122°26'28.65" W, thence 37°48'24.95" N, 122°26'25.25" W, thence 37°48'31.24" N, 122°25'38.66" W, thence 37°48'37.96" N, 122°25'33.80" W, thence 37°48'40.70" N, 122°25'24.74" W, thence 37°48'51.90" N, 122°25'24.79" W, lastly to 37°48'49.14" N, 122°26'34.08" W.

No person or vessel may enter or remain within the safety zone unless authorized by the Captain of the Port (COTP), Sector San Francisco, or his designated representative. The Coast Guard may be assisted by other Federal, State, or local law enforcement agencies in enforcing this safety zone.

Because this safety zone will be in effect for a limited period, it should not result in a significant disruption to maritime traffic. Additionally, the maritime community will be provided

advance notification of these events via public broadcast notice to mariners.

Regulatory Evaluation

This proposed rule is not a "significant regulatory action" under section 3(f) of Executive Order 12866, Regulatory Planning and Review, and does not require an assessment of potential costs and benefits under section 6(a)(3) of that Order. The Office of Management and Budget has not reviewed it under that Order.

We expect the economic impact of this proposed rule to be so minimal that a full Regulatory Evaluation is unnecessary.

Although this safety zone restricts access to a portion of the navigable waters, the effect of this zone will not be significant because: (i) The zone encompasses only a small portion of the waterway; (ii) vessels are able to pass safely around the zone; and (iii) the practice is a short duration in time, lasting only 4 hours.

The size of the zone is the minimum necessary to provide adequate protection for personnel or vessels during live fire training. The entities most likely to be affected are pleasure craft engaged in recreational activities and sightseeing and commercial fishing vessels.

Small Entities

Under the Regulatory Flexibility Act (5 U.S.C. 601–612), we have considered whether this proposed rule would have a significant economic impact on a substantial number of small entities. The term "small entities" comprises small businesses, not-for-profit organizations that are independently owned and operated and are not dominant in their fields, and governmental jurisdictions with populations of less than 50,000.

The Coast Guard certifies under 5 U.S.C. 605(b) that this proposed rule will not have a significant economic impact on a substantial number of small entities. Although this safety zone prevents traffic from transiting a portion of San Francisco Bay during the air show practice, the effect of this zone will not be significant because small vessels will be able to transit around the regulated area and the duration of the safety zone is limited to four hours in length. The entities most likely to be affected are pleasure craft engaged in recreational activities and sightseeing.

Small entities and the maritime public will also be advised of this safety zone via public broadcast notice to mariners. In addition, vessels will be able to pass through the zone on a case-by-case basis. Therefore, the economic

impact of this waterway closure is not expected to be significant.

If you think that your business, organization, or governmental jurisdiction qualifies as a small entity and that this rule would have a significant economic impact on it, please submit a comment (see **ADDRESSES**) explaining why you think it qualifies and how and to what degree this rule would economically affect it.

Assistance for Small Entities

Under section 213(a) of the Small Business Regulatory Enforcement Fairness Act of 1996 (Pub. L. 104–121), we want to assist small entities in understanding this proposed rule so that they can better evaluate its effects on them and participate in the rulemaking. If the rule would affect your small business, organization, or governmental jurisdiction and you have questions concerning its provisions or options for compliance, please contact the Waterways Safety Branch at the address under **ADDRESSES**. The Coast Guard will not retaliate against small entities that question or complain about this rule or any policy or action of the Coast Guard.

Collection of Information

This proposed rule would call for no new collection of information under the Paperwork Reduction Act of 1995 (44 U.S.C. 3501–3520).

Federalism

A rule has implications for federalism under Executive Order 13132, Federalism, if it has a substantial direct effect on State or local governments and would either preempt State law or impose a substantial direct cost of compliance on them. We have analyzed this proposed rule under that Order and have determined that it does not have implications for federalism.

Unfunded Mandates Reform Act

The Unfunded Mandates Reform Act of 1995 (2 U.S.C. 1531–1538) requires Federal agencies to assess the effects of their discretionary regulatory actions. In particular, the Act addresses actions that may result in the expenditure by a State, local, or tribal government, in the aggregate, or by the private sector of \$100,000,000 or more in any one year. Though this proposed rule would not result in such an expenditure, we do discuss the effects of this rule elsewhere in this preamble.

Taking of Private Property

This proposed rule would not effect a taking of private property or otherwise have taking implications under Executive Order 12630, Governmental

Actions and Interference with Constitutionally Protected Property Rights.

Civil Justice Reform

This proposed rule meets applicable standards in sections 3(a) and 3(b)(2) of Executive Order 12988, Civil Justice Reform, to minimize litigation, eliminate ambiguity, and reduce burden.

Protection of Children

We have analyzed this proposed rule under Executive Order 13045, Protection of Children from Environmental Health Risks and Safety Risks. This rule is not an economically significant rule and would not create an environmental risk to health or risk to safety that might disproportionately affect children.

Indian Tribal Governments

This proposed rule does not have tribal implications under Executive Order 13175, Consultation and Coordination with Indian Tribal Governments, because it would not have a substantial direct effect on one or more Indian tribes, on the relationship between the Federal Government and Indian tribes, or on the distribution of power and responsibilities between the Federal Government and Indian tribes.

Energy Effects

We have analyzed this proposed rule under Executive Order 13211, Actions Concerning Regulations That Significantly Affect Energy Supply, Distribution, or Use. We have determined that it is not a "significant energy action" under that order because it is not a "significant regulatory action" under Executive Order 12866 and is not likely to have a significant adverse effect on the supply, distribution, or use of energy. The Administrator of the Office of Information and Regulatory Affairs has not designated it as a significant energy action. Therefore, it does not require a Statement of Energy Effects under Executive Order 13211.

Technical Standards

The National Technology Transfer and Advancement Act (NTTAA) (15 U.S.C. 272 note) directs agencies to use voluntary consensus standards in their regulatory activities unless the agency provides Congress, through the Office of Management and Budget, with an explanation of why using these standards would be inconsistent with applicable law or otherwise impractical. Voluntary consensus standards are technical standards (e.g., specifications of materials, performance, design, or

operation; test methods; sampling procedures; and related management systems practices) that are developed or adopted by voluntary consensus standards bodies.

This proposed rule does not use technical standards. Therefore, we did not consider the use of voluntary consensus standards.

Environment

We have analyzed this proposed rule under Commandant Instruction M16475.ID and Department of Homeland Security Management Directive 5100.1, which guide the Coast Guard in complying with the National Environmental Policy Act of 1969 (NEPA)(42 U.S.C. 4321–4370f), and have made a preliminary determination that there are no factors in this case that would limit the use of a categorical exclusion under section 2.B.2 of the Instruction. Therefore, we believe that this rule should be categorically excluded, under figure 2–1, paragraph (34)(g), of the Instruction, from further environmental documentation.

A final "Environmental Analysis Check List" and a final "Categorical Exclusion Determination" will be available in the docket where indicated under **ADDRESSES**.

List of Subjects in 33 CFR Part 165

Harbors, Marine safety, Navigation (water), Reporting and recordkeeping requirements, Security measures, Waterways.

For the reasons discussed in the preamble, the Coast Guard proposes to amend 33 CFR part 165 as follows:

PART 165—REGULATED NAVIGATION AREAS AND LIMITED ACCESS AREAS

1. The authority citation for part 165 continues to read as follows:

Authority: 33 U.S.C. 1226, 1231; 46 U.S.C. Chapter 701; 50 U.S.C. 191; 33 CFR 1.05–1(g), 6.04–1, 6.04–6, and 160.5; Pub. L. 107–295, 116 Stat. 2064; Department of Homeland Security Delegation No. 0170.1.

2. Add § 165.T11–144 to read as follows:

§ 165.T11–144 Safety Zone; Red Bull Air Show Practice, San Francisco Bay, CA.

(a) *Location.* The safety zone will include all navigable waters, from the surface to the seafloor, encompassed by connecting the following points to form an approximate square security zone, beginning at 37°48'29.50" N, 122°26'34.08" W, thence 37°48'29.32" N, 122°26'28.65" W, thence 37°48'24.95" N, 122°26'25.25" W, thence 37°48'31.24" N, 122°25'38.66" W, thence 37°48'37.96" N, 122°25'33.80" W, thence 37°48'40.70" N,

122°25'24.74" W, thence 37°48'51.90" N, 122°25'24.79" W, lastly to 37°48'49.14" N, 122°26'34.08" W.

(b) *Definitions.* As used in this section: (1) *Designated representative* means a commissioned, warrant, or petty officer of the Coast Guard who has been designated by the Captain of the Port (COTP), Coast Guard Sector San Francisco, or a Federal, State, and local officer designated by or assisting the COTP in the enforcement of the safety zone.

(2) [Reserved]

(c) *Regulations.* (1) Under the general regulations in § 165.23, entry into, transiting, or anchoring within this safety zone is prohibited unless authorized by the COTP or his designated representative.

(2) Vessel operators desiring to enter or operate within the safety zone may contact the COTP or his representative at telephone number 415–399–3547 or on VHF–FM channel 16 (156.8 MHz). Vessel operators given permission to enter or operate in the safety zone must comply with all directions given to them by the COTP or his designated representative.

(d) *Enforcement and suspension of enforcement of certain safety zones.* The COTP will provide notice of the enforcement of the safety zones listed in paragraph (a) of this section and notice of suspension of enforcement by the means appropriate to affect the widest publicity, including broadcast notice to mariners and publication in the local notice to mariners.

(e) *Effective period.* This section is effective October 4, 2006 from 10 a.m. through 2 p.m.

Dated: September 8, 2006.

W. J. Uberti,

Captain, U.S. Coast Guard, Captain of the Port, San Francisco, California.

[FR Doc. 06–8134 Filed 9–22–06; 8:45 am]

BILLING CODE 4910–15–P

DEPARTMENT OF TRANSPORTATION

Pipeline and Hazardous Materials Safety Administration

49 CFR Parts 171, 172, 173, 175, 177, 178, and 180

[Docket No. PHMSA–05–21812 (HM–218D)]

RIN 2137–AE10

Hazardous Materials; Miscellaneous Amendments

AGENCY: Pipeline and Hazardous Materials Safety Administration (PHMSA), DOT.

ACTION: Notice of proposed rulemaking (NPRM).

SUMMARY: PHMSA proposes to make miscellaneous amendments to the Hazardous Materials Regulations based on petitions for rulemaking and PHMSA initiatives. These proposed amendments are intended to update, clarify or provide relief from certain regulatory requirements. Among other provisions, PHMSA is proposing a new proper shipping name and UN identification number for fuel mixtures composed of ethanol and gasoline to help emergency response personnel respond appropriately to incidents involving such fuel mixtures. In addition, PHMSA proposes to update certain incorporations by reference, revise and clarify certain hazard communication requirements, and clarify transportation requirements applicable to dry ice, detonator assemblies and explosives. PHMSA also proposes to provide expanded exceptions from regulation for household hazardous wastes and small amounts of materials used in pharmaceutical research.

DATES: Comments must be received by November 24, 2006.

ADDRESSES: You may submit comments identified by DOT DMS Docket Number PHMSA-05-21812 by any of the following methods:

- **Web site:** <http://dms.dot.gov>. Follow the instructions for submitting comments on the DOT electronic docket site.
- **Fax:** 202-493-2251.
- **Mail:** Docket Management Facility; U.S. Department of Transportation, 400 Seventh Street, SW., Nassif Building, PL-401, Washington, DC 20590-0001.
- **Hand Delivery:** Room PL-401 on the plaza level of the Nassif Building, 400 Seventh Street, SW., Washington, DC, between 9 a.m. and 5 p.m., Monday through Friday, except Federal holidays.
- **Federal eRulemaking Portal:** Go to <http://www.regulations.gov>. Follow the online instructions for submitting comments.

Instructions: All submissions must include the agency name and docket number or Regulatory Identification Number (RIN) for this rulemaking. For detailed instructions on submitting comments and additional information on the rulemaking process, see the Public Participation heading of the Supplementary Information section of this document. Note that all comments received will be posted, without change, to <http://dms.dot.gov> including any personal information provided. Please see the Privacy Act heading under Regulatory Analyses and Notices.

Docket: For access to the docket to read background documents and comments received, go to <http://dms.dot.gov> at any time or to Room PL-401 on the plaza level of the Nassif Building, 400 Seventh Street, SW., Washington, DC between 9 a.m. and 5 p.m., Monday through Friday, except Federal holidays.

FOR FURTHER INFORMATION CONTACT: Cameron Satterthwaite, Office of Hazardous Materials Standards, (202) 366-8553, Pipeline and Hazardous Materials Safety Administration, U.S. Department of Transportation, 400 Seventh Street, SW., Washington, DC 20590-0001.

SUPPLEMENTARY INFORMATION:

I. Background

This NPRM is designed to reduce regulatory burdens on industry by incorporating changes into the Hazardous Materials Regulations (HMR; 49 CFR Parts 171-180) based on PHMSA's own initiatives and petitions for rulemaking submitted in accordance with 49 CFR 106.95. To this end, we are proposing to eliminate, revise, clarify and relax certain regulatory requirements.

In this NPRM, we are proposing to:

- (1) Update incorporations by reference of industry consensus standards issued by the Chlorine Institute and the Compressed Gas Association (*see* §§ 171.7, 173.301, 178.337-9, and 178.337-10).
- (2) Add a definition for "household wastes" to clarify the current exception in the HMR for transportation of such materials (*see* §§ 171.8, 173.12 and 173.134).
- (3) Revise the Hazardous Materials Table (HMT) to harmonize certain entries with international standards (*see* § 172.101) by removing, adding, and revising certain proper shipping names. Most significantly, we are adding a new hazardous material entry to the HMR for ethanol and gasoline mixtures (E85) to ensure emergency responders utilize the most effective emergency response procedures for incidents involving fuel mixtures of ethanol and gasoline (*see* item no. 9 below).
- (4) Revise certain hazard communication requirements to address marine pollutant, limited quantity, and proper shipping name markings on packages and labels on overpacks and intermediate bulk containers (IBCs) (*see* §§ 172.203, 172.315, and 172.406).
- (5) Clarify that shippers of materials for which safety permits are required in accordance with the Federal Motor Carrier Safety Regulations must utilize only carriers with current safety permits (*see* § 173.22).

(6) Clarify requirements applicable to the transportation of dry ice on aircraft, detonator assemblies, and packagings authorized for the transportation of certain explosives (*see* §§ 173.24, 173.61, 173.62, 173.217, 175.30, and 175.900).

(7) Add an exception from HMR for small amounts of hazardous materials (*see* § 173.4).

(8) Clarify segregation requirements for hazardous materials transported by motor carrier (*see* § 177.848).

(9) The 2004 Emergency Response Guidebook (ERG2004) refers to Guide 127 (Flammable Liquids Polar/Water-Miscible) for response to incidents involving Alcohols, n.o.s., 3, UN1987, and Denatured alcohol, 3, NA1987. Guide 127 specifies the use of alcohol resistant foam. For incidents involving Flammable liquid, n.o.s., (ethanol, gasoline), 3, UN1993, and Gasohol, 3, NA1203, ERG 2004 refers to Guide 128 (Flammable Liquids Non-Polar/Water-Immiscible). Guide 128 specifies the use of regular foam, but contains the following warning: CAUTION: "For mixtures containing a high percentage of an alcohol or polar solvent, alcohol-resistant foam may be more effective."

To help emergency responders utilize the most effective emergency response procedures for incidents involving fuel mixtures composed of ethanol (or "ethyl alcohol") and gasoline in various concentrations we are proposing to add a new entry "Ethanol and gasoline mixture or Ethanol and motor spirit or Ethanol and petrol mixture, *with more than 10% ethanol*, 3, UN3475, II" to the HMT. This proposed new HMT entry is consistent with a proposed amendment to be incorporated into the 15th Revised Edition of the UN Model Regulations. We are also proposing to revise the entry for "Gasohol gasoline mixed with ethyl alcohol, with not more than 20 percent alcohol, 3, NA1203, II" to limit this entry gasoline mixtures with no more than 10 percent alcohol. We are also proposing a 2-year transition period for these proposals. (*See* discussion under § 171.14).

Alternative fuels such as bio-diesel, ethanol and methanol, have been produced and used on a small scale for decades, driven by environmental, economic, and energy security concerns. The most common of these fuels is designated E85. E85 is composed of 85 percent ethyl alcohol (ethanol) and 15 percent petroleum (gasoline) and is being used in increasing volumes in the United States. Fires involving E85 and other ethanol/gasoline mixtures containing more than 10% ethanol should be treated differently than traditional gasoline fires because these

mixtures are polar/water-miscible flammable liquids (*i.e.*, they mix with water) and will degrade the effectiveness of fire-fighting foam that is not alcohol-resistant.

We understand that if we adopt this new shipping description, fuel suppliers and cargo tank operators may incur additional costs associated with revisions to the hazard communication requirements. Therefore, we are interested in identifying measures to minimize costs while effectively communicating the hazards to the emergency response community. Because numerical data for these proposals are difficult to obtain, we invite commenters to address the merits of the proposal to add the new entry "Ethanol and gasoline mixture or Ethanol and motor spirit or Ethanol and petrol mixture, *with more than 10% ethanol*," 3, UN3475, II to the HMT and of the proposal to limit the entry for "Gasohol gasoline mixed with ethyl alcohol, 3, NA1203, II to gasoline mixtures with no more than 10 percent alcohol.

To provide outreach to emergency responders, PHMSA issued a Safety Alert to provide emergency responders with guidance on appropriate procedures for responding to incidents involving fuel mixtures composed of ethanol. In addition, PHMSA is providing Hazardous Material Emergency Preparedness Grants to emergency responders for planning and training which includes training for responses to incidents involving gasoline and ethanol mixtures. PHMSA is also partnering with the Renewable Fuel Association and the International Association of Fire Chiefs to revise existing safety training materials for emergency response personnel to include guidance for responding to incidents involving gasoline and ethanol fuel mixtures.

These proposals are discussed in more detail in the section-by-section review.

II. Section-by-Section Review

The following is a section-by-section summary of the proposed changes.

Part 171

Section 171.4

Section 171.4 prohibits the transportation of materials meeting the definition of a marine pollutant except in accordance with HMR requirements. Currently, paragraph (c) excepts marine pollutants transported in non-bulk packagings from HMR requirements, unless the transportation is by vessel.

We are proposing to revise paragraph (c) to clarify shipments for which all or part of the transportation is by vessel must conform to applicable HMR requirements, even if the initial transportation is by rail or highway. A more complete explanation of this issue can be found in the preamble discussion for § 172.203.

Section 171.7

We have reviewed the updated Chlorine Institute's pamphlets pertaining to cargo tanks and bulk transfer facilities. We have also reviewed the updated Compressed Gas Association's pamphlets pertaining to compressed gas cylinders. As a result, we have found no provisions that would impose additional requirements or would have an adverse impact on safety. Therefore, we are proposing to update, revise, and add the following incorporation by reference (IBR) materials in paragraph (a)(3), within the Table of material incorporated by reference,:

- In response to a Chlorine Institute petition (P-1444), under the entry "Chlorine Institute," we propose to update "Type 1½ JQ 225, Dwg., H51970, Revision D April 5, 1989; or Type 1½ JQ 225, Dwg. H50155, Revision F, April 4, 1989" to Revisions F and H respectively.

- In response to a Chlorine Institute petition (P-1444), under the entry "Chlorine Institute," we propose to update "Section 3, Pamphlet 57, Emergency Shut-Off Systems for Bulk Transfer of Chlorine, 3rd Edition, October 1997" to the 4th Edition, October 2003.

- In response to a Chlorine Institute petition (P-1444), under the entry "Chlorine Institute," we propose to add "Section 3, Pamphlet 166 Angle Valve Guidelines for Chlorine Bulk Transportation, 1st Edition, October 2002."

- In response to a Chlorine Institute petition (P-1444) and a Midland Manufacturing Corporation petition (P-1448), under the entry "Chlorine Institute," we propose to add "Typical Manway Arrangement Chlorine Cargo Tank, Dwg. 137-5, November 1996."

- In response to a Chlorine Institute petition (P-1444), under the entry "Chlorine Institute," we propose to remove the section reference for "Standards for Housing and Manway Covers for Steel Cargo Tanks, Dwg. 137-1 and 137-2, September 1, 1982."

- We propose to update "CGA Pamphlet C-5 Cylinder Service Life—Seamless Steel High Pressure Cylinders, 1991" to the reaffirmed 1995 Edition.

- In response to a Compressed Gas Association (CGA) petition (P-1472), we propose to update "CGA Pamphlet C-7, A Guide for the Preparation of Precautionary Markings of Compressed Gas Containers, appendix A, issued 1992 (6th Edition)" to the 2004 (Eighth) Edition. The updated pamphlet allows for hazard class numbers to be placed on subsidiary labels which is prohibited in the 1992 edition.

- In response to a Compressed Gas Association (CGA) petition (P-1440), we propose to permit the use of "CGA Pamphlet S-1.1, Pressure Relief Device Standards-Part 1-Cylinders for Compressed Gases, 2005 (with the exception of paragraph 9.1.1.1), Twelfth Edition" for DOT specification cylinders and UN pressure receptacles. Currently, the Ninth edition (1996) is authorized for DOT specification cylinders and the Eleventh edition (2003) is authorized for UN pressure receptacles.

- In response to a CGA petition (P-1440), we propose to update "CGA Pamphlet S-7, Method for Selecting Pressure Relief Devices for Compressed Gas Mixtures in Cylinders, 1996" to the 2005 Edition.

- We propose to update "ISO 7225, Gas cylinders—Precautionary labels, First Edition, November 1994, (Corrected and reprinted August 1995), (E)" to the Second edition, July 2005.

We are also proposing to revise paragraph (b) of this section, which is the list of informational materials not requiring incorporation by reference, to add an additional reference to guidance material for those who perform hydrostatic testing and visual inspections on cylinders. This document is entitled "CGA Pamphlet C-1.1-Personnel Training and Certification Guidelines for Cylinder Requalification By the Volumetric Expansion, issued 2004 (1st Edition)."

Section 171.8

The HMR, in § 173.134(b)(13)(i), include an exception from regulatory requirements for household wastes. However, the HMR currently do not define "household wastes." In this NPRM, we are proposing to add a new definition for "Household wastes" to mean "any solid waste (including garbage, trash, and sanitary waste from septic tanks) derived from households (including single and multiple residences, hotels and motels, bunkhouses, ranger stations, crew quarters, campgrounds, picnic grounds, and day-use recreation areas)." We are also proposing to clarify that household wastes are not subject to the HMR. See the preamble discussion for § 173.12 for

a more complete explanation of this clarification.

Section 171.14

This section lists specific transition periods for certain provisions adopted into the HMR. In this NPRM, to provide shippers, carriers and emergency responders sufficient time to plan for and implement the proposed new shipping description pertaining to E85 with minimal costs (*see* § 171.101), we propose to add a new paragraph (g) to provide a 2-year transition period for the mandatory use of the revised proper shipping description “Gasohol gasoline mixed with ethyl alcohol, with not more than 10% alcohol.”

Part 172

Section 172.101 Hazardous Materials Table (HMT)

The 2004 Emergency Response Guidebook (ERG2004) refers to Guide 127 (Flammable Liquids Polar/Water-Miscible) for response to incidents involving Alcohols, n.o.s., 3, UN1987, and Denatured alcohol, 3, NA1987. Guide 127 specifies the use of alcohol resistant foam. For incidents involving Flammable liquid, n.o.s., (ethanol, gasoline), 3, UN1993, and Gasohol, 3, NA1203, ERG 2004 refers to Guide 128 (Flammable Liquids Non-Polar/Water-Immiscible). Guide 128 specifies the use of regular foam, but contains the following warning: CAUTION: “For mixtures containing a high percentage of an alcohol or polar solvent, alcohol-resistant foam may be more effective.”

To help emergency responders utilize the most effective emergency response procedures for incidents involving fuel mixtures composed of ethanol (or “ethyl alcohol”) and gasoline in various concentrations we are proposing to add a new entry “Ethanol and gasoline mixture or Ethanol and motor spirit or Ethanol and petrol mixture, with more than 10% ethanol, 3, UN3475, II” to the HMT. This proposed new HMT entry is consistent with a proposed amendment to be incorporated into the 15th Revised Edition of the UN Model Regulations. We are also proposing to revise the entry for “Gasohol gasoline mixed with ethyl alcohol, with not more than 20 percent alcohol, 3, NA1203, II” to limit this entry gasoline mixtures with no more than 10 percent alcohol. We are also proposing a 2-year transition period for these proposals. (*See* discussion under § 171.14)

Alternative fuels such as bio-diesel, ethanol and methanol, have been produced and used on a small scale for decades, driven by environmental, economic, and energy security concerns.

The most common of these fuels is designated E85. E85 is composed of 85 percent ethyl alcohol (ethanol) and 15 percent petroleum (gasoline) and is being used in increasing volumes in the United States. Fires involving E85 and other ethanol/gasoline mixtures containing more than 10% ethanol should be treated differently than traditional gasoline fires because these mixtures are polar/water-miscible flammable liquids (*i.e.*, they mix with water) and will degrade the effectiveness of fire-fighting foam that is not alcohol-resistant.

We understand that if we adopt this new shipping description, fuel suppliers and cargo tank operators may incur additional costs associated with revisions to the hazard communication requirements. Therefore, we are interested in identifying measures to minimize costs while effectively communicating the hazards to the emergency response community. Because numerical data for these proposals are difficult to obtain, we invite commenters to address the merits of the proposal to add the new entry “Ethanol and gasoline mixture or Ethanol and motor spirit or Ethanol and petrol mixture, with more than 10% ethanol,” 3, UN3475, II to the HMT and of the proposal to limit the entry for “Gasohol gasoline mixed with ethyl alcohol, with not more than 20 percent alcohol, 3, NA1203, II” to gasoline mixtures with no more than 10 percent alcohol. Commenters may wish to consider the following questions:

- What cost impacts are associated with our proposal to add a new entry to the HMT for fuel mixtures containing ethanol?
- What cost impacts are associated with our proposed revision to the HMT entry for gasohol?
- Are two separate entries for “Ethanol and gasoline mixture or Ethanol and motor spirit or Ethanol and petrol mixture, with more than 10% ethanol” and “Gasohol gasoline mixed with ethyl alcohol, with not more than 10 percent alcohol” necessary or should all alcohol/gasoline mixtures be transported using a single proper shipping name?
- Does the proposed 2-year transition period provide sufficient time for shippers and carriers to incorporate the proposed new shipping name and UN number into shipping papers and package markings with minimal disruptions to normal business operations? Given the emergency response concerns about incidents involving ethanol/gasoline mixtures, should the proposed 2-year transition

period be shortened to ensure that the new shipping name and UN number are utilized as quickly as possible? How should we balance these two potentially competing goals?

We are also proposing to harmonize certain entries in the HMR with the most recent editions of the UN Recommendations for the Transport of Dangerous Goods (UN Recommendations), the International Civil Aviation Organization Technical Instructions for the Safe Transport of Dangerous Goods by Air (ICAO Technical Instructions), and the International Maritime Organization Dangerous Goods Code (IMDG Code), and correct other entries, as follows:

- The entry “Radioactive material, Type A package non-special form, non fissile or fissile-excepted, UN2915” is revised to add a reference “419” to column (8B) and “418” to column (8C). This proposed revision will correct these packaging references inadvertently omitted in a final rule published on September 23, 2005, under Docket No. PHMSA 05–22071 (HM–189Y; 70 FR 56084).

- The entry “Sodium aluminate, solid, UN2812,” is revised to include an “A” in column 1 of the HMT to indicate this material is only regulated when offered or intended for transportation by aircraft. We propose to revise this entry to align with the UN Recommendations, which only apply to solid forms of sodium aluminate when transported by air. Under the ICAO Technical Instructions, sodium aluminate is regulated for air transportation because of its corrosive effects on aluminum, which is the primary construction material for aircraft.

- We are proposing to add several new entries to the HMT to assist shippers in determining the most appropriate hazardous materials description to use when shipping polyamines. The proposed new entries include:

- Polyamines, flammable, corrosive, n.o.s. *see* Amines, flammable, corrosive, n.o.s.
- Polyamines, liquid, corrosive, flammable, n.o.s. *see* Amines, liquid, corrosive, flammable, n.o.s.
- Polyamines, liquid, corrosive, n.o.s. *see* Amines, liquid, corrosive, n.o.s.

- We are proposing to remove the entry “Gas generator assemblies (aircraft), containing a non-flammable non-toxic gas and a propellant cartridge.” This description was removed from the ICAO Technical Instructions in the 2003–2004 edition. In addition, we are proposing to remove the packaging section for gas generator

assemblies specified in § 173.335 in its entirety.

Section 172.102

When column 7 of the § 172.102 table refers to a special provision for a hazardous material, the meaning and requirements of that special provision are set forth in this section. In this NPRM, we are proposing to add a new Special Provision 177 and revise Special Provision B69. The proposed special provision addition and revision are as follows:

- Consistent with the proposed new proper shipping description “Ethanol and gasoline mixture or Ethanol and motor spirit or Ethanol and petrol mixture, *with more than 10% ethanol*, 3, UN3475, II,” we are proposing to add a new Special Provision 177 to specify proper applicability of this description.

- Currently, Special Provision B69 specifies that “Dry sodium cyanide or potassium cyanide” may be shipped in a sift-proof weather-resistant metal covered hopper car, covered motor vehicle, portable tank or non-specification bin. Bins must be approved by the Associate Administrator. We are proposing to amend Special Provision B69 to clarify that metal covered hopper cars, covered motor vehicles, portable tanks, and non-specification bins must be sift-proof and weather-resistant. The current wording of this special provision has caused some confusion as to whether the requirement for the packaging to be sift-proof and weather-resistant applies only to metal-covered hopper cars or to all packagings authorized for the transportation of dry sodium cyanide and potassium cyanide. In addition, we are proposing to amend Special Provision B69 to remove the requirement for bins to be approved by the Associate Administrator.

So long as the bins meet applicable requirements, approval is not necessary.

Section 172.203

Section 172.203(l) addresses shipping paper requirements for shipments of marine pollutants. Paragraph (l)(4) excepts marine pollutants in non-bulk packagings from the requirements of the HMR unless the transportation is by vessel. The International Vessel Operators Hazardous Materials Association, Inc. (VOHMA) petitioned PHMSA (P-1465) to amend paragraph (l)(4) to clarify that the exception for non-bulk packages of marine pollutants transported by motor vehicle, rail car or aircraft does not apply to a marine pollutant “intended for transport” aboard a vessel. VOHMA states the current language suggests the consignor

who prepares the shipment and offers it in intermodal transportation has no obligation to declare the marine pollutant on the shipping paper if the initial transport is by motor vehicle or rail. Because the current language in the HMR suggests there is no obligation by the consignor, when preparing a non-bulk shipment for intermodal transportation, to indicate on a shipping paper the words “Marine Pollutant” in association with the basic description for a material which is a marine pollutant, a shipment intended for transportation by vessel and initially offered into transportation by highway, rail or air may be improperly described on the vessel shipping documents by a freight forwarder. This was not our intention when this provision was originally adopted. Therefore, we are proposing to revise paragraph (l)(4) to clarify that marine pollutants in non-bulk packagings transported all or in part by vessel must be indicated on a shipping paper by the words “Marine Pollutant” in association with the basic description.

Section 172.315

Except for transportation by aircraft, this section excepts limited quantity shipments of hazardous materials from the requirement for marking the proper shipping name of the material on the package when the identification number of the material is shown within a square-on-point configuration. Section 172.324 requires materials that are hazardous substances, as defined in § 171.8, to be marked with the name of the hazardous substance and the letters “RQ” in association with the proper shipping name. We are proposing to clarify if a shipper identifies a limited quantity material which is also a hazardous substance, the shipper is required to mark the letters “RQ” on the package in association with the square-on-point configuration containing the identification number of the material. We also invite comments on whether or not the name of the hazardous substance should also be included along with letters “RQ,” even though the proper shipping name is not required.

Section 172.336

Paragraphs (c)(4) and (c)(5) except from the identification number marking requirements each of the different liquid petroleum distillate fuels, including gasoline and gasohol, transported in a compartmented cargo tank, tank car or cargo tank, if the identification number is displayed for the liquid petroleum distillate fuel having the lowest flash point. As a result of the proposed new HMT entry “Ethanol and gasoline

mixture or Ethanol and motor spirit or Ethanol and petrol mixture, *with more than 10% ethanol*,” 3, UN3475, II, individuals could attempt to apply this exception to the proposed new entry, which is not our intent (*see* discussion under § 172.101). Therefore, to eliminate any confusion, we are proposing to revise paragraphs (c)(4) and (c)(5) to specify the provisions of the paragraphs (c)(4) and (c)(5) do not apply to “Ethanol and gasoline mixture or Ethanol and motor spirit or Ethanol and petrol mixture, *with more than 10% ethanol*.” We are also proposing a 2-year transition period for this proposal. We understand that if we adopt this new shipping description, fuel suppliers and cargo tank operators may incur additional costs associated with revisions to the hazard communication requirements. Therefore, we are interested in identifying measures to minimize costs while effectively communicating the hazards to the emergency response community. As a result of this proposal, we invite commenters to specifically address the following questions:

- Does the proposed 2-year transition period provide sufficient time for shippers and carriers to incorporate the proposed new shipping name and UN number into shipping papers and package markings with minimal disruptions to normal business operations? Given the emergency response concerns about incidents involving ethanol/gasoline mixtures, should the proposed 2-year transition period be shortened to ensure that the new shipping name and UN number are utilized as quickly as possible? How should we balance these two potentially competing goals?
- Are there measures that can be employed to ease potential costs to shippers and carriers with respect to cargo tanks that are permanently marked?
- What are the cost impacts of our proposal to limit the applicability of the current exceptions in § 172.336 (c)(4) and (c)(5)?

Section 172.406

Paragraph (e) of this section prescribes requirements for the duplicate labeling of packages based on size. Paragraph (e)(1) requires each package or overpack having a volume of 1.8m³ (64 cubic feet) or more to be labeled on at least two sides or two ends (other than the bottom of the package). There has been some confusion as to whether this requirement also applies to IBCs. Therefore, we are proposing to add a new paragraph (e)(6) to clarify IBCs having a volume of 1.8m³ (64 cubic

feet) or more are required to be labeled on at least two sides or two ends.

Part 173

Section 173.4

This section establishes exceptions for small quantities of hazardous materials. The Dangerous Goods Advisory Council (DGAC) (P-1454) and Pharmaceutical Research and Manufacturers of America (PhRMA) (P-1457) petitioned PHMSA to provide an exception from the HMR for de minimis quantities, less than 1 gram for solids and less than 1 milliliter for liquids, of PG II and PG III materials of Class 3, Division 4.1, Division 4.2, Division 4.3, Division 5.1, Division 6.1, Class 8, and Class 9. The petitioners estimate an annual cost savings of approximately \$1 million if their petitions are implemented. After reviewing the petitions and evaluating the risks associated with the de minimis quantities, we agree with the petitioners that because these materials are present in minute quantities, usually a gram or less, and are packaged in such a manner, and have determined that safety would not be undermined by allowing these minute quantities and would not pose an unreasonable risk during transportation. Therefore, we are proposing to add a new paragraph (e) to provide conditions for authorizing de minimis quantities of these materials to be excepted from the HMR.

Section 173.5

This section establishes the conditions under which agricultural products such as pesticides and fertilizers are excepted from HMR requirements. Paragraph (b)(2) specifies limits for the amount of agricultural product that may be transported in a single vehicle in order to utilize the exception applicable to transportation to or from a farm, within 150 miles of the farm. The HMR do not define the term "single vehicle;" thus, it is not clear whether the exception applies to agricultural products transported in a single "motor vehicle" or "transport vehicle." To clarify this exception, we are proposing to revise paragraph (b)(2) to replace the term "vehicle" with "motor vehicle." The term "motor vehicle" is defined in § 171.8 to mean a vehicle, machine, tractor, trailer, or semi-trailer, or any combination thereof, propelled or drawn by mechanical power and used on the highways to transport people or property.

Section 173.12

In a final rule published on January 24, 2005, under Docket No. RSPA 03-16370 (HM-233; 70 FR 3304), we added

a new paragraph (e) to this section to authorize the storage, loading and transportation of waste cyanide and waste cyanide mixtures or solutions with Class 8 acids under certain conditions. Acids are not only found in Class 8, but also in Class 3 and in Divisions 4.1, 4.2, 4.3, 5.1 and 5.2. We believe acids in the aforementioned Classes and Divisions may be safely transported and stored with waste cyanide and waste cyanide mixtures or solution under the conditions specified in §§ 174.81(c), 176.83(b), and 177.848(c). Therefore, in this NPRM, we are proposing to revise paragraph (e) to authorize the transportation of waste cyanides and waste cyanide mixtures or solutions with all acids.

In this section, we are also proposing to add a new paragraph (f) to specify that materials meeting the proposed definition of "household wastes" in § 171.8 would not be subject to the requirements of the HMR. Currently, § 173.134(b)(13) excepts any waste or recyclable material, other than regulated medical waste, from regulation under the HMR. However, the location of this exception in the section of Part 173 that establishes definitions for Division 6.2 materials (infectious substances) suggests the current exception excepts household wastes only from requirements applicable to Division 6.2 materials. This was not our intention. In letters of interpretation, including an October 8, 2004 letter to Mr. David Allard of Pennsylvania Department of Environmental Protection (Ref. No. 04-0197), we specify household wastes as being excepted from the HMR. The addition of a broad exception for "household wastes" in the proposed paragraph (f) will clarify our intent.

Section 173.22

This section establishes a shipper's responsibility for complying with applicable requirements of the HMR. National Tank Truck Carriers (NTTC) petitioned PHMSA (P-1469) to amend this section to specify that shippers who offer certain hazardous materials for transportation must use carriers holding a valid safety permit issued by the Federal Motor Carrier Safety Administration (FMCSA). FMCSA regulations (49 CFR Part 385, Subpart E) require motor carriers transporting certain types and amounts of hazardous materials to apply for a safety permit. To obtain a safety permit, a carrier must have a "satisfactory" safety rating and must meet certain other safety and security requirements. The safety permit requirements apply to motor carriers transporting: (1) A highway route-controlled quantity of a Class 7

(radioactive) material; (2) certain high explosives; (3) certain TIH materials; and (4) certain bulk shipments of liquefied methane gas and liquefied natural gas. A carrier may not transport any of the listed materials unless it has a valid safety permit. In response to the NTTC petition, we are proposing in this NPRM to prohibit a person from offering any of the materials for which a safety permit is required to a motor carrier not possessing a valid safety permit.

Section 173.24

This section establishes general requirements for packagings and packages. Paragraph (g) of this section addresses venting from packages during transportation and currently specifies that a package containing a hazardous material and transported on board an aircraft must not vent. This provision conflicts with current § 173.217, which requires carbon dioxide, solid (dry ice) to be packed in packagings designed and constructed to permit the release of carbon dioxide gas to prevent a buildup of pressure that could rupture the packaging when offered for transportation or transported by aircraft or water. To eliminate these contradictory requirements, in this NPRM we are proposing to revise paragraph (g)(1) to specify that the venting of packagings containing carbon dioxide, solid (dry ice) would not be prohibited for air transportation. We also invite comments on other materials to which this provision would also apply.

Section 173.61

This section establishes general requirements for transporting Class 1 materials (explosives) in the same outside packaging. Paragraph (c) of this section lists specific explosives that may not be transported in the same outside packaging as other Class 1 materials. In a final rule published May 6, 1997 (HM 215B; 62 FR 24708) we added a new entry to the Hazardous Materials Table "Detonator, assemblies, non-electric for blasting," UN0500. This entry should have also been added to paragraph (c) to indicate that this material is not authorized to be packed together with other Class 1 explosives. Therefore, we are proposing to correct this oversight by amending paragraph (c) to include UN 0500 "Detonator assemblies, non-electric for blasting."

Section 173.62

This section establishes specific packaging requirements for Class 1 materials. The Table of Packing Methods in paragraph (c) specifies the packing instructions assigned to each

explosive. To harmonize the HMR with international standards and to remove a source of potential confusion within the regulated community, we are proposing to revise packing instruction (PI) 134 in the Table of Packing Methods, in paragraph (c), to authorize the use of a specification 4H1 plastic box as an outer packaging for certain explosives.

Section 173.134

This section establishes definitions and exceptions for infectious substances. Paragraph (b)(13)(i) contains an exception from the requirements of the HMR relative to Division 6.2 materials for waste derived from households. We are proposing to revise this paragraph to incorporate the proposed new household waste definition in § 171.8. See preamble discussions in specified above in §§ 171.8 and 173.12 for background information.

Section 173.217

This section establishes packaging requirements for carbon dioxide, solid (dry ice). We are proposing to revise this section for clarity and to harmonize the HMR with requirements in the ICAO Technical Instructions applicable to the transportation of dry ice by air. Currently under paragraph (d), the HMR require the shipper to have a specific and special written arrangement with the air carrier to transport more than 441 pounds of dry ice in a single compartment. The ICAO Technical Instructions no longer include this requirement. The United Parcel Service (UPS) petitioned PHMSA (P-1439) to amend this section for consistency with the most recent edition of the ICAO Technical Instructions. We agree and are proposing to revise the current paragraph (d) accordingly. In addition, we are proposing to revise paragraph (d) to address air specific provisions such as ventilation safety procedures, net mass marking requirements, and quantity limit exceptions for dry ice used as a refrigerant for non-hazardous materials. In addition, we are proposing requirements for air carriers who transport dry ice in the proposed new § 175.900. See § 175.900 preamble discussion.

Currently, paragraph (e) in § 173.217 provides an exception from the shipping paper and certification requirements for dry ice shipments prepared in accordance with paragraphs (a) and (d) provided the package is marked "Carbon dioxide, solid" or "Dry ice" and with an indication that the material being refrigerated is used for diagnostic or treatment purposes. To eliminate any confusion, we are proposing to revise

paragraph (e) to specify only dry ice actually used to refrigerate materials being shipped for diagnostic or treatment purposes may be transported under this exception.

For clarity and ease of use by the reader, we are proposing to consolidate the modal requirements applicable to dry ice by relocating the vessel provisions to paragraph (b) and the aircraft provisions to paragraph (c). As a result of this proposal, the dry ice provisions relative to diagnostic specimens currently in paragraph (e) would be moved to paragraph (d).

Section 173.301

This section establishes general requirements for the transportation of compressed gases in cylinders and spherical pressure vessels. Paragraph (f) of this section addresses pressure relief devices (PRDs); paragraph (g) addresses manifolded cylinders in transportation. CGA petitioned PHMSA (P-1440) to update the incorporation by reference of CGA Pamphlets S-1.1 and S-7, which are both referenced in paragraphs (f)(1) and (g)(1). The pamphlets contain requirements for PRDs on cylinders. We reviewed the differences between currently referenced pamphlets and the updated pamphlets. We agree the incorporations by reference should be updated to the current editions.

Section 173.335

This section establishes requirements for the transportation of gas generator assemblies. This entry was initially added in a December 21, 1990 (55 FR 52402; HM-181) rulemaking to harmonize the HMR with various international standards such as the ICAO Technical Instructions, IMDG Code, and UN Recommendations. However, ICAO removed this entry in the 2003-2004 edition of the ICAO Technical Instructions. Therefore, we are proposing to remove this section in its entirety to harmonize with ICAO. The removal of this entry does not mean that the material is not subject to the HMR. Section 173.22 requires each shipper to properly class a material and prepare it for transportation. See the preamble discussion under § 172.101 Hazardous Materials Table (HMT) regarding Gas generator assemblies.

Part 175

Section 175.10

This section establishes exceptions for the transportation of certain hazardous materials by aircraft, including hazardous materials that may be carried by passengers or crew members in checked or carry-on baggage. We are

proposing to revise paragraph (a)(10) to harmonize the HMR with an ICAO provision applicable to the transportation of dry ice in checked or carry-on baggage. Specifically, we are proposing to authorize exceptions for shipments of dry ice used to pack perishables in carry-on and checked baggage.

Section 175.900

In response to a UPS petition (P-1439) and to harmonize with international standards, we are proposing to add a new § 175.900 to adopt the ICAO Technical Instructions loading requirements for carbon dioxide, solid (dry ice). This provision will provide guidelines to the operator for handling dry ice shipments, including informing ground staff, checking aircraft ventilation rates, stowage, and providing the Pilot-in-Command with information to reflect any quantity change of dry ice. Comments are invited regarding the use of the term "suitable arrangements" in this section. See the preamble discussion in § 173.217 for further discussion.

Part 177

Section 177.848

This section addresses segregation requirements for hazardous materials transported by motor carrier. Paragraph (a), which discusses the applicability requirements for segregation, does not specifically include all bulk packages that may be placarded instead of labeled as packages for which segregation requirements must be met. To correct this oversight, we are proposing to revise paragraph (a)(1) to specify that the segregation requirements for hazardous materials would be applicable to packages that are required to be placarded. The addition of this provision ensures hazardous materials when packaged in IBCs and Large Packagings are properly segregated.

Part 178

Section 178.274

This section establishes design and manufacturing requirements for UN portable tanks. In paragraph (b)(1), the end value for temperature range is incorrectly specified as "– 50 °C." The negative symbol should be removed and value should be specified as "50 °C." We are proposing to revise paragraph (b)(1) to correct this error.

Section 178.337–9

This section establishes requirements for pressure relief devices, piping, valves, hoses, and fittings on MC 331

specification cargo tanks. Currently, paragraph (b)(8) requires angle valves used on cargo tanks intended for chlorine service to comply with the standards of The Chlorine Institute Dwg. 104–8. The Chlorine Institute (P–1444) and Midland Manufacturing Corporation (P–1448) petitioned PHMSA to incorporate Chlorine Institute Pamphlet 166, which contains provisions for the use of angle valves on cargo tanks in chlorine service. In its petition, The Chlorine Institute points to DOT exemptions/special permits such as DOT–E 9694, which has authorized the use of an angle valve that conforms to this pamphlet for over fifteen years. Therefore, we are proposing to revise paragraph (b)(8) to include a reference to the Chlorine Institute’s “Section 3, Pamphlet 166 Angle Valve Guidelines for Chlorine Bulk Transportation, 1st Edition,” dated October 2002 to allow for the use of alternative angle valves for cargo tanks that transport chlorine.

Section 178.337–10

This section establishes accident damage protection requirements for MC 331 specification cargo tanks. The Chlorine Institute petitioned PHMSA (P–1444) to update the references to the Chlorine Institute’s drawings 137–1 and 137–2 entitled “Standards for Housing and Manway Covers for Steel Cargo Tanks,” dated September 1, 1982 by replacing them with the Chlorine Institute’s drawing 137–5 entitled “Typical Manway Arrangement Chlorine Cargo Tank,” dated November 1996. The petitioner states that this is necessary to provide critical manway arrangement details to ensure the use of CI Emergency Kit C, which is referenced in § 177.840(e)(2). We are proposing to revise paragraph (d) to incorporate the petitioner’s request. We are proposing removing the old drawings (drawings 137–1 and 137–2), completely from the HMR. We are soliciting comments regarding this proposed deletion to determine whether this poses an undue regulatory burden.

Part 180

Section 180.205

This section establishes general requirements for the requalification of cylinders. Paragraph (g) of this section establishes requirements for pressure testing. We are proposing to add a new paragraph (g)(6) to incorporate guidance material for cylinder requalifiers that perform volumetric expansion tests on cylinders. This document is entitled “CGA Pamphlet C–1.1—Personnel Training and Certification Guidelines for Cylinder Requalification By the

Volumetric Expansion, issued 2004 (1st Edition).”

III. Sunset Provision

To assure the HMR account for new technologies and updated business practices, PHMSA is considering whether certain requirements proposed in this NPRM should be afforded a “sunset” provision. If we adopt such a provision, certain amendments adopted through this rulemaking would expire after a fixed amount of time (*e.g.* 10 years) from the publication date of the final rule.

Certain standards that we are proposing to adopt by reference likely will be updated periodically in response to changes in international standards or may be replaced by other more relevant or technically superior standards. Future changes to these standards would have to consider whether to retain or extend the sunset date. If we choose to do nothing, a sunset provision would mean the HMR would revert to the language and requirements in effect before the issuance of the final rule. We are requesting comments on whether certain amendments should be tied to a sunset provision.

IV. Regulatory Analyses and Notices

A. Statutory/Legal Authority for This Rulemaking

This NPRM is published under authority of Federal hazardous materials transportation law (Federal hazmat law; 49 U.S.C. 5101 *et seq.*). Section 5103(b) of Federal hazmat law authorizes the Secretary of Transportation to prescribe regulations for the safe transportation, including security, of hazardous materials in intrastate, interstate, and foreign commerce.

B. Executive Order 12866 and DOT Regulatory Policies and Procedures

This proposed rule is not considered a significant regulatory action under section 3(f) Executive Order 12866 and, therefore, was not reviewed by the Office of Management and Budget (OMB). The proposed rule is not considered a significant rule under the Regulatory Policies and Procedures order issued by the U.S. Department of Transportation (44 FR 11034).

In this notice, we propose to amend miscellaneous provisions in the HMR to clarify the provisions and to relax overly burdensome requirements. We are also responding to requests from industry associations, such as the Chlorine Institute and CGA, to update and add references to standards that are incorporated in the HMR. PHMSA anticipates the proposals contained in

this rule will have economic benefits to the regulated community. This NPRM is designed to increase the clarity of the HMR, thereby increasing voluntary compliance while reducing compliance costs. Further, the addition of an exception from regulatory requirements for small amounts of hazardous materials used in pharmaceutical research and clarification of the exception for household hazardous wastes will result in reduced compliance costs by eliminating some or all regulations a person must comply with and reducing packaging costs. This NPRM also proposes to update a number of incorporations by reference to permit the industry to utilize the most recent versions of industry consensus standards. Incorporation of material by reference reduces the regulatory burden on persons who offer hazardous material for transportation and persons who transport hazardous materials in commerce. Industry standards developed and adopted by consensus are accepted and followed by the industry; thus, their inclusion in the HMR assures that the industry is not forced to comply with a different set of standards to accomplish the same safety goal.

The 2004 Emergency Response Guidebook (ERG2004) refers to Guide 127 (Flammable Liquids Polar/Water-Miscible) for response to incidents involving Alcohols, n.o.s., 3, UN1987, and Denatured alcohol, 3, NA1987. Guide 127 specifies the use of alcohol resistant foam. For incidents involving Flammable liquid, n.o.s., (ethanol, gasoline), 3, UN1993, and Gasohol, 3, NA1203, ERG 2004 refers to Guide 128 (Flammable Liquids Non-Polar/Water-Immiscible). Guide 128 specifies the use of regular foam, but contains the following warning: CAUTION: “For mixtures containing a high percentage of an alcohol or polar solvent, alcohol-resistant foam may be more effective.” Therefore, to help emergency responders utilize the most effective emergency response procedures for incidents involving fuel mixtures composed of ethanol (or “ethyl alcohol”) and gasoline in various concentrations we are proposing to add a new entry “Ethanol and gasoline mixture or Ethanol and motor spirit or Ethanol and petrol mixture, *with more than 10% ethanol*, 3, UN3475, II” to the HMT. Overall, the proposals in this NPRM should reduce regulatory burdens on the regulated community while increasing flexibility and transportation options.

C. Executive Order 13132

This proposed rule was analyzed in accordance with the principles and criteria contained in Executive Order 13132 ("Federalism"). This proposed rule would preempt State, local and Indian tribe requirements but does not propose any regulation that has substantial direct effects on the States, the relationship between the national government and the States, or the distribution of power and responsibilities among the various levels of government. Therefore, the consultation and funding requirements of Executive Order 13132 do not apply.

The Federal hazardous material transportation law, 49 U.S.C. 5125(b)(1), contains an express preemption provision (49 U.S.C. 5125(b)) preempting State, local, and Indian tribe requirements on certain covered subjects. Covered subjects are:

- (i) The designation, description, and classification of hazardous materials;
- (ii) The packing, repacking, handling, labeling, marking, and placarding of hazardous materials;
- (iii) The preparation, execution, and use of shipping documents related to hazardous materials and requirements related to the number, content, and placement of those documents;
- (iv) The written notification, recording, and reporting of the unintentional release in transportation of hazardous materials; or
- (v) The design, manufacture, fabrication, marking, maintenance, reconditioning, repair, or testing of a packaging or container which is represented, marked, certified, or sold as qualified for use in the transport of hazardous materials.

This proposed rule concerns the classification, packaging, marking, labeling, and handling of hazardous materials, among other covered subjects. If adopted as final, this rule would preempt any State, local, or Indian tribe requirements concerning these subjects unless the non-Federal requirements are "substantively the same" (see 49 CFR 107.202(d)) as the Federal requirements.

Federal hazardous materials transportation law provides at 49 U.S.C. 5125(b)(2) that if PHMSA issues a regulation concerning any of the covered subjects, PHMSA must determine and publish in the **Federal Register** the effective date of Federal preemption. That effective date may not be earlier than the 90th day following the date of issuance of the final rule and not later than two years after the date of issuance. PHMSA proposes the effective date of federal preemption be 90 days from publication of a final rule in this matter in the **Federal Register**.

D. Executive Order 13175

This proposed rule has been analyzed in accordance with the principles and criteria contained in Executive Order 13175 ("Consultation and Coordination with Indian Tribal Governments"). Because this proposed rule does not have tribal implications, does not impose substantial direct compliance costs on Indian tribal governments, and does not preempt tribal law, the funding and consultation requirements of Executive Order 13175 do not apply, and a tribal summary impact statement is not required.

E. Regulatory Flexibility Act, Executive Order 13272, and DOT Procedures and Policies

The Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*) requires an agency to review regulations to assess their impact on small entities. An agency must conduct a regulatory flexibility analysis unless it determines and certifies that a rule is not expected to have a significant impact on a substantial number of small entities. This proposed rule would amend miscellaneous provisions in the HMR to clarify provisions based on our own initiatives and also on petitions for rulemaking. While maintaining safety, it would relax certain requirements that are overly burdensome and would update references to consensus standards that are incorporated in the HMR. The proposed changes are generally intended to provide relief to shippers, carriers, and packaging manufacturers, including small entities. Therefore, I certify that this proposal, if promulgated, would not have a significant economic impact on a substantial number of small entities.

This proposed rule has been developed in accordance with Executive Order 13272 ("Proper Consideration of Small Entities in Agency Rulemaking") and DOT's procedures and policies to promote compliance with the Regulatory Flexibility Act to ensure that potential impacts of draft rules on small entities are properly considered.

F. Paperwork Reduction Act

This proposed rule does not impose any new information collection requirements.

G. Regulation Identifier Number (RIN)

A regulation identifier number (RIN) is assigned to each regulatory action listed in the Unified Agenda of Federal Regulations. The Regulatory Information Service Center publishes the Unified Agenda in April and October of each year. The RIN number contained in the heading of this document can be used

to cross-reference this action with the Unified Agenda.

H. Unfunded Mandates Reform Act

This proposed rule does not impose unfunded mandates under the Unfunded Mandates Reform Act of 1995. It does not result in costs of \$120.7 million or more to either State, local, or tribal governments, in the aggregate, or to the private sector, and is the least burdensome alternative that achieves the objective of the rule.

I. Environmental Assessment

The National Environmental Policy Act of 1969 (NEPA), as amended (42 U.S.C. 4321–4347) requires Federal agencies to consider the consequences of major Federal actions and prepare a detailed statement on actions significantly affecting the quality of the human environment. PHMSA proposes to make miscellaneous amendments to the HMR based on petitions for rulemaking and PHMSA's own initiatives. The proposed amendments are intended to update, clarify, or provide relief from certain existing regulatory requirements to promote safer transportation practices; eliminate unnecessary regulatory requirements; finalize outstanding petitions for rulemaking; facilitate international commerce; and make these requirements easier to understand. We determined there would be no significant environmental impacts associated with this proposed rule.

J. Privacy Act

Anyone is able to search the electronic form of any written communications and comments received into any of our dockets by the name of the individual submitting the document (or signing the document, if submitted on behalf of an association, business, labor union, *etc.*). You may review DOT's complete Privacy Act Statement in the **Federal Register** published on April 11, 2000 (65 FR 19477) or you may visit <http://dms.dot.gov>.

List of Subjects

49 CFR Part 171

Exports, Hazardous materials transportation, Hazardous waste, Imports, Incorporation by reference, Reporting and recordkeeping requirements.

49 CFR Part 172

Education, Hazardous materials transportation, Hazardous waste, Incorporation by Reference, Labeling, Markings, Packaging and containers,

Reporting and recordkeeping requirements.

49 CFR Part 173

Hazardous materials transportation, Incorporation by Reference, Packaging and containers, Radioactive materials, Reporting and recordkeeping requirements, Uranium.

49 CFR Part 175

Hazardous materials transportation, Air carriers, Reporting and recordkeeping requirements.

49 CFR Part 177

Hazardous materials transportation, Incorporation by reference, Motor carriers, Segregation requirements, Reporting and recordkeeping requirements.

49 CFR Part 178

Hazardous materials transportation, Incorporation by reference, Motor vehicle safety, Packaging and containers, Reporting and recordkeeping requirements.

49 CFR Part 180

Hazardous materials transportation, Incorporation by reference, Motor carriers, Motor vehicle safety, Packaging and containers, Railroad safety, Reporting and recordkeeping requirements.

In consideration of the foregoing, we propose to amend 49 CFR Chapter I as follows:

PART 171—GENERAL INFORMATION, REGULATIONS, AND DEFINITIONS

1. The authority citation for part 171 continues to read as follows:

Authority: 49 U.S.C. 5101–5128, 44701; 49 CFR 1.45 and 1.53; Pub. L. 101–410 section 4 (28 U.S.C. 2461 note); Pub. L. 104–134, section 31001.

2. In § 171.4, paragraph (c) is revised to read as follows:

§ 171.4 Marine Pollutants.

* * * * *

(c) *Exceptions.* Except when all or part of the transportation is by vessel, the requirements of this subchapter specific to marine pollutants do not apply to non-bulk packagings transported by motor vehicle, rail car or aircraft.

3. In § 171.7, in paragraph (a)(3) and (b) tables, the following amendments are made:

a. Under the entry “Chlorine Institute, Inc.,” the entry “Type 1½ JQ 225, Dwg., H51970, Revision D April 5, 1989; or Type 1½ JQ 225, Dwg. H50155, Revision F, April 4, 1989” is revised;

b. Under the entry “Chlorine Institute, Inc.,” the entry “Section 3, Pamphlet 57, Emergency Shut-Off Systems for Bulk Transfer of Chlorine, 3rd Edition, October 1997” is revised;

c. Under the entry “Chlorine Institute, Inc.,” the entry “Section 3, Pamphlet 166 Angle Valve Guidelines for Chlorine Bulk Transportation, 1st Edition, October 2002” is added;

d. Under the entry “Chlorine Institute, Inc.,” the entry “Typical Manway Arrangement Chlorine Cargo Tank, Dwg. 137–5, November 1996” is added;

e. Under the entry “Chlorine Institute, Inc.,” the entry “Standards for Housing and Manway Covers for Steel Cargo Tanks, Dwg. 137–1 and 137–2, September 1, 1982” is removed;

f. Under the entry “Compressed Gas Association, Inc.,” the entry “CGA Pamphlet C–5 Cylinder Service Life—Seamless Steel High Pressure Cylinders, 1991” is revised;

g. Under the entry “Compressed Gas Association, Inc.,” the entry “CGA Pamphlet C–7, A Guide for the Preparation of Precautionary Markings of Compressed Gas Containers, appendix A, issued 1992 (6th Edition)” is revised;

h. Under the entry “Compressed Gas Association, Inc.,” the entry “CGA

Pamphlet S–1.1, Pressure Relief Device Standards—Part 1—Cylinders for Compressed Gases, 2001 (with the exception of paragraph 9.1.1.1), Ninth Edition” is removed;

i. Under the entry “Compressed Gas Association, Inc.,” the entry “CGA Pamphlet S–1.1, Pressure Relief Device Standards—Part 1—Cylinders for Compressed Gases, 2003 (with the exception of paragraph 9.1.1.1), Eleventh Edition” is removed;

j. Under the entry “Compressed Gas Association, Inc.,” the entry “CGA Pamphlet S–1.1, Pressure Relief Device Standards—Part 1—Cylinders for Compressed Gases, 2005 (with the exception of paragraph 9.1.1.1), Twelfth Edition” is added;

k. Under the entry “Compressed Gas Association, Inc.,” the entry “CGA Pamphlet S–7, Method for Selecting Pressure Relief Devices for Compressed Gas Mixtures in Cylinders, 1996” is revised;

l. Under the entry “International Organization for Standardization,” the entry “ISO 7225, Gas cylinders—Precautionary labels, First Edition, November 1994, (Corrected and reprinted August 1995), (E)” is revised; and

m. In paragraph (b), a new entry “Compressed Gas Association, Inc.,” 4221 Walney Road, 5th Floor, Chantilly, Virginia 20151, “CGA Pamphlet C–1.1—Personnel Training and Certification Guidelines for Cylinder Requalification By the Volumetric Expansion, issued 2004 (1st Edition)” is added in alphabetical order.

The revisions and additions read as follows:

§ 171.7 Reference material.

(a) * * *

(3) *Table of material incorporated by reference.* * * *

Source and name of material						49 CFR reference
*	*	*	*	*	*	*
<i>Chlorine Institute, Inc.</i>						
*	*	*	*	*	*	*
Type 1½ JQ 225, Dwg., H51970, Revision F, November 1996; or Type 1½ JQ 225, Dwg. H50155, Revision H, November 1996 ..						173.315.
Section 3, Pamphlet 57, Emergency Shut-Off Systems for Bulk Transfer of Chlorine, Edition 4, October 2003						177.840.
Section 3, Pamphlet 166 Angle Valve Guidelines for Chlorine Bulk Transportation, 1st Edition, October 2002						178.337–9.
*	*	*	*	*	*	*
Typical Manway Arrangement Chlorine Cargo Tank, Dwg 137–5, November 1996						178.337–10.

Source and name of material	49 CFR reference
* * * * *	*
<i>Compressed Gas Association, Inc.</i>	
* * * * *	*
CGA Pamphlet C-5, Cylinder Service Life—Seamless Steel High Pressure Cylinders, 1991 (reaffirmed 1995)	172.302(a).
* * * * *	*
CGA Pamphlet C-7, Guide to Preparation of Precautionary Labeling and Marking of Compressed Gas Containers, appendix A, issued 2004 (8th Edition)	172.400a.
* * * * *	*
CGA Pamphlet S-1.1, Pressure Relief Device Standards—Part 1—Cylinders for Compressed Gases, 2005 (with the exception of paragraph 9.1.1.1), Twelfth Edition	173.301, 173.304a, 178.75.
* * * * *	*
CGA Pamphlet S-7, Method for Selecting Pressure Relief Devices for Compressed Gas Mixtures in Cylinders, 2005	173.301.
* * * * *	*
<i>International Organization for Standardization,</i>	
* * * * *	*
ISO 7225, Gas cylinders—Precautionary labels, Second Edition, July 2005, (E)	178.71
* * * * *	*

(b) *List of informational materials not requiring incorporation by reference.*

* * * * *

Source and name of material	49 CFR reference
* * * * *	*
Compressed Gas Association, Inc., 4221 Walney Road, 5th Floor, Chantilly, Virginia 20151.	
CGA Pamphlet C-1.1, Personnel Training and Certification Guidelines For Cylinder Requalification By the Volumetric Expansion Method, 2004, First Edition	180.209.
* * * * *	*

4. In § 171.8, a new definition for “Household waste” is added in alphabetical order as follows:

§ 171.8 Definitions and abbreviations.

* * * * *

Household waste means any solid waste (including garbage, trash, and sanitary waste from septic tanks) derived from households (including single and multiple residences, hotels and motels, bunkhouses, ranger stations, crew quarters, campgrounds, picnic grounds, and day-use recreation areas).

* * * * *

5. In § 171.14, a new paragraph (g) is added to read as follows:

§ 171.14 Transitional provisions for implementing certain requirements.

* * * * *

(g) The proper shipping name “Gasohol gasoline mixed with ethyl alcohol, with not more than 20% alcohol” in effect on [DATE OF PUBLICATION OF FINAL RULE] may continue to be used until [DATE TWO YEARS FROM EFFECTIVE DATE OF FINAL RULE].

PART 172—HAZARDOUS MATERIALS TABLE, SPECIAL PROVISIONS, HAZARDOUS MATERIALS COMMUNICATIONS, EMERGENCY RESPONSE INFORMATION, AND TRAINING REQUIREMENTS

6. The authority citation for part 172 continues to read as follows:

Authority: 49 U.S.C. 5101–5128, 44701; 49 CFR 1.45 and 1.53.

7. In § 172.101, the Hazardous Materials Table is amended by removing, adding and revising, in the appropriate alphabetical sequence, the following entries to read as follows:

[REMOVE:]

Symbols	Hazardous materials descriptions and proper shipping names	Hazard class or division	Identification numbers	PG	Label codes	Special provisions (§ 172.102)	Packaging (§ 173.* * *)			Quantity limitations (9)		Vessel stowage (10)	
							Exceptions	Non-bulk	Bulk	Passenger aircraft/rail	Cargo aircraft only	Location	Other
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8A)	(8B)	(8C)	(9A)	(9B)	(10A)	(10B)
[REMOVE:]													
	Gas generator assemblies (aircraft), containing a non-flammable non-toxic gas and a propellant cartridge.	*	2.2	*	2.2	*	None	335	None	75 kg	150 kg	A.	
D	Gasohol gasoline mixed with ethyl alcohol, with not more than 20 percent alcohol.	*	3 NA1203	II	3	144	150	202	242	5 L	60 L	E.	
[ADD:]													
D	Ethanol and gasoline mixture or Ethanol and motor spirit mixture or Ethanol mixture and petrol mixture, with more than 10% ethanol.	*	3 UN3475	II	3	144, 177, IB2, T4, TP1.	150	202	242	5 L	60 L	E.	
D	Gasohol gasoline mixed with ethyl alcohol, with not more than 10 % alcohol.	*	3 NA1203	II	3	144, IB2, T7, TP1, TP8, TP28.	150	202	242	5 L	60 L	E.	
	Polyamines, flammable, corrosive, n.o.s. see Amines, flammable, corrosive, n.o.s.	*		*		*			*	*			
	Polyamines, liquid, corrosive, n.o.s. see Amines, liquid, corrosive, n.o.s.	*		*					*	*			
	Polyamines, liquid, corrosive, flammable, n.o.s. see Amines, liquid, corrosive, flammable, n.o.s.	*		*					*	*			
	Amines, liquid, corrosive, flammable, n.o.s.	*		*					*	*			
[REVISE:]													

[REVISE:]

* * * * *

8. In § 172.102, in paragraph (c)(1), Special provision 177 is added and in paragraph (c)(3), Special provision B69 is revised to read as follows.

§ 172.102 Special provisions.

* * * * *

(c) * * *

(1) * * *

Code/Special Provisions

* * * * *

177 Ethanol and gasoline mixtures for use in spark-ignition engines (e.g. in automobiles, stationary engines and other engines) shall be assigned to this entry regardless of variations in volatility.

* * * * *

(3) * * *

Code/Special Provisions

* * * * *

B69 Dry sodium cyanide or potassium cyanide may be shipped in the following sift-proof and weather resistant packagings: Metal covered hopper cars, covered motor vehicles, portable tanks, or non-specification bins.

* * * * *

9. In § 172.203, paragraph (l)(4) is revised to read as follows:

§ 172.203 Additional description requirements.

* * * * *

(l) * * *

(4) Except when all or part of transportation is by vessel, marine pollutants in non-bulk packagings are not subject to the requirements of paragraphs (l)(1) and (l)(2) of this section (see § 171.4 of this subchapter).

* * * * *

10. In § 172.315, a new paragraph (c) is added as follows:

§ 172.315 Packages containing limited quantities.

* * * * *

(c) As applicable, the letters "RQ" should be marked in association with the square-on-point border containing the identification (ID) number.

11. In § 172.336, paragraphs (c)(4) and (c)(5) are revised to read as follows:

§ 172.336 Identification numbers; special provisions.

* * * * *

(c) * * *

(4) For each of the different liquid petroleum distillate fuels, including gasoline and gasohol in a compartmented cargo tank or tank car, if the identification number is displayed for the distillate fuel having the lowest

flash point. Effective [DATE TWO YEARS FROM EFFECTIVE DATE OF FINAL RULE] the provisions of this paragraph do not apply to an Ethanol and gasoline mixture or Ethanol and motor spirit or Ethanol and petrol mixture, *with more than 10% ethanol*.

(5) For each of the different liquid petroleum distillate fuels, including gasoline and gasohol transported in a cargo tank, if the identification number is displayed for the liquid petroleum distillate fuel having the lowest flash point. Effective [DATE TWO YEARS FROM EFFECTIVE DATE OF FINAL RULE] the provisions of this paragraph do not apply to an Ethanol and gasoline mixture or Ethanol and motor spirit or Ethanol and petrol mixture, *with more than 10% ethanol*.

* * * * *

13. In § 172.406, paragraphs (e)(4) and (e)(5) are revised and a new paragraph (e)(6) is added to read as follows:

§ 172.406 Placement of labels.

* * * * *

(e) * * *

(4) Each portable tank of less than 3,785 L (1000 gallons) capacity;

(5) Each freight container or aircraft unit load device having a volume of 1.8 m³ (64 cubic feet) or more, but less than 18 m³ (640 cubic feet). One of each required label must be displayed on or near the closure; and

(6) An IBC having a volume of 1.8 m³ (64 cubic feet) or more.

* * * * *

PART 173—SHIPPERS—GENERAL REQUIREMENTS FOR SHIPMENTS AND PACKAGINGS

14. The authority citation for part 173 continues to read as follows:

Authority: 49 U.S.C. 5101–5128, 44701; 49 CFR 1.45 and 1.53.

15. In § 173.4, a new paragraph (e) is added to read as follows:

§ 173.4 Small quantity exceptions.

* * * * *

(e) Packing Groups II and III materials in Class 3, Division 4.1, Division 4.2, Division 4.3, Division 5.1, Division 6.1, Class 8, and Class 9 are not subject to any other requirements of this subchapter when—

(1) The maximum quantity of material per inner receptacle or article is limited to—

(i) One (1) mL (0.03 ounce) for authorized liquids; and

(ii) One (1) g (0.04 ounce) for authorized solid materials;

(2) Each inner receptacle with a removable closure has its closure held securely in place with wire, tape, or other positive means;

(3) Unless equivalent cushioning and absorbent material surrounds the inside packaging, each inner receptacle is securely packed in an inside packaging with cushioning and absorbent material that:

(i) Will not react chemically with the material, and

(ii) Is capable of absorbing the entire contents (if a liquid) of the receptacle;

(4) The inside packaging is securely packed in a strong outside packaging;

(5) The completed package is capable of sustaining—

(i) Each of the following free drops made from a height of 1.8 m (5.9 feet) directly onto a solid unyielding surface without breakage or leakage from any inner receptacle and without a substantial reduction in the effectiveness of the package:

(A) One drop flat on bottom;

(B) One drop flat on top;

(C) One drop flat on the long side;

(D) One drop flat on the short side; and

(E) One drop on a corner at the junction of three intersecting edges; and

(ii) A compressive load as specified in § 178.606(c) of this subchapter.

Each of the tests in this paragraph (e)(5) may be performed on a different but identical package; that is, all tests need not be performed on the same package.

(6) Placement of the material in the package or packing different materials in the package does not result in a violation of § 173.21;

(7) The aggregate quantity of hazardous material per package must not exceed 100 g (0.22 pounds) or 100 ml (3.38 ounces);

(8) The gross mass of the completed package does not exceed 29 kg (64 pounds); and

(9) The package is not opened or otherwise altered until it is no longer in commerce.

16. In § 173.5, paragraph (b)(2) is revised to read as follows:

§ 173.5 Agricultural operations.

* * * * *

(b) * * *

(2) The total amount of agricultural product being transported on a single motor vehicle does not exceed:

(i) 7,300 kg (16,094 lbs.) of ammonium nitrate fertilizer properly classed as Division 5.1, PG III, in a bulk packaging, or

(ii) 1900 L (502 gallons) for liquids or gases, or 2,300 kg (5,070 lbs.) for solids, of any other agricultural product;

* * * * *

17. In § 173.12, paragraph (e)(1)(ii) is revised and a new paragraph (f) added as follows:

§ 173.12 Exceptions for shipment of waste materials.

* * * * *

(e) * * *

(1) * * *

(ii) The acids must be packaged in lab packs in accordance with paragraph (b) of this section or in authorized single packagings not exceeding 208 L (55 gallons) capacity;

* * * * *

(f) *Household waste.* Household waste, as defined in § 171.8 of this subchapter, is not subject to the requirements of this subchapter.

18. In § 173.22, paragraph (b) is added to read as follows:

§ 173.22 Shipper's responsibility.

* * * * *

(b) No person may offer a motor carrier any hazardous material specified

in 49 CFR 385.403 unless that motor carrier holds a safety permit issued by the Federal Motor Carrier Safety Administration.

* * * * *

19. In § 173.24, paragraph (g)(1) is revised to read as follows:

§ 173.24 General requirements for packagings and packages.

* * * * *

(g) * * *

(1) Except for shipments of carbon dioxide, solid (dry ice), transportation by aircraft is not involved;

* * * * *

20. In § 173.61, paragraph (c) is revised to read as follows:

§ 173.61 Mixed packaging requirements.

* * * * *

(c) The following explosives may not be packed together with other Class 1 explosives: UN 0029, UN 0030, UN 0073, UN 0106, UN 0107, UN 0255, UN 0257, UN 0267, UN 0350, UN 0360, UN 0361, UN 0364, UN 0365, UN 0366, UN 0367, UN 0408, UN 0409, UN 0410, UN 0455, UN 0456, and UN 0500. These explosives may be mix-packed with each other in accordance with the compatibility requirements prescribed in paragraph (e).

* * * * *

21. In § 173.62, in paragraph (c), the "Table of Packing Methods," is amended by revising entry 134 to read as follows:

§ 173.62 Mixed packaging requirements.

* * * * *

(c) * * *

TABLE OF PACKING METHODS

Packing instruction	Inner packagings	Intermediate packagings	Outer packagings
134	Bags: water resistant Receptacles: fibreboard, metal, plastics, wood. Sheets: fibreboard, corrugated Tubes: fibreboard	Not necessary	Boxes: steel (4A), aluminium (4B), wood, natural, ordinary (4C1), wood natural, sift proof walls (4C2), plywood (4D), reconstituted wood (4F), fibreboard (4G), plastics, expanded (4H1), plastics, solid (4H2). Drums: fibreboard (1G), plastics, removable head (1H2), steel, removable head (1A2), aluminium, removable head (1B2), Plywood (1D).

22. In § 173.134, paragraph (b)(13)(i), as amended in FR Rule Doc. 06-4992, published at 71 FR 32244, June 2, 2006, effective October 1, 2006, is revised to read as follows:

§ 173.134 Class 6, Division 6.2—Definitions and exceptions.

* * * * *

(b) * * *

(13) * * *

(i) Household waste as defined in § 171.8,

* * * * *

23. Section 173.217 is revised to read as follows:

§ 173.217 Carbon dioxide, solid (dry ice).

(a) Carbon dioxide, solid (dry ice), when offered for transportation or transported by aircraft or water, must be packed in packagings designed and constructed to permit the release of carbon dioxide gas to prevent a buildup of pressure that could rupture the packagings. Packagings must conform to

the general packaging requirements of subpart B of this part but need not conform to the requirements of part 178 of this subchapter.

(b) For transportation by vessel:

(1) Each transport vehicle and freight container containing solid carbon dioxide must be conspicuously marked on two sides "WARNING CO₂ SOLID (DRY ICE)."

(2) Other packagings containing solid carbon dioxide must be marked "CARBON DIOXIDE, SOLID—DO NOT STOW BELOW DECKS."

(c) For transportation by aircraft:

(1) The net mass of the carbon dioxide, solid (dry ice) must be marked on the outside of the package.

(2) Arrangements between shipper and operator(s) must be made for each shipment, to monitor and limit ventilation rates to ensure passengers, flight crew members, and animals are not affected by the venting of carbon dioxide.

(3) Dry ice used as a refrigerant for other than hazardous materials loaded

in a unit load device or, other type of pallet, the quantity limits per package shown in Columns (9A) and (9B) of the Hazardous Materials Table in § 172.101 are not applicable. In such a case, the unit load device, or other type of pallet must be identified to the operator and must allow the venting of the carbon dioxide gas to prevent a dangerous build up of pressure.

(4) Dry ice is excepted from the shipping paper requirements of subpart C of part 172 of this subchapter, provided alternative written documentation is supplied containing the following information: Proper shipping name (Dry ice or Carbon dioxide, solid), class 9, UN number 1845, the number of packages, and the net quantity of dry ice in each package. The information must be included with the description of the materials.

(5) Carbon dioxide, solid (dry ice), in quantities not exceeding 2.3 kg (5 pounds) per package and used as a refrigerant for the contents of the package is excepted from all other

requirements of this subchapter if the requirements of paragraph (a) of this section are complied with and the package is marked "Carbon dioxide, solid" or "Dry ice", marked with the name of the contents being cooled, and marked with the net weight of the dry ice or an indication that the net weight is 2.3 kg (5 pounds) or less.

(d) Carbon dioxide, solid (dry ice), when used to refrigerate materials being shipped for diagnostic or treatment purposes (e.g., frozen medical specimens), is excepted from the shipping paper and certification requirements of this subchapter if the requirements of paragraphs (a) and (c)(2) of this section are met and the package is marked "Carbon dioxide, solid" or "Dry ice" and marked with an indication that the material being refrigerated is being transported for diagnostic or treatment purposes.

24. In § 173.301, paragraphs (f)(1) and (g)(1) are revised to read as follows:

§ 173.301 General requirements for shipment of compressed gases in cylinders and spherical pressure vessels.

* * * * *

(f) * * *

(1) Except as provided in paragraphs (f)(5), (f)(6), and (l)(2) of this section, a cylinder filled with a gas and offered for transportation must be equipped with one or more pressure relief devices sized and selected as to type, location, and quantity, and tested in accordance with CGA S-1.1 (compliance with paragraph 9.1.1.1 of CGA S-1.1 is not required) and S-7. The pressure relief device must be capable of preventing rupture of the normally filled cylinder when subjected to a fire test conducted in accordance with CGA C-14 (IBR, *see* § 171.7 of this subchapter), or, in the case of an acetylene cylinder, CGA C-12 (IBR, *see* § 171.7 of this subchapter).

* * * * *

(g) * * *

(1) Cylinder manifolding is authorized only under conditions prescribed in this paragraph (g). Manifolded cylinders must be supported and held together as a unit by structurally adequate means. Except for Division 2.2 materials, each cylinder must be equipped with an individual shutoff valve that must be tightly closed while in transit. Manifold branch lines must be sufficiently flexible to prevent damage to the valves that otherwise might result from the use of rigid branch lines. Each cylinder must be individually equipped with a pressure relief device as required in paragraph (f) of this section, except that pressure relief devices on manifolded horizontal cylinders that are mounted on a motor vehicle or framework may be

selected as to type, location, and quantity according to the lowest marked pressure limit of an individual cylinder in the manifolded unit. The pressure relief devices selected for the manifolded unit must have been tested in accordance with CGA S-1.1 and S-7. Pressure relief devices on manifolded horizontal cylinders filled with a compressed gas must be arranged to discharge unobstructed to the open air. In addition, for Division 2.1 (flammable gas) material, the PRDs must be arranged to discharge upward to prevent any escaping gas from contacting personnel or any adjacent cylinders. Valves and pressure relief devices on manifolded cylinders filled with a compressed gas must be protected from damage by framing, a cabinet, or other method. Manifolding is authorized for cylinders containing the following gases:

(i) Nonliquefied (permanent) compressed gases authorized by § 173.302.

(ii) Liquefied compressed gases authorized by § 173.304. Each manifolded cylinder containing a liquefied compressed gas must be separately filled and means must be provided to ensure no interchange of cylinder contents can occur during transportation.

(iii) Acetylene as authorized by § 173.303.

* * * * *

§ 173.335 [Removed]

25. Section 173.335 is removed and reserved.

PART 175—CARRIAGE BY AIRCRAFT

26. The authority citation for part 175 continues to read as follows:

Authority: 49 U.S.C. 5101–5128, 44701; 49 CFR 1.45 and 1.53.

27. In § 175.10, paragraph (a)(10) is revised to read as follows:

§ 175.10 Exceptions for passengers, crewmembers, and air operators.

* * * * *

(a) * * *

(10) Dry ice (carbon dioxide, solid):

(i) in quantities not exceeding 2.3 kg (5 pounds) per person in carry-on baggage, when used to pack perishables not subject to the HMR. The package must permit the release of carbon dioxide gas; and/or

(ii) in checked baggage, with the approval of the operator(s), when each package is marked "DRY ICE" or "CARBON DIOXIDE, SOLID", and marked with the net mass of dry ice or

an indication the net weight is 2.3 kg (5 pounds) or less.

* * * * *

28. A new § 175.900 is added to read as follows:

§ 175.900 Handling requirements for carbon dioxide, solid (dry ice).

Carbon dioxide, solid (dry ice) when shipped by itself or when used as a refrigerant for other commodities, may only be carried provided the operator has made suitable arrangements dependent on the aircraft type, the aircraft ventilation rates, the method of packing and stowing, whether animals will be carried on the same flight and other factors. The operator must ensure that the ground staff is informed that the dry ice is being loaded or is on board the aircraft. For arrangements between the shipper and operator *see* § 173.217 of this subchapter. Where dry ice is contained in a unit load device or other type of pallet prepared by a single shipper in accordance with § 173.217 and the operator after the acceptance adds additional dry ice, the operator must ensure that the information provided to the Pilot-in-Command reflects that revised quantity of dry ice.

PART 177—CARRIAGE BY PUBLIC HIGHWAY

29. The authority citation for part 177 continues to read as follows:

Authority: 49 U.S.C. 5101–5128; 49 CFR 1.53.

30. In § 177.848, paragraph (a)(1) is revised to read as follows:

§ 177.848 Segregation of hazardous materials.

(a) * * *

(1) In packages that must be labeled or placarded in accordance with part 172 of this subchapter;

* * * * *

PART 178—SPECIFICATIONS FOR PACKAGINGS

31. The authority citation for part 178 continues to read as follows:

Authority: 49 U.S.C. 5101–5128; 49 CFR 1.53.

32. In § 178.274, in paragraph (b)(1), the first sentence is revised to read as follows:

§ 178.274 Specifications for UN portable tanks.

* * * * *

(b) *General design and construction requirements.* (1) The design temperature range for the shell must be –40 °C to 50 °C (–40 °F to 122 °F) for hazardous materials transported under normal conditions of transportation,

except for portable tanks used for refrigerated liquefied gases where the minimum design temperature must not be higher than the lowest (coldest) temperature (for example, service temperature) of the contents during filling, discharge or transportation.

* * *

* * * * *

33. In § 178.337–9, paragraph (b)(8) is revised to read as follows:

§ 178.337–9 Pressure relief devices, piping, valves, hoses, and fittings.

* * * * *

(b) * * *

(8) *Chlorine cargo tanks.* Angle valves on cargo tanks intended for chlorine service must conform to the standards of The Chlorine Institute, Inc., Dwg. 104–8 or “Section 3, Pamphlet 166 Angle Valve Guidelines for Chlorine Bulk Transportation.” (IBR, see § 171.7 of this subchapter). Before installation, each angle valve must be tested for leakage at

not less than 225 psig using dry air or inert gas.

* * * * *

34. In § 178.337–10, paragraph (d) is revised to read as follows:

§ 178.337–10 Accident damage protection.

* * * * *

(d) *Chlorine tanks.* A chlorine tank must be equipped with a protective housing and a manway cover to permit the use of standard emergency kits for controlling leaks in fittings on the dome cover plate. For tanks manufactured on or after and [PUBLICATION DATE OF FINAL RULE], the housing and manway cover must conform to the Chlorine Institute, Inc., Dwg. 137–5 (IBR, see § 171.7 of this subchapter).

* * * * *

PART 180—CONTINUING QUALIFICATION AND MAINTENANCE OF PACKAGINGS

35. The authority citation for part 180 continues to read as follows:

Authority: 49 U.S.C. 5101–5128; 49 CFR 1.53.

36. In § 180.205, a new paragraph (g)(6) added to read as follows:

§ 180.205 General requirements for requalification of cylinders.

* * * * *

(g) * * *

(6) The guidelines contained in CGA Pamphlet C 1.1 may be used for training persons who requalify cylinders using the volumetric expansion test method.

* * * * *

Issued in Washington, DC on September 15, 2006 under authority delegated in 49 CFR part 106.

Robert A. McGuire,

Associate Administrator for Hazardous Materials Safety.

[FR Doc. 06–7913 Filed 9–22–06; 8:45 am]

BILLING CODE 4910–60–P

Notices

Federal Register

Vol. 71, No. 185

Monday, September 25, 2006

This section of the FEDERAL REGISTER contains documents other than rules or proposed rules that are applicable to the public. Notices of hearings and investigations, committee meetings, agency decisions and rulings, delegations of authority, filing of petitions and applications and agency statements of organization and functions are examples of documents appearing in this section.

DEPARTMENT OF AGRICULTURE

Forest Service

Ouachita-Ozark Resource Advisory Committee

AGENCY: Forest Service, USDA.

ACTION: Meeting notice for the Ouachita-Ozark Resource Advisory Committee under Section 205 of the Secure Rural Schools and Community Self Determination Act of 2000 (Pub. L. 106–393).

SUMMARY: This notice is published in accordance with section 10(a)(2) of the Federal Advisory Committee Act. Meeting notice is hereby given for the Ouachita-Ozark Resource Advisory Committee pursuant to section 205 of the Secure Rural Schools and Community Self Determination Act of 2000, Public Law 106–393. Topics to be discussed include: General information, proposed new Title II projects, updates on current or completed Title II projects, renewal of committee member terms and committee member recruitment needs and, if appropriate, next meeting date and agenda.

DATES: The meeting will be held on September 28, 2006, beginning at 6 p.m. and ending at approximately 9 p.m.

ADDRESSES: The meeting will be held at the Scott County Courthouse, 100 W. First Street, Waldron, AR 71958.

FOR FURTHER INFORMATION CONTACT: Caroline Mitchell, Committee Coordinator, USDA, Ouachita National Forest, P.O. Box 1270, Hot Springs, AR 71902 (501–321–5318).

SUPPLEMENTARY INFORMATION: The meeting is open to the public. Committee discussion is limited to Forest Service Staff, Committee members, and elected officials. However, persons who wish to bring matters to the attention of the Committee may file written statements with the Committee staff before or after the meeting. Individuals wishing to speak or propose agenda items must

send their names and proposals to Bill Pell, DFO, P.O. Box 1270, Hot Springs, AR 71902

Dated: September 12, 2006.

Caroline Mitchell,

Committee Coordinator.

[FR Doc. 06–8129 Filed 9–22–06; 8:45 am]

BILLING CODE 3410–52–M

DEPARTMENT OF COMMERCE

International Trade Administration

[A–201–817]

Oil Country Tubular Goods from Mexico; Extension of Time Limits for Preliminary and Final Results of Full Five-year (“Sunset”) Review of Antidumping Duty Order

AGENCY: Import Administration, International Trade Administration, Department of Commerce.

EFFECTIVE DATE: September 25, 2006.

FOR FURTHER INFORMATION CONTACT: John Drury or Abdelali Elouaradia, AD/CVD Operations, Office 7, Import Administration, International Trade Administration, U.S. Department of Commerce, 14th Street & Constitution Avenue, N.W., Washington, D.C. 20230; telephone: (202) 482–0195 or (202) 482–1374, respectively.

SUPPLEMENTARY INFORMATION:

Background

On June 1, 2006, the Department of Commerce (“the Department”) published in the **Federal Register** the notice of initiation of its sunset reviews of the antidumping duty orders on oil country tubular goods (“OCTG”) from Argentina, Italy, Japan, South Korea, and Mexico. *See Initiation of Five-year (“Sunset”) Reviews*, 71 FR 31153 (June 1, 2006). On June 14, 2006, domestic interested party United States Steel Corporation (“U.S. Steel”) submitted a letter indicating its intent to participate in the sunset review on OCTG from Mexico. On June 15, 2006, the domestic interested parties IPSCO Tubulars Inc., Lone Star Steel Company, Koppel Steel (NS Group), Maverick Tube Corporation, Newport Steel (NS Group), and V&M Star LP, submitted a letter indicating their intent to participate in the sunset reviews. On June 29, 2006, June 30, 2006, and July 3, 2006, domestic and respondent interested

parties provided substantive responses as required under section 351.218 (d)(3) of the Department’s regulations. Respondent interested parties Hylsa, S.A. de C.V. (“Hylsa”) and Tubos de Acero de Mexico, S.A. (“TAMSA”), included, in their substantive responses, arguments regarding “other factors” under section 752(c)(2) of the Tariff Act of 1930, as amended (“the Act”) and their effect on the Department’s determination whether dumping is likely to continue or recur. Domestic interested parties filed rebuttal comments on July 5, 2006, and July 14, 2006.

On July 21, 2006, the Department determined that the participation of the respondent interested parties was adequate, and that it was appropriate to conduct full sunset reviews. *See Memorandum to Steven J. Claeyes: Adequacy Determination; Sunset Review of the Antidumping Duty Order on Oil Country Tubular Goods from Mexico*, dated July 21, 2006, and on file in the Central Records Unit, Room B–099 of the Department of Commerce building.

Extension of Time Limits for Preliminary and Final Results of Reviews

The Act provides for the completion of a full sunset review within 240 days of the publication of the initiation notice. *See* section 751(c)(5)(A) of the Act. In accordance with section 751(c)(5)(B) of the Act, the Department may extend the period of time for making its determination by not more than 90 days, if it determines that the review is extraordinarily complicated. We determine that this review is extraordinarily complicated, pursuant to sections 751(c)(5)(C) (i) and (ii) of the Act, because there are a large number of issues and the issues to be considered are complex. Therefore, the Department requires additional time to complete its analysis. The Department’s preliminary results of the sunset review of the antidumping duty order on OCTG are scheduled for September 19, 2006. However, the Department will extend the deadline in this proceeding for the above-stated reasons. As a result, the Department intends to issue the preliminary results of the full sunset review by December 18, 2006, and the final results of that review by April 27, 2007. These dates are 90 days from the

original scheduled dates of the preliminary and final results of the sunset review.

This notice is issued in accordance with sections 751(c)(5)(B) and (C) of the Act.

Dated: September 19, 2006.

Stephen J. Claeys,

Deputy Assistant Secretary for Import Administration.

[FR Doc. 06-8181 Filed 9-22-06; 8:45 am]

BILLING CODE 3510-DS-S

COMMITTEE FOR THE IMPLEMENTATION OF TEXTILE AGREEMENTS

Adjustment of Import Limits for Certain Cotton and Man-Made Fiber Textile Products Produced or Manufactured in the Socialist Republic of Vietnam

September 18, 2006.

AGENCY: Committee for the Implementation of Textile Agreements (CITA).

ACTION: Issuing a directive to the Commissioner, U.S. Customs and Border Protection.

EFFECTIVE DATE: September 25, 2006

FOR FURTHER INFORMATION CONTACT: Ross Arnold, International Trade Specialist, Office of Textiles and Apparel, U.S. Department of Commerce, (202) 482-4212. For information on the quota status of these limits, refer to the U.S. Customs and Border Protection website (<http://www.cbp.gov>), or call (202) 344-2650. For information on embargoes and quota re-openings, refer to the Office of Textiles and Apparel website at <http://otexa.ita.doc.gov>.

SUPPLEMENTARY INFORMATION:

Authority: Section 204 of the Agricultural Act of 1956, as amended (7 U.S.C. 1854); Executive Order 11651 of March 3, 1972, as amended.

The Bilateral Textile Agreement of July 17, 2003, as amended, between the Governments of the United States and the Socialist Republic of Vietnam, establishes limits for certain cotton, wool and man-made fiber textiles and textile products, produced or manufactured in the Socialist Republic of Vietnam. The current limits for certain categories are being adjusted for carryover.

A description of the textile and apparel categories in terms of HTS numbers is available in the **CORRELATION:** Textile and Apparel Categories with the Harmonized Tariff Schedule of the United States (refer to the Office of Textiles and Apparel

website at <http://otexa.ita.doc.gov>). See 70 FR 75156 (December 19, 2005).

Philip J. Martello,

Acting Chairman, Committee for the Implementation of Textile Agreements.

Committee for the Implementation of Textile Agreements

September 18, 2006.

Commissioner,
U.S. Customs and Border Protection,
Washington, DC 20229

Dear Commissioner: This directive amends, but does not cancel, the directive issued to you on December 13, 2005, by the Chairman, Committee for the Implementation of Textile Agreements. That directive concerns imports of certain cotton, wool, and man-made fiber textiles and textile products, produced or manufactured in Vietnam and exported during the twelve-month period which began on January 1, 2006 and extends through December 31, 2006.

Effective on September 25, 2006, you are directed to increase the limits for the following categories, as provided for under the terms of the current bilateral textile agreement between the Governments of the United States and Vietnam:

Category	Restraint limit
342/642	752,777 dozen.
347/348	9,502,903 dozen.

¹ The limits have not been adjusted to account for any imports exported after December 31, 2005.

The Committee for the Implementation of Textile Agreements has determined that these actions fall within the foreign affairs exception to the rulemaking provisions of 5 U.S.C. 553(a)(1).

Sincerely,

Philip J. Martello,

Acting Chairman, Committee for the Implementation of Textile Agreements.

[FR Doc. 06-8178 Filed 9-22-06; 8:45 am]

BILLING CODE 3510-DS

DEPARTMENT OF DEFENSE

Department of the Army; Corps of Engineers

Notice of Intent To Prepare an Environmental Impact Statement and Conduct a Public Scoping Meeting for the Bluestone Hydropower Project, Hinton, Summers County, WV

AGENCY: Department of the Army, U.S. Army Corps of Engineers, DoD.

ACTION: Notice of intent.

SUMMARY: Pursuant to the National Environmental Policy Act of 1969 (NEPA), the U.S. Army Corps of Engineers, DoD, Huntington District will prepare an Environmental Impact Statement (EIS) to evaluate potential impacts to the natural, physical, and

human environment as a result of the proposed installation of hydropower generation facilities at Bluestone Dam, Hinton, Summers County, WV (Hydropower Project). The proposed hydropower project would utilize three of the six existing penstocks which were part of the original construction of the dam. The proposed project would also involve the discharge of dredged and fill material into waters of the United States (U.S.) and would involve work in the New River, a navigable water of the U.S. Therefore, the subject proposal would require a Department of the Army (DA) permit pursuant to section 404 of the Clean Water Act (Section 404) and Section 10 of the Rivers and Harbors Act of 1899 (Section 10). This EIS will document the agency's evaluation of all reasonable alternatives as they affect stability of the dam and control the release of water from Bluestone Dam, and will document analysis of impacts to Waters of the U.S. sufficient to accommodate the NEPA process for permitting under section 10 and section 404.

DATES: A public scoping meeting is announced for October 2, 2006, from 11 a.m.–8 p.m. at Hinton Technology Center, 301 Summers Street, Hinton, Summers County, WV.

ADDRESSES: Send written comments and suggestions concerning this proposed project to John Preston, PM-PD-R, U.S. Army Corps of Engineers, Huntington District, 502 Eighth Street, Huntington, WV, 25701-2070. Telephone: (304) 399-5870. Electronic mail:

John.S.Preston@usace.army.mil.

Requests to be placed on the mailing list should also be sent to this address.

FOR FURTHER INFORMATION CONTACT: To obtain additional information about the proposed project, contact Kenneth Halstead EC-WH, U.S. Army Corps of Engineers, Huntington District, 502 Eighth Street, Huntington, WV, 25701-2070. Telephone: (304) 399-5811. Electronic mail:

Kenneth.C.Halstead@usace.army.mil.

SUPPLEMENTARY INFORMATION: 1. *Public Participation:* a. The Corps of Engineers will conduct a public scoping meeting (open house format) to gain input from interested agencies, organizations, and the general public concerning the content of the EIS, issues and impacts to be addressed in the EIS, and alternatives that should be analyzed. The meeting is scheduled for (see **DATES**).

b. The Corps invites full public participation to promote open communication and better decision-making. All persons and organizations that have an interest in potential effects

of hydropower development and electric power generation at Bluestone Dam and the affected environment are urged to participate in this NEPA environmental analysis process. Assistance will be provided upon request to anyone having difficulty.

c. Public comments are welcomed anytime throughout the NEPA process. Formal opportunities for public participation include: (1) Public meetings to be held near the community of Hinton; (2) Anytime during the NEPA process via mail, telephone or e-mail; (3) During Review and Comment on the Draft EIS (DEIS)—approximately late Summer 2007; and (4) Review of the Final EIS (FEIS)—Winter 2007/2008. Schedules and locations will be announced in local news media. Interested parties may also request to be included on the mailing list for public distribution of meeting announcements and documents (see **ADDRESSES**).

d. To ensure that all issues related to the proposed project are approximately addressed, the Corps invites input from interested agencies, local and regional stakeholders and the general public to assist in identifying areas of concern, issues and impacts to be addressed in the EIS, and the alternatives that should be analyzed. Scoping for the DEIS will continue to build upon the knowledge and information developed during the more than 50 years of Corps of Engineer operation of the Bluestone Dam.

2. *Background:* a. The Bluestone Lake project is located in southern West Virginia, with the uppermost reaches of the lake extending into Virginia. Bluestone Dam is on the New River at Hinton, WV. Authorized in the 1935 and 1938 Flood Control Acts (FCAs) for flood control and hydropower, the Bluestone Lake project was completed in 1949. As the first of four authorized reservoirs in the Kanawha River Basin, Bluestone is operated for flood control. During construction hydropower development at Bluestone was delayed until other basin flood control projects could be constructed, with penstocks incorporated to permit future power facilities installation. Two of the three planned projects (Sutton and Summerville Lakes) have been constructed and the third was de-authorized. The Bluestone project was designed to operate at a normal summer pool elevation of 1490 feet and maximum flood control pool elevation of 1520 feet; 40 percent of the active storage was planned for flood control and almost 60 percent for hydropower. Current operations maintain the summer pool at 1410, with maximum flood control pool at 1520 and 97 percent of the active storage for flood

control. The 1944 FCA authorized the Secretary of the Army to permit recreation development at water resources projects, and during the 1950s and in 1970 project operations at Bluestone were changed to provide a conservation pool that allowed lake recreation. Section 6 of the 1988 Water Resources Development Act added recreation and downstream recreation as project purposes at Bluestone Lake.

b. Section 547 of Water Resources Development Act of 2000 (Pub. L. 106–541) authorized the Tri-Cities Power Authority to construct hydroelectric generating facilities at the Bluestone dam. “Tri-Cities Power Authority” (TCPA) refers to the entity established by the City of Hinton, WV, the City of White Sulphur Springs, WV, and the City of Philippi, WV, pursuant to a document entitled “Second Amended and Restated Intergovernmental Agreement” approved by the Attorney General of West Virginia on February 14, 2002. Further, this act directs the Secretary of the Army to enter into a binding agreement with the Secretary of Energy and TCPA to accomplish construction of the project.

c. Section 122 of the Energy and Water Development Appropriations Act, 2006 (Pub. L. 109–103) amended the aforementioned legislation. These amendments include the designation of TCPA as the owner and operator of said hydropower project. Further, section 122 removed hydroelectric power as an authorized project purpose “so long as Tri-Cities Power Authority continues to exercise its responsibilities as he builder, owner, and operator of the hydropower facilities at Bluestone Dam.” In addition, this legislation focused the approval that the Secretary of the Army must exercise for the proposed project, which is “to review the design and construction activities for all features of the hydroelectric project that pertain to and affect stability of the dam and control the release of water from Bluestone Dam to ensure that the quality of construction of those features meets all standards established for similar facilities constructed by the Secretary.”

d. Reasonable alternatives for hydropower development are limited to those which will provide profitable power generation, meet established design criteria with respect to stability of the dam, do not significantly affect other Bluestone Lake project purposes as related to flow, and are environmentally acceptable. Only one physical hydropower facility design has been found feasible by TCPA. No changes to pool elevations are proposed.

e. The proposed hydropower facility would utilize up to 9000 cubic feet per second (cfs) of flow. Under current operating procedures for the dam, a minimum discharge of 610 cfs is maintained. The alternatives to be considered in the EIS are those which evaluate various discharges through the stilling basin of the dam, including providing all flow up to 9000 cfs through the hydropower facility. In addition, the no-action alternative will be evaluated. As necessary, any reasonable alternatives that may become apparent as the evaluation process will be addressed.

3. *Cooperating Agencies:* a. At this time, no other federal, state, or local agencies are expected to be cooperating agencies in preparation of this EIS. However, numerous federal and state agencies, including the U.S. Environmental Protection Agency, Region III, U.S. Fish and Wildlife Service, Elkins West Virginia Field Office, Department of Interior National Park Service, West Virginia Department of Environmental Protection, and the West Virginia Division of Wildlife, are expected to be involved in this process.

4. *Additional Information and Review:* a. Compliance with other federal and state requirements that will be addressed in the EIS include, but will not be limited to, State Water Quality Certification under section 401 of the Clean Water Act, West Virginia Pollution Discharge Elimination System section 402 permit, section 7 of the Endangered Species Act, the Fish and Wildlife Coordination Act and section 106 of the National Historic Preservation Act.

5. *Availability of the Draft:* a. The draft EIS is projected to be available late Summer 2007. A formal public hearing will be conducted following release of the Draft EIS.

Brenda S. Bowen,

Army Federal Register Liaison Officer.

[FR Doc. 06–8126 Filed 9–22–06; 8:45 am]

BILLING CODE 3710-GM-M

DEPARTMENT OF DEFENSE

Department of the Navy

[USN–2006–0058]

Privacy Act of 1974; System of Records

AGENCY: Department of the Navy, DoD.

ACTION: Notice to amend systems of records.

SUMMARY: The Department of the Navy is amending a system of records notice

in its existing inventory of record systems subject to the Privacy Act of 1974, (5 U.S.C. 552a), as amended.

DATES: This proposed action will be effective without further notice on October 25, 2006 unless comments are received which result in a contrary determination.

ADDRESSES: Send comments to the Department of the Navy, PA/FOIA Policy Branch, Chief of Naval Operations (DNS-36), 2000 Navy Pentagon, Washington, DC 20350-2000.

FOR FURTHER INFORMATION CONTACT: Mrs. Doris Lama at (202) 685-6545.

SUPPLEMENTARY INFORMATION: The Department of the Navy systems of records notices subject to the Privacy Act of 1974, (5 U.S.C. 552a), as amended, have been published in the **Federal Register** and are available from the address above.

The specific changes to the record system being amended are set forth below followed by the notice, as amended, published in its entirety. The proposed amendments are not within the purview of subsection (r) of the Privacy Act of 1974, (5 U.S.C. 552a), as amended, which requires the submission of a new or altered system report.

Dated: September 18, 2006.

C. R. Choate,

Alternate OSD Federal Register Liaison Officer, Department of Defense.

N04066-3

SYSTEM NAME:

Layaway Sales Records (September 20, 1993, 58 FR 48852).

CHANGES:

* * * * *

Authority for maintenance of the system: Delete entry and replace with "10 U.S.C. 5013, Secretary of the Navy."

* * * * *

STORAGE:

Delete entry and replace with "Electronic journals and paper records in file folders include layaway tickets and layaway patron lists."

RETRIEVABILITY:

Delete entry and replace with "Name and address."

SAFEGUARDS:

Delete entry and replace with "Controlled access to electronic journals and supervised records space."

RETENTION AND DISPOSAL:

Delete entry and replace with "Paid in full layaway records are maintained in an electronic journal for a period of one

year and then destroyed. Paper records are destroyed after two years."

SYSTEM MANAGER(S) AND ADDRESS:

Delete second paragraph and replace with "Record Holder: Director, Operations Group, Navy Exchange Service Command, 3280 Virginia Beach Boulevard, Virginia Beach, VA 23452-5724. Individual record holders within the central system may be contacted through the central system record holder."

* * * * *

N04066-3

SYSTEM NAME:

Layaway Sales Records

SYSTEM LOCATION:

Navy Exchange Service Command, 3280 Virginia Beach Boulevard, Virginia Beach, VA 23452-5724 (for all Navy exchanges).

CATEGORIES OF INDIVIDUALS COVERED BY THE SYSTEM:

Patrons of Navy exchanges who buy goods on layaway.

CATEGORIES OF RECORDS IN THE SYSTEM:

Layaway tickets and layaway patron lists.

AUTHORITY FOR MAINTENANCE OF THE SYSTEM:

10 U.S.C. 5013, Secretary of the Navy.

PURPOSE(S):

To record the selection of layaway merchandise, record payments, verify merchandise pick-up and perform sales audits.

ROUTINE USES OF RECORDS MAINTAINED IN THE SYSTEM, INCLUDING CATEGORIES OF USERS AND THE PURPOSES OF SUCH USES:

In addition to those disclosures generally permitted under 5 U.S.C. 552a(b) of the Privacy Act, these records or information contained therein may specifically be disclosed outside the DoD as a routine use pursuant to 5 U.S.C. 552a(b)(3) as follows:

The DoD "Blanket Routine Uses" that appear at the beginning of the Navy's compilation of systems notices apply to this system.

Policies and practices for storing, retrieving, accessing, retaining, and disposing of records in the system:

STORAGE:

Electronic journals and paper records in file folders include layaway tickets and layaway patron lists.

RETRIEVABILITY:

Name and address.

SAFEGUARDS:

Controlled access to electronic journals and supervised records space.

RETENTION AND DISPOSAL:

Paid in full layaway records are maintained in an electronic journal for a period of one year and then destroyed. Paper records are destroyed after two years.

SYSTEM MANAGER(S) AND ADDRESS:

Policy Official: Commander, Navy Exchange Service Command, 3280 Virginia Beach Boulevard, Virginia Beach, VA 23452-5724.

RECORD HOLDER:

Director, Operations Group, Navy Exchange Service Command, 3280 Virginia Beach Boulevard, Virginia Beach, VA 23452-5724. Individual record holders within the central system may be contacted through the central system record holder.

NOTIFICATION PROCEDURE:

Individuals seeking to determine whether this system of records contains information about themselves should address written inquiries to the Commander, Navy Exchange Service Command, 3280 Virginia Beach Boulevard, Virginia Beach, VA 23452-5724.

In the initial inquiry, the requester must provide full name and activity where layaway sales were transacted. A list of other offices the requester may visit will be provided after initial contact at the office listed above. At the time of personal visit, requesters must provide proof of identity containing the requester's signature.

RECORD ACCESS PROCEDURES:

Individuals seeking access to records about themselves should address written inquiries to the Commander, Navy Exchange Service Command, 3280 Virginia Beach Boulevard, Virginia Beach, VA 23452-5724. The requester must provide full name and activity where layaway sales were transacted. A list of other offices the requester may visit will be provided after initial contact at the office listed above. At the time of personal visit, requesters must provide proof of identity containing the requester's signature.

CONTESTING RECORD PROCEDURES:

The Navy's rules for accessing records, and for contesting contents and appealing initial agency determinations are published in Secretary of the Navy Instruction 5211.5; 32 CFR part 701; or may be obtained from the system manager.

RECORD SOURCE CATEGORIES:

The individual.

EXEMPTIONS CLAIMED FOR THE SYSTEM:

None.

[FR Doc. 06-8157 Filed 9-22-06; 8:45 am]

BILLING CODE 5001-06-U

DEPARTMENT OF DEFENSE**Department of the Navy**

[USN-2006-0057]

Privacy Act of 1974; System of Records

AGENCY: Department of the Navy, DoD.

ACTION: Notice to Amend Systems of Records.

SUMMARY: The Department of the Navy is amending a system of records notice in its existing inventory of record systems subject to the Privacy Act of 1974, (5 U.S.C. 552a), as amended.

DATES: This proposed action will be effective without further notice on October 25, 2006 unless comments are received which result in a contrary determination.

ADDRESSES: Send comments to the Department of the Navy, PA/FOIA Policy Branch, Chief of Naval Operations (DNS-36), 2000 Navy Pentagon, Washington, DC 20350-2000.

FOR FURTHER INFORMATION CONTACT: Mrs. Doris Lama at (202) 685-6545.

SUPPLEMENTARY INFORMATION: The Department of the Navy systems of records notices subject to the Privacy Act of 1974, (5 U.S.C. 552a), as amended, have been published in the **Federal Register** and are available from the address above.

The specific changes to the record system being amended are set forth below followed by the notice, as amended, published in its entirety. The proposed amendments are not within the purview of subsection (r) of the Privacy Act of 1974, (5 U.S.C. 552a), as amended, which requires the submission of a new or altered system report.

Dated: September 18, 2006.

C. R. Choate,

Alternate OSD Federal Register Liaison Officer, Department of Defense.

N01306-1**SYSTEM NAME:**

Job Advertisement and Selection System (JASS) (February 8, 2000, 65 FR 6184).

CHANGES:

* * * * *

SYSTEM NAME:

Delete entry and replace with "Job Advertisement/Career Management/Detailing System."

SYSTEM LOCATION:

Delete entry and replace with "SPAWAR Systems Center New Orleans (SSC NOLA), 2251 Lakeshore Drive, New Orleans, LAS 70145—and all Navy afloat units."

CATEGORIES OF INDIVIDUALS COVERED BY THE SYSTEM:

Delete entry and replace with "All Navy enlisted personnel: active, Selected Reserve (SELRES), Full Time Support (FTS), and Junior Officer Submariners."

* * * * *

PURPOSE(S):

Delete entry and replace with "To administer the Job Advertisement and Selection System (JASS) and Career Management System and Interactive Detailing (CMS/ID). To assist Navy officials and employees in the initiation, development, implementation of policies pertaining to enlisted personnel assignment, placement, retention, career enhancement and motivation, and other career related matters to meet manpower allocations and requirements."

* * * * *

STORAGE:

Delete entry and replace with "Automated records may be stored on magnetic tapes, disc, and drums. Manual records may be stored in paper file folders, or removable electronic storage media."

RETRIEVABILITY:

Delete entry and replace with "Name, Social Security Number, rate/pay grade, activity, and/or record status within command."

* * * * *

System manager(s) and address:

Delete entry and replace with "Commander, Navy Personnel Command (Pers-455), 5720 Integrity Drive, Millington, TN 38055-0600."

NOTIFICATION PROCEDURE:

Delete first paragraph and replace with "Individuals seeking to determine whether this system of records contains information about themselves should address written inquiries to the Commander, Navy Personnel Command (Pers-455), 5720 Integrity Drive, Millington, TN 38055-0600."

RECORD ACCESS PROCEDURES:

Delete first paragraph and replace with "Individuals seeking access to records about themselves contained in this system of records should address written inquiries to the Commander, Navy Personnel Command (Pers-455), 5720 Integrity Drive, Millington, TN 38055-0600."

* * * * *

N01306-1**SYSTEM NAME:**

Job Advertisement/Career Management/Detailing System.

SYSTEM LOCATION:

SPAWAR Systems Center New Orleans (SSC NOLA), 2251 Lakeshore Drive, New Orleans, LAS 70145—and all Navy afloat units.

CATEGORIES OF INDIVIDUALS COVERED BY THE SYSTEM:

All Navy enlisted personnel: active, Selected Reserve (SELRES), Full Time Support (FTS), and Junior Officer Submariners.

CATEGORIES OF RECORDS IN THE SYSTEM:

Limited personnel records in automated form displaying basic qualifications. This system primarily displays a listing of available billets from which a sailor can request through their career counselor.

AUTHORITY FOR MAINTENANCE OF THE SYSTEM:

5 U.S.C. 301, Departmental Regulations; 10 U.S.C. 5013, Secretary of the Navy; and E.O. 9397 (SSN).

PURPOSE(S):

To administer the Job Advertisement and Selection System (JASS) and Career Management System and Interactive Detailing (CMS/ID).

To assist Navy officials and employees in the initiation, development, implementation of policies pertaining to enlisted personnel assignment, placement, retention, career enhancement and motivation, and other career related matters to meet manpower allocations and requirements.

ROUTINE USES OF RECORDS MAINTAINED IN THE SYSTEM, INCLUDING CATEGORIES OF USERS AND THE PURPOSES OF SUCH USES:

In addition to those disclosures generally permitted under 5 U.S.C. 552a(b) of the Privacy Act, these records or information contained therein may specifically be disclosed outside the DoD as a routine use pursuant to 5 U.S.C. 552a(b)(3) as follows:

The DoD 'Blanket Routine Uses' that appear at the beginning of the Navy's

compilation of system of record notices apply to this system.

POLICIES AND PRACTICES FOR STORING, RETRIEVING, ACCESSING, RETAINING, AND DISPOSING OF RECORDS IN THE SYSTEM:

STORAGE:

Automated records may be stored on magnetic tapes, disc, and drums. Manual records may be stored in paper file folders, or removable electronic storage media.

RETRIEVABILITY:

Name, Social Security Number, rate/pay grade, activity, and/or record status within command.

SAFEGUARDS:

Computer processing facilities and terminals are located in restricted areas accessible only to authorized persons that are properly screened, cleared, and trained. Manual records and computer printouts are available only to authorized personnel having a need-to-know.

RETENTION AND DISPOSAL:

Records are generally maintained until superseded or for a period of two years and then disposed of by burning or shredding.

SYSTEM MANAGER(S) AND ADDRESS:

Commander, Navy Personnel Command (Pers—455), 5720 Integrity Drive, Millington, TN 38055-0600.

NOTIFICATION PROCEDURE:

Individuals seeking to determine whether this system of records contains information about themselves should address written inquiries to the Commander, Navy Personnel Command (Pers—455), 5720 Integrity Drive, Millington, TN 38055-0600.

The letter should contain full name, Social Security Number (and/or enlisted service number), rate, military status, and signature of the requester.

RECORD ACCESS PROCEDURES:

Individuals seeking access to records about themselves contained in this system of records should address written inquiries to the Commander, Navy Personnel Command (Pers—455), 5720 Integrity Drive, Millington, TN 38055-0600.

The letter should contain full name, Social Security Number (and/or enlisted service number), rate, military status, and signature of the requester.

CONTESTING RECORD PROCEDURES:

The Navy's rules for accessing records, and for contesting contents and appealing initial agency determinations are published in Secretary of the Navy

Instruction 5211.5; 32 CFR part 701; or may be obtained from the system manager.

RECORD SOURCE CATEGORIES:

Personnel service jackets, correspondence, official records of professional qualifications, and educational institutions.

EXEMPTIONS CLAIMED FOR THE SYSTEM:

None.

[FR Doc. 06-8158 Filed 9-22-06; 8:45 am]

BILLING CODE 5001-06-U

DEPARTMENT OF ENERGY

Federal Energy Regulatory Commission

[Docket No. PF06-13-000]

Downeast LNG, Inc.; Supplemental Notice of Intent To Prepare an Environmental Impact Statement for the Proposed Downeast LNG Project and Request for Comments on Environmental Issues

September 18, 2006.

The Federal Energy Regulatory Commission (FERC or Commission) and the U.S. Department of Homeland Security, U.S. Coast Guard (Coast Guard) are preparing an environmental impact statement (EIS) that will discuss the environmental impacts of the Downeast Liquefied Natural Gas (LNG) Project proposed by Downeast LNG, Inc. (Downeast). The FERC and the U.S. Coast Guard will be the lead federal agencies in the preparation of the EIS, but will prepare the EIS in coordination with their cooperating agencies: the Environmental Protection Agency, U.S. Army Corps of Engineers, and the National Oceanic and Atmospheric Administration National Marine Fisheries Service. The document will satisfy the requirements of the National Environmental Policy Act.

This notice supplements the Notice of Intent (NOI) to prepare an EIS issued on March 13, 2006. The NOI provided information about the proposed project and the environmental review process and requested comments on the scope of issues to address in the EIS. The comment period for the NOI closed on April 17, 2006.

Since the NOI dated March 13, 2006, the natural gas sendout pipeline routes have been analyzed in greater technical detail by Downeast. Originally, Downeast evaluated three options for the sendout pipeline route. Option 3 has been eliminated from further consideration because of significant residential impacts and the lack of

available land area adjacent to roadways. Downeast has identified two additional route options (Route Options 4 and 5). The previous transmittal identified Route Option 1 as the preferred alternative for the pipeline route. Among the route option alternatives now available and evaluated, Option 4 is now the preferred route for the following reasons:

- Shorter pipeline length by 3 miles (28 miles long);
- Follows existing transmission corridors for 57 percent of its length;
- Reduced potential for wetlands impact;
- Reduced number of residences within 50 feet of the construction ROW;
- Reduced acreage of Significant Wildlife Habitat within 250 feet of the construction ROW;
- An inability to receive irrevocable license agreements from the Maine Department of Transportation for use of the existing but inactive railroad and other roadways;
- The potential for re-activation of the railway would require reconstruction of the rail bed and straightening of rail line segments which could require relocation of the proposed gas pipeline; and
- On-going discussions with the staff at the Moosehorn National Wildlife Refuge regarding minimization of pipeline routing through the refuge.

A map depicting the current preferred route and alternative route locations is included in Appendix 1¹. We² are specifically requesting comments on the new preferred Route Option 4. Your input will help identify the issues that need to be evaluated in the EIS. The scoping period for this Notice ends on October 18, 2006.

Public Participation

You can make a difference by providing us with your specific comments or concerns about the planned project. By becoming a commentor, your concerns will be addressed in the EIS and considered by the Commission. Your comments should focus on the potential environmental effects, reasonable alternatives (including alternative pipeline routes), and measures to avoid

¹ The appendices referenced in this notice are not being printed in the *Federal Register*. Copies are available on the Commission's Web site (excluding maps) at the "eLibrary" link or from the Commission's Public Reference Room or call (202) 502-8371. For instructions on connecting to eLibrary refer to the end of this notice. Copies of the appendices were sent to all those receiving this notice in the mail.

² "We", "us", and "our" refer to the environmental staff of the FERC's Office of Energy Projects.

or lessen environmental impacts. The more specific your comments, the more useful they will be. To ensure that your comments are timely and properly recorded, please follow these instructions:

- Send an original and two copies of your letter to: Magalie R. Salas, Secretary, Federal Energy Regulatory Commission, 888 First St., NE., Room 1A, Washington, DC 20426.
- Label one copy of your comments for the attention of OEP/DG2E/Gas Branch 3.
- Reference Docket No. PF06–13–000 on the original and both copies.
- Mail your comments so that they will be received in Washington, DC on or before October 18, 2006. Appropriate copies will be provided to the Coast Guard.

The Commission strongly encourages electronic filing of any comments in response to this NOI. For information on electronically filing comments, please see the instructions on the Commission's Web site at <http://www.ferc.gov> under the "e-Filing" link and the link to the User's Guide as well as information in 18 CFR 385.2001(a)(1)(iii). Before you can file comments you will need to create a free account, which can be accomplished on-line.

Becoming an Intervenor

Because the NEPA Pre-Filing Process occurs before an application to begin a proceeding is officially filed, petitions to intervene during this process are premature and will not be accepted by the Commission. When Downeast files its application for authorization to construct the proposed facilities, the Commission will publish notice of the application in the **Federal Register** and establish a deadline for interested persons to intervene in the proceeding.

To become an intervenor you must file a motion to intervene according to Rule 214 of the Commission's Rules of Practice and Procedure (18 CFR 385.214). Intervenor has the right to seek rehearing of the Commission's decision. Motions to Intervene should be electronically submitted using the Commission's eFiling system at <http://www.ferc.gov>. Persons without Internet access should send an original and 14 copies of their motion to the Secretary of the Commission at the address indicated previously. Persons filing Motions to Intervene on or before the comment deadline indicated above must send a copy of the motion to the Applicant. All filings, including late interventions, submitted after the comment deadline must be served on the Applicant and all other intervenors

identified on the Commission's service list for this proceeding. Persons on the service list with e-mail addresses may be served electronically; others must be served a hard copy of the filing.

Affected landowners and parties with environmental concerns may be granted intervenor status upon showing good cause by stating that they have a clear and direct interest in this proceeding which would not be adequately represented by any other parties. You do not need intervenor status to have your environmental comments considered.

Environmental Mailing List

All commentors will be retained on our mailing list. If you do not want to send comments at this time but still want to keep informed and receive copies of the Draft and Final EISs, you must return the Information Request (Appendix 2). Also, indicate on the form your preference for receiving a paper version in lieu of an electronic version of the EIS on CD-ROM. If you do not return this form, we will remove your name from our mailing list.

Please note, if you have previously submitted comments or returned an Information Request, you are already on our mailing list and do not need to re-submit comments or an Information Request.

Additional Information

Additional information about the project is available from the Commission's Office of External Affairs, at 1–866–208–FERC (3372) or on the FERC Internet Web site (<http://www.ferc.gov>) using the "eLibrary link." Click on the eLibrary link, select "General Search" and enter the project docket number excluding the last three digits (*i.e.*, PF06–13) in the "Docket Number" field. Be sure you have selected an appropriate date range. For assistance with eLibrary, the eLibrary helpline can be reached at 1–866–208–3676, TTY (202) 502–8659, or by e-mail at FercOnlineSupport@ferc.gov. The eLibrary link on the FERC Internet Web site also provides access to the texts of formal documents issued by the Commission, such as orders, notices, and rule makings.

In addition, the FERC now offers a free service called eSubscription that allows you to keep track of all formal issuances and submittals in specific dockets. This can reduce the amount of time you spend researching proceedings by automatically providing you with notification of these filings, document summaries, and direct links to the documents. To register for this service, go to <http://www.ferc.gov/esubscribenow.htm>.

Public meetings or site visits will be posted on the Commission's calendar located at <http://www.ferc.gov/EventCalendar/EventsList.aspx> along with other related information.

Finally, Downeast has established an Internet Web site for this project at <http://www.downeastlng.com/index.htm>. The Web site includes a project overview, status, potential impacts and mitigation, and answers to frequently asked questions. You can also request additional information by calling Downeast directly at 207–214–5926.

Magalie R. Salas,
Secretary.

[FR Doc. E6–15666 Filed 9–22–06; 8:45 am]

BILLING CODE 6717–01–P

DEPARTMENT OF ENERGY

Federal Energy Regulatory Commission

Notice of Application Accepted for Filing and Soliciting Motions To Intervene, Protests and Comments

September 18, 2006.

Take notice that the following hydroelectric application has been filed with the Commission and is available for public inspection:

- Type of Application:* Preliminary Permit.
- Project No.:* P–12723–000.
- Date filed:* August 18, 2006.
- Applicant:* City of Quincy, Illinois.
- Name of Project:* Mississippi Lock & Dam No. 20 Hydroelectric Project.
- Location:* At the existing U.S. Army Corps of Engineers' Mississippi Lock and Dam No. 20 on the Mississippi River, in Lewis County, Missouri, and Adams County, Illinois.
- Filed Pursuant to:* Federal Power Act 16 U.S.C. 791(a)–825(r).
- Applicant Contact:* Mr. Kenneth Cantrell, Director of Administrative Services, City of Quincy, 730 Maine Street, Quincy, IL 62301, (217) 228–4500.
- FERC Contact:* Patricia W. Gillis at (202) 502–8735.
- Deadline for filing comments, protests, and motions to intervene:* November 24, 2006.

The Commission's Rules of Practice and Procedure require all intervenors filing documents with the Commission to serve a copy of that document on each person in the official service list for the project. Further, if an intervenor files comments or documents with the Commission relating to the merits of an issue that may affect the responsibilities of a particular resource agency, they

must also serve a copy of the document on that resource agency.

k. *Description of Project:* The proposed project would utilize the existing U.S. Army Corps of Engineers' Mississippi Lock and Dam No. 20, and would consist of the following facilities: (1) A proposed powerhouse containing 16 generating units with an installed capacity of 17.63 megawatts; (2) a proposed 12-mile-long, 34.5-kilovolt or a proposed 4-mile-long 69-kilovolt transmission line; and (3) appurtenant facilities. The average annual generation is estimated to be 68,527 megawatt hours.

l. *Locations of Applications:* A copy of the application is available for inspection and reproduction at the Commission in the Public Reference Room, located at 888 First Street NE., Room 2A, Washington DC 20426, or by calling (202) 502-8371. This filing may also be viewed on the Commission's Web site at <http://www.ferc.gov> using the "eLibrary" link. Enter the docket number excluding the last three digits in the docket number field to access the document. For assistance, call toll-free 1-866-208-3676 or e-mail FERCOnlineSupport@ferc.gov. For TTY, call (202) 502-8659. A copy is also available for inspection and reproduction at the address in item h above.

m. Individuals desiring to be included on the Commission's mailing list should so indicate by writing to the Secretary of the Commission.

n. *Competing Preliminary Permit:* Anyone desiring to file a competing application for preliminary permit for a proposed project must submit the competing application itself, or a notice of intent to file such an application, to the Commission on or before the specified comment date for the particular application (see 18 CFR 4.36). Submission of a timely notice of intent allows an interested person to file the competing preliminary permit application no later than 30 days after the specified comment date for the particular application. A competing preliminary permit application must conform with 18 CFR 4.30(b) and 4.36.

o. *Competing Development Application:* Any qualified development applicant desiring to file a competing development application must submit to the Commission, on or before a specified comment date for the particular application, either a competing development application or a notice of intent to file such an application. Submission of a timely notice of intent to file a development application allows an interested person to file the competing application no

later than 120 days after the specified comment date for the particular application. A competing license application must conform with 18 CFR 4.30(b) and 4.36.

p. *Notice of Intent:* A notice of intent must specify the exact name, business address, and telephone number of the prospective applicant, and must include an unequivocal statement of intent to submit, if such an application may be filed, either a preliminary permit application or a development application (specify which type of application). A notice of intent must be served on the applicant(s) named in this public notice.

q. *Proposed Scope of Studies Under Permit:* A preliminary permit, if issued, does not authorize construction. The term of the proposed preliminary permit would be 36 months. The work proposed under the preliminary permit would include economic analysis, preparation of preliminary engineering plans, and a study of environmental impacts. Based on the results of these studies, the Applicant would decide whether to proceed with the preparation of a development application to construct and operate the project.

r. *Comments, Protests, or Motions to Intervene:* Anyone may submit comments, a protest, or a motion to intervene in accordance with the requirements of Rules of Practice and Procedure, 18 CFR 385.210, .211, .214. In determining the appropriate action to take, the Commission will consider all protests or other comments filed, but only those who file a motion to intervene in accordance with the Commission's Rules may become a party to the proceeding. Any comments, protests, or motions to intervene must be received on or before the specified comment date for the particular application.

Comments, protests and interventions may be filed electronically via the Internet in lieu of paper; See 18 CFR 385.2001(a)(1)(iii) and the instructions on the Commission's Web site under "e-filing" link. The Commission strongly encourages electronic filing.

s. *Filing and Service of Responsive Documents:* Any filings must bear in all capital letters the title "COMMENTS", "RECOMMENDATIONS FOR TERMS AND CONDITIONS", "PROTEST", OR "MOTION TO INTERVENE", as applicable, and the Project Number of the particular application to which the filing refers. Any of the above-named documents must be filed by providing the original and the number of copies provided by the Commission's regulations to: The Secretary, Federal Energy Regulatory Commission, 888

First Street, NE., Washington, DC 20426. A copy of any motion to intervene must also be served upon each representative of the Applicant specified in the particular application.

t. *Agency Comments:* Federal, State, and local agencies are invited to file comments on the described application. A copy of the application may be obtained by agencies directly from the Applicant. If an agency does not file comments within the time specified for filing comments, it will be presumed to have no comments. One copy of an agency's comments must also be sent to the Applicant's representatives.

Magalie R. Salas,
Secretary.

[FR Doc. E6-15664 Filed 9-22-06; 8:45 am]

BILLING CODE 6717-01-P

DEPARTMENT OF ENERGY

Federal Energy Regulatory Commission

Notice of Applications Accepted for Filing and Soliciting Comments, Motions To Intervene, and Protests

September 18, 2006.

Take notice that the following hydroelectric applications have been filed with the Commission and are available for public inspection:

a. *Type of Applications:* Preliminary Permit (Competing).

b. *Applicants, Project Numbers, and Dates Filed:*

The City of Quincy, Illinois filed the application for Project No. 12725-000 on August 18, 2006.

HydroUrban Development, LLC filed the application for Project No. 12728-000 on August 28, 2006.

c. Name of the project is Mississippi Lock & Dam No. 22 Project, located at the existing U.S. Army Corps of Engineers' Mississippi Lock and Dam No. 22 on the Mississippi River, in Ralls County, Missouri, and Pike County, Illinois.

d. *Filed Pursuant to:* Federal Power Act, 16 U.S.C. 791a-825r.

e. *Applicants Contacts:* For City of Quincy, Illinois: Mr. Kenneth Cantrell, Director of Administrative Services, City of Quincy, 730 Maine Street, Quincy, IL 62301, (217) 228-4500. For HydroUrban Development, LLC: Mr. Victor Barrett, HydroUrban Development, LLC, 3306 Shutten Way, St. Charles, MO, 63301 (314) 484-0400.

f. *FERC Contact:* Patricia W. Gillis at (202) 502-8735.

g. *Deadline for filing comments, protests, and motions to intervene:* November 24, 2006.

The Commission's Rules of Practice and Procedure require all intervenors filing documents with the Commission to serve a copy of that document on each person in the official service list for the project. Further, if an intervenor files comments or documents with the Commission relating to the merits of an issue that may affect the responsibilities of a particular resource agency, they must also serve a copy of the document on that resource agency.

h. *Description of Projects:* The project proposed by the City of Quincy, Illinois would utilize the existing U.S. Army Corps of Engineers' Mississippi Lock and Dam No. 22, and would consist of: (1) A proposed powerhouse containing 16 generating units with a total installed capacity of 17.70 megawatts; (2) a proposed 10-mile-long, 69-kilovolt or a proposed 8-mile-long 69-kilovolt or 11-mile-long 34.5 kilovolt transmission line; and (3) appurtenant facilities. The average annual generation is estimated to be 81,429 megawatt hours.

The project proposed by HydroUrban Development, LLC would utilize the existing U.S. Army Corps of Engineers' Mississippi Lock and Dam No. 22, and would consist of: (1) A proposed powerhouse containing 10–20 generating units with a total installed capacity of 30 megawatts; (2) a proposed 300–400-foot-long 14.7-kilovolt transmission line; and (3) appurtenant facilities. The average annual generation is estimated to be 183 gigawatt hours.

i. *Locations of Applications:* A copy of the application is available for inspection and reproduction at the Commission in the Public Reference Room, located at 888 First Street NE., Room 2A, Washington DC 20426, or by calling (202) 502–8371. This filing may also be viewed on the Commission's Web site at <http://www.ferc.gov> using the "eLibrary" link. Enter the docket number excluding the last three digits in the docket number field to access the document. For assistance, call toll-free 1–866–208–3676 or e-mail FERCOnlineSupport@ferc.gov. For TTY, call (202) 502–8659. A copy is also available for inspection and reproduction at the address in item e above.

j. Individuals desiring to be included on the Commission's mailing list should so indicate by writing to the Secretary of the Commission.

k. *Competing Preliminary Permit:* Anyone desiring to file a competing application for preliminary permit for a proposed project must submit the competing application itself, or a notice of intent to file such an application, to the Commission on or before the specified comment date for the

particular application (see 18 CFR 4.36). Submission of a timely notice of intent allows an interested person to file the competing preliminary permit application no later than 30 days after the specified comment date for the particular application. A competing preliminary permit application must conform with 18 CFR 4.30(b) and 4.36.

l. *Competing Development Application:* Any qualified development applicant desiring to file a competing development application must submit to the Commission, on or before a specified comment date for the particular application, either a competing development application or a notice of intent to file such an application. Submission of a timely notice of intent to file a development application allows an interested person to file the competing application no later than 120 days after the specified comment date for the particular application. A competing license application must conform with 18 CFR 4.30(b) and 4.36.

m. *Notice of Intent:* A notice of intent must specify the exact name, business address, and telephone number of the prospective applicant, and must include an unequivocal statement of intent to submit, if such an application may be filed, either a preliminary permit application or a development application (specify which type of application). A notice of intent must be served on the applicant(s) named in this public notice.

n. *Proposed Scope of Studies under Permit:* A preliminary permit, if issued, does not authorize construction. The term of the proposed preliminary permit would be 36 months. The work proposed under the preliminary permit would include economic analysis, preparation of preliminary engineering plans, and a study of environmental impacts. Based on the results of these studies, the Applicant would decide whether to proceed with the preparation of a development application to construct and operate the project.

o. *Comments, Protests, or Motions to Intervene:* Anyone may submit comments, a protest, or a motion to intervene in accordance with the requirements of Rules of Practice and Procedure, 18 CFR 385.210, .211, .214. In determining the appropriate action to take, the Commission will consider all protests or other comments filed, but only those who file a motion to intervene in accordance with the Commission's Rules may become a party to the proceeding. Any comments, protests, or motions to intervene must be received on or before the specified

comment date for the particular application.

Comments, protests and interventions may be filed electronically via the Internet in lieu of paper; See 18 CFR 385.2001 (a)(1)(iii) and the instructions on the Commission's web site under "e-filing" link. The Commission strongly encourages electronic filing.

p. *Filing and Service of Responsive Documents:* Any filings must bear in all capital letters the title "COMMENTS", "RECOMMENDATIONS FOR TERMS AND CONDITIONS", "PROTEST", OR "MOTION TO INTERVENE", as applicable, and the Project Number of the particular application to which the filing refers. Any of the above-named documents must be filed by providing the original and the number of copies provided by the Commission's regulations to: The Secretary, Federal Energy Regulatory Commission, 888 First Street, NE., Washington, DC 20426. A copy of any motion to intervene must also be served upon each representative of the Applicant specified in the particular application.

q. *Agency Comments:* Federal, State, and local agencies are invited to file comments on the described application. A copy of the application may be obtained by agencies directly from the Applicant. If an agency does not file comments within the time specified for filing comments, it will be presumed to have no comments. One copy of an agency's comments must also be sent to the Applicant's representatives.

Magalie R. Salas,
Secretary.

[FR Doc. E6–15665 Filed 9–22–06; 8:45 am]

BILLING CODE 6717–01–P

DEPARTMENT OF ENERGY

Federal Energy Regulatory Commission

Notice of FERC Staff Attendance at Southwest Power Pool Annual Members Meeting and Meetings of Southwest Power Pool Board of Directors/Members Committee, Southwest Power Pool Market & Operations Policy Committee, and Southwest Power Pool Regional State Committee

September 18, 2006.

The Federal Energy Regulatory Commission hereby gives notice that members of its staff may attend the meetings of the Southwest Power Pool (SPP) Board of Directors/Members Committee, SPP Markets & Operations Policy Committee, and SPP Regional State Committee noted below. Their

attendance is part of the Commission's ongoing outreach efforts.

Board of Directors/Members Committee: September 29, 2006 (10 a.m.–3 p.m. CDT), Sheraton Grand Hotel DFW, 4440 West John Carpenter Freeway, Irving, TX 75063; 972–929–8400.

Markets & Operations Policy Committee: October 10–11, 2006 (1 p.m.–5 p.m. and 8 a.m.–3 p.m. CDT), Marriott Tulsa Southern Hills, 1902 East 71st St., Tulsa, OK 74136; 918–493–7000.

SPP Regional State Committee: October 23, 2006 (1 p.m.–5 p.m. CDT), DoubleTree Hotel at Warren Place, 6110 South Yale Ave., Tulsa, OK 74136; 918–495–1000.

Board of Directors/Members Committee and Annual Members Meeting: October 24, 2006 (8:30 a.m.–3 p.m. CDT), DoubleTree Hotel at Warren Place, 6110 South Yale Ave., Tulsa, OK 74136; 918–495–1000.

The discussions may address matters at issue in the following proceedings:

Docket No. ER05–799, Southwest Power Pool, Inc.

Docket No. ER05–526, Southwest Power Pool, Inc.

Docket No. ER05–106, Entergy Services, Inc.

Docket No. ER05–1416, Southwest Power Pool, Inc.

Docket No. ER06–15, Southwest Power Pool, Inc.

Docket No. ER06–432, Southwest Power Pool, Inc.

Docket No. ER06–448, Southwest Power Pool, Inc.

Docket No. ER06–451, Southwest Power Pool, Inc.

Docket No. ER06–641, Southwest Power Pool, Inc.

Docket No. ER06–729, Southwest Power Pool, Inc.

Docket No. ER06–767, Southwest Power Pool, Inc.

Docket No. ER06–1467, Southwest Power Pool, Inc.

Docket No. EC06–46, Southwest Power Pool, Inc.

Docket Nos. EL06–61 and EL06–71, *Associated Electric Cooperative, Inc. v. Southwest Power Pool.*

These meetings are open to the public.

For more information, contact Tony Ingram, Office of Energy Markets and Reliability, Federal Energy Regulatory Commission at (501) 614–4789 or tony.ingram@ferc.gov.

Magalie R. Salas,
Secretary.

[FR Doc. E6–15667 Filed 9–22–06; 8:45 am]

BILLING CODE 6717–01–P

ENVIRONMENTAL PROTECTION AGENCY

[EPA–HQ–OECA–2006–0441; FRL–8222–6]

Agency Information Collection Activities; Submission to OMB for Review and Approval; Comment Request; NESHAP for Perchloroethylene Dry Cleaning Facilities, EPA ICR Number 1415.07, OMB Control Number 2060–0234

AGENCY: Environmental Protection Agency.

ACTION: Notice.

SUMMARY: In compliance with the Paperwork Reduction Act (44 U.S.C. 3501 *et seq.*), this document announces that an Information Collection Request (ICR) has been forwarded to the Office of Management and Budget (OMB) for review and approval. This is a request to renew an existing approved collection. The ICR, which is abstracted below, describes the nature of the information collection and its estimated burden and cost.

DATES: Additional comments may be submitted on or before October 25, 2006.

ADDRESSES: Submit your comments, referencing docket ID number EPA–HQ–OECA–2006–0441, to (1) EPA online using www.regulations.gov (our preferred method), by e-mail to docket.oeca@epa.gov, or by mail to: EPA Docket Center (EPA/DC), Environmental Protection Agency, Enforcement and Compliance Docket and Information Center, Mail Code 2201T, 1200 Pennsylvania Avenue, NW., Washington, DC 20460, and (2) OMB at: Office of Information and Regulatory Affairs, Office of Management and Budget (OMB), Attention: Desk Officer for EPA, 725 17th Street, NW., Washington, DC 20503.

Note: The EPA Docket Center suffered damage due to flooding during the last week of June 2006. The Docket Center is continuing to operate. However, during the cleanup, there will be temporary changes to Docket Center telephone numbers, addresses, and hours of operation for people who wish to make hand deliveries or visit the Public Reading Room to view documents. Consult EPA's **Federal Register** notice at 71 FR 38147 (July 5, 2006) or the EPA Web site at <http://www.epa.gov/epahome/dockets.htm> for current information on docket operations, locations and telephone numbers. The Docket Center's mailing address for U.S. mail and the procedure for submitting comments to www.regulations.gov are not affected by the flooding and will remain the same.

FOR FURTHER INFORMATION CONTACT:
Learia Williams, Compliance Assessment and Media Programs

Division, Office of Compliance, Mail Code 2223A, Environmental Protection Agency, 1200 Pennsylvania Avenue, NW., Washington, DC 20460; telephone number: (202) 564–4113; fax number: (202) 564–0050; e-mail address: williams.learia@epa.gov.

SUPPLEMENTARY INFORMATION: EPA has submitted the following ICR to OMB for review and approval according to the procedures prescribed in 5 CFR 1320.12. On June 21, 2006 (71 FR 35652), EPA sought comments on this ICR pursuant to 5 CFR 1320.8(d). EPA received no comments. Any additional comments on this ICR should be submitted to EPA and OMB within 30 days of this notice.

EPA has established a public docket for this ICR under Docket ID No. EPA–HQ–OECA–2006–0441, which is available for online viewing at <http://www.regulations.gov>, or in person viewing at the Enforcement and Compliance Docket and Information Center in the EPA Docket Center (EPA/DC), EPA West, Room B102, 1301 Constitution Avenue, NW., Washington, DC. The EPA Docket Center Public Reading Room is open from 8:30 a.m. to 4:30 p.m., Monday through Friday, excluding legal holidays. The telephone number for the Reading Room is (202) 566–1744, and the telephone number for the Enforcement and Compliance Docket Center is (202) 566–1927.

Use EPA's electronic docket and comment system at www.regulations.gov, to submit or view public comments, access the index listing of the contents of the docket, and to access those documents in the docket that are available electronically. Once in the system, select “docket search,” then key in the docket ID number identified above. Please note that EPA's policy is that public comments, whether submitted electronically or in paper, will be made available for public viewing at www.regulations.gov as EPA receives them and without change, unless the comment contains copyrighted material, CBI, or other information whose public disclosure is restricted by statute. For further information about the electronic docket, go to www.regulations.gov.

Title: NESHAP for Perchloroethylene Dry Cleaning Facilities (Renewal).

ICR Numbers: EPA ICR No. 1415.07; OMB control No. 2060–0234.

ICR Status: The ICR is scheduled to expire on October 31, 2006. Under OMB regulations, the Agency may continue to conduct or sponsor the collection of information while this submission is pending at OMB. An Agency may not conduct or sponsor, and a person is not required to respond to, a collection of

information, unless it displays a currently valid OMB control number. The OMB control numbers for EPA's regulations in title 40 of the CFR, after appearing in the **Federal Register** when approved, are listed in 40 CFR part 9, are displayed either by publication in the **Federal Register** or by other appropriate means, such as on the related collection instrument or form, if applicable. The display of OMB control numbers in certain EPA regulations is consolidated in 40 CFR part 9.

Abstract: These standards apply to owners or operators of dry cleaning facilities that use perchloroethylene (PCE). Owners or operators of such facilities must provide EPA, or the delegated state regulatory authority, with the one-time notifications and reports. The owners or operators must also perform weekly monitoring (or biweekly for the smaller facilities), and must keep records for five years. The notification and reports enable EPA or the delegated state regulatory authority to determine whether the appropriate control technology is installed and properly operated and maintained, and to schedule inspections and/or compliance assistance activities. The responses to this information collection are mandatory under Clean Air Act Section 112 and 40 CFR part 63, subpart M. The responses are not anticipated to be kept confidential due to the nature of the information collected; however, any information submitted to the Agency for which a claim of confidentiality is made will be safeguarded according to the Agency policies set forth in 40 CFR part 2.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid OMB Control Number. The OMB control numbers for EPA's regulations are listed in 40 CFR part 9 and 48 CFR chapter 15, and are identified on the form and/or instrument, if applicable.

Burden Statement: The annual public reporting and recordkeeping burden for this collection of information is estimated to average 42 hours per response. Burden means the total time, effort, or financial resources expended by persons to generate, maintain, retain, or disclose or provide information to or for a Federal agency. This includes the time needed to review instructions; develop, acquire, install, and utilize technology and systems for the purposes of collecting, validating, and verifying information, processing and maintaining information, and disclosing and providing information; adjust the existing ways to comply with any previously applicable instructions and

requirements; train personnel to be able to respond to a collection of information; search data sources; complete and review the collection of information; and transmit or otherwise disclose the information.

Respondents/Affected Entities: Perchloroethylene Dry Cleaning Facilities.

Estimated Number of Respondents: 34,240.

Frequency of Response: Annually and Initially.

Estimated Total Annual Hour Burden: 1,537,784 hours.

Estimated Total Annual Costs: \$53,340, includes no annualized capital/startup costs and \$53,340 annualized O&M costs.

Changes in the Estimates: There is no change in the total estimated burden currently identified in the OMB Inventory of Approved ICR Burdens.

Dated: August 16, 2006.

Oscar Morales,

Director, Collection Strategies Division.

[FR Doc. 06-8172 Filed 9-22-06; 8:45 am]

BILLING CODE 6560-50-P

ENVIRONMENTAL PROTECTION AGENCY

[EPA-HQ-OECA-2006-0452, FRL-8222-7]

Agency Information Collection Activities; Submission to OMB for Review and Approval; Comment Request; NESHAP for Miscellaneous Organic Chemical Manufacturing (Renewal); EPA ICR Number 1969.03, OMB Control Number 2060-0533

AGENCY: Environmental Protection Agency.

ACTION: Notice.

SUMMARY: In compliance with the Paperwork Reduction Act (PRA) (44 U.S.C. 3501 *et seq.*), this document announces that an Information Collection Request (ICR) has been forwarded to the Office of Management and Budget (OMB) for review and approval. This is a request to renew an existing approved collection. The ICR, which is abstracted below, describes the nature of the information collection and its estimated burden and cost.

DATES: Additional comments may be submitted on or before October 25, 2006.

ADDRESSES: Submit your comments, referencing Docket ID Number EPA-HQ-OECA-2006-0452, to (1) EPA online using www.regulations.gov (our preferred method), by e-mail to docket.oeca@epa.gov, or by mail to: EPA Docket Center, Environmental

Protection Agency, Enforcement and Compliance Docket and Information Center (ECDIC), 2201 T, 1200 Pennsylvania Avenue, NW., Washington, DC 20460, and (2) OMB by mail to: Office of Information and Regulatory Affairs, Office of Management and Budget (OMB), Attention: Desk Officer for EPA, 725 17th Street, NW., Washington, DC 20503.

Note: The EPA Docket Center suffered damage due to flooding during the last week of June 2006. The Docket Center is continuing to operate. However, during the cleanup, there will be temporary changes to Docket Center telephone numbers, addresses, and hours of operation for people who wish to visit the Public Reading Room to view documents. Consult EPA's **Federal Register** notice at 71 FR 38147 (July 5, 2006) or the EPA Web site at <http://www.epa.gov/epahome/dockets.htm> for current information on docket status, locations and telephone numbers.

FOR FURTHER INFORMATION CONTACT:

Marcia B. Mia of the Office of Compliance at 202-564-7042 (phone) or 202-564-0050 (fax), or via e-mail to: mia.marcia@epa.gov; or by mail to Mail Code 2223A, 1200 Pennsylvania Avenue, NW., Washington, DC 20460.

SUPPLEMENTARY INFORMATION: EPA has submitted the following ICR to OMB for review and approval according to the procedures prescribed in 5 CFR 1320.12. On June 21, 2006 (71 FR 35652), EPA sought comments on this ICR pursuant to 5 CFR 1320.8(d). EPA received no comments. Any additional comments on this ICR should be submitted to EPA and OMB within 30 days of this notice.

EPA has established a public docket for this ICR under Docket ID Number EPA-HQ-OECA-2006-0452, which is available for online viewing at www.regulations.gov, or in person viewing at the Enforcement and Compliance Docket and Information Center (ECDIC) in the EPA Docket Center (EPA/DC), EPA West, Room B102, 1301 Constitution Avenue, NW., Washington, DC. The EPA/DC Public Reading Room is open from 8 a.m. to 4:30 p.m., Monday through Friday, excluding legal holidays. The telephone number for the Reading Room is 202-566-1744, and the telephone number for the Enforcement and Compliance Docket and Information Center (ECDIC) is 202-566-1972.

Use EPA's electronic docket and comment system at www.regulations.gov, to submit or view public comments, to access the index listing of the contents of the docket, and to access those documents in the docket that are available electronically. Once in the system, select "docket search," then

key in the docket ID number identified above. Please note that EPA's policy is that public comments, whether submitted electronically or in paper, will be made available for public viewing at www.regulations.gov as EPA receives them and without change, unless the comment contains copyrighted material, CBI, or other information whose public disclosure is restricted by statute. For further information about the electronic docket, go to www.regulations.gov.

Title: NESHAP for Miscellaneous Organic Chemical Manufacturing (Renewal).

ICR numbers: EPA ICR Number 1969.03, OMB Control Number 2060-0533.

ICR Status: This ICR is scheduled to expire on October 31, 2006. Under OMB regulations, the Agency may continue to conduct or sponsor the collection of information while this submission is pending at OMB. An Agency may not conduct or sponsor, and a person is not required to respond to, a collection of information, unless it displays a currently valid OMB control number. The OMB control numbers for EPA's regulations in title 40 of the CFR, after appearing in the **Federal Register** when approved, are listed in 40 CFR part 9, are displayed either by publication in the **Federal Register** or by other appropriate means, such as on the related collection instrument or form, if applicable. The display of OMB control numbers in certain EPA regulations is consolidated in 40 CFR part 9.

Abstract: The National Emission Standards for Hazardous Air Pollutants (NESHAP) for the regulations published at 40 CFR part 63, subpart FFFF, were proposed on April 4, 2002, and promulgated on November 10, 2003. These regulations apply to new and existing facilities that manufacture a miscellaneous organic chemical and are located at, or are part of, major sources of hazardous air pollutant (HAP) emissions. New facilities include those that commenced construction or reconstruction after the date of proposal. This information is being collected to assure compliance with 40 CFR part 63 subpart FFFF.

In general, all NESHAP standards require initial notifications, performance tests, and periodic reports by the owners/operators of the affected facilities. They are also required to maintain records of the occurrence and duration of any startup, shutdown, or malfunction in the operation of an affected facility, or any period during which the monitoring system is inoperative. These notifications, reports, and records are essential in determining

compliance, and are required of all affected facilities subject to NESHAP.

Any owner/operator subject to the provisions of this part shall maintain a file of these measurements, and retain the file for at least five years following the date of such measurements, maintenance reports, and records. All reports are sent to the delegated state or local authority. In the event that there is no such delegated authority, the reports are sent directly to the United States Environmental Protection Agency (EPA) regional office.

Burden Statement: The annual public reporting and recordkeeping burden for this collection of information is estimated to average 254 hours per response. Burden means the total time, effort, or financial resources expended by persons to generate, maintain, retain, or disclose or provide information to or for a Federal agency. This includes the time needed to review instructions; develop, acquire, install, and utilize technology and systems for the purposes of collecting, validating, and verifying information, processing and maintaining information, and disclosing and providing information; adjust the existing ways to comply with any previously applicable instructions and requirements which have subsequently changed; train personnel to be able to respond to a collection of information; search data sources; complete and review the collection of information; and transmit or otherwise disclose the information.

Respondents/Affected Entities: New and existing facilities that manufacture a miscellaneous organic chemical and are located at, or are part of, major sources of hazardous air pollutant (HAP) emissions.

Estimated Number of Respondents: 257.

Frequency of Response: One-time, semiannually, and on occasion.

Estimated Total Annual Hour Burden: 416,830.

Estimated Total Annual Cost: \$6,132,909, includes \$670,256 annualized capital/startup costs and \$5,462,653 O&M costs.

Changes in the Estimates: There is an increase of 399,085 hours in the total estimated burden currently identified in the OMB Inventory of Approved ICR Burdens. The increase in burden from the most recently approved ICR is primarily due to the fact that this is the first ICR prepared after the compliance date. In the previous ICR, annual burden hours and costs associated with one-time activities were phased in over the course of the three-year period. In this ICR, existing sources have been phased into compliance and are subject to on-

going requirements, and new sources are subject to various one-time activities. Additionally, some burden hours from the previous ICR were deleted because it was not consistent with the concept of burden.

Dated: September 12, 2006.

Oscar Morales,

Director, Collection Strategies Division.

[FR Doc. 06-8173 Filed 9-22-06; 8:45 am]

BILLING CODE 6560-50-P

ENVIRONMENTAL PROTECTION AGENCY

[FRL-8222-8]

Agency Information Collection Activities OMB Responses

AGENCY: Environmental Protection Agency (EPA).

ACTION: Notice.

SUMMARY: This document announces the Office of Management and Budget's (OMB) response to Agency Clearance requests, in compliance with the Paperwork Reduction Act (44 U.S.C. 3501 *et. seq.*). An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid OMB control number. The OMB control numbers for EPA's regulations are listed in 40 CFR part 9 and 48 CFR chapter 15.

FOR FURTHER INFORMATION CONTACT:

Susan Auby (202) 566-1672, or e-mail at auby.susan@epa.gov and please refer to the appropriate EPA Information Collection Request (ICR) Number.

SUPPLEMENTARY INFORMATION:

OMB Responses to Agency Clearance Requests

OMB Approvals

EPA ICR No. 0997.08; NSPS for Petroleum Dry Cleaners; in 40 CFR part 60, subpart JJJ; was approved 08/07/2006; OMB Number 2060-0079; expires 08/31/2009.

EPA ICR No. 0940.18; Ambient Air Quality Surveillance (Renewal); in 40 CFR part 58; was approved 08/07/2006; OMB Number 2060-0084; expires 08/31/2009.

EPA ICR No. 1711.05; Voluntary Customer Service Satisfaction Surveys; was approved 08/09/2006; OMB Number 2090-0019; expires 08/31/2009.

EPA ICR No. 2023.03; NESHAP for Clay Ceramics Manufacturing (Renewal); in 40 CFR part 63, subpart KKKKK; was approved 08/10/2006; OMB Number 2060-0513; expires 08/31/2009.

EPA ICR No. 1712.05; NESHAP for Shipbuilding and Ship Repair Facilities (Surface Coating); in 40 CFR part 63, subpart II; was approved 08/10/2006; OMB Number 2060-0330; expires 08/31/2009.

EPA ICR No. 2042.03; NESHAP for Semiconductor Manufacturing (Renewal); in 40 CFR part 63, subpart BBBBB; was approved 08/10/2006; OMB Number 2060-0519; expires 08/31/2009.

EPA ICR No. 0113.09; NESHAP for Mercury (Renewal); in 40 CFR part 61, subpart E; was approved 08/10/2006; OMB Number 2060-0097; expires 08/31/2009.

EPA ICR No. 1541.08; NESHAP for Benzene Waste Operations (Renewal); in 40 CFR part 61, subpart FF; was approved 08/10/2006; OMB Number 2060-0183; expires 08/31/2009.

EPA ICR No. 1891.04; NESHAP for Publicly Owned Treatment Works; in 40 CFR part 63, subpart VVV; was approved 08/10/2006; OMB Number 2060-0428; expires 08/31/2009.

EPA ICR No. 1938.03; NESHAP for Municipal Solid Waste Landfills (Renewal); in 40 CFR part 63, subpart AAAA; was approved 08/10/2006; OMB Number 2060-0505; expires 08/31/2009.

EPA ICR No. 2196.02; Standards of Performance for Stationary Compression Ignition Internal Combustion Engines (Final Rule); in 40 CFR part 60, subpart IIII; was approved 08/10/2006; OMB number 2060-0590; expires 08/31/2009.

EPA ICR No. 2003.03; NESHAP for Integrated Iron and Steel Manufacturing (Renewal); in 40 CFR part 63, subpart FFFFF; was approved 08/10/2006; OMB Number 2060-0517; expires 08/31/2009.

EPA ICR No. 1995.03; NESHAP for Coke Oven Pushing Quenching and Battery Stack (Renewal); in 40 CFR part 63, subpart CCCCC; was approved 08/10/2006; OMB Number 2060-0521; expires 08/31/2009.

EPA ICR No. 2029.03; NESHAP for Asphalt Processing and Asphalt Roofing Manufacturing (Renewal); in 40 CFR part 63, subpart LLLLL; was approved 08/10/2006; OMB Number 2060-0520; expires 08/31/2009.

EPA ICR No. 0595.09; Notice of Pesticide Registration by States to Meet a Special Local Need (SLN) Under FIFRA Section 23 (c); in 40 CFR part 162; was approved 08/11/2006; OMB Number 2070-0055; expires 08/31/2009.

EPA ICR No. 1899.03; State and Federal Emission Guidelines for Hospital/Medical Infectious Waste Incinerators (Renewal); in 40 CFR part 60, subpart Ce and 40 CFR part 62, subpart HHH; was approved 08/22/2006; OMB Number 2060-0422; expires 08/31/2009.

EPA ICR No. 1428.07; Trade Secret Claims for Emergency Planning and Community Right-to-Know Act (EPCRA Section 322) (Renewal); in 40 CFR part 350; was approved 08/30/2006; OMB Number 2050-0078; expires 08/31/2009.

Short Term Extensions

EPA ICR No. 1949.03; Implementation of Incentives Designed for EPA's National Environmental Performance Track Program (Final Rule); OMB Number 2010-0032; on 08/29/2006 OMB extended the expiration date to 10/31/2006.

Comment Filed

EPA ICR No. 2210.01; Alternative Work Practice to Detect Leaks from Equipment (Proposed Rule); in 40 CFR parts 60, 61, 63, and 63 subpart A); OMB filed comments on 08/10/2006.

EPA ICR No. 2222.01; Residual Risk Standards for NESHAP for Source Categories: Organics Hazardous Air Pollutants from the Synthetic Organic Chemical Manufacturing Industry (Proposed Rule); OMB filed comments on 08/10/2006.

EPA ICR No. 2227.01; Standards of Performance for New Stationary Spark Ignition Internal Combustion Engines (Proposed Rule); OMB filed comments on 08/10/2006.

Dated: September 13, 2006.

Oscar Morales,

Director, Collection Strategies Division.

[FR Doc. 06-8174 Filed 9-22-06; 8:45 am]

BILLING CODE 6560-50-P

ENVIRONMENTAL PROTECTION AGENCY

[FRL-8222-5]

Science Advisory Board (SAB) Staff Office; Notification of Multiple Upcoming SAB Hypoxia Advisory Panel Teleconferences

AGENCY: Environmental Protection Agency (EPA).

ACTION: Notice.

SUMMARY: The EPA Science Advisory Board (SAB) Staff Office announces seven upcoming public teleconferences of the SAB Hypoxia Advisory Panel Subgroups.

DATES: The dates for the seven teleconferences are:

(1) SAB Hypoxia Advisory Panel Subgroup 1 Characterization of the Causes Hypoxia—October 17, 2006 from 2 to 5 p.m. Eastern Standard Time, and November 15, 2006 from 9 a.m. to 12 p.m. Eastern Standard Time;

(2) SAB Hypoxia Advisory Panel Subgroup 2 Characterization of Nutrient

Fate, Transport, and Sources—October 16 and November 21, 2006 from 10 a.m. to 1 p.m. Eastern Standard Time; and

(3) SAB Hypoxia Advisory Panel Subgroup 3 Scientific Basis for Goals and Management Options—October 6, October 30, and November 27, 2006 1 to 4 p.m. Eastern Standard Time.

FOR FURTHER INFORMATION CONTACT:

Members of the public who wish to obtain the teleconference call-in numbers and access codes to participate in the teleconferences may contact the following individuals.

(1) For the SAB Hypoxia Advisory Panel Subgroup 1—Characterization of the Causes of Hypoxia teleconferences, contact Dr. Thomas Armitage, Designated Federal Officer (DFO), by telephone at (202) 343-9995, fax at (202) 233-0643, or e-mail at armitage.thomas@epa.gov.

(2) For the SAB Hypoxia Advisory Panel Subgroup 2—Characterization of Nutrient Fate, Transport, and Sources teleconferences, contact Mr. David Wangsness, DFO, by telephone at (202) 343-9975, fax at (202) 233-0643, or e-mail at wangsness.david@epa.gov.

(3) For the Hypoxia Advisory Panel Subgroup 3—Scientific Basis for Goals and Management Options SAB teleconferences, contact Dr. Holly Stallworth, DFO, by telephone at (202) 343-9867, fax at (202) 233-0643, or e-mail at stallworth.holly@epa.gov. General information about the SAB, as well as any updates concerning the teleconferences announced in this notice, may be found on the SAB Web site at: <http://www.epa.gov/sab>.

SUPPLEMENTARY INFORMATION: Pursuant to the Federal Advisory Committee Act, Public Law 92-463, notice is hereby given that the SAB Hypoxia Advisory Panel will hold seven public teleconferences to allow its three subgroups to develop issues related to advancements in the state of the science regarding hypoxia in the Northern Gulf of Mexico. Issues resulting from the public teleconferences will be further discussed by the entire SAB Hypoxia Advisory Panel at a future public meeting to be announced in a separate **Federal Register** notice. The SAB was established by 42 U.S.C. 4365 to provide independent scientific and technical advice to the Administrator on the technical basis for Agency positions and regulations. The SAB is a Federal Advisory Committee chartered under the Federal Advisory Committee Act (FACA), as amended, 5 U.S.C., App. The SAB will comply with the provisions of FACA and all appropriate SAB Staff Office procedural policies.

Background

EPA participates with other Federal agencies, state and tribes in the Mississippi River/Gulf of Mexico Watershed Nutrient Task Force. In 2001, the Task Force released the *Action Plan for Reducing, Mitigating and Controlling Hypoxia in the Northern Gulf of Mexico* (or *Action Plan* available at <http://www.epa.gov/msbasin/taskforce/actionplan.htm>). The *Action Plan* was informed by the science described in *An Integrated Assessment of Hypoxia in the Northern Gulf of Mexico* (or *Integrated Assessment* (available at http://www.noaa.gov/products/hypox_finalfront.pdf) developed by the National Science and Technology Council, Committee on Environment and Natural Resources. Six technical reports provided the scientific foundation for the *Integrated Assessment* and are available at http://www.nos.noaa.gov/products/pub_hypox.html. The aforementioned documents provide a comprehensive summary of the state-of-the-science for the Gulf of Mexico hypoxic zone to about the year 2000.

EPA's Office of Water has requested that the SAB develop a report that evaluates the state-of-the-science regarding the causes and extent of hypoxia in the Gulf of Mexico, as well as the scientific basis of possible management options in the Mississippi River Basin. The SAB is asked to focus on scientific advances since 2000 that may have increased scientific understanding and control options in three general areas.

1. *Characterization the Cause(s) of Hypoxia.* The physical, biological and chemical processes that affect the development, persistence and extent of hypoxia in the northern Gulf of Mexico.

2. *Characterization of Nutrient Fate, Transport and Sources.* Nutrient loadings, fate, transport and sources in the Mississippi River that impact Gulf hypoxia.

3. *Scientific Basis for Goals and Management Options.* The scientific basis for, and recommended revisions to, the goals proposed in the *Action Plan*; and the scientific basis for the efficacy of recommended management actions to reduce nutrient flux from point and nonpoint sources.

In response to EPA's request, the SAB Staff Office has formed the SAB Hypoxia Advisory Panel. Background on the Panel formation process was provided in a **Federal Register** notice published on February 17, 2006 (71 FR 8578–8580). Background for the first meeting of the SAB Hypoxia Advisory Panel was announced in a **Federal**

Register notice published on August 9, 2006 (71 FR 45543–45544). At its first meeting on September 6–7, 2006 the Panel organized itself into three subgroups corresponding to the three general areas described above. General information about the SAB Hypoxia Advisory Panel, as well as any updates concerning the teleconferences announced in this notice, may be found on the SAB Web site at: <http://www.epa.gov/sab>.

Availability of Meeting Materials: Pursuant to the Federal Advisory Committee Act, Public Law 92–463, notice is hereby given that the SAB Hypoxia Advisory Panel Subgroups will hold the seven public teleconferences on the dates and times provided above. Rosters of the SAB Hypoxia Advisory Panel, their biosketches, and the teleconference agendas will be posted on the SAB Web site <http://www.epa.gov/sab> prior to the teleconference.

Procedures for Providing Public Input: The SAB Staff Office accepts written public statements of any length, and accommodates oral public statements whenever possible. The SAB Staff Office expects that public statements presented at SAB meetings will not repeat previously submitted oral or written statements. *Oral Statements:* In general, individuals or groups requesting an oral presentation at a teleconference meeting will usually be limited to three minutes per speaker with no more than a total of fifteen minutes for all speakers. Interested parties should contact the appropriate DFO at the contact information provided above in writing via e-mail at least 10 days prior to the scheduled teleconference to be placed on the public speaker list for the teleconference. Speakers should provide an electronic copy of their statements to the DFO for distribution to interested parties and participants in the meeting. *Written Statements:* Written statements should be received in the SAB Staff Office at least seven days before scheduled teleconference so that the statements may be made available to the Panel for their consideration. Statements should be supplied to the appropriate DFO at the address and contact information provided above in the following formats: One hard copy with original signature, and one electronic copy via e-mail (acceptable file format: Adobe Acrobat, WordPerfect, Word, or Rich Text files in IBM-PC/Windows 98/2000/XP format).

Meeting Accommodations: Individuals requiring special accommodation to access the teleconference should contact the appropriate DFO at the phone number

or e-mail address noted above at least five business days prior to the meeting so that appropriate arrangements can be made.

Dated: September 15, 2006.

Anthony F. Maciorowski,
Associate Director for Science, EPA Science
Advisory Board Staff Office.

[FR Doc. 06–8177 Filed 9–22–06; 8:45 am]

BILLING CODE 6560–50–P

FEDERAL COMMUNICATIONS COMMISSION

Privacy Act System of Records

AGENCY: Federal Communications Commission (FCC or Commission).

ACTION: Notice; two altered Privacy Act systems of records; addition and/or modification of routine uses.

SUMMARY: Pursuant to subsection (e)(4) of the Privacy Act of 1974, as amended (5 U.S.C. 552a), the FCC proposes to change the name and alter two system of records, FCC/OMD–16, “Personal Security Files” (formerly “Personnel Investigation Records”) and FCC/OMD–24, “Physical Access Control System (PACS)” (formerly “Access Control System”). The two altered systems of records incorporate changes pursuant to the FCC's compliance with the Homeland Security Presidential Directive 12 (HSPD–12). The FCC will alter what information is maintained; the authority under which the systems of records are maintained; the purposes for which the information is maintained; add or modify the routine uses; revise the policies and practices for how the information is stored, safeguarded, retained, and disposed of; and will make other edits and revisions as necessary to comply with HSPD–12 implementation requirements and associated guidance provided in OMB Memorandum M–06–06 (February 17, 2006).

DATES: In accordance with subsections (e)(4) and (e)(11) of the Privacy Act of 1974, as amended (5 U.S.C. 552a), any interested person may submit written comments concerning the alteration of these two systems of records on or before October 25, 2006. Pursuant to Appendix I, 4(e) of OMB Circular A–130, the FCC is asking the Office of Management and Budget (OMB), which has oversight responsibility under the Privacy Act, to grant a waiver of the 40 day review period by OMB, the House of Representatives, and the Senate for this system of records. The FCC is requesting this waiver to comply with the deadline for implementation of the

HSPD-12 requirements. The two proposed altered systems shall be effective on October 25, 2006 unless the FCC receives comments that require a contrary determination. The Commission will publish a document in the **Federal Register** notifying the public if any changes are necessary. As required by 5 U.S.C. 552a(r) of the Privacy Act of 1974, as amended, the FCC is submitting reports on these proposed altered systems to OMB and to both Houses of Congress.

ADDRESSES: Comments should be sent to Leslie F. Smith, Privacy Analyst, Performance Evaluation and Records Management (PERM), Room 1-C216, Federal Communications Commission (FCC), 445 12th Street, SW., Washington, DC 20554, (202) 418-0217, or via the Internet at Leslie.Smith@fcc.gov. Comments may also be sent to Hillary A. Jaffe, Policy Analyst, Information Policy and Technology Branch, Office of Management and Budget, New Executive Office Building, 725 17th Street, NW., Washington, DC 20503, fax (202) 395-5167, or via the Internet at Hillary_A._Jaffe@omb.eop.gov.

FOR FURTHER INFORMATION CONTACT: Leslie F. Smith, Performance Evaluation and Records Management (PERM), Room 1-C216, Federal Communications Commission, 445 12th Street, SW., Washington, DC 20554, (202) 418-0217 or via the Internet at Leslie.Smith@fcc.gov.

SUPPLEMENTARY INFORMATION: As required by the Privacy Act of 1974, as amended, 5 U.S.C. 552a(e)(4) and (e)(11), this document sets forth notice of the proposed alteration of two systems of records maintained by the FCC; and addition and/or modification of the routine uses. The FCC previously gave complete notice of the system of records covered under this Notice by publication in the **Federal Register** on April 5, 2006 (71 FR 17234) for FCC/ OMD-16, "Personal Security Files," and on October 23, 2000, (65 FR 63468) for FCC/ OMD-24, "Physical Access Control System (PACS)." This notice is a summary of the more detailed information about the two proposed altered systems of records, which may be viewed at the location given above in the **ADDRESSES** section. The purposes for altering FCC/ OMD-16, "Personnel Security Files" and FCC/ OMD-24, "Physical Access Control System (PACS)," are to change the name of each system of records; to change the information that is being maintained; to change the statutory authority under which information is maintained; to add or modify the routine uses; to change

the policies and practices for storage, retrieval, retention, access, and disposal of information; and otherwise to alter, update, and revise the two systems of records, as necessary, to comply with the requirements for implementation of HSPD-12 and to adhere to the guidance provided in OMB Memorandum M-06-06 (February 17, 2006).

The FCC proposes to achieve these purposes by altering each system of records with these changes: FCC/ OMD-16, "Personnel Security Files" (formerly "Personnel Investigation Records") with these changes:

Changes in the information that is being maintained; changes in the authority under which the information is collected and maintained; changes to the purposes for maintaining the information; and changes to the policies for storing, retrieving, accessing, retaining, adding and/or modifying the routine uses; disposing of records in the two systems of records to make them compliant with the requirements of HSPD-12. All these changes are done to adhere to the guidelines contained in OMB Memorandum M-06-06 (February 17, 2006).

The proposed routine uses for FCC/ OMD-16, Personnel Security Files, are:

1. Litigation by the Department of Justice—when (a) the FCC or any component thereof; or (b) any employee of the FCC in his or her official capacity; (c) any employee of the FCC in his or her individual capacity where the Department of Justice (DOJ) has agreed to represent the employee; or (d) the United States Government, is a party to litigation, and by careful review, the FCC determines that the records are both relevant and necessary to the litigation and the use of such records by the DOJ is therefore deemed by the FCC to be for a purpose compatible with the purpose for which the FCC collected the records.

2. A Court or Adjudicative Body—in a proceeding when: (a) The FCC or any component thereof; (b) any employee of the FCC in his or her official capacity; (c) any employee of the FCC in his or her individual capacity where the Department of Justice (DOJ) has agreed to represent the employee; or (d) the United States Government, is a party to litigation, and by careful review, the FCC determines that the records are both relevant and necessary to the litigation and the use of such records is therefore deemed by the FCC to be for a purpose that is compatible with the purpose for which the FCC collected the records;

3. Law Enforcement and Investigation—except as noted on Forms SF 85, 85-P, and 86, when a record on its face, or in conjunction with other records, indicates a violation or potential violation of a law, whether civil, criminal, or regulatory in nature, and whether arising by general statute or particular program statute, or by regulation, rule, or order issued pursuant thereto, disclosure may be made to the appropriate public authority, whether Federal, foreign, State, local, or tribal, otherwise, responsible for enforcing, investigating, or prosecuting such violation or charged with enforcing or implementing the statute, or rule, regulation, or order issued pursuant thereto, if the information disclosed is relevant to any enforcement, regulatory, investigative, or prosecutorial responsibility of the receiving entity.

4. Congressional Inquiries—when requested by a Congressional office in response to an inquiry by an individual made to the Congressional office for their own records;

5. Government-wide Program Management and Oversight—when requested by the National Archives and Records Administration or the General Services Administration for the purpose of records management inspections conducted under authority of 44 U.S.C. 2904 and 2906; when the U.S. Department of Justice is contacted in order to obtain that department's advice regarding disclosure obligations under the Freedom of Information Act; or when the Office of Management and Budget is contacted in order to obtain that office's advice regarding obligations under the Privacy Act, or when necessary to the review of private relief legislation pursuant to OMB Circular A-19;

6. Contract Services, Grants, or Cooperative Agreements—a record may be disclosed to FCC contractors, grantees, or volunteers who have been engaged to assist the FCC in the performance of a contract service, grant, cooperative agreement, or other activity related to this system of records and who need to have access to the records in order to perform their activity. Recipients shall be required to comply with the requirements of the Privacy Act of 1974, as amended, 5 U.S.C. 552a.

7. Employment, Clearances, Licensing, Contract, Grant, or other Benefits Decisions by the agency—disclosure may be made to a Federal, State, or local government maintaining civil, criminal, or other relevant enforcement records, or other pertinent records, or to another public authority or professional organization, if

necessary to obtain information relevant to an investigation concerning the retention of an employee or other personnel action (other than hiring), the retention of a security clearance, the letting of a contract, or the issuance or retention of a grant or other benefit. The other agency or licensing organization may then make a request supported by the written consent of the individual for the entire record if it so chooses. No disclosure will be made unless the information has been determined to be sufficiently reliable to support a referral to another office within the FCC or to another Federal agency for criminal, civil, administrative personnel, or regulatory action;

8. **Employment, Clearances, Licensing, Contract, Grant, or other Benefits Decisions** by other than the agency—disclosure may be made to a Federal, State, local, or tribal government or other public authority of the fact that this system of records contains information relevant to the retention of an employee, the retention of a security clearance, the letting of a contract, or the issuance or retention of a license, grant, or other benefit. The other agency or licensing organization may then make a request supported by the written consent of the individual for the entire record if it so chooses. No disclosure will be made unless the information has been determined to be sufficiently reliable to support a referral to another office within the FCC or to another Federal agency for criminal, civil, administrative personnel, or regulatory action

9. **Labor Relations**—disclosure may be made to officials of labor organizations recognized under 5 U.S.C. Chapter 71 upon receipt of a formal request and in accord with the conditions of 5 U.S.C. 7114 when relevant and necessary to their duties of exclusive representation concerning personnel policies, practices, and matters affecting working conditions.

10. **National Security and Intelligence Matters**—disclosure of these records may be disclosed to Federal, State, local agencies, or other appropriate entities or individuals, or through established liaison channels to selected foreign government in order to enable an intelligence agency to carry out its responsibilities under the National Security Act of 1947, as amended, the CIA Act of 1949, as amended, Executive Order 12333 or any successor order, applicable to national security directives, or classified implementing procedures approved by the Attorney General and promulgated pursuant to such statutes, orders, or directives.

The FCC will use the records in FCC/ OMD-16, "Personal Security Files," to conduct background investigations to determine compliance with Federal regulations and/or to make a determination about an individual's suitability, eligibility, and fitness for Federal employment or contractual services, access to classified materials and/or restricted areas, to evaluate the appropriate security clearance(s), and to take action on or to respond to a complaint about a threat, harassment, intimidation, violence, or other inappropriate behavior involving FCC employees, interns, volunteers, and contractors.

The proposed routine uses for FCC/ OMD-24, Physical Access Control System (PACS), are:

1. **Litigation by the Department of Justice**—when (a) the FCC or any component thereof; or (b) any employee of the FCC in his or her official capacity; (c) any employee of the FCC in his or her individual capacity where the FCC or the Department of Justice (DOJ) has agreed to represent the employee; or (d) the United States Government, is a party to litigation or has an interest in such litigation, and by careful review, the FCC determines that the records are both relevant and necessary to the litigation and the use of such records by the DOJ is therefore deemed by the FCC to be for a purpose compatible with the purpose for which the FCC collected the records.

2. **Court or Adjudicative Body**—in a proceeding when: (a) The FCC or any component thereof; (b) any employee of the FCC in his or her official capacity; (c) any employee of the FCC in his or her individual capacity where the Department of Justice (DOJ) has agreed to represent the employee; or (d) the United States Government, is a party to litigation or has an interest in such litigation, and by careful review, the FCC determines that the records are both relevant and necessary to the litigation and the use of such records is therefore deemed by the FCC to be for a purpose that is compatible with the purpose for which the FCC collected the records;

3. **Law Enforcement and Investigation**—except as noted on Forms SF 85, 85-P, and 86, when a record on its face, or in conjunction with other records, indicates a violation or potential violation of a law, whether civil, criminal, or regulatory in nature, and whether arising by general statute or particular program statute, or by regulation, rule, or order issued pursuant thereto, disclosure may be made to the appropriate public authority, whether Federal, foreign,

State, local, or tribal, otherwise, responsible for enforcing, investigating, or prosecuting such violation or charged with enforcing or implementing the statute, or rule, regulation, or order issued pursuant thereto, if the information disclosed is relevant to any enforcement, regulatory, investigative, or prosecutorial responsibility of the receiving entity.

4. **Congressional Inquiries**—when requested by a Congressional office in response to an inquiry by an individual made to the Congressional office for their own records;

5. **Government-wide Program Management and Oversight**—when requested by the National Archives and Records Administration or the General Services Administration for the purpose of records management inspections conducted under authority of 44 U.S.C. 2904 and 2906; when the U.S. Department of Justice is contacted in order to obtain that department's advice regarding disclosure obligations under the Freedom of Information Act; or when the Office of Management and Budget is contacted in order to obtain that office's advice regarding obligations under the Privacy Act, or when necessary for the review of private relief legislation pursuant to OMB Circular No. A-19;

6. **Contract Services, Grants, or Cooperative Agreements**—a record may be disclosed to FCC contractors, grantees, or volunteers who have been engaged to assist the FCC in the performance of a contract service, grant, cooperative agreement, or other activity related to this system of records and who need to have access to the records in order to perform their activity. Recipients shall be required to comply with the requirements of the Privacy Act of 1974, as amended, 5 U.S.C. 552a.

7. **Employment, Clearances, Licensing, Contract, Grant, or other Benefits Decisions** by the agency—disclosure may be made to a Federal, State, or local government maintaining civil, criminal, or other relevant enforcement records, or other pertinent records, or to another public authority or professional organization, if necessary to obtain information relevant to an investigation concerning the retention of an employee or other personnel action (other than hiring), the retention of a security clearance, the letting of a contract, or the issuance or retention of a grant or other benefit;

8. **Employment, Clearances, Licensing, Contract, Grant, or other Benefits Decisions** by other than the agency—disclosure may be made to a Federal, State, local, or tribal government, or other public authority of

the fact that this system of records contains information relevant to the retention of an employee, the retention of a security clearance, the letting of a contract, or the issuance or retention of a license, grant, or other benefit. The other agency or licensing organization may then make a request supported by the written consent of the individual for the entire records if it so chooses. No disclosure will be made unless the information has been determined to be sufficiently reliable to support a referral to another office within the agency or to another Federal agency for criminal, civil, administrative, personnel or regulatory action;

9. Labor Relations—A record from this system may be disclosed to officials of labor organizations recognized under 5 U.S.C. Chapter 71 upon receipt of a formal request and in accord with the conditions of 5 U.S.C. 7114 when relevant and necessary to their duties of exclusive representation concerning personnel policies, practices, and matters affecting working conditions.

10. National Security and Intelligence Matters—disclosure of these records may be disclosed to Federal, State, local agencies, or other appropriate entities or individuals, or through established liaison channels to selected foreign government in order to enable an intelligence agency to carry out its responsibilities under the National Security Act of 1947, as amended, the CIA Act of 1949, as amended, Executive Order 12333 or any successor order, applicable to national security directives, or classified implementing procedures approved by the Attorney General and promulgated pursuant to such statutes, orders, or directives;

11. Invalid PIV Card Notification—disclosure may be made to notify another Federal agency, when, or to verify whether, a PIV card is no longer valid; and

Note: Disclosures to the FCC of data pertaining to date and time of entry and exit of a Commission employee working in the District of Columbia may not be made to supervisors, managers, or any other individuals (other than the individual to whom the information applies) to verify the employee's time and attendance record for personnel actions because 5 U.S.C. 6106 prohibits Federal Executive Agencies (other than the Bureau of Engraving and Printing) from using a recording clock within the District of Columbia, unless the clock is used as part of a flexible schedule program under 5 U.S.C. 6120 *et seq.* The FCC will use records in FCC/OMD-24, "Physical Access Control System (PACS)," to ensure the safety and security of FCC facilities, systems, and information, employees, contractors, interns, guests, frequent visitors, while they are within the FCC buildings and facilities; to

verify that all individuals entering the FCC buildings and other Federal facilities, and using FCC and Federal information resources have such authorization; and to track and control FCC badges issued to individuals entering and existing FCC facilities, using FCC systems, and/or accessing classified information.

This notice meets the requirement documenting the change in the two FCC systems of records, and provides the public, Congress, and the Office of Management and Budget (OMB) an opportunity to comment.

FCC/OMD-16

SYSTEM NAME:

Personnel Security Files.¹

SECURITY CLASSIFICATION:

Most personnel identity verification records are not classified. However, in some cases, records of certain individuals, or portions of some records may have national defense/foreign policy classifications.

SYSTEM LOCATION:

Security Operations Center, Office of Managing Director, Federal Communications Commission (FCC), 445 12th Street, SW., Room 1-B458, Washington, DC 20554.

CATEGORIES OF INDIVIDUALS COVERED BY THE SYSTEM:

Information includes:

1. Current and former Federal Communications Commission (FCC) employees, including Commission retirees and those who resigned from the Commission, other Federal employees, applicants for employment in the Federal service or contracts, contractors of the FCC, experts, instructors, consultants to FCC and other Federal programs, visitors, and all others who may require regular, on-going access to FCC and other Federal facilities, information technology systems, or information classified in the interest of national security, and individuals formerly in any of these positions;

2. Individuals who are authorized to perform or to use services provide in FCC facilities, *e.g.*, FCC credit union and employee assistance program staff (EAP); and

3. Individuals who are neither applicants nor employees of the Federal Government, but who are or were involved in Federal programs under a co-operative agreement, *e.g.*, students and interns.

CATEGORIES OF RECORDS IN THE SYSTEM:

Information includes:

1. Data needed to identify an individual, including: Individual's last, first, middle names (filed alphabetically by last name), and former name(s) (as applicable); Social Security Number; date of birth; birthplace; home address; home telephone number(s); residential history; organizational unit; position title;

2. Individual's citizenship; security classification; types and dates of investigations; and agency conducting investigation, investigation dates, security clearance(s) and grant date(s), and position sensitivity level(s); and miscellaneous investigation comments;

3. Names of relatives; birth date(s), home address, and citizenship; relatives who work for the Federal government;

4. Reports about the individual's qualifications for a position, *e.g.*, employee/applicant's employment/work history, summary report of investigation, results of suitability decisions, employment references and contact information; and educational/training institutions attended, degrees and certifications earned, and educational and training references;

5. Information needed to investigate an individual's character, conduct, and behavior in the community where he or she lives or lived; criminal history, *e.g.*, arrests and convictions for violations against the law; mental health history; drug use; financial information, *e.g.*, income tax return information and credit reports; reports of interviews with present and former supervisors, co-workers, associates, educators, and other related personal references and contact information;

6. Reports of inquiries with law enforcement agencies, employers, and reports of action after the Office of Personnel Management or FBI Section 8(d) Full Field Investigation; Notices of Security Investigation and other information developed from the above described Certificates of Clearance, *e.g.*, date of security clearances, requests for appeals, witness statements, investigator's notes, security violations, circumstances of violations, and agency action(s) taken;

7. Information needed to investigate allegations of FCC employee's misconduct;

8. Information needed to investigate miscellaneous complaints not covered by the FCC's formal or informal grievance procedure;

9. Information needed to conduct inquiries under the "President's Program to Eliminate Waste and Fraud in Government;" and

10. Information needed to investigate violence, threats, harassment, intimidation, or other inappropriate

¹ This system of records was formerly titled "Personnel Investigation Records."

behavior causing an FCC employee, contractor, or visitor(s) to fear for his/her personal safety in the FCC workplace: Case number, victim's name, office telephone number, room number, organizational unit, duty station, position, supervisor, supervisor's telephone number, location of incident, activity at time of incident, circumstances surrounding the incident, perpetrator, name(s) and telephone number(s) of witness(es), injured party(s), medical treatment(s), medical report, property damages, report(s) to police and/or Federal Protective Services, and related miscellaneous information.

11. Information obtained from SF-85, SF-85P, SF-86, and SF-87 forms; summary reports from OPM or another Federal agency conducting background investigations; and results of adjudications and security violations. (**NOTE:** This system of records does not duplicate or supersede the Office of Personnel Management (OPM) Central-9 system of records, which covers the investigations OPM and its contractors conduct on behalf of other agencies.)

AUTHORITY FOR MAINTENANCE OF THE SYSTEM:

Depending upon the purpose(s) for the investigation, the U.S. government is authorized to ask for this information under 5 U.S.C. 1303, 1304, 3301, 7902, 9101; 42 U.S.C. 2165 and 2201; 50 U.S.C. 781 to 887; 5 CFR Parts 5, 732, and 736; Executive Orders 9397, 10450, 10865, 12196, 12333, 12356, and 12674; and Homeland Security Presidential Directive (HSPD) 12, "Policy for a Common Identification Standard for Federal Employees and Contractors," August 27, 2004.

PURPOSE(S):

FCC Security Officer and the Personnel Security Specialist use this information to document and support decisions:

1. To determine compliance with Federal regulations and/or to make a determination about an individual's suitability, eligibility, and fitness for Federal employment, access to classified information or restricted areas, position sensitivity, security clearances, evaluations of qualifications, and loyalty to the United States, and to document such determinations;

2. To evaluate an applicant's qualifications and suitability to perform contractual services for the U.S. Government and to document such determinations;

3. To evaluate the eligibility and suitability of students, interns, or volunteers to the extent that their duties require access to FCC and other Federal

facilities, information, systems, or applications, and to document such determinations;

4. To respond to a written inquiry conducted under the "President's Program to Eliminate Waste and Fraud in the Government;"

5. To take action on, or to respond to a complaint about a threat, harassment, intimidation, violence, or other inappropriate behavior involving one or more FCC employees and/or contract employees, and to counsel employees; and

6. To document security violations and supervisory actions taken.

ROUTINE USES OF RECORDS MAINTAINED IN THE SYSTEM, INCLUDING CATEGORIES OF USERS AND THE PURPOSES OF SUCH USES:

Information about individuals in this system of records may routinely be disclosed under the following conditions:

1. Litigation by the Department of Justice—when (a) the FCC or any component thereof; or (b) any employee of the FCC in his or her official capacity; (c) any employee of the FCC in his or her individual capacity where the Department of Justice (DOJ) has agreed to represent the employee; or (d) the United States Government, is a party to litigation or has an interest in such litigation, and by careful review, the FCC determines that the records are both relevant and necessary to the litigation and the use of such records by the DOJ is therefore deemed by the FCC to be for a purpose compatible with the purpose for which the FCC collected the records.

2. A Court or Adjudicative Body—in a proceeding when: (a) The FCC or any component thereof; (b) any employee of the FCC in his or her official capacity; (c) any employee of the FCC in his or her individual capacity where the Department of Justice (DOJ) has agreed to represent the employee; or (d) the United States Government, is a party to litigation or has an interest in such litigation, and by careful review, the FCC determines that the records are both relevant and necessary to the litigation and the use of such records is therefore deemed by the FCC to be for a purpose that is compatible with the purpose for which the FCC collected the records;

3. Law Enforcement and Investigation—except as noted on Forms SF 85, 85-P, and 86, when a record on its face, or in conjunction with other records, indicates a violation or potential violation of a law, whether civil, criminal, or regulatory in nature, and whether arising by general statute or particular program statute, or by

regulation, rule, or order issued pursuant thereto, disclosure may be made to the appropriate public authority, whether Federal, foreign, State, local, or tribal, otherwise, responsible for enforcing, investigating, or prosecuting such violation or charged with enforcing or implementing the statute, or rule, regulation, or order issued pursuant thereto, if the information disclosed is relevant to any enforcement, regulatory, investigative, or prosecutorial responsibility of the receiving entity.

4. Congressional Inquiries—when requested by a Congressional office in response to an inquiry by an individual made to the Congressional office for their own records;

5. Government-wide Program Management and Oversight—when requested by the National Archives and Records Administration or the General Services Administration for the purpose of records management inspections conducted under authority of 44 U.S.C. 2904 and 2906; when the U.S. Department of Justice is contacted in order to obtain that department's advice regarding disclosure obligations under the Freedom of Information Act; or when the Office of Management and Budget is contacted in order to obtain that office's advice regarding obligations under the Privacy Act, or when necessary to the review of private relief legislation pursuant to OMB Circular A-19;

6. Contract Services, Grants, or Cooperative Agreements—a record may be disclosed to FCC contractors, grantees, or volunteers who have been engaged to assist the FCC in the performance of a contract service, grant, cooperative agreement, or other activity related to this system of records and who need to have access to the records in order to perform their activity. Recipients shall be required to comply with the requirements of the Privacy Act of 1974, as amended, 5 U.S.C. 552a.

7. Employment, Clearances, Licensing, Contract, Grant, or other Benefits Decisions by the agency—disclosure may be made to a Federal, State, or local government maintaining civil, criminal, or other relevant enforcement records, or other pertinent records, or to another public authority or professional organization, if necessary to obtain information relevant to an investigation concerning the retention of an employee or other personnel action (other than hiring), the retention of a security clearance, the letting of a contract, or the issuance or retention of a grant or other benefit. The other agency or licensing organization may then make a request supported by

the written consent of the individual for the entire record if it so chooses. No disclosure will be made unless the information has been determined to be sufficiently reliable to support a referral to another office within the FCC or to another Federal agency for criminal, civil, administrative personnel, or regulatory action;

8. Employment, Clearances, Licensing, Contract, Grant, or other Benefits Decisions by other than the agency—disclosure may be made to a Federal, State, local, or tribal government, or other public authority of the fact that this system of records contains information relevant to the retention of an employee, the retention of a security clearance, the letting of a contract, or the issuance or retention of a license, grant, or other benefit. The other agency or licensing organization may then make a request supported by the written consent of the individual for the entire record if it so chooses. No disclosure will be made unless the information has been determined to be sufficiently reliable to support a referral to another office within the FCC or to another Federal agency for criminal, civil, administrative personnel, or regulatory action.

9. Labor Relations—disclosure may be made to officials of labor organizations recognized under 5 U.S.C. Chapter 71 upon receipt of a formal request and in accord with the conditions of 5 U.S.C. 7114 when relevant and necessary to their duties of exclusive representation concerning personnel policies, practices, and matters affecting working conditions.

10. National Security and Intelligence Matters—disclosure of these records may be disclosed to Federal, State, local agencies, or other appropriate entities or individuals, or through established liaison channels to selected foreign government in order to enable an intelligence agency to carry out its responsibilities under the National Security Act of 1947, as amended, the CIA Act of 1949, as amended, Executive Order 12333 or any successor order, applicable to national security directives, or classified implementing procedures approved by the Attorney General and promulgated pursuant to such statutes, orders, or directives.

In each of these cases, the FCC will determine whether disclosure of the records is compatible with the purpose for which the records were collected.

DISCLOSURE TO CONSUMER REPORTING AGENCIES:

None.

POLICIES AND PRACTICES FOR STORING, RETRIEVING, ACCESSING, RETAINING, AND DISPOSING OF RECORDS IN THE SYSTEM:

STORAGE:

Information is stored on paper records, which are stored in file folders in security containers, and in electronic records that are maintained in a stand-alone computer database.

RETRIEVABILITY:

Records are retrieved by an individual's name or Social Security Number (SSN).

SAFEGUARDS:

Comprehensive paper records are maintained in file folders and stored in approved security containers, which are locked and located within a secure, access-controlled area. Access is limited to approved security office and administrative personnel who have a need for them in the performance of their official duties, *e.g.*, who have responsibility for suitability determinations. Paper records limited (in number and scope) are kept in the FCC's regional offices and laboratory facilities in locked metal file cabinets in locked rooms.

Comprehensive electronic records are maintained in networked computer database(s). The computer database is secured through controlled access and passwords restricted to Federal employee and contractor security and administrative personnel on a "need to know" basis, *e.g.*, who have a need for them in the performance of their official duties, *e.g.*, who have responsibility for suitability determinations. Access to the records is restricted to those with a specific role in the Personal Identification Verification (PIV) process that requires access to background investigation forms to perform their duties, and who have been given a password to access that part of the system including background investigation records. The FCC Security Office staff maintains an audit trail. Individuals given roles in the PIV process must complete training specific to their roles to ensure that they are knowledgeable about how to protect individually identifiable information. The databases are backed-up on a daily basis to floppy disk(s), which are then stored in a secured area.

RETENTION AND DISPOSAL:

These records are retained and disposed of in accordance with General Records Schedule 18, item 22a, approved by the National Archives and Records Administration (NARA). Both paper and electronic records are retained during employment or while an

individual is actively involved in Federal programs. As appropriate, records are returned to investigating agencies after employment terminates; otherwise, the records are destroyed upon notification of death or not later than five years after the employee's retirement or separation from the FCC, or the employee's transfer to another Federal agency or department, whichever is applicable.

In accordance with NARA guidelines, the FCC destroys paper records by shredding; and electronic records are destroyed by electronic erasure. Individuals interested in further information about retention and disposal may request a copy of the disposition instructions from the FCC Privacy Act Officer.

SYSTEM MANAGER(S) AND ADDRESS:

Security Operations Center, Office of the Managing Director, Federal Communications Commission (FCC), 445 12th Street, SW., Room 1-B458, Washington, DC 20554.

NOTIFICATION PROCEDURE:

Under the authority granted to heads of agencies by 5 U.S.C. 552a (k), the FCC has determined (47 CFR 0.561) that this system of records is exempt from disclosing its notification procedure for this system of records.

RECORD ACCESS PROCEDURES:

Under the authority granted to heads of agencies by 5 U.S.C. 552a (k), the FCC has determined (47 CFR 0.561) that this system of records is exempt from disclosing its record access procedures for this system of records.

CONTESTING RECORD PROCEDURE:

Under the authority granted to heads of agencies by 5 U.S.C. 552a (k), the FCC has determined (47 CFR 0.561) that this system of records is exempt from disclosing its contesting record procedure for this system of records.

RECORD SOURCE CATEGORIES:

Under the authority granted to heads of agencies by 5 U.S.C. 552a (k), the FCC has determined (47 CFR 0.561) that this system of records is exempt from disclosing its record sources for this system of records.

EXEMPTION FROM CERTAIN PROVISIONS OF THE ACT:

This system of records is exempt from sections (c)(3), (d), (e)(4)(G), (H), and (I), and (f) of the Privacy Act of 1974, 5 U.S.C. 552a, and from 47 CFR 0.554–0.557 of the Commission's rules. These provisions concern the notification, record access, and contesting procedures described above, and also

the publication of record sources. The system is exempt from these provisions because it contains the following types of information:

1. Investigative material compiled for law enforcement purposes as defined in Section (k)(2) of the Privacy Act;

2. Properly classified information, obtained from another Federal agency during the course of a personnel investigation, which pertains to national defense and foreign policy, as stated in Section (k)(1) of the Privacy Act; and

3. Investigative material compiled solely for the purpose of determining suitability, eligibility, or qualifications for Federal civilian employment, as described in Section (k)(5) of the Privacy Act, as amended. (Information will be withheld to the extent it identifies witnesses promised confidentiality as a condition of providing information during the course of the background investigation.)

FCC/OMD-24

SYSTEM NAME:

Physical Access Control System (PACS)²

SECURITY CLASSIFICATION:

None.

SYSTEM LOCATION:

Information in this system is maintained in the following location: Security Operations Center, Office of the Managing Director, Federal Communications Commission (FCC), 445 12th Street, SW., Room 1-B458, Washington, DC 20554. This location is in a Federal building, where staffed guard stations have been established and which has an installed Personal Identity Verification (PIV) card reader system.

CATEGORIES OF INDIVIDUALS COVERED BY THE SYSTEM:

Any individual who requires regular, on-going access to FCC facilities and information technology systems. This includes but is not limited to:

1. Current FCC employees and current contractors;

2. Frequent visitors, temporary hires, special parking access users, and day contractors;

3. Applicants for Federal employment or contract work;

4. FCC students, interns, volunteers, affiliates, and individuals formerly in these positions, *e.g.*, retired FCC employees; and

5. Non-FCC employees who are authorized to perform or use services in

FCC facilities on an on-going basis, *e.g.*, credit union employees, restaurant employees, and building maintenance and cleaning employees.

This system does apply to occasional visitors or short-term guests to whom the FCC will issue temporary identification and credentials, who may include:

1. All visitors to FCC, *e.g.*, non-FCC federal employees and contractors, students, interns, volunteers, and affiliates; and

2. Individuals authorized to perform or use services provided in FCC facilities on an infrequent basis, *e.g.*, and service and maintenance workers performing cleaning, maintenance, and repair duties in the Commission's buildings and facilities.

CATEGORIES OF RECORDS IN THE SYSTEM:

The system consists of a computer database containing records on those individuals to whom the FCC has issued credentials. The records are filed alphabetically by last name, with a corresponding badge number.

1. FCC employee/temporary hire database includes: Full name (first, middle, and last names), Social Security Number (SSN), birth date, signature, image (photograph), fingerprints, hair color, eye color, height, weight, FCC telephone number, FCC Bureau/Office, FCC office/room number, personal identification number (PIN), background investigation form data and results, date the personal identify verification (PIV) card was issued and expiration dates, PIV registrar approval signature, PIV card serial number, emergency responder designation, copies of documents verifying identification or information derived from such documents, *e.g.* document title, document issuing authority, document number, document expiration date, other document information), national security level clearance and expiration date, parking permit data, computer system user name, user access and permission rights, authentication certificates, and digital signature information.

2. Contractor database includes: First, middle, and last name, Social Security Number (SSN), birth date, signature, image (photograph), fingerprints, hair color, eye color, height, weight, contractor company name, Federal supervisor, telephone number, FCC point of contact, FCC Bureau/Office, FCC office/room number, FCC telephone number, and FCC contractor badge number, personal identification number (PIN), background investigation form data and results, date the personal identify verification (PIV) card was

issued and expiration dates, PIV registrar approval signature, PIV card serial number, emergency responder designation, copies of documents verifying identification or information derived from such documents, *e.g.*, document title, document issuing authority, document number, document expiration date, other document information), national security level clearance and expiration date, parking permit data, computer system user name, user access and permission rights, authentication certificates, and digital signature information.

3. Frequent Visitor's database includes: First and last names, employer's name, address, telephone number, image (photograph), and date of issuance and expiration date.

4. Day contractor database includes: First and last name along with badge number, date of issuance and expiration date.

5. Visitor database includes: First and last name, image (photograph), FCC point of contact and date of issuance.

6. Special Parking Access database includes: First and last name, telephone number, employer, FCC point of contact, and date of issuance.

Note: Records maintained on cardholders entering FCC facilities or using FCC systems, *e.g.*, FCC employees and contractors, include: Individual's first, middle, and last name, PIV card number, date, time, and location of entry and exit, FCC bureau/office, contractor/visitor's employer's name, address, telephone number, level of national security clearance and expiration date, digital signature information, and computer networks/applications/data accessed, and FCC point of contact.

AUTHORITY FOR MAINTENANCE OF THE SYSTEM:

5 U.S.C. 301; Federal Information Security Act (Pub. L. 104-106, sec. 5113); Electronic Government Act (Pub. L. 104-347, sec. 203); Paperwork Reduction Act of 1995 (44 U.S.C. 3501); Government Paperwork Elimination Act (Pub. L. 105-277, 44 U.S.C. 3504); Homeland Security Presidential Directive (HSPD) 12, "Policy for a Common Identification Standard for Federal Employees and Contractors," August 27, 2004; Federal Property and Administrative Act of 1949, as amended; and Department of Justice Report, "Vulnerability Assessment of Federal Facilities," June 28, 1995.

PURPOSE(S):

The purposes of the system are:

1. To ensure the safety and security of FCC facilities, systems, and information, FCC employees, contractors, interns, guests, and frequent visitors;

2. To verify that all people entering the FCC facilities, using FCC and

² This system of records was formerly titled "Access Control System."

Federal information resources (or accessing classified information), are authorized to do so;

3. To track and control FCC badges (PIV cards) issued to individuals entering and exiting these facilities, using FCC systems, or accessing classified information; and

4. To provide a method by which the FCC may ascertain the times each person was in these facilities.

ROUTINE USES OF RECORDS MAINTAINED IN THE SYSTEM, INCLUDING CATEGORIES OF USERS AND THE PURPOSES OF SUCH USES:

1. Litigation by the Department of Justice—when (a) the FCC or any component thereof; or (b) any employee of the FCC in his or her official capacity; (c) any employee of the FCC in his or her individual capacity where the FCC or the Department of Justice (DOJ) has agreed to represent the employee; or (d) the United States Government, is a party to litigation or has an interest in such litigation, and by careful review, the FCC determines that the records are both relevant and necessary to the litigation and the use of such records by the DOJ is therefore deemed by the FCC to be for a purpose compatible with the purpose for which the FCC collected the records;

2. Court or Adjudicative Body—in a proceeding when: (a) The FCC or any component thereof; (b) any employee of the FCC in his or her official capacity; (c) any employee of the FCC in his or her individual capacity where the Department of Justice (DOJ) has agreed to represent the employee; or (d) the United States Government, is a party to litigation or has an interest in such litigation, and by careful review, the FCC determines that the records are both relevant and necessary to the litigation and the use of such records is therefore deemed by the FCC to be for a purpose that is compatible with the purpose for which the FCC collected the records;

3. Law Enforcement and Investigation—except as noted on Forms SF 85, 85-P, and 86, when a record on its face, or in conjunction with other records, indicates a violation or potential violation of a law, whether civil, criminal, or regulatory in nature, and whether arising by general statute or particular program statute, or by regulation, rule, or order issued pursuant thereto, disclosure may be made to the appropriate public authority, whether Federal, foreign, State, local, or tribal, otherwise, responsible for enforcing, investigating, or prosecuting such violation or charged with enforcing or implementing the statute, or rule, regulation, or order

issued pursuant thereto, if the information disclosed is relevant to any enforcement, regulatory, investigative, or prosecutorial responsibility of the receiving entity;

4. Congressional Inquiries—when requested by a Congressional office in response to an inquiry by an individual made to the Congressional office for their own records;

5. Government-wide Program Management and Oversight—when requested by the National Archives and Records Administration or the General Services Administration for the purpose of records management inspections conducted under authority of 44 U.S.C. 2904 and 2906; when the U.S. Department of Justice is contacted in order to obtain that department's advice regarding disclosure obligations under the Freedom of Information Act; or when the Office of Management and Budget is contacted in order to obtain that office's advice regarding obligations under the Privacy Act, or when necessary for the review of private relief legislation pursuant to OMB Circular No. A-19;

6. Contract Services, Grants, or Cooperative Agreements—a record may be disclosed to FCC contractors, grantees, or volunteers who have been engaged to assist the FCC in the performance of a contract service, grant, cooperative agreement, or other activity related to this system of records and who need to have access to the records in order to perform their activity. Recipients shall be required to comply with the requirements of the Privacy Act of 1974, as amended, 5 U.S.C. 552a;

7. Employment, Clearances, Licensing, Contract, Grant, or other Benefits Decisions by the agency—disclosure may be made to a Federal, State, or local government maintaining civil, criminal, or other relevant enforcement records, or other pertinent records, or to another public authority or professional organization, if necessary to obtain information relevant to an investigation concerning the retention of an employee or other personnel action (other than hiring), the retention of a security clearance, the letting of a contract, or the issuance or retention of a grant or other benefit;

8. Employment, Clearances, Licensing, Contract, Grant, or other Benefits Decisions by other than the agency—disclosure may be made to a Federal, State, local, or tribal government, or other public authority of the fact that this system of records contains information relevant to the retention of an employee, the retention of a security clearance, the letting of a contract, or the issuance or retention of

a license, grant, or other benefit. The other agency or licensing organization may then make a request supported by the written consent of the individual for the entire records if it so chooses. No disclosure will be made unless the information has been determined to be sufficiently reliable to support a referral to another office within the agency or to another Federal agency for criminal, civil, administrative, personnel or regulatory action;

9. Labor Relations—A record from this system may be disclosed to officials of labor organizations recognized under 5 U.S.C. Chapter 71 upon receipt of a formal request and in accord with the conditions of 5 U.S.C. 7114 when relevant and necessary to their duties of exclusive representation concerning personnel policies, practices, and matters affecting working conditions;

10. National Security and Intelligence Matters—disclosure of these records may be disclosed to Federal, State, local agencies, or other appropriate entities or individuals, or through established liaison channels to selected foreign government in order to enable an intelligence agency to carry out its responsibilities under the National Security Act of 1947, as amended, the CIA Act of 1949, as amended, Executive Order 12333 or any successor order, applicable to national security directives, or classified implementing procedures approved by the Attorney General and promulgated pursuant to such statutes, orders, or directives; and

11. Invalid PIV Card Notification—disclosure may be made to notify another Federal agency, when, or to verify whether, a PIV card is no longer valid.

In each of these cases, the FCC will determine whether disclosure of the records is compatible with the purpose for which the records were collected.

Note: Disclosures to the FCC of data pertaining to date and time of entry and exit of a Commission employee working in the District of Columbia may not be made to supervisors, managers, or any other individuals (other than the individual to whom the information applies) to verify the employee's time and attendance record for personnel actions because 5 U.S.C. 6106 prohibits Federal Executive Agencies (other than the Bureau of Engraving and Printing) from using a recording clock within the District of Columbia, unless the clock is used as part of a flexible schedule program under 5 U.S.C. 6120 *et seq.*

POLICIES AND PRACTICES FOR STORING, RETRIEVING, ACCESSING, RETAINING, AND DISPOSING OF RECORDS IN THE SYSTEM:

STORAGE:

The information is maintained in a password-protected or logical access

controlled electronic media, *e.g.*, computer database(s), and in securely controlled paper files.

RETRIEVABILITY:

The information can be retrieved by: (1) The name of the individual; (2) Social Security Number (SSN); (3) other ID number, *e.g.*, FCC employee, contractor, or frequent visitor badge number; or (4) PIV card serial number.

SAFEGUARDS:

Paper records are kept in locked cabinets in secure facilities and access to them is restricted to individuals, *e.g.*, FCC Security Operations Center staff, whose role requires use of the information. The computer servers in which the information is stored are located in FCC facilities that are secured by limited access card readers. The computer servers themselves are password-protected. Access by individuals working at guard stations is password-protected; each person granted access to the system at guard stations must be individually authorized to use the system. A *Privacy Act Warning Notice* appears on the monitor screen when records containing information on individuals are first displayed. The FCC Security Operations Center staff performs a backup operation on these files on a regular basis using a secure medium. The backup data are stored in a locked and controlled room in a secure location.

RETENTION AND DISPOSAL:

Records relating to individuals with FCC access cards, covered by this system, are retained in accordance with General Records Schedule 18, Item 17 approved by the National Archives and Records Administration (NARA). The records disposal is done in accordance with the Commission's disposal policies. Unless retained for specific, on-going security investigations, records of facility access are maintained for one year and then destroyed.

All other records relating to individuals are retained and disposed of in accordance with General Records Schedule 18, item 22a, approved by NARA. The records are disposed of in accordance with FCC Security Operations Center disposal policies, as follows:

1. When an employee/contractor/temporary hire/special parking access leaves the FCC, the file in the database is deleted.
2. Frequent visitor badges are given a two-year valid period, after which the card will automatically deactivate.
3. All returned day contractor cards will be reused on a daily basis.

4. Transaction data for all cards will be stored using a secure medium and retained for one year in the FCC Security Operations Center, which is locked and secured with an alarm system. Otherwise, access records are destroyed upon notification of death, or not later than one year after the employee's retirement or separation from the FCC, or the employee's transfer to another Federal agency, whichever is applicable.

In accordance with HSPD-12, PIV Cards are deactivated within eighteen (18) hours of notification of cardholder separation, loss of card, or expiration. The information on PIV Cards is maintained in accordance with General Records Schedule 11, Item 4. PIV Cards are destroyed by burning in an approved Federal burn-facility.

SYSTEM MANAGER(S) AND ADDRESS:

Security Operations Center, Office of Managing Director, Federal Communications Commission (FCC), 445 12th Street, SW., Room 1-B458, Washington, DC 20554.

NOTIFICATION PROCEDURE:

Individuals wishing to inquire whether this system of records contains information about them should contact the system manager indicated above. Individuals must furnish their full name, birth date, Federal agency name, and work location for their records to be located and identified. An individual requesting notification of records in person must provide identity documents sufficient to satisfy the system manager of the records that the requester is entitled to access, *e.g.*, government-issued photo ID. Individuals requesting notification via mail or telephone must furnish, at a minimum, their name, date of birth, Social Security Number, and home address to establish identity. *See* 47 CFR 0.554-0.555.

RECORD ACCESS PROCEDURES:

Individuals wishing to request access to records about them should contact the system manager indicated above. Individuals must furnish their full name (first, middle, and last name), birth date, for their record to be located and identified. An individual requesting access must also follow FCC Privacy Act regulations regarding verification of identity and access to records. *See* 47 CFR 0.554-0.555.

CONTESTING RECORD PROCEDURES:

Individuals wishing to request amendment of their records should contact the system manager indicated above. Individuals must furnish their

full name (first, middle, and last name), birth date, for their record to be located and identified. An individual requesting amendment must also follow the FCC Privacy Act regulations regarding verification of identity and amendment of records. *See* 47 CFR 0.556-0.557.

RECORD SOURCE CATEGORIES:

The individual FCC employee to whom the information applies, contractor, or applicant for employment; sponsoring agency; former sponsoring agency; other federal agencies; contract employer; and/or former employee.

EXEMPTIONS CLAIMED FOR THE SYSTEM:

None.
Federal Communications Commission.
Marlene H. Dortch,
Secretary.
[FR Doc. 06-8182 Filed 9-22-06; 8:45 am]
BILLING CODE 6712-01-P

FEDERAL RESERVE SYSTEM

Change in Bank Control Notices; Acquisition of Shares of Bank or Bank Holding Companies

The notificants listed below have applied under the Change in Bank Control Act (12 U.S.C. 1817(j)) and § 225.41 of the Board's Regulation Y (12 CFR 225.41) to acquire a bank or bank holding company. The factors that are considered in acting on the notices are set forth in paragraph 7 of the Act (12 U.S.C. 1817(j)(7)).

The notices are available for immediate inspection at the Federal Reserve Bank indicated. The notices also will be available for inspection at the office of the Board of Governors. Interested persons may express their views in writing to the Reserve Bank indicated for that notice or to the offices of the Board of Governors. Comments must be received not later than October 10, 2006.

A. Federal Reserve Bank of Philadelphia (Michael E. Collins, Senior Vice President) 100 North 6th Street, Philadelphia, Pennsylvania 19105-1521:

1. *Paul C. Woelkers*, Moscow, Pennsylvania; to acquire voting shares of Landmark Community Bank, Pittston, Pennsylvania.

Board of Governors of the Federal Reserve System, September 20, 2006.

Robert deV. Frierson,
Deputy Secretary of the Board.
[FR Doc. E6-15661 Filed 9-22-06; 8:45 am]
BILLING CODE 6210-01-S

FEDERAL RESERVE SYSTEM

Formations of, Acquisitions by, and Mergers of Bank Holding Companies

The companies listed in this notice have applied to the Board for approval, pursuant to the Bank Holding Company Act of 1956 (12 U.S.C. 1841 *et seq.*) (BHC Act), Regulation Y (12 CFR Part 225), and all other applicable statutes and regulations to become a bank holding company and/or to acquire the assets or the ownership of, control of, or the power to vote shares of a bank or bank holding company and all of the banks and nonbanking companies owned by the bank holding company, including the companies listed below.

The applications listed below, as well as other related filings required by the Board, are available for immediate inspection at the Federal Reserve Bank indicated. The application also will be available for inspection at the offices of the Board of Governors. Interested persons may express their views in writing on the standards enumerated in the BHC Act (12 U.S.C. 1842(c)). If the proposal also involves the acquisition of a nonbanking company, the review also includes whether the acquisition of the nonbanking company complies with the standards in section 4 of the BHC Act (12 U.S.C. 1843). Unless otherwise noted, nonbanking activities will be conducted throughout the United States. Additional information on all bank holding companies may be obtained from the National Information Center website at www.ffiec.gov/nic/.

Unless otherwise noted, comments regarding each of these applications must be received at the Reserve Bank indicated or the offices of the Board of Governors not later than October 20, 2006.

A. Federal Reserve Bank of St. Louis
(Glenda Wilson, Community Affairs Officer) 411 Locust Street, St. Louis, Missouri 63166-2034:

1. *Citizens First Corporation*, Bowling Green, Kentucky; to acquire 100 percent of the voting shares of Kentucky Banking Centers, Inc., Glasgow, Kentucky.

Board of Governors of the Federal Reserve System, September 20, 2006.

Robert deV. Frierson,

Deputy Secretary of the Board.

[FR Doc. E6-15660 Filed 9-22-06; 8:45 am]

BILLING CODE 6210-01-S

DEPARTMENT OF HEALTH AND HUMAN SERVICES

Agency for Healthcare Research and Quality

Request for Measures of Consumers' Home Health Care Experiences

AGENCY: Agency for Healthcare Research and Quality (AHRQ), DHHS.

ACTION: Notice of request for measures.

SUMMARY: The Agency for Healthcare Research and Quality (AHRQ) is soliciting the submission of instruments or items that measure perceptions of patients and their informal caregivers regarding the quality of home health care these patients received from home health providers, health plans, other health care providers, stakeholders, vendors, researchers who include home health care as part of their research, and other interested parties. This initiative is in response to the need to develop a new CAHPS® home health care survey. The Centers for Medicare & Medicaid Services is interested in incorporating this survey as part of its Home Health Quality Initiative which is intended to empower consumers with quality of care information to make more informed decisions about their health care while also encouraging Medicare certified home health agencies to improve the quality of care they deliver to all patients regardless of payer source. The survey is likely to assess the quality of care and services provided by nurses, therapists, home health aides, medical social workers, and home health agency administrative staff.

Based on the agency's prior consumer assessment of health care work, there are several functional areas that this instrument could assess such as: Communication; courtesy and respect; information provided and shared decision making; coordination/integration of care; time related issues (e.g., arrived and departed according to schedule, amount of time spent, visit frequency); competence; influence/control over care giver activities; unmet need issues, and customer service.

DATES: Please submit instruments and supporting information on or before October 25, 2006. AHRQ will not respond individually to submitters, but will consider all submitted instruments and publicly report the results of the review of the submissions in aggregate.

ADDRESSES: Submissions should include a brief cover letter, a copy of the instrument or items for consideration and supporting information as specified under the Submission Criteria below. Submissions may be in the form of a

letter or e-mail, preferably with an electronic file as an E-mail attachment. Responses to this request should be submitted to: Charles Darby, Center for Quality Improvement and Patient Safety, Agency for Healthcare Research and Quality, 540 Gaither Road, Rockville, MD 20850, Phone: (301) 427-1324, Fax: (301) 427-1341, E-mail: charles.darby@ahrq.hhs.gov.

To facilitate handling of submissions, please include full information about the instrument developer and/or a designated contact: (a) Name, (b) title, (c) organization, (d) mailing address, (e) telephone number, (f) fax number, and (g) e-mail address. Also, please submit a copy of the instrument or items for consideration, and evidence that meets the criteria below. It is requested that citation of a peer-reviewed journal article pertaining to the instrument to include the title of the article, author(s), publication year, journal name, volume, issue, and page numbers where article appears, be included, but is not required. Submitters must also provide a statement of willingness to grant to AHRQ the right to use and authorize others to use submitted measures and their documentation as part of a CAHPS®-trademarked instrument. This final CAHPS® instrument for collecting patient perspectives on the quality of home health care and services will be made publicly available, free of charge. Electronic submissions are encouraged.

FOR FURTHER INFORMATION CONTACT:
Charles Darby, at the address above.

Submission Criteria

Instruments submitted should focus on home health care or closely related care areas (e.g., home care; personal assistant services/community based care) and address areas of interest such as: communication, information provided and shared decision making, courtesy and respect, coordination/integration, time related issues (e.g., arrival and departed according to schedule, amount of time spent; visit frequency competence) influence/control over care giver activities, unmet need issues, and customer service.

Measures submitted must meet these criteria to be considered: capture the patients' experience of home health care workers and agency administrative and demonstrate a high degree of reliability and validity. Submitters' willingness to grant to AHRQ the right to use and authorize others to the instrument or item means that the CAHPS® trademark will be applied to a new instrument combining the best features of all the submissions as well as any ideas that may develop from reviewing them. This will ensure free access to the

instrument, and free access to the instrument's supportive/administrative information. AHRQ, in collaboration with CAHPS grantees, and in consultation with CMS, will evaluate all submitted instruments or items. As the CAHPS instrument is constructed, one or more instruments may be selected, either in whole or in part, or items may be modified prior to testing them.

Submitters will relinquish ownership of any items that appear in the final instrument. However, item ownership will be protected during testing of the survey.

The final instrument(s) will bear the CAHPS® trademark and they will be made freely available for use by all interested parties. As a matter of quality control, there will be warnings that the CAHPS® identification may not be used if any changes are made to the instrument or the final measure set or the methodology or instructions, without review and permission of the agency.

Each submission should include the following information: the name of the instrument, domains included, language(s) the instrument is available in, evidence of cultural/cross group comparability, if any, instrument reliability (internal consistency, test-retest, etc.), validity (content, construct, criterion-related), response rates, methods and results of cognitive testing and field-testing and description of sampling strategies (including payer type) and data collection protocols, including such elements as mode of administration, use of advance letters, timing and frequencies of contacts. In addition, a list of where the instrument has been fielded should also be included in the submission. Submission of copies of existing report formats developed to disclose findings to consumers and providers is desirable, but not required. Additionally, information about existing database(s) for collecting results gathered using the instrument(s) or items submitted is helpful, but not required for submission. Evidence of the criteria should be demonstrated through submission of peer-reviewed journal article(s) or through the best evidence available at the time of submission.

SUPPLEMENTARY INFORMATION:

Background

The CAHPS program was initiated in 1995 to develop a survey and report on consumers' perspectives on the quality of their health plans. Since that time the CAHPS program, in partnership with CMS and others, has expanded its scope and developed surveys and reports

regarding patient assessments of care received from individual clinicians, group practices, in-center hemodialysis services, nursing homes and hospitals. Now, CMS has asked the CAHPS team to develop a survey to obtain the consumer's perspective on home health care and services.

One of the top priorities of the Centers for Medicare & Medicaid Services is to increase the transparency in healthcare by providing quality and cost information to the public. One of the critical components missing from the current measurement set for home health agencies is information from the consumer perspective on the quality of care provided. The proposed instrument described above will address this need for useful patient assessments.

Dated: September 19, 2006.

Carolyn M. Clancy,

Director.

[FR Doc. 06-8183 Filed 9-22-06; 8:45 am]

BILLING CODE 4160-90-M

DEPARTMENT OF HEALTH AND HUMAN SERVICES

Centers for Disease Control and Prevention

[30Day-06-0237]

Agency Forms Undergoing Paperwork Act Review

The Centers for Disease Control and Prevention (CDC) publishes a list of information collection requests under review by the Office of Management and Budget (OMB) in compliance with the Paperwork Reduction Act (44 U.S.C. Chapter 35). To request a copy of these requests, call the CDC Reports Clearance Officer at (404) 639-5960 or send an e-mail to omb@cdc.gov. Send written comments to CDC Desk Officer, Office of Management and Budget, Washington, DC or by fax to (202) 395-6974. Written comments should be received within 30 days of this notice.

Proposed Project

The 2007-2008 National Health and Nutrition Examination Survey NHANES—(0920-0237)—Revision—National Center for Health Statistics (NCHS), Centers for Disease Control and Prevention (CDC).

Background and Brief Description

The National Health and Nutrition Examination Survey (NHANES) has been conducted periodically since 1970 and continuously since 1999 by the National Center for Health Statistics, CDC. Participants will receive a

household interview, a physical examination, a telephone dietary interview and a telephone interview. The telephone interview, as well as selected questions in the household interview will be referred to as the Flexible Consumer Behavior Survey (FCBS) and will include questions on food expenditures, diet and health knowledge and other food and nutrition topics. Of the over 13,000 individuals who will be screened, it is estimated that approximately 5,000 participants will be examined annually. Participation in the survey is completely voluntary and confidential.

NHANES programs produce descriptive statistics which measure the health and nutrition status of the general population. Through the use of questionnaires, physical examinations, and laboratory tests, NHANES studies the relationship between diet, nutrition and health in a representative sample of the United States. NHANES monitors the prevalence of chronic conditions and risk factors related to health such as asthma, osteoporosis, infectious diseases, diabetes, eye disease, high blood pressure, high cholesterol, obesity, smoking, drug and alcohol use, physical activity, environmental exposures, and diet. NHANES data are used to establish the norms for the general population against which health care providers can compare such patient characteristics as height, weight, and nutrient levels in the blood. Data from NHANES can be compared to those from previous surveys to monitor changes in the health of the U.S. population. NHANES will also establish a national probability sample of genetic material for future genetic research for susceptibility to disease.

Users of NHANES data include Congress; the World Health Organization; Federal agencies such as NIH, EPA, and USDA; private groups such as the American Heart Association; schools of public health; private businesses; individual practitioners; and administrators. NHANES data are used to establish, monitor, and/or evaluate recommended dietary allowances, food fortification policies, environmental exposures, immunization guidelines and health education and disease prevention programs. The current submission requests approval for three years.

There is no net cost to respondents other than their time. Respondents are reimbursed for any out-of-pocket costs such as transportation to and from the examination center. The total estimated annualized burden hours are 59,864.

ESTIMATED ANNUALIZED BURDEN HOURS

Burden category	Number of respondents per year	Number of responses per respondent	Average burden per response (hours)
1. Screening interview only	13,333	1	10/60
2. Screener, family, and sample person interviews only	300	1	1.10
3. Screener, family, and sample person interviews and MEC examination (including pilot studies)	5,180	1	5.9
4. Second dietary recall interview	4,300	1	30/60
5. Telephone Interview (FCBS)	3,000	1	20/60
6. Follow-up, special studies, and tests of procedures	4,000	1	5.9

Dated: September 19, 2006.

Joan F. Karr,

Acting Reports Clearance Officer, Centers for Disease Control and Prevention.

[FR Doc. 06-8164 Filed 9-22-06; 8:45 am]

BILLING CODE 4163-18-P

DEPARTMENT OF HEALTH AND HUMAN SERVICES

Administration for Children and Families

Proposed Information Collection Activity; Comment Request

Proposed Projects

Title: DHHS/ACF/ASPE/DOL Enhanced Services for the Hard-to-Employ Demonstration and Evaluation: Rhode Island 15-Month Survey Amendment.

OMB No. 0970-0276.

Description: The Enhanced Services for the Hard-to-Employ Demonstration and Evaluation Project (HtE) seeks to learn what works in this area to date and is explicitly designed to build on past research by rigorously testing a wide variety of approaches to promote employment and improve family functioning and child well-being. The

HtE project is designed to help Temporary Assistance for Needy Families (TANF) recipients, former TANF recipients, or low-income parents who are hard-to-employ. The project is sponsored by the Office of Planning, Research and Evaluation (OPRE) of the Administration for Children and Families (ACF), the Office of the Assistant Secretary for Planning and Evaluation (ASPE) in the U.S. Department of Health and Human Services (HHS), and the U.S. Department of Labor (DOL).

The evaluation involves an experimental, random assignment design in four sites, testing a diverse set of strategies to promote employment for low-income parents who face serious obstacles to employment. The four include: (1) Intensive care management to facilitate the use of evidence-based treatment for major depression among parents receiving Medicaid in Rhode Island; (2) job readiness training, worksite placements, job coaching, job development and other training opportunities for recent parolees in New York City; (3) pre-employment services and transitional employment for long-term TANF participants in Philadelphia; and (4) home- and center-based care, enhanced with self-sufficiency services,

for low-income families who have young children or are expecting in Kansas and Missouri.

Materials for follow-up surveys for each of these sites were previously submitted to OMB and were approved. The purpose of this submission is to add physiological measures to the follow-up effort to the Rhode Island study.

Respondents: The respondents to this component of the Rhode Island follow-up survey will be low-income parents and their children from the Rhode Island site currently participating in the HtE Project. As described in the prior OMB submission, these parents are Medicaid recipients between the ages of 18 and 45 receiving Medicaid through the managed care provider United Behavioral Health (UBH) in Rhode Island who meet study criteria with regard to their risk for depression. Children are the biological, adopted, and step-children of these parents, between the ages of 1 and 18 years of age.

The annual burden estimates are detailed below, and the substantive content of each component will be detailed in the supporting statement attached to the forthcoming 30-day notice.

ANNUAL BURDEN ESTIMATES

Instrument	Number of respondents	Number of responses per respondent	Average burden hours per response	Total burden hours
RI 15-month, parent physiological component	400	8	5 minutes or .08 hrs	266.66
RI 15-month young child physiological component	160	8	5 minutes or .08 hrs	106.66
RI 15-month youth physiological component	242	8	5 minutes or .08 hrs	161.33

Estimated Total Annual Burden Hours: 534.65.

In compliance with the requirements of Section 3506(c)(2)(A) of the Paperwork Reduction Act of 1995, the Administration for Children and Families is soliciting public comment on the specific aspects of the information collection described above.

Copies of the proposed collection of information can be obtained and comments may be forwarded by writing to the Administration for Children and Families, Office of Administration, Office of Information Services, 370 L'Enfant Promenade, SW., Washington, DC 20447, Attn: ACF Reports Clearance Officer. E-mail address:

infocollection@acf.hhs.gov. All requests should be identified by the title of the information collection.

The Department specifically requests comments on: (a) Whether the proposed collection of information is necessary for the proper performance of the functions of the agency, including whether the information shall have

practical utility; (b) the accuracy of the agency's estimate of the burden of the proposed collection of information; (c) the quality, utility, and clarity of the information to be collected; and (d) ways to minimize the burden of the collection of information on respondents, including through the use of automated collection techniques or other forms of information technology. Consideration will be given to comments and suggestions submitted within 60 days of this publication.

Dated: September 19, 2006.

Robert Sargis,

Reports Clearance Officer.

[FR Doc. 06-8110 Filed 9-22-06; 8:45 am]

BILLING CODE 4184-01-M

DEPARTMENT OF HEALTH AND HUMAN SERVICES

Food and Drug Administration

[Docket No. 2006E-0031]

Determination of Regulatory Review Period for Purposes of Patent Extension; CLOLAR

AGENCY: Food and Drug Administration, HHS.

ACTION: Notice.

SUMMARY: The Food and Drug Administration (FDA) has determined the regulatory review period for CLOLAR and is publishing this notice of that determination as required by law. FDA has made the determination because of the submission of an application to the Director of Patents and Trademarks, Department of Commerce, for the extension of a patent which claims that human drug product.

ADDRESSES: Submit written comments and petitions to the Division of Dockets Management (HFA-305), Food and Drug Administration, 5630 Fishers Lane, rm. 1061, Rockville, MD 20852. Submit electronic comments to <http://www.fda.gov/dockets/ecomments>.

FOR FURTHER INFORMATION CONTACT: Beverly Friedman, Office of Regulatory Policy (HFD-007), Food and Drug Administration, 5600 Fishers Lane, Rockville, MD 20857, 301-594-2041.

SUPPLEMENTARY INFORMATION: The Drug Price Competition and Patent Term Restoration Act of 1984 (Public Law 98-417) and the Generic Animal Drug and Patent Term Restoration Act (Public Law 100-670) generally provide that a patent may be extended for a period of up to 5 years so long as the patented item (human drug product, animal drug product, medical device, food additive, or color additive) was subject to

regulatory review by FDA before the item was marketed. Under these acts, a product's regulatory review period forms the basis for determining the amount of extension an applicant may receive.

A regulatory review period consists of two periods of time: A testing phase and an approval phase. For human drug products, the testing phase begins when the exemption to permit the clinical investigations of the human drug product becomes effective and runs until the approval phase begins. The approval phase starts with the initial submission of an application to market the human drug product and continues until FDA grants permission to market the drug product. Although only a portion of a regulatory review period may count toward the actual amount of extension that the Director of Patents and Trademarks may award (for example, half the testing phase must be subtracted as well as any time that may have occurred before the patent was issued), FDA's determination of the length of a regulatory review period for a human drug product will include all of the testing phase and approval phase as specified in 35 U.S.C. 156(g)(1)(B).

FDA recently approved for marketing the human drug product CLOLAR (clofarabine). CLOLAR is indicated for the treatment of pediatric patients 1 to 21 years old with relapsed or refractory acute lymphoblastic leukemia after at least two prior regimens. Subsequent to this approval, the Patent and Trademark Office received a patent term restoration application for CLOLAR (U.S. Patent No. 5,661,136) from Southern Research Institute, and the Patent and Trademark Office requested FDA's assistance in determining this patent's eligibility for patent term restoration. In a letter dated February 24, 2006, FDA advised the Patent and Trademark Office that this human drug product had undergone a regulatory review period and that the approval of CLOLAR represented the first permitted commercial marketing or use of the product. Shortly thereafter, the Patent and Trademark Office requested that FDA determine the product's regulatory review period.

FDA has determined that the applicable regulatory review period for CLOLAR is 2,200 days. Of this time, 1,926 days occurred during the testing phase of the regulatory review period, while 274 days occurred during the approval phase. These periods of time were derived from the following dates:

1. *The date an exemption under section 505(i) of the Federal Food, Drug, and Cosmetic Act (the act) (21 U.S.C. 355(i)) became effective:* December 22, 1998. The applicant claims February 10,

1999, as the date the investigational new drug application (IND) became effective. However, FDA records indicate that the IND effective date was December 22, 1998, the date FDA removed the clinical hold on the application.

2. *The date the application was initially submitted with respect to the human drug product under section 505(b) of the act:* March 30, 2004. The applicant claims September 26, 2003, as the date the new drug application (NDA) for CLOLAR (NDA 21-673) was initially submitted. However, FDA records indicate that NDA 21-673 was submitted in its entirety on March 30, 2004.

3. *The date the application was approved:* December 28, 2004. FDA has verified the applicant's claim that NDA 21-673 was approved on December 28, 2004.

This determination of the regulatory review period establishes the maximum potential length of a patent extension. However, the U.S. Patent and Trademark Office applies several statutory limitations in its calculations of the actual period for patent extension. In its application for patent extension, this applicant seeks 1,303 days of patent term extension.

Anyone with knowledge that any of the dates as published are incorrect may submit to the Division of Dockets Management (see **ADDRESSES**) written or electronic comments and ask for a redetermination by November 24, 2006. Furthermore, any interested person may petition FDA for a determination regarding whether the applicant for extension acted with due diligence during the regulatory review period by March 26, 2007. To meet its burden, the petition must contain sufficient facts to merit an FDA investigation. (See H. Rept. 857, part 1, 98th Cong., 2d sess., pp. 41-42, 1984.) Petitions should be in the format specified in 21 CFR 10.30.

Comments and petitions should be submitted to the Division of Dockets Management. Three copies of any mailed information are to be submitted, except that individuals may submit one copy. Comments are to be identified with the docket number found in brackets in the heading of this document. Comments and petitions may be seen in the Division of Dockets Management between 9 a.m. and 4 p.m., Monday through Friday.

Dated: September 1, 2006.

Jane A. Axelrad,

Associate Director for Policy, Center for Drug Evaluation and Research.

[FR Doc. 06-8115 Filed 9-22-06; 8:45 am]

BILLING CODE 4160-01-S

DEPARTMENT OF HOMELAND SECURITY**Federal Emergency Management Agency****[FEMA-1659-DR]****New Mexico; Amendment No. 2 to Notice of a Major Disaster Declaration**

AGENCY: Federal Emergency Management Agency, Department of Homeland Security.

ACTION: Notice.

SUMMARY: This notice amends the notice of a major disaster for the State of New Mexico (FEMA-1659-DR), dated August 30, 2006, and related determinations.

DATES: *Effective Date:* September 18, 2006.

FOR FURTHER INFORMATION CONTACT: Magda Ruiz, Recovery Division, Federal Emergency Management Agency, Washington, DC 20472, (202) 646-2705.

SUPPLEMENTARY INFORMATION: Notice is hereby given that the incident period for this disaster is closed effective September 18, 2006.

(The following Catalog of Federal Domestic Assistance Numbers (CFDA) are to be used for reporting and drawing funds: 97.030, Community Disaster Loans; 97.031, Cora Brown Fund Program; 97.032, Crisis Counseling; 97.033, Disaster Legal Services Program; 97.034, Disaster Unemployment Assistance (DUA); 97.046, Fire Management Assistance; 97.048, Individuals and Households Housing; 97.049, Individuals and Households Disaster Housing Operations; 97.050 Individuals and Households Program—Other Needs; 97.036, Public Assistance Grants; 97.039, Hazard Mitigation Grant Program.)

R. David Paulison,

Under Secretary for Federal Emergency Management and Director of FEMA.

[FR Doc. 06-8184 Filed 9-22-06; 8:45 am]

BILLING CODE 9110-10-P

DEPARTMENT OF THE INTERIOR**Fish and Wildlife Service****Proposed Low-Effect Habitat Conservation Plan for the Offices at Parkshore, Folsom, Sacramento County, CA**

AGENCY: Fish and Wildlife Service, Interior.

ACTION: Notice of availability and receipt of an application.

SUMMARY: Mark III Engineering Contractors of Sacramento, California (the Applicant), has applied to the Fish and Wildlife Service (Service) for a 5-

year incidental take permit for one covered species pursuant to section 10(a)(1)(B) of the Endangered Species Act of 1973, as amended (Act). The application addresses the potential for “take” of the threatened valley elderberry longhorn beetle (*Desmocerus californicus dimorphus*) associated with grading a 6.48-acre project site and construction of the Offices at Parkshore, a 9-building office complex off Parkshore Drive in the Lake Forest Technical Center, Folsom, Sacramento County, California. The Applicant would implement a conservation program to minimize and mitigate for the project activities, as described in the Low-Effect Habitat Conservation Plan for the Offices at Parkshore (Plan).

We request comments on the permit application and Plan, and on the Service’s preliminary determination that the Plan qualifies as a “low-effect” habitat conservation plan, eligible for a Categorical Exclusion under the National Environmental Policy Act of 1969, as amended (NEPA). The basis for the Categorical Exclusion determination is discussed in the Service’s Environmental Action Statement (EAS), which is also available for public review.

DATES: Written comments should be received on or before October 25, 2006.

ADDRESSES: Please address written comments to Lori Rinek, Chief, Conservation Planning and Recovery Division, Fish and Wildlife Service, Sacramento Fish and Wildlife Office, 2800 Cottage Way, Room W-2605, Sacramento, California 95825. Written comments may be sent by facsimile to (916) 414-6713.

FOR FURTHER INFORMATION CONTACT: Holly Herod, Chief, Sacramento Valley Branch, or Nina Bicknese, Senior Biologist, at the Sacramento Fish and Wildlife Office; telephone: (916) 414-6600.

SUPPLEMENTARY INFORMATION:**Availability of Documents**

Copies of the permit application, Plan, and EAS can be obtained from the individuals named above (see **FOR FURTHER INFORMATION CONTACT**). Copies of these documents are available for public inspection, by appointment, during regular business hours, at the Sacramento Fish and Wildlife Office (see **ADDRESSES**).

Background Information

Section 9 of the Act and its implementing Federal regulations prohibit the “take” of fish or wildlife species listed as endangered or threatened. Take is defined under the

Act to include the following activities: To harass, harm, pursue, hunt, shoot, wound, kill, trap, capture or collect listed animal species, or to attempt to engage in such conduct. However, under section 10(a)(1)(B) of the Act, the Service may issue permits to authorize incidental take of listed species. “Incidental take” is defined by the Act as take that is incidental to, and not the purpose of, carrying out an otherwise lawful activity. Regulations governing incidental take permits for endangered and threatened species, respectively, are found in the Code of Federal Regulations at 50 CFR 17.22 and 50 CFR 17.32.

The Applicant is seeking a permit for take of one federally listed species, the threatened valley elderberry longhorn beetle, (*Desmocerus californicus dimorphus*), which is referred to as the “covered species” in the Plan. The Applicant would receive “No Surprises” assurances for this species under the Service’s “No Surprises” regulations (50 CFR 17.22(b)(5) and 17.32(b)(5)). No other species are included in the Plan.

The Applicant proposes to construct eight one-story office buildings and a single two-story office building, which would collectively provide 74,435 square feet of new office space. Site improvements would include two vehicular driveways, a 377-space asphalt parking lot, sidewalks, pedestrian walkways, underground utilities, and landscaping. The 6.48-acre project site is the last undeveloped portion of an established office park. The project site supports degraded remnants of scrub and oak woodland vegetation, including habitat (e.g., elderberry shrubs) for the beetle. Elderberry plants are present in three locations in the project site. Thirty-nine of these elderberry plants exhibit stems with basal diameters equal to or greater than one inch, which is a sufficient size to be habitat for the beetle. An inventory identified a single beetle exit-hole, indicating that the species is likely present in the project site. Resident elderberry plants would be permanently removed from the project site to accommodate the proposed project.

The Applicant proposes to avoid and minimize take and associated adverse project impacts to the beetle by fully implementing their Plan. The Applicant will mitigate the impacts of taking the beetle by transplanting the 39 elderberry shrubs from the project site to a Service-approved conservation bank, and by purchasing 11 habitat credits for the beetle at the same conservation bank. Each habitat credit includes an established ratio of elderberry seedlings

and native riparian plant seedlings. Transplanting outside of the dormant period for elderberry shrubs, November 16 to February 15, would increase the likelihood of adult beetles and larvae being killed or injured. Therefore, the Applicant has agreed to purchase 12 additional habitat credits from the conservation bank (i.e., a total of 23 credits) if the elderberry shrubs are transplanted during the active growing season. The Applicant's Plan also describes measures and funding sources that ensure the elements of the Plan would be implemented in a timely manner, actions to be taken if unforeseen events occur, and other required elements.

The Service's proposed action consists of approving the Applicant's Plan and issuance of an incidental take permit for the Applicant's project. As required by the Act, the Applicant's Plan also considered alternatives to the take considered under the proposed action. Under the No Action Alternative, no permit would be issued, the office buildings and parking lot would not be built, and no take would occur. Under the Reduced Take Alternative, the office buildings and parking lot would be built, but the size and scope would be reduced. This alternative would allow some elderberry shrubs to remain on the project site with fewer elderberry shrubs transplanted to the Service-approved conservation bank, thus reducing take below the level anticipated for the proposed action.

National Environmental Policy Act

As discussed in the EAS, the Service has made a preliminary determination that approval of the proposed Plan and issuance of the permit would qualify as a Categorical Exclusion under NEPA, as provided by Federal regulations (40 CFR 1500.5(k), 1507.3(b)(2), 1508.4) and the Department of Interior Manual (516 DM 2 and 516 DM8). The EAS found that the proposed Plan qualifies as a "low-effect" habitat conservation plan, as defined by the Service's Habitat Conservation Planning Handbook (November 1996). Determination of low-effect habitat-conservation plans is based on the following criteria: (1) Implementation of the Plan would result in minor or negligible effects on federally listed, proposed, and candidate species and their habitats; (2) implementation of the Plan would result in minor or negligible effects on other environmental values or resources; (3) impacts of the Plan, considered together with the impacts of other past, present and reasonably foreseeable similarly situated projects would not result, over time, in cumulative effects to

environmental values or resources which would be considered significant. Based upon the preliminary determinations in the EAS, the Service does not intend to prepare further NEPA documentation. The Service will consider public comments when making the final determination on whether to prepare an additional NEPA document on the proposed action.

Public Review

The Service provides this notice pursuant to section 10(c) of the Act and the NEPA public-involvement regulations (40 CFR 1500.1(b), 1500.2(d), and 1506.6). The Service will evaluate the permit application, including the Plan, and comments submitted thereon to determine whether the application meets the requirements of section 10(a) of the Act. If the requirements are met, the Service will issue a permit to Mark III Engineering Contractors for the incidental take of the beetle during construction of the Offices at Parkshore. The Service will make the final permit decision no sooner than 30 days from the date of this notice.

Dated: September 19, 2006.

David L. Harlow,

Acting Field Supervisor, Sacramento Fish and Wildlife Office, Sacramento, California.

[FR Doc. 06-8161 Filed 9-22-06; 8:45 am]

BILLING CODE 4310-55-P

DEPARTMENT OF THE INTERIOR

Fish and Wildlife Service

Draft Comprehensive Conservation Plan and Environmental Assessment for Stone Lakes National Wildlife Refuge

AGENCY: Fish and Wildlife Service, Department of the Interior.

ACTION: Notice of availability; request for comments.

SUMMARY: The U.S. Fish and Wildlife Service (Service) announces that a Draft Comprehensive Conservation Plan and Environmental Assessment (Draft CCP/EA) for Stone Lakes National Wildlife Refuge (Refuge) is available for review and comment. Also available for review with the Draft CCP/EA are draft compatibility determinations for fishing; wildlife observation and photography; environmental education and interpretation; high-speed boating; recreational boating associated with hunting, fishing, wildlife observation and photography; research; plant gathering; and mosquito monitoring and control.

DATES: Written comments must be received at the address below by October 28, 2006. In addition, two public meetings will be held on October 4 and October 5, 2006 from 7 p.m. to 9 p.m. in California.

ADDRESSES: For more information on obtaining documents and submitting comments, see "Review and Comment" under **SUPPLEMENTARY INFORMATION**. For public meeting location see "Public Meetings."

FOR MORE INFORMATION CONTACT: Tom Harvey, Project Leader at the Stone Lakes NWR address under "Review and Comment" or David Bergendorf, Refuge Planner, at the CA/NV Refuge Planning Office address under "Review and Comment" or at (916) 414-6503 (telephone).

SUPPLEMENTARY INFORMATION: This Draft CCP/EA, prepared pursuant to the National Wildlife Refuge System Administration Act of 1966, as amended by the National Wildlife Refuge Improvement Act of 1997 (16 U.S.C. 668dd *et seq.*) as amended and the National Environmental Policy Act of 1969 (42 U.S.C. 4321-4347) as amended, describes the Service's proposal for managing the Refuge for the next 15 years.

Review and Comment

Copies of the Draft CCP/EA may be obtained by writing to the U.S. Fish and Wildlife Service, Attn: David Bergendorf, CA/NV Refuge Planning Office, 2800 Cottage Way, W-1832, Sacramento, CA 95825-1846. Copies of the Draft CCP/EA may be viewed at this address or at Stone Lakes National Wildlife Refuge, 1624 Hood-Franklin Road, Elk Grove, CA 95758. The Draft CCP/EA will also be available for viewing and downloading online at <http://www.fws.gov/stonelakes/publicreview.htm>. Printed documents will also be available for review at the following libraries: Sacramento Central Library, 828 I Street, Sacramento, CA 95814; Arden-Dimick Library, 891 Watt Avenue, Sacramento, CA 95864; Belle Cooledge Library, 5600 South Land Park Drive, Sacramento, CA 95822; Elk Grove Library, 8962 Elk Grove Blvd., Elk Grove, CA 95624; Clarksburg Yolo County Library, 52915 Netherlands Road, Clarksburg, CA 95612; Colonial Heights Library, 4799 Stockton Blvd., Sacramento, CA 95820; Courtland Library Neighborhood Library, 170 Primasing Avenue, Courtland, CA 95615; and the Galt Branch Library (Marian O. Lawrence Library), 1000 Caroline Avenue, Galt, CA 95632.

Comments on the Draft CCP/EA should be addressed to: David

Bergendorf, Refuge Planner, 2800 Cottage Way, W-1832, Sacramento, CA 95825-1846. Comments may also be faxed to (916) 414-6497 or submitted via electronic mail to david_bergendorf@fws.gov. If submitting comments by fax, please address to Attn: David Bergendorf, re: Stone Lakes NWR CCP. If submitting electronic mail, please type "Stone Lakes NWR CCP" in the subject line.

Public Meetings

Our two public meetings will take place at the Elk Grove Community Services District, Administration Building, boardroom located at 8820 Elk Grove Blvd., Elk Grove, CA 95624.

Background

The Refuge was established in 1994 under the authority of the Emergency Wetlands Resources Act of 1986, the Fish and Wildlife Act of 1956, the Migratory Bird Conservation Act and the Endangered Species Act of 1973. The Refuge boundary encompasses 17,600 acres; this includes a core Refuge area of about 9,000 acres and a 9,000-acre cooperative Wildlife Management Area that encompasses land managed by other agencies in concert with Refuge purposes. The Service actively manages about 6,000 acres. The Refuge is located in the Beach-Stone Lakes Basin within the Sacramento Valley in southwestern Sacramento County; it lies about 10 miles south of the city of Sacramento, straddling Interstate 5 from the town of Freeport south to Lost Slough.

Purpose and Need for Action

The Service prepared the Stone Lakes NWR Draft CCP to guide management of wildlife, other natural resources, and public use on the Refuge for the next 15 years. The CCP is flexible; it will be revised periodically to ensure that its goals, objectives, implementation strategies and timetables remain valid and appropriate. Major revisions require and provide a process for public involvement and National Environmental Policy Act (NEPA) review, if needed.

Alternatives

The draft EA/CCP presents an evaluation of the environmental effects of three alternatives for managing the Stone Lakes National Wildlife Refuge for the next 15 years. The Service proposes to implement Alternative B, as described in the EA. Alternative B best achieves the Refuges' purposes, vision, and goals; contributes to the Refuge System mission; addresses the significant issues and relevant mandates; and is consistent with

principles of sound fish and wildlife management. This alternative is described in more detail in the CCP.

There are many features of proposed Refuge management that are common to all three alternatives. Features common to all alternatives include ongoing coordination with the Sacramento/Yolo Mosquito and Vector Control District on mosquito control, ongoing weed management including coordination with the Stone Lakes Water Hyacinth Control Group, implementation of a hunt program, vernal pool management, boating access with a no-wake zone on all Refuge waters, and riparian habitat maintenance and restoration. There are also many features of each alternative that are distinct.

Alternative A, the no action alternative, assumes no change from current management programs and is considered the baseline to compare other alternatives against. Under Alternative A, the primary management focus of the Refuge would continue to be providing habitat for migrating, wintering and nesting migratory and resident birds with an emphasis on waterbirds and endangered species by restoring and maintaining wetland, riparian woodland and grassland habitats, and valuable agricultural lands. The Refuge would continue to offer limited wildlife-dependent recreation, including volunteer participation in restoration, limited wildlife observation and photography, limited environmental education and interpretative programs, and hunting, with emphasis on youth and disabled hunters.

Under Alternative B, the Refuge would continue its current focus of providing wintering habitat for migratory birds and management to benefit endangered species. Management programs for migratory birds and other Central Valley wildlife would be expanded and improved and public use opportunities would also be expanded. The number of units open to the public would increase from one to five. In addition, environmental education, interpretation, wildlife observation, wildlife photography, hunting, and fishing programs would be expanded.

Under Alternative C, the Refuge would continue to focus on providing wintering habitat for migratory birds and managing for endangered species while placing a greater emphasis on historic conditions in management and habitat restoration activities. Opportunities for the six priority public uses: Hunting, fishing, wildlife observation and photography, environmental education and

interpretation, would be expanded beyond both Alternatives A and B.

Public Comments

After the review and comment period ends for this Draft CCP/EA, comments will be analyzed by the Service and addressed in the Final CCP. All comments received from individuals, including names and addresses, become part of the official public record and may be released. Requests for such comments will be handled in accordance with the Freedom of Information Act, the Council on Environmental Quality's NEPA regulations, and other Service and Departmental policies and procedures.

Dated: July 31, 2006.

Margaret T. Kolar,

Acting Manager, California/Nevada Operations, Sacramento, California.

[FR Doc. 06-8159 Filed 9-22-06; 8:45 am]

BILLING CODE 4310-55-P

DEPARTMENT OF THE INTERIOR

Bureau of Land Management

[WY-920-1320-EL, WYW173097]

Notice of Invitation for Coal Exploration License Application, Wyoming

AGENCY: Bureau of Land Management, Interior.

ACTION: Notice of Invitation for Coal Exploration License Application, Ark Land Company, WYW173097, Wyoming.

SUMMARY: Pursuant to section 2(b) of the Mineral Leasing Act of 1920, as amended by section 4 of the Federal Coal Leasing Amendments Act of 1976, 90 Stat. 1083, 30 U.S.C. 201 (b), and to the regulations adopted as 43 Code of Federal Regulations (CFR) 3410, all interested qualified parties, as provided in 43 CFR 3472.1, are hereby invited to participate with Ark Land Company on a pro rata cost sharing basis in a program for the exploration of coal deposits owned by the United States of America in the following-described lands in Campbell County, Wyoming:

T. 46 N., R. 70 W., 6th P.M., Wyoming,
Sec. 18: Lots 7 through 10, 14 through 17;
Sec. 19: Lots 7 through 10, 15 through 18;
Sec. 30: Lots 5 through 20;
Sec. 31: Lots 1, 5 through 19;
Sec. 32: Lots 5 through 8, 11 through 14.

Containing 2,274.14 acres, more or less.

DATES: Any party electing to participate in this exploration program must send written notice to both the Bureau of Land Management and Ark Land Company, as provided in the **ADDRESSES**

section below, which must be received within 30 days after publication of this Notice of Invitation in the **Federal Register**.

ADDRESSES: Copies of the exploration plan are available for review during normal business hours in the following offices (serialized under number WYW173097): Bureau of Land Management, Wyoming State Office, 5353 Yellowstone Road, P.O. Box 1828, Cheyenne, WY 82003; and, Bureau of Land Management, Casper Field Office, 2987 Prospector Drive, Casper, WY 82604. The written notice should be sent to the following addresses: Ark Land Company, *Attn:* Mike Lincoln, P.O. Box 460, Hanna, WY 82327, and the Bureau of Land Management, Wyoming State Office, Branch of Solid Minerals, *Attn:* Mavis Love, P.O. Box 1828, Cheyenne, WY 82003.

SUPPLEMENTARY INFORMATION: All of the coal in the above-described land consists of unleased Federal coal within the Powder River Basin Known Coal Leasing Area. The purpose of the exploration program is to gain additional knowledge of the coal underlying the exploration area for the purpose of assessing the reserves contained in a potential lease.

This notice of invitation will be published in The News-Record of Gillette, WY, once each week for two consecutive weeks beginning the week of August 28, 2006, and in the **Federal Register**.

The foregoing is published in the **Federal Register** pursuant to 43 CFR 3410.2-1(c)(1).

Dated: August 14, 2006.

Alan Rabinoff,

Deputy State Director, Minerals and Lands.
[FR Doc. E6-15218 Filed 9-22-06; 8:45 am]

BILLING CODE 4310-22-P

Park Service, 1849 C St., NW., 2280, Washington, DC 20240; by all other carriers, National Register of Historic Places, National Park Service, 1201 Eye St., NW., 8th floor, Washington DC 20005; or by fax, 202-371-6447. Written or faxed comments should be submitted by October 10, 2006.

John W. Roberts,

Acting Chief, National Register/National Historic Landmarks Program.

ALABAMA

Jefferson County

Birmingham Civil Rights Historic District, (Civil Rights Movement in Birmingham, Alabama MPS), Roughly bounded 9th Ave., Richard Arrington Jr. Blvd., 1st Ave. and 14th St., Birmingham, 06000940

ARKANSAS

Ashley County

Portland United Methodist Church, 300 N. Main St., Portland, 06000942

Pulaski County

Stift Station Historic District, Bounded by W. Markham, W. 7th, Woodrow and Martin Sts., Little Rock, 06000941

NEW JERSEY

Cape May County

Brandywine Shoal Light Station, (Light Stations of the United States MPS) In lower Delaware Bay, about 8.8 mi. WNW of Cape May Point, Cape May Point, 06000943

OREGON

Multnomah County

Seufert House, 1511 Knott St., Portland, 06000944

WISCONSIN

Barron County

Stebbins, Edward N. and Mary T., House, 130 E. Division Ave., Barron, 06000945

[FR Doc. 06-8145 Filed 9-22-06; 8:45 am]

BILLING CODE 4312-51-P

Reclamation announces that the Council will meet as detailed below.

Dates and Location: The Council will conduct its annual meeting at the following time and location:

Wednesday, October 25, 2006—

Scottsdale AZ—The meeting will be held at the Chaparral Suites Resort, 5001 North Scottsdale Road. The meeting will begin at 8 a.m., recess at approximately 1 p.m., and reconvene briefly the following day at 1 p.m.

ADDRESSES: The meeting of the Council is open to the public. Any member of the public may file written statements with the Council before, during, or up to 30 days after the meeting, in person or by mail. To the extent that time permits, the Council chairman will allow public presentation of oral comments at the meeting. To allow full consideration of information by Council members, written notice must be provided to Kib Jacobson, Bureau of Reclamation, Upper Colorado Regional Office, 125 South State Street, Room 6107, Salt Lake City, Utah 84138-1147; telephone (801) 524-3753; faxogram (801) 524-3826; e-mail at: kjacobson@uc.usbr.gov at least FIVE (5) days prior to the meeting. Any written comments received prior to the meeting will be provided to Council members at the meeting.

SUPPLEMENTARY INFORMATION: The purpose of the meeting will be to discuss the accomplishments of Federal agencies and make recommendations on future activities to control salinity. Council members will be briefed on the status of salinity control activities and receive input for drafting the Council's annual report. The Bureau of Reclamation, Bureau of Land Management, U.S. Fish and Wildlife Service, and United States Geological Survey of the Department of the Interior; the Natural Resources Conservation Service of the Department of Agriculture; and the Environmental Protection Agency will each present a progress report and a schedule of activities on salinity control in the Colorado River Basin. The Council will discuss salinity control activities and the contents of the reports.

Public Disclosure

It is our practice to make comments, including names, home addresses, home telephone numbers, and e-mail addresses of respondents, available for public review. Individual respondents may request that we withhold their names and/or home addresses, *etc.*, but if you wish us to consider withholding this information you must state this prominently at the beginning of your

DEPARTMENT OF THE INTERIOR

National Park Service

National Register of Historic Places; Notification of Pending Nominations and Related Actions

Nominations for the following properties being considered for listing or related actions in the National Register were received by the National Park Service before September 9, 2006. Pursuant to § 60.13 of 36 CFR Part 60 written comments concerning the significance of these properties under the National Register criteria for evaluation may be forwarded by United States Postal Service, to the National Register of Historic Places, National

DEPARTMENT OF THE INTERIOR

Bureau of Reclamation

Colorado River Basin Salinity Control Advisory Council

AGENCY: Bureau of Reclamation, Interior.

ACTION: Notice of Public Meeting.

SUMMARY: The Colorado River Basin Salinity Control Advisory Council (Council) was established by the Colorado River Basin Salinity Control Act of 1974 (Pub. L. 93-320) (Act) to receive reports and advise Federal agencies on implementing the Act. In accordance with the Federal Advisory Committee Act, the Bureau of

comments. In addition, you must present a rationale for withholding this information. This rationale must demonstrate that disclosure would constitute a clearly unwarranted invasion of privacy. Unsupported assertions will not meet this burden. In the absence of exceptional, documentable circumstances, this information will be released. We will always make submissions from organizations or businesses, and from individuals identifying themselves as representatives or officials of organizations or businesses, available for public inspection in their entirety.

FOR FURTHER INFORMATION CONTACT: Kib Jacobson, telephone (801) 524-3753; faxogram (801) 524-3826; e-mail at: kjacobson@uc.usbr.gov.

Dated: August 23, 2006.

Darryl Beckmann,

*Deputy Regional Director—UC Region,
Bureau of Reclamation.*

[FR Doc. 06-8160 Filed 9-22-06; 8:45 am]

BILLING CODE 4310-MN-P

INTERNATIONAL TRADE COMMISSION

[Investigation Nos. 731-TA-703 and 705 (Second Review)]

Furfuryl Alcohol From China and Thailand

Determinations

On the basis of the record¹ developed in the subject five-year reviews, the United States International Trade Commission (Commission) determines, pursuant to section 751(c) of the Tariff Act of 1930 (19 U.S.C. 1675(c)) (the Act), that revocation of the antidumping duty orders on furfuryl alcohol from China and Thailand would be likely to lead to continuation or recurrence of material injury to an industry in the United States within a reasonably foreseeable time.

Background

The Commission instituted these reviews on April 3, 2006 (71 FR 16587) and determined on July 7, 2006 that it would conduct expedited reviews (71 FR 41469, July 21, 2006). Notice of the scheduling of the Commission's reviews was given by posting copies of the notice in the Office of the Secretary, U.S. International Trade Commission, Washington, DC, and by publishing the notice in the **Federal Register** on July 21, 2006 (71 FR 41469).

¹ The record is defined in sec. 207.2(f) of the Commission's Rules of Practice and Procedure (19 CFR 207.2(f)).

The Commission transmitted its determinations in these reviews to the Secretary of Commerce on September 15, 2006. The views of the Commission are contained in USITC Publication 3885 (September 2006), entitled *Furfuryl Alcohol from China and Thailand: Investigation Nos. 731-TA-703 and 705 (Second Review)*.

Issued: September 20, 2006.

By order of the Commission.

Marilyn R. Abbott,

Secretary to the Commission.

[FR Doc. 06-8170 Filed 9-22-06; 8:45 am]

BILLING CODE 7020-02-P

INTERNATIONAL TRADE COMMISSION

[Investigation Nos. 701-TA-442-443 and 731-TA-1095-1097 (Final)]

Certain Lined Paper School Supplies From China, India, and Indonesia

Determination

On the basis of the record¹ developed in the subject investigations, the United States International Trade Commission (Commission) determines, pursuant to sections 705(b) and 735(b) of the Tariff Act of 1930 (19 U.S.C. 1671d(b) and 1673d(b)) (the Act), that an industry in the United States is materially injured by reason of imports from India and Indonesia of certain lined paper school supplies that have been found by the Department of Commerce (Commerce) to be subsidized by the Governments of India and Indonesia, and by reason of imports from China, India, and Indonesia of certain lined paper school supplies that have been found by Commerce to be sold in the United States at less than fair value (LTFV).² The Commission finds that critical circumstances do not exist with respect to subject imports from China and Indonesia.

Background

The Commission instituted these investigations effective September 9, 2005, following receipt of a petition filed with the Commission and Commerce by MeadWestvaco Corp., Dayton, OH; Norcom, Inc., Norcross, GA; and Top Flight, Inc., Chattanooga,

¹ The record is defined in sec. 207.2(f) of the Commission's Rules of Practice and Procedure (19 CFR 207.2(f)).

² Chairman Daniel R. Pearson and Commissioners Jennifer A. Hillman and Deanna Tanner Okun dissented, determining that an industry in the United States is threatened with material injury by reason of subject imports from China, but is neither materially injured nor threatened with material injury by reason of subject imports from India and Indonesia.

TN (collectively, the Association of American School Paper Suppliers). The final phase of the investigations was scheduled by the Commission following notification of a preliminary determination by Commerce that imports of certain lined paper school supplies from Indonesia were being subsidized within the meaning of section 703(b) of the Act (19 U.S.C. 1671b(b)). Notice of the scheduling of the final phase of the Commission's investigations and of a public hearing to be held in connection therewith was given by posting copies of the notice in the Office of the Secretary, U.S. International Trade Commission, Washington, DC, and by publishing the notice in the **Federal Register** of April 7, 2006 (71 FR 17914). On May 30, 2006, the Commission published notice of a revised schedule and public hearing date (71 FR 30694). The hearing was held in Washington, DC, on July 25, 2006, and all persons who requested the opportunity were permitted to appear in person or by counsel.

The Commission transmitted its determinations in these investigations to the Secretary of Commerce on September 21, 2006. The views of the Commission are contained in USITC Publication 3884 (September 2006), entitled *Certain Lined Paper School Supplies From China, India, and Indonesia: Investigation Nos. 701-TA-442-443 and 731-TA-1095-1097 (Final)*.

Issued: September 20, 2006.

By order of the Commission.

Marilyn R. Abbott,

Secretary to the Commission.

[FR Doc. 06-8171 Filed 9-22-06; 8:45 am]

BILLING CODE 7020-02-P

DEPARTMENT OF JUSTICE

[OMB Number 1105-0080]

Civil Division; Agency Information Collection Activities: Proposed Collection; Comments Requested

ACTION: 30-Day Notice of Information Collection Under Review: Annuity Broker Qualification Declaration Form.

The Department of Justice (DOJ), Civil Division, has submitted the following information collection request to the Office of Management and Budget (OMB) for review and approval in accordance with the Paperwork Reduction Act of 1995. The proposed information collection is published to obtain comments from the public and affected agencies. This proposed information collection was previously

published in the **Federal Register** Volume 71, Number 150, page 44313–44314 on August 4, 2006, allowing for a 60-day comment period.

The purpose of this notice is to allow for an additional 30 days for public comment until October 25, 2006. This process is conducted in accordance with 5 CFR 1320.10.

Written comments and/or suggestions regarding the items contained in this notice, especially the estimated public burden and associated response time, should be directed to the Office of Management and Budget, Office of Information and Regulatory Affairs, Attention Department of Justice Desk Officer, Washington, DC 20503. Additionally, comments may be submitted to OMB via facsimile to (202) 395–5806. Written comments and suggestions from the public and affected agencies concerning the proposed collection of information are encouraged. Your comments should address one or more of the following four points:

- Evaluate whether the proposed collection of information is necessary for the proper performance of the functions of the agency, including whether the information will have practical utility;
- Evaluate the accuracy of the agencies estimate of the burden of the proposed collection of information, including the validity of the methodology and assumptions used;
- Enhance the quality, utility, and clarity of the information to be collected; and
- Minimize the burden of the collection of information on those who are to respond, including through the use of appropriate automated, electronic, mechanical, or other technological collection techniques or other forms of information technology, e.g., permitting electronic submission of responses.

Overview of This Information Collection

(1) *Type of Information Collection:* Extension, without change, of a currently approved collection.

(2) *Title of the Form/Collection:* Annuity Broker Qualification Declaration Form.

(3) *Agency form number, if any, and the applicable component of the Department sponsoring the collection:* The Civil Division, United States Department of Justice is sponsoring the collection.

(4) *Affected public who will be asked or required to respond, as well as a brief abstract:* Primary: Individuals. This declaration is to be submitted annually

to determine whether a broker meets the qualifications to be listed as an annuity broker pursuant to Section 11015(b) of Public Law 107–273.

(5) *An estimate of the total number of respondents and the amount of time estimated for an average respondent to respond:* It is estimated that 400 respondents will complete the form annually within approximately 1 hour.

(6) *An estimate of the total public burden (in hours) associated with the collection:* There are an estimated 400 total annual burden hours associated with this collection.

If additional information is required contact: Lynn Bryant, Department Clearance Officer, United States Department of Justice, Justice Management Division, Policy and Planning Staff, Patrick Henry Building, Suite 1600, 601 D Street, NW., Washington, DC 20530.

Dated: September 19, 2006.

Lynn Bryant,

Department Clearance Officer, Department of Justice.

[FR Doc. 06–8130 Filed 9–22–06; 8:45 am]

BILLING CODE 4410–12–P

DEPARTMENT OF JUSTICE

[OMB Number 1122–0006]

Office on Violence Against Women; Agency Information Collection Activities: Revision of a Currently Approved Collection

ACTION: 60-Day Notice of Information Collection Under Review: Semi-Annual Progress Report for the Grants to Encourage Arrest Policies and Enforcement of Protection Orders Program.

The Department of Justice, Office on Violence Against Women (OVW) has submitted the following information collection request to the Office of Management and Budget (OMB) for review and approval in accordance with the Paperwork Reduction Act of 1995. Comments are encouraged and will be accepted for “sixty days” until November 24, 2006. This process is conducted in accordance with 5 CFR 1320.10.

Written comments and/or suggestions regarding the items contained in this notice, especially the estimated public burden and associated response time, should be directed to the Office of Management and Budget, Office of Information and Regulatory Affairs, Attention Department of Justice Desk Officer, Washington, DC 20503. Additionally, comments may be

submitted to OMB via facsimile to (202) 395–5806.

Written comments and suggestions from the public and affected agencies concerning the proposed collection of information are encouraged. Your comments should address one or more of the following four points:

(1) Evaluate whether the proposed collection of information is necessary for the proper performance of the functions of the agency, including whether the information will have practical utility;

(2) Evaluate the accuracy of the agency’s estimate of the burden of the proposed collection of information, including the validity of the methodology and assumptions used;

(3) Enhance the quality, utility, and clarity of the information to be collected; and

(4) Minimize the burden of the collection of information on those who are to respond, including through the use of appropriate automated, electronic, mechanical, or other technological collection techniques or other forms of information technology, e.g., permitting electronic submission of responses.

Overview of This Information Collection

(1) *Type of Information Collection:* Revision of a currently approved collection

(2) *Title of the Form/Collection:* Semi-Annual Progress Report for Grants to Encourage Arrest Policies and Enforcement of Protection Orders Program

(3) *Agency form number, if any, and the applicable component of the Department sponsoring the collection:* Form Number: 1122–0006. U.S. Department of Justice, Office on Violence Against Women

(4) *Affected public who will be asked or required to respond, as well as a brief abstract:* The affected public includes the approximately 200 grantees of the Grants to Encourage Arrest Policies and Enforcement of Protection Orders Program (Arrest Program) whose eligibility is determined by statute. The Arrest Program was authorized through the Violence Against Women Act (VAWA) and reauthorized and amended by the Violence Against Women Act of 2000 (VAWA 2000) and by the Violence Against Women Act of 2005 (VAWA 2005). The Arrest Program promotes mandatory or pro-arrest policies and encourages jurisdictions to treat domestic violence and sexual assault as a serious crime, establish coordinated community responses and facilitate the enforcement of protection orders. By

statute, eligible grantees for the Arrest Program are States, Indian tribal governments, State and local courts including juvenile courts, tribal courts, and units of local government. For the purpose of this Program, a unit of local government is any city, county, township, town, borough, parish, village, or other general-purpose political subdivision of a State; an Indian tribe that performs law enforcement functions as determined by the Secretary of Interior; or, for the purpose of assistance eligibility, any agency of the District of Columbia government or the United States Government performing law enforcement functions in and for the District of Columbia, and any Trust Territory of the U.S.

(5) *An estimate of the total number of respondents and the amount of time estimated for an average respondent to respond:* It is estimated that it will take the 200 respondents (Arrest Program grantees) approximately one hour to complete a semi-annual progress report. The semi-annual progress report is divided into sections that pertain to the different types of activities that grantees may engage in, i.e. training or developing a protection order registry, and the different types of grantees that receive funds, i.e. law enforcement agencies, prosecutors' offices, courts, victim services agencies, etc. An Arrest Program grantee will only be required to complete those sections of the form that pertain to their own specific activities.

(6) *An estimate of the total public burden (in hours) associated with the collection:* The total annual hour burden to complete the data collection forms is 400 hours, that is 200 grantees completing a form twice a year with an estimate completion time for the form being one hour.

If additional information is required contact: Lynn Bryant, Clearance Officer, United States Department of Justice, Justice Management Division, Policy and Planning Staff, Suite 1600, Patrick Henry Building, 601 D Street, NW., Washington, DC 20530.

Dated: September 19, 2006.

Lynn Bryant,

Department Clearance Officer, United States Department of Justice.

[FR Doc. 06-8131 Filed 9-22-06; 8:45 am]

BILLING CODE 4410-FX-P

LEGAL SERVICES CORPORATION

Sunshine Act Meeting of the Board of Directors

Amended Notice

Changes to the Agenda and Reconvening of Meeting

Notice: The Legal Services Corporation (LSC) is announcing amendments to the notice of the September 18, 2006 meeting of the Board of Directors (Board). This meeting was announced in the **Federal Register** dated September 12, 2006, Volume 71, Number 176. The amendment is being made to reflect a change to the meeting Agenda. Notice is also being given of the reconvening of the Board's meeting.

Reconvening of Meeting

There being insufficient time for the Board to conclude its business on September 18, 2006, the Board voted to recess the meeting and reconvene on Friday, September 22, 2006, at which time it will meet telephonically until its business is concluded.

Times and Date(s): At 9 a.m., on Friday, September 22, 2006, the Legal Services Corporation Board of Directors will reconvene the meeting recessed on September 18, 2006. The meeting will be by telephone. Members of the public wishing to attend the meeting in person may do so by coming to the Corporation's 3rd floor Conference Center at the address given below. The call-in information for members of the public wishing to participate in the meeting by telephone follows.

Toll-free number: 1-888-323-2717.

Call Leader: Patricia Batie.

Pass Code: Victor Fortuno.

Location: The Legal Services Corporation, 3rd Floor Conference Center, 3333 K Street, NW., Washington, DC.

Status of Meetings: Open, except as noted below.

- *Status:* Board of Directors Meeting—Open, except that a portion of the meeting of the Board of Directors may be closed to the public pursuant to a vote of the Board of Directors. At the closed session, the Board will receive briefings¹ from the Inspector General on the investigation requested by Congressmen Enzi, Grassley and Cannon, and a separate briefing from LSC management on the same matter. The closing will be authorized by the relevant provisions of the Government in the Sunshine Act [5 U.S.C. 552b(c)(9)(b)] and the Legal Services

Corporation's corresponding regulation, 45 CFR 1622.5(g).

Amended Agenda

During the September 18, 2006 meeting of the Board of Directors, the agenda was amended as indicated below. Changes appear in italicized, bold print.

Open Session

1. Approval of agenda.
2. Approval of minutes of the Board's meeting of July 29, 2006.
3. Approval of minutes of the Executive Session of the Board's meeting of July 29, 2006.
4. Consider and act on Staff report on document requests dated April 12, 2006, June 19, 2006 and August 8, 2006 that were received from Congress and LSC's responses thereto.
5. Consider and act on Staff report on the CBS News story of August 13, 2006 and the Associated Press story of August 14, 2006 and LSC's response(s) thereto.
6. Chairman's report.
7. Consider and act on report of the Board's Finance Committee.
8. Consider and act on other business.
9. Consider and act on whether to authorize the Chairman of the Board, after consultation with the Board's Vice Chairman and the Chairman of the Board's Finance Committee, to communicate to the Congress the Board's view of H.R. 5974.
10. Public comment.
11. Consider and act on whether to authorize non-public briefings of the Board and discussion by the Board as per the items listed below under Closed Session.

Closed Session

12. Briefing by the OIG on status of CRLA investigation.
 13. Briefing by management on CRLA referral issues.
 14. Briefing by the OIG on status of the investigation requested by Chairmen Enzi, Grassley and Cannon.
 15. Briefing by LSC Management on the investigation requested by Chairmen Enzi, Grassley and Cannon.
 16. Discussion of above briefings.
 17. Briefing on recent developments in litigation involving the Corporation.
 18. Consider and act on motion to adjourn meeting.
- The agenda amendments to the agenda were authorized by a majority vote of the Board of Directors as indicated below.

¹ Any portion of the closed session consisting solely of staff briefings does not fall within the Sunshine Act's definition of the term "meeting"

and, therefore, the requirements of the Sunshine Act do not apply to such portion of the closed

session. 5 U.S.C. 552(b)(a)(2) and (b). See also 45 CFR 1622.2 & 1622.3

RECORD OF VOTES

Member	Yes	No	Absent
Lillian BeVier	Yes		Absent
Jonann Chiles	Yes .....	.....	
Thomas Fuentes	Yes .....	.....	
Herbert Garten	Yes .....	.....	
David Hall .....	.....	.....	
Michael McKay	Yes .....	.....	
Thomas Meites	Yes .....	.....	
Bernice Phillips	Yes .....	.....	
Sarah Singleton	Yes .....	.....	
Frank Strickland	Yes .....	.....	

The following agenda reflects only those items from the original agenda for September 18, 2006, as amended, that will be considered by the Board on September 22, 2006.

Matters to Be Considered on Friday, September 22, 2006

Board of Directors

Open Session

1. Approval of Agenda.

11. Consider and act on whether to authorize non-public briefings of the Board and discussion by the Board as per the items listed below under Closed Session.

Closed Session

14. Briefing by the OIG on status of the investigation requested by Chairmen Enzi, Grassley and Cannon.

15. Briefing by LSC Management on the investigation requested by Chairmen Enzi, Grassley and Cannon.

16. Discussion of above briefings.

Open Session

18. Consider and act on closed session briefings regarding the investigation requested by Chairmen Enzi, Grassley and Cannon.

19. Consider and act on motion to adjourn meeting.

Contact Person For Information:
Patricia D. Batie, Manager of Board Operations, at (202) 295-1500.

Special Needs: Upon request, meeting notices will be made available in alternate formats to accommodate visual and hearing impairments. Individuals who have a disability and need an accommodation to attend the meeting may notify Patricia D. Batie, at (202) 295-1500.

Dated: September 20, 2006.

Victor M. Fortuno,

Vice President for Legal Affairs, General Counsel & Corporate Secretary.

[FR Doc. 06-8204 Filed 9-20-06; 4:57 pm]

BILLING CODE 7050-01-P

NUCLEAR REGULATORY COMMISSION

[Docket No. 50-285]

Omaha Public Power District Notice of Withdrawal of Application for Amendment to Facility Operating License

The U.S. Nuclear Regulatory Commission (the Commission) has granted the request of Omaha Public Power District (the licensee) to withdraw its May 14, 2004, application for proposed amendment to Facility Operating License No. DPR-40 for the Fort Calhoun Station, Unit No. 1 (FCS), located in Washington County, Nebraska.

The proposed amendment would have revised the Technical Specifications Section 2.3(2)b, "Modification of Minimum Requirements." Specifically, the proposed change would have provided a risk-informed alternative to the existing restoration period for the High-Pressure Safety Injection System.

The Commission had previously issued a Notice of Consideration of Issuance of Amendment published in the **Federal Register** on July 6, 2004 (69 FR 40677). However, by letter dated August 25, 2006, the licensee withdrew the proposed change.

For further details with respect to this action, see the application for amendment dated May 14, 2004, and the licensee's letter dated August 25, 2006, which withdrew the application for license amendment. Documents may be examined, and/or copied for a fee, at the NRC's Public Document Room (PDR), located at One White Flint North, Public File Area O1 F21, 11555 Rockville Pike (first floor), Rockville, Maryland. Publicly available records will be accessible electronically from the Agencywide Documents Access and Management Systems (ADAMS) Public Electronic Reading Room on the internet at the NRC Web site, <http://www.nrc.gov/reading-rm.html>. Persons

who do not have access to ADAMS or who encounter problems in accessing the documents located in ADAMS should contact the NRC PDR Reference staff by telephone at 1-800-397-4209, or 301-415-4737 or by e-mail to pdr@nrc.gov.

Dated at Rockville, Maryland, this 8th day of September 2006.

For the Nuclear Regulatory Commission.

Alan B. Wang,

Project Manager, Plant Licensing Branch IV, Division of Operating Reactor Licensing, Office of Nuclear Reactor Regulation.

[FR Doc. 06-8153 Filed 9-22-06; 8:45 am]

BILLING CODE 7590-01-P

NUCLEAR REGULATORY COMMISSION

Notice of Opportunity To Comment on Model Application on Technical Specification Improvement To Modify Requirements Regarding LCO 3.10.1, Inservice Leak and Hydrostatic Testing Operation Using the Consolidated Line Item Improvement Process

AGENCY: Nuclear Regulatory Commission.

ACTION: Request for comment.

SUMMARY: Notice is hereby given that the staff of the Nuclear Regulatory Commission (NRC) has prepared a model licensee application relating to the modification of shutdown testing requirements in technical specifications (TS) for Boiling Water Reactors (BWR). The purpose of this model is to permit the NRC to efficiently process amendments that propose to modify LCO 3.10.1 that would allow control rod scram time testing to be performed concurrently with inservice leak and hydrostatic testing. Licensees of nuclear power reactors to which the model applies could then request amendments, confirming the applicability to their reactors. The NRC staff is requesting comment on the model application prior to announcing its availability for license amendment applications. A model

safety evaluation and no significant hazards determination regarding the proposed changes to LCO 3.10.1 have been previously posted in the **Federal Register** for comment on August 21, 2006 (71 FR 48561).

DATES: The comment period expires October 25, 2006. Comments received after this date will be considered if it is practical to do so, but the Commission is able to ensure consideration only for comments received on or before this date.

ADDRESSES: Comments may be submitted either electronically or via U.S. mail. Submit written comments to Chief, Rulemaking, Directives, and Editing Branch, Division of Administrative Services, Office of Administration, Mail Stop: T-6 D59, U.S. Nuclear Regulatory Commission, Washington, DC 20555-0001. Hand deliver comments to: 11545 Rockville Pike, Rockville, Maryland, between 7:45 a.m. and 4:15 p.m. on Federal workdays. Copies of comments received may be examined at the NRC's Public Document Room, 11555 Rockville Pike (Room O-1F21), Rockville, Maryland. Comments may be submitted by electronic mail to NRCREP@nrc.gov.

FOR FURTHER INFORMATION CONTACT: Tim Kobetz, Mail Stop: O-12H2, Division of Inspections and Regional Support, Office of Nuclear Reactor Regulation, U.S. Nuclear Regulatory Commission, Washington, DC 20555-0001, telephone 301-415-1932.

SUPPLEMENTARY INFORMATION:

Background

Regulatory Issue Summary 2000-06, "Consolidated Line Item Improvement Process for Adopting Standard Technical Specification Changes for Power Reactors," was issued on March 20, 2000. The consolidated line item improvement process (CLIIP) is intended to improve the efficiency of NRC licensing processes by processing proposed changes to the standard technical specifications (STS) in a manner that supports subsequent license amendment applications. The CLIIP includes an opportunity for the public to comment on a proposed change to the STS after a preliminary assessment by the NRC staff and a finding that the change will likely be offered for adoption by licensees. A model safety evaluation and no significant hazards determination regarding the proposed changes to LCO 3.10.1 have been previously posted in the **Federal Register** for comment on August 21, 2006 (71 FR 48561). This notice solicits comment on a proposed model licensee application that would

modify LCO 3.10.1 to allow control rod scram time testing to be performed concurrently with inservice leak and hydrostatic testing.

Applicability

Licensees opting to apply for this TS change are responsible for reviewing the staff's evaluation, referencing the applicable technical justifications, and providing any necessary plant-specific information. Each amendment application made in response to the notice of availability will be processed and noticed in accordance with applicable rules and NRC procedures.

Public Notices

This notice requests comments from interested members of the public within 30 days of the date of publication in the **Federal Register**. After evaluating the comments received as a result of this notice, the staff will either reconsider the proposed change or announce the availability of the change in a subsequent notice (perhaps with some changes to the safety evaluation or the proposed no significant hazards consideration determination as a result of public comments). If the staff announces the availability of the change, licensees wishing to adopt the change must submit an application in accordance with applicable rules and other regulatory requirements. For each application the staff will publish a notice of consideration of issuance of amendment to facility operating licenses, a proposed no significant hazards consideration determination, and a notice of opportunity for a hearing. The staff will also publish a notice of issuance of an amendment to an operating license to announce the modification of TS 3.10.1, Inservice Leak and Hydrostatic Testing, for each plant that receives the requested change.

Proposed Model Application for License Amendments Adopting TSTF-484, Rev. 0, "Use of TS 3.10.1 for Scram Time Testing Activities"

U.S. Nuclear Regulatory Commission, Document Control Desk, Washington, DC 20555.

Subject: [Plant Name]

Docket No. 50—License Amendment Request for Adoption of TSTF-484, Rev. 0, "Use of TS 3.10.1 for Scram Time Testing Activities"

In accordance with the provisions of Section 50.90 of Title 10 of the Code of Federal Regulations (10 CFR), [Licensee] is submitting a request for an amendment to the technical specifications (TS) for [Plant Name, Unit No.].

The proposed amendment would revise LCO 3.10.1, and the associated Bases, to expand its scope to include provisions for temperature excursions greater than [200]°F as a consequence of inservice leak and hydrostatic testing, and as a consequence of scram time testing initiated in conjunction with an inservice leak or hydrostatic test, while considering operational conditions to be in Mode 4. This change is consistent with NRC approved Revision 0 to Technical Specification Task Force (TSTF) Improved Standard Technical Specification Change Traveler, TSTF-484, "Use of TS 3.10.1 for Scram Time Testing Activities". The availability of this TS improvement was announced in the **Federal Register** on [Date] ([] FR []) as part of the consolidated line item improvement process (CLIIP).

Attachment 1 provides an evaluation of the proposed change. Attachment 2 provides the existing TS pages marked up to show the proposed change. Attachment 3 provides the proposed TS changes in final typed format. Attachment 4 provides the existing Bases pages marked up to show the proposed change.

[Licensee] requests approval of the proposed license amendment by [Date], with the amendment being implemented [By Date or within X Days].

In accordance with 10 CFR 50.91, a copy of this application, with attachments, is being provided to the designated [State] Official.

If you should have any questions regarding this submittal, please contact [].

I declare under penalty of perjury under the laws of the United States of America that I am authorized by [Licensee] to make this request and that the foregoing is true and correct.

Executed on [Date].

[Name, Title]

Attachments: 1. Evaluation of Proposed Change
2. Proposed Technical Specification Change (Mark-Up)
3. Proposed Technical Specification Change (Re-Typed)
4. Proposed Technical Specification Bases Change (Mark-Up)
cc: [NRR Project Manager]
[Regional Office]
[Resident Inspector]
[State Contact]

Attachment 1—Evaluation of Proposed Change

License Amendment Request for Adoption of TSTF-484, Rev. 0, "Use of TS 3.10.1 for SCRAM Time Testing Activities"

1.0 Description

- 2.0 Proposed Change
- 3.0 Background
- 4.0 Technical Analysis
- 5.0 Regulatory Safety Analysis
- 5.1 No Significant Hazards Determination
- 5.2 Applicable Regulatory Requirements/ Criteria
- 6.0 Environmental Consideration
- 7.0 References

1.0 Description

The proposed amendment would revise LCO 3.10.1, and the associated Bases, to expand its scope to include provisions for temperature excursions greater than [200]°F as a consequence of inservice leak and hydrostatic testing, and as a consequence of scram time testing initiated in conjunction with an inservice leak or hydrostatic test, while considering operational conditions to be in Mode 4. This change is consistent with NRC approved Revision 0 to Technical Specification Task Force (TSTF) Improved Standard Technical Specification Change Traveler, TSTF-484, "Use of TS 3.10.1 for Scram Time Testing Activities." The availability of this TS improvement was announced in the **Federal Register** on [Date] ([] FR []) as part of the consolidated line item improvement process (CLIIP).

2.0 Proposed Change

Consistent with the NRC approved Revision 0 of TSTF-484, the proposed TS changes include a revised TS 3.10.1, "Inservice Leak and Hydrostatic Testing Operation." Proposed revisions to the TS Bases are also included in this application. Adoption of the TS Bases associated with TSTF-484, Revision 0 is an integral part of implementing this TS amendment. The changes to the affected TS Bases pages will be incorporated in accordance with the TS Bases Control Program.

This application is being made in accordance with the CLIIP. [Licensee] is not proposing variations or deviations from the TS changes described in TSTF-484, Revision 0, or the NRC staff's model safety evaluation (SE) published on [Date] ([] FR []) as part of the CLIIP Notice of Availability.

3.0 Background

The background for this application is adequately addressed by the NRC Notice of Availability published on [Date] ([] FR []).

4.0 Technical Analysis

[Licensee] has reviewed the safety evaluation (SE) published on [Date] ([] FR []) as part of the CLIIP Notice of Availability. [Licensee] has concluded that the technical justifications presented in the SE prepared by the NRC staff are applicable to [Plant, UNIT

No.] and therefore justify this amendment for the incorporation of the proposed changes to the [Plant] TS.

5.0 Regulatory Safety Analysis

5.1 No Significant Hazards Determination

[Licensee] has reviewed the no significant hazards determination published on [Date] ([] FR []) as part of the CLIIP Notice of Availability. [Licensee] has concluded that the determination presented in the notice is applicable to [Plant, Unit No.] and the determination is hereby incorporated by reference to satisfy the requirements of 10 CFR 50.91(a).

5.2 Applicable Regulatory Requirements/Criteria

A description of the proposed TS change and its relationship to applicable regulatory requirements was provided in the NRC Notice of Availability published on [Date] ([] FR []).

6.0 Environmental Consideration

[Licensee] has reviewed the environmental evaluation included in the safety evaluation (SE) published on [Date] ([] FR []) as part of the CLIIP Notice of Availability. [Licensee] has concluded that the staff's findings presented in that evaluation are applicable to [Plant, No.] and the evaluation is hereby incorporated by reference for this application.

7.0 References

1. **Federal Register** Notice, Notice of Availability published on [Date] ([] FR []).
2. **Federal Register** Notice, Notice for Comment published on August 21, 2006 (71 FR 48561)
3. TSTF-484 Revision 0, "Use of TS 3.10.1 for Scram Times Testing Activities"

Attachment 2—Proposed Technical Specification Change (Mark-Up)

Attachment 3—Proposed Technical Specification Change (Re-Typed)

Attachment 4—Proposed Technical Specification Bases Change (Mark-Up)

Principal Contributor: Aron Lewin.

Dated at Rockville, Maryland, this 30th of August 2006.

For the Nuclear Regulatory Commission.

Timothy Kobetz,

*Chief, Technical Specifications Branch,
Division of Inspections and Regional Support,
Office of Nuclear Reactor Regulation.*

[FR Doc. 06-8152 Filed 9-22-06; 8:45 am]

BILLING CODE 7590-01-P

OFFICE OF PERSONNEL MANAGEMENT

Submission for Omb Review; Comment Request for Reclearance of a Revised Information Collection: RI 30-9

AGENCY: Office of Personnel Management.

ACTION: Notice.

SUMMARY: In accordance with the Paperwork Reduction Act of 1995 (Pub. L. 104-13, May 22, 1995), this notice announces that the Office of Personnel Management (OPM) has submitted to the Office of Management and Budget (OMB) a request for reclearance of a revised information collection. RI 30-9, Reinstatement of Disability Annuity Previously Terminated Because of Restoration to Earning Capacity, informs former disability annuitants of their right to request restoration under title 5, U.S.C. Section 8337. It also specifies the conditions to be met and the documentation required for a person to request reinstatement.

Approximately 200 forms are completed annually. The form takes approximately 60 minutes to respond, including a medical examination. The annual estimated burden is 200 hours. Burden may vary depending on the time required for a medical examination.

For copies of this proposal, contact Mary Beth Smith-Toomey on (202) 606-8358, FAX (202) 418-3251 or via E-mail to MaryBeth.Smith-Toomey@opm.gov. Please include a mailing address with your request.

DATES: Comments on this proposal should be received within 30 calendar days from the date of this publication.

ADDRESSES: Send or deliver comments to—

Pamela S. Israel, Chief, Operations Support Group, Center for Retirement and Insurance Services, U.S. Office of Personnel Management, 1900 E Street, NW., Room 3349, Washington, DC 20415-3540. and

Brenda Aguilar, OPM Desk Officer, Office of Information & Regulatory Affair, Office of Management and Budget, New Executive Office Building, NW., Room 10235, Washington, DC 20503.

*For Information Regarding
Administrative Coordination—Contact:*
Cyrus S. Benson, Team Leader,
Publications Team, RIS Support
Services/Support Group, (202) 606-0623.

U.S. Office of Personnel Management.
Dan G. Blair,
Deputy Director.
 [FR Doc. 06-8139 Filed 9-22-06; 8:45 am]
 BILLING CODE 6325-38-P

OFFICE OF PERSONNEL MANAGEMENT

Submission for OMB Review; Comment Request for Review of a Revised Information Collection: RI 25-15

AGENCY: Office of Personnel
Management.

ACTION: Notice.

SUMMARY: In accordance with the Paperwork Reduction Act of 1995 (Pub. L. 104-13, May 22, 1995 and 5 CFR 1320), this notice announces that the Office of Personnel Management (OPM) has submitted to the Office of Management and Budget (OMB) a request for review of a revised information collection. RI 25-15, Notice of Change in Student's Status, is used to collect sufficient information from adult children of deceased Federal employees or annuitants to assure that the child continues to be eligible for payments from OPM.

Approximately 2,500 certifications are processed annually. Each form takes approximately 20 minutes to complete. The annual estimated burden is 835 hours.

For copies of this proposal, contact Mary Beth Smith-Toomey on (202) 606-8358, FAX (202) 418-3251 or E-mail to *MaryBeth.Smith-Toomey@opm.gov*. Please include your mailing address with your request.

DATES: Comments on this proposal should be received within 30 calendar days from the date of this publication.

ADDRESSES: Send or deliver comments to—

Pamela S. Israel, Chief, Operations Support Group, Center for Retirement and Insurance Services, U.S. Office of Personnel Management, 1900 E Street, NW., Room 3349, Washington, DC 20415-3540, and

Brenda Aguilar, OPM Desk Officer, Office of Information & Regulatory Affairs, Office of Management and Budget, New Executive Office Building, NW., Room 10235, Washington, DC 20503.

For Information Regarding Administrative Coordination Contact:

Cyrus S. Benson, Team Leader, Publications Team, RIS Support Services/Support Group, (202) 606-0623.

U.S. Office of Personnel Management.
Dan G. Blair,
Deputy Director.
 [FR Doc. 06-8144 Filed 9-22-06; 8:45 am]
 BILLING CODE 6325-38-P

POSTAL SERVICE

Changes in Domestic Mail Classifications

AGENCY: Postal Service.

ACTION: Notice of implementation of changes to the Domestic Mail Classification Schedule.

SUMMARY: This notice sets forth the changes to the Domestic Mail Classification Schedule to be implemented as a result of the Decision of the Governors of the United States Postal Service on the Opinion and Recommended Decision of the Postal Rate Commission on Extension of Capital One NSA, Docket No. MC2006-6.

DATES: *Effective Date:* September 13, 2006.

FOR FURTHER INFORMATION CONTACT: Matthew J. Connolly, (202) 268-8582.

SUPPLEMENTARY INFORMATION: On July 26, 2006 the United States Postal Service, in conformance with chapter 36 of the Postal Reorganization Act (39 U.S.C. 101 *et seq.*), filed a request for a recommended decision by the Postal Rate Commission (PRC) asking that it recommend a one-year extension of an existing negotiated service agreement (NSA) with Capital One Services, Inc. The PRC designated this filing as Docket No. MC2006-6. On August 25, 2006, pursuant to 39 U.S.C. 3624, the PRC issued to the Governors of the Postal Service its Opinion and Recommended Decision Approving the Extension of the Duration of a Negotiated Service Agreement, Docket No. MC2006-6. The PRC recommended that the NSA with Capital One Services, Inc. be extended for one year, through September 1, 2007.

Pursuant to 39 U.S.C. 3625, the Governors of the United States Postal Service acted on the PRC's recommendation on September 11, 2006. In the Decision of the Governors of the United States Postal Service on the Opinion and Recommended Decision of the Postal Rate Commission on Extension of Capital One NSA, Docket No. MC2006-6, the Governors of the Postal Service approved the recommended decision. In accordance with Resolution 06-8, the Board of Governors established an implementation date of September 13, 2006 on which the approved changes to

the classification schedule for Negotiated Service Agreements take effect. The attachment to the Governors' Decision, setting forth the classification changes ordered into effect by the Governors, is set forth below.

In accordance with the Decision of the Governors and Resolution No. 06-8 of the Board of Governors, the Postal Service hereby gives notice that the classification changes set forth below became effective at 12:01 a.m. on September 13, 2006.

Attachment to the Decision of the Governors of the United States Postal Service on the Opinion and Recommended Decision of the Postal Rate Commission on Extension of Capital One NSA, Docket No. MC2006-6
 (Additions Underlined; Deletions in Brackets)

Domestic Mail Classification Schedule

Negotiated Service Agreements,
Classification Schedule

610 Capital One Negotiated Service Agreement

* * * * *

610.33 Additional Discounts (Year 2 [and Year 3], *Year 3, and Year 4*). If eligible First-Class Mail volume for the first year is less than 1.025 billion pieces, the additional discount tiers shown in Rate Schedule 610B shall apply to the incremental volumes in the second [and third], *third, and fourth* years in addition to the incremental discounts in Rate Schedule 610A.

* * * * *

610.5 Expiration

The provisions of section 610 expire on September 1, [2006]2007 at 12:01 a.m.

* * * * *

Stanley F. Mires,

Chief Counsel, Legislative.

[FR Doc. 06-8195 Filed 9-22-06; 8:45 am]

BILLING CODE 7710-12-P

SECURITIES AND EXCHANGE COMMISSION

Submissions for OMB Review; Comment Request

Upon Written Request, Copies Available From: Securities and Exchange Commission, Office of Filings and Information Services, Washington, DC 20549.

Extensions:

Form T-6; OMB Control No. 3235-0391;
SEC File No. 270-344.
Form 11-K; OMB Control No. 3235-0082;
SEC File No. 270-101.
Form 144; OMB Control No. 3235-0101;
SEC File No. 270-112.

Notice is hereby given that pursuant to the Paperwork Reduction Act of 1995

(44 U.S.C. 3501 *et seq.*) the Securities and Exchange Commission ("Commission") has submitted to the Office of Management and Budget these requests for extension of the previously approved collections of information discussed below.

Form T-6 (17 CFR 269.9) is a statement of eligibility and qualification for a foreign corporate trustee under the Trust Indenture Act of 1939 (15 U.S.C. 77aaa *et seq.*). Form T-6 provides the basis for determining if a trustee is qualified. Form T-6 is filed on occasion. The information collected must be filed with the Commission and is publicly available. Form T-6 takes approximately 17 burden hours per response and is filed by 1 respondent. We estimate that 25% of the 17 total burden hours (4 hours) is prepared by the filer. The remaining 75% of burden hours is prepared by outside counsel.

Form 11-K (17 CFR 249.311) is the annual report designed for use by employee stock purchase, savings and similar plans. Form 11-K provides employees with financial information so that they can assess the performance of the investment vehicle in which their money is invested. Form 11-K is filed on occasion. The information collected must be filed with the Commission and is publicly available. Form 11-K takes approximately 30 burden hours per response and is filed by 2,000 respondents for total of 60,000 burden hours.

Form 144 (17 CFR 239.144) is used to report the sale of securities during any three-month period that exceeds 500 shares or other units or has an aggregate sales price in excess of \$10,000. Form 144 operates in conjunction with Rule 144. If the information collection was not required, the objectives of the rule could not be met. The information collected must be filed with the Commission and is publicly available. Form 144 takes approximately 2 burden hours per response and is filed by 60,500 respondents for a total of 121,000 total burden hours.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number.

Written comments regarding the above information should be directed to the following persons: (i) Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Office of Management and Budget, Room 10102, New Executive Office Building, Washington, DC 20503 or send an e-mail to David_Rostker@omb.eop.gov; and (ii) R. Corey Booth, Director/Chief

Information Officer, Securities and Exchange Commission, C/O Shirley Martinson, 6432 General Green Way, Alexandria, Virginia 22312; or send an e-mail to: PRA_Mailbox@sec.gov. Comments must be submitted to OMB within 30 days of this notice.

Dated: September 18, 2006.

Nancy M. Morris,
Secretary.

[FR Doc. 06-8135 Filed 9-22-06; 8:45 am]

BILLING CODE 8010-01-P

SECURITIES AND EXCHANGE COMMISSION

Submission for OMB Review; Comment Request

Upon Written Request, Copies Available From: Securities and Exchange Commission, Office of Filings and Information Services, Washington, DC 20549.

Extension:

Rule 15c3-4; SEC File No. 270-441; OMB Control No. 3235-0497.

Notice is hereby given that pursuant to the Paperwork Reduction Act of 1995 (44 U.S.C. 3501 *et seq.*), the Securities and Exchange Commission ("Commission") has submitted to the Office of Management and Budget a request for extension of the previously approved collection of information discussed below.

Rule 15c3-4 (17 CFR 240.15c3-4) (the "Rule") under the Securities Exchange Act of 1934 (15 U.S.C. 78a *et seq.*) (the "Exchange Act") requires certain broker-dealers that are registered with the Commission as OTC Derivatives Dealers to establish, document, and maintain a system of internal risk management controls. The Rule sets forth the basic elements for an OTC Derivatives Dealer to consider and include when establishing, documenting, and reviewing its internal risk management control system, which are designed to, among other things, ensure the integrity of an OTC Derivatives Dealer's risk measurement, monitoring, and management process, to clarify accountability at the appropriate organizational level, and to define the permitted scope of the dealer's activities and level of risk. The Rule also requires that management of an OTC Derivatives Dealer must periodically review, in accordance with written procedures, the OTC Derivatives Dealer's business activities for consistency with its risk management guidelines.

The staff estimates that the average amount of time an OTC Derivatives Dealer will spend

implementing its risk management control system is 2,000 hours and that, on average, an OTC Derivatives Dealer will spend approximately 200 hours each year reviewing and updating its risk management control system. Currently, five firms are registered with the Commission as an OTC Derivatives Dealer. The staff estimates that approximately one additional OTC Derivatives Dealer may become registered within the next three years. Accordingly, the staff estimates the total hour burden for six OTC Derivatives Dealers to be 1,200 hours annually.

The staff believes that the cost of complying with Rule 15c3-4 will be approximately \$205 per hour.¹ This per hour cost is based upon an annual average hourly salary for a compliance manager who would be responsible for ensuring compliance with the requirements of Rule 15c3-4. The total annual cost for all affected OTC Derivatives Dealers is estimated to be \$246,000, based on 1,200 hours at \$205 per hour.

The records required to be made by OTC Derivatives Dealers pursuant to the Rule and the results of the periodic reviews conducted under paragraph (d) of Rule 15c3-4 must be preserved under Rule 17a-4 of the Exchange Act (17 CFR 240.17a-4) for a period of not less than three years, the first two years in an accessible place. The Commission will not generally publish or make available to any person notice or reports received pursuant to the Rule. The statutory basis for the Commission's refusal to disclose such information to the public is the exemption contained in Section (b)(4) of the Freedom of Information Act, 5 U.S.C. 552, which essentially provides that the requirement of public dissemination does not apply to commercial or financial information which is privileged or confidential.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number.

Comments should be directed to (i) the Desk Officer for the SEC, Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Office of Management and Budget, Room 10102, New Executive Office Building, Washington, DC 20503 or by sending an e-mail to: David_Rostker@omb.eop.gov;

¹ Based on the average annual salary for a Compliance Manager based inside New York City of about \$69,000, as reflected in SIA Management and Professional Earnings for 2005, modified to account for an 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead.

and (ii) R. Corey Booth, Director/Chief Information Officer, Securities and Exchange Commission, c/o Shirley Martinson, 6432 General Green Way, Alexandria, Virginia 22312 or send an e-mail to: PRA_Mailbox@sec.gov. Comments must be submitted to OMB within 30 days of this notice.

Dated: September 18, 2006.

Nancy M. Morris,

Secretary.

[FR Doc. 06-8136 Filed 9-22-06; 8:45 am]

BILLING CODE 8010-01-P

SECURITIES AND EXCHANGE COMMISSION

Submission for OMB Review; Comment Request

Upon Written Request, Copies Available

From: Securities and Exchange Commission, Office of Filings and Information Services, Washington, DC 20549.

Extension:

Rule 17a-11 SEC File No. 270-94 OMB Control No. 3235-0085

Notice is hereby given that pursuant to the Paperwork Reduction Act of 1995 (44 U.S.C. 3501 *et seq.*), the Securities and Exchange Commission ("Commission") has submitted to the Office of Management and Budget a request for an extension of the previously approved collection of information discussed below.

In response to an operational crisis in the securities industry between 1967 and 1970, the Securities and Exchange Commission ("Commission") adopted Rule 17a-11 (17 CFR 240.17a-11) under the Securities Exchange Act of 1934 (15 U.S.C. 78a *et seq.*) ("Exchange Act") on July 11, 1971. The Rule requires broker-dealers that are experiencing financial or operational difficulties to provide notice to the Commission, the broker-dealer's designated examining authority ("DEA"), and the Commodity Futures Trading Commission ("CFTC") if the broker-dealer is registered with the CFTC as a futures commission merchant. Rule 17a-11 is an integral part of the Commission's financial responsibility program which enables the Commission, a broker-dealer's DEA, and the CFTC to increase surveillance of a broker-dealer experiencing difficulties and to obtain any additional information necessary to gauge the broker-dealer's financial or operational condition.

Rule 17a-11 also requires over-the-counter ("OTC") derivatives dealers and broker-dealers that are permitted to compute net capital pursuant to

Appendix E to Exchange Act Rule 15c3-1 to notify the Commission when their tentative net capital drops below certain levels. OTC derivatives dealers must also provide notice to the Commission of backtesting exceptions identified pursuant to Appendix F of Rule 15c3-1 (17 CFR 240.15c3-1f).

Compliance with the Rule is mandatory. The Commission will generally not publish or make available to any person notice or reports received pursuant to Rule 17a-11. The Commission believes that information obtained under Rule 17a-11 relates to a condition report prepared for the use of the Commission, other Federal governmental authorities, and securities industry self-regulatory organizations responsible for the regulation or supervision of financial institutions.

Only broker-dealers whose capital declines below certain specified levels or who are otherwise experiencing financial or operational problems have a reporting burden under Rule 17a-11. In 2005, the Commission received approximately 600 notices under this Rule. The Commission did not receive any Rule 17a-11 notices from OTC derivatives dealers or broker-dealers that are permitted to compute net capital pursuant to Appendix E to Exchange Act Rule 15c3-1.

Each broker-dealer reporting pursuant to Rule 17a-11 will spend approximately one hour preparing and transmitting the notice required by the Rule. Accordingly, the total estimated annualized burden under Rule 17a-11 is 600 hours.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number.

Comments regarding the estimated burden hours should be directed to: (i) The Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Office of Management and Budget, Room 10102, New Executive Office Building, Washington, DC 20503 or by e-mail to David_Rostker@omb.eop.gov; and (ii) R. Corey Booth, Director/Chief Information Officer, Securities and Exchange Commission, c/o Shirley Martinson, 6432 General Green Way, Alexandria, VA 22312, or by e-mail to PRA_Mailbox@sec.gov. Comments must be submitted to the Office of Management and Budget within 30 days of this notice.

Dated: September 18, 2006.

Nancy M. Morris,

Secretary.

[FR Doc. 06-8137 Filed 9-22-06; 8:45 am]

BILLING CODE 8010-01-P

SECURITIES AND EXCHANGE COMMISSION

[Investment Company Act Release No. 27485; 812-13302]

Northwestern Mutual Series Fund, Inc. and Mason Street Advisors, LLC; Notice of Application

September 19, 2006.

AGENCY: Securities and Exchange Commission ("Commission").

ACTION: Notice of an application under section 6(c) of the Investment Company Act of 1940 ("Act") for an exemption from section 15(a) of the Act and rule 18-2 under the Act, as well as certain disclosure requirements.

SUMMARY OF APPLICATION: Applicants request an order that would permit them to enter into and materially amend sub-advisory agreements without shareholder approval and would grant relief from certain disclosure requirements.

APPLICANTS: Northwestern Mutual Series Fund, Inc. (the "Company") and Mason Street Advisors, LLC (the "Adviser").

FILING DATES: The application was filed on June 14, 2006, and amended on September 8, 2006.

HEARING OR NOTIFICATION OF HEARING: An order granting the application will be issued unless the Commission orders a hearing. Interested persons may request a hearing by writing to the Commission's Secretary and serving applicants with a copy of the request, personally or by mail. Hearing requests should be received by the Commission by 5:30 p.m. on October 16, 2006, and should be accompanied by proof of service on the applicants, in the form of an affidavit or, for lawyers, a certificate of service. Hearing requests should state the nature of the writer's interest, the reason for the request, and the issues contested. Persons may request notification of a hearing by writing to the Commission's Secretary.

ADDRESSES: Secretary, U.S. Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549-1090. Applicants, c/o Randy Pavlick, Esq., Northwestern Mutual Series Fund, Inc., 720 East Wisconsin Avenue, Milwaukee, WI 53202.

FOR FURTHER INFORMATION CONTACT: Stacy L. Fuller, Branch Chief, at (202)

551-6821 (Division of Investment Management, Office of Investment Company Regulation).

SUPPLEMENTARY INFORMATION: The following is a summary of the application. The complete application may be obtained for a fee at the Commission's Public Reference Desk, 100 F Street, NE., Washington DC 20549-0102 (tel. 202-551-5850).

Applicants' Representations

1. The Company is organized as a Maryland corporation and is registered under the Act as an open-end management investment company. The Company is organized as a series investment company and currently consists of eighteen series ("Portfolios"), each with separate investment objectives, policies, and restrictions. The Adviser, a Delaware limited liability company, is registered as an investment adviser under the Investment Advisers Act of 1940 ("Advisers Act") and serves as an investment adviser to each Portfolio pursuant to an investment advisory agreement with the Company ("Advisory Agreement").¹ The Advisory Agreement has been approved by the Company's board of directors ("Board"), including a majority of the directors who are not "interested persons," as defined in section 2(a)(19) of the Act, of the Company ("Independent Directors"), as well as by each applicable Portfolio's shareholders.²

2. Under the Advisory Agreement, the Adviser manages each Portfolio's investments, subject to oversight by the Board. The Advisory Agreement permits the Adviser to enter into a separate sub-advisory agreement ("Sub-Advisory Agreement") with one or more investment sub-advisers (each, a "Sub-Adviser") to provide investment management services for the Funds. Each Sub-Adviser is registered under

the Advisers Act. The Adviser evaluates the Sub-Advisers and makes recommendations to the Board regarding their hiring, retention and termination. The shareholders and the Board, including a majority of the Independent Directors, approve the Sub-Advisory Agreements. The Adviser pays an investment advisory fee to each Sub-Adviser out of the fee paid to the Adviser under the Advisory Agreement.

3. Applicants request relief to permit the Adviser to enter into and materially amend Sub-Advisory Agreements for the Funds without shareholder approval. The requested relief will not extend to any Sub-Adviser that is an "affiliated person," as defined in section 2(a)(3) of the Act, of the Company or the Adviser, other than by reason of serving as a Sub-Adviser to one or more of the Funds ("Affiliated Sub-Adviser"). None of the current Sub-Advisers is an Affiliated Sub-Adviser.

4. Applicants also request an exemption from the various disclosure provisions described below that may require the Funds to disclose the fees paid by the Adviser to the Sub-Advisers. An exemption is requested to permit a Fund to disclose (as both a dollar amount and as a percentage of its net assets): (a) The aggregate fees paid to the Adviser and any Affiliated Sub-Advisers, and (b) the aggregate fees paid to Sub-Advisers other than Affiliated Sub-Advisers (collectively, "Aggregate Fee Disclosure"). If a Fund employs an Affiliated Sub-Adviser, the Fund will provide separate disclosure of any fees paid to the Affiliated Sub-Adviser.

Applicants' Legal Analysis

1. Section 15(a) of the Act provides, in relevant part, that it is unlawful for any person to act as an investment adviser to a registered investment company except under a written contract that has been approved by the vote of a majority of the company's outstanding voting securities. Rule 18f-2 under the Act provides that each series or class of stock in a series company affected by a matter must approve such matter if the Act requires shareholder approval.

2. Form N-1A is the registration statement used by open-end investment companies. Item 14(a)(3) of Form N-1A requires an open-end fund to disclose the method and amount of the investment adviser's compensation.

3. Rule 20a-1 under the Act requires proxies solicited with respect to an investment company to comply with Schedule 14A under the Securities Exchange Act of 1934 ("Exchange Act"). Items 22(c)(1)(ii), 22(c)(1)(iii), 22(c)(8) and 22(c)(9) of Schedule 14A, taken

together, require a proxy statement for a shareholder meeting at which the advisory contract will be voted upon to include the "rate of compensation of the investment adviser," the "aggregate amount of the investment adviser's fees," a description of the "terms of the contract to be acted upon," and, if a change in the advisory fee is proposed, the existing and proposed fees and the difference between the two fees.

4. Form N-SAR is the semi-annual report filed with the Commission by registered investment companies. Item 48 of Form N-SAR requires a registered investment company to disclose the rate schedule for fees paid to investment advisers, which may include Sub-Advisers.

5. Regulation S-X sets forth the requirements for financial statements required to be included as part of investment company registration statements and shareholder reports filed with the Commission. Sections 6-07(2)(a), (b), and (c) of Regulation S-X require registered investment companies to include in their financial statements information about investment advisory fees.

6. Section 6(c) of the Act provides that the Commission may exempt any person, security, or transaction or any class or classes of persons, securities, or transactions from any provision of the Act, or from any rule thereunder, if such exemption is necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the Act. Applicants believe that the requested relief meets this standard for the reasons discussed below.

7. Applicants assert that permitting the Adviser to select, supervise and evaluate Sub-Advisers without incurring unnecessary delay or expense is appropriate in the interests of Fund shareholders and will allow the Funds to operate more efficiently. Applicants state that Fund shareholders will look to the Adviser to select Sub-Adviser(s) well-suited to achieve the Fund's investment objectives. Applicants compare the role of the Sub-Advisers to that of individual portfolio managers employed by traditional investment advisory firms. Applicants note that the Advisory Agreement will continue to be subject to the shareholder approval requirements of section 15(a) of the Act and rule 18f-2 under the Act.

8. Applicants assert that many investment advisers charge their customers for advisory services according to a "posted" fee schedule. Applicants state that while investment advisers typically are willing to

¹ Applicants also request that any relief granted pursuant to the application extend to future series of the Company and any other existing or future registered open-end management investment company or series thereof that: (a) Is advised by the Adviser or a person controlling, controlled by or under common control with the Adviser (included in the term Adviser); (b) uses the management structure described in the application; and (c) complies with the terms and conditions of the Application (together with the Portfolios that meet these requirements, the "Funds"). The only existing registered open-end management investment company that currently intends to rely on the requested order is named as an applicant. If the name of any Fund contains the name of a Sub-Adviser (as defined below), the name of the Adviser that serves as the primary adviser to the Fund will precede the name of the Sub-Adviser.

² The term "shareholders" includes variable life insurance policy and variable annuity contract owners that are unitholders of any separate account for which a Portfolio serves as a funding vehicle.

negotiate fees lower than those posted in the rate schedule, they are reluctant to do so where the fees are disclosed to other prospective and existing customers. Applicants submit that the relief would allow the Adviser to negotiate more effectively with each individual Sub-Adviser.

Applicants' Conditions

Applicants agree that any order granting the requested relief will be subject to the following conditions:

1. Before a Fund may rely on the requested order, the operation of the Fund in the manner described in the application will be approved by a majority of the Fund's outstanding voting securities, as defined in the Act, or, in the case of a Fund whose public shareholders purchased shares on the basis of a prospectus containing the disclosure contemplated by condition 2 below, by the sole initial shareholder before offering the Fund's shares to the public.

2. Each Fund will disclose in its prospectus the existence, substance, and effect of any order granted pursuant to this application. Each Fund will hold itself out to the public as employing the management structure described in the application. The prospectus will prominently disclose that the Adviser has ultimate responsibility, subject to oversight by the Board, for the investment performance of a Fund due to its responsibility to oversee Sub-Advisers and recommend their hiring, termination and replacement.

3. Within 90 days of the hiring of a new Sub-Adviser, the affected Fund's shareholders will be furnished all the information about the new Sub-Adviser that would be included a proxy statement, except as modified to permit the Aggregate Fee Disclosure. This information will include Aggregate Fee Disclosure and any change in such disclosure caused by the addition of a new Sub-Adviser. To meet this condition, the affected Fund will provide Fund shareholders within 90 days of the hiring of a new Sub-Adviser, with an Information Statement meeting the requirements of Regulation 14C, Schedule 14C and Item 22 of Schedule 14A under the Exchange Act, except as modified by the order to permit Aggregate Fee Disclosure.

4. The Adviser will not enter into a Sub-Advisory Agreement with any Affiliated Sub-Adviser without such agreement, including the compensation to be paid thereunder, being approved by the shareholders of the applicable Fund.

5. At all times, a majority of the Board will be Independent Directors, and the

nomination of new or additional Independent Directors will be at the discretion of the then-existing Independent Directors.

6. Whenever a Sub-Adviser change is proposed for a Fund with an Affiliated Sub-Adviser, the Board, including a majority of the Independent Directors, will make a separate finding, reflected in the Board minutes, that the change is in the best interests of the Fund and its shareholders and does not involve a conflict of interest from which the Adviser or the Affiliated Sub-Adviser derives an inappropriate advantage.

7. Independent legal counsel, as defined in rule 0-1(a)(6) under the Act, will be engaged to represent the Independent Directors. The selection of such counsel will be within the discretion of the then existing Independent Directors.

8. The Adviser will provide the Board, no less frequently than quarterly, with information about the profitability of the Adviser on a per-Fund basis. The information will reflect the impact on profitability of the hiring or termination of any Sub-Adviser during the applicable quarter.

9. Whenever a Sub-Adviser is hired or terminated, the Adviser will provide the Board with information showing the expected impact on the profitability of the Adviser.

10. The Adviser will provide general management services to each Fund, including overall supervisory responsibility for the general management and investment of the Fund's assets, and, subject to review and approval by the Board, will: (a) Set each Fund's overall investment strategies, (b) evaluate, select and recommend Sub-Advisers to manage all or a part of a Fund's, (c) allocate and, when appropriate, reallocate a Fund's assets among Sub-Advisers, (d) monitor and evaluate the performance of the Sub-Advisers, and (e) implement procedures reasonably designed to ensure that the Sub-Advisers comply with the relevant Fund's investment objective, policies and restrictions.

11. No director or officer of the Company, or director or officer of the Adviser, will own directly or indirectly (other than through a pooled investment vehicle that is not controlled by such person), any interest in a Sub-Adviser, except for (a) ownership of interests in the Adviser or any entity that controls, is controlled by, or is under common control with the Adviser, or (b) ownership of less than 1% of the outstanding securities of any class of equity or debt of a publicly traded company that is either a Sub-Adviser or an entity that controls, is controlled by,

or is under common control with a Sub-Adviser.

12. Each Fund will disclose in its registration statement the Aggregate Fee Disclosure.

13. The requested order will expire on the effective date of rule 15a-5 under the Act, if adopted.

For the Commission, by the Division of Investment Management, under delegated authority.

Nancy M. Morris,

Secretary.

[FR Doc. 06-8140 Filed 9-22-06; 8:45 am]

BILLING CODE 8010-01-P

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-54463; File No. SR-NASD-2006-100]

Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Relating to Delivery of Options Disclosure Documents

September 15, 2006.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ and Rule 19b-4 thereunder,² notice is hereby given that on August 17, 2006, the National Association of Securities Dealers, Inc. ("NASD") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II and III below, which Items have been prepared by NASD. NASD filed the proposed rule change as a "non-controversial" rule change under Rule 19b-4(f)(6) under the Act,³ which rendered the proposal effective upon filing with the Commission. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

NASD proposes to amend NASD Rule 2860 (Options) to (1) require that a copy of each amendment to the options disclosure document, Characteristics and Risks of Standardized Options ("ODD"), be distributed to each customer not later than the time of the delivery of a confirmation of a transaction in the category of options issued by The Options Clearing Corporation ("OCC") to which the amendment pertains and (2) clarify that

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ 17 CFR 240.19b-4(f)(6).

revisions to the Special Statement for Uncovered Option Writers ("Special Written Statement") be distributed to each customer approved for writing uncovered short options not later than the time of the delivery of a confirmation of a transaction in options issued by the OCC. The text of the proposed rule change is available on NASD's Web site, <http://www.nasd.com>, at NASD's Office of the Secretary, and at the Commission's Public Reference Room.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, NASD included statements concerning the purpose of, and basis for, the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. NASD has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

NASD is proposing revisions to the requirement to deliver amendments and/or revisions to the options disclosure documents in NASD Rule 2860 to conform to similar rules of other self-regulatory organizations.⁴ Specifically, NASD is amending the rule to more clearly delineate the particular delivery requirements applicable to the ODD and the Special Written Statement.

Currently, NASD Rule 2860(b)(11)(A) requires that amendments and revisions to both disclosure documents be distributed to each customer not later than the time a confirmation of a transaction is delivered to each customer who enters into a transaction in options issued by the OCC. By contrast, the rules of the Options Exchanges require that amendments to the ODD be distributed to each customer not later than the time a confirmation of a transaction in the category of options to which the amendment pertains is delivered to such customer.

NASD believes that the delivery of an amendment to the ODD is appropriately triggered by a customer transaction in an options contract to which such amendment pertains. Furthermore, the

proposed rule change will harmonize NASD's rule for amendments to the ODD with those of the Options Exchanges.

In addition, through a new subparagraph (2), NASD is clarifying that revisions to the Special Written Statement be distributed to each customer having an account approved for writing uncovered short options not later than the time a confirmation of a transaction is delivered to each customer who enters into a transaction in options issued by the OCC. NASD states that the rules of the Options Exchanges do not address delivery of revisions to the Special Written Statement.

NASD has filed the proposed rule change for immediate effectiveness. NASD will announce the implementation date of the proposed rule change in a Notice to Members to be published no later than 60 days following the filing of the rule change with the Commission for immediate effectiveness. The implementation date will be 30 days after the date of the Notice to Members.

2. Statutory Basis

NASD believes that the proposed rule change is consistent with Section 15A(b)(6)⁵ of the Act in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. NASD is proposing the rule change to harmonize NASD's rule for delivery of amendments to the ODD with those of the Options Exchanges and to clarify members' delivery obligations for revisions to the Special Written Statement.

B. Self-Regulatory Organization's Statement on Burden on Competition

NASD does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants or Others

NASD has neither solicited nor received written comments on the proposed rule change.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Because the proposed rule change: (i) Does not significantly affect the protection of investors or the public interest; (ii) does not impose any significant burden on competition; and (iii) by its terms, does not become operative for 30 days after the date of filing, or such shorter time as the Commission may designate, if consistent with the protection of investors and the public interest, the proposed rule change has become effective pursuant to Section 19(b)(3)(A) of the Act⁶ and subparagraph (f)(6) of Rule 19b-4 thereunder.⁷

At any time within 60 days of the filing of the proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in the furtherance of the purposes of the Act.⁸

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-NASD-2006-100 on the subject line.

Paper Comments

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549-1090.

All submissions should refer to File Number SR-NASD-2006-100. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule

⁴ See CBOE Rule 9.15; ISE Rule 616; Phlx Rule 1029; Amex Rule 926; and NYSE Rule 726 (collectively, "Options Exchanges").

⁵ 15 U.S.C. 78o-3(b)(6).

⁶ 15 U.S.C. 78s(b)(3)(A).

⁷ 17 CFR 240.19b-4(f)(6).

⁸ See 15 U.S.C. 78s(b)(3)(C).

change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing also will be available for inspection and copying at the principal office of NASD. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-NASD-2006-100 and should be submitted on or before October 16, 2006.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁹

Nancy M. Morris,
Secretary.

[FR Doc. 06-8141 Filed 9-22-06; 8:45 am]

BILLING CODE 8010-01-P

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-54462; File No. SR-NASD-2006-107]

Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Related to Thru Orders for Nasdaq's INET Facility

September 15, 2006.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ and Rule 19b-4 thereunder,² notice is hereby given that on September 11, 2006, the National Association of Securities Dealers, Inc. ("NASD"), through its subsidiary, The Nasdaq Stock Market, Inc. ("Nasdaq"), filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I and II below, which Items have been prepared by Nasdaq. Nasdaq has filed the proposal pursuant to Section 19(b)(3)(A) of the Act³ and Rule 19b-4(f)(6) thereunder,⁴ which renders the proposal effective upon filing with the Commission. The Commission is

publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

Nasdaq proposes to introduce a new Thru order type for Nasdaq's INET Facility that will allow users to direct that their order be delivered by the INET system to the American Stock Exchange ("Amex") or New York Stock Exchange ("NYSE"), as appropriate. Nasdaq has designated this proposal as non-controversial and has requested that the Commission waive the 30-day pre-operative waiting period contained in Rule 19b-4(f)(6)(iii) under the Act.⁵

The text of the proposed rule change is below. Proposed new language is *italicized*; proposed deletions are in [brackets].

* * * * *

4956. Routing

(a) INET Order Routing Process

(1) The INET Order Routing Process shall be available to Participants from 7 a.m. to 8 p.m. Eastern Time, and shall route orders as described below:

(A) Routing Options.

The System provides [eight] *nine* routing options for orders. Of these eight, [five] *six*—DOT Immediate, DOT Alternative, DOT Alternative 2, Reactive Only DOT, [and] DOT Nasdaq—and *Thru DOT*—are available for orders ultimately sought to be directed to either the New York Stock Exchange ("NYSE") or the American Stock Exchange ("AMEX"). The System also allows firms to send individual orders to the NYSE Direct + System, and to elect to have orders not be sent to the AMEX. The [eight] *nine* System routing options are:

(i)–(viii) No Change.

(ix) *Thru DOT ("TDOT")—under this option, orders are sent directly to either the NYSE or AMEX, as directed by the entering party. If unexecuted, the order (or unexecuted portion thereof) shall be returned to the entering party. This option may only be used for orders with time-in-force parameters of either DAY, IOC, or market-on-open/close.*

(B) No Change.

* * * * *

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, Nasdaq included statements concerning the purpose of and basis for the

proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. Nasdaq has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

Nasdaq proposes to create a new order routing option for its INET facility that would allow users to direct that their orders be delivered by the INET system to the NYSE or the Amex, as appropriate. Nasdaq notes that this direct delivery functionality already exists in Nasdaq's Brut facility as the Thru Brut order⁶ and would provide additional flexibility and functionality to INET system users that desire to send orders to the NYSE or the Amex.

2. Statutory Basis

Nasdaq believes that the proposed rule change is consistent with the provisions of Section 15A of the Act,⁷ in general, and with Section 15A(b)(6) of the Act,⁸ in particular, in that it is designed to promote just and equitable principles of trade, and to remove impediments to a free and open market and a national market system.

B. Self-Regulatory Organization's Statement on Burden on Competition

Nasdaq does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants or Others

Written comments were neither solicited nor received.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

The foregoing proposed rule change is subject to Section 19(b)(3)(A)(iii) of the Act⁹ and Rule 19b-4(f)(6) thereunder¹⁰ because the proposal: (i) Does not significantly affect the protection of investors or the public interest; (ii) does not impose any significant burden on

⁹ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ 15 U.S.C. 78s(b)(3)(A).

⁴ 17 CFR 240.19b-4(f)(6).

⁵ 17 CFR 240.19b-4(f)(6)(iii).

⁶ See NASD Rule 4903(b).

⁷ 15 U.S.C. 78o-3.

⁸ 15 U.S.C. 78o-3(b)(6).

⁹ 15 U.S.C. 78s(b)(3)(A)(iii).

¹⁰ 17 CFR 240.19b-4(f)(6).

competition; and (iii) does not become operative prior to 30 days after the date of filing or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest; provided that Nasdaq has given the Commission notice of its intent to file the proposed rule change, along with a brief description and text of the proposed rule change, at least five business days prior to the date of filing of the proposed rule change, or such shorter time as designated by the Commission.

Nasdaq has fulfilled the five-day pre-filing requirement. Nasdaq has requested that the Commission waive the 30-day operative delay. The Commission believes that waiving the 30-day operative delay is consistent with the protection of investors and the public interest because such waiver would provide users of Nasdaq's INET facility the ability to utilize the proposed Thru DOT order type immediately, an order type with the same functionality as an order type that is currently available for use in Nasdaq's Brut facility. For these reasons, the Commission designates the proposed rule change to be effective and operative upon filing with the Commission.¹¹

At any time within 60 days of the filing of such proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors or otherwise in furtherance of the purposes of the Act.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-NASD-2006-107 on the subject line.

Paper Comments

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission,

100 F Street, NE., Washington, DC 20549-1090.

All submissions should refer to File Number SR-NASD-2006-107. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of the filing also will be available for inspection and copying at the principal office of the NASD. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-NASD-2006-107 and should be submitted on or before October 16, 2006.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹²

Nancy M. Morris,
Secretary.

[FR Doc. 06-8142 Filed 9-22-06; 8:45 am]

BILLING CODE 8010-01-P

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-54461; File No. SR-NASD-2006-106]

Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Related to Market/Limit-on-Open Orders Sent to the American Stock Exchange or New York Stock Exchange

September 15, 2006.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ and Rule 19b-4 thereunder,²

notice is hereby given that on September 11, 2006, the National Association of Securities Dealers, Inc. ("NASD"), through its subsidiary, The Nasdaq Stock Market, Inc. ("Nasdaq"), filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I and II below, which Items have been prepared by Nasdaq. Nasdaq has filed the proposal pursuant to Section 19(b)(3)(A) of the Act³ and Rule 19b-4(f)(6) thereunder,⁴ which renders the proposal effective upon filing with the Commission. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

Nasdaq proposes to establish a new order processing option for its INET and Brut facilities that allow those system users to direct that their market/limit-on-open orders being sent to the American Stock Exchange ("Amex") or New York Stock Exchange ("NYSE") for participation in those markets" opening processes have any shares remaining unexecuted after the open be returned to the Nasdaq facility of their origin for display and potential execution, as appropriate. Nasdaq has designated this proposal as non-controversial and has requested that the Commission waive the 30-day pre-operative waiting period contained in Rule 19b-4(f)(6)(iii) under the Act.⁵

The text of the proposed rule change is below. Proposed new language is *italicized*.

* * * * *

4903. Order Entry Parameters

(a)-(b) No Change.

(c) Thru Brut Orders—

(1) General. A Thru Brut Order is an order submitted to the System that is designated for routing to another market center. The following requirements shall apply to Thru Brut Orders:

(A)-(B) No Change.

(C) *Market/Limit on Open Orders—if requested by the entering party, unexecuted share amounts of market on open orders directed to the New York or American stock exchanges will be returned to the System for display and potential execution.*

(d)-(f) No Change.

* * * * *

¹¹ For purposes only of accelerating the operative date of this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

¹² 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ 15 U.S.C. 78s(b)(3)(A).

⁴ 17 CFR 240.19b-4(f)(6).

⁵ 17 CFR 240.19b-4(f)(6)(iii).

4956. Routing

(a) INET Order Routing Process.

(1) The INET Order Routing Process shall be available to Participants from 7 a.m. to 8 p.m. Eastern Time, and shall route orders as described below:

(A)–(B) No Change.

(C) *Market/Limit on Open Orders.*

If requested by the entering party, unexecuted share amounts of market on open orders directed to the New York or American stock exchanges will be returned to the INET System for display and potential execution.

* * * * *

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, Nasdaq included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. Nasdaq has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

Nasdaq proposes to provide a new voluntary option for its INET and Brut facilities that would allow users to direct that, for orders being sent to the NYSE or Amex for participation in those markets' opening process, thereafter return any unexecuted share amounts back to the originating facility for display and potential execution. Currently, such share amounts are automatically cancelled back to the entering party, and Nasdaq wishes give its facility users the ability to elect to have those unexecuted remainders to instead continue to participate in Nasdaq's automated execution environment. Nasdaq believes that the above option would enhance the choices available to users of the INET and Brut systems to select the best method to execute proprietary and customer orders across multiple trading venues.

2. Statutory Basis

Nasdaq believes that the proposed rule change is consistent with the provisions of Section 15A of the Act,⁶ in general, and with Section 15A(b)(6) of

the Act,⁷ in particular, in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to a free and open market and a national market system, and, in general, to protect investors and the public interest.

B. Self-Regulatory Organization's Statement on Burden on Competition

Nasdaq does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants or Others

Written comments were neither solicited nor received.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

The foregoing proposed rule change is subject to Section 19(b)(3)(A)(iii) of the Act⁸ and Rule 19b-4(f)(6) thereunder⁹ because the proposal: (i) Does not significantly affect the protection of investors or the public interest; (ii) does not impose any significant burden on competition; and (iii) does not become operative prior to 30 days after the date of filing or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest; provided that Nasdaq has given the Commission notice of its intent to file the proposed rule change, along with a brief description and text of the proposed rule change, at least five business days prior to the date of filing of the proposed rule change, or such shorter time as designated by the Commission.

Nasdaq has fulfilled the five-day pre-filing requirement. Nasdaq has requested that the Commission waive the 30-day operative delay. The Commission believes that waiving the 30-day operative delay is consistent with the protection of investors and the public interest because such waiver would immediately provide users of Nasdaq's INET and Brut facilities the choice to have unexecuted remainders of certain orders either continue to participate in Nasdaq's automated execution environment or be automatically cancelled. For these reasons, the Commission designates the proposed rule change to be effective and

operative upon filing with the Commission.¹⁰

At any time within 60 days of the filing of such proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors or otherwise in furtherance of the purposes of the Act.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-NASD-2006-106 on the subject line.

Paper Comments

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549-1090.

All submissions should refer to File Number SR-NASD-2006-106. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of the filing also will be available for inspection and copying at the principal office of the NASD. All comments received will be posted without change; the Commission does

¹⁰ For purposes only of accelerating the operative date of this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

⁷ 15 U.S.C. 78o-3(b)(6).

⁸ 15 U.S.C. 78s(b)(3)(A)(iii).

⁹ 17 CFR 240.19b-4(f)(6).

⁶ 15 U.S.C. 78o-3.

not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-NASD-2006-106 and should be submitted on or before October 16, 2006.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹¹

Nancy M. Morris,
Secretary.

[FR Doc. 06-8143 Filed 9-22-06; 8:45 am]

BILLING CODE 8010-01-P

DEPARTMENT OF TRANSPORTATION

Federal Aviation Administration

Notice of Opportunity for Public Comment on Grant Acquired Property Release at Lexington County, Pelion, SC

AGENCY: Federal Aviation Administration (FAA), DOT.

ACTION: Notice.

SUMMARY: Under the provisions of Title 49, U.S.C. 47107(h)(2), notice is being given that the FAA is considering a request from the County of Lexington to waive the requirement that approximately 2.38—acres of airport property, located at the Lexington County Airport, be used for aeronautical purposes.

DATES: Comments must be received on or before October 25, 2006.

ADDRESSES: Comments on this notice may be mailed or delivered in triplicate to the FAA at the following address: Atlanta Airports District Office, Attn: Parks Preston, Program Manager, 1701 Columbia Ave., Suite 2-260, Atlanta, GA 30337-2747.

In addition, one copy of any comments submitted to the FAA must be mailed or delivered to Katherine L. Doucett, County Administrator for Lexington County at the following address: Lexington County Administrator, 212 South Lake Drive, Lexington, SC 29072.

FOR FURTHER INFORMATION CONTACT: Parks Preston, Program Manager, Atlanta Airports District Office, 1701 Columbia Ave., Suite 2-260, Atlanta, GA 30337-2747, (404) 305-7149. The application may be reviewed in person at this same location.

SUPPLEMENTARY INFORMATION: The FAA is reviewing an application by the County of Lexington to release

approximately 2.38 acres of airport property at the Lexington County Airport. The property consists of one parcel located on the west side of the airport along South Carolina Highway 625. This property is currently shown on the approved Airport Layout Plan as aeronautical use land; however the property is currently not being used for aeronautical purposes and the proposed use of this property is compatible with airport operations. The County will ultimately sell the property for a future South Region Public Safety Service Center with proceeds of the sale providing funding for future airport development.

Any person may inspect the application in person at the FAA office listed above under **FOR FURTHER INFORMATION CONTACT**. In addition, any person may, upon request, inspect the application, notice and other documents germane to the request in person at the Lexington County government offices.

Issued in Atlanta, Georgia on September 8, 2006.

Scott L. Seritt,
*Manager, Atlanta Airports District Office,
Southern Region.*

[FR Doc. 06-8125 Filed 9-22-06; 8:45 am]

BILLING CODE 4910-13-M

DEPARTMENT OF TRANSPORTATION

Federal Aviation Administration

Agency Information Collection Activity Seeking OMB Approval

AGENCY: Federal Aviation Administration (FAA), DOT.

ACTION: Notice.

SUMMARY: The FAA invites public comments about our intention to request the Office of Management and Budget's (OMB) revision of a current information collection. The Federal Register Notice with a 60-day comment period soliciting comments on the following collection of information was published on March 15, 2006, vol. 71, no. 50, pages 13444-13445. Fractional Ownership is a program that offers increased flexibility in aircraft ownership.

DATES: Please submit comments by October 25, 2006.

FOR FURTHER INFORMATION CONTACT: Carla Mauney at Carla.Mauney@faa.gov.

SUPPLEMENTARY INFORMATION:

Federal Aviation Administration (FAA)

Title: Fractional Aircraft Ownership Programs.

Type of Request: Revision of a currently approved collection.

OMB Control Number: 2120-0684.

Forms(s): There are no FAA forms associated with this collection.

Affected Public: An estimated 11 respondents.

Frequency: This information is collected on occasion.

Estimated Average Burden per Response: Approximately 45 minutes per response.

Estimated Annual Burden Hours: An estimated 16,484 hours annually.

Abstract: Fractional Ownership is a program that offers increased flexibility in aircraft ownership. Owners purchase shares of an aircraft and agree to share their aircraft with others having an ownership share in that same aircraft. Owners agree to put their aircraft into a "pool" of other shared aircraft and to lease their aircraft to another owner in that pool. That aircraft owners use a common management company to maintain the aircraft and administer the leasing of the aircraft among the owners.

ADDRESSES: Interested persons are invited to submit written comments on the proposed information collection to the Office of Information and Regulatory Affairs, Office of Management and Budget. Comments should be addressed to Nathan Lesser, Desk Officer, Department of Transportation/FAA, and sent via electronic mail to oir_submission@omb.eop.gov or faxed to (202) 395-6974. Comments are invited on: Whether the proposed collection of information is necessary for the proper performance of the functions of the Department, including whether the information will have practical utility; the accuracy of the Department's estimates of the burden of the proposed information collection; ways to enhance the quality, utility, and clarity of the information to be collected; and ways to minimize the burden of the collection of information on respondents, including the use of automated collection techniques or other forms of information technology.

Dated: Issued in Washington, DC, on September 15, 2006.

Carla Mauney,
FAA Information Collection Clearance Officer, Information Systems and Technology Services Staff, ABA-20.

[FR Doc. 06-8127 Filed 9-22-06; 8:45 am]

BILLING CODE 4910-13-M

¹¹ 17 CFR 200.30-3(a)(12).

DEPARTMENT OF TRANSPORTATION**Federal Aviation Administration****Notice of the Availability of the Record of Decision (ROD) for the Final Environmental Impact Statement (FEIS) that Evaluated the Proposed Relocation of the Panama City-Bay County International Airport, Panama City, Florida, Published in May 2006**

AGENCY: Federal Aviation Administration (FAA), DOT.

ACTION: Notice of Availability for Record of Decision.

SUMMARY: The FAA is issuing this notice to advise the public that it has issued a ROD for the FEIS that evaluated a proposal to relocate the existing Panama City-Bay County International Airport (PFN) to a new site in western Bay County, Florida. The ROD provides final agency determination and approvals for those federal actions by the FAA necessary for the proposed relocation of PFN.

SUPPLEMENTARY INFORMATION: The FAA has completed and is publishing its Record of Decision for the proposed relocation of the Panama City-Bay County International Airport to a new site in western Bay County, Florida. The Environmental Protection Agency published FAA's notice of availability of the FEIS for this airport relocation project in the **Federal Register** on May 19, 2006. The FEIS was prepared in compliance with the National Environmental Policy Act of 1969 (NEPA) [42 U.S.C. Section 4321, *et seq.*], the implementing regulations of the Council on Environmental Quality (CEQ) [40 CFR Parts 1500–1508] and FAA directives [Order 1050.1E and Order 5050.4A], and assessed the potential impact of six development alternatives, as well as the No Action Alternative where the airport would be neither improved at the existing site nor relocated to a new site in western Bay County. The FAA accepted comments on the Final EIS and these comments, along with the FAA's responses, are included in Appendix B of the ROD.

The FAA has identified the West Bay Site 8,400 foot Alternative, the Airport Sponsor's Proposed Project (Proposed Project), as its preferred alternative in the FEIS and selected alternative in the ROD. The Proposed Project consists of relocation of the existing PFN to a new site in Bay County, Florida, called the West Bay Site. The Proposed Project is identified as Phase 1 (initial development area), which encompasses approximately 1,378 acres of the 4,000-acre West Bay Site. The relocation of the

airport includes, but is not limited to, construction of a primary air carrier runway 8,400 feet in length, a crosswind runway 5,000 feet in length, airside and landside facilities to support the runway operations (such as taxiways, aprons, a commercial passenger terminal, access roads and parking, fuel storage facilities, an Air Traffic Control Tower, etc.), general aviation and fixed base operator facilities, and navigation aids. The FAA is selecting and granting approval of a layout plan for the FAA's preferred alternative, the West Bay Site 8,400 foot Alternative, with conditions as noted in Section 12 of the ROD. Copies of the ROD and FEIS are available for public review at the following locations during normal business hours:

Panama City-Bay County International Administration Office, 3173 Airport Road, Panama City, Florida 32405, Telephone (850) 783–6751, Bay County Public Library, 25 West Government Street, Panama City, Florida 32401, Telephone (850) 872–7500; Federal Aviation Administration, Orlando Airports District Office, 5950 Hazeltine National Drive, Suite 400, Orlando, Florida 32822, Telephone (407) 812–6331; Federal Aviation Administration Southern Region Office, 1701 Columbia Avenue, College Park, GA, 30337, Telephone (404) 305–6700.

The FEIS is available for review at <http://www.pcairport.com>. The ROD will also be available for review at this Web site by late September 2006.

FOR FURTHER INFORMATION CONTACT: Virginia Lane, Environmental Specialist, Federal Aviation Administration, Orlando Airports District Office, 5950 Hazeltine National Drive, Suite 400, Orlando, Florida 32822, Telephone (407) 812–6331 Extension 129.

Issued in Orlando, Florida on September 15, 2006.

Matthew J. Thys,

Acting Manager, Orlando Airports District Office.

[FR Doc. 06–8128 Filed 9–22–06; 8:45 am]

BILLING CODE 4910–13–M

DEPARTMENT OF TRANSPORTATION**Federal Motor Carrier Safety Administration****Solicitation of Applications for FY 2007 Border Enforcement Grant Funding**

AGENCY: Federal Motor Carrier Safety Administration (FMCSA), DOT.

ACTION: Notice.

SUMMARY: FMCSA announces that it has published an opportunity to apply for FY2007 Border Enforcement Grant

(BEG) funding on the grants.gov Web site. Section 4110 of the Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy For Users established the BEG program. The program is a discretionary grant program that provides funding for border commercial motor vehicle (CMV) safety programs and related enforcement activities and projects. An entity or a State that shares a land border with another country is eligible to receive grant funding. To apply for funding, applicants must register online with the grants.gov Web site (http://www.grants.gov/applicants/get_registered.jsp), and submit an application in accordance with instructions provided. Applications for grant funding must be submitted electronically to the FMCSA through the grants.gov Web site.

DATES: FMCSA will initially consider funding of applications submitted by November 1, 2006 for qualified applicants. If additional funding remains available, applications submitted after November 1, 2006 will be considered on a case-by-case basis. Funds will not be available for allocation until such time as FY2007 appropriations legislation is passed and signed into law.

FOR FURTHER INFORMATION CONTACT: Mr. Milt Schmidt, Federal Motor Carrier Safety Administration, Office of Safety Programs, North American Borders Division (MC–ESB), (518) 431–4239, extension 262, Leo W. O'Brien Federal Building, Room 742, Clinton Avenue and North Pearl Street, Albany, New York 12207. Office hours are from 7:30 a.m. to 4 p.m., e.t., Monday through Friday, except Federal holidays.

Issued on: September 15, 2006.

John H. Hill,

Administrator.

[FR Doc. 06–8121 Filed 9–22–06; 8:45 am]

BILLING CODE 4910–EX–P

DEPARTMENT OF TRANSPORTATION**Federal Motor Carrier Safety Administration**

[Docket No. FMCSA–00–7006, FMCSA–00–7165, FMCSA–04–17984]

Qualification of Drivers; Exemption Applications; Vision

AGENCY: Federal Motor Carrier Safety Administration (FMCSA), DOT.

ACTION: Notice of renewal of exemption; request for comments.

SUMMARY: FMCSA announces its decision to renew the exemptions from

the vision requirement in the Federal Motor Carrier Safety Regulations for 18 individuals. FMCSA has statutory authority to exempt individuals from the vision requirement if the exemptions granted will not compromise safety. The Agency has concluded that granting these exemptions will provide a level of safety that will be equivalent to, or greater than, the level of safety maintained without the exemptions for these commercial motor vehicle (CMV) drivers.

DATES: This decision is effective October 15, 2006. Comments must be received on or before October 25, 2006.

ADDRESSES: You may submit comments identified by DOT Docket Management System (DMS) Docket Numbers FMCSA-00-7006, FMCSA-00-7165, FMCSA-04-17984, using any of the following methods.

- Web Site: <http://dmses.dot.gov>. Follow the instructions for submitting comments on the DOT electronic docket site.

- Fax: 1-202-493-2251.

- Mail: Docket Management Facility; U.S. Department of Transportation, 400 Seventh Street, SW., Nassif Building, Room PL-401, Washington, DC 20590-0001.

- Hand Delivery: Room PL-401 on the plaza level of the Nassif Building, 400 Seventh Street, SW., Washington, DC, between 9 a.m. and 5 p.m., Monday through Friday, except Federal holidays.

- Federal eRulemaking Portal: Go to <http://www.regulations.gov>. Follow the online instructions for submitting comments.

Instructions: All submissions must include the Agency name and docket numbers for this Notice. Note that all comments received will be posted without change to <http://dms.dot.gov>, including any personal information provided. Please see the Privacy Act heading for further information.

Docket: For access to the docket to read background documents or comments received, go to <http://dms.dot.gov> at any time or Room PL-401 on the plaza level of the Nassif Building, 400 Seventh Street, SW., Washington, DC, between 9 a.m. and 5 p.m., Monday through Friday, except Federal holidays. The DMS is available 24 hours each day, 365 days each year. If you want us to notify you that we received your comments, please include a self-addressed, stamped envelope or postcard or print the acknowledgement page that appears after submitting comments on-line.

Privacy Act: Anyone may search the electronic form of all comments

received into any of our dockets by the name of the individual submitting the comment (or of the person signing the comment, if submitted on behalf of an association, business, labor union, etc.). You may review the Department of Transportation's complete Privacy Act Statement in the **Federal Register** published on April 11, 2000 (65 FR 19477; Apr. 11, 2000). This information is also available at <http://dms.dot.gov>.

FOR FURTHER INFORMATION CONTACT: Dr. Mary D. Gunnels, Chief, Physical Qualifications Division, (202) 366-4001, maggi.gunnels@dot.gov FMCSA, Department of Transportation, 400 Seventh Street, SW., Room 8301, Washington, DC 20590-0001. Office hours are from 8:30 a.m. to 5 p.m., E.T., Monday through Friday, except Federal holidays.

SUPPLEMENTARY INFORMATION:

Exemption Decision

Under 49 U.S.C. 31136(e) and 31315, FMCSA may renew an exemption from the vision requirements in 49 CFR 391.41(b)(10), which applies to drivers of CMVs in interstate commerce, for a two-year period if it finds "such exemption would likely achieve a level of safety that is equivalent to, or greater than, the level that would be achieved absent such exemption." The procedures for requesting an exemption (including renewals) are set out in 49 CFR part 381. This Notice addresses 18 individuals who have requested renewal of their exemptions in a timely manner. FMCSA has evaluated these 18 applications for renewal on their merits and decided to extend each exemption for a renewable two-year period. They are:

Robert L. Aurandt
Harry R. Brewer
Clarence N. Florey, Jr.
Thanh V. Ha
David M. Hagadorn
Donald R. Hiltz
Kelly R. Konesky
Ronnie L. LeMasters
Gregory T. Lingard
Hollis J. Martin
Robert E. Moore
Kevin C. Palmer
Charles O. Rhodes
Einar H. Rice
Gordon G. Roth
Halman Smith
LaLanne Taylor
James A. Walker

These exemptions are extended subject to the following conditions: (1) That each individual have a physical examination every year (a) by an ophthalmologist or optometrist who attests that the vision in the better eye

continues to meet the standard in 49 CFR 391.41(b)(10), and (b) by a medical examiner who attests that the individual is otherwise physically qualified under 49 CFR 391.41; (2) that each individual provide a copy of the ophthalmologist's or optometrist's report to the medical examiner at the time of the annual medical examination; and (3) that each individual provide a copy of the annual medical certification to the employer for retention in the driver's qualification file and retain a copy of the certification on his/her person while driving for presentation to a duly authorized Federal, State, or local enforcement official. Each exemption will be valid for two years unless rescinded earlier by FMCSA. The exemption will be rescinded if: (1) The person fails to comply with the terms and conditions of the exemption; (2) the exemption has resulted in a lower level of safety than was maintained before it was granted; or (3) continuation of the exemption would not be consistent with the goals and objectives of 49 U.S.C. 31136(e) and 31315.

Basis for Renewing Exemptions

Under 49 U.S.C. 31315(b)(1), an exemption may be granted for no longer than two years from its approval date and may be renewed upon application for additional two year periods. In accordance with 49 U.S.C. 31136(e) and 31315, each of the 18 applicants has satisfied the entry conditions for obtaining an exemption from the vision requirements (65 FR 20245; 65 FR 57230; 67 FR 57266; 69 FR 52741; 65 FR 33406; 65 FR 57234; 69 FR 33997; 69 FR 61292). Each of these 18 applicants has requested timely renewal of the exemption and has submitted evidence showing that the vision in the better eye continues to meet the standard specified at 49 CFR 391.41(b)(10) and that the vision impairment is stable. In addition, a review of each record of safety while driving with the respective vision deficiencies over the past two years indicates each applicant continues to meet the vision exemption standards. These factors provide an adequate basis for predicting each driver's ability to continue to drive safely in interstate commerce. Therefore, FMCSA concludes that extending the exemption for each renewal applicant for a period of two years is likely to achieve a level of safety equal to that existing without the exemption.

Request for Comments

FMCSA will review comments received at any time concerning a particular driver's safety record and determine if the continuation of the

exemption is consistent with the requirements at 49 U.S.C. 31136(e) and 31315. However, FMCSA requests that interested parties with specific data concerning the safety records of these drivers submit comments by October 25, 2006.

FMCSA believes that the requirements for a renewal of an exemption under 49 U.S.C. 31136(e) and 31315 can be satisfied by initially granting the renewal and then requesting and evaluating, if needed, subsequent comments submitted by interested parties. As indicated above, the Agency previously published Notices of final disposition announcing its decision to exempt these 17 individuals from the vision requirement in 49 CFR 391.41(b)(10). That final decision to grant the exemption to each of these individuals was based on the merits of each case and only after careful consideration of the comments received to its Notices of applications. Those Notices of applications stated in detail the qualifications, experience, and medical condition of each applicant for an exemption from the vision requirements. That information is available by consulting the above cited **Federal Register** publications.

Interested parties or organizations possessing information that would otherwise show that any, or all of these drivers, are not currently achieving the statutory level of safety should immediately notify FMCSA. The Agency will evaluate any adverse evidence submitted and, if safety is being compromised or if continuation of the exemption would not be consistent with the goals and objectives of 49 U.S.C. 31136(e) and 31315, FMCSA will take immediate steps to revoke the exemption of a driver.

Issued on: September 13, 2006.

Rose A. McMurray,
Associate Administrator, Policy and Program Development.

[FR Doc. 06-8119 Filed 9-22-06; 8:45 am]

BILLING CODE 4910-EX-P

DEPARTMENT OF TRANSPORTATION

Federal Motor Carrier Safety Administration

[Docket No. FMCSA-2005-24231]

Hours of Service of Drivers: Withdrawal of Application for Exemption; FedEx Ground Package System, Inc.

AGENCY: Federal Motor Carrier Safety Administration (FMCSA), DOT.

ACTION: Notice of application for exemption; withdrawal.

SUMMARY: The FMCSA announces that it is withdrawing its notice of an application for exemption upon the request of the applicant, FedEx Ground Package System, Inc. (FedEx).

DATES: The notice of application with request for comments published on July 31, 2006 is withdrawn, effective immediately.

FOR FURTHER INFORMATION CONTACT: Mr. Thomas Yager, Chief, Driver and Carrier Operations Division, Office of Bus and Truck Standards and Operations, MC-PSD, Federal Motor Carrier Safety Administration, 400 Seventh Street, SW., Washington, DC 20590. Telephone: 202-366-4009. E-mail: MCPSD@dot.gov.

SUPPLEMENTARY INFORMATION: On July 31, 2006, FMCSA published a notice requesting public comment on FedEx's application for an exemption from certain hours-of-service requirements for truck drivers (71 FR 43277). FedEx sought a limited exemption from the definition of "on duty" under FMCSA's hours-of-service regulations governing drivers who operate commercial motor vehicles. FedEx subsequently withdrew its exemption application. The FedEx letter requesting withdrawal of this matter has been placed in the docket identified in the caption of this notice.

Issued on: September 15, 2006.

John H. Hill,
Administrator.

[FR Doc. 06-8123 Filed 9-22-06; 8:45 am]

BILLING CODE 4910-EX-P

DEPARTMENT OF TRANSPORTATION

Federal Motor Carrier Safety Administration

[Docket No. FMCSA-2006-24065]

Compliance with Interstate Motor Carrier Noise Emission Standards: Exhaust Systems

AGENCY: Federal Motor Carrier Safety Administration (FMCSA), DOT.

ACTION: Notice; request for comments.

SUMMARY: FMCSA requests public comment on the merits of a petition for rulemaking filed by the Truck Manufacturers Association. This trade association, whose members include all of the major North American manufacturers of medium and heavy-duty trucks, has petitioned FMCSA to amend the Federal Motor Carrier Safety Regulations to eliminate turbochargers from the list of equipment considered to be noise dissipative devices. The Truck

Manufacturers Association contends that virtually all trucks are now equipped with turbochargers. Hence, these trucks cannot be cited for failure to meet the visual exhaust system inspection requirements of FMCSA's safety regulations if they have no muffler.

DATES: Comments must be received on or before October 25, 2006.

ADDRESSES: You may submit comments [identified by DOT DMS Docket No. FMCSA-2006-24065] by any of the following methods:

- **Web site:** <http://dms.dot.gov>.

Follow the instructions for submitting comments on the DOT electronic docket site.

- **Fax:** 1-202-493-2251.

- **Mail:** Docket Management Facility, U.S. Department of Transportation, 400 Seventh Street, SW., Nassif Building, Room PL-401, Washington, DC 20590-0001.

- **Hand Delivery:** Room PL-401 on the Plaza Level of the Nassif Building, 400 Seventh Street, SW., Washington, DC, between 9 a.m. and 5 p.m., Monday through Friday, except Federal holidays.

- **Federal eRulemaking Portal:** Go to <http://www.regulations.gov>. Follow the online instructions for submitting comments.

Instructions: All submissions must include the Agency name and docket number for this notice. Note that all comments received will be posted without change (including any personal information provided) to <http://dms.dot.gov>. See the Privacy Act heading for further information.

Docket: For access to the docket to read background documents or comments received, go to <http://dms.dot.gov> at any time or to Room PL-401 on the Plaza Level of the Nassif Building, 400 Seventh Street, SW., Washington, DC, between 9 a.m. and 5 p.m., Monday through Friday, except Federal holidays. The Docket Management System (DMS) is available 24 hours each day, 365 days each year. If you want to be notified that we received your comments, please include a self-addressed, stamped envelope or postcard or print the acknowledgement page that appears after submitting comments online.

Privacy Act: Anyone may search the electronic form of all comments received into any of DOT's dockets by the name of the individual submitting the comment (or of the person signing the comment, if submitted on behalf of an association, business, labor union, or other entity). You may review DOT's complete Privacy Act Statement in the **Federal Register** published on April 11,

2000 (65 FR 19476). This statement is also available at <http://dms.dot.gov>.

FOR FURTHER INFORMATION CONTACT: Mr. Michael Huntley, Division Chief, Vehicle and Roadside Operations Division (MC-PSV), Office of Bus and Truck Standards and Operations, phone (202) 366-4001, e-mail MCPSV@dot.gov.

SUPPLEMENTARY INFORMATION:

Background

On October 21, 1974, the Environmental Protection Agency (EPA) issued final regulations establishing the Interstate Motor Carrier Noise Emission Standards for maximum external noise emissions of motor vehicles having a gross vehicle weight rating (GVWR) or a gross combination weight rating (GCWR) of more than 10,000 pounds that are operated by commercial motor carriers engaged in interstate commerce (39 FR 38208). These regulations were issued under the authority of section 18 of the Noise Control Act of 1972, which also directed the Secretary of Transportation to promulgate regulations to ensure compliance with the EPA standards.

On February 28, 1975, the Federal Highway Administration (FHWA) published in the **Federal Register** (40 FR 8658) a text of proposed regulations establishing measurement methodologies for determining whether commercial motor vehicles (CMV) conform to the Interstate Motor Carrier Noise Emission Standards published by the EPA at 40 CFR part 202. FHWA published final regulations on September 12, 1975 (40 FR 42432). The new requirements, found at 29 CFR 325.91, became effective on October 15, 1975.

The current requirements of § 325.91—unchanged since their adoption in 1975—were established to support enforcement of EPA's Interstate Motor Carrier Noise Emission Standards. While the corresponding section of the EPA regulation requires CMVs with a GVWR or GCWR of more than 10,000 pounds which are operated by interstate motor carriers to be “ * * * equipped with a muffler or other noise dissipative device; * * *”, the language adopted by FHWA in § 325.91 requires the same vehicles to be “ * * * equipped with either a muffler or other noise dissipative device, such as a turbocharger (supercharger driven by exhaust gases) * * *.”

It is not clear why the language that was adopted in § 325.91 is largely identical to that established by EPA except that it additionally considers a turbocharger to be a noise dissipative device under § 325.91(b). There is no

discussion in the preambles to either the February 1975 notice of proposed rulemaking or in the September 1975 final rule explaining why turbochargers were specifically included in the list of noise dissipative devices. In its petition, the Truck Manufacturers Association (TMA) noted:

At the time these regulations were written, many diesel engines were naturally aspirated, and coincidentally much louder than then-comparable turbocharged equipped engines/trucks. In that context, it made sense to include turbochargers with mufflers as acceptable noise dissipative devices, since both devices quieted trucks appreciably compared to trucks with naturally aspirated engines and totally unmuffled exhaust systems.

All newly manufactured trucks are currently equipped and certified to meet EPA's Transportation Equipment Noise Emission Controls requirement of 80 dB(A) (40 CFR part 205) when they are placed into initial service. Section 325.91 provides a simple inspection protocol to assist Federal and State safety inspectors in confirming compliance with the EPA exhaust system requirements of the Interstate Motor Carrier Noise Emission Standards (40 CFR 202.22).

While FMCSA believes that the vast majority of CMV operators currently comply with § 325.91, the TMA petition notes that the regulatory language of § 325.91, as currently written, conceivably permits vehicle operators to remove mufflers or other noise dissipative devices and still meet the Federal inspection requirements merely because the CMV engine is equipped with a turbocharger.

In its petition, TMA noted that

* * * removing the muffler can cause the truck to be 10–20 dB(A) louder; a 10 to 100 fold increase in the emitted sound power level of the vehicle.

Additionally, TMA stated that it is * * * not aware of any other credible, satisfactorily performing, and commercially available exhaust noise dissipative device other than mufflers.

Petition for Rulemaking

In its June 17, 2005 petition for rulemaking, TMA requested that the Federal Motor Carrier Safety Regulations (FMCSRs) be amended to eliminate turbochargers from the list of equipment considered to be noise dissipative devices. TMA proposes that the phrase “, such as a turbocharger (supercharger driven by exhaust gases)” be removed from 49 CFR 325.91(b).

Request for Comments

FMCSA requests public comment on TMA's petition for rulemaking to amend

49 CFR 325.91(b). Specifically, FMCSA requests that commenters indicate whether they believe the FMCSRs should be amended as requested by the petitioner and whether there is any data or other relevant information to suggest the need for such a change. FMCSA also requests information concerning the impact of the requested change on motor carriers' ability to achieve compliance with the requirements of section 325.91.

FMCSA will consider all comments received by close of business on October 25, 2006. Comments will be available for examination in the docket at the location listed under the **ADDRESSES** section of this notice. FMCSA will file comments received after the comment closing date in the public docket and will consider them to the extent practicable. In addition to late comments, FMCSA will also continue to file in the public docket relevant information that becomes available after the comment closing date. Interested persons should monitor the public docket for new material.

Issued on: September 8, 2006.

John H. Hill,
Administrator.

[FR Doc. 06–8156 Filed 9–22–06; 8:45 am]

BILLING CODE 4910-EX-P

DEPARTMENT OF TRANSPORTATION

Federal Railroad Administration

Docket No. [FRA–2000–7257; Notice No. 37]

Railroad Safety Advisory Committee (RSAC); Working Group Activity Update

AGENCY: Federal Railroad Administration (FRA), Department of Transportation (DOT).

ACTION: Announcement of Railroad Safety Advisory Committee (RSAC) Working Group Activities.

SUMMARY: The FRA is updating its announcement of RSAC's Working Group activities to reflect its current status.

FOR FURTHER INFORMATION CONTACT: Patricia Butera or Lydia Leeds, RSAC Coordinator, FRA, 1120 Vermont Avenue, NW., Mailstop 25, Washington, DC 20590, (202) 493–6212/6213 or Grady Cothen, Deputy Associate Administrator for Safety, FRA, 1120 Vermont Avenue, NW., Mailstop 25, Washington, DC 20590, (202) 493–6302.

SUPPLEMENTARY INFORMATION: This notice serves to update FRA's last announcement of working group activities and status reports of May 12,

2006, (71 FR 27781). The 29th full Committee meeting was held May 18, 2006.

Since its first meeting in April of 1996, the RSAC has accepted twenty-two tasks. Status for each of the tasks is provided below:

Open Tasks

Task 96-4—Reviewing the appropriateness of the agency's current policy regarding the applicability of existing and proposed regulations to tourist, excursion, scenic, and historic railroads. This Task was accepted on April 2, 1996, and a Working Group was established. The Working Group monitored the steam locomotive regulation task. Planned future activities involve the review of other regulations for possible adaptation to the safety needs of tourist and historic railroads. Contact: Grady Cothen, (202) 493-6302.

Task 97-2—Evaluating the extent to which environmental, sanitary, and other working conditions in locomotive cabs affect the crew's health and the safe operation of locomotives, proposing standards where appropriate. This Task was accepted June 24, 1997.

(Sanitation) (Completed)

(Noise exposure) On June 27, 2003, the full RSAC gave consensus by ballot on the NPRM. The NPRM was published in the **Federal Register** on June 23, 2004. The comment period ended September 21, 2004. Task Force and Working Group meetings were held March 1, and March 2 and 3, 2005, respectively, to review the public comments and recommend a final rule. The Working Group reached agreement on all issues, and its report was presented to the full Committee on May 18, 2005. The final rule is in review and clearance.

(Cab Temperature) (Completed)

Note: Additional related topics such as vibration may be considered by the Working Group in the future. Contact: Jeffrey Horn, (202) 493-6283.

Task 03-01—Passenger Safety. This Task was accepted on May 20, 2003, and a Working Group was established. Prior to embarking on substantive discussions of a specific task, the Working Group set forth in writing a specific description of the task. The Working Group will report any planned activity to the full Committee at each scheduled full RSAC meeting, including milestones for completion of projects and progress toward completion. At the first meeting held September 9-10, 2003, a consolidated list of issues was completed. At the second meeting held

November 6-7, 2003, four task groups were established: emergency preparedness; mechanical-general issues; mechanical-safety appliances; and track/vehicle interaction. The task groups met and reported on activities for Working Group consideration at the third meeting held May 11-12, 2004, and a fourth meeting was held October 26-27, 2004. The Working Group met on March 21-22, 2006, and tentatively agreed to establish a task force on General Passenger Safety. The Working Group met September 12-13, 2006, and activated the General Passenger Safety Task Force.

(Emergency Preparedness) At the Working Group meeting of March 9-10, 2005, the Working Group received and approved the consensus report of the Emergency Preparedness Task Force related to emergency egress and rescue access. These recommendations were presented to and approved by the full Committee on May 18, 2005. The Working Group met on September 7-8, 2005, and additional, supplementary recommendations were presented to and accepted by the full RSAC on October 11, 2005. An NPRM on Emergency Systems was published on August 24, 2006, and is open for comments until October 23, 2006.

(General Mechanical) Initial recommendations on mechanical issues (revisions to 49 CFR Part 238) were approved by the full Committee on January 26, 2005. At the Working Group meeting of September 7-8, 2005, the task force presented additional perfecting amendments and the full RSAC approved them on October 11, 2005. An NPRM was published in the **Federal Register** on December 8, 2005, (70 FR 73070). Public comments were due by February 17, 2006. FRA is currently preparing a final rule.

(Passenger Equipment Crashworthiness) The Crashworthiness Task Force provided consensus recommendations on static end strength that were adopted by the Working Group on September 7-8, 2005. The full Committee accepted the recommendations on October 11, 2005. The FRA is preparing an NPRM.

(Vehicle/Track Interaction) The task force is developing proposed revisions to Parts 213 and 238 principally regarding high-speed passenger service. Contact: Charles Bielitz, (202) 493-6314.

Task 05-01—Review of Roadway Worker Protection issues. This Task was accepted on January 26, 2005, to review 49 CFR 214, Subpart C, Roadway Worker Protection, and related sections of Subpart A; recommend consideration of specific actions to advance the on-track safety of railroad employees and

contractors engaged in maintenance-of-way activities throughout the general system of railroad transportation, including clarification of existing requirements. A Working Group has been established and will report to the RSAC any specific actions identified as appropriate. The first meeting of the Working Group was held on April 12-14, 2005. The Working Group will report planned activity to the full Committee at each scheduled Committee meeting, including milestones for completion of projects and progress toward completion. The Working Group met on June 22-24, 2005, August 8-11, 2005, September 20-22, 2005, November 8-9, 2005, January 10-11, 2006, February 1-2, 2006, March 15-16, 2006, April 11-12, 2006, and August 22-23, 2006. To date, the group has drafted and accepted regulatory language for various revisions, clarifications, and additions to 16 sections of the rule. The next Working Group meeting is being planned for November, 2006. A meeting is scheduled for January 17-18, 2007, with the final meeting scheduled for February 27-28, 2007. Contact: Christopher Schulte, (202) 493-6251.

Task 05-02—Reduce Human Factor-Caused Train Accident/Incidents. This Task was accepted on May 18, 2005, to reduce the number of human factor-caused train accidents/incidents and related employee injuries. A Working Group was established. The Working Group will report any planned activity to the full Committee at each scheduled full RSAC meeting, including milestones for completion of projects and progress toward completion. The Working Group met on July 12-13, 2005, August 31-September 1, 2005, September 28-29, 2005, October 25-26, 2005, November 16-17, 2005, and December 6-7, 2005. The final Working Group meeting devoted to developing a proposed rule was held February 8-9, 2006. The Working Group was not able to deliver a consensus regulatory proposal, but did recommend that it be used to review comments on FRA's forthcoming NPRM, which is under development with the Working Group's discussion draft as its basis. Contact: Douglas Taylor, (202) 493-6255.

Task 06-01—Locomotive Safety Standards. This task was accepted on February 22, 2006, to review Title 49 CFR Part 229, Railroad Locomotive Safety Standards, and revise as appropriate. A Working Group has been established. The Working Group will report any planned activity to the full Committee at each scheduled full RSAC meeting, including milestones for completion of projects and progress

toward completion. The first Working Group meeting was held May 8–10, 2006. The Working Group met on August 8–9, 2006, and the next meeting is scheduled for September 25–26, 2006. Contact: George Scerbo, (202) 493–6249.

Task 06–02—Track Safety Standards and Continuous Welded Rail. Section 9005 of the Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users (Pub. L. No. 109–59, “SAFETEA-LU”), the 2005 surface transportation authorization act, requires FRA to issue requirements for inspection of joint bars in continuous welded rail (CWR) to detect cracks that could affect the integrity of the track structure. 49 U.S.C. 20142(e). FRA published an Interim Final Rule establishing new requirements for inspections on November 2, 2005, (70 FR 66288). On October 11, 2005, FRA offered the RSAC a task to review comments on this IFR, but the conditions could not be established under which the Committee could have undertaken this with a view toward consensus. Comments on the IFR were received through December 19, 2005. FRA is reviewing the comments. On February 22, 2006, the RSAC accepted this task to review and revise the CWR related to provisions of the Track Safety Standards, with particular emphasis on reduction of derailments and consequent injuries and damage caused by defective conditions, including joint failures, in track using CWR. A Working Group has been established. The Working Group will report any planned activity to the full Committee at each scheduled full RSAC meeting, including milestones for completion of projects and progress toward completion. The first Working Group meeting was held April 3–4, 2006, at which time the Working Group reviewed comments on the IFR. The second Working Group meeting was held April 26–28, 2006. The Working Group also met May 24–25, 2006, and July 19–20, 2006. The Working Group reported consensus recommendations for the final rule that were accepted by the full Committee by mail ballot on August 11, 2006. FRA is currently preparing a final rule. Contact: Ken Rusk, (202) 493–6236.

Completed Tasks

Task 96–1—(Completed) Revising the Freight Power Brake Regulations.

Task 96–2—(Completed) Reviewing and recommending revisions to the Track Safety Standards (49 CFR Part 213).

Task 96–3—(Completed) Reviewing and recommending revisions to the Radio Standards and Procedures (49 CFR Part 220).

Task 96–5—(Completed) Reviewing and recommending revisions to Steam Locomotive Inspection Standards (49 CFR Part 230).

Task 96–6—(Completed) Reviewing and recommending revisions to miscellaneous aspects of the regulations addressing Locomotive Engineer Certification (49 CFR Part 240).

Task 96–7—(Completed) Developing Roadway Maintenance Machines (On-Track Equipment) Safety Standards.

Task 96–8—(Completed) This Planning Task evaluated the need for action responsive to recommendations contained in a report to Congress entitled, Locomotive Crashworthiness & Working Conditions.

Task 97–1—(Completed) Developing crashworthiness specifications (49 CFR Part 229) to promote the integrity of the locomotive cab in accidents resulting from collisions.

Task 97–3—(Completed) Developing event recorder data survivability standards.

Task 97–4 and Task 97–5—(Completed) Defining Positive Train Control (PTC) functionalities, describing available technologies, evaluating costs and benefits of potential systems, and considering implementation opportunities and challenges, including demonstration and deployment.

Task 97–6—(Completed) Revising various regulations to address the safety implications of processor-based signal and train control technologies, including communications-based operating systems.

Task 97–7—(Completed) Determining damages qualifying an event as a reportable train accident.

Task 00–1—(Completed—task withdrawn) Determining the need to amend regulations protecting persons who work on, under, or between rolling equipment and persons applying, removing or inspecting rear end marking devices (Blue Signal Protection).

Task 01–1—(Completed) Developing conformity of FRA’s regulations for accident/incident reporting (49 CFR Part 225) to revised regulations of the Occupational Safety and Health Administration (OSHA), U.S. Department of Labor, and to make appropriate revisions to the FRA Guide for Preparing Accident/Incident Reports (Reporting Guide).

Please refer to the notice published in the **Federal Register** on March 11, 1996, (61 FR 9740) for more information about the RSAC.

Issued in Washington, DC, on September 18, 2006.

Grady C. Cothen, Jr.

Deputy Associate Administrator for Safety Standards and Program Development.

[FR Doc. 06–8124 Filed 9–22–06; 8:45 am]

BILLING CODE 4910–06–P

DEPARTMENT OF TRANSPORTATION

Surface Transportation Board

[STB Ex Parte No. 664]

Methodology To Be Employed in Determining the Railroad Industry’s Cost of Capital

AGENCY: Surface Transportation Board.

ACTION: Request for comments.

SUMMARY: The Board is seeking comments on the appropriate methodology to be employed in determining the railroad industry’s estimated cost of capital to be used in future annual cost-of-capital determinations. We are also soliciting comments on how evidence should be submitted and analyzed in future cost-of-capital proceedings.

DATES: Comments are due on or before November 6, 2006.

ADDRESSES: Send comments (an original and 10 copies) referring to STB Ex Parte No. 664 to: Surface Transportation Board, 1925 K Street, NW., Washington, DC 20423–0001.

FOR FURTHER INFORMATION CONTACT: Paul Aguiar, (202) 565–1527. [Assistance for the hearing impaired is available through the Federal Information Relay Service (FIRS) at 1–800–877–8339.]

SUPPLEMENTARY INFORMATION: Section 205 of the Railroad Revitalization and Regulatory Reform Act of 1976 (4R Act) first codified the requirement for the Board or its predecessor to establish and maintain standards for railroad revenue adequacy. This provision stated that railroad revenues should provide a flow of net income plus depreciation adequate to support prudent capital outlays, assure the repayment of a reasonable level of debt, permit the raising of needed equity capital, cover the effects of inflation, and attract and retain capital in amounts adequate to provide a sound transportation system in the United States. Subsequent laws (including the ICC Termination Act of 1995) have retained this requirement. Thus, each year the Board makes a determination of which railroads are or are not revenue adequate.

The annual determination of the railroad industry’s cost of capital is used in evaluating the adequacy of railroad

revenues each year. It may also be utilized in other Board proceedings, including, but not necessarily limited to, those involving the prescription of maximum reasonable rate levels.

The cost-of-capital calculation has three elements: (1) The railroads' cost-of-debt capital; (2) the railroads' cost of preferred stock equity capital; (3) the railroads' cost of common stock equity capital; and (4) the capital structure mix of the railroad industry on a market value basis. With respect to the cost of equity, there are essentially two general approaches. It can be estimated directly by estimating its component parts, the factors for which investors ask compensation. These parts are the real time value of money, a premium for expected inflation, and a premium for risk. This is commonly referred to as the Capital Asset Pricing Model (CAPM) methodology. Alternatively, it can be estimated indirectly on the basis of the return expectations embodied in the prices investors are willing to pay for stocks, the Discounted Cash Flow (DCF) methodology. The point has often been raised, most notably by the railroads, that investors place less importance on historical growth factors than on the analysts' forecasts, thus making the forecast more meaningful. Other parties contend that investors do rely on historical trends and tend to discount the analysts' forecasts as being overly optimistic.

The Board has, for all previous cost-of-capital determinations, relied upon the DCF methodology to determine the railroads' cost of capital. We have also used the Institutional Brokers Estimate System (IBES) consensus forecast data to determine the growth rate ("g") component of the DCF formula. While the Board has relied on the use of the DCF methodology for determining the cost of common equity, there are other methodologies that could be employed. These include the CAPM, risk premium methods other than CAPM, earnings-price ratios, and the comparable earnings method.

We are seeking comments on the appropriate techniques and methodologies to be used to develop and evaluate the evidence submitted for the cost of capital. Parties should discuss any changes in underlying railroad industry economic conditions that would create the need to change the methodology currently employed by the Board, and how any proposed methodology will overcome the shortcomings, if any, of the currently used DCF method.

This proceeding will provide all interested parties an opportunity to comment on the DCF model, the proper

source for the inputs to that model, and whether the Board should adopt an alternative to that method, such as the CAPM model, for future cost of capital determinations.

This action will not significantly affect either the quality of the human environment or the conservation of energy resources.

Pursuant to 5 U.S.C. 605(b), we certify that the proposed action would not have a significant economic impact on a substantial number of small entities within the meaning of the Regulatory Flexibility Act.

Board decisions and notices are available on our Web site at <http://www.stb.dot.gov>.

Decided: September 15, 2006.

By the Board, Chairman Nottingham, Vice Chairman Mulvey, and Commissioner Buttrey.

Vernon A. Williams,
Secretary.

[FR Doc. 06-8098 Filed 9-22-06; 8:45 am]

BILLING CODE 4915-01-P

DEPARTMENT OF TRANSPORTATION

Surface Transportation Board

[STB Docket No. AB-871X]

State of New Hampshire Department of Transportation—Abandonment Exemption—in Belknap County, NH

The State of New Hampshire, Department of Transportation, Bureau of Rail and Transit (NHDOT), has filed an amended notice of exemption¹ under 49 CFR part 1152 subpart F—*Exempt Abandonments* to abandon a portion of rail line known as the Lakeport Spur, in Belknap County, NH, extending from engineering station 1 + 70 to engineering station 11 + 28.11 (on Valuation Section V.21, Map 65-A).² The line traverses United States Postal Service Zip Code 03246.

NHDOT has certified that: (1) No local traffic has moved over the line for at least 2 years; (2) there is no overhead traffic on the line to be rerouted; (3) no formal complaint filed by a user of rail service on the line (or by a state or local government entity acting on behalf of such user) regarding cessation of service

over the line either is pending with the Surface Transportation Board or with any U.S. District Court or has been decided in favor of complainant within the 2-year period; and (4) the requirements at 49 CFR 1105.7 (environmental reports), 49 CFR 1105.8 (historic reports), 49 CFR 1105.11 (transmittal letter), 49 CFR 1105.12 (newspaper publication), and 49 CFR 1152.50(d)(1) (notice to governmental agencies) have been met.

As a condition to this exemption, any employee adversely affected by the abandonment shall be protected under *Oregon Short Line R. Co.—Abandonment—Goshen*, 360 I.C.C. 91 (1979). To address whether this condition adequately protects affected employees, a petition for partial revocation under 49 U.S.C. 10502(d) must be filed.

Provided no formal expression of intent to file an offer of financial assistance (OFA) has been received, this exemption will be effective on October 25, 2006, unless stayed pending reconsideration. Petitions to stay that do not involve environmental issues,³ formal expressions of intent to file an OFA under 49 CFR 1152.27(c)(2),⁴ and trail use/rail banking requests under 49 CFR 1152.29 must be filed by October 5, 2006. Petitions to reopen or requests for public use conditions under 49 CFR 1152.28 must be filed by October 16, 2006, with the Surface Transportation Board, 1925 K Street, NW., Washington, DC 20423-0001.

A copy of any petition filed with the Board should be sent to NHDOT's representative: Stephen G. LaBonte, Assistant Attorney General, Office of the Attorney General, 33 Capitol Street, Concord, NH 03301.

If the verified notice contains false or misleading information, the exemption is void *ab initio*.

NHDOT has filed a combined environmental report and historic report which addresses the effects, if any, of the abandonment on the environment and historic resources. SEA will issue an environmental assessment (EA) by September 29, 2006. Interested persons may obtain a copy of the EA by writing to SEA (Room 500, Surface Transportation Board, Washington, DC

¹ NHDOT originally filed its notice of exemption on March 14, 2006. After consulting with the Board's Section of Environmental Analysis (SEA), NHDOT filed an amended notice of exemption on September 5, 2006, which became the official filing date.

² NHDOT states that, prior to the filing of this notice of exemption, the property was acquired by James R. Irwin, & Sons, Inc., and currently is being used for a commercial boat storage facility and marina.

³ The Board will grant a stay if an informed decision on environmental issues (whether raised by a party or by SEA in its independent investigation) cannot be made before the exemption's effective date. *See Exemption of Out-of-Service Rail Lines*, 5 I.C.C.2d 377 (1989). Any request for a stay should be filed as soon as possible so that the Board may take appropriate action before the exemption's effective date.

⁴ Each OFA must be accompanied by the filing fee, which currently is set at \$1,300. *See* 49 CFR 1002.2(f)(25).

20423-0001) or by calling SEA, at (202) 565-1539. [Assistance for the hearing impaired is available through the Federal Information Relay Service (FIRS) at 1-800-877-8339.] Comments on environmental and historic preservation matters must be filed within 15 days after the EA becomes available to the public.

Environmental, historic preservation, public use, or trail use/rail banking

conditions will be imposed, where appropriate, in a subsequent decision.

Pursuant to the provisions of 49 CFR 1152.29(e)(2), NHDOT shall file a notice of consummation with the Board to signify that it has exercised the authority granted and fully abandoned the line. If consummation has not been effected by NHDOT's filing of a notice of consummation by September 25, 2007, and there are no legal or regulatory barriers to consummation,

the authority to abandon will automatically expire.

Board decisions and notices are available on our Web site at <http://www.stb.dot.gov>.

Decided: September 15, 2006.

By the Board, David M. Konschnik,
Director, Office of Proceedings.

Vernon A. Williams,

Secretary.

[FR Doc. 06-7968 Filed 9-22-06; 8:45 am]

BILLING CODE 4915-01-P



Federal Register

**Monday,
September 25, 2006**

Part II

Department of the Treasury Office of the Comptroller of the Currency

**Office of Thrift Supervision
12 CFR Part 3 and 566**

Federal Reserve System

12 CFR Parts 208 and 225

Federal Deposit Insurance Corporation

12 CFR Part 325

**Risk-Based Capital Standards: Advanced
Capital Adequacy Framework and Market
Risk; Proposed Rules and Notices**

DEPARTMENT OF THE TREASURY**Office of the Comptroller of the Currency****12 CFR Part 3**

[Docket No. 06–09]

RIN 1557–AC91

FEDERAL RESERVE SYSTEM**12 CFR Parts 208 and 225**

[Regulations H and Y; Docket No. R–1261]

FEDERAL DEPOSIT INSURANCE CORPORATION**12 CFR Part 325**

RIN 3064–AC73

DEPARTMENT OF THE TREASURY**Office of Thrift Supervision****12 CFR Part 566**

RIN 1550–AB56

Risk-Based Capital Standards: Advanced Capital Adequacy Framework

AGENCIES: Office of the Comptroller of the Currency, Treasury; Board of Governors of the Federal Reserve System; Federal Deposit Insurance Corporation; and Office of Thrift Supervision, Treasury.

ACTION: Joint notice of proposed rulemaking.

SUMMARY: The Office of the Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve System (Board), the Federal Deposit Insurance Corporation (FDIC), and the Office of Thrift Supervision (OTS) (collectively, the agencies) are proposing a new risk-based capital adequacy framework that would require some and permit other qualifying banks¹ to use an internal ratings-based approach to calculate regulatory credit risk capital requirements and advanced measurement approaches to calculate regulatory operational risk capital requirements. The proposed rule describes the qualifying criteria for banks required or seeking to operate under the proposed framework and the applicable risk-based capital

requirements for banks that operate under the framework.

DATES: Comments must be received on or before January 23, 2007.

ADDRESSES: Comments should be directed to:

OCC: You should include OCC and Docket Number 06–09 in your comment. You may submit comments by any of the following methods:

- *Federal eRulemaking Portal:* <http://www.regulations.gov>. Follow the instructions for submitting comments.

- *OCC Web Site:* <http://www.occ.treas.gov>. Click on “Contact the OCC,” scroll down and click on “Comments on Proposed Regulations.”

- *E-mail address:* regs.comments@occ.treas.gov.

- *Fax:* (202) 874–4448.

- *Mail:* Office of the Comptroller of the Currency, 250 E Street, SW., Mail Stop 1–5, Washington, DC 20219.

- *Hand Delivery/Courier:* 250 E Street, SW., Attn: Public Information Room, Mail Stop 1–5, Washington, DC 20219.

Instructions: All submissions received must include the agency name (OCC) and docket number or Regulatory Information Number (RIN) for this notice of proposed rulemaking. In general, OCC will enter all comments received into the docket without change, including any business or personal information that you provide. You may review comments and other related materials by any of the following methods:

- *Viewing Comments Personally:* You may personally inspect and photocopy comments at the OCC’s Public Information Room, 250 E Street, SW., Washington, DC. You can make an appointment to inspect comments by calling (202) 874–5043.

- *Board:* You may submit comments, identified by Docket No. R–1261, by any of the following methods:

- *Agency Web Site:* <http://www.federalreserve.gov>. Follow the instructions for submitting comments at <http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm>.

- *Federal eRulemaking Portal:* <http://www.regulations.gov>. Follow the instructions for submitting comments.

- *E-mail:* regs.comments@federalreserve.gov. Include docket number in the subject line of the message.

- *FAX:* 202/452–3819 or 202/452–3102.

- *Mail:* Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, NW., Washington, DC 20551.

All public comments are available from the Board’s Web site at www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm as submitted, unless modified for technical reasons. Accordingly, your comments will not be edited to remove any identifying or contact information. Public comments may also be viewed electronically or in paper in Room MP–500 of the Board’s Martin Building (20th and C Streets, NW.) between 9 a.m. and 5 p.m. on weekdays.

FDIC: You may submit comments, identified by RIN number, by any of the following methods:

- *Federal eRulemaking Portal:* <http://www.regulations.gov>. Follow the instructions for submitting comments.

- *Agency Web Site:* <http://www.fdic.gov/regulations/laws/federal/propose.html>.

- *Mail:* Robert E. Feldman, Executive Secretary, Attention: Comments, Federal Deposit Insurance Corporation, 550 17th Street, NW., Washington, DC 20429.

- *Hand Delivery/Courier:* Guard station at rear of the 550 17th Street Building (located on F Street) on business days between 7 a.m. and 5 p.m.

- *E-mail:* Comments@FDIC.gov.

- *Public Inspection:* Comments may be inspected at the FDIC Public Information Center, Room E–1002, 3502 Fairfax Drive, Arlington, VA 22226, between 9 a.m. and 5 p.m. on business days.

Instructions: Submissions received must include the agency name and RIN for this rulemaking. Comments received will be posted without change to <http://www.fdic.gov/regulations/laws/federal/propose.html> including any personal information provided.

OTS: You may submit comments, identified by No. 2006–33, by any of the following methods:

- *Federal eRulemaking Portal:* <http://www.regulations.gov>. Follow the instructions for submitting comments.

- *E-mail address:* regs.comments@ots.treas.gov. Please include No. 2006–33 in the subject line of the message and include your name and telephone number in the message.

- *Fax:* (202) 906–6518.

- *Mail:* Regulation Comments, Chief Counsel’s Office, Office of Thrift Supervision, 1700 G Street, NW., Washington, DC 20552, Attention: No. 2006–33.

- *Hand Delivery/Courier:* Guard’s Desk, East Lobby Entrance, 1700 G Street, NW., from 9 a.m. to 4 p.m. on business days, *Attention:* Regulation Comments, Chief Counsel’s Office, *Attention:* No. 2006–33.

Instructions: All submissions received must include the agency name and

¹ For simplicity, and unless otherwise indicated, this notice of proposed rulemaking (NPR) uses the term “bank” to include banks, savings associations, and bank holding companies (BHCs). The terms “bank holding company” and “BHS” refer only to bank holding companies regulated by the board and do not include savings and loan holding companies regulated by the OTS.

docket number or Regulatory Information Number (RIN) for this rulemaking. All comments received will be posted without change to the OTS Internet Site at <http://www.ots.treas.gov/pagehtml.cfm?catNumber=67&an=1>, including any personal information provided.

Docket: For access to the docket to read background documents or comments received, go to <http://www.ots.treas.gov/pagehtml.cfm?catNumber=67&an=1>.

In addition, you may inspect comments at the Public Reading Room, 1700 G Street, NW., by appointment. To make an appointment for access, call (202) 906-5922, send an e-mail to public.info@ots.treas.gov, or send a facsimile transmission to (202) 906-7755. (Prior notice identifying the materials you will be requesting will assist us in serving you.) We schedule appointments on business days between 10 a.m. and 4 p.m. In most cases, appointments will be available the next business day following the date we receive a request.

FOR FURTHER INFORMATION CONTACT:

OCC: Roger Tufts, Senior Economic Advisor, Capital Policy (202-874-4925) or Ron Shimabukuro, Special Counsel, Legislative and Regulatory Activities Division (202-874-5090). Office of the Comptroller of the Currency, 250 E Street, SW., Washington, DC 20219.

Board: Barbara Bouchard, Deputy Associate Director (202-452-3072 or barbara.bouchard@frb.gov) or Anna Lee Hewko, Senior Supervisory Financial Analyst (202-530-6260 or anna.hewko@frb.gov), Division of Banking Supervision and Regulation; or Mark E. Van Der Weide, Senior Counsel (202-452-2263 or mark.vanderweide@frb.gov), Legal Division. For users of Telecommunications Device for the Deaf ("TDD") only, contact 202-263-4869.

FDIC: Jason C. Cave, Associate Director, Capital Markets Branch, (202) 898-3548, Bobby R. Bean, Senior Quantitative Risk Analyst, Capital Markets Branch, (202) 898-3575, Kenton Fox, Senior Capital Markets Specialist, Capital Markets Branch, (202) 898-7119, Division of Supervision and Consumer Protection; or Michael B. Phillips, Counsel, (202) 898-3581, Supervision and Legislation Branch, Legal Division, Federal Deposit Insurance Corporation, 550 17th Street, NW., Washington, DC 20429.

OTS: Michael D. Solomon, Director, Capital Policy, Supervision Policy (202) 906-5654; David W. Riley, Senior Analyst, Capital Policy (202) 906-6669; or Karen Osterloh, Special Counsel,

Regulations and Legislation Division (202) 906-6639, Office of Thrift Supervision, 1700 G Street, NW., Washington, DC 20552.

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I. Introduction

A. Background

On August 4, 2003, the agencies issued an advance notice of proposed rulemaking (ANPR) (68 FR 45900) that sought public comment on a new risk-based regulatory capital framework based on the Basel Committee on Banking Supervision (BCBS)² April 2003 consultative paper entitled “New Basel Capital Accord” (Proposed New Accord). The Proposed New Accord set forth a “three pillar” framework encompassing risk-based capital requirements for credit risk, market risk, and operational risk (Pillar 1); supervisory review of capital adequacy (Pillar 2); and market discipline through enhanced public disclosures (Pillar 3). The Proposed New Accord incorporated several methodologies for determining a bank’s risk-based capital requirements for credit, market, and operational risk.³

The ANPR sought comment on selected regulatory capital approaches contained in the Proposed New Accord that the agencies believe are appropriate for large, internationally active U.S. banks. These approaches include the

internal ratings-based (IRB) approach for credit risk and the advanced measurement approaches (AMA) for operational risk (together, the advanced approaches). The IRB framework uses risk parameters determined by a bank’s internal systems in the calculation of the bank’s credit risk capital requirements. The AMA relies on a bank’s internal estimates of its operational risks to generate an operational risk capital requirement for the bank. The ANPR included a number of questions highlighting various issues for the industry’s consideration. The agencies received approximately 100 public comments on the ANPR from banks, trade associations, supervisory authorities, and other interested parties. These comments addressed the agencies’ specific questions as well as a range of other issues. Commenters generally encouraged further development of the framework, and most supported the overall direction of the ANPR. Commenters did, however, raise a number of conceptual and technical issues that they believed required additional consideration.

Since the issuance of the ANPR, the agencies have worked domestically and with other BCBS member countries to modify the methodologies in the Proposed New Accord to reflect comments received during the international consultation process and the U.S. ANPR comment process. In June 2004, the BCBS issued a document entitled “International Convergence of Capital Measurement and Capital Standards: A Revised Framework” (New Accord or Basel II). The New Accord recognizes developments in financial products, incorporates advances in risk measurement and management practices, and assesses capital requirements that are generally more sensitive to risk. It is intended for use by individual countries as the basis for national consultation and implementation. Accordingly, the agencies are issuing this proposed rule to implement the New Accord for banks in the United States.

B. Conceptual Overview

The framework outlined in this proposal (IRB framework) is intended to

produce risk-based capital requirements that are more risk-sensitive than the existing risk-based capital rules of the agencies (general risk-based capital rules). The proposed framework seeks to build on improvements to risk assessment approaches that a number of large banks have adopted over the last decade. In particular, the proposed framework requires banks to assign risk parameters to exposures and provides specific risk-based capital formulas that would be used to transform these risk parameters into risk-based capital requirements.

The proposed framework is based on the “value-at-risk” (VaR) approach to measuring credit risk and operational risk. VaR modeling techniques for measuring risk have been the subject of economic research and are used by large banks. The proposed framework has benefited significantly from comments on the ANPR, as well as consultations organized in conjunction with the BCBS’s development of the New Accord. Because bank risk measurement practices are both continually evolving and subject to model and other errors, the proposed framework should be viewed less as an effort to produce a statistically precise measurement of risk, and more as an effort to improve the risk sensitivity of the risk-based capital requirements for banks.

The proposed framework’s conceptual foundation is based on the view that risk can be quantified through the assessment of specific characteristics of the probability distribution of potential losses over a given time horizon. This approach assumes that a suitable estimate of that probability distribution, or at least of the specific characteristics to be measured, can be produced. Figure 1 illustrates some of the key concepts associated with the proposed framework. The figure shows a probability distribution of potential losses associated with some time horizon (for example, one year). It could reflect, for example, credit losses, operational losses, or other types of losses.

² The BCBS is a committee of banking supervisory authorities, which was established by the central bank governors of the G–10 countries in 1975. It consists of senior representatives of bank supervisory authorities and central banks from Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, the Netherlands, Spain, Sweden, Switzerland, the United Kingdom, and the United States.

³ The BCBS developed the Proposed New Accord to modernize its first capital Accord, which was endorsed by the G–10 governors in 1988 and implemented by the agencies in the United States in 1989. The BCBS’s 1988 Accord is described in a document entitled “International Convergence of Capital Measurement and Capital Standards.” This document and other documents issued by the BCBS are available through the Bank for International

Settlements Web site at <http://www.bis.org>. The agencies’ implementing regulations are available at 12 CFR part 3, Appendices A and B (national banks); 12 CFR part 208, Appendices A and E (state member banks); 12 CFR part 225, Appendixes A and E (bank holding companies); 12 CFR part 325, Appendixes A and C (state nonmember banks); and 12 CFR part 567 (savings associations).

Figure 1 – Probability Distribution of Potential Losses



The area under the curve to the right of a particular loss amount is the probability of experiencing losses exceeding this amount within a given time horizon. The figure also shows the statistical mean of the loss distribution, which is equivalent to the amount of loss that is “expected” over the time horizon. The concept of “expected loss” (EL) is distinguished from that of “unexpected loss” (UL), which represents potential losses over and above the expected loss amount. A given level of unexpected loss can be defined by reference to a particular percentile threshold of the probability distribution. In the figure, for example, the 99.9th percentile is shown. Unexpected losses, measured at the 99.9th percentile level, are equal to the value of the loss distribution corresponding to the 99.9th percentile, less the amount of expected losses. This is shown graphically at the bottom of the figure.

The particular percentile level chosen for the measurement of unexpected losses is referred to as the “confidence level” or the “soundness standard” associated with the measurement. If capital is available to cover losses up to and including this percentile level, then the bank will remain solvent in the face of actual losses of that magnitude. Typically, the choice of confidence level or soundness standard reflects a very high percentile level, so that there is a very low estimated probability that actual losses would exceed the unexpected loss amount associated with that confidence level or soundness standard.

Assessing risk and assigning regulatory capital requirements by reference to a specific percentile of a probability distribution of potential losses is commonly referred to as a VaR approach. Such an approach was adopted by the FDIC, Board, and OCC for assessing a bank’s risk-based capital requirements for market risk in 1996 (market risk amendment or MRA). Under the MRA, a bank’s own internal models are used to estimate the 99th percentile of the bank’s market risk loss distribution over a ten-business-day horizon. The bank’s market risk capital requirement is based on this VaR estimate, generally multiplied by a factor of three. The agencies implemented this multiplication factor to provide a prudential buffer for market volatility and modeling error.

1. The IRB Framework for Credit Risk

The conceptual foundation of this proposal’s approach to credit risk capital requirements is similar to the MRA’s approach to market risk capital requirements, in the sense that each is VaR-oriented. That is, the proposed framework bases minimum credit risk capital requirements largely on estimated statistical measures of credit risk. Nevertheless, there are important differences between this proposal and the MRA. The MRA approach for assessing market risk capital requirements currently employs a nominal confidence level of 99.0 percent and a ten-business-day horizon, but otherwise provides banks with substantial modeling flexibility in determining their market risk loss distribution and capital requirements. In contrast, the IRB framework for

assessing credit risk capital requirements is based on a 99.9 percent nominal confidence level, a one-year horizon, and a supervisory model of credit losses embodying particular assumptions about the underlying drivers of portfolio credit risk, including loss correlations among different asset types.⁴

The IRB framework is broadly similar to the credit VaR approaches used by many banks as the basis for their internal assessment of the economic capital necessary to cover credit risk. It is common for a bank’s internal credit risk models to consider a one-year loss horizon, and to focus on a high loss threshold confidence level. As with the internal credit VaR models used by banks, the output of the risk-based capital formulas in the IRB framework is an estimate of the amount of credit losses above expected credit losses (ECL) over a one-year horizon that would only be exceeded a small percentage of the time. The agencies believe that a one-year horizon is

⁴ The theoretical underpinnings for the supervisory model of credit risk underlying this proposal are provided in Michael Gordy, “A Risk-Factor Model Foundation for Ratings-Based Bank Capital Rules,” *Journal of Financial Intermediation*, July 2003. The IRB formulas are derived as an application of these results to a single-factor CreditMetrics-style model. For mathematical details on this model, see Michael Gordy, “A Comparative Anatomy of Credit Risk Models,” *Journal of Banking and Finance*, January 2000, or H.U. Koyluoglu and A. Hickman, “Reconcilable Differences,” *Risk*, October 1998. For a less technical overview of the IRB formulas, see the BCBS’s “An Explanatory Note on the Basel II Risk Weight Functions,” July 2005 (Explanatory Note). The document can be found on the Bank for International Settlements Web site at <http://www.bis.org>.

appropriate because it balances the fact that banking book positions likely could not be easily or rapidly exited with the possibility that in many cases a bank can cover credit losses by raising additional capital should the underlying credit problems manifest themselves gradually. The nominal confidence level of the IRB risk-based capital formulas (99.9 percent) means that if all the assumptions in the IRB supervisory model for credit risk were correct for a bank, there would be less than a 0.1 percent probability that credit losses at the bank in any year would exceed the IRB risk-based capital requirement.⁵

As noted above, the supervisory model of credit risk underlying the IRB framework embodies specific assumptions about the economic drivers of portfolio credit risk at banks. As with any modeling approach, these assumptions represent simplifications of very complex real-world phenomena and, at best, are only an approximation of the actual credit risks at any bank. To the extent these assumptions (described in greater detail below) do not characterize a given bank precisely, the actual confidence level implied by the IRB risk-based capital formulas may exceed or fall short of the framework's nominal 99.9 percent confidence level.

In combination with other supervisory assumptions and parameters underlying this proposal, the IRB framework's 99.9 percent nominal confidence level reflects a judgmental pooling of available information, including supervisory experience. The framework underlying this proposal reflects a desire on the part of the agencies to achieve (i) *relative* risk-based capital requirements across different assets that are broadly consistent with maintaining at least an investment grade rating (for example, at least BBB) on the liabilities funding those assets, even in periods of economic adversity; and (ii) for the U.S. banking system as a whole, aggregate minimum regulatory capital requirements that are not a material reduction from the aggregate minimum regulatory capital requirements under the general risk-based capital rules.

A number of important explicit generalizing assumptions and specific parameters are built into the IRB framework to make the framework

applicable to a range of banks and to obtain tractable information for calculating risk-based capital requirements. Chief among the assumptions embodied in the IRB framework are: (i) Assumptions that a bank's credit portfolio is infinitely granular; (ii) assumptions that loan defaults at a bank are driven by a single, systematic risk factor; (iii) assumptions that systematic and non-systematic risk factors are log-normal random variables; and (iv) assumptions regarding correlations among credit losses on various types of assets.

The specific risk-based capital formulas in this proposed rule require the bank to estimate certain risk parameters for its wholesale and retail exposures, which the bank may do using a variety of techniques. These risk parameters are probability of default (PD), expected loss given default (ELGD), loss given default (LGD), exposure at default (EAD), and, for wholesale exposures, effective remaining maturity (M). The risk-based capital formulas into which the estimated risk parameters are inserted are simpler than the economic capital methodologies typically employed by banks (which often require complex computer simulations). In particular, an important property of the IRB risk-based capital formulas is portfolio invariance. That is, the risk-based capital requirement for a particular exposure generally does not depend on the other exposures held by the bank. Like the general risk-based capital rules, the total credit risk capital requirement for a bank's wholesale and retail exposures is the sum of the credit risk capital requirements on individual wholesale exposures and retail exposures.

The IRB risk-based capital formulas contain supervisory asset value correlation (AVC) factors, which have a significant impact on the capital requirements generated by the formulas. The AVC assigned to a given portfolio of exposures is an estimate of the degree to which any unanticipated changes in the financial conditions of the underlying obligors of the exposures are correlated (that is, would likely move up and down together). High correlation of exposures in a period of economic downturn conditions is an area of supervisory concern. For a portfolio of exposures having the same risk parameters, a larger AVC implies less diversification within the portfolio, greater overall systematic risk, and, hence, a higher risk-based capital requirement.⁶ For example, a 15 percent AVC for a portfolio of residential

mortgage exposures would result in a lower risk-based capital requirement than a 20 percent AVC and a higher risk-based capital requirement than a 10 percent AVC.

The AVCs that appear in the IRB risk-based capital formulas for wholesale exposures decline with increasing PD; that is, the IRB risk-based capital formulas generally imply that a group of low-PD wholesale exposures are more correlated than a group of high-PD wholesale exposures. Thus, under the proposed rule, a low-PD wholesale exposure would have a higher relative risk-based capital requirement than that implied by its PD were the AVC in the IRB risk-based capital formulas for wholesale exposures fixed rather than a function of PD. This inverse relationship between PD and AVC for wholesale exposures is broadly consistent with empirical research undertaken by G10 supervisors and moderates the sensitivity of IRB risk-based capital requirements for wholesale exposures to the economic cycle. *Question 1: The agencies seek comment on and empirical analysis of the appropriateness of the proposed rule's AVCs for wholesale exposures in general and for various types of wholesale exposures (for example, commercial real estate exposures).*

The AVCs included in the IRB risk-based capital formulas for retail exposures also reflect a combination of supervisory judgment and empirical evidence.⁷ However, the historical data available for estimating these correlations was more limited than was the case with wholesale exposures, particularly for non-mortgage retail exposures. As a result, supervisory judgment played a greater role. Moreover, the flat 15 percent AVC for residential mortgage exposures is based largely on empirical analysis of traditional long-term, fixed-rate mortgages. *Question 2: The agencies seek comment on and empirical analysis of the appropriateness and risk sensitivity of the proposed rule's AVC for residential mortgage exposures—not only for long-term, fixed-rate mortgages, but also for adjustable-rate mortgages, home equity lines of credit, and other mortgage products—and for other retail portfolios.*

Another important conceptual element of the IRB framework concerns the treatment of EL. The ANPR generally would have required banks to hold capital against the measured amount of UL plus EL over a one-year horizon, except in the limited instance of credit card exposures where future

⁵ Banks' internal economic capital models typically focus on measures of equity capital, whereas the total regulatory capital measure underlying this proposal includes not only equity capital, but also certain debt and hybrid instruments, such as subordinated debt. Thus, the 99.9 percent nominal confidence level embodied in the IRB framework is not directly comparable to the nominal solvency standards underpinning banks' economic capital models.

⁶ See Explanatory Note.

⁷ See Explanatory Note, section 5.3.

margin income (FMI) was allowed to offset ECL. The ANPR treatment also would have maintained the existing definition of regulatory capital, which includes the allowance for loan and lease losses (ALLL) in tier 2 capital up to a limit equal to 1.25 percent of risk-weighted assets. The ANPR requested comment on the proposed treatment of EL. Many commenters on the ANPR objected to this treatment on conceptual grounds, arguing that capital is not the appropriate mechanism for covering EL. In response to this feedback, the agencies sought and obtained changes to the BCBS's proposals in this area.

The agencies supported the BCBS's proposal, announced in October 2003, to remove ECL (as defined below) from the risk-weighted assets calculation. This NPR, consistent with the New Accord, removes ECL from the risk-weighted assets calculation but requires a bank to compare its ECL to its eligible credit reserves (as defined below). If a bank's ECL exceeds its eligible credit reserves, the bank must deduct the excess ECL amount 50 percent from tier 1 capital and 50 percent from tier 2 capital. If a bank's eligible credit reserves exceed its ECL, the bank would be able to include the excess eligible credit reserves amount in tier 2 capital, up to 0.6 percent of the bank's credit risk-weighted assets. This treatment is intended to maintain a capital incentive to reserve prudently and seeks to ensure that ECL over a one-year horizon is covered either by reserves or capital. This treatment also recognizes that prudent reserving that considers probable losses over the life of a loan may result in a bank holding reserves in excess of ECL measured with a one-year horizon. The BCBS calibrated the proposed 0.6 percent limit on inclusion of excess reserves in tier 2 capital to be approximately as restrictive as the existing cap on the inclusion of ALLL under the general risk-based capital rules, based on data obtained in the BCBS's Third Quantitative Impact Study (QIS-3).⁸ *Question 3: The agencies seek comment and supporting data on the appropriateness of this limit.*

The agencies are aware that certain banks believe that FMI should be eligible to cover ECL for the purposes of such a calculation, while other banks have asserted that, for certain business lines, prudential reserving practices do not involve setting reserves at levels consistent with ECL over a horizon as long as one year. The agencies nevertheless believe that the proposed approach is appropriate because banks

should receive risk-based capital benefits only for the most highly reliable ECL offsets.

The combined impact of these changes in the treatment of ECL and reserves will depend on the reserving practices of individual banks. Nevertheless, if other factors are equal, the removal of ECL from the calculation of risk-weighted assets will result in a lower amount of risk-weighted assets than the proposals in the ANPR. However, the impact on risk-based capital ratios should be partially offset by related changes to the numerators of the risk-based capital ratios—specifically, (i) the ALLL will be allowed in tier 2 capital up to certain limits only to the extent that it and certain other reserves exceed ECL, and (ii) if ECL exceeds reserves, the reserve shortfall must be deducted 50 percent from tier 1 capital and 50 percent from tier 2 capital.

Using data from QIS-3, the BCBS conducted an analysis of the risk-based capital requirements that would be generated under the New Accord, taking into account the aggregate effect of ECL-related changes to both the numerator and the denominator of the risk-based capital ratios. The BCBS concluded that to offset these changes relative to the credit risk-based capital requirements of the Proposed New Accord, it might be necessary under the New Accord to apply a “scaling factor” (multiplier) to credit risk-weighted assets. The BCBS, in the New Accord, indicated that the best estimate of the scaling factor using QIS-3 data adjusted for the EL-UL decisions was 1.06. The BCBS noted that a final determination of any scaling factor would be reconsidered prior to full implementation of the new framework. The agencies are proposing a multiplier of 1.06 at this time, consistent with the New Accord.

The agencies note that a 1.06 multiplier should be viewed as a placeholder. The BCBS is expected to revisit the determination of a scaling factor based on the results of the latest international QIS (QIS-5, which was not conducted in the United States).⁹ The agencies will consider the BCBS's determination, as well as other factors including the most recent QIS conducted in the United States (QIS-4, which is described below),¹⁰ in determining a multiplier for the final rule. As the agencies gain more experience with the proposed advanced approaches, the agencies will revisit the scaling factor along with other

calibration issues identified during the parallel run and transitional floor periods (described below) and make changes to the rule as necessary. While a scaling factor is one way to ensure that regulatory capital is maintained at a certain level, particularly in the short- to medium-term, the agencies also may address calibration issues through modifications to the underlying IRB risk-based capital formulas.

2. The AMA for Operational Risk

The proposed rule also includes the AMA for determining risk-based capital requirements for operational risk. Under the proposed rule, operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people, and systems or from external events. This definition of operational risk includes legal risk—which is the risk of loss (including litigation costs, settlements, and regulatory fines) resulting from the failure of the bank to comply with laws, regulations, prudent ethical standards, and contractual obligations in any aspect of the bank's business—but excludes strategic and reputational risks.

Under the AMA, a bank would use its internal operational risk management systems and processes to assess its exposure to operational risk. Given the complexities involved in measuring operational risk, the AMA provides banks with substantial flexibility and, therefore, does not require a bank to use specific methodologies or distributional assumptions. Nevertheless, a bank using the AMA must demonstrate to the satisfaction of its primary Federal supervisor that its systems for managing and measuring operational risk meet established standards, including producing an estimate of operational risk exposure that meets a 1-year, 99.9th percentile soundness standard. A bank's estimate of operational risk exposure includes both expected operational loss (EOL) and unexpected operational loss (UOL) and forms the basis of the bank's risk-based capital requirement for operational risk.

The AMA allows a bank to base its risk-based capital requirement for operational risk on UOL alone if the bank can demonstrate to the satisfaction of its primary Federal supervisor that the bank has eligible operational risk offsets, such as certain operational risk reserves, that equal or exceed the bank's EOL. To the extent that eligible operational risk offsets are less than EOL, the bank's risk-based capital requirement for operational risk must incorporate the shortfall.

⁸ BCBS, “QIS 3: Third Quantitative Impact Study,” May 2003.

⁹ See <http://www.bis.org/bcbs/qis/qis5.htm>.

¹⁰ See “Summary Findings of the Fourth Quantitative Impact Study,” February 24, 2006.

C. Overview of Proposed Rule

The proposed rule maintains the general risk-based capital rules' minimum tier 1 risk-based capital ratio of 4.0 percent and total risk-based capital ratio of 8.0 percent. The components of tier 1 and total capital are also generally the same, with a few adjustments described in more detail below. The primary difference between the general risk-based capital rules and the proposed rule is the methodologies used for calculating risk-weighted assets. Banks applying the proposed rule generally would use their internal risk measurement systems to calculate the inputs for determining the risk-weighted asset amounts for (i) general credit risk (including wholesale and retail exposures); (ii) securitization exposures; (iii) equity exposures; and (iv) operational risk. In certain cases, however, external ratings or supervisory risk weights would be used to determine risk-weighted asset amounts. Each of these areas is discussed below.

Banks using the proposed rule also would be subject to supervisory review of their capital adequacy (Pillar 2) and certain public disclosure requirements to foster transparency and market discipline (Pillar 3). In addition, each bank using the advanced approaches would continue to be subject to the tier 1 leverage ratio requirement, and each depository institution (DI) (as defined in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813)) using the advanced approaches would continue to be subject to the prompt corrective action (PCA) thresholds. Those banks subject to the MRA also would continue to be subject to the MRA.

Under the proposed rule, a bank must identify whether each of its on- and off-balance sheet exposures is a wholesale, retail, securitization, or equity exposure. Assets that are not defined by any exposure category (and certain immaterial portfolios of exposures) generally would be assigned risk-weighted asset amounts equal to their carrying value (for on-balance sheet exposures) or notional amount (for off-balance sheet exposures).

Wholesale exposures under the proposed rule include most credit exposures to companies and governmental entities. For each wholesale exposure, a bank would assign five quantitative risk parameters: PD (which is stated as a percentage and measures the likelihood that an obligor will default over a 1-year horizon); ELGD (which is stated as a percentage and is an estimate of the economic loss rate if a default occurs); LGD (which is

stated as a percentage and is an estimate of the economic loss rate if a default occurs during economic downturn conditions); EAD (which is measured in dollars and is an estimate of the amount that would be owed to the bank at the time of default); and M (which is measured in years and reflects the effective remaining maturity of the exposure). Banks would be able to factor into their risk parameter estimates the risk mitigating impact of collateral, credit derivatives, and guarantees that meet certain criteria. Banks would input the risk parameters for each wholesale exposure into an IRB risk-based capital formula to determine the risk-based capital requirement for the exposure.

Retail exposures under the proposed rule include most credit exposures to individuals and small businesses that are managed as part of a segment of exposures with similar risk characteristics, not on an individual-exposure basis. A bank would classify each of its retail exposures into one of three retail subcategories—residential mortgage exposures, qualifying revolving exposures (QREs) (for example, credit cards and overdraft lines), and other retail exposures. Within these three subcategories, the bank would group exposures into segments with similar risk characteristics. The bank would then assign the risk parameters PD, ELGD, LGD, and EAD to each retail segment. The bank would be able to take into account the risk mitigating impact of collateral and guarantees in the segmentation process and in the assignment of risk parameters to retail segments. Like wholesale exposures, the risk parameters for each retail segment would be used as inputs into an IRB risk-based capital formula to determine the risk-based capital requirement for the segment. *Question 4: The agencies seek comment on the use of a segment-based approach rather than an exposure-by-exposure approach for retail exposures.*

For securitization exposures, the bank would apply one of three general approaches, subject to various conditions and qualifying criteria: the Ratings-Based Approach (RBA), which uses external ratings to risk-weight exposures; an Internal Assessment Approach (IAA), which uses internal ratings to risk-weight exposures to asset-backed commercial paper programs (ABCP programs); or the Supervisory Formula Approach (SFA). Securitization exposures in the form of gain-on-sale or credit-enhancing interest-only strips

(CEIOs)¹¹ and securitization exposures that do not qualify for the RBA, the IAA, or the SFA would be deducted from regulatory capital.

Banks would be able to use an internal models approach (IMA) for determining risk-based capital requirements for equity exposures, subject to certain qualifying criteria and floors. If a bank does not have a qualifying internal model for equity exposures, or chooses not to use such a model, the bank must apply a simple risk weight approach (SRWA) in which publicly traded equity exposures would have a 300 percent risk weight and non-publicly traded equity exposures would have a 400 percent risk weight. Under both the IMA and the SRWA, equity exposures to certain entities or made pursuant to certain statutory authorities would be subject to a 0 to 100 percent risk weight.

Banks would have to develop qualifying AMA systems to determine risk-based capital requirements for operational risk. Under the AMA, a bank would use its own methodology to identify operational loss events, measure its exposure to operational risk, and assess a risk-based capital requirement for operational risk.

Under the proposed rule, a bank would calculate its risk-based capital ratios by first converting any dollar risk-based capital requirements for exposures produced by the IRB risk-based capital formulas into risk-weighted asset amounts by multiplying the capital requirements by 12.5 (the inverse of the overall 8.0 percent risk-based capital requirement). After determining the risk-weighted asset amounts for credit risk and operational risk, a bank would sum these amounts and then subtract any allocated transfer risk reserves and excess eligible credit reserves not included in tier 2 capital (defined below) to determine total risk-weighted assets. The bank would then calculate its risk-based capital ratios by dividing its tier 1 capital and total qualifying capital by the total risk-weighted assets amount.

The proposed rule contains specific public disclosure requirements to provide important information to market participants on the capital structure, risk exposures, risk assessment processes, and, hence, the

¹¹ A CEIO is an on-balance-sheet asset that (i) represents the contractual right to receive some or all of the interest and no more than a minimal amount of principal due on the underlying exposures of a securitization and (ii) exposes the holder to credit risk directly or indirectly associated with the underlying exposures that exceeds its pro rata claim on the underlying exposures whether through subordination provisions or other credit-enhancement techniques.

capital adequacy of a bank. The public disclosure requirements would apply only to the DI or bank holding company representing the top consolidated level of the banking group that is subject to the advanced approaches. In addition, the agencies are also publishing today proposals to require certain disclosures from subsidiary DIs in the banking group through the supervisory reporting process. The agencies believe that the reporting of key risk parameter estimates for each DI applying the advanced approaches will provide the primary Federal supervisor of the DI and other relevant supervisors with important data for assessing the reasonableness and accuracy of the institution's calculation of its risk-based capital requirements under this proposal and the adequacy of the institution's capital in relation to its risks. Some of the proposed supervisory reports would be publicly available (for example, on the Call Report or Thrift Financial Report), and others would be confidential disclosures to the agencies to augment the supervisory process.

D. Structure of Proposed Rule

The agencies are considering implementing a comprehensive regulatory framework for the advanced approaches in which each agency would have an advanced approaches regulation or appendix that sets forth (i) the elements of tier 1 and tier 2 capital and associated adjustments to the risk-based capital ratio numerator, (ii) the qualification requirements for using the advanced approaches, and (iii) the details of the advanced approaches. For proposal purposes, the agencies are issuing a single proposed regulatory text for comment. Unless otherwise indicated, the term "bank" in the regulatory text includes banks, savings associations, and bank holding companies (BHCs). The term "[AGENCY]" in the regulatory text refers to the primary Federal supervisor of the bank applying the rule. Areas where the regulatory text would differ by agency—for example, provisions that would only apply to savings associations or to BHCs—are generally indicated in appropriate places.

In this proposed rule, the agencies are not restating the elements of tier 1 and tier 2 capital, which would generally remain the same as under the general risk-based capital rules. Adjustments to the risk-based capital ratio numerators specific to banks applying the advanced approaches are in part II of the proposed rule and explained in greater detail in section IV of this preamble. The OCC, Board, and FDIC also are proposing to incorporate their existing market risk

rules by cross-reference and are proposing modifications to the market risk rules in a separate NPR issued concurrently.¹² The OTS is proposing its own market risk rule, including the proposed modifications, as a part of that separate NPR. In addition, the agencies may need to make additional conforming amendments to certain of their regulations that use tier 1 or total qualifying capital or the risk-based capital ratios for various purposes.

The proposed rule is structured in eight broad parts. Part I identifies criteria for determining which banks are subject to the rule, provides key definitions, and sets forth the minimum risk-based capital ratios. Part II describes the adjustments to the numerator of the risk-based capital ratios for banks using the advanced approaches. Part III describes the qualification process and provides qualification requirements for obtaining supervisory approval for use of the advanced approaches. This part incorporates critical elements of supervisory oversight of capital adequacy (Pillar 2).

Parts IV through VII address the calculation of risk-weighted assets. Part IV provides the risk-weighted assets calculation methodologies for wholesale and retail exposures; on-balance-sheet assets that do not meet the regulatory definition of a wholesale, retail, securitization, or equity exposure; and certain immaterial portfolios of credit exposures. This part also describes the risk-based capital treatment for over-the-counter (OTC) derivative contracts, repo-style transactions, and eligible margin loans. In addition, this part describes the methodology for reflecting eligible credit risk mitigation techniques in risk-weighted assets for wholesale and retail exposures. Furthermore, this part sets forth the risk-based capital requirements for failed and unsettled securities, commodities, and foreign exchange transactions.

Part V identifies operating criteria for recognizing risk transference in the securitization context and outlines the approaches for calculating risk-weighted assets for securitization exposures. Part VI describes the approaches for calculating risk-weighted assets for equity exposures. Part VII describes the calculation of risk-weighted assets for operational risk. Finally, Part VIII provides public disclosure requirements for banks employing the advanced approaches (Pillar 3).

The structure of the preamble generally follows the structure of the

proposed regulatory text. Definitions, however, are discussed in the portions of the preamble where they are most relevant.

E. Quantitative Impact Study 4 and Overall Capital Objectives

1. Quantitative Impact Study 4

After the BCBS published the New Accord, the agencies conducted the additional quantitative impact study referenced above, QIS-4, in the fall and winter of 2004–2005, to better understand the potential impact of the proposed framework on the risk-based capital requirements for individual U.S. banks and U.S. banks as a whole. The results showed a substantial dollar-weighted average decline and variation in risk-based capital requirements across the 26 participating U.S. banks and their portfolios.¹³ In an April 2005 press release,¹⁴ the agencies expressed their concern about the magnitude of the drop in QIS-4 risk-based capital requirements and the dispersion of those requirements and decided to undertake further analysis.

The QIS-4 analysis indicated a dollar-weighted average reduction of 15.5 percent in risk-based capital requirements at participating banks when moving from the current Basel I-based framework to a Basel II-based framework.¹⁵ Table A provides a numerical summary of the QIS-4 results, in total and by portfolio, aggregated across all QIS-4 participants.¹⁶ The first column shows

¹³ Since neither an NPR and associated supervisory guidance nor final regulations implementing a Basel II-based framework had been issued in the United States at the time of data collection, all QIS-4 results relating to the U.S. implementation of Basel II are based on the description of the framework contained in the QIS-4 instructions. These instructions differed from the framework issued by the BCBS in June 2004 in several respects. For example, the QIS-4 articulation of the Basel II framework does not include the 1.06 scaling factor. The QIS-4 instructions are available at <http://www.ffiec.gov/qis4>.

¹⁴ See "Banking Agencies to Perform Additional Analysis Before Issuing Notice of Proposed Rulemaking Related to Basel II," Apr. 29, 2005.

¹⁵ The Basel II framework on which QIS-4 is based uses a UL-only approach (even though EL requirements were included in QIS-4). But the current Basel I risk-based capital requirements use a UL+EL approach. Therefore, in order to compare the Basel II results from QIS-4 with the current Basel I requirements, the EL requirements from QIS-4 had to be added to the UL capital requirements from QIS-4.

¹⁶ In the table, "Minimum required capital" (MRC) refers to the total risk-based capital requirement before incorporating the impact of reserves. "Effective MRC" is equal to MRC adjusted for the impact of reserves. As noted above, under the Basel II framework, a shortfall in reserves generally increases the total risk-based capital requirement and a surplus in reserves generally

¹² See elsewhere in today's issue of the **Federal Register**.

changes in dollar-weighted average minimum required capital (MRC) both by portfolio and overall, as well as in dollar-weighted average overall effective MRC. Column 2 shows the relative contribution of each portfolio to the overall dollar-weighted average decline of 12.5 percent in MRC, representing

both the increase/decrease and relative size of each portfolio. The table also shows (column 3) that risk-based capital requirements declined by more than 26 percent in half the banks in the study. Most portfolios showed double-digit declines in risk-based capital requirements for over half the banks,

with the exception of credit cards. It should be noted that column 3 gives every participating bank equal weight. Column 4 shows the analogous weighted median change, using total exposures as weights.

Table A — QIS-4 Results

QIS-4 Results: Changes in Minimum Required Capital						
Portfolio	Column 1: % Change in Portfolio MRC	Column 2: % Point Contrib. to MRC Change	Column 3: Median % Change in Port. MRC	Column 4: Weighted Median % Chg in Port. MRC	Column 5: Share of Basel I MRC	Column 6: Share of Basel II MRC*
Wholesale Credit	(24.6%)	(10.9%)	(24.5%)	(21.6%)	44.3%	38.2%
Corporate, Bank, Sovereign	(21.9%)	(7.4%)	(29.7%)	(13.5%)	33.9%	30.3%
Small Business	(26.6%)	(1.2%)	(27.1%)	(24.8%)	4.6%	3.9%
High Volatility CRE	(33.4%)	(0.6%)	(23.2%)	(42.4%)	1.8%	1.3%
Income Producing RE	(41.4%)	(1.7%)	(52.5%)	(52.4%)	4.0%	2.7%
Retail Credit	(25.6%)	(7.8%)	(49.8%)	(28.7%)	30.6%	26.0%
Home Equity (HELOC)	(74.3%)	(4.6%)	(78.6%)	(76.8%)	6.1%	1.8%
Residential Mortgage	(61.4%)	(6.8%)	(72.7%)	(64.4%)	11.1%	4.9%
Credit Card (QRE)	66.0%	4.0%	62.8%	72.2%	6.1%	11.6%
Other Consumer	(6.5%)	(0.4%)	(35.2%)	(18.3%)	6.0%	6.4%
Retail Business Exposures	(5.8%)	(0.1%)	(29.2%)	11.6%	1.2%	1.3%
Equity	6.6%	0.1%	(24.4%)	9.6%	1.3%	1.6%
Other assets	(11.7%)	(1.2%)	(3.2%)	(11.6%)	10.0%	10.1%
Securitization	(17.9%)	(1.4%)	(39.7%)	(45.8%)	8.1%	7.6%
Operational Risk		9.2%			0.0%	10.5%
Trading Book	0.0%	0.0%	0.0%		5.2%	5.9%
Change in MRC	(12.5%)	(12.5%)	(23.8%)	(17.1%)	100.0%	100.0%
Change in Effective MRC	(15.5%)		(26.3%)	(21.7%)		

* QIS-4 interpretation of Basel II framework as articulated in QIS-4 instructions

Notes to the table: The first two columns of the table show the *dollar-weighted* average percentage change in MRC by portfolio and the percentage point contribution of each portfolio to the overall average percentage change (of 12.5%). The third column shows the *unweighted* median percentage change in MRC by portfolio. The fourth column shows the *weighted* median percentage change in MRC by portfolio, weighting by total exposures at the portfolio level. The next two columns show the share each portfolio contributes to MRC, under the current framework (column 5) and the QIS-4 interpretation of Basel II as defined in the QIS-4 instructions (column 6). Entries in parentheses denote negative numbers. There are no percentage change numbers for operational risk because it is not separated out as a specific risk-based capital requirement under Basel I.

QIS-4 results (not shown in Table A) also suggested that tier 1 risk-based capital requirements under a Basel II-based framework would be lower for many banks than they are under the general risk-based capital rules, in part reflecting the move to a UL-only risk-based capital requirement. Tier 1 risk-based capital requirements declined by

22 percent in the aggregate. The unweighted median indicates that half of the participating banks reported reductions in tier 1 risk-based capital requirements of over 31 percent. The MRC calculations do not take into account the impact of the tier 1 leverage ratio requirement. Were such results produced under a fully implemented

Basel II-based risk-based capital regime, the existing tier 1 leverage ratio requirement could be a more important constraint than it is currently.

Evidence from some of the follow-up analysis also illustrated that similar loan products at different banks may have resulted in very different risk-based capital requirements. Analysis

reduces the total risk-based capital requirement, though not with equal impact.

determined that this dispersion in capital requirements not only reflected differences in actual risk or portfolio composition, but also reflected differences in the banks' estimated risk parameters for similar exposures.

Although concerns with dispersion might be remedied to some degree with refinements to internal bank risk measurement and management systems and through the rulemaking process, the agencies also note that some of the dispersion encountered in the QIS-4 exercise is a reflection of the flexibility in methods to quantify the risk parameters that may be allowed under implementation of the proposed framework.

The agencies intend to conduct other analyses of the impact of the Basel II framework during both the parallel run and transitional floor periods. These analyses will look at both the impact of the Basel II framework and the preparedness of banks to compute risk-based capital requirements in a manner consistent with the Basel II framework.

2. Overall Capital Objectives

The ANPR stated: "The Agencies do not expect the implementation of the New Accord to result in a significant decrease in aggregate capital requirements for the U.S. banking system. Individual banking organizations may, however, face increases or decreases in their minimum risk-based capital requirements because the New Accord is more risk sensitive than the 1988 Accord and the Agencies' existing risk-based capital rules (general risk-based capital rules)."¹⁷ The ANPR was in this respect consistent with statements made by the BCBS in its series of Basel II consultative papers and its final text of the New Accord, in which the BCBS stated as an objective broad maintenance of the overall level of risk-based capital requirements while allowing some incentives for banks to adopt the advanced approaches.

The agencies remain committed to these objectives. Were the QIS-4 results just described produced under an up-and-running risk-based capital regime, the risk-based capital requirements generated under the framework would not meet the objectives described in the ANPR, and thus would be considered unacceptable.

When considering QIS-4 results and their implications, it is important to recognize that banking organizations participated in QIS-4 on a best-efforts basis. The agencies had not qualified any of the participants to use the Basel II framework and had not conducted

any formal supervisory review of their progress toward meeting the Basel II qualification requirements. In addition, the risk measurement and management systems of the QIS-4 participants, as indicated by the QIS-4 exercise, did not yet meet the Basel II qualification requirements outlined in this proposed rule.

As banks work with their supervisors to refine their risk measurement and management systems, it will become easier to determine the actual quantitative impact of the advanced approaches. The agencies have decided, therefore, not to recalibrate the framework at the present time based on QIS-4 results, but to await further experience with more fully developed bank risk measurement and management systems.

If there is a material reduction in aggregate minimum regulatory capital requirements upon implementation of Basel II-based rules, the agencies will propose regulatory changes or adjustments during the transitional floor periods. In this context, materiality will depend on a number of factors, including the size, source, and nature of any reduction; the risk profiles of banks authorized to use Basel II-based rules; and other considerations relevant to the maintenance of a safe and sound banking system. In any event, the agencies will view a 10 percent or greater decline in aggregate minimum required risk-based capital (without reference to the effects of the transitional floors described in a later section of this preamble), compared to minimum required risk-based capital as determined under the existing rules, as a material reduction warranting modifications to the supervisory risk functions or other aspects of this framework.

The agencies are, in short, identifying a numerical benchmark for evaluating and responding to capital outcomes during the parallel run and transitional floor periods that do not comport with the overall capital objectives outlined in the ANPR. At the end of the transitional floor periods, the agencies would re-evaluate the consistency of the framework, as (possibly) revised during the transitional floor periods, with the capital goals outlined in the ANPR and with the maintenance of broad competitive parity between banks adopting the framework and other banks, and would be prepared to make further changes to the framework if warranted. *Question 5: The agencies seek comment on this approach to ensuring that overall capital objectives are achieved.*

The agencies also noted above that tier 1 capital requirements reported in QIS-4 declined substantially more than did total capital requirements. The agencies have long placed special emphasis on the importance of tier 1 capital in maintaining bank safety and soundness because of its ability to absorb losses on a going concern basis. The agencies will continue to monitor the trend in tier 1 capital requirements during the parallel run and transitional floor periods and will take appropriate action if reductions in tier 1 capital requirements are inconsistent with the agencies' overall capital goals.

Similar to the attention the agencies will give to overall risk-based capital requirements for the U.S. banking system, the agencies will carefully consider during the transitional floor periods whether dispersion in risk-based capital results across banks and portfolios appropriately reflects differences in risk. A conclusion by the agencies that dispersion in risk-based capital requirements does not appropriately reflect differences in risk could be another possible basis for proposing regulatory adjustments or refinements during the transitional floor periods.

It should also be noted that given the bifurcated regulatory capital framework that would result from the adoption of this rule, issues related to overall capital may be inextricably linked to the competitive issues discussed elsewhere in this document. The agencies indicated in the ANPR that if the competitive effects of differential capital requirements were deemed significant, "the Agencies would need to consider potential ways to address those effects while continuing to seek the objectives of the current proposal. Alternatives could potentially include modifications to the proposed approaches, as well as fundamentally different approaches."¹⁸ In this regard, the agencies view the parallel run and transitional floor periods as a trial of the new framework under controlled conditions. While the agencies hope and expect that regulatory changes proposed during those years would be in the nature of adjustments made within the framework described in this proposed rule, more fundamental changes cannot be ruled out if warranted based on future experience or comments received on this proposal.

The agencies reiterate that, especially in light of the QIS-4 results, retention of the tier 1 leverage ratio and other existing prudential safeguards (for example, PCA) is critical for the

¹⁷ 68 FR 45900, 45902 (Aug. 4, 2003).

¹⁸ 68 FR 45900, 45905 (August 4, 2003).

preservation of a safe and sound regulatory capital framework. In particular, the leverage ratio is a straightforward and tangible measure of solvency and serves as a needed complement to the risk-sensitive Basel II framework based on internal bank inputs.

F. Competitive Considerations

A fundamental objective of the New Accord is to strengthen the soundness and stability of the international banking system while maintaining sufficient consistency in capital adequacy regulation to ensure that the New Accord will not be a significant source of competitive inequity among internationally active banks. The agencies support this objective and believe that it is crucial to promote continual advancement of the risk measurement and management practices of large and internationally active banks. For this reason, the agencies propose to implement only the advanced approaches of the New Accord because these approaches utilize the most sophisticated and risk-sensitive risk measurement and management techniques.

While all banks should work to enhance their risk management practices, the advanced approaches and the systems required to support their use may not be appropriate for many banks from a cost-benefit point of view. For these banks, the agencies believe that, with some modifications, the general risk-based capital rules are a reasonable alternative. As discussed in section E.2. above, this proposal's bifurcated approach to risk-based capital requirements raises difficult issues and inextricably links competitive considerations with overall capital issues. One such issue relates to concerns about competitive inequities between U.S. banks operating under different regulatory capital regimes. The ANPR cited this concern, and a number of commenters expressed their belief that in some portfolios competitive inequities would be worsened under the proposed bifurcated framework. These commenters expressed the concern that the Proposed New Accord might place community banks operating under the general risk-based capital rules at a competitive disadvantage to banks applying the advanced approaches because the IRB framework would likely result in lower risk-based capital requirements on some types of exposures, such as residential mortgage exposures, other retail exposures, and small business loans.

Some commenters asserted that the application of lower risk-based capital

requirements under the Proposed New Accord would create a competitive disadvantage for banks operating under the general risk-based capital rules, which in turn may adversely affect their asset quality and cost of capital. Other commenters suggested that if the advanced approaches in the Proposed New Accord are implemented, the agencies should consider revising their general risk-based capital rules to enhance risk sensitivity and to mitigate potential competitive inequities associated with the bifurcated system.

The agencies recognize that the industry has concerns with the potential competitive inequities associated with a bifurcated risk-based capital framework. The agencies reaffirm their intention, expressed in the ANPR, to address competitive issues while continuing to pursue the objectives of the current proposal. In addition to the QIS-4 analysis discussed above, the agencies have also researched discrete topics to further understand where competitive pressures might arise. As part of their effort to develop a bifurcated risk-based capital framework that minimizes competitive inequities and is not disruptive to the banking sector, the agencies issued an Advance Notice of Proposed Rulemaking (Basel IA ANPR) considering various modifications to the general risk-based capital rules to improve risk sensitivity and to reduce potential competitive disparities between Basel II banks and non-Basel II banks.¹⁹ The comment period for the Basel IA ANPR ended on January 18, 2006, and the agencies intend to consider all comments and issue for public comment a more fully developed risk-based capital proposal for non-Basel II banks. The comment period for the non-Basel II proposal is expected to overlap that of this proposal, allowing commenters to analyze the effects of the two proposals concurrently.

In addition, some commenters expressed concern about competitive inequities arising from differences in implementation and application of the New Accord by supervisory authorities in different countries. In particular, some commenters expressed concern about the different implementation timetables of various jurisdictions, and differences in the scope of application in various jurisdictions or in the range of approaches that different jurisdictions will allow. The BCBS has established an Accord Implementation Group, comprised of supervisors from member countries, whose primary objectives are to work through implementation issues, maintain a

constructive dialogue about implementation processes, and harmonize approaches as much as possible within the range of national discretion embedded in the New Accord.

While supervisory judgment will play a critical role in the evaluation of risk measurement and management practices at individual banks, supervisors are committed to developing protocols and information-sharing arrangements that should minimize burdens on banks operating in multiple countries and ensure that supervisory authorities are implementing the New Accord as consistently as possible. The New Accord identifies numerous areas where national discretion is encouraged. This design was intended to enable national supervisors to implement the methodology, or combination of methodologies, most appropriate for banks in their jurisdictions. Disparate implementation decisions are expected, particularly during the transition years. Over time, the agencies expect that industry and supervisory practices likely will converge in many areas, thus mitigating differences across countries. Competitive considerations, both internationally and domestically, will be monitored and discussed by the agencies on an ongoing basis. With regard to implementation timing concerns, the agencies believe that the transitional arrangements described in section III.A. of this preamble below provide a prudent and reasonable framework for moving to the advanced approaches. Where international implementation differences affect an individual bank, the agencies expect to work with the bank and appropriate national supervisory authorities for the bank to ensure that implementation proceeds as smoothly as possible.

Question 6: The agencies seek comment on all potential competitive aspects of this proposal and on any specific aspects of the proposal that might raise competitive concerns for any bank or group of banks.

II. Scope

The agencies have identified three groups of banks: (i) Large or internationally active banks that would be required to adopt the advanced approaches in the proposed rule (core banks); (ii) banks that voluntarily decide to adopt the advanced approaches (opt-in banks); and (iii) banks that do not adopt the advanced approaches (general banks). Each core and opt-in bank would be required to meet certain qualification requirements to the satisfaction of its primary Federal supervisor, in consultation with other

¹⁹ See 70 FR 61068 (Oct. 20, 2005).

relevant supervisors, before the bank may use the advanced approaches for risk-based capital purposes.

Pillar I of the New Accord requires all banks subject to the New Accord to calculate capital requirements for exposure to both credit risk and operational risk. The New Accord provides a bank three approaches to calculate its credit risk capital requirement and three approaches to calculate its operational risk capital requirement. Outside the United States, countries that are replacing Basel I with the New Accord generally have required all banks to comply with the New Accord, but have provided banks the option of choosing among the New Accord's various approaches for calculating credit risk and operational risk capital requirements.²⁰ For banks in the United States, the NPR, like the ANPR, takes a different approach. It would not subject all U.S. banks to the New Accord, but instead focuses on only the largest and most internationally active banks. Due to the size and complexity of these banks, the NPR would require core banks to comply with the most advanced approaches for calculating credit and operational risk capital requirements "that is, the IRB and the AMA. In addition, the NPR would allow other U.S. banks to "opt in" to Basel II-based rules, but, as with core banks, the only Basel II-based rules available to U.S. "opt-in" banks would be the New Accord's most advanced approaches.

Question 7: The agencies request comment on whether U.S. banks subject to the advanced approaches in the proposed rule (that is, core banks and opt-in banks) should be permitted to use other credit and operational risk approaches similar to those provided under the New Accord. With respect to the credit risk capital requirement, the agencies request comment on whether banks should be provided the option of using a U.S. version of the so-called "standardized approach" of the New Accord and on the appropriate length of time for such an option.

A. Core and Opt-In Banks

A DI is a core bank if it meets either of two independent threshold criteria: (i) Consolidated total assets of \$250 billion or more, as reported on the most

recent year-end regulatory reports; or (ii) consolidated total on-balance sheet foreign exposure of \$10 billion or more at the most recent year-end. To determine total on-balance sheet foreign exposure, a bank would sum its adjusted cross-border claims, local country claims, and cross-border revaluation gains (calculated in accordance with the Federal Financial Institutions Examination Council (FFIEC) Country Exposure Report (FFIEC 009)). Adjusted cross-border claims would equal total cross-border claims less claims with the head office/guarantor located in another country, plus redistributed guaranteed amounts to the country of head office/guarantor. A DI also is a core bank if it is a subsidiary of another DI or BHC that uses the advanced approaches.

Under the proposed rule, a U.S.-chartered BHC²¹ is a core bank if the BHC has: (i) Consolidated total assets (excluding assets held by an insurance underwriting subsidiary) of \$250 billion or more, as reported on the most recent year-end regulatory reports; (ii) consolidated total on-balance sheet foreign exposure of \$10 billion or more at the most recent year-end; or (iii) a subsidiary DI that is a core bank or opt-in bank. Currently 11 top-tier banking organizations meet these criteria. The agencies note that, using this approach to define whether a BHC is a core bank, it is possible that no single DI under a BHC would meet the threshold criteria, but that all of the BHC's subsidiary DIs would be core banks.

The proposed BHC consolidated asset threshold is different from the threshold in the ANPR, which applied to the total consolidated DI assets of a BHC. The proposed shift to total consolidated assets (excluding assets held by an insurance underwriting subsidiary) recognizes that BHCs can hold similar assets within and outside of DIs and reduces potential incentives to structure BHC assets and activities to arbitrage capital regulations. The proposed rule excludes assets held in an insurance underwriting subsidiary of a BHC because the New Accord was not designed to address insurance company exposures. *Question 8A: The Board seeks comment on the proposed BHC consolidated non-insurance assets threshold relative to the consolidated DI assets threshold in the ANPR.*

A bank that is subject to the proposed rule either as a core bank or as an opt-in bank would be required to apply the

rule unless its primary Federal supervisor determines in writing that application of the rule is not appropriate in light of the bank's asset size, level of complexity, risk profile, or scope of operations. *Question 8B: The agencies seek comment on the proposed scope of application. In particular, the agencies seek comment on the regulatory burden of a framework that requires the advanced approaches to be implemented by each subsidiary DI of a BHC or bank that uses the advanced approaches.*

B. U.S. DI Subsidiaries of Foreign Banks

Any U.S.-chartered DI that is a subsidiary of a foreign banking organization is subject to the U.S. regulatory capital requirements applied to domestically-owned U.S. DIs. Thus, if the U.S. DI subsidiary of a foreign banking organization meets any of the threshold criteria, it would be a core bank and would be subject to the advanced approaches. If it does not meet any of the criteria, the U.S. DI may remain a general bank or may opt-in to the advanced approaches, subject to the same qualification process and requirements as a domestically-owned U.S. DI. A top-tier U.S. BHC, and its subsidiary DIs, that is owned by a foreign banking organization also would be subject to the same threshold levels for core bank determination as would a top-tier BHC that is not owned by a foreign banking organization. A U.S. BHC that meets the conditions in Federal Reserve SR letter 01-01²² and is a core bank would not be required to meet the minimum capital ratios in the Board's capital adequacy guidelines, although it would be required to adopt the advanced approaches, compute and report its capital ratios in accordance with the advanced approaches, and make the required public and regulatory disclosures.

A DI subsidiary of such a U.S. BHC would be a core bank and would be required to adopt the advanced approaches (unless specifically exempted from the advanced approaches by its primary Federal supervisor) and meet the minimum capital ratio requirements. In addition, the Board retains its supervisory authority to require any BHC, including a U.S. BHC owned or controlled by a foreign banking organization that is or is treated as a financial holding company (FHC), to maintain capital levels above

²⁰ Despite the options provided in national legislation and rules, most non-U.S. banks comparable in size and complexity to U.S. core banks are adopting some form of the advanced approaches. For example, based on currently available information, the vast majority of large, internationally-active banks based outside of the United States plan to employ an internal ratings-based approach in the calculation of credit risk capital requirements.

²¹ OTS does not currently impose any explicit capital requirements on savings and loan holding companies and does not propose to apply the Basel II proposal to these holding companies.

²² SR 01-01, "Application of the Board's Capital Adequacy Guidelines to Bank Holding Companies Owned by Foreign Banking Organizations," January 5, 2001.

the regulatory minimums. *Question 9: The agencies seek comment on the application of the proposed rule to DI subsidiaries of a U.S. BHC that meets the conditions in Federal Reserve SR letter 01-01 and on the principle of national treatment in this context.*

C. Reservation of Authority

The proposed rule would restate the authority of a bank's primary Federal supervisor to require the bank to hold an overall amount of capital greater than would otherwise be required under the rule if the agency determines that the bank's risk-based capital requirements under the rule are not commensurate with the bank's credit, market, operational, or other risks. In addition, the agencies anticipate that there may be instances when the proposed rule generates a risk-weighted asset amount for specific exposures that is not commensurate with the risks posed by such exposures. In these cases, under the proposed rule, the bank's primary Federal supervisor would retain the authority to require the bank to use a different risk-weighted asset amount for the exposures or to use different risk parameters (for wholesale or retail exposures) or model assumptions (for modeled equity or securitization exposures) than those required in the proposed rule when calculating the risk-weighted asset amount for those exposures. Similarly, the proposed rule would provide authority for a bank's primary Federal supervisor to require the bank to assign a different risk-weighted asset amount for operational risk, to change elements of its operational risk analytical framework (including distributional and dependence assumptions), or to make other changes to the bank's operational risk management processes, data and assessment systems, or quantification systems if the supervisor finds that the risk-weighted asset amount for operational risk produced by the bank under the rule is not commensurate with the operational risks of the bank. Any agency that exercises this reservation of authority would notify each of the other agencies of its determination.

III. Qualification

A. The Qualification Process

1. In General

Supervisory qualification to use the advanced approaches is a continuous and iterative process that begins when a bank's board of directors adopts an implementation plan and continues as the bank operates under the advanced approaches. Before a bank may use the

advanced approaches for risk-based capital purposes, it must develop and adopt a written implementation plan, establish and maintain a comprehensive and sound planning and governance process to oversee the implementation efforts described in the plan, demonstrate to its primary Federal supervisor that it meets the qualification requirements in section 22 of the proposed rule, and complete a satisfactory "parallel run" (discussed below). A bank's primary Federal supervisor would be responsible, after consultation with other relevant supervisors, for evaluating the bank's initial and ongoing compliance with the qualification requirements for the advanced approaches.

The agencies will jointly issue supervisory guidance describing agency expectations for wholesale, retail, securitization, and equity exposures, as well as for operational risk.²³ The agencies recognize that a consistent and transparent process to oversee implementation of the advanced approaches is crucial, and will consult with each other on significant issues raised during the implementation process.

Under the proposed rule, a bank preparing to implement the advanced approaches must adopt a written implementation plan, approved by its board of directors, describing in detail how the bank complies, or intends to comply, with the qualification requirements. A core bank must adopt a plan no later than six months after it meets a threshold criterion in section 1(b)(1) of the proposed rule. If a bank meets a threshold criterion on the effective date of the final rule, the bank would have to adopt a plan within six months of the effective date. Banks that do not meet a threshold criterion, but are nearing any criterion by direct growth or merger, would be expected to engage in ongoing dialogue with their primary Federal supervisor regarding implementation strategies to ensure their readiness to adopt the advanced approaches when a threshold criterion is reached. An opt-in bank may adopt an implementation plan at any time, but must adopt an implementation plan and notify its primary Federal supervisor in writing at least twelve months before it proposes to begin the first floor period (as discussed later in this section of the preamble).

In developing an implementation plan, a bank must assess its current state

of readiness relative to the qualification requirements in this proposed rule and related supervisory guidance. This assessment would include a gap analysis that identifies where additional work is needed and a remediation or action plan that clearly sets forth how the bank intends to fill the gaps it has identified. The implementation plan must comprehensively address the qualification requirements for the bank and each of its consolidated subsidiaries (U.S. and foreign-based) with respect to all portfolios and exposures of the bank and each of its consolidated subsidiaries. The implementation plan must justify and support any proposed temporary or permanent exclusion of a business line, portfolio, or exposure from the advanced approaches. The business lines, portfolios, and exposures that the bank proposes to exclude from the advanced approaches must be, in the aggregate, immaterial to the bank. The implementation plan must include objective, measurable milestones (including delivery dates and a date when the bank's implementation of the advanced approaches will be fully operational). For core banks, the implementation plan must include an explicit first floor period start date that is no later than 36 months after the later of the effective date of the rule or the date the bank meets at least one of the threshold criteria.²⁴ Further, the implementation plan must describe the resources that the bank has budgeted and are available to implement the plan.

During implementation of the advanced approaches, a bank would work closely with its primary Federal supervisor to ensure that its risk measurement and management systems are fully functional and reliable and are able to generate risk parameter estimates that can be used to calculate the risk-based capital ratios correctly under the advanced approaches. The implementation plan, including the gap analysis and action plan, will provide a basis for ongoing supervisory dialogue and review during this period. The primary Federal supervisor will assess a bank's progress relative to its implementation plan. To the extent that adjustments to target dates are needed, these adjustments would be made subject to the ongoing supervisory discussion between the bank and its primary Federal supervisor.

2. Parallel Run and Transitional Floor Periods

Once a bank has adopted its implementation plan, it must complete

²³ The agencies have issued for public comment draft supervisory guidance on corporate and retail exposures and operational risk. See 68 FR 45949 (Aug. 4, 2003); 69 FR 62748 (Oct. 27, 2004).

²⁴ The bank's primary Federal supervisor may extend the bank's first floor period start date.

a satisfactory parallel run before it may use the advanced approaches to calculate its risk-based capital requirements. A satisfactory parallel run is a period of at least four consecutive calendar quarters during which the bank complies with all of the qualification requirements to the satisfaction of its primary Federal supervisor. During this period, the bank would continue to be subject to the general risk-based capital rules but would simultaneously calculate its risk-based capital ratios under the advanced approaches. During the parallel run period, a bank would report its risk-based capital ratios under both the general risk-based capital rules and the advanced approaches to its primary Federal supervisor through the supervisory process on a quarterly basis. The agencies will share this information with each other for calibration and other analytical purposes.

A bank's primary Federal supervisor would notify the bank of the date when it may begin to use the advanced approaches for risk-based capital purposes. A bank would not be permitted to begin using the advanced approaches for risk-based capital purposes until its primary Federal supervisor is satisfied that the bank fully complies with the qualification requirements, the bank has satisfactorily completed a parallel run, and the bank has an adequate process to ensure ongoing compliance with the qualification requirements.

To provide for a smooth transition to the advanced approaches, the proposed rule would impose temporary limits on the amount by which a bank's risk-based capital requirements could decline over a period of at least three years (that is, at least four consecutive calendar quarters in each of the three transitional floor periods). Based on its assessment of the bank's ongoing compliance with the qualification requirements, a bank's primary Federal supervisor would determine when the bank is ready to move from one transitional floor period to the next period and, after the full transition has been completed, to move to stand-alone use of the advanced approaches. Table B sets forth the proposed transitional floor periods for banks moving to the advanced approaches:

TABLE B.—TRANSITIONAL FLOORS

Transitional floor period	Transitional floor percentage
First floor period	95
Second floor period	90
Third floor period	85

During the transitional floor periods, a bank would calculate its risk-weighted assets under the general risk-based capital rules. Next, the bank would multiply this risk-weighted assets amount by the appropriate floor percentage in the table above. This product would be the bank's "floor-adjusted" risk-weighted assets. Third, the bank would calculate its tier 1 and total risk-based capital ratios using the definitions of tier 1 and tier 2 capital (and associated deductions and adjustments) in the general risk-based capital rules for the numerator values and floor-adjusted risk-weighted assets for the denominator values. These ratios would be referred to as the "floor-adjusted risk-based capital ratios."

The bank also would calculate its tier 1 and total risk-based capital ratios using the definitions and rules in this proposed rule. These ratios would be referred to as the "advanced approaches risk-based capital ratios." In addition, the bank would calculate a tier 1 leverage ratio using tier 1 capital as defined in this proposed rule for the numerator of the ratio.

During a bank's transitional floor periods, the bank would report all five regulatory capital ratios described above—two floor-adjusted risk-based capital ratios, two advanced approaches risk-based capital ratios, and one leverage ratio. To determine its applicable capital category for PCA purposes and for all other regulatory and supervisory purposes, a bank's risk-based capital ratios during the transitional floor periods would be set equal to the lower of the respective floor-adjusted risk-based capital ratio and the advanced approaches risk-based capital ratio. During the transitional floor periods, a bank's tier 1 capital and tier 2 capital for all non-risk-based-capital supervisory and regulatory purposes (for example, lending limits and Regulation W quantitative limits) would be the bank's tier 1 capital and tier 2 capital as calculated under the advanced approaches.

Thus, for example, in order to be well capitalized under PCA, a bank would have to have a floor-adjusted tier 1 risk-based capital ratio and an advanced approaches tier 1 risk-based capital ratio of 6 percent or greater, a floor-adjusted total risk-based capital ratio and an advanced approaches total risk-based capital ratio of 10 percent or greater, and a tier 1 leverage ratio of 5 percent or greater (with tier 1 capital calculated under the advanced approaches). Although the PCA rules do not apply to BHCs, a BHC would be required to report all five of these regulatory capital ratios and would have to meet

applicable supervisory and regulatory requirements using the lower of the respective floor-adjusted risk-based capital ratio and the advanced approaches risk-based capital ratio.

After a bank completes its transitional floor periods and its primary Federal supervisor determines the bank may begin using the advanced approaches with no further transitional floor, the bank would use its tier 1 and total risk-based capital ratios as calculated under the advanced approaches and its tier 1 leverage ratio calculated using the advanced approaches definition of tier 1 capital for PCA and all other supervisory and regulatory purposes.

The transitional floor calculations described above are linked to the general risk-based capital rules. As noted above, the agencies issued the Basel IA ANPR outlining possible modifications to those rules and are developing an NPR in this regard. The agencies are still considering the extent and nature of these modifications to the general risk-based capital rules and the scope of application of these modifications, including for banks that transition to the advanced approaches. The agencies expect banks that meet the threshold criteria in section 1(b)(1) of the proposed rule (that is, core banks) as of the effective date of the rule, and banks that opt-in pursuant to section 1(b)(2) at the earliest possible date, will use the general risk-based capital rules in place immediately before the rule becomes effective both during the parallel run and as a basis for the transitional floor calculations. Other changes to the general risk-based capital rules (outside the scope of the changes outlined in the Basel IA ANPR) may be considered by the agencies, as appropriate. *Question 10: The agencies seek comment on this approach, including the transitional floor thresholds and transition period, and on how and to what extent future modifications to the general risk-based capital rules should be incorporated into the transitional floor calculations for advanced approaches banks.*

Banks' computation of risk-based capital requirements under both the general risk-based capital rules and the advanced approaches will help the agencies assess the impact of the advanced approaches on overall capital requirements, including whether the change in capital requirements relative to the general risk-based capital rules is consistent with the agencies' overall capital objectives. *Question 11: The agencies seek comment on what other information should be considered in deciding whether those overall capital goals have been achieved.*

The agencies are proposing to make 2008 the first possible year for a bank to conduct its parallel run and 2009–2011 the first possible years for the three transitional floor periods. *Question 12: The agencies seek comment on this proposed timetable for implementing the advanced approaches in the United States.*

B. Qualification Requirements

Because the Basel II framework uses banks' estimates of certain key risk parameters to determine risk-based capital requirements, the advanced approaches would introduce greater complexity to the regulatory capital framework and would require banks using the advanced approaches to possess a high level of sophistication in risk measurement and risk management systems. As a result, the agencies propose to require each core or opt-in bank to meet the qualification requirements described in section 22 of the proposed rule to the satisfaction of its primary Federal supervisor for a period of at least four consecutive calendar quarters before using the advanced approaches to calculate its minimum risk-based capital requirements (subject to the transitional floors for at least an additional three years). The qualification requirements are written broadly to accommodate the many ways a bank may design and implement a robust internal credit and operational risk measurement and management system and to permit industry practice to evolve.

Many of the qualification requirements relate to a bank's advanced IRB systems. A bank's advanced IRB systems must incorporate five interdependent components in a framework for evaluating credit risk and measuring regulatory capital:

(i) A risk rating and segmentation system that assigns ratings to individual wholesale obligors and exposures and assigns individual retail exposures to segments;

(ii) A quantification process that translates the risk characteristics of wholesale obligors and exposures and segments of retail exposures into numerical risk parameters that are used as inputs to the IRB risk-based capital formulas;

(iii) An ongoing process that validates the accuracy of the rating assignments, segmentations, and risk parameters;

(iv) A data management and maintenance system that supports the advanced IRB systems; and

(v) Oversight and control mechanisms that ensure the advanced IRB systems are functioning effectively and producing accurate results.

1. Process and Systems Requirements

One of the objectives of the proposed framework is to provide appropriate incentives for banks to develop and use better techniques for measuring and managing their risks. The proposed rule specifically requires a bank to have a rigorous process for assessing its overall capital adequacy in relation to its total risk profile and a comprehensive strategy for maintaining appropriate capital levels. Consistent with Pillar 2 of the New Accord, a bank's primary Federal supervisor will evaluate how well the bank is assessing its capital needs relative to its risks and, if deficiencies are identified, will take any necessary action to ensure that appropriate and prudent levels of capital are maintained.

A bank should address all of its material risks in its overall capital assessment process. Although not every risk can be measured precisely, the following risks, at a minimum, should be factored into a bank's capital assessment process: credit risk, market risk, operational risk, interest rate risk in the banking book, liquidity risk, concentration risk, reputational risk, and strategic risk. With regard to interest rate risk in the banking book, the agencies note that for some assets—for example, a long-term mortgage loan—interest rate risk may be as great as, or greater than, the credit risk of the asset. The agencies will continue to focus attention on exposures where interest rate risk may be significant and will foster sound interest rate risk measurement and management practices across banks. Additionally, because credit risk concentrations can pose substantial risk to a bank that might be managing individual credits in a satisfactory manner, a bank also should give proper attention to such concentrations.

Banks already are required to hold capital sufficient to meet their risk profiles, and existing rules allow Federal supervisors to require a bank to increase its capital if its current capital levels are deficient or some element of its business practices suggests the need for more capital. Existing supervisory guidance directs banks to meaningfully tie the identification, monitoring, and evaluation of risk to the determination of the bank's capital needs. Banks are expected to implement and continually update the fundamental elements of a sound internal capital adequacy analysis—identifying and measuring all material risks, setting capital adequacy goals that relate to risk, and assessing conformity to the bank's stated objectives. The agencies expect that all

banks operating under the advanced approaches would address specific assumptions embedded in the advanced approaches (such as diversification in credit portfolios), and would evaluate these banks, in part, on their ability to account for deviations from the underlying assumptions in their own portfolios.

As noted, each core or opt-in bank would apply the advanced approaches for risk-based capital purposes at the consolidated top-tier legal entity level (that is, either the top-tier BHC or top-tier DI that is a core or opt-in bank) and at the level of each DI that is a subsidiary of such a top-tier legal entity. Thus, each bank that applies the advanced approaches must have an appropriate infrastructure with risk measurement and management processes that meet the proposed rule's qualification requirements and that are appropriate given the bank's size and level of complexity. Regardless of whether the systems and models that generate the risk parameters necessary for calculating a bank's risk-based capital requirements are located at any affiliate of the bank, each legal entity that applies the advanced approaches must ensure that the risk parameters (that is, PD, ELGD, LGD, EAD, and M) and reference data used to determine its risk-based capital requirements are representative of its own credit and operational risk exposures.

The proposed rule also requires that the systems and processes that an advanced approaches bank uses for risk-based capital purposes must be sufficiently consistent with the bank's internal risk management processes and management information reporting systems such that data from the latter processes and systems can be used to verify the reasonableness of the inputs the bank uses for risk-based capital purposes.

2. Risk Rating and Segmentation Systems for Wholesale and Retail Exposures

To implement the IRB framework, a bank must have internal risk rating and segmentation systems that accurately and reliably differentiate between degrees of credit risk for wholesale and retail exposures. As described below, wholesale exposures include most credit exposures to companies, sovereigns, and governmental entities, as well as some exposures to individuals. Retail exposures include most credit exposures to individuals and small businesses that are managed as part of a segment of exposures with homogeneous risk characteristics. Together, wholesale and retail

exposures cover most credit exposures of banks.

To differentiate among degrees of credit risk, a bank must be able to make meaningful and consistent distinctions among credit exposures along two dimensions—default risk and loss severity in the event of a default. In addition, a bank must be able to assign wholesale obligors to rating grades that approximately reflect likelihood of default and must be able to assign wholesale exposures to rating grades (or ELGD and LGD estimates) that approximately reflect the loss severity expected in the event of default. As discussed below, the proposed rule requires banks to treat wholesale exposures differently from retail exposures when differentiating among degrees of credit risk.

Wholesale exposures. For wholesale exposures, a bank must have an internal risk rating system that indicates the likelihood of default of each individual obligor and may use an internal risk rating system that indicates the economic loss rate upon default of each individual exposure.²⁵ A bank would assign an internal risk rating to each wholesale obligor, which should reflect the obligor's PD—that is, its long-run average one-year default rate over a reasonable mix of economic conditions. PD is defined in more detail below.

In determining an obligor rating, a bank should consider key obligor attributes, including both quantitative and qualitative factors that could affect the obligor's default risk. From a quantitative perspective, this could include an assessment of the obligor's historic and projected financial performance, trends in key financial performance ratios, financial contingencies, industry risk, and the obligor's position in the industry. On the qualitative side, this could include an assessment of the quality of the obligor's financial reporting, non-financial contingencies (for example, labor problems and environmental issues), and the quality of the obligor's management based on an evaluation of management's ability to make realistic projections, management's track record in meeting projections, and management's ability to effectively deal with changes in the economy and the competitive environment.

A bank must assign each legal entity wholesale obligor to a single rating grade. Accordingly, if a single wholesale exposure of the bank to an obligor

triggers the proposed rule's definition of default, all of the bank's wholesale exposures to that obligor are in default for risk-based capital purposes. In addition, a bank may not consider the value of collateral pledged to support a particular wholesale exposure (or any other exposure-specific characteristics) when assigning a rating to the obligor of the exposure, even in the context of nonrecourse loans and other loans underwritten primarily based on the operating income or cash flows from real estate collateral. A bank may, of course, consider all available financial information about the obligor—including, where applicable, the total operating income or cash flows from all of the obligor's projects or businesses—when assigning an obligor rating.

Question 13: The agencies seek comment on this aspect of the proposed rule and on any circumstances under which it would be appropriate to assign different obligor ratings to different exposures to the same obligor (for example, income-producing property lending or exposures involving transfer risk).

A bank's rating system must have at least seven discrete (non-overlapping) obligor grades for non-defaulted obligors and at least one obligor grade for defaulted obligors. The agencies believe that because the risk-based capital requirement of a wholesale exposure is directly linked to its obligor rating grade, a bank must have at least seven non-overlapping obligor grades to sufficiently differentiate the creditworthiness of non-defaulted wholesale obligors.

A bank would capture the estimated loss severity upon default for a wholesale exposure either by directly assigning an ELGD and LGD estimate to the exposure or by grouping the exposure with other wholesale exposures into loss severity rating grades (reflecting the bank's estimate of the ELGD or LGD of the exposure). The LGD of an exposure is an estimate of the economic loss rate on the exposure, taking into account related material costs and recoveries, in the event of the obligor's default during a period of economic downturn conditions. LGD is described in more detail below. Whether a bank chooses to assign ELGD and LGD values directly or, alternatively, to assign exposures to rating grades and then quantify the ELGD or LGD, as appropriate, for the rating grades, the key requirement is that the bank must identify exposure characteristics that influence ELGD and LGD. Each of the loss severity rating grades would be associated with an empirically supported ELGD or LGD

estimate. Banks employing loss severity grades must have a sufficiently granular loss severity grading system to avoid grouping together exposures with widely ranging ELGDs or LGDs.

Retail exposures. To implement the advanced approach for retail exposures, a bank must have an internal system that segments its retail exposures to differentiate accurately and reliably among degrees of credit risk. The most significant difference between the proposed rule's treatment of wholesale and retail exposures is that the risk parameters for retail exposures are not assigned at the individual exposure level. Banks typically manage retail exposures on a segment basis, where each segment contains exposures with similar risk characteristics. Therefore, a key characteristic of the proposed rule's retail framework is that the risk parameters for retail exposures would be assigned to segments of exposures rather than to individual exposures. Under the retail framework, a bank would group its retail exposures into segments with homogeneous risk characteristics and then estimate PD, ELGD, and LGD for each segment.

A bank must first group its retail exposures into three separate subcategories: (i) Residential mortgage exposures; (ii) QREs; and (iii) other retail exposures. The bank would then classify the retail exposures in each subcategory into segments to produce a meaningful differentiation of risk. The proposed rule requires banks to segment separately (i) defaulted retail exposures from non-defaulted retail exposures and (ii) retail eligible margin loans for which the bank adjusts EAD rather than ELGD and LGD to reflect the risk mitigating effects of financial collateral from other retail eligible margin loans. Otherwise, the agencies are not proposing to require that banks consider any particular risk drivers or employ any minimum number of segments in any of the three retail subcategories.

In determining how to segment retail exposures within each subcategory for the purpose of assigning risk parameters, a bank should use a segmentation approach that is consistent with its approach for internal risk assessment purposes and that classifies exposures according to predominant risk characteristics or drivers. Examples of risk drivers could include loan-to-value (LTV) ratios, credit scores, loan terms and structure (for example, interest only or payment option adjustable rate mortgages), origination channel, geographical location of the borrower, and collateral type. A bank must be able to demonstrate to its primary Federal

²⁵ As explained below, a bank that chooses not to use an internal risk rating system for ELGD and LGD for a wholesale exposure must directly assign an ELGD and LGD estimate to the wholesale exposure.

supervisor that its system assigns accurate and reliable PD, ELGD, and LGD estimates for each retail segment on a consistent basis.

Definition of default. In the ANPR, the agencies proposed to define default for a wholesale exposure as either or both of the following events: (i) The bank determines that the borrower is unlikely to pay its obligations to the bank in full, without recourse to actions by the bank such as the realization of collateral; or (ii) the borrower is more than 90 days past due on principal or interest on any material obligation to the bank.

A number of commenters encouraged the agencies to use a definition of default that conforms more closely to that used by bank risk managers. Many of these commenters recommended that the agencies define default as the entry into non-accrual status for wholesale exposures and the number of days past due for retail exposures, or as the entry into charge-off status for wholesale and retail exposures. The agencies have amended the ANPR definitions of default to respond to these concerns and recognize that the definition of default in this proposed rule is different from the definitions that are being implemented in other jurisdictions.

Under the proposed rule's definition of default, a bank's wholesale obligor would be in default if, for any credit exposure of the bank to the obligor, the bank has (i) placed the exposure on non-accrual status consistent with the Call Report Instructions or the Thrift Financial Report and the Thrift Financial Report Instruction Manual; (ii) taken a full or partial charge-off or write-down on the exposure due to the distressed financial condition of the obligor; or (iii) incurred a credit-related loss of 5 percent or more of the exposure's initial carrying value in connection with the sale of the exposure or the transfer of the exposure to the held-for-sale, available-for-sale, trading account, or other reporting category. Under the proposed definition, a wholesale exposure to an obligor remains in default until the bank has reasonable assurance of repayment and performance for all contractual principal and interest payments on all exposures of the bank to the obligor (other than exposures that have been fully written-down or charged-off). The agencies would expect a bank to employ standards for determining whether it has a reasonable assurance of repayment and performance that are similar to those for determining whether to restore a loan from non-accrual to accrual status.

When a bank sells a set of wholesale exposures, the bank must examine the

sale prices of the individual exposures contained in the set and evaluate whether a credit loss of 5 percent or more of the exposure's initial carrying value has occurred on any given exposure. Write-downs of securities that are not credit-related (for example, a write-down that is due to a change in market interest rates) would not be a default event.

Question 14: The agencies seek comment on this proposed definition of default and on how well it captures substantially all of the circumstances under which a bank could experience a material credit-related economic loss on a wholesale exposure. In particular, the agencies seek comment on the appropriateness of the 5 percent credit loss threshold for exposures sold or transferred between reporting categories. The agencies also seek commenters' views on specific issues raised by applying different definitions of default in multiple national jurisdictions and on ways to minimize potential regulatory burden, including use of the definition of default in the New Accord, keeping in mind that national bank supervisory authorities must adopt default definitions that are appropriate in light of national banking practices and conditions.

In response to comments on the ANPR, the agencies propose to define default for retail exposures according to the timeframes for loss classification that banks generally use for internal purposes and that are embodied in the FFIEC's Uniform Retail Credit Classification and Account Management Policy.²⁶ Specifically, revolving retail exposures and residential mortgages would be in default at 180 days past due; other retail exposures would be in default at 120 days past due. In addition, a retail exposure would be in default if the bank has taken a full or partial charge-off or write-down of principal on the exposure for credit-related reasons. Such an exposure would remain in default until the bank has reasonable assurance of repayment and performance for all contractual principal and interest payments on the exposure.

The proposed definition of default for retail exposures differs from the proposed definition for the wholesale portfolio in several important respects. First, the proposed retail default definition applies on an exposure-by-exposure basis (rather than, as is the case for wholesale exposures, on an obligor-by-obligor basis). In other words,

default on one retail exposure would not require a bank to treat all other obligations of the same obligor to the bank as defaulted. This difference reflects the fact that banks generally manage retail credit risk based on segments of similar exposures rather than through the assignment of ratings to particular obligors. In addition, it is quite common for retail borrowers that default on some of their obligations to continue payment on others.

Second, the retail definition of default, unlike the wholesale definition of default, does not include exposures placed on non-accrual status. The agencies recognize that retail non-accrual practices vary considerably among banks. Accordingly, the agencies have determined that removing non-accrual from the retail definition of default would promote greater consistency among banks in the treatment of retail exposures.

In addition, the retail definition of default, unlike the wholesale definition of default, does not explicitly state that an exposure is in default if a bank incurs credit-related losses of 5 percent or more in connection with the sale of the exposure. Because of the large number of diverse retail exposures that banks usually sell in a single transaction, banks typically do not allocate the sales price of a pool of retail exposures in such a way as to enable the bank to calculate the premium or discount on individual retail exposures. Although the proposed rule's definition of retail default does not explicitly include credit-related losses in connection with loan sales, the agencies would expect banks to assess carefully the impact of retail exposure sales in quantifying the risk parameters calculated by the bank for its retained retail exposures.

Rating philosophy. A bank must explain to its primary Federal supervisor its rating philosophy—that is, how the bank's wholesale obligor rating assignments are affected by the bank's choice of the range of economic, business, and industry conditions that are considered in the obligor rating process. The philosophical basis of a bank's ratings system is important because, when combined with the credit quality of individual obligors, it will determine the frequency of obligor rating changes in a changing economic environment. Rating systems that rate obligors based on their ability to perform over a wide range of economic, business, and industry conditions, sometimes described as "through-the-cycle" systems, would tend to have ratings that migrate more slowly as conditions change. Banks that rate

²⁶ FFIEC, "Uniform Retail Credit Classification and Account Management Policy," 65 FR 36903 (June 12, 2000).

obligors based on a more narrow range of likely expected conditions (primarily on recent conditions), sometimes called "point-in-time" systems, would tend to have ratings that migrate more frequently. Many banks will rate obligors using an approach that considers a combination of the current conditions and a wider range of other likely conditions. In any case, the bank would need to specify the rating philosophy used and establish a policy for the migration of obligors from one rating grade to another in response to economic cycles. A bank should understand the effects of ratings migration on its risk-based capital requirements and ensure that sufficient capital is maintained during all phases of the economic cycle.

Rating and segmentation reviews and updates. A bank must have a policy that ensures that each wholesale obligor rating and (if applicable) wholesale exposure loss severity rating reflects current information. A bank's internal risk rating system for wholesale exposures must provide for the review and update (as appropriate) of each obligor rating and (if applicable) loss severity rating whenever the bank receives new material information, but no less frequently than annually. A bank's retail exposure segmentation system must provide for the review and update (as appropriate) of assignments of retail exposures to segments whenever the bank receives new material information, but no less frequently than quarterly.

3. Quantification of Risk Parameters for Wholesale and Retail Exposures

A bank must have a comprehensive risk parameter quantification process that produces accurate, timely, and reliable estimates of the risk parameters—PD, ELGD, LGD, EAD, and (for wholesale exposures) M—for its wholesale obligors and exposures and retail exposures. Statistical methods and models used to develop risk parameter estimates, as well as any adjustments to the estimates or empirical default data, should be transparent, well supported, and documented. The following sections of the preamble discuss the proposed rule's definitions of the risk parameters for wholesale and retail exposures.

Probability of default (PD). As noted above, under the proposed rule, a bank must assign each of its wholesale obligors to an internal rating grade and then must associate a PD with each rating grade. PD for a wholesale exposure to a non-defaulted obligor would be the bank's empirically based best estimate of the long-run average of

one-year default rates for the rating grade assigned by the bank to the obligor, capturing the average default experience for obligors in the rating grade over a mix of economic conditions (including economic downturn conditions) sufficient to provide a reasonable estimate of the average one-year default rate over the economic cycle for the rating grade. This estimate of the long-run average PD is converted into an estimate of PD under economic downturn conditions as part of the IRB risk-based capital formulas.

In addition, under the proposed rule, a bank must assign a PD to each segment of retail exposures. The proposed rule provides two different definitions of the PD of a segment of non-defaulted retail exposures based on the materiality of seasoning effects for the segment or for the segment's retail exposure subcategory. Some types of retail exposures display a distinct seasoning pattern—that is, the exposures have relatively low default rates in their first year, rising default rates in the next few years, and declining default rates for the remainder of their terms. A bank must use a separate definition of PD that addresses seasoning effects for a segment of non-defaulted retail exposures unless the bank has determined that seasoning effects are not material for the segment or for the segment's entire retail exposure subcategory.

The proposed rule provides a definition of PD for segments of non-defaulted retail exposures where seasoning is not a material consideration that tracks closely the wholesale PD definition. Specifically, PD for a segment of non-defaulted retail exposures for which seasoning effects are not material, or for a segment of non-defaulted retail exposures in a retail exposure subcategory for which seasoning effects are not material, would be the bank's empirically based best estimate of the long-run average of one-year default rates for the exposures in the segment, capturing the average default experience for exposures in the segment over a mix of economic conditions (including economic downturn conditions) sufficient to provide a reasonable estimate of the average one-year default rate over the economic cycle for the segment. Banks that use this PD formulation for a segment of retail exposures should be able to demonstrate to their primary Federal supervisor, using empirical data, why seasoning effects are not material for the segment or the retail exposure subcategory in which the segment resides.

Because of the one-year IRB horizon, the agencies are proposing a different PD definition for retail segments with material seasoning effects. Under the proposed rule, PD for a segment of non-defaulted retail exposures for which seasoning effects are material would be the bank's empirically based best estimate of the annualized cumulative default rate over the expected remaining life of exposures in the segment, capturing the average default experience for exposures in the segment over a mix of economic conditions (including economic downturn conditions) to provide a reasonable estimate of the average performance over the economic cycle for the segment. A bank's PD estimates for these retail segments with material seasoning effects also should reflect potential changes in the expected remaining life of exposures in the segment over the economic cycle.

For wholesale exposures to defaulted obligors and for segments of defaulted retail exposures, PD would be 100 percent.

Loss given default (LGD) and expected loss given default (ELGD). Under the proposed rule, a bank must directly estimate an ELGD and LGD risk parameter for each wholesale exposure or must assign each wholesale exposure to an expected loss severity grade and a downturn loss severity grade, estimate an ELGD risk parameter for each expected loss severity grade, and estimate an LGD risk parameter for each loss severity grade. In addition, a bank must estimate an ELGD and LGD risk parameter for each segment of retail exposures. The same ELGD and LGD may be appropriate for more than one retail segment.

LGD is an estimate of the economic loss that would be incurred on an exposure, relative to the exposure's EAD, if the exposure were to default within a one-year horizon during economic downturn conditions. The economic loss amount must capture all material credit-related losses on the exposure (including accrued but unpaid interest or fees, losses on the sale of repossessed collateral, direct workout costs, and an appropriate allocation of indirect workout costs). Where positive or negative cash flows on a wholesale exposure to a defaulted obligor or on a defaulted retail exposure (including proceeds from the sale of collateral, workout costs, and draw-downs of unused credit lines) occur after the date of default, the economic loss amount must reflect the net present value of cash flows as of the default date using a discount rate appropriate to the risk of the exposure.

The LGD of some exposures may be substantially higher during economic downturn conditions than during other periods, while for other types of exposures it may not. Accordingly, the proposed rule requires banks to use an LGD estimate that reflects economic downturn conditions for purposes of calculating the risk-based capital requirements for wholesale exposures and retail segments; however, the LGD of an exposure may never be less than the exposure's ELGD. More specifically, banks must produce for each wholesale exposure (or downturn loss severity rating grade) and retail segment an estimate of the economic loss per dollar of EAD that the bank would expect to incur if default were to occur within a one-year horizon during economic downturn conditions. The estimate of LGD can be thought of as the ELGD plus an increase if appropriate to reflect the impact of economic downturn conditions.

For the purpose of defining economic downturn conditions, the proposed rule identifies two wholesale exposure subcategories—high-volatility commercial real estate (HVCRE) wholesale exposures and non-HVCRE wholesale exposures (that is, all wholesale exposures that are not HVCRE exposures)—and three retail exposure subcategories—residential mortgage exposures, QREs, and other retail exposures. The proposed rule defines economic downturn conditions with respect to an exposure as those conditions in which the aggregate default rates for the exposure's entire wholesale or retail subcategory held by the bank (or subdivision of such subcategory selected by the bank) in the exposure's national jurisdiction (or subdivision of such jurisdiction selected by the bank) are significantly higher than average.

Under this approach, a bank with a geographical or industry sector concentration in a subcategory of exposures may find that information relating to a downturn in that geographical region or industry sector may be more relevant for the bank than a general downturn affecting many regions or industries. At this time, however, the proposed rule does not require a bank with a geographical, industry sector, or other concentration to subdivide exposure subcategories or national jurisdictions to reflect such concentrations; rather, the proposed rule allows banks to subdivide exposure subcategories or national jurisdictions as they deem appropriate given the exposures held by the bank. The agencies understand that downturns in particular geographical subdivisions of

national jurisdictions or in particular industrial sectors may result in significantly increased loss rates in material subdivisions of a bank's exposures in an exposure subcategory. *Question 15: In light of the possibility of significantly increased loss rates at the subdivision level due to downturn conditions in the subdivision, the agencies seek comment on whether to require banks to determine economic downturn conditions at a more granular level than an entire wholesale or retail exposure subcategory in a national jurisdiction.*

The proposed rule provides banks two methods of generating LGD estimates for wholesale and retail exposures. First, a bank may use its own estimates of LGD for a subcategory of exposures if the bank has prior written approval from its primary Federal supervisor to use internal estimates for that subcategory of exposures. In approving a bank's use of internal estimates of LGD, a bank's primary Federal supervisor will consider whether the bank's internal estimates of LGD are reliable and sufficiently reflective of economic downturn conditions. The supervisor will also consider whether the bank has rigorous and well-documented policies and procedures for identifying economic downturn conditions for the exposure subcategory, identifying material adverse correlations between the relevant drivers of default rates and loss rates given default, and incorporating identified correlations into internal LGD estimates. If a bank has supervisory approval to use its own estimates of LGD for an exposure subcategory, it must use its own estimates of LGD for all exposures within that subcategory.

As noted above, the LGD of an exposure or segment may never be less than the ELGD of that exposure or segment. The proposed rule defines the ELGD of a wholesale exposure as the bank's empirically-based best estimate of the default-weighted average economic loss per dollar of EAD the bank expects to incur in the event that the obligor of the exposure (or a typical obligor in the loss severity grade assigned by the bank to the exposure) defaults within a one-year horizon.²⁷ For a segment of retail exposures, ELGD is the bank's empirically-based best estimate of the default-weighted average economic loss per dollar of EAD the bank expects to incur on exposures in the segment that default within a one-year horizon. ELGD estimates must incorporate a mix of economic

conditions (including economic downturn conditions). For example, given appropriate data, the ELGD could be estimated by calculating the default-weighted average economic loss per dollar of EAD given default for exposures in a particular loss severity grade or segment observed over a complete credit cycle.

As an alternative to internal estimates of LGD, the proposed rule provides a supervisory mapping function for converting ELGD into LGD for risk-based capital purposes. Although the agencies encourage banks to develop internal LGD estimates, the agencies are aware that it may be difficult at this time and in the near future for banks to produce internal estimates of LGD that are sufficient for risk-based capital purposes because LGD data for important portfolios may be sparse, and there is very limited industry experience with incorporating downturn conditions into LGD estimates. Accordingly, under the proposed rule, a bank that does not qualify for use of its own estimates of LGD for a subcategory of exposures must instead compute LGD by applying a supervisory mapping function to its internal estimates of ELGD for such exposures. The bank would adjust its ELGDs upward to LGDs using the linear supervisory mapping function: $LGD = 0.08 + 0.92 \times ELGD$. Under this mapping function, for example, an ELGD of 0 percent is converted to an LGD of 8 percent, an ELGD of 20 percent is converted to an LGD of 26.4 percent, and an ELGD of 50 percent is converted to an LGD of 54 percent. A bank would not have to apply the supervisory mapping function to repo-style transactions, eligible margin loans, and OTC derivative contracts (defined below in section V.C. of the preamble). For these exposures, the agencies believe that the difference between a bank's estimate of LGD and its estimate of ELGD is likely to be small. Instead a bank would set LGD equal to ELGD for these exposures.

As noted, the proposed rule would permit a bank to use the supervisory mapping function to translate ELGDs to LGDs and would only permit a bank to use its own estimates of LGD for an exposure subcategory if the bank has received prior written approval from its primary Federal supervisor. The agencies also are considering whether to require every bank, as a condition to qualifying for use of the advanced approaches, to be able to produce credible and reliable internal estimates of LGD for all its wholesale and retail exposures. Under this stricter approach, a bank that is unable to demonstrate to

²⁷ Under the proposal, ELGD is not the statistical expected value of LGD.

its primary Federal supervisor that it could produce credible and reliable internal estimates of LGD would not be permitted to use the advanced approaches.

Question 16: The agencies seek comment on and supporting empirical analysis of (i) the proposed rule's definitions of ELGD and ELGD; (ii) the proposed rule's overall approach to LGD estimation; (iii) the appropriateness of requiring a bank to produce credible and reliable internal estimates of LGD for all its wholesale and retail exposures as a precondition for using the advanced approaches; (iv) the appropriateness of requiring all banks to use a supervisory mapping function, rather than internal estimates, for estimating LGDs, due to limited data availability and lack of industry experience with incorporating economic downturn conditions in LGD estimates; (v) the appropriateness of the proposed supervisory mapping function for translating ELGD into LGD for all portfolios of exposures and possible alternative supervisory mapping functions; (vi) exposures for which no mapping function would be appropriate; and (vii) exposures for which a more lenient (that is, producing a lower LGD for a given ELGD) or more strict (that is, producing a higher LGD for a given ELGD) mapping function may be appropriate (for example, residential mortgage exposures and HVCRE exposures).

The agencies are concerned that some approaches to ELGD or LGD quantification could produce estimates that are pro-cyclical, particularly if these estimates are based on economic indicators, such as frequently updated loan-to-value (LTV) ratios, that are highly sensitive to current economic conditions. *Question 17: The agencies seek comment on the extent to which ELGD or LGD estimates under the proposed rule would be pro-cyclical, particularly for longer-term secured exposures. The agencies also seek comment on alternative approaches to measuring ELGDs or LGDs that would address concerns regarding potential pro-cyclicality without imposing undue burden on banks.*

This proposed rule incorporates comments on the ANPR suggesting a need to better accommodate certain credit products, most prominently asset-based lending programs, whose structures typically result in a bank recovering substantial amounts of the exposure prior to the default date—for example, through paydowns of outstanding principal. The agencies believe that actions taken prior to default to mitigate losses are an

important component of a bank's overall credit risk management, and that such actions should be reflected in ELGD and LGD when banks can quantify their effectiveness in a reliable manner. In the proposed rule, this is achieved by measuring ELGD and LGD relative to the exposure's EAD (defined in the next section) as opposed to the amount actually owed at default.²⁸

In practice, the agencies would expect methods for estimating ELGD and LGD, and the way those methods reflect changes in exposure during the period prior to default, to be consistent with other aspects of the proposed rule. For example, a default horizon that is longer than one year could result in lower estimates of economic loss due to greater contractual amortization prior to default, or a greater likelihood that covenants would enable a bank to accelerate paydowns of principal as the condition of an obligor deteriorates, but such long horizons could be inconsistent with the one-year default horizon incorporated in other aspects of this proposed rule, such as the quantification of PD.

The agencies intend to limit recognition of the impact on ELGD and LGD of pre-default paydowns to certain types of exposures where the pattern is common, measurable, and especially significant, as with various types of asset-based lending. In addition, not all paydowns during the period prior to default warrant recognition as part of the recovery process. For example, a pre-default reduction in the outstanding amount on one exposure may simply reflect a refinancing by the obligor with the bank, with no reduction in the bank's total exposure to the obligor.

Question 18: The agencies seek comment on the feasibility of recognizing such pre-default changes in exposure in a way that is consistent with the safety and soundness objectives of this proposed rule. The agencies also seek comment on appropriate restrictions to place on any such recognition to ensure that the results are not counter to the objectives of this proposal to ensure adequate capital within a more risk-sensitive capital framework. In addition, the agencies

²⁸ To illustrate, suppose that for a particular asset-based lending exposure, the EAD equaled \$100 and that for every \$1 owed by the obligor at the time of default, the bank's recovery would be \$0.40. Furthermore, suppose that in the event of default, within a one-year horizon, pre-default paydowns of \$20 would reduce the exposure amount to \$80 at the time of default. In this case, the bank's economic loss rate measured relative to the amount owed at default (60%) would exceed the economic loss rate measured relative to EAD (48% = 60% × (\$100 - \$20)/\$100), because the former does not reflect fully the impact of the pre-default paydowns.

seek comment on whether, for wholesale exposures, allowing ELGD and LGD to reflect anticipated future contractual paydowns prior to default may be inconsistent with the proposed rule's imposition of a one-year floor on M (for certain types of exposures) or may lead to some double-counting of the risk-mitigating benefits of shorter maturities for exposures not subject to this floor.

Exposure at default (EAD). Except as noted below, EAD for the on-balance-sheet component of a wholesale or retail exposure means (i) the bank's carrying value for the exposure (including net accrued but unpaid interest and fees)²⁹ less any allocated transfer risk reserve for the exposure, if the exposure is held-to-maturity or for trading; or (ii) the bank's carrying value for the exposure (including net accrued but unpaid interest and fees) less any allocated transfer risk reserve for the exposure and any unrealized gains on the exposure, plus any unrealized losses on the exposure, if the exposure is available for sale. For the off-balance-sheet component of a wholesale or retail exposure (other than an OTC derivative contract, repo-style transaction, or eligible margin loan) in the form of a loan commitment or line of credit, EAD means the bank's best estimate of net additions to the outstanding amount owed the bank, including estimated future additional draws of principal and accrued but unpaid interest and fees, that are likely to occur over the remaining life of the exposure assuming the exposure were to go into default. This estimate of net additions must reflect what would be expected during a period of economic downturn conditions. For the off-balance-sheet component of a wholesale or retail exposure other than an OTC derivative contract, repo-style transaction, eligible margin loan, loan commitment, or line of credit issued by a bank, EAD means the notional amount of the exposure.

For a segment of retail exposures, EAD is the sum of the EADs for each individual exposure in the segment. For wholesale or retail exposures in which only the drawn balance has been securitized, the bank must reflect its share of the exposures' undrawn balances in EAD. The undrawn balances of exposures for which the drawn balances have been securitized must be allocated between the seller's and investors' interests on a pro rata basis, based on the proportions of the seller's and investors' shares of the securitized drawn balances. For example, if the

²⁹ "Net accrued but unpaid interest and fees" are accrued but unpaid interest and fees net of any amount expensed by the bank as uncollectable.

EAD of a group of securitized exposures' undrawn balances is \$100, and the bank's share (seller's interest) in the securitized exposures is 25 percent, the bank must reflect \$25 in EAD for the undrawn balances.

The proposed rule contains a special treatment of EAD for OTC derivative contracts, repo-style transactions, and eligible margin loans, which is in section 32 of the proposed rule and discussed in more detail in section V.C. of the preamble.

General quantification principles. The proposed rule requires data used by a bank to estimate risk parameters to be relevant to the bank's actual wholesale and retail exposures and of sufficient quality to support the determination of risk-based capital requirements for the exposures. For wholesale exposures, estimation of the risk parameters must be based on a minimum of 5 years of default data to estimate PD, 7 years of loss severity data to estimate ELGD and LGD, and 7 years of exposure amount data to estimate EAD. For segments of retail exposures, estimation of risk parameters must be based on a minimum of 5 years of default data to estimate PD, 5 years of loss severity data to estimate ELGD and LGD, and 5 years of exposure amount data to estimate EAD. Default, loss severity, and exposure amount data must include periods of economic downturn conditions or the bank must adjust its estimates of risk parameters to compensate for the lack of data from such periods. Banks must base their estimates of PD, ELGD, LGD, and EAD on the proposed rule's definition of default, and must review at least annually and update (as appropriate) their risk parameters and risk parameter quantification process.

In all cases, banks would be expected to use the best available data for quantifying the risk parameters. A bank could meet the minimum data requirement by using internal data, external data, or pooled data combining internal data with external data. Internal data refers to any data on exposures held in a bank's existing or historical portfolios, including data elements or information provided by third parties. External data refers to information on exposures held outside of the bank's portfolio or aggregate information across an industry.

For example, for new lines of business where a bank lacks sufficient internal data, it must use external data to supplement its internal data. The agencies recognize that the minimum sample period for reference data provided in the proposed rule may not provide the best available results. A

longer sample period usually captures varying economic conditions better than a shorter sample period; in addition, a longer sample period will include more default observations for ELGD, LGD, and EAD estimation. Banks should consider using a longer-than-minimum sample period when possible. However, the potential increase in precision afforded by a larger sample should be weighed against the potential for diminished comparability of older data to the existing portfolio; striking the correct balance is an important aspect of quantitative modeling.

Both internal and external reference data should not differ systematically from a bank's existing portfolio in ways that seem likely to be related to default risk, loss severity, or exposure at default. Otherwise, the derived PD, ELGD, LGD, or EAD estimates may not be applicable to the bank's existing portfolio. Accordingly, the bank must conduct a comprehensive review and analysis of reference data at least annually to determine the relevance of reference data to the bank's exposures, the quality of reference data to support PD, ELGD, LGD, and EAD estimates, and the consistency of reference data to the definition of default contained in the proposed rule. Furthermore, a bank must have adequate data to estimate risk parameters for all its wholesale and retail exposures as if they were held to maturity, even if some loans are likely to be sold or securitized before their long-term credit performance can be observed.

As noted above, periods of economic downturn conditions must be included in the data sample (or adjustments to risk parameters must be made). If the reference data include data from beyond the minimum number of years (to capture a period of economic downturn conditions or for other valid reasons), the reference data need not cover all of the intervening years. However, a bank should justify the exclusion of available data and, in particular, any temporal discontinuities in data used. Including periods of economic downturn conditions increases the size and potentially the breadth of the reference data set. According to some empirical studies, the average loss rate is higher during periods of economic downturn conditions, such that exclusion of such periods would bias ELGD, LGD, or EAD estimates downward and unjustifiably lower risk-based capital requirements.

Risk parameter estimates should take into account the robustness of the quantification process. The assumptions and adjustments embedded in the quantification process should reflect the degree of uncertainty or potential error

inherent in the process. In practice, a reasonable estimation approach likely would result in a range of defensible risk parameter estimates. The choices of the particular assumptions and adjustments that determine the final estimate, within the defensible range, should reflect the uncertainty in the quantification process. That is, more uncertainty in the process should be reflected in the assignment of final risk parameter estimates that result in higher risk-based capital requirements relative to a quantification process with less uncertainty. The degree of conservatism applied to adjust for uncertainty should be related to factors such as the relevance of the reference data to a bank's existing exposures, the robustness of the models, the precision of the statistical estimates, and the amount of judgment used throughout the process. Margins of conservatism need not be added at each step; indeed, that could produce an excessively conservative result. Instead, the overall margin of conservatism should adequately account for all uncertainties and weaknesses in the quantification process. Improvements in the quantification process (including use of more complete data and better estimation techniques) may reduce the appropriate degree of conservatism over time.

Judgment will inevitably play a role in the quantification process and may materially affect the estimates of risk parameters. Judgmental adjustments to estimates are often necessary because of some limitations on available reference data or because of inherent differences between the reference data and the bank's existing exposures. The bank must ensure that adjustments are not biased toward optimistically low risk parameter estimates. This standard does not prohibit individual adjustments that result in lower estimates of risk parameters, as both upward and downward adjustments are expected. Individual adjustments are less important than broad patterns; consistent signs of judgmental decisions that lower risk parameter estimates materially may be evidence of systematic bias, which would not be permitted.

In estimating relevant risk parameters, banks should not rely on the possibility of U.S. government financial assistance, except for the financial assistance that the government has legally committed to provide.

4. Optional Approaches That Require Prior Supervisory Approval

A bank that intends to apply the internal models methodology to

counterparty credit risk, the double default treatment for credit risk mitigation, the internal assessment approach (IAA) for securitization exposures to ABCP programs, or the internal models approach (IMA) to equity exposures must receive prior written approval from its primary Federal supervisor. The criteria on which approval would be based are described in the respective sections below.

5. Operational Risk

A bank must have operational risk management processes, data and assessment systems, and quantification systems that meet the qualification requirements in section 22(h) of the proposed rule. A bank must have an operational risk management function independent from business line management. The operational risk management function is responsible for the design, implementation, and oversight of the bank's operational risk data and assessment systems, operational risk quantification systems, and related processes. The roles and responsibilities of the operational risk management function may vary between banks, but must be clearly documented. The operational risk management function should have organizational stature commensurate with the bank's operational risk profile. At a minimum, the bank's operational risk management function should ensure the development of policies and procedures for the explicit management of operational risk as a distinct risk to the bank's safety and soundness.

A bank also must establish and document a process to identify, measure, monitor, and control operational risk in bank products, activities, processes, and systems. This process should provide for the consistent and comprehensive collection of the data needed to estimate the bank's exposure to operational risk. The process must also ensure reporting of operational risk exposures, operational loss events, and other relevant operational risk information to business unit management, senior management, and to the board of directors (or a designated committee of the board). The proposed rule defines operational loss events as events that result in loss and are associated with internal fraud; external fraud; employment practices and workplace safety; clients, products, and business practices; damage to physical assets; business disruption and system failures; or execution, delivery, and process management. A bank's operational risk management processes should reflect

the scope and complexity of its business lines, as well as its corporate organizational structure. Each bank's operational risk profile is unique and requires a tailored risk management approach appropriate for the scale and materiality of the operational risks present in the bank.

Operational risk data and assessment system. A bank must have an operational risk data and assessment system that incorporates on an ongoing basis the following four elements: internal operational loss event data, external operational loss event data, results of scenario analysis, and assessments of the bank's business environment and internal controls. These four operational risk elements should aid the bank in identifying the level and trend of operational risk, determining the effectiveness of operational risk management and control efforts, highlighting opportunities to better mitigate operational risk, and assessing operational risk on a forward-looking basis. A bank's operational risk data and assessment system must be structured in a manner consistent with the bank's current business activities, risk profile, technological processes, and risk management processes.

The proposed rule defines operational loss as a loss (excluding insurance or tax effects) resulting from an operational loss event. Operational losses include all expenses associated with an operational loss event except for opportunity costs, forgone revenue, and costs related to risk management and control enhancements implemented to prevent future operational losses. The definition of operational loss is an important issue, as it is a critical building block in a bank's calculation of its operational risk capital requirement under the AMA. More specifically, under the proposed rule, the bank's estimate of operational risk exposure—the basis for determining a bank's risk-weighted asset amount for operational risk—is an estimate of aggregate operational losses generated by the bank's AMA process.

The agencies are considering whether to define operational loss based solely on the effect of an operational loss event on a bank's regulatory capital or to use a definition of operational loss that incorporates, to a greater extent, economic capital concepts. In either case, operational losses would continue to be determined exclusive of insurance and tax effects.

With respect to most operational loss events, the agencies believe that the operational loss amount incorporated into a bank's AMA process would be

substantially the same whether viewed from the perspective of its effect on the bank's regulatory capital or an alternative approach that more directly incorporates economic capital concepts. In the case of operational loss events associated with premises and other fixed assets, however, potential loss amounts used in a bank's estimate of its operational risk exposure could be considerably different under the two approaches. The agencies recognize that, for purposes of economic capital analysis, banks often use replacement cost or market value, and not carrying value, to determine the amount of an operational loss with respect to fixed assets. The use of carrying value would be consistent with a definition of operational loss that covers a loss event's effect on a bank's regulatory capital, but may not reflect the full economic impact of a loss event in the case of assets that have a carrying value that is different from their market value.

Further, the agencies recognize that there is a potential to double-count all or a portion of the risk-based capital requirement associated with fixed assets. Under section 31(e)(3) of the proposed rule, which addresses calculation of risk-weighted asset amounts for assets that are not included in an exposure category, the risk-weighted asset amount for a bank's premises will equal the carrying value of the premises on the financial statements of the bank, determined in accordance with generally accepted accounting principles (GAAP). A bank's operational risk exposure estimate addressing bank premises generally will be different than the risk-based capital requirement generated under section 31(e)(3) of the proposed rule and, at least in part, will address the same risk exposure.

Question 19: The agencies solicit comment on all aspects of the proposed treatment of operational loss and, in particular, on (i) the appropriateness of the proposed definition of operational loss; (ii) whether the agencies should define operational loss in terms of the effect an operational loss event has on the bank's regulatory capital or should consider a broader definition based on economic capital concepts; and (iii) how the agencies should address the potential double-counting issue for premises and other fixed assets.

A bank must have a systematic process for capturing and using internal operational loss event data in its operational risk data and assessment systems. Consistent with the ANPR, the proposed rule defines internal operational loss event data for a bank as gross operational loss amounts, dates,

recoveries, and relevant causal information for operational loss events occurring at the bank. A bank's operational risk data and assessment system must include a minimum historical observation period of five years of internal operational losses. With approval of its primary Federal supervisor, however, a bank may use a shorter historical observation period to address transitional situations such as integrating a new business line. A bank may refrain from collecting internal operational loss event data for individual operational losses below established dollar threshold amounts if the bank can demonstrate to the satisfaction of its primary Federal supervisor that the thresholds are reasonable, do not exclude important internal operational loss event data, and permit the bank to capture substantially all the dollar value of the bank's operational losses.

A bank also must establish a systematic process for determining its methodologies for incorporating external operational loss event data into its operational risk data and assessment systems. The proposed rule defines external operational loss event data for a bank as gross operational loss amounts, dates, recoveries, and relevant causal information for operational loss events occurring at organizations other than the bank. External operational loss event data may serve a number of different purposes in a bank's operational risk data and assessment systems. For example, external operational loss event data may be a particularly useful input in determining a bank's level of exposure to operational risk when internal operational loss event data are limited. In addition, external operational loss event data provide a means for the bank to understand industry experience and, in turn, provide a means for the bank to assess the adequacy of its internal operational loss event data.

While internal and external operational loss event data provide a historical perspective on operational risk, it is also important that a bank incorporate forward-looking elements in its operational risk data and assessment systems. Accordingly, a bank must incorporate a business environment and internal control factor analysis in its operational risk data and assessment systems to fully assess its exposure to operational risk. In principle, a bank with strong internal controls in a stable business environment would have less exposure to operational risk than a bank with internal control weaknesses that is growing rapidly or introducing new products. In this regard, a bank should

identify and assess the level and trends in operational risk and related control structures at the bank. These assessments should be current, should be comprehensive across the bank, and should identify the operational risks facing the bank. The framework established by a bank to maintain these risk assessments should be sufficiently flexible to accommodate increasing complexity, new activities, changes in internal control systems, and an increasing volume of information. A bank must also periodically compare the results of its prior business environment and internal control factor assessments against the bank's actual operational losses incurred in the intervening period.

Similar to business environment and internal control factor assessments, the results of scenario analysis provide a means for a bank to incorporate a forward-looking element in its operational risk data and assessment systems. Under the proposed rule, scenario analysis is a systematic process of obtaining expert opinions from business managers and risk management experts to derive reasoned assessments of the likelihood and loss impact of plausible high-severity operational losses that may occur at a bank. A bank must establish a systematic process for determining its methodologies for incorporating scenario analysis into its operational risk data and assessment systems. As an input to a bank's operational risk data and assessment systems, scenario analysis is especially relevant for business lines or loss event types where internal data, external data, and assessments of the business environment and internal control factors do not provide a sufficiently robust estimate of the bank's exposure to operational risk.

A bank's operational risk data and assessment systems must include credible, transparent, systematic, and verifiable processes that incorporate all four operational risk elements. The bank should have clear standards for the collection and modification of all elements. The bank should combine these four elements in a manner that most effectively enables it to quantify its exposure to operational risk.

Operational risk quantification system. A bank must have an operational risk quantification system that measures its operational risk exposure using its operational risk data and assessment systems. The proposed rule defines operational risk exposure as the 99.9th percentile of the distribution of potential aggregate operational losses, as generated by the bank's operational risk quantification system over a one-

year horizon (and not incorporating eligible operational risk offsets or qualifying operational risk mitigants). The mean of such a total loss distribution is the bank's EOL. The proposed rule defines EOL as the expected value of the distribution of potential aggregate operational losses, as generated by the bank's operational risk quantification system using a one-year horizon. The bank's UOL is the difference between the bank's operational risk exposure and the bank's EOL.

As part of its estimation of its operational risk exposure, a bank must demonstrate that its unit of measure is appropriate for the bank's range of business activities and the variety of operational loss events to which it is exposed. The proposed rule defines a unit of measure as the level (for example, organizational unit or operational loss event type) at which the bank's operational risk quantification system generates a separate distribution of potential operational losses. A bank must also demonstrate that it has not combined business activities or operational loss events with different risk profiles within the same loss distribution.

The agencies recognize that operational losses across operational loss event types and business lines may be related. A bank may use its internal estimates of dependence among operational losses within and across business lines and operational loss event types if the bank can demonstrate to the satisfaction of its primary Federal supervisor that its process for estimating dependence is sound, robust to a variety of scenarios, and implemented with integrity, and allows for the uncertainty surrounding the estimates. The agencies expect that a bank's assumptions regarding dependence will be conservative given the uncertainties surrounding dependence modeling for operational risk. If a bank does not satisfy the requirements surrounding dependence described above, the bank must sum operational risk exposure estimates across units of measure to calculate its operational risk exposure.

A bank's chosen unit of measure affects how it should account for dependence. Explicit assumptions regarding dependence across units of measure are always necessary to estimate operational risk exposure at the bank level. However, explicit assumptions regarding dependence within units of measure are not necessary, and under many circumstances models assume statistical independence within each unit of measure. The use of only a few units of

measure heightens the need to ensure that dependence within units of measure is suitably reflected in the operational risk exposure estimate.

In addition, the bank's process for estimating dependence should provide for ongoing monitoring, recognizing that dependence estimates can change. The agencies expect that a bank's approach for developing explicit and objective dependence determinations will improve over time. As such, the bank should develop a process for assessing incremental improvements to the approach (for example, through out-of-sample testing).

A bank must review and update (as appropriate) its operational risk quantification system whenever the bank becomes aware of information that may have a material effect on the bank's estimate of operational risk exposure, but no less frequently than annually.

As described above, the agencies expect a bank using the AMA to demonstrate that its systems for managing and measuring operational risk meet established standards, including producing an estimate of operational risk exposure at the 99.9 percent confidence level. However, the agencies recognize that, in limited circumstances, there may not be sufficient data available for a bank to generate a credible estimate of its own operational risk exposure at the 99.9 percent confidence level. In these limited circumstances, a bank may propose use of an alternative operational risk quantification system to that specified in section 22(h)(3)(i) of the proposed rule, subject to approval by the bank's primary Federal supervisor. The alternative approach is not available at the BHC level.

The agencies are not prescribing specific estimation methodologies under this approach and expect use of an alternative approach to occur on a very limited basis. A bank proposing to use an alternative operational risk quantification system must submit a proposal to its primary Federal supervisor. In evaluating a bank's proposal, the bank's primary Federal supervisor will review the bank's justification for requesting use of an alternative approach in light of the bank's size, complexity, and risk profile. The bank's primary Federal supervisor will also consider whether the proposed approach results in capital levels that are commensurate with the bank's operational risk profile, is sensitive to changes in the bank's risk profile, can be supported empirically, and allows the bank's board of directors to fulfill its fiduciary responsibilities to ensure that the bank is adequately capitalized.

Furthermore, the agencies expect a bank using an alternative operational risk quantification system to adhere to the qualification requirements outlined in the proposed rule, including establishment and use of operational risk management processes and data and assessment systems.

A bank proposing an alternative approach to operational risk based on an allocation methodology should be aware of certain limitations associated with use of such an approach. Specifically, the agencies will not accept an allocation of operational risk capital requirements that includes non-DI entities or the benefits of diversification across entities. The exclusion of allocations that include non-DIs is in recognition that, unlike the cross-guarantee provision of the Federal Deposit Insurance Act, which provides that a DI is liable for any losses incurred by the FDIC in connection with the failure of a commonly controlled DI, there are no statutory provisions requiring cross-guarantees between a DI and its non-DI affiliates.³⁰ Furthermore, depositors and creditors of a DI generally have no legal recourse to capital funds that are not held by the DI or its affiliate DIs.

6. Data Management and Maintenance

A bank must have data management and maintenance systems that adequately support all aspects of the bank's advanced IRB systems, operational risk management processes, operational risk data and assessment systems, operational risk quantification systems, and, to the extent the bank uses the following systems, the internal models methodology to counterparty credit risk, double default excessive correlation detection process, IMA to equity exposures, and IAA to securitization exposures to ABCP programs (collectively, advanced systems). The bank's data management and maintenance systems must ensure the timely and accurate reporting of risk-based capital requirements. Specifically, a bank must retain sufficient data elements to permit monitoring, validation, and refinement of the bank's advanced systems. A bank's data management and maintenance systems should generally support the proposed rule's qualification requirements relating to quantification, validation, and control and oversight mechanisms, as well as the bank's broader risk management and reporting needs. The precise data elements to be collected would be dictated by the features and

methodologies of the risk measurement and management systems employed by the bank. To meet the significant data management challenges presented by the quantification, validation, and control and oversight requirements of the advanced approaches, a bank must store its data in an electronic format that allows timely retrieval for analysis, reporting, and disclosure purposes.

7. Control and Oversight Mechanisms

The consequences of an inaccurate or unreliable advanced system can be significant, particularly on the calculation of risk-based capital requirements. Accordingly, bank senior management would be responsible for ensuring that all advanced system components function effectively and are in compliance with the qualification requirements of the advanced approaches. Moreover, the bank's board of directors (or a designated committee of the board) must evaluate at least annually the effectiveness of, and approve, the bank's advanced systems.

To support senior management's and the board of directors' oversight responsibilities, a bank must have an effective system of controls and oversight that ensures ongoing compliance with the qualification requirements and maintains the integrity, reliability, and accuracy of the bank's advanced systems. Banks would have flexibility in how they achieve integrity in their risk management systems. They would, however, be expected to follow standard control principles in their systems such as checks and balances, separation of duties, appropriateness of incentives, and data integrity assurance, including that of information purchased from third parties. Moreover, the oversight process should be sufficiently independent of the advanced systems' development, implementation, and operation to ensure the integrity of the component systems. The objective of risk management system oversight is to ensure that the various systems used in determining risk-based capital requirements are operating as intended. The oversight process should draw conclusions on the soundness of the components of the risk management system, identify errors and flaws, and recommend corrective action as appropriate.

Validation. A bank must validate its advanced systems on an ongoing basis. Validation is the set of activities designed to give the greatest possible assurances of accuracy of the advanced systems. Validation includes three broad components: (i) Evaluation of the conceptual soundness of the advanced

³⁰ 12 U.S.C. 1815(e).

systems, taking into account industry developments; (ii) ongoing monitoring that includes process verification and comparison of the bank's internal estimates with relevant internal and external data sources or results using other estimation techniques (benchmarking); and (iii) outcomes analysis that includes comparisons of actual outcomes to the bank's internal estimates by backtesting and other methods.

Each of these three components of validation must be applied to the bank's risk rating and segmentation systems, risk parameter quantification processes, and internal models that are part of the bank's advanced systems. A sound validation process should take business cycles into account, and any adjustments for stages of the economic cycle should be clearly specified in advance and fully documented as part of the validation policy. Senior management of the bank should be notified of the validation results and should take corrective action, where appropriate.

A bank's validation process must be independent of the advanced systems' development, implementation, and operation, or be subject to independent assessment of its adequacy and effectiveness. A bank should ensure that individuals who perform the review are independent—that is, are not biased in their assessment due to their involvement in the development, implementation, or operation of the processes or products. For example, reviews of the internal risk rating and segmentation systems should be performed by individuals who were not part of the development, implementation, or maintenance of those systems. In addition, individuals performing the reviews should possess the requisite technical skills and expertise to fulfill their mandate.

The first component of validation is evaluating conceptual soundness, which involves assessing the quality of the design and construction of a risk measurement or management system. This evaluation of conceptual soundness should include documentation and empirical evidence supporting the methods used and the variables selected in the design and quantification of the bank's advanced systems. The documentation should also include evidence of an understanding of the limitations of the systems. The development of internal risk rating and segmentation systems and their quantification processes requires banks to adopt methods, choose characteristics, and make adjustments; each of these actions requires judgment.

Validation should ensure that these judgments are well informed and considered, and generally include a body of expert opinion. A bank should review developmental evidence whenever the bank makes material changes in its advanced systems.

The second component of the validation process for a bank's advanced systems is ongoing monitoring to confirm that the systems were implemented appropriately and continue to perform as intended. Such monitoring involves process verification and benchmarking. Process verification includes verifying that internal and external data are accurate and complete and ensuring that internal risk rating and segmentation systems are being used, monitored, and updated as designed and that ratings are assigned to wholesale obligors and exposures as intended, and that appropriate remediation is undertaken if deficiencies exist.

Benchmarking is the set of activities that uses alternative data sources or risk assessment approaches to draw inferences about the correctness of internal risk ratings, segmentations, risk parameter estimates, or model outputs before outcomes are actually known. For credit risk ratings, examples of alternative data sources include independent internal raters (such as loan review), external rating agencies, wholesale and retail credit risk models developed independently, or retail credit bureau models. Because it will take considerable time before outcomes will be available and backtesting is possible, benchmarking will be a very important validation device. Benchmarking would be applied to all quantification processes and internal risk rating and segmentation activities.

Benchmarking allows a bank to compare its estimates with those of other estimation techniques and data sources. Results of benchmarking exercises can be a valuable diagnostic tool in identifying potential weaknesses in a bank's risk quantification system. While benchmarking activities allow for inferences about the appropriateness of the quantification processes and internal risk rating and segmentation systems, they are not the same as backtesting. When differences are observed between the bank's risk estimates and the benchmark, this should not necessarily indicate that the internal risk ratings, segmentation decisions, or risk parameter estimates are in error. The benchmark itself is an alternative prediction, and the difference may be due to different data or methods. As part of the benchmarking exercise, the bank should

investigate the source of the differences and whether the extent of the differences is appropriate.

The third component of the validation process is outcomes analysis, which is the comparison of the bank's forecasts of risk parameters and other model outputs with actual outcomes. A bank's outcomes analysis must include backtesting, which is the comparison of the bank's forecasts generated by its internal models with actual outcomes during a sample period not used in model development. In this context, backtesting is one form of out-of-sample testing. The agencies note that in other contexts backtesting may refer to in-sample fit, but in-sample fit analysis is not what the proposed rule requires a bank to do as part of the advanced approaches validation process.

Actual outcomes would be compared with expected ranges around the estimated values of the risk parameters and model results. Random chance and many other factors will make discrepancies between realized outcomes and the estimated risk parameters inevitable. Therefore the expected ranges should take into account relevant elements of a bank's internal risk rating or segmentation processes. For example, depending on the bank's rating philosophy, year-by-year realized default rates may be expected to differ significantly from the long-run one-year average. Also, changes in economic conditions between the historical data and current period can lead to differences between realizations and estimates.

Internal audit. A bank must have an internal audit function independent of business-line management that assesses at least annually the effectiveness of the controls supporting the bank's advanced systems. At least annually, internal audit should review the validation process, including validation procedures, responsibilities, results, timeliness, and responsiveness to findings. Further, internal audit should evaluate the depth, scope, and quality of the risk management system review process and conduct appropriate testing to ensure that the conclusions of these reviews are well founded. Internal audit must report its findings at least annually to the bank's board of directors (or a committee thereof).

Stress testing. A bank must periodically stress test its advanced systems. Stress testing analysis is a means of understanding how economic cycles, especially downturns as described by stress scenarios, affect risk-based capital requirements, including migration across rating grades or segments and the credit risk mitigation

benefits of double default treatment. Under the proposed rule, changes in borrower credit quality will lead to changes in risk-based capital requirements. Because credit quality changes typically reflect changing economic conditions, risk-based capital requirements may also vary with the economic cycle. During an economic downturn, risk-based capital requirements would increase if wholesale obligors or retail exposures migrate toward lower credit quality ratings or segments.

Supervisors expect that banks will manage their regulatory capital position so that they remain at least adequately capitalized during all phases of the economic cycle. A bank that is able to credibly estimate regulatory capital levels during a downturn can be more confident of appropriately managing regulatory capital. Stress testing analysis consists of identifying a stress scenario and then translating the scenario into its effect on the levels of key performance measures, including regulatory capital ratios.

Banks should use a range of plausible but severe scenarios and methods when stress testing to manage regulatory capital. Scenarios could be historical, hypothetical, or model-based. Key variables specified in a scenario could include, for example, interest rates, transition matrices (ratings and score-band segments), asset values, credit spreads, market liquidity, economic growth rates, inflation rates, exchange rates, or unemployment rates. A bank may choose to have scenarios apply to an entire portfolio, or it may identify scenarios specific to various sub-portfolios. The severity of the stress scenarios should be consistent with the periodic economic downturns experienced in the bank's market areas. Such scenarios may be less severe than those used for other purposes, such as testing a bank's solvency.

The scope of stress testing analysis should be broad and include all material portfolios. The time horizon of the analysis should be consistent with the specifics of the scenario and should be long enough to measure the material effects of the scenario on key performance measures. For example, if a scenario such as a historical recession has material income and segment or ratings migration effects over two years, the appropriate time horizon is at least two years.

8. Documentation

A bank must document adequately all material aspects of its advanced systems, including but not limited to the internal risk rating and segmentation

systems, risk parameter quantification processes, model design, assumptions, and validation results. The guiding principle governing documentation is that it should support the requirements for the quantification, validation, and control and oversight mechanisms as well as the bank's broader risk management and reporting needs. Documentation is also critical to the supervisory oversight process.

The bank should document the rationale for all material assumptions underpinning its chosen analytical frameworks, including the choice of inputs, distributional assumptions, and weighting of quantitative and qualitative elements. The bank also should document and justify any subsequent changes to these assumptions.

C. Ongoing Qualification

An advanced approaches bank must meet the qualification requirements on an ongoing basis. Banks are expected to improve their advanced systems as they improve data gathering capabilities and as industry practice evolves. To facilitate the supervisory oversight of such systems changes, a bank must notify its primary Federal supervisor when it makes a change to its advanced systems that results in a material change in the bank's risk-weighted asset amount for an exposure type, or when the bank makes any significant change to its modeling assumptions.

Due to the advanced approaches' rigorous systems requirements, a core or opt-in bank that merges with or acquires another company that does not calculate risk-based capital requirements using the advanced approaches might not be able to use the advanced approaches immediately for the merged or acquired company's exposures. Therefore, the proposed rule would permit a core or opt-in bank to use the general risk-based capital rules to compute the risk-weighted assets and associated capital for the merged or acquired company's exposures for up to 24 months following the calendar quarter during which the merger or acquisition consummates.

Any ALLL associated with the acquired company's exposures may be included in the acquiring bank's tier 2 capital up to 1.25 percent of the acquired company's risk-weighted assets. Such ALLL would be excluded from the acquiring bank's eligible credit reserves. The risk-weighted assets of the acquired company would not be included in the acquiring bank's credit-risk-weighted assets but would be included in the acquiring bank's total risk-weighted assets. Any amount of the acquired company's ALLL that was eliminated in accounting for the

acquisition would not be included in the acquiring bank's regulatory capital. An acquiring bank using the general risk-based capital rules for acquired exposures would be required to disclose publicly the amounts of risk-weighted assets and qualifying capital calculated under the general risk-based capital rules with respect to the acquired company and under the proposed rule for the acquiring bank.

Similarly, due to the substantial infrastructure requirements of the proposed rule, a core or opt-in bank that merges with or acquires another core or opt-in bank might not be able to apply its own version of the advanced approaches immediately to the acquired bank's exposures. Accordingly, the proposed rule permits a core or opt-in bank that merges with or acquires another core or opt-in bank to use the acquired bank's advanced approaches to determine the risk-weighted asset amounts for, and deductions from capital associated with, the acquired bank's exposures for up to 24 months following the calendar quarter during which the merger or acquisition consummates.

In all mergers and acquisitions involving a core or opt-in bank, the acquiring bank must submit an implementation plan for using advanced approaches for the merged or acquired company to its primary Federal supervisor within 30 days of consummating the merger or acquisition. A bank's primary Federal supervisor may extend the transition period for mergers or acquisitions for up to an additional 12 months. The primary Federal supervisor of the bank will monitor the merger or acquisition to determine whether the application of the general risk-based capital rules by the acquired company produces appropriate risk weights for the assets of the acquired company in light of the overall risk profile of the combined bank.

Question 20: The agencies seek comment on the appropriateness of the 24-month and 30-day time frames for addressing the merger and acquisition transition situations advanced approaches banks may face.

If a bank that uses the advanced approaches to calculate its risk-based capital requirements falls out of compliance with the qualification requirements, the bank must establish a plan satisfactory to its primary Federal supervisor to return to compliance with the qualification requirements. Such a bank also must disclose to the public its failure to comply with the qualification requirements promptly after receiving notice of non-compliance from its

primary Federal supervisor. If the bank's primary Federal supervisor determines that the bank's risk-based capital requirements are not commensurate with the bank's credit, market, operational, or other risks, it may require the bank to calculate its risk-based capital requirements using the general risk-based capital rules or a modified form of the advanced approaches (for example, with fixed supervisory risk parameters).

IV. Calculation of Tier 1 Capital and Total Qualifying Capital

The proposed rule maintains the minimum risk-based capital ratio requirements of 4.0 percent tier 1 capital to total risk-weighted assets and 8.0 percent total qualifying capital to total risk-weighted assets. Under the proposed rule, a bank's total qualifying capital is the sum of its tier 1 (core) capital elements and tier 2 (supplemental) capital elements, subject to various limits and restrictions, minus certain deductions (adjustments). The agencies are not restating the elements of tier 1 and tier 2 capital in this proposed rule. Those capital elements generally remain as they are currently in the general risk-based capital rules.³¹ The agencies have provided proposed regulatory text for, and the following discussion of, proposed adjustments to the capital elements for purposes of the advanced approaches.

The agencies are considering restating the elements of tier 1 and tier 2 capital, with any necessary conforming and technical amendments, in any final rules that are issued regarding this proposed framework so that a bank using the advanced approaches would have a single, comprehensive regulatory text that describes both the numerator and denominator of the bank's minimum risk-based capital ratios. The agencies decided not to set forth the capital elements in this proposed rule so that commenters would be able to focus attention on the parts of the risk-based capital framework that the agencies propose to amend. *Question 21: Commenters are encouraged to provide views on the proposed adjustments to the components of the risk-based capital numerator as described below. Commenters also may provide views on numerator-related issues that they believe would be useful to the agencies' consideration of the proposed rule.*

After identifying the elements of tier 1 and tier 2 capital, a bank would make certain adjustments to determine its tier 1 capital and total qualifying capital (that is, the numerator of the total risk-based capital ratio). Some of these adjustments would be made only to the tier 1 portion of the capital base. Other adjustments would be made 50 percent from tier 1 capital and 50 percent from tier 2 capital.³² Under the proposed rule, a bank must still have at least 50 percent of its total qualifying capital in the form of tier 1 capital.

The bank would continue to deduct from tier 1 capital goodwill, other intangible assets, and deferred tax assets to the same extent that those assets are currently required to be deducted from tier 1 capital under the general risk-based capital rules. Thus, all goodwill would be deducted from tier 1 capital. Qualifying intangible assets—including mortgage servicing assets, non-mortgage servicing assets, and purchased credit card relationships—that meet the conditions and limits in the general risk-based capital rules would not have to be deducted from tier 1 capital. Likewise, deferred tax assets that are dependent upon future taxable income and that meet the valuation requirements and limits in the general risk-based capital rules would not have to be deducted from tier 1 capital.³³

Under the general risk-based capital rules, a bank also must deduct from its tier 1 capital certain percentages of the adjusted carrying value of its nonfinancial equity investments. An advanced approaches bank would no longer be required to make this deduction. Instead, the bank's equity exposures would be subject to the equity treatment in part VI of the proposed rule and described in section V.F. of this preamble.³⁴

³² If the amount deductible from tier 2 capital exceeds the bank's actual tier 2 capital, however, the bank must deduct the shortfall amount from tier 1 capital.

³³ See 12 CFR part 3, § 2 (national banks); 12 CFR part 208, Appendix A, § 2L3II (state member banks); 12 CFR part 225, Appendix A, § II (bank holding companies); 12 CFR part 325, Appendix A, § II (state nonmember banks). OTS existing rules are formulated differently, but include similar deductions. Under OTS rules, for example, goodwill is included within the definition of "intangible assets" and is deducted from tier 1 (core) capital along with other intangible assets. See 12 CFR 567.1 and 567.5(a)(2)(i). Similarly, purchased credit card relationships and mortgage and non-mortgage servicing assets are included in capital to the same extent as the other agencies' rules. See 12 CFR 567.5(a)(2)(ii) and 567.12. The deduction of deferred tax assets is discussed in Thrift Bulletin 56.

³⁴ By contrast, OTS rules require the deduction of equity investments from total capital. 12 CFR 567.5(c)(2)(ii). "Equity investments" are defined to include (i) investments in equity securities (other

Under the general risk-based capital rules, a bank is allowed to include in tier 2 capital its ALLL up to 1.25 percent of risk-weighted assets (net of certain deductions). Amounts of ALLL in excess of this limit, as well as allocated transfer risk reserves, may be deducted from the gross amount of risk-weighted assets.

Under the proposed framework, as noted above, the ALLL is treated differently. The proposed rule includes a methodology for adjusting risk-based capital requirements based on a comparison of the bank's eligible credit reserves to its ECL. The proposed rule defines eligible credit reserves as all general allowances, including the ALLL, that have been established through a charge against earnings to absorb credit losses associated with on- or off-balance sheet wholesale and retail exposures. Eligible credit reserves would not include allocated transfer risk reserves established pursuant to 12 U.S.C. 3904³⁵ and other specific reserves created against recognized losses.

The proposed rule defines a bank's total ECL as the sum of ECL for all wholesale and retail exposures other than exposures to which the bank has applied the double default treatment (described below). The bank's ECL for a wholesale exposure to a non-defaulted obligor or a non-defaulted retail segment is the product of PD, ELGD, and EAD for the exposure or segment. The bank's ECL for a wholesale exposure to a defaulted obligor or a defaulted retail segment is equal to the bank's impairment estimate for ALLL purposes for the exposure or segment.

The proposed method of measuring ECL for non-defaulted exposures is different than the proposed method of measuring ECL for defaulted exposures. For non-defaulted exposures, ECL depends directly on ELGD and hence would reflect economic losses, including the cost of carry and direct and indirect workout expenses. In contrast, for defaulted exposures, ECL is based on accounting measures of credit

than investments in subsidiaries, equity investments that are permissible for national banks, indirect ownership interests in certain pools of assets (for example, mutual funds), Federal Home Loan Bank stock and Federal Reserve Bank stock); and (ii) investments in certain real property. 12 CFR 567.1. Savings associations applying the proposed rule would not be required to deduct investments in equity securities. Instead, such investments would be subject to the equity treatment in part VI of the proposed rule. Equity investments in real estate would continue to be deducted to the same extent as under the current rules.

³⁵ 12 U.S.C. 3904 does not apply to savings associations regulated by the OTS. As a result, the OTS rule will not refer to allocated transfer risk reserves.

³¹ See 12 CFR part 3, Appendix A, § 2 (national banks); 12 CFR part 208, Appendix A, § II (state member banks); 12 CFR part 225, Appendix A, § II (bank holding companies); 12 CFR part 325, Appendix A (state nonmember banks); and 12 CFR 567.5 (savings associations).

loss incorporated into a bank's charge-off and reserving practices.

The agencies believe that, for defaulted exposures, any difference between a bank's best estimate of economic losses and its impairment estimate for ALLL purposes is likely to be small. As a result, the agencies are proposing to use a bank's ALLL impairment estimate in the determination of ECL for defaulted exposures to reduce implementation burden for banks. The agencies recognize that this proposed treatment would require a bank to specify how much of its ALLL is attributable to defaulted exposures, and that a bank still would need to capture all material economic losses on defaulted exposures when building its databases for estimating ELGDs and LGDs for non-defaulted exposures. *Question 22: The agencies seek comment on the proposed ECL approach for defaulted exposures as well as on an alternative treatment, under which ECL for a defaulted exposure would be calculated as the bank's current carrying value of the exposure multiplied by the bank's best estimate of the expected economic loss rate associated with the exposure (measured relative to the current carrying value), that would be more consistent with the proposed treatment of ECL for non-defaulted exposures. The agencies also seek comment on whether these two approaches would likely produce materially different ECL estimates for defaulted exposures. In addition, the agencies seek comment on the appropriate measure of ECL for assets held at fair value with gains and losses flowing through earnings.*

A bank must compare the total dollar amount of its ECL to its eligible credit reserves. If there is a shortfall of eligible credit reserves compared to total ECL, the bank would deduct 50 percent of the shortfall from tier 1 capital and 50 percent from tier 2 capital. If eligible credit reserves exceed total ECL, the excess portion of eligible credit reserves may be included in tier 2 capital up to 0.6 percent of credit-risk-weighted assets. The proposed rule defines credit-risk-weighted assets as 1.06 multiplied by the sum of total wholesale and retail risk-weighted assets, risk-weighted assets for securitization exposures, and risk-weighted assets for equity exposures.

A bank must deduct from tier 1 capital any increase in the bank's equity capital at the inception of a securitization transaction (gain-on-sale), other than an increase in equity capital that results from the bank's receipt of cash in connection with the securitization. The agencies have

designed this deduction to offset accounting treatments that produce an increase in a bank's equity capital and tier 1 capital at the inception of a securitization—for example, a gain attributable to a CEIO that results from Financial Accounting Standard (FAS) 140 accounting treatment for the sale of underlying exposures to a securitization special purpose entity (SPE). Over time, as the bank, from an accounting perspective, realizes the increase in equity capital and tier 1 capital that was booked at the inception of the securitization through actual receipt of cash flows, the amount of the required deduction would shrink accordingly.

Under the general risk-based capital rules,³⁶ a bank must deduct CEIOs, whether purchased or retained, from tier 1 capital to the extent that the CEIOs exceed 25 percent of the bank's tier 1 capital. Under the proposed rule, a bank must deduct CEIOs from tier 1 capital to the extent they represent gain-on-sale, and must deduct any remaining CEIOs 50 percent from tier 1 capital and 50 percent from tier 2 capital.

Under the proposed rule, certain other securitization exposures also would be deducted from tier 1 and tier 2 capital. These exposures include, for example, securitization exposures that have an applicable external rating (defined below) that is more than one category below investment grade (for example, below BB) and most subordinated unrated securitization exposures. When a bank must deduct a securitization exposure (other than gain-on-sale) from regulatory capital, the bank must take the deduction 50 percent from tier 1 capital and 50 percent from tier 2 capital. Moreover, a bank may calculate any deductions from regulatory capital with respect to a securitization exposure (including after-tax gain-on-sale) net of any deferred tax liabilities associated with the exposure.

The proposed rule also requires a bank to deduct the bank's exposure on certain unsettled and failed capital markets transactions 50 percent from tier 1 capital and 50 percent from tier 2 capital, as discussed in more detail below in section V.D. of the preamble.

The agencies note that investments in unconsolidated banking and finance subsidiaries and reciprocal holdings of bank capital instruments would continue to be deducted from regulatory capital as described in the general risk-

based capital rules. Under the agencies' current rules, a national or state bank that controls or holds an interest in a financial subsidiary does not consolidate the assets and liabilities of the financial subsidiary with those of the bank for risk-based capital purposes. In addition, the bank must deduct its equity investment (including retained earnings) in the financial subsidiary from regulatory capital—at least 50 percent from tier 1 capital and up to 50 percent from tier 2 capital.³⁷ A BHC generally does not deconsolidate the assets and liabilities of the financial subsidiaries of the BHC's subsidiary banks and does not deduct from its regulatory capital the equity investments of its subsidiary banks in financial subsidiaries. Rather, a BHC generally fully consolidates the financial subsidiaries of its subsidiary banks. These treatments would continue under the proposed rule.

For BHCs with consolidated insurance underwriting subsidiaries that are functionally regulated (or subject to comparable supervision and minimum regulatory capital requirements in their home jurisdiction), the following treatment would apply. The assets and liabilities of the subsidiary would be consolidated for purposes of determining the BHC's risk-weighted assets. However, the BHC must deduct from tier 1 capital an amount equal to the insurance underwriting subsidiary's minimum regulatory capital requirement as determined by its functional (or equivalent) regulator. For U.S. regulated insurance subsidiaries, this amount generally would be 200 percent of the subsidiary's Authorized Control Level as established by the appropriate state insurance regulator.

This approach with respect to functionally-regulated consolidated insurance underwriting subsidiaries is different from the New Accord, which broadly endorses a deconsolidation and deduction approach for insurance subsidiaries. The Board believes a full deconsolidation and deduction

³⁷ See 12 CFR 5.39(h)(1) (national banks); 12 CFR 208.73(a) (state member banks); 12 CFR part 325, Appendix A, section I.B.2. (state nonmember banks). Again, OTS rules are formulated differently. For example, OTS rules do not use the terms "unconsolidated banking and finance subsidiary" or "financial subsidiary." Rather, as required by section 5(t)(5) of the Home Owners' Loan Act (HOLA), equity and debt investments in non-includable subsidiaries (generally subsidiaries that are engaged in activities that are not permissible for a national bank) are deducted from assets and tier 1 (core) capital. 12 CFR 567.5(a)(2)(iv) and (v). As required by HOLA, OTS will continue to deduct non-includable subsidiaries. Reciprocal holdings of bank capital instruments are deducted from a savings association's total capital under 12 CFR 567.5(c)(2).

³⁶ See 12 CFR part 3, Appendix A, section 2(c)(4) (national banks); 12 CFR part 208, Appendix A, section I.B.1.c. (state member banks); 12 CFR part 225, Appendix A, section I.B.1.c. (bank holding companies); 12 CFR part 325, Appendix A, section I.B.5. (state nonmember banks); 12 CFR 567.5(a)(2)(iii) (savings associations).

approach does not fully capture the risk in insurance underwriting subsidiaries at the consolidated BHC level and, thus, has proposed the consolidation and deduction approach described above.

Question 23: The Board seeks comment on this proposed treatment and in particular on how a minimum insurance regulatory capital proxy for tier 1 deduction purposes should be determined for insurance underwriting subsidiaries that are not subject to U.S. functional regulation.

A March 10, 2005, final rule issued by the Board defined restricted core capital elements for BHCs and generally limited restricted core capital elements for internationally active banking organizations to 15 percent of the sum of all core capital elements net of goodwill less any associated deferred tax liability.³⁸ Restricted core capital elements are defined as qualifying cumulative perpetual preferred stock (and related surplus), minority interest related to qualifying cumulative perpetual preferred stock directly issued by a consolidated DI or foreign bank subsidiary, minority interest related to qualifying common or qualifying perpetual preferred stock issued by a consolidated subsidiary that is neither a DI nor a foreign bank, and qualifying trust preferred securities. The final rule defined an internationally active banking organization to be a BHC that (i) as of its most recent year-end FR Y-9C reports total consolidated assets equal to \$250 billion or more or (ii) on a consolidated basis, reports total on-balance sheet foreign exposure of \$10 billion or more in its filing of the most recent year-end FFIEC 009 Country Exposure Report. The Board intends to change the definition of an internationally active banking organization in the Board's capital adequacy guidelines for BHCs to make it consistent with the definition of a core bank. This change would be less restrictive on BHCs because the BHC threshold in this proposed rule uses total consolidated assets excluding insurance rather than total consolidated assets including insurance.

V. Calculation of Risk-Weighted Assets

A bank's total risk-weighted assets would be the sum of its credit risk-weighted assets and risk-weighted assets

for operational risk, minus the sum of its excess eligible credit reserves (that is, its eligible credit reserves in excess of its total ECL) not included in tier 2 capital and allocated transfer risk reserves.

A. Categorization of Exposures

To calculate credit risk-weighted assets, a bank must group its exposures into four general categories: wholesale, retail, securitization, and equity. It must also identify assets not included in an exposure category and any non-material portfolios of exposures to which the bank elects not to apply the IRB framework. In order to exclude a portfolio from the IRB framework, a bank must demonstrate to the satisfaction of its primary Federal supervisor that the portfolio (when combined with all other portfolios of exposures that the bank seeks to exclude from the IRB framework) is not material to the bank.

1. Wholesale Exposures

The proposed rule defines a wholesale exposure as a credit exposure to a company, individual, sovereign or governmental entity (other than a securitization exposure, retail exposure, or equity exposure).³⁹ The term "company" is broadly defined to mean a corporation, partnership, limited liability company, depository institution, business trust, SPE, association, or similar organization. Examples of a wholesale exposure include: (i) A non-tranched guarantee issued by a bank on behalf of a company;⁴⁰ (ii) a repo-style transaction entered into by a bank with a company and any other transaction in which a bank posts collateral to a company and faces counterparty credit risk; (iii) an exposure that the bank treats as a covered position under the MRA for which there is a counterparty credit risk charge in section 32 of the proposed rule; (iv) a sale of corporate loans by a

bank to a third party in which the bank retains full recourse; (v) an OTC derivative contract entered into by a bank with a company; (vi) an exposure to an individual that is not managed by the bank as part of a segment of exposures with homogeneous risk characteristics; and (vii) a commercial lease.

The agencies are proposing two subcategories of wholesale exposures—HVCRE exposures and non-HVCRE exposures. Under the proposed rule, HVCRE exposures would be subject to a separate IRB risk-based capital formula that would produce a higher risk-based capital requirement for a given set of risk parameters than the IRB risk-based capital formula for non-HVCRE wholesale exposures. An HVCRE exposure is defined as a credit facility that finances or has financed the acquisition, development, or construction of real property, excluding facilities used to finance (i) one- to four-family residential properties or (ii) commercial real estate projects where: (A) The exposure's LTV ratio is less than or equal to the applicable maximum supervisory LTV ratio in the real estate lending standards of the agencies;⁴¹ (B) the borrower has contributed capital to the project in the form of cash or unencumbered readily marketable assets (or has paid development expenses out-of-pocket) of at least 15 percent of the real estate's appraised "as completed" value; and (C) the borrower contributed the amount of capital required before the bank advances funds under the credit facility, and the capital contributed by the borrower or internally generated by the project is contractually required to remain in the project throughout the life of the project.

Once an exposure is determined to be HVCRE, it would remain an HVCRE exposure until paid in full, sold, or converted to permanent financing. After considering comments received on the ANPR, the agencies are proposing to retain a separate IRB risk-based capital formula for HVCRE exposures in recognition of the high levels of systematic risk inherent in some of these exposures. The agencies believe that the revised definition of HVCRE in the proposed rule appropriately identifies exposures that are particularly susceptible to systematic risk. *Question 24: The agencies seek comment on how to strike the appropriate balance between the enhanced risk sensitivity and marginally higher risk-based capital*

³⁸ 70 FR 11827 (Mar. 10, 2005). The final rule also allowed internationally active banking organizations to include restricted core capital elements in their tier 1 capital up to 25 percent of the sum of all core capital elements net of goodwill less associated deferred tax liability so long as any amounts of restricted core capital elements in excess of the 15 percent limit were in the form of mandatory convertible preferred securities.

³⁹ The proposed rule excludes from the definition of a wholesale exposure certain pre-sold one-to-four family residential construction loans and certain multifamily residential loans. The treatment of such loans is discussed below in section V.B.5. of the preamble.

⁴⁰ As described below, tranched guarantees (like most transactions that involve a tranching of credit risk) generally would be securitization exposures under this proposal. The proposal defines a guarantee broadly to include almost any transaction (other than a credit derivative executed under standard industry credit derivative documentation) that involves the transfer of the credit risk of an exposure from one party to another party. This definition of guarantee generally would include, for example, a credit spread option under which a bank has agreed to make payments to its counterparty in the event of an increase in the credit spread associated with a particular reference obligation issued by a company.

⁴¹ 12 CFR part 34, Subpart D (OCC); 12 CFR part 208, Appendix C (Board); 12 CFR part 365, Subpart D (FDIC); and 12 CFR 560.100–560.101 (OTS).

requirements obtained by separating HVCRE exposures from other wholesale exposures and the additional complexity the separation entails.

The New Accord identifies five sub-classes of specialized lending for which the primary source of repayment of the obligation is the income generated by the financed asset(s) rather than the independent capacity of a broader commercial enterprise. The sub-classes are project finance, object finance, commodities finance, income-producing real estate, and HVCRE. The New Accord provides a methodology to accommodate banks that cannot meet the requirements for the estimation of PD for these exposure types. The sophisticated banks that would apply the advanced approaches in the United States should be able to estimate risk parameters for specialized lending exposures, and therefore the agencies are not proposing a separate treatment for specialized lending beyond the separate IRB risk-based capital formula for HVCRE exposures specified in the New Accord.

In contrast to the New Accord, the agencies are not including in this proposed rule an adjustment that would result in a lower risk weight for a loan to a small- and medium-size enterprise (SME) that has the same risk parameter values as a loan to a larger firm. The agencies are not aware of compelling evidence that smaller firms with the same PD and LGD as larger firms are subject to less systematic risk. *Question 25: The agencies request comment and supporting evidence on the consistency of the proposed treatment with the underlying riskiness of SME portfolios. Further, the agencies request comment on any competitive issues that this aspect of the proposed rule may cause for U.S. banks.*

2. Retail Exposures

Under the proposed rule, a retail exposure would generally include exposures (other than securitization exposures or equity exposures) to an individual or small business that are managed as part of a segment of similar exposures, that is, not on an individual-exposure basis. Under the proposed rule, there are three subcategories of retail exposure: (i) Residential mortgage exposures; (ii) QREs; and (iii) other retail exposures. The agencies propose generally to define residential mortgage exposure as an exposure that is primarily secured by a first or subsequent lien on one-to-four-family residential property.⁴² This includes

both term loans and revolving home equity lines of credit (HELOCs). An exposure primarily secured by a first or subsequent lien on residential property that is not one-to-four family would also be included as a residential mortgage exposure as long as the exposure has both an original and current outstanding amount of no more than \$1 million. There would be no upper limit on the size of an exposure that is secured by one-to-four-family residential properties. To be a residential mortgage exposure, the bank must manage the exposure as part of a segment of exposures with homogeneous risk characteristics. Residential mortgage loans that are managed on an individual basis, rather than managed as part of a segment, would be categorized as wholesale exposures.

QREs would be defined as exposures to individuals that are (i) revolving, unsecured, and unconditionally cancelable by the bank to the fullest extent permitted by Federal law; (ii) have a maximum exposure amount (drawn plus undrawn) of up to \$100,000; and (iii) are managed as part of a segment with homogeneous risk characteristics. In practice, QREs typically would include exposures where customers' outstanding borrowings are permitted to fluctuate based on their decisions to borrow and repay, up to a limit established by the bank. Most credit card exposures to individuals and overdraft lines on individual checking accounts would be QREs.

The category of other retail exposures would include two types of exposures. First, all exposures to individuals for non-business purposes (other than residential mortgage exposures and QREs) that are managed as part of a segment of similar exposures would be other retail exposures. Such exposures may include personal term loans, margin loans, auto loans and leases, credit card accounts with credit lines above \$100,000, and student loans. The agencies are not proposing an upper limit on the size of these types of retail exposures to individuals. Second, exposures to individuals or companies for business purposes (other than residential mortgage exposures and QREs), up to a single-borrower exposure threshold of \$1 million, that are managed as part of a segment of similar exposures would be other retail exposures. For the purpose of assessing exposure to a single borrower, the bank

would aggregate all business exposures to a particular legal entity and its affiliates that are consolidated under GAAP. If that legal entity is a natural person, any consumer loans (for example, personal credit card loans or mortgage loans) to that borrower would not be part of the aggregate. A bank could distinguish a consumer loan from a business loan by the loan department through which the loan is made. Exposures to a borrower for business purposes primarily secured by residential property would count toward the \$1 million single-borrower other retail business exposure threshold.⁴³

The residual value portion of a retail lease exposure is excluded from the definition of an other retail exposure. A bank would assign the residual value portion of a retail lease exposure a risk-weighted asset amount equal to its residual value as described in section 31 of the proposed rule.

3. Securitization Exposures

The proposed rule defines a securitization exposure as an on-balance sheet or off-balance sheet credit exposure that arises from a traditional or synthetic securitization. A traditional securitization is a transaction in which (i) all or a portion of the credit risk of one or more underlying exposures is transferred to one or more third parties other than through the use of credit derivatives or guarantees; (ii) the credit risk associated with the underlying exposures has been separated into at least two tranches reflecting different levels of seniority; (iii) performance of the securitization exposures depends on the performance of the underlying exposures; and (iv) all or substantially all of the underlying exposures are financial exposures. Examples of financial exposures are loans, commitments, receivables, asset-backed securities, mortgage-backed securities, corporate bonds, equity securities, or credit derivatives. For purposes of the proposed rule, mortgage-backed pass-through securities guaranteed by Fannie Mae or Freddie Mac (whether or not issued out of a structure that tranches credit risk) also would be securitization exposures.⁴⁴

⁴³ The proposed rule excludes from the definition of an other retail exposure certain pre-sold one-to-four family residential construction loans and certain multi-family residential loans. The treatment of such loans is discussed below in section V.B.5. of the preamble.

⁴⁴ In addition, margin loans and other credit exposures to personal investment companies, all or substantially all of whose assets are financial exposures, typically would meet the definition of a securitization exposure.

⁴² The proposed rule excludes from the definition of a residential mortgage exposure certain pre-sold

one-to-four family residential construction loans and certain multi-family residential loans. The treatment of such loans is discussed below in section V.B.5. of the preamble.

A synthetic securitization is a transaction in which (i) all or a portion of the credit risk of one or more underlying exposures is transferred to one or more third parties through the use of one or more credit derivatives or guarantees (other than a guarantee that transfers only the credit risk of an individual retail exposure); (ii) the credit risk associated with the underlying exposures has been separated into at least two tranches reflecting different levels of seniority; (iii) performance of the securitization exposures depends on the performance of the underlying exposures; and (iv) all or substantially all of the underlying exposures are financial exposures. Accordingly, the proposed definition of a securitization exposure would include tranching cover or guarantee arrangements—that is, arrangements in which an entity transfers a portion of the credit risk of an underlying exposure to one or more other guarantors or credit derivative providers but also retains a portion of the credit risk, where the risk transferred and the risk retained are of different seniority levels.⁴⁵

Provided that there is a tranching of credit risk, securitization exposures also could include, among other things, asset-backed and mortgage-backed securities; loans, lines of credit, liquidity facilities, and financial standby letters of credit; credit derivatives and guarantees; loan servicing assets; servicer cash advance facilities; reserve accounts; credit-enhancing representations and warranties; and CDOs. Securitization exposures also could include assets sold with retained tranching recourse. Both the designation of exposures as securitization exposures and the calculation of risk-based capital requirements for securitization exposures will be guided by the economic substance of a transaction rather than its legal form.

As noted above, for a transaction to constitute a securitization transaction under the proposed rule, all or substantially all of the underlying exposures must be financial exposures. The proposed rule includes this

requirement because the proposed securitization framework was designed to address the tranching of the credit risk of exposures to which the IRB framework can be applied. Accordingly, a specialized loan to finance the construction or acquisition of large-scale projects (for example, airports and power plants), objects (for example, ships, aircraft, or satellites), or commodities (for example, reserves, inventories, precious metals, oil, or natural gas) generally would not be a securitization exposure because the assets backing the loan typically would be nonfinancial assets (the facility, object, or commodity being financed). In addition, although some structured transactions involving income-producing real estate or HVCRE can resemble securitizations, these transactions generally would not be securitizations because the underlying exposure would be real estate. Consequently, exposures resulting from the tranching of the risks of nonfinancial assets are not subject to the proposed rule's securitization framework, but generally are subject to the proposal's rules for wholesale exposures. *Question 26: The agencies request comment on the appropriate treatment of tranching exposures to a mixed pool of financial and non-financial underlying exposures. The agencies specifically are interested in the views of commenters as to whether the requirement that all or substantially all of the underlying exposures of a securitization be financial exposures should be softened to require only that some lesser portion of the underlying exposures be financial exposures.*

4. Equity Exposures

The proposed rule defines an equity exposure to mean:

(i) A security or instrument whether voting or non-voting that represents a direct or indirect ownership interest in, and a residual claim on, the assets and income of a company, unless: (A) The issuing company is consolidated with the bank under GAAP; (B) the bank is required to deduct the ownership interest from tier 1 or tier 2 capital; (C) the ownership interest is redeemable; (D) the ownership interest incorporates a payment or other similar obligation on the part of the issuing company (such as an obligation to pay periodic interest); or (E) the ownership interest is a securitization exposure.

(ii) A security or instrument that is mandatorily convertible into a security or instrument described in (i).

(iii) An option or warrant that is exercisable for a security or instrument described in (i).

(iv) Any other security or instrument (other than a securitization exposure) to the extent the return on the security or instrument is based on the performance of security or instrument described in (i). For example, a short position in an equity security or a total return equity swap would be characterized as an equity exposure.

Nonconvertible term or perpetual preferred stock generally would be considered wholesale exposures rather than equity exposures. Financial instruments that are convertible into an equity exposure only at the option of the holder or issuer also generally would be considered wholesale exposures rather than equity exposures provided that the conversion terms do not expose the bank to the risk of losses arising from price movements in that equity exposure. Upon conversion, the instrument would be treated as an equity exposure.

The agencies note that, as a general matter, each of a bank's exposures will fit in one and only one exposure category. One principal exception to this rule is that equity derivatives generally will meet the definition of an equity exposure (because of the bank's exposure to the underlying equity security) and the definition of a wholesale exposure (because of the bank's credit risk exposure to the counterparty). In such cases, as discussed in more detail below, the bank's risk-based capital requirement for the derivative generally would be the sum of its risk-based capital requirement for the derivative counterparty credit risk and for the underlying exposure.

5. Boundary Between Operational Risk and Other Risks

With the introduction of an explicit risk-based capital requirement for operational risk, issues arise about the proper treatment of operational losses that could also be attributed to either credit risk or market risk. The agencies recognize that these boundary issues are important and have significant implications for how banks would compile loss data sets and compute risk-based capital requirements under the proposed rule. Consistent with the treatment in the New Accord, the agencies propose treating operational losses that are related to market risk as operational losses for purposes of calculating risk-based capital requirements under this proposed rule. For example, losses incurred from a failure of bank personnel to properly execute a stop loss order, from trading fraud, or from a bank selling a security

⁴⁵ If a bank purchases an asset-backed security issued by a securitization SPE and purchases a credit derivative to protect itself from credit losses associated with the asset-backed security, the purchase of the credit derivative by the investing bank does not turn the traditional securitization into a synthetic securitization. Instead, under the proposal, the investing bank would be viewed as having purchased a traditional securitization exposure and would reflect the CRM benefits of the credit derivative through the securitization CRM rules described later in the preamble and in section 46 of the proposed rule.

when a purchase was intended, would be treated as operational losses.

The agencies generally propose to treat losses that are related to both operational risk and credit risk as credit losses for purposes of calculating risk-based capital requirements. For example, where a loan defaults (credit risk) and the bank discovers that the collateral for the loan was not properly secured (operational risk), the bank's resulting loss would be attributed to credit risk (not operational risk). This general separation between credit and operational risk is supported by current U.S. accounting standards for the treatment of credit risk.

The proposed exception to this standard is retail credit card fraud losses. More specifically, retail credit card losses arising from non-contractual, third party-initiated fraud (for example, identity theft) are to be treated as external fraud operational losses under this proposed rule. All other third party-initiated losses are to be treated as credit losses. Based on discussions with the industry, this distinction is consistent with prevailing practice in the credit card industry, with banks commonly considering these losses to be operational losses and treating them as such for risk management purposes.

Question 27: The agencies seek commenters' perspectives on other loss types for which the boundary between credit and operational risk should be evaluated further (for example, with respect to losses on HELOCs).

6. Boundary Between the Proposed Rule and the Market Risk Amendment (MRA)

Positions currently subject to the MRA include all positions classified as trading consistent with GAAP. The New Accord sets forth additional criteria for positions to be eligible for application of the MRA. The agencies propose to incorporate these additional criteria into the MRA through a separate notice of proposed rulemaking concurrently published in the **Federal Register**. Advanced approaches banks subject to the MRA would use the MRA as amended for trading exposures eligible for application of the MRA. Advanced approaches banks not subject to the MRA would use this proposed rule for all of their exposures. *Question 28: The agencies generally seek comment on the proposed treatment of the boundaries between credit, operational, and market risk.*

B. Risk-Weighted Assets for General Credit Risk (Wholesale Exposures, Retail Exposures, On-Balance Sheet Assets That Are Not Defined by Exposure Category, and Immaterial Credit Portfolios)

Under the proposed rule, the wholesale and retail risk-weighted assets calculation consists of four phases: (1) Categorization of exposures; (2) assignment of wholesale exposures to rating grades and segmentation of retail exposures; (3) assignment of risk parameters to wholesale obligors and exposures and segments of retail exposures; and (4) calculation of risk-weighted asset amounts. Phase 1 involves the categorization of a bank's exposures into four general categories—wholesale exposures, retail exposures, securitization exposures, and equity exposures. Phase 1 also involves the further classification of retail exposures into subcategories and identifying certain wholesale exposures that receive a specific treatment within the wholesale framework. Phase 2 involves the assignment of wholesale obligors and exposures to rating grades and the segmentation of retail exposures. Phase 3 requires the bank to assign a PD, ELGD, LGD, EAD, and M to each wholesale exposure and a PD, ELGD, LGD, and EAD to each segment of retail exposures. In phase 4, the bank calculates the risk-weighted asset amount (i) for each wholesale exposure and segment of retail exposures by inserting the risk parameter estimates into the appropriate IRB risk-based capital formula and multiplying the formula's dollar risk-based capital requirement output by 12.5; and (ii) for on-balance sheet assets that are not included in one of the defined exposure categories and for certain immaterial portfolios of exposures by multiplying the carrying value or notional amount of the exposures by a 100 percent risk weight.

1. Phase 1—Categorization of Exposures

In phase 1, a bank must determine which of its exposures fall into each of the four principal IRB exposure categories—wholesale exposures, retail exposures, securitization exposures, and equity exposures. In addition, a bank must identify within the wholesale exposure category certain exposures that receive a special treatment under the wholesale framework. These exposures include HVCRE exposures, sovereign exposures, eligible purchased wholesale receivables, eligible margin loans, repo-style transactions, OTC derivative contracts, unsettled transactions, and eligible guarantees and eligible credit

derivatives that are used as credit risk mitigants.

The treatment of HVCRE exposures and eligible purchased wholesale receivables is discussed below in this section. The treatment of eligible margin loans, repo-style transactions, OTC derivative contracts, and eligible guarantees and eligible credit derivatives that are credit risk mitigants is discussed in section V.C. of the preamble. In addition, sovereign exposures and exposures to or directly and unconditionally guaranteed by the Bank for International Settlements, the International Monetary Fund, the European Commission, the European Central Bank, and multi-lateral development banks⁴⁶ are exempt from the 0.03 percent floor on PD discussed in the next section.

In phase 1, a bank also must subcategorize its retail exposures as residential mortgage exposures, QREs, or other retail exposures. In addition, a bank must identify any on-balance sheet asset that does not meet the definition of a wholesale, retail, securitization, or equity exposure, as well as any non-material portfolio of exposures to which it chooses, subject to supervisory review, not to apply the IRB risk-based capital formulas.

2. Phase 2 Assignment of Wholesale Obligors and Exposures to Rating Grades and Retail Exposures to Segments

In phase 2, a bank must assign each wholesale obligor to a single rating grade (for purposes of assigning an estimated PD) and may assign each wholesale exposure to loss severity rating grades (for purposes of assigning an estimated ELGD and LGD). A bank that elects not use a loss severity rating grade system for a wholesale exposure will directly assign ELGD and LGD to the wholesale exposure in phase 3. As a part of the process of assigning wholesale obligors to rating grades, a bank must identify which of its wholesale obligors are in default.

In addition, a bank must divide its retail exposures within each retail subcategory into segments that have homogeneous risk characteristics.⁴⁷

⁴⁶ Multi-lateral development bank is defined as any multi-lateral lending institution or regional development bank in which the U.S. government is a shareholder or contributing member. These institutions currently are the International Bank for Reconstruction and Development, the International Finance Corporation, the Inter-American Development Bank, the Asian Development Bank, the African Development Bank, and the European Bank for Reconstruction and Development.

⁴⁷ A bank must segment defaulted retail exposures separately from non-defaulted retail

Segmentation is the grouping of exposures within each subcategory according to the predominant risk characteristics of the borrower (for example, credit score, debt-to-income ratio, and delinquency) and the exposure (for example, product type and LTV ratio). In general, retail segments should not cross national jurisdictions. A bank would have substantial flexibility to use the retail portfolio segmentation it believes is most appropriate for its activities, subject to the following broad principles:

- **Differentiation of risk—**

Segmentation should provide meaningful differentiation of risk. Accordingly, in developing its risk segmentation system, a bank should consider the chosen risk drivers' ability to separate risk consistently over time and the overall robustness of the bank's approach to segmentation.

- **Reliable risk characteristics—**

Segmentation should use borrower-related risk characteristics and exposure-related risk characteristics that reliably and consistently over time differentiate a segment's risk from that of other segments.

- **Consistency—**Risk drivers for segmentation should be consistent with the predominant risk characteristics used by the bank for internal credit risk measurement and management.

- **Accuracy—**The segmentation system should generate segments that separate exposures by realized performance and should be designed so that actual long-run outcomes closely approximate the retail risk parameters estimated by the bank.

A bank might choose to segment exposures by common risk drivers that are relevant and material in determining the loss characteristics of a particular retail product. For example, a bank may segment mortgage loans by LTV band, age from origination, geography, origination channel, and credit score. Statistical modeling, expert judgment, or some combination of the two may determine the most relevant risk drivers. Alternatively, a bank might segment by grouping exposures with similar loss characteristics, such as loss rates or default rates, as determined by historical performance of segments with similar risk characteristics.

Banks commonly obtain tranching credit protection, for example first-loss or second-loss guarantees, on certain retail exposures such as residential mortgages. The agencies recognize that

the securitization framework, which applies to tranching wholesale exposures, is not appropriate for individual retail exposures. The agencies therefore are proposing to exclude tranching guarantees that apply only to an individual retail exposure from the securitization framework. An important result of this exclusion is that, in contrast to the treatment of wholesale exposures, a bank may recognize recoveries from both an obligor and a guarantor for purposes of estimating the ELGD and LGD for certain retail exposures. *Question 29: The agencies seek comment on this approach to tranching guarantees on retail exposures and on alternative approaches that could more appropriately reflect the risk mitigating effect of such guarantees while addressing the agencies' concerns about counterparty credit risk and correlation between the credit quality of an obligor and a guarantor.*

Banks have expressed concern about the treatment of retail margin loans under the New Accord. Due to the highly collateralized nature and low loss frequency of margin loans, banks typically collect little customer-specific information that they could use to differentiate margin loans into segments. The agencies believe that a bank could appropriately segment its margin loan portfolio using only product-specific risk drivers, such as product type and origination channel. A bank could then use the retail definition of default to associate a PD, ELGD, and LGD with each segment. As described in section 32 of the proposed rule, a bank could adjust the EAD of eligible margin loans to reflect the risk-mitigating effect of financial collateral. For a segment of retail eligible margin loans, a bank would associate an ELGD and LGD with the segment that do not reflect the presence of collateral. If a bank is not able to estimate PD, ELGD, and LGD for a segment of eligible margin loans, the bank may apply a 300 percent risk weight to the EAD of the segment. *Question 30: The agencies seek comment on wholesale and retail exposure types for which banks are not able to calculate PD, ELGD, and LGD and on what an appropriate risk-based capital treatment for such exposures might be.*

In phase 3, each retail segment will typically be associated with a separate PD, ELGD, LGD, and EAD. In some cases, it may be reasonable to use the same PD, ELGD, LGD, or EAD estimate for multiple segments.

A bank must segment defaulted retail exposures separately from non-defaulted retail exposures and should

base the segmentation of defaulted retail exposures on characteristics that are most predictive of current loss and recovery rates. This segmentation should provide meaningful differentiation so that individual exposures within each defaulted segment do not have material differences in their expected loss severity.

Purchased wholesale receivables. A bank may also elect to use a top-down approach, similar to the treatment of retail exposures, for eligible purchased wholesale receivables. Under this approach, in phase 2, a bank would group its eligible purchased wholesale receivables that, when consolidated by obligor, total less than \$1 million into segments that have homogeneous risk characteristics. To be an eligible purchased wholesale receivable, several criteria must be met:

- The purchased wholesale receivable must be purchased from an unaffiliated seller and must not have been directly or indirectly originated by the purchasing bank;

- The purchased wholesale receivable must be generated on an arm's-length basis between the seller and the obligor. Intercompany accounts receivable and receivables subject to contra-accounts between firms that buy and sell to each other are ineligible;

- The purchasing bank must have a claim on all proceeds from the receivable or a pro-rata interest in the proceeds; and

- The purchased wholesale receivable must have an effective remaining maturity of less than one year.

Wholesale lease residuals. The agencies are proposing a treatment for wholesale lease residuals that differs from the New Accord. A wholesale lease residual typically exposes a bank to the risk of a decline in value of the leased asset and to the credit risk of the lessee. Although the New Accord provides for a flat 100 percent risk weight for wholesale lease residuals, the agencies believe this is excessively punitive for leases to highly creditworthy lessees. Accordingly, the proposed rule would require a bank to treat its net investment in a wholesale lease as a single exposure to the lessee. There would not be a separate capital calculation for the wholesale lease residual. In contrast, a retail lease residual, consistent with the New Accord, would be assigned a risk-weighted asset amount equal to its residual value (as described in more detail above).

exposures and, if the bank determines the EAD for eligible margin loans using the approach in section 32(a) of the proposed rule, it must segment retail eligible margin loans for which the bank uses this approach separately from other retail exposures.

3. Phase 3—Assignment of Risk Parameters to Wholesale Obligor and Exposures and Retail Segments

In phase 3, a bank would associate a PD with each wholesale obligor rating grade; associate an ELGD or LGD with each wholesale loss severity rating grade or assign an ELGD and LGD to each wholesale exposure; assign an EAD and M to each wholesale exposure; and assign a PD, ELGD, LGD, and EAD to each segment of retail exposures. The quantification phase can generally be divided into four steps—obtaining historical reference data, estimating the risk parameters for the reference data, mapping the historical reference data to the bank's current exposures, and determining the risk parameters for the bank's current exposures.

A bank should base its estimation of the values assigned to PD, ELGD, LGD, and EAD⁴⁸ on historical reference data that are a reasonable proxy for the bank's current exposures and that provide meaningful predictions of the performance of such exposures. A "reference data set" consists of a set of exposures to defaulted wholesale obligors and defaulted retail exposures (in the case of ELGD, LGD, and EAD estimation) or to both defaulted and non-defaulted wholesale obligors and retail exposures (in the case of PD estimation).

The reference data set should be described using a set of observed characteristics. Relevant characteristics might include debt ratings, financial measures, geographic regions, the economic environment and industry/sector trends during the time period of the reference data, borrower and loan characteristics related to the risk parameters (such as loan terms, LTV ratio, credit score, income, debt-to-income ratio, or performance history), or other factors that are related in some way to the risk parameters. Banks may use more than one reference data set to improve the robustness or accuracy of the parameter estimates.

A bank should then apply statistical techniques to the reference data to determine a relationship between risk characteristics and the estimated risk parameter. The result of this step is a model that ties descriptive characteristics to the risk parameter estimates. In this context, the term 'model' is used in the most general sense; a model may be simple, such as the calculation of averages, or more complicated, such as an approach based on advanced regression techniques. This

step may include adjustments for differences between this proposed rule's definition of default and the default definition in the reference data set, or adjustments for data limitations. This step should also include adjustments for seasoning effects related to retail exposures.

A bank may use more than one estimation technique to generate estimates of the risk parameters, especially if there are multiple sets of reference data or multiple sample periods. If multiple estimates are generated, the bank must have a clear and consistent policy on reconciling and combining the different estimates.

Once a bank estimates PD, ELGD, LGD, and EAD for its reference data sets, it would create a link between its portfolio data and the reference data based on corresponding characteristics. Variables or characteristics that are available for the existing portfolio would be mapped or linked to the variables used in the default, loss-severity, or exposure amount model. In order to effectively map the data, reference data characteristics would need to allow for the construction of rating and segmentation criteria that are consistent with those used on the bank's portfolio. An important element of mapping is making adjustments for differences between reference data sets and the bank's exposures.

Finally, a bank would apply the risk parameters estimated for the reference data to the bank's actual portfolio data. The bank would attribute a PD to each wholesale obligor and each segment of retail exposures, and an ELGD, LGD, and EAD to each wholesale exposure and to each segment of retail exposures. If multiple data sets or estimation methods are used, the bank must adopt a means of combining the various estimates at this stage.

The proposed rule, as noted above, permits a bank to elect to segment its eligible purchased wholesale receivables like retail exposures. A bank that chooses to apply this treatment must directly assign a PD, ELGD, LGD, EAD, and M to each such segment. If a bank can estimate ECL (but not PD or LGD) for a segment of eligible purchased wholesale receivables, the bank must assume that the ELGD and LGD of the segment equal 100 percent and that the PD of the segment equals ECL divided by EAD. The bank must estimate ECL for the receivables without regard to any assumption of recourse or guarantees from the seller or other parties. The bank would then use the wholesale exposure formula in section 31(e) of the proposed rule to determine the risk-based capital requirement for each

segment of eligible purchased wholesale receivables.

A bank may recognize the credit risk mitigation benefits of collateral that secures a wholesale exposure by adjusting its estimate of the ELGD and LGD of the exposure and may recognize the credit risk mitigation benefits of collateral that secures retail exposures by adjusting its estimate of the PD, ELGD, and LGD of the segment of retail exposures. In certain cases, however, a bank may take financial collateral into account in estimating the EAD of repo-style transactions, eligible margin loans, and OTC derivative contracts (as provided in section 32 of the proposed rule).

The proposed rule also provides that a bank may use an EAD of zero for (i) derivative contracts that are traded on an exchange that requires the daily receipt and payment of cash-variation margin; (ii) derivative contracts and repo-style transactions that are outstanding with a qualifying central counterparty, but not for those transactions that the qualifying central counterparty has rejected; and (iii) credit risk exposures to a qualifying central counterparty that arise from derivative contracts and repo-style transactions in the form of clearing deposits and posted collateral. The proposed rule defines a qualifying central counterparty as a counterparty (for example, a clearing house) that: (i) Facilitates trades between counterparties in one or more financial markets by either guaranteeing trades or novating contracts; (ii) requires all participants in its arrangements to be fully collateralized on a daily basis; and (iii) the bank demonstrates to the satisfaction of its primary Federal supervisor is in sound financial condition and is subject to effective oversight by a national supervisory authority.

Some repo-style transactions and OTC derivative contracts giving rise to counterparty credit risk may give rise, from an accounting point of view, to both on- and off-balance sheet exposures. Where a bank is using an EAD approach to measure the amount of risk exposure for such transactions, factoring in collateral effects where applicable, it would not also separately apply a risk-based capital requirement to an on-balance sheet receivable from the counterparty recorded in connection with that transaction. Because any exposure arising from the on-balance sheet receivable is captured in the capital requirement determined under the EAD approach, a separate capital requirement would double count the

⁴⁸ EAD for repo-style transactions, eligible margin loans, and OTC derivatives is calculated as described in section 32 of the proposed rule.

exposure for regulatory capital purposes.

A bank may take into account the risk reducing effects of eligible guarantees and eligible credit derivatives in support of a wholesale exposure by applying the PD substitution approach or the LGD adjustment approach to the exposure as provided in section 33 of the proposed rule or, if applicable, applying double default treatment to the exposure as provided in section 34 of the proposed rule. A bank may decide separately for each wholesale exposure that qualifies for the double default treatment whether to apply the PD substitution approach, the LGD adjustment approach, or the double default treatment. A bank may take into account the risk reducing effects of guarantees and credit derivatives in support of retail exposures in a segment when quantifying the PD, ELGD, and LGD of the segment.

There are several supervisory limitations imposed on risk parameters assigned to wholesale obligors and exposures and segments of retail exposures. First, the PD for each wholesale obligor or segment of retail exposures may not be less than 0.03 percent, except for exposures to or directly and unconditionally guaranteed by a sovereign entity, the Bank for International Settlements, the International Monetary Fund, the European Commission, the European Central Bank, or a multi-lateral development bank, to which the bank assigns a rating grade associated with a PD of less than 0.03 percent. Second, the LGD of a segment of residential mortgage exposures (other than segments of residential mortgage exposures for which all or substantially all of the principal of the exposures is directly and unconditionally guaranteed by the full faith and credit of a sovereign entity) may not be less than 10 percent. These supervisory floors on PD and LGD apply regardless of whether the bank recognizes an eligible guarantee or eligible credit derivative as provided in sections 33 and 34 of the proposed rule.

The agencies would not allow a bank to artificially group exposures into segments specifically to avoid the LGD floor for mortgage products. A bank should use consistent risk drivers to determine its retail exposure segmentations and not artificially segment low LGD loans with higher LGD loans to avoid the floor.

A bank also must calculate the effective remaining maturity (M) for each wholesale exposure. For wholesale exposures other than repo-style transactions, eligible margin loans, and OTC derivative contracts subject to a

qualifying master netting agreement, M would be the weighted-average remaining maturity (measured in whole or fractional years) of the expected contractual cash flows from the exposure, using the undiscounted amounts of the cash flows as weights. A bank may use its best estimate of future interest rates to compute expected contractual interest payments on a floating-rate exposure, but it may not consider expected but noncontractually required returns of principal, when estimating M. A bank could, at its option, use the nominal remaining maturity (measured in whole or fractional years) of the exposure. The M for repo-style transactions, eligible margin loans, and OTC derivative contracts subject to a qualifying master netting agreement would be the weighted-average remaining maturity (measured in whole or fractional years) of the individual transactions subject to the qualifying master netting agreement, with the weight of each individual transaction set equal to the notional amount of the transaction. *Question 31: The agencies seek comment on the appropriateness of permitting a bank to consider prepayments when estimating M and on the feasibility and advisability of using discounted (rather than undiscounted) cash flows as the basis for estimating M.*

Under the proposed rule, a qualifying master netting agreement is defined to mean any written, legally enforceable bilateral agreement, provided that:

- (i) The agreement creates a single legal obligation for all individual transactions covered by the agreement upon an event of default, including bankruptcy, insolvency, or similar proceeding, of the counterparty;
- (ii) The agreement provides the bank the right to accelerate, terminate, and close-out on a net basis all transactions under the agreement and to liquidate or set off collateral promptly upon an event of default, including upon an event of bankruptcy, insolvency, or similar proceeding, of the counterparty, provided that, in any such case, any exercise of rights under the agreement will not be stayed or avoided under applicable law in the relevant jurisdictions;
- (iii) The bank has conducted and documented sufficient legal review to conclude with a well-founded basis that the agreement meets the requirements of paragraph (ii) of this definition and that in the event of a legal challenge (including one resulting from default or from bankruptcy, insolvency, or similar proceeding) the relevant court and administrative authorities would find the agreement to be legal, valid, binding,

and enforceable under the law of the relevant jurisdictions;

(iv) The bank establishes and maintains procedures to monitor possible changes in relevant law and to ensure that the agreement continues to satisfy the requirements of this definition; and

(v) The agreement does not contain a walkaway clause (that is, a provision that permits a non-defaulting counterparty to make lower payments than it would make otherwise under the agreement, or no payment at all, to a defaulter or the estate of a defaulter, even if the defaulter or the estate of the defaulter is a net creditor under the agreement).

The agencies would consider the following jurisdictions to be relevant for a qualifying master netting agreement: The jurisdiction in which each counterparty is chartered or the equivalent location in the case of non-corporate entities, and if a branch of a counterparty is involved, then also the jurisdiction in which the branch is located; the jurisdiction that governs the individual transactions covered by the agreement; and the jurisdiction that governs the agreement.

For most exposures, M may be no greater than five years and no less than one year. For exposures that have an original maturity of less than one year and are not part of a bank's ongoing financing of the obligor, however, a bank may set M equal to the greater of one day and M. An exposure is not part of a bank's ongoing financing of the obligor if the bank (i) has a legal and practical ability not to renew or roll over the exposure in the event of credit deterioration of the obligor; (ii) makes an independent credit decision at the inception of the exposure and at every renewal or rollover; and (iii) has no substantial commercial incentive to continue its credit relationship with the obligor in the event of credit deterioration of the obligor. Examples of transactions that may qualify for the exemption from the one-year maturity floor include due from other banks, including deposits in other banks; bankers' acceptances; sovereign exposures; short-term self-liquidating trade finance exposures; repo-style transactions; eligible margin loans; unsettled trades and other exposures resulting from payment and settlement processes; and collateralized OTC derivative contracts subject to daily remargining.

4. Phase 4—Calculation of Risk-Weighted Assets

After a bank assigns risk parameters to each of its wholesale obligors and

exposures and retail segments, the bank would calculate the dollar risk-based capital requirement for each wholesale exposure to a non-defaulted obligor or segment of non-defaulted retail exposures (except eligible guarantees and eligible credit derivatives that hedge another wholesale exposure and exposures to which the bank is applying the double default treatment in section

34 of the proposed rule) by inserting the risk parameters for the wholesale obligor and exposure or retail segment into the appropriate IRB risk-based capital formula specified in Table C and multiplying the output of the formula (K) by the EAD of the exposure or segment. Eligible guarantees and eligible credit derivatives that are hedges of a wholesale exposure would be reflected

in the risk-weighted assets amount of the hedged exposure (i) through adjustments made to the risk parameters of the hedged exposure under the PD substitution or LGD adjustment approach in section 33 of the proposed rule or (ii) through a separate double default risk-based capital requirement formula in section 34 of the proposed rule.

Table C – IRB risk-based capital formulas for wholesale exposures to non-defaulted obligors and segments of non-defaulted retail exposures*

Retail	Capital Requirement (K) Non-Defaulted Exposures	$K = \left[LGD \times N \left(\frac{N^{-1}(PD) + \sqrt{R} \times N^{-1}(0.999)}{\sqrt{1-R}} \right) - (ELGD \times PD) \right]$
	Correlation Factor (R)	For residential mortgage exposures: $R = 0.15$
		For qualifying revolving exposures: $R = 0.04$
		For other retail exposures: $R = 0.03 + 0.13 \times e^{-35 \times PD}$
Wholesale	Capital Requirement (K) Non-Defaulted Exposures	$K = \left[LGD \times N \left(\frac{N^{-1}(PD) + \sqrt{R} \times N^{-1}(0.999)}{\sqrt{1-R}} \right) - (ELGD \times PD) \right] \times \left(\frac{1 + (M - 2.5) \times b}{1 - 1.5 \times b} \right)$
	Correlation Factor (R)	For HVCRE exposures: $R = 0.12 + 0.18 \times e^{-50 \times PD}$
		For wholesale exposures other than HVCRE exposures: $R = 0.12 + 0.12 \times e^{-50 \times PD}$
	Maturity Adjustment (b)	$b = (0.11852 - 0.05478 \times \ln(PD))^2$

*N(.) means the cumulative distribution function for a standard normal random variable. N⁻¹(.) means the inverse cumulative distribution function for a standard normal random variable. The symbol e refers to the base of the natural logarithms, and the function ln(.) refers to the natural logarithm of the expression within parentheses. The formulas apply when PD is greater than zero. If the PD equals zero, the capital requirement K is equal to zero.

The sum of the dollar risk-based capital requirements for wholesale exposures to a non-defaulted obligor and segments of non-defaulted retail exposures (including exposures subject to the double default treatment described below) would equal the total dollar risk-based capital requirement for those exposures and segments. The total dollar risk-based capital requirement

would be converted into a risk-weighted asset amount by multiplying it by 12.5.

To compute the risk-weighted asset amount for a wholesale exposure to a defaulted obligor, a bank would first have to compare two amounts: (i) The sum of 0.08 multiplied by the EAD of the wholesale exposure plus the amount of any charge-offs or write-downs on the exposure; and (ii) K for the wholesale exposure (as determined in Table C

immediately before the obligor became defaulted), multiplied by the EAD of the exposure immediately before the exposure became defaulted. If the amount calculated in (i) is equal to or greater than the amount calculated in (ii), the dollar risk-based capital requirement for the exposure is 0.08 multiplied by the EAD of the exposure. If the amount calculated in (i) is less than the amount calculated in (ii), the

dollar risk-based capital requirement for the exposure is K for the exposure (as determined in Table C immediately before the obligor became defaulted), multiplied by the EAD of the exposure. The reason for this comparison is to ensure that a bank does not receive a regulatory capital benefit as a result of the exposure moving from non-defaulted to defaulted status.

The proposed rule provides a simpler approach for segments of defaulted retail exposures. The dollar risk-based capital requirement for a segment of defaulted retail exposures equals 0.08 multiplied by the EAD of the segment. The agencies are proposing this uniform 8 percent risk-based capital requirement for defaulted retail exposures to ease implementation burden on banks and in light of accounting and other supervisory policies in the retail context that would help prevent the sum of a bank's ECL and risk-based capital requirement for a retail exposure from declining at the time of default.

To convert the dollar risk-based capital requirements to a risk-weighted asset amount, the bank would sum the dollar risk-based capital requirements for all wholesale exposures to defaulted obligors and segments of defaulted retail exposures and multiply the sum by 12.5.

A bank could assign a risk-weighted asset amount of zero to cash owned and held in all offices of the bank or in transit, and for gold bullion held in the bank's own vaults or held in another bank's vaults on an allocated basis, to the extent it is offset by gold bullion liabilities. On-balance-sheet assets that do not meet the definition of a wholesale, retail, securitization, or equity exposure—for example, property, plant, and equipment and mortgage servicing rights—and portfolios of exposures that the bank has demonstrated to its primary Federal supervisor's satisfaction are, when combined with all other portfolios of exposures that the bank seeks to treat as immaterial for risk-based capital purposes, not material to the bank generally would be assigned risk-weighted asset amounts equal to their carrying value (for on-balance-sheet exposures) or notional amount (for off-balance-sheet exposures). For this purpose, the notional amount of an OTC derivative contract that is not a credit derivative is the EAD of the derivative as calculated in section 32 of the proposed rule.

Total wholesale and retail risk-weighted assets would be the sum of risk-weighted assets for wholesale exposures to non-defaulted obligors and segments of non-defaulted retail

exposures, wholesale exposures to defaulted obligors and segments of defaulted retail exposures, assets not included in an exposure category, non-material portfolios of exposures, and unsettled transactions minus the amounts deducted from capital pursuant to the general risk-based capital rules (excluding those deductions reversed in section 12 of the proposed rule).

5. Statutory Provisions on the Regulatory Capital Treatment of Certain Mortgage Loans

The general risk-based capital rules assign 50 and 100 percent risk weights to certain one- to four-family residential pre-sold construction loans and multifamily residential loans.⁴⁹ The agencies adopted these provisions as a result of the Resolution Trust Corporation Refinancing, Restructuring, and Improvement Act of 1991 (RTCRI Act).⁵⁰ The RTCRI Act mandates that each agency provide in its capital regulations (i) a 50 percent risk weight for certain one- to four-family residential pre-sold construction loans and multifamily residential loans that meet specific statutory criteria set forth in the Act and any other underwriting criteria imposed by the agencies; and (ii) a 100 percent risk weight for one- to four-family residential pre-sold construction loans for residences for which the purchase contract is cancelled.⁵¹

When Congress enacted the RTCRI Act in 1991, the agencies' risk-based capital rules reflected the Basel I framework. Consequently, the risk weight treatment for certain categories of mortgage loans in the RTCRI Act assumes a risk weight bucketing approach, instead of the more risk-sensitive IRB approach in the Basel II framework.

For purposes of this proposed rule implementing the Basel II IRB approach, the agencies are proposing that the three types of residential mortgage loans

addressed by the RTCRI Act should continue to receive the risk weights provided in the Act. Specifically, consistent with the general risk-based capital rules, the proposed rule requires a bank to use the following risk weights (instead of the risk weights that would otherwise be produced under the IRB risk-based capital formulas): (i) A 50 percent risk weight for one- to four-family residential construction loans if the residences have been pre-sold under firm contracts to purchasers who have obtained firm commitments for permanent qualifying mortgages and have made substantial earnest money deposits, and the loans meet the other underwriting characteristics established by the agencies in the general risk-based capital rules;⁵² (ii) a 50 percent risk weight for multifamily residential loans that meet certain statutory loan-to-value, debt-to-income, amortization, and performance requirements, and meet the other underwriting characteristics established by the agencies in the general risk-based capital rules;⁵³ and (iii) a 100 percent risk weight for one- to four-family residential pre-sold construction loans for a residence for which the purchase contract is canceled.⁵⁴ Mortgage loans that do not meet the relevant criteria do not qualify for the statutory risk weights and will be risk-weighted according to the IRB risk-based capital formulas.

The agencies understand that there is a tension between the statutory risk weights provided by the RTCRI Act and the more risk-sensitive IRB approaches to risk-based capital that are contained in this proposed rule. *Question 32: The agencies seek comment on whether the agencies should impose the following underwriting criteria as additional requirements for a Basel II bank to qualify for the statutory 50 percent risk weight for a particular mortgage loan: (i) That the bank has an IRB risk measurement and management system in place that assesses the PD and LGD of prospective residential mortgage exposures; and (ii) that the bank's IRB system generates a 50 percent risk weight for the loan under the IRB risk-based capital formulas.* The agencies note that a capital-related provision of the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA), enacted by Congress just four days after its adoption of the RTCRI Act, directs each agency to revise its risk-based capital standards for DIs to ensure that those standards "reflect the

⁴⁹ See 12 CFR part 3, Appendix A, section 3(a)(3)(iii) (national banks); 12 CFR part 208, Appendix A, section III.C.3. (state member banks); 12 CFR part 225, Appendix A, section III.C.3. (bank holding companies); 12 CFR part 325, Appendix A, section II.C.a. (state nonmember banks); 12 CFR 567.6(a)(1)(iii) and (iv) (savings associations).

⁵⁰ See sections 618(a) and (b) of the RTCRI Act. The first class includes loans for the construction of a residence consisting of 1- to 4-family dwelling units that have been pre-sold under firm contracts to purchasers who have obtained firm commitments for permanent qualifying mortgages and have made substantial earnest money deposits. The second class includes loans that are secured by a first lien on a residence consisting of more than 4 dwelling units if the loan meets certain criteria outlined in the RTCRI Act.

⁵¹ See sections 618(a) and (b) of the RTCRI Act.

⁵² See section 618(a)(1)(B) of the RTCRI Act.

⁵³ See section 618(b)(1)(B) of the RTCRI Act.

⁵⁴ See section 618(a)(2) of the RTCRI Act.

actual performance and expected risk of loss of multifamily mortgages.”⁵⁵

Question 33: The agencies seek comment on all aspects of the proposed treatment of one- to four-family residential pre-sold construction loans and multifamily residential loans.

C. Credit Risk Mitigation (CRM) Techniques

Banks use a number of techniques to mitigate credit risk. This section of the preamble describes how the proposed rule recognizes the risk-mitigating effects of both financial collateral (defined below) and nonfinancial collateral, as well as guarantees and credit derivatives, for risk-based capital purposes. To recognize credit risk mitigants for risk-based capital purposes, a bank should have in place operational procedures and risk management processes that ensure that all documentation used in collateralizing or guaranteeing a transaction is legal, valid, binding, and enforceable under applicable law in the relevant jurisdictions. The bank should have conducted sufficient legal review to reach a well-founded conclusion that the documentation meets this standard and should reconduct such a review as necessary to ensure continuing enforceability.

Although the use of CRM techniques may reduce or transfer credit risk, it simultaneously may increase other risks, including operational, liquidity, and market risks. Accordingly, it is imperative that banks employ robust procedures and processes to control risks, including roll-off risk and concentration risk, arising from the bank's use of CRM techniques and to monitor the implications of using CRM techniques for the bank's overall credit risk profile.

1. Collateral

Under the proposed rule, a bank generally recognizes collateral that secures a wholesale exposure as part of the ELGD and LGD estimation process and generally recognizes collateral that secures a retail exposure as part of the PD, ELGD, and LGD estimation process,

as described above in section V.B.3. of the preamble. However, in certain limited circumstances described in the next section, a bank may adjust EAD to reflect the risk mitigating effect of financial collateral.

When reflecting the credit risk mitigation benefits of collateral in its estimation of the risk parameters of a wholesale or retail exposure, a bank should:

(i) Conduct sufficient legal review to ensure, at inception and on an ongoing basis, that all documentation used in the collateralized transaction is binding on all parties and legally enforceable in all relevant jurisdictions;

(ii) Consider the relation (that is, correlation) between obligor risk and collateral risk in the transaction;

(iii) Consider any currency and/or maturity mismatch between the hedged exposure and the collateral;

(iv) Ground its risk parameter estimates for the transaction in historical data, using historical recovery rates where available; and

(v) Fully take into account the time and cost needed to realize the liquidation proceeds and the potential for a decline in collateral value over this time period.

The bank also should ensure that:

(i) The legal mechanism under which the collateral is pledged or transferred ensures that the bank has the right to liquidate or take legal possession of the collateral in a timely manner in the event of the default, insolvency, or bankruptcy (or other defined credit event) of the obligor and, where applicable, the custodian holding the collateral;

(ii) The bank has taken all steps necessary to fulfill legal requirements to secure its interest in the collateral so that it has and maintains an enforceable security interest;

(iii) The bank has clear and robust procedures for the timely liquidation of collateral to ensure observation of any legal conditions required for declaring the default of the borrower and prompt liquidation of the collateral in the event of default;

(iv) The bank has established procedures and practices for (A) conservatively estimating, on a regular

ongoing basis, the market value of the collateral, taking into account factors that could affect that value (for example, the liquidity of the market for the collateral and obsolescence or deterioration of the collateral), and (B) where applicable, periodically verifying the collateral (for example, through physical inspection of collateral such as inventory and equipment); and

(v) The bank has in place systems for promptly requesting and receiving additional collateral for transactions whose terms require maintenance of collateral values at specified thresholds.

2. EAD for Counterparty Credit Risk

This section describes two EAD-based methodologies—a collateral haircut approach and an internal models methodology—that a bank may use instead of an ELGD/LGD estimation methodology to recognize the benefits of financial collateral in mitigating the counterparty credit risk associated with repo-style transactions, eligible margin loans, collateralized OTC derivative contracts, and single product groups of such transactions with a single counterparty subject to a qualifying master netting agreement. A third methodology, the simple VaR methodology, is also available to recognize financial collateral mitigating the counterparty credit risk of single product netting sets of repo-style transactions and eligible margin loans.

A bank may use any combination of the three methodologies for collateral recognition; however, it must use the same methodology for similar exposures. A bank may choose to use one methodology for agency securities lending transactions—that is, repo-style transactions in which the bank, acting as agent for a customer, lends the customer's securities and indemnifies the customer against loss—and another methodology for all other repo-style transactions. This section also describes the methodology for calculating EAD for an OTC derivative contract or set of OTC derivative contracts subject to a qualifying master netting agreement. Table D illustrates which EAD estimation methodologies may be applied to particular types of exposure.

⁵⁵ Section 305(b)(1)(B) of FDICIA (12 U.S.C. 1828 notes).

TABLE D

	Current exposure methodology	Collateral haircut approach	Models approach	
			Simple VaR ⁵⁶ methodology	Internal models methodology
OTC derivative	X			X
Recognition of collateral for OTC derivatives		X ⁵⁷		X
Repo-style transaction		X	X	X
Eligible margin loan		X	X	X
Cross-product netting set				X

Question 34: For purposes of determining EAD for counterparty credit risk and recognizing collateral mitigating that risk, the proposed rule allows banks to take into account only financial collateral, which, by definition, does not include debt securities that have an external rating lower than one rating category below investment grade. The agencies invite comment on the extent to which lower-rated debt securities or other securities that do not meet the definition of financial collateral are used in these transactions and on the CRM value of such securities.

EAD for repo-style transactions and eligible margin loans. Under the proposal, a bank could recognize the risk mitigating effect of financial collateral that secures a repo-style transaction, eligible margin loan, or

single-product group of such transactions with a single counterparty subject to a qualifying master netting agreement (netting set) through an adjustment to EAD rather than ELGD and LGD. The bank may use a collateral haircut approach or one of two models approaches: a simple VaR methodology (for single-product netting sets of repo-style transactions or eligible margin loans) or an internal models methodology. Figure 2 illustrates the methodologies available for calculating EAD and LGD for eligible margin loans and repo-style transactions.

The proposed rule defines repo-style transaction as a repurchase or reverse repurchase transaction, or a securities borrowing or securities lending transaction (including a transaction in which the bank acts as agent for a

customer and indemnifies the customer against loss), provided that:

(i) The transaction is based solely on liquid and readily marketable securities or cash;

(ii) The transaction is marked to market daily and subject to daily margin maintenance requirements;

(iii) The transaction is executed under an agreement that provides the bank the right to accelerate, terminate, and close-out the transaction on a net basis and to liquidate or set off collateral promptly upon an event of default (including upon an event of bankruptcy, insolvency, or similar proceeding) of the counterparty, provided that, in any such case, any exercise of rights under the agreement will not be stayed or avoided under applicable law in the relevant jurisdictions;⁵⁸ and

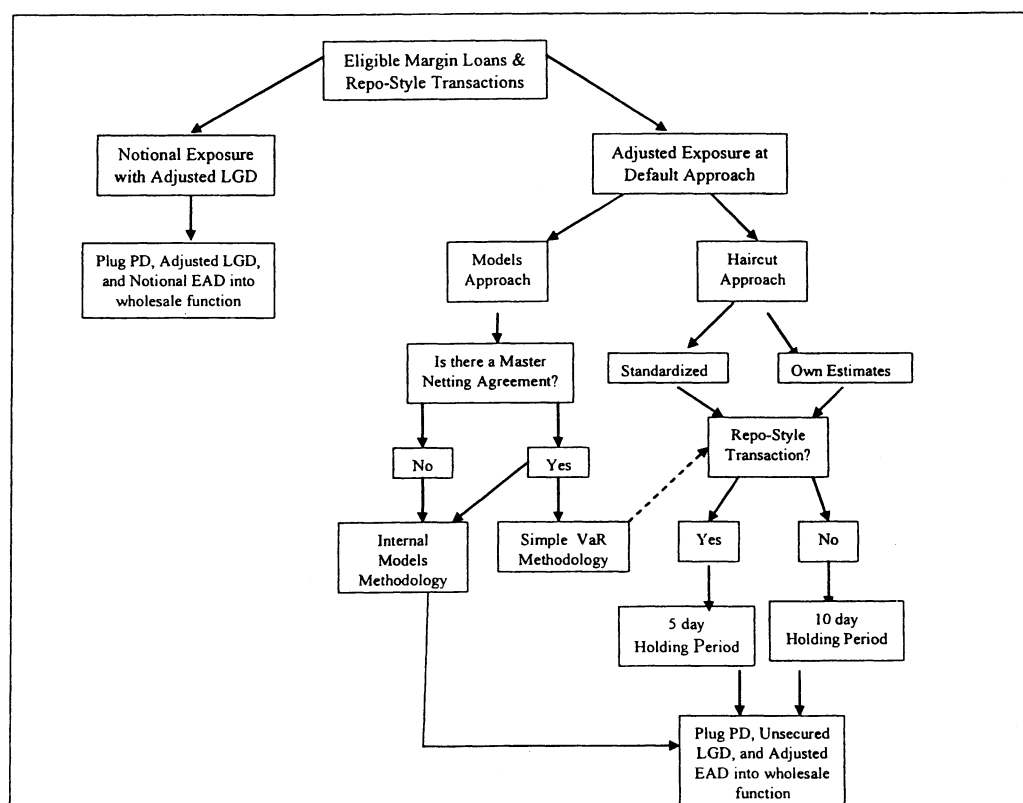
⁵⁶ Only repo-style transactions and eligible margin loans subject to a single-product qualifying master netting agreement are eligible for the simple VaR methodology.

⁵⁷ In conjunction with the current exposure methodology.

⁵⁸ This requirement is met where all transactions under the agreement are (i) executed under U.S. law and (ii) constitute "securities contracts" or "repurchase agreements" under section 555 or 559, respectively, of the Bankruptcy Code (11 U.S.C. 555 or 559), qualified financial contracts under section 11(e)(8) of the Federal Deposit Insurance Act (12

U.S.C. 1821(e)(8)), or netting contracts between or among financial institutions under sections 401–407 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (12 U.S.C. 4401–4407) or the Federal Reserve Board's Regulation EE (12 CFR part 231).

Figure 2 – EAD and LGD for Eligible Margin Loans and Repo-Style Transactions



(iv) The bank has conducted and documented sufficient legal review to conclude with a well-founded basis that the agreement meets the requirements of paragraph (iii) of this definition and is legal, valid, binding, and enforceable under applicable law in the relevant jurisdictions.

Question 35: The agencies recognize that criterion (iii) above may pose challenges for certain transactions that would not be eligible for certain exemptions from bankruptcy or receivership laws because the counterparty—for example, a sovereign entity or a pension fund—is not subject to such laws. The agencies seek comment on ways this criterion could be crafted to accommodate such transactions when justified on prudential grounds, while ensuring that the requirements in criterion (iii) are met for transactions that are eligible for those exemptions.

The proposed rule defines an eligible margin loan as an extension of credit where:

(i) The credit extension is collateralized exclusively by debt or equity securities that are liquid and readily marketable;

(ii) The collateral is marked to market daily and the transaction is subject to daily margin maintenance requirements;

(iii) The extension of credit is conducted under an agreement that provides the bank the right to accelerate and terminate the extension of credit and to liquidate or set off collateral promptly upon an event of default (including upon an event of bankruptcy, insolvency, or similar proceeding) of the counterparty, provided that, in any such case, any exercise of rights under the agreement will not be stayed or avoided under applicable law in the relevant jurisdictions;⁵⁹ and

(iv) The bank has conducted and documented sufficient legal review to conclude with a well-founded basis that the agreement meets the requirements of paragraph (iii) of this definition and is legal, valid, binding, and enforceable under applicable law in the relevant jurisdictions.

The proposed rule describes various ways that a bank may recognize the risk mitigating impact of financial collateral. The proposed rule defines financial collateral as collateral in the form of any of the following instruments in which the bank has a perfected, first priority

security interest or the legal equivalent thereof: (i) Cash on deposit with the bank (including cash held for the bank by a third-party custodian or trustee); (ii) gold bullion; (iii) long-term debt securities that have an applicable external rating of one category below investment grade or higher (for example, at least BB-); (iv) short-term debt instruments that have an applicable external rating of at least investment grade (for example, at least A-3); (v) equity securities that are publicly traded; (vi) convertible bonds that are publicly traded; and (vii) mutual fund shares for which a share price is publicly quoted daily and money market mutual fund shares. *Question 36: The agencies seek comment on the appropriateness of requiring that a bank have a perfected, first priority security interest, or the legal equivalent thereof, in the definition of financial collateral.*

The proposed rule defines an external rating as a credit rating assigned by a nationally recognized statistical rating organization (NRSRO) to an exposure that fully reflects the entire amount of credit risk the holder of the exposure has with regard to all payments owed to it under the exposure. For example, if a holder is owed principal and interest on an exposure, the external rating must

⁵⁹ This requirement is met under the circumstances described in the previous footnote.

fully reflect the credit risk associated with timely repayment of principal and interest. Moreover, the external rating must be published in an accessible form and must be included in the transition matrices made publicly available by the NRSRO that summarize the historical performance of positions it has rated.⁶⁰ Under the proposed rule, an exposure's applicable external rating is the lowest external rating assigned to the exposure by any NRSRO.

Collateral haircut approach. Under the collateral haircut approach, a bank would set EAD equal to the sum of three quantities: (i) The value of the exposure less the value of the collateral; (ii) the absolute value of the net position in a given security (where the net position in a given security equals the sum of the current market values of the particular security the bank has lent, sold subject to repurchase, or posted as collateral to the counterparty minus the sum of the current market values of that same

security the bank has borrowed, purchased subject to resale, or taken as collateral from the counterparty) multiplied by the market price volatility haircut appropriate to that security; and (iii) the sum of the absolute values of the net position of both cash and securities in each currency that is different from the settlement currency multiplied by the haircut appropriate to each currency mismatch. To determine the appropriate haircuts, a bank could choose to use standard supervisory haircuts or its own estimates of haircuts. For purposes of the collateral haircut approach, a given security would include, for example, all securities with a single Committee on Uniform Securities Identification Procedures (CUSIP) number and would not include securities with different CUSIP numbers, even if issued by the same issuer with the same maturity date.

Question 37: The agencies recognize that this is a conservative approach and

seek comment on other approaches to consider in determining a given security for purposes of the collateral haircut approach.

Standard Supervisory Haircuts

If a bank chooses to use standard supervisory haircuts, it would use an 8 percent haircut for each currency mismatch and the haircut appropriate to each security in table E below. These haircuts are based on the 10-business-day holding period for eligible margin loans and may be multiplied by the square root of $\frac{1}{2}$ to convert the standard supervisory haircuts to the 5-business-day minimum holding period for repo-style transactions. A bank must adjust the standard supervisory haircuts upward on the basis of a holding period longer than 10 business days for eligible margin loans or 5 business days for repo-style transactions where and as appropriate to take into account the illiquidity of an instrument.

TABLE E.—STANDARD SUPERVISORY MARKET PRICE VOLATILITY HAIRCUTS

Applicable external rating grade category for debt securities	Residual maturity for debt securities	Issuers exempt from the 3 b.p. floor	Other issuers
Two highest investment grade rating categories for long-term ratings/highest investment grade rating category for short-term ratings.	≤1 year	.005	.01
	>1 year, ≤5 years	.02	.04
	>5 years	.04	.08
Two lowest investment grade rating categories for both short- and long-term ratings.	≤1 year	.01	.02
	>1 year, ≤5 years	.03	.06
	>5 years	.06	.12
One rating category below investment grade	All	.15	.25
Main index equities ⁶¹ (including convertible bonds) and gold		.15	
Other publicly traded equities (including convertible bonds)			.25
Mutual funds		Highest haircut applicable to any security in which the fund can invest.	
Cash on deposit with the bank (including a certificate of deposit issued by the bank)			0

As an example, assume a bank that uses standard supervisory haircuts has extended an eligible margin loan of \$100 that is collateralized by 5-year U.S. Treasury notes with a market value of \$100. The value of the exposure less the value of the collateral would be zero, and the net position in the security (\$100) times the supervisory haircut (.02) would be \$2. There is no currency mismatch. Therefore, the EAD of the exposure would be \$0 + \$2 = \$2.

Own estimates of haircuts. With the prior written approval of the bank's

primary Federal supervisor, a bank may calculate security type and currency mismatch haircuts using its own internal estimates of market price volatility and foreign exchange volatility. The bank's primary Federal supervisor would base approval to use internally estimated haircuts on the satisfaction of certain minimum qualitative and quantitative standards. These standards include: (i) The bank must use a 99th percentile one-tailed confidence interval and a minimum 5-business-day holding period for repo-

style transactions and a minimum 10-business-day holding period for all other transactions; (ii) the bank must adjust holding periods upward where and as appropriate to take into account the illiquidity of an instrument; (iii) the bank must select a historical observation period for calculating haircuts of at least one year; and (iv) the bank must update its data sets and recompute haircuts no less frequently than quarterly and must update its data sets and recompute haircuts whenever market prices change materially. A bank must estimate

⁶⁰ Banks should take particular care with these requirements where the financial collateral is in the form of a securitization exposure.

⁶¹ The proposed rule defines a "main index" as the S&P 500 Index, the FTSE All-World Index, and any other index for which the bank demonstrates to the satisfaction of its primary Federal supervisor

that the equities represented in the index have comparable liquidity, depth of market, and size of bid-ask spreads as equities in the S&P 500 Index and the FTSE All-World Index.

individually the volatilities of the exposure, the collateral, and foreign exchange rates, and may not take into account the correlations between them.

A bank that uses internally estimated haircuts would have to adhere to the following rules. The bank may calculate internally estimated haircuts for categories of debt securities that have an applicable external rating of at least investment grade. The haircut for a category of securities would have to be representative of the internal volatility estimates for securities in that category that the bank has actually lent, sold subject to repurchase, posted as collateral, borrowed, purchased subject to resale, or taken as collateral. In determining relevant categories, the bank would have to take into account (i) the type of issuer of the security; (ii) the applicable external rating of the security; (iii) the maturity of the security; and (iv) the interest rate sensitivity of the security. A bank would calculate a separate internally estimated haircut for each individual debt security that has an applicable external rating below investment grade and for each individual equity security. In addition, a bank would internally estimate a separate currency mismatch haircut for each individual mismatch between each net position in a currency that is different from the settlement currency.

When a bank calculates an internally estimated haircut on a T_N -day holding period, which is different from the minimum holding period for the transaction type, the applicable haircut (H_M) must be calculated using the following square root of time formula:

$$H_M = H_N \sqrt{\frac{T_M}{T_N}},$$

Where:

- (i) $T_M = 5$ for repo-style transactions and 10 for eligible margin loans;

- (ii) T_N = holding period used by the bank to derive H_N ; and
(iii) H_N = haircut based on the holding period T_N .

Simple VaR methodology. As noted above, a bank may use one of two internal models approaches to recognize the risk mitigating effects of financial collateral that secures a repo-style transaction or eligible margin loan. This section of the preamble describes the simple VaR methodology; a later section of the preamble describes the internal models methodology (which also may be used to determine the EAD for OTC derivative contracts).

With the prior written approval of its primary Federal supervisor, a bank may estimate EAD for repo-style transactions and eligible margin loans subject to a single product qualifying master netting agreement using a VaR model. Under the simple VaR methodology, a bank's EAD for the transactions subject to such a netting agreement would be equal to the value of the exposures minus the value of the collateral plus a VaR-based estimate of the potential future exposure (PFE), that is, the maximum exposure expected to occur on a future date with a high level of confidence. The value of the exposures is the sum of the current market values of all securities and cash the bank has lent, sold subject to repurchase, or posted as collateral to a counterparty under the netting set. The value of the collateral is the sum of the current market values of all securities and cash the bank has borrowed, purchased subject to resale, or taken as collateral from a counterparty under the netting set.

The VaR model must estimate the bank's 99th percentile, one-tailed confidence interval for an increase in the value of the exposures minus the value of the collateral ($\Sigma E - \Sigma C$) over a 5-business-day holding period for repo-style transactions or over a 10-business-day holding period for eligible

margin loans using a minimum one-year historical observation period of price data representing the instruments that the bank has lent, sold subject to repurchase, posted as collateral, borrowed, purchased subject to resale, or taken as collateral.

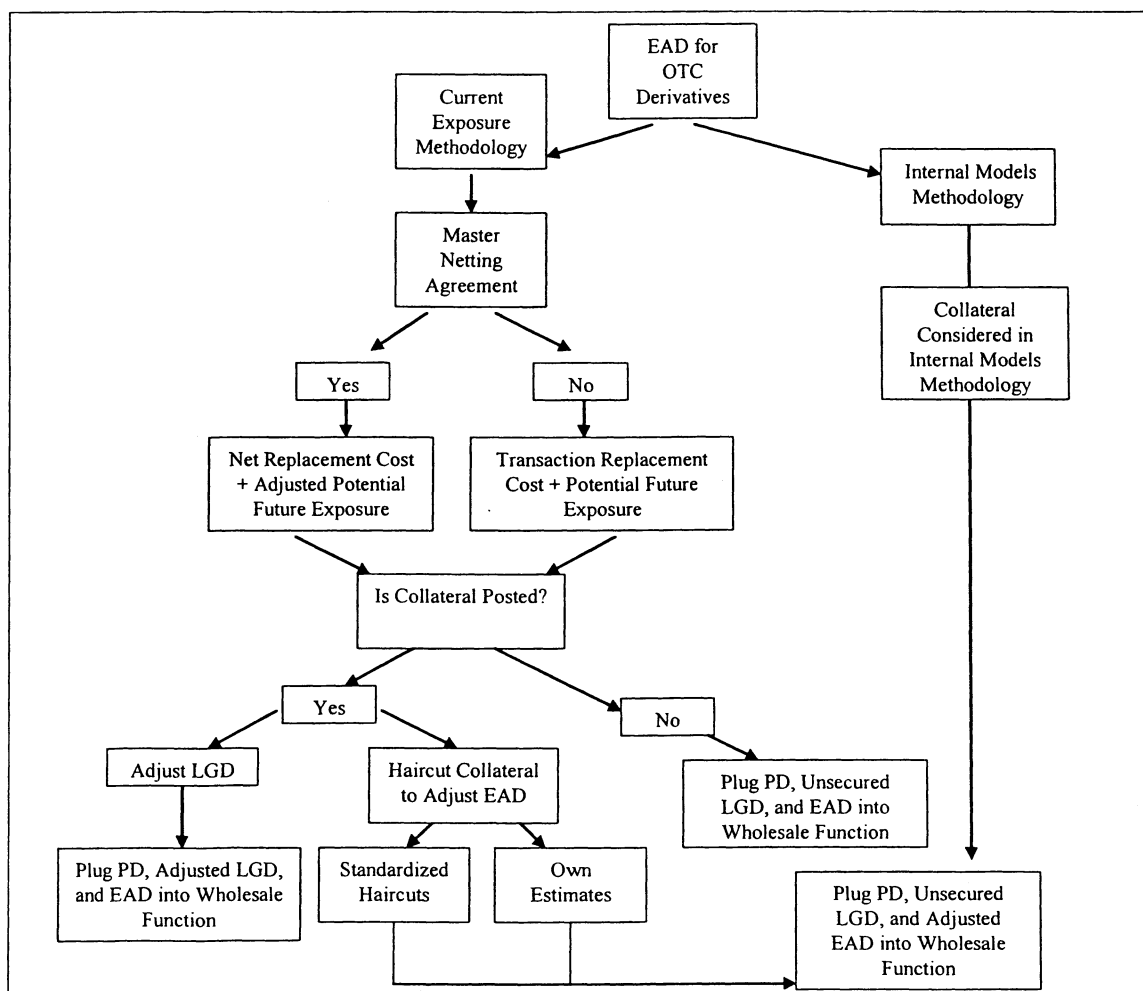
The qualifying requirements for the use of a VaR model are less stringent than the qualification requirements for the internal models methodology described below. The main ongoing qualification requirement for using a VaR model is that the bank must validate its VaR model by establishing and maintaining a rigorous and regular backtesting regime.

3. EAD for OTC Derivative Contracts

A bank may use either the current exposure methodology or the internal models methodology to determine the EAD for OTC derivative contracts. An OTC derivative contract is defined as a derivative contract that is not traded on an exchange that requires the daily receipt and payment of cash-variation margin. A derivative contract is defined to include interest rate derivative contracts, exchange rate derivative contracts, equity derivative contracts, commodity derivative contracts, credit derivatives, and any other instrument that poses similar counterparty credit risks. The proposed rule also would define derivative contracts to include unsettled securities, commodities, and foreign exchange trades with a contractual settlement or delivery lag that is longer than the normal settlement period (which the proposed rule defines as the lesser of the market standard for the particular instrument or 5 business days). This would include, for example, agency mortgage-backed securities transactions conducted in the To-Be-Announced market.

Figure 3 illustrates the treatment of OTC derivative contracts.

Figure 3—EAD and LGD for OTC Derivative Contracts



Current exposure methodology. The proposed current exposure methodology for determining EAD for single OTC derivative contracts is similar to the methodology in the general risk-based capital rules, in that the EAD for an OTC derivative contract would be equal to the sum of the bank's current credit exposure and PFE on the derivative contract. The current credit exposure for a single OTC derivative contract is the greater of the mark-to-market value of the derivative contract or zero.

The proposed current exposure methodology for OTC derivative contracts subject to qualifying master netting agreements is also similar to the treatment set forth in the agencies' general risk-based capital rules. Banks would need to calculate net current exposure and adjust the gross PFE using a formula that includes the net to gross current exposure ratio. Moreover, under the agencies' general risk-based capital rules, a bank may not recognize netting agreements for OTC derivative contracts for capital purposes unless it obtains a

written and reasoned legal opinion representing that, in the event of a legal challenge, the bank's exposure would be found to be the net amount in the relevant jurisdictions. The agencies are proposing to retain this standard for netting agreements covering OTC derivative contracts. While the legal enforceability of contracts is necessary for a bank to recognize netting effects in the capital calculation, there may be ways other than obtaining an explicit written opinion to ensure the enforceability of a contract. For example, the use of industry developed standardized contracts for certain OTC products and reliance on commissioned legal opinions as to the enforceability of these contracts in many jurisdictions may be sufficient. *Question 38: The agencies seek comment on methods banks would use to ensure enforceability of single product OTC derivative netting agreements in the absence of an explicit written legal opinion requirement.*

The proposed rule's conversion factor (CF) matrix used to compute PFE is based on the matrices in the general risk-based capital rules, with two exceptions. First, under the proposed rule the CF for credit derivatives that are not used to hedge the credit risk of exposures subject to an IRB credit risk capital requirement is specified to be 5.0 percent for contracts with investment grade reference obligors and 10.0 percent for contracts with non-investment grade obligors.⁶² The CF for a credit derivative contract does not depend on the remaining maturity of the contract. The second change is that floating/floating basis swaps would no longer be exempted from the CF for interest rate derivative contracts. The exemption was put into place when such swaps were very simple, and the

⁶² The counterparty credit risk of a credit derivative that is used to hedge the credit risk of an exposure subject to an IRB credit risk capital requirement is captured in the IRB treatment of the hedged exposure, as detailed in sections 33 and 34 of the proposed rule.

agencies believe it is no longer appropriate given the evolution of the product. The computation of the PFE of multiple OTC derivative contracts subject to a qualifying master netting agreement would not change from the general risk-based capital rules.

If an OTC derivative contract is collateralized by financial collateral, a bank would first determine an unsecured EAD as described above and in section 32(b) of the proposed rule. To take into account the risk-reducing effects of the financial collateral, the bank may either adjust the ELGD and LGD of the contract or, if the transaction is subject to daily marking-to-market and remargining, adjust the EAD of the contract using the collateral haircut approach for repo-style transactions and eligible margin loans described above and in section 32(a) of the proposed rule.

Under part VI of the proposed rule, a bank must treat an equity derivative contract as an equity exposure and compute a risk-weighted asset amount for that exposure. If the bank is using the internal models approach for its equity exposures, it also must compute a risk-weighted asset amount for its counterparty credit risk exposure on the equity derivative contract. However, if the bank is using the simple risk weight approach for its equity exposures, it may choose not to hold risk-based capital against the counterparty credit risk of the equity derivative contract. Likewise, a bank that purchases a credit derivative that is recognized under section 33 or 34 of the proposed rule as a credit risk mitigant for an exposure that is not a covered position under the MRA does not have to compute a separate counterparty credit risk capital requirement for the credit derivative. If a bank chooses not to hold risk-based capital against the counterparty credit risk of such equity or credit derivative contracts, it must do so consistently for all such equity derivative contracts or for all such credit derivative contracts. Further, where the contracts are subject to a qualifying master netting agreement, the bank must either include them all or exclude them all from any measure used to determine counterparty credit risk exposure to all relevant counterparties for risk-based capital purposes.

Where a bank provides protection through a credit derivative that is not treated as a covered position under the MRA, it must treat the credit derivative as a wholesale exposure to the reference obligor and compute a risk-weighted asset amount for the credit derivative under section 31 of the proposed rule. The bank need not compute a

counterparty credit risk capital requirement for the credit derivative, so long as it does so consistently for all such credit derivatives and either includes all or excludes all such credit derivatives that are subject to a master netting contract from any measure used to determine counterparty credit risk exposure to all relevant counterparties for risk-based capital purposes. Where the bank provides protection through a credit derivative treated as a covered position under the MRA, it must compute a counterparty credit risk capital requirement under section 32 of the proposed rule.

4. Internal Models Methodology

This proposed rule includes an internal models methodology for the calculation of EAD for transactions with counterparty credit exposure, namely, OTC derivatives, eligible margin loans, and repo-style transactions. The internal models methodology requires a risk model that captures counterparty credit risk and estimates EAD at the level of a "netting set." A netting set is a group of transactions with a single counterparty that are subject to a qualifying master netting agreement. A transaction not subject to a qualifying master netting agreement is considered to be its own netting set and EAD must be calculated for each such transaction individually. A bank may use the internal models methodology for OTC derivatives (collateralized or uncollateralized) and single-product netting sets thereof, for eligible margin loans and single-product netting sets thereof, or for repo-style transactions and single-product netting sets thereof. A bank that uses the internal models methodology for a particular transaction type (that is, OTC derivative contracts, eligible margin loans, or repo-style transactions) must use the internal models methodology for all transactions in that transaction type. However, a bank may choose whether or not to use the internal models methodology for each transaction type.

A bank also may use the internal models methodology for OTC derivatives, eligible margin loans, and repo-style transactions subject to a qualifying cross-product master netting agreement if (i) the bank effectively integrates the risk mitigating effects of cross-product netting into its risk management and other information technology systems; and (ii) the bank obtains the prior written approval of its primary Federal supervisor.

A qualifying cross-product master netting agreement is defined as a qualifying master netting agreement that provides for termination and close-out netting across multiple types of

financial transactions or qualifying master netting agreements in the event of a counterparty's default, provided that:

(i) The underlying financial transactions are OTC derivative contracts, eligible margin loans, or repo-style transactions; and

(ii) The bank obtains a written legal opinion verifying the validity and enforceability of the netting agreement under applicable law of the relevant jurisdictions if the counterparty fails to perform upon an event of default, including upon an event of bankruptcy, insolvency, or similar proceeding.

Banks use several measures to manage their exposure to counterparty credit risk including PFE, expected exposure (EE), and expected positive exposure (EPE). PFE is the maximum exposure estimated to occur on a future date at a high level of statistical confidence. Banks often use PFE when measuring counterparty credit risk exposure against counterparty credit limits. EE is the probability-weighted average exposure to a counterparty estimated to exist at any specified future date, whereas EPE is the time-weighted average of individual expected exposures estimated for a given forecasting horizon (one year in the proposed rule). Banks typically compute EPE, EE, and PFE using a common stochastic model.

A paper published by the BCBS in July 2005 titled "The Application of Basel II to Trading Activities and the Treatment of Double Default Effects" notes that EPE is an appropriate EAD measure for determining risk-based capital requirements for counterparty credit risk because transactions with counterparty credit risk "are given the same standing as loans with the goal of reducing the capital treatment's influence on a firm's decision to extend an on-balance sheet loan rather than engage in an economically equivalent transaction that involves exposure to counterparty credit risk."⁶³ An adjustment to EPE, called effective EPE and described below, is used in the calculation of EAD under the internal models methodology. EAD is calculated as a multiple of effective EPE.

To address the concern that EE and EPE may not capture risk arising from the replacement of existing short-term positions over the one year horizon used for capital requirements (that is, rollover risk) or may underestimate the exposures of eligible margin loans, repo-style transactions, and OTC derivatives

⁶³ BCBS, "The Application of Basel II to Trading Activities and the Treatment of Double Default Effects," July 2005, ¶ 15.

with short maturities, the proposed rule uses a netting set's "effective EPE" as the basis for calculating EAD for counterparty credit risk. Consistent with the use of a one-year PD horizon, effective EPE is the time-weighted average of effective EE over one year where the weights are the proportion that an individual effective EE represents in a one-year time interval. If all contracts in a netting set mature before one year, effective EPE is the average of effective EE until all contracts in the netting set mature. For example, if the longest maturity contract in the netting set matures in six months, effective EPE would be the average of effective EE over six months.

Effective EE is defined as:

Effective $EE_{tk} = \max(\text{Effective } EE_{tk-1}, EE_{tk})$ where exposure is measured at future dates $t1, t2, t3, \dots$ and effective EE_{t0} equals current exposure. Alternatively, a bank may use a measure that is more conservative than effective EPE for every counterparty (that is, a measure based on peak exposure) with prior approval of the primary Federal supervisor.

The EAD for instruments with counterparty credit risk must be determined assuming economic downturn conditions. To accomplish this determination in a prudent manner, the internal models methodology sets EAD equal to EPE multiplied by a scaling factor termed "alpha." Alpha is set at 1.4; a bank's primary Federal supervisor would have the flexibility to raise this value based on the bank's specific characteristics of counterparty credit risk. With supervisory approval, a bank may use its own estimate of alpha as described below, subject to a floor of 1.2. *Question 39: The agencies request comment on all aspect of the effective EPE approach to counterparty credit risk, and in particular on the appropriateness of the monotonically increasing effective EE function, the alpha constant of 1.4, and the floor on internal estimates of alpha of 1.2.*

A bank's primary Federal supervisor must determine that the bank meets certain qualifying criteria before the bank may use the internal models methodology. These criteria consist of operational requirements, modeling standards, and model validation requirements.

First, the bank must have the systems capability to estimate EE on a daily basis. While this requirement does not require the bank to report EE daily, or even estimate EE daily, the bank must

demonstrate that it is capable of performing the estimation daily.

Second, the bank must estimate EE at enough future time points to accurately reflect all future cash flows of contracts in the netting set. To accurately reflect the exposure arising from a transaction, the model should incorporate those contractual provisions, such as reset dates, that can materially affect the timing, probability, or amount of any payment. The requirement reflects the need for an accurate estimate of EPE. However, in order to balance the ability to calculate exposures with the need for information on timely basis, the number of time points is not specified.

Third, the bank must have been using an internal model that broadly meets the minimum standards to calculate the distributions of exposures upon which the EAD calculation is based for a period of at least one year prior to approval. This requirement is to insure that the bank has integrated the modeling into its counterparty credit risk management process.

Fourth, the bank's model must account for the non-normality of exposure distribution where appropriate. Non-normality of exposures means high loss events occur more frequently than would be expected on the basis of a normal distribution, the statistical term for which is leptokurtosis. In many instances, there may not be a need to account for this. Expected exposures are much less likely to be affected by leptokurtosis than peak exposures or high percentile losses. However, the bank must demonstrate that its EAD measure is not affected by leptokurtosis or must account for it within the model.

Fifth, the bank must measure, monitor, and control the exposure to a counterparty over the whole life of all contracts in the netting set, in addition to accurately measuring and actively monitoring the current exposure to counterparties. The bank should exercise active management of both existing exposure and exposure that could change in the future due to market moves.

Sixth, the bank must measure and manage current exposures gross and net of collateral held, where appropriate. The bank must estimate expected exposures for OTC derivative contracts both with and without the effect of collateral agreements.

Seventh, the bank must have procedures to identify, monitor, and control specific wrong-way risk throughout the life of an exposure. In

this context, wrong-way risk is the risk that future exposure to a counterparty will be high when the counterparty's probability of default is also high. Wrong-way risk generally arises from events specific to the counterparty, rather than broad market downturns.

Eighth, the data used by the bank should be adequate for the measurement and modeling of the exposures. In particular, current exposures must be calculated on the basis of current market data. When historical data are used to estimate model parameters, at least three years of data that cover a wide range of economic conditions must be used. This requirement reflects the longer horizon for counterparty credit risk exposures compared to market risk exposures. The data must be updated at least quarterly. Banks are encouraged also to incorporate model parameters based on forward looking measures "for example, using implied volatilities in situations where historic volatilities may not capture changes in the risk drivers anticipated by the market—where appropriate.

Ninth, the bank must subject its models used in the calculation of EAD to an initial validation and annual model review process. The model review should consider whether the inputs and risk factors, as well as the model outputs, are appropriate. The review of outputs should include a rigorous program of backtesting model outputs against realized exposures.

Maturity under the internal models methodology. Like corporate loan exposures, counterparty exposure on netting sets is susceptible to changes in economic value that stem from deterioration in the counterparty's creditworthiness short of default. The effective maturity parameter (M) reflects the impact of these changes on capital. The formula used to compute M for netting sets with maturities greater than one year must be different than that generally applied to wholesale exposures in order to reflect how counterparty credit exposures change over time. The proposed approach is based on a weighted average of expected exposures over the life of the transactions relative to their one year exposures.

If the remaining maturity of the exposure or the longest-dated contract contained in a netting set is greater than one year, the bank must set M for the exposure or netting set equal to the lower of 5 years or $M(EPE)$, where:

$$(i) M(EPE) = 1 + \frac{\sum_{t_k > 1 \text{ year}}^{\text{maturity}} EE_k \times \Delta t_k \times df_k}{\sum_{t_k \leq 1 \text{ year}} \text{effective} EE_k \times \Delta t_k \times df_k};$$

and (ii) df_k is the risk-free discount factor for future time period t_k . The cap of five years on M is consistent with the treatment of wholesale exposures under section 31 of the proposed rule.

If the remaining maturity of the exposure or the longest-dated contract in the netting set is one year or less, the bank must set M for the exposure or netting set equal to 1 year except as provided in section 31(d)(7) of the proposed rule. In this case, repo-style transactions, eligible margin loans, and collateralized OTC derivative transactions subject to daily remargining agreements may use the effective maturity of the longest maturity transaction in the netting set as M .

Collateral agreements under the internal models methodology. If the bank has prior written approval from its primary Federal supervisor, it may capture the effect on EAD of a collateral agreement that requires receipt of collateral when exposure to the counterparty increases within its internal model. In no circumstances may the bank take into account in EAD collateral agreements triggered by deterioration of counterparty credit quality. For this purpose, a collateral agreement means a legal contract that: (i) Specifies the time when, and circumstances under which, the counterparty is required to exchange collateral with the bank for a single financial contract or for all financial contracts covered under a qualifying master netting agreement; and (ii) confers upon the bank a perfected, first priority security interest, or the legal equivalent thereof, in the collateral posted by the counterparty under the agreement. This security interest must provide the bank with a right to close out the financial positions and the collateral upon an event of default or failure to perform by the counterparty under the collateral agreement. A contract would not satisfy this requirement if the bank's exercise of rights under the agreement may be stayed or avoided under applicable law in the relevant jurisdictions.

If the internal model does not capture the effects of collateral agreements, the following "shortcut" method is proposed that will provide some benefit, in the form of a smaller EAD, for collateralized counterparties. Although this "shortcut" method will be

permitted, the agencies expect banks that make extensive use of collateral agreements to develop the modeling capacity to measure the impact of such agreements on EAD.

The "shortcut" method sets effective EPE for a counterparty subject to a collateral agreement equal to the lesser of:

(i) The threshold, defined as the exposure amount at which the counterparty is required to post collateral under the collateral agreement, if the threshold is positive, plus an add-on that reflects the potential increase in exposure over the margin period of risk. The add-on is computed as the expected increase in the netting set's exposure beginning from current exposure of zero over the margin period of risk; and

(ii) Effective EPE without a collateral agreement.

The margin period of risk means, with respect to a netting set subject to a collateral agreement, the time period from the most recent exchange of collateral with a counterparty until the next required exchange of collateral plus the period of time required to sell and realize the proceeds of the least liquid collateral that can be delivered under the terms of the collateral agreement, and, where applicable, the period of time required to re-hedge the resulting market risk, upon the default of the counterparty. The minimum margin period of risk is 5 business days for repo-style transactions and 10 days for other transactions when liquid financial collateral is posted under a daily margin maintenance requirement. This period should be extended to cover any additional time between margin calls; any potential closeout difficulties; any delays in selling collateral, particularly if the collateral is illiquid; and any impediments to prompt re-hedging of any market risk.

Own estimate of alpha. This proposed rule would allow a bank to estimate a bank-wide alpha, subject to prior written approval from its primary Federal supervisor. The internal estimate of alpha would be the ratio of economic capital from a full simulation of counterparty credit risk exposure that incorporates a joint simulation of market and credit risk factors (numerator) to economic capital based on EPE (denominator). For purposes of

this calculation, economic capital is the unexpected losses for all counterparty credit risks measured at the 99.9 percent confidence level over a one-year horizon. Internal estimates of alpha are subject to a floor of 1.2. To obtain supervisory approval to use an internal estimate of alpha in the calculation of EAD, a bank must meet the following minimum standards to the satisfaction of its primary Federal supervisor:

(i) The bank's own estimate of alpha must capture the effects in the numerator of:

(A) The material sources of stochastic dependency of distributions of market values of transactions or portfolios of transactions across counterparties;

(B) Volatilities and correlations of market risk factors used in the joint simulation, which must be related to the credit risk factor used in the simulation to reflect potential increases in volatility or correlation in an economic downturn, where appropriate; and

(C) The granularity of exposures, that is, the effect of a concentration in the proportion of each counterparty's exposure that is driven by a particular risk factor;

(ii) The bank must assess the potential model risk in its estimates of alpha;

(iii) The bank must calculate the numerator and denominator of alpha in a consistent fashion with respect to modeling methodology, parameter specifications, and portfolio composition; and

(iv) The bank must review and adjust as appropriate its estimates of the numerator and denominator on at least a quarterly basis and more frequently as appropriate when the composition of the portfolio varies over time.

Alternative models. The proposed rule allows a bank to use an alternative model to determine EAD, provided that the bank can demonstrate to its primary Federal supervisor that the model output is more conservative than an alpha of 1.4 (or higher) times effective EPE. This may be appropriate where a new product or business line is being developed, where a recent acquisition has occurred, or where the bank believes that other more conservative methods to measure counterparty credit risk for a category of transactions are prudent. The alternative method should be applied to all similar transactions. When an alternative model is used, the

bank should either treat the particular transactions concerned as a separate netting set with the counterparty or apply the alternative model to the entire original netting set.

5. Guarantees and Credit Derivatives That Cover Wholesale Exposures

The New Accord specifies that a bank may adjust either the PD or the LGD of a wholesale exposure to reflect the risk mitigating effects of a guarantee or credit derivative. Under the proposed rule, a bank may choose either a PD substitution or an LGD adjustment approach to recognize the risk mitigating effects of an eligible guarantee or eligible credit derivative on a wholesale exposure (or in certain circumstances may choose to use a double default treatment, as discussed below). In all cases a bank must use the same risk parameters for calculating ECL for a wholesale exposure as it uses for calculating the risk-based capital requirement for the exposure. Moreover, in all cases, a bank's ultimate PD and LGD for the hedged wholesale exposure may not be lower than the PD and LGD floors discussed above and described in section 31(d) of the proposed rule.

Eligible guarantees and eligible credit derivatives. To be recognized as CRM for a wholesale exposure under the proposed rule, guarantees and credit derivatives must meet specific eligibility requirements. The proposed rule defines an eligible guarantee as a guarantee that:

- (i) Is written and unconditional;
- (ii) Covers all or a pro rata portion of all contractual payments of the obligor on the reference exposure;
- (iii) Gives the beneficiary a direct claim against the protection provider;
- (iv) Is non-cancelable by the protection provider for reasons other than the breach of the contract by the beneficiary;
- (v) Is legally enforceable against the protection provider in a jurisdiction where the protection provider has sufficient assets against which a judgment may be attached and enforced; and
- (vi) Requires the protection provider to make payment to the beneficiary on the occurrence of a default (as defined in the guarantee) of the obligor on the reference exposure without first requiring the beneficiary to demand payment from the obligor. Clearly, a bank could not provide an eligible guarantee on its own exposures.

The proposed rule defines an eligible credit derivative as a credit derivative in the form of a credit default swap, nth-to-default swap, or total return swap provided that:

(i) The contract meets the requirements of an eligible guarantee and has been confirmed by the protection purchaser and the protection provider;

(ii) Any assignment of the contract has been confirmed by all relevant parties;

(iii) If the credit derivative is a credit default swap or nth-to-default swap, the contract includes the following credit events:

(A) Failure to pay any amount due under the terms of the reference exposure (with a grace period that is closely in line with the grace period of the reference exposure); and

(B) Bankruptcy, insolvency, or inability of the obligor on the reference exposure to pay its debts, or its failure or admission in writing of its inability generally to pay its debts as they become due, and similar events;

(iv) The terms and conditions dictating the manner in which the contract is to be settled are incorporated into the contract;

(v) If the contract allows for cash settlement, the contract incorporates a robust valuation process to estimate loss reliably and specifies a reasonable period for obtaining post-credit event valuations of the reference exposure;

(vi) If the contract requires the protection purchaser to transfer an exposure to the protection provider at settlement, the terms of the exposure provide that any required consent to transfer may not be unreasonably withheld;

(vii) If the credit derivative is a credit default swap or nth-to-default swap, the contract clearly identifies the parties responsible for determining whether a credit event has occurred, specifies that this determination is not the sole responsibility of the protection provider, and gives the protection purchaser the right to notify the protection provider of the occurrence of a credit event; and

(viii) If the credit derivative is a total return swap and the bank records net payments received on the swap as net income, the bank records offsetting deterioration in the value of the hedged exposure (either through reductions in fair value or by an addition to reserves).

Question 40: The agencies request comment on the appropriateness of these criteria in determining whether the risk mitigation effects of a credit derivative should be recognized for risk-based capital purposes.

Under the proposed rule, a bank may recognize an eligible credit derivative that hedges an exposure that is different from the credit derivative's reference exposure used for determining the

derivative's cash settlement value, deliverable obligation, or occurrence of a credit event only if:

(i) The reference exposure ranks *pari passu* (that is, equal) or junior to the hedged exposure; and

(ii) The reference exposure and the hedged exposure share the same obligor (that is, the same legal entity) and legally enforceable cross-default or cross-acceleration clauses are in place.

PD substitution approach. Under the PD substitution approach, if the protection amount (as defined below) of the eligible guarantee or eligible credit derivative is greater than or equal to the EAD of the hedged exposure, a bank would substitute for the PD of the hedged exposure the PD associated with the rating grade of the protection provider. If the bank determines that full substitution leads to an inappropriate degree of risk mitigation, the bank may substitute a higher PD for that of the protection provider.

If the guarantee or credit derivative provides the bank with the option to receive immediate payout on triggering the protection, then the bank would use 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. The bank also would use the ELGD associated with the required LGD. If the guarantee or credit derivative does not provide the bank with the option to receive immediate payout on triggering the protection (and instead provides for the guarantor to assume the payment obligations of the obligor over the remaining life of the hedged exposure), the bank would use the LGD and ELGD of the guarantee or credit derivative.

If the protection amount of the eligible guarantee or eligible credit derivative is less than the EAD of the hedged exposure, however, the bank must treat the hedged exposure as two separate exposures (protected and unprotected) in order to recognize the credit risk mitigation benefit of the guarantee or credit derivative. The bank must calculate its risk-based capital requirement for the protected exposure under section 31 of the proposed rule (using a PD equal to the protection provider's PD, an ELGD and LGD determined as described above, and an EAD equal to the protection amount of the guarantee or credit derivative). If the bank determines that full substitution leads to an inappropriate degree of risk mitigation, the bank may use a higher PD than that of the protection provider. The bank must calculate its risk-based capital requirement for the unprotected exposure under section 31 of the proposed rule (using a PD equal to the

obligor's PD, an ELGD and LGD equal to the hedged exposure's ELGD and LGD not adjusted to reflect the guarantee or credit derivative, and an EAD equal to the EAD of the original hedged exposure minus the protection amount of the guarantee or credit derivative).

The protection amount of an eligible guarantee or eligible credit derivative would be the effective notional amount of the guarantee or credit derivative reduced by any applicable haircuts for maturity mismatch, lack of restructuring, and currency mismatch (each described below). The effective notional amount of a guarantee or credit derivative would be the lesser of the contractual notional amount of the credit risk mitigant and the EAD of the hedged exposure, multiplied by the percentage coverage of the credit risk mitigant. For example, the effective notional amount of a guarantee that covers, on a pro rata basis, 40 percent of any losses on a \$100 bond would be \$40.

LGD adjustment approach. Under the LGD adjustment approach, if the protection amount of the eligible guarantee or eligible credit derivative is greater than or equal to the EAD of the hedged exposure, the bank's risk-based capital requirement for the hedged exposure would be the greater of (i) the risk-based capital requirement for the exposure as calculated under section 31 of the proposed rule (with the ELGD and LGD of the exposure adjusted to reflect the guarantee or credit derivative); or (ii) the risk-based capital requirement for a direct exposure to the protection provider as calculated under section 31 of the proposed rule (using the bank's PD for the protection provider, the bank's ELGD and LGD for the guarantee or credit derivative, and an EAD equal to the EAD of the hedged exposure).

If the protection amount of the eligible guarantee or eligible credit derivative is less than the EAD of the hedged exposure, however, the bank must treat the hedged exposure as two separate exposures (protected and unprotected) in order to recognize the credit risk mitigation benefit of the guarantee or credit derivative. The bank's risk-based capital requirement for the protected exposure would be the greater of (i) the risk-based capital requirement for the protected exposure as calculated under section 31 of the proposed rule (with the ELGD and LGD of the exposure adjusted to reflect the guarantee or credit derivative and EAD set equal to the protection amount of the guarantee or credit derivative); or (ii) the risk-based capital requirement for a direct exposure to the protection provider as calculated under section 31

of the proposed rule (using the bank's PD for the protection provider, the bank's ELGD and LGD for the guarantee or credit derivative, and an EAD set equal to the protection amount of the guarantee or credit derivative). The bank must calculate its risk-based capital requirement for the unprotected exposure under section 31 of the proposed rule using a PD set equal to the obligor's PD, an ELGD and LGD set equal to the hedged exposure's ELGD and LGD (not adjusted to reflect the guarantee or credit derivative), and an EAD set equal to the EAD of the original hedged exposure minus the protection amount of the guarantee or credit derivative.

The PD substitution approach allows a bank to effectively assess risk-based capital against a hedged exposure as if it were a direct exposure to the protection provider, and the LGD adjustment approach produces a risk-based capital requirement for a hedged exposure that is never lower than that of a direct exposure to the protection provider. Accordingly, these approaches do not fully reflect the risk mitigation benefits certain types of guarantees and credit derivatives may provide because the resulting risk-based capital requirement does not consider the joint probability of default of the obligor of the hedged exposure and the protection provider, sometimes referred to as the "double default" benefit. The agencies have decided, consistent with the New Accord, to recognize double default benefits in the wholesale framework only for certain hedged exposures covered by certain guarantees and credit derivatives. A later section of the preamble describes which hedged exposures would be eligible for the proposed double default treatment and describes the double default treatment that would be available to those exposures.

Maturity mismatch haircut. A bank that seeks to reduce the risk-based capital requirement on a wholesale exposure by recognizing an eligible guarantee or eligible credit derivative would have to adjust the protection amount of the credit risk mitigant downward to reflect any maturity mismatch between the hedged exposure and the credit risk mitigant. A maturity mismatch occurs when the effective residual maturity of a credit risk mitigant is less than that of the hedged exposure(s). When the hedged exposures have different residual maturities, the longest residual maturity of any of the hedged exposures would be used as the residual maturity of all hedged exposures.

The effective residual maturity of a hedged exposure should be gauged as the longest possible remaining time before the obligor is scheduled to fulfil its obligation on the exposure. When determining the effective residual maturity of the guarantee or credit derivative, embedded options that may reduce the term of the credit risk mitigant should be taken into account so that the shortest possible residual maturity for the credit risk mitigant is used to determine the potential maturity mismatch. Where a call is at the discretion of the protection provider, the residual maturity of the guarantee or credit derivative would be deemed to be at the first call date. If the call is at the discretion of the bank purchasing the protection, but the terms of the arrangement at inception of the guarantee or credit derivative contain a positive incentive for the bank to call the transaction before contractual maturity, the remaining time to the first call date would be deemed to be the residual maturity of the credit risk mitigant. For example, where there is a step-up in the cost of credit protection in conjunction with a call feature or where the effective cost of protection increases over time even if credit quality remains the same or improves, the residual maturity of the credit risk mitigant would be the remaining time to the first call.

Eligible guarantees and eligible credit derivatives with maturity mismatches may only be recognized if their original maturities are equal to or greater than one year. As a result, a guarantee or credit derivative would not be recognized for a hedged exposure with an original maturity of less than one year unless the credit risk mitigant has an original maturity of equal to or greater than one year or an effective residual maturity equal to or greater than that of the hedged exposure. In all cases, credit risk mitigants with maturity mismatches may not be recognized when they have an effective residual maturity of three months or less.

When a maturity mismatch exists, a bank would apply the following maturity mismatch adjustment to determine the protection amount of the guarantee or credit derivative adjusted for maturity mismatch: $Pm = E \times (t - 0.25) / (T - 0.25)$, where:

- (i) Pm = protection amount of the guarantee or credit derivative adjusted for maturity mismatch;
- (ii) E = effective notional amount of the guarantee or credit derivative;
- (iii) t = lesser of T or effective residual maturity of the guarantee or credit derivative, expressed in years; and

(iv) T = lesser of 5 or effective residual maturity of the hedged exposure, expressed in years.

Restructuring haircut. An originating bank that seeks to recognize an eligible credit derivative that does not include a distressed restructuring as a credit event that triggers payment under the derivative would have to reduce the recognition of the credit derivative by 40 percent. A distressed restructuring is a restructuring of the hedged exposure involving forgiveness or postponement of principal, interest, or fees that results in a charge-off, specific provision, or other similar debit to the profit and loss account.

In other words, the protection amount of the credit derivative adjusted for lack of restructuring credit event (and maturity mismatch, if applicable) would be: $Pr = Pm \times 0.60$, where:

(i) Pr = protection amount of the credit derivative, adjusted for lack of restructuring credit event (and maturity mismatch, if applicable); and

(ii) Pm = effective notional amount of the credit derivative (adjusted for maturity mismatch, if applicable).

Currency mismatch haircut. Where the eligible guarantee or eligible credit derivative is denominated in a currency different from that in which any hedged exposure is denominated, the protection amount of the guarantee or credit derivative adjusted for currency mismatch (and maturity mismatch and lack of restructuring credit event, if applicable) would be: $Pc = Pr \times (1 - Hfx)$, where:

(i) Pc = protection amount of the guarantee or credit derivative, adjusted for currency mismatch (and maturity mismatch and lack of restructuring credit event, if applicable);

(ii) Pr = effective notional amount of the guarantee or credit derivative (adjusted for maturity mismatch and lack of restructuring credit event, if applicable); and

(iii) Hfx = haircut appropriate for the currency mismatch between the guarantee or credit derivative and the hedged exposure.

A bank may use a standard supervisory haircut of 8 percent for Hfx (based on a 10-business day holding period and daily marking-to-market and remargining). Alternatively, a bank may use internally estimated haircuts for Hfx based on a 10-business day holding period and daily marking-to-market and remargining if the bank qualifies to use the own-estimates haircuts in paragraph (a)(2)(iii) of section 32, the simple VaR methodology in paragraph (a)(3) of section 32, or the internal models methodology in paragraph (c) of section 32 of the proposed rule. The bank must

scale these haircuts up using a square root of time formula if the bank revalues the guarantee or credit derivative less frequently than once every 10 business days.

Example. Assume that a bank holds a five-year \$100 corporate exposure, purchases a \$100 credit derivative to mitigate its credit risk on the exposure, and chooses to use the PD substitution approach. The unsecured ELGD and LGD of the corporate exposure are 20 and 30 percent, respectively; the ELGD and LGD of the credit derivative are 75 and 80 percent, respectively. The credit derivative is an eligible credit derivative, has the bank's exposure as its reference exposure, has a three-year maturity, immediate cash payout on default, no restructuring provision, and no currency mismatch with the bank's hedged exposure. The effective notional amount and initial protection amount of the credit derivative would be \$100. The maturity mismatch would reduce the protection amount to $\$100 \times (3 - .25) / (5 - .25)$ or \$57.89. The haircut for lack of restructuring would reduce the protection amount to $\$57.89 \times 0.6$ or \$34.74. So the bank would treat the \$100 corporate exposure as two exposures: (i) An exposure of \$34.74 with the PD of the protection provider, an ELGD of 20 percent, an LGD of 30 percent, and an M of 5; and (ii) an exposure of \$65.26 with the PD of the obligor, an ELGD of 20 percent, an LGD of 30 percent, and an M of 5.

Multiple credit risk mitigants. The New Accord provides that if multiple credit risk mitigants (for example, two eligible guarantees) cover a single exposure, a bank must disaggregate the exposure into portions covered by each credit risk mitigant (for example, the portion covered by each guarantee) and must calculate separately the risk-based capital requirement of each portion.⁶⁴ The New Accord also indicates that when credit risk mitigants provided by a single protection provider have differing maturities, they should be subdivided into separate layers of protection.⁶⁵ *Question 41: The agencies are interested in the views of commenters as to whether and how the agencies should address these and other similar situations in which multiple credit risk mitigants cover a single exposure.*

Double default treatment. As noted above, the proposed rule contains a separate risk-based capital methodology for hedged exposures eligible for double default treatment. To be eligible for double default treatment, a hedged exposure must be fully covered or covered on a pro rata basis (that is, there must be no tranching of credit risk) by an uncollateralized single-reference-obligor credit derivative or guarantee (or

certain nth-to-default credit derivatives) provided by an eligible double default guarantor (as defined below). Moreover, the hedged exposure must be a wholesale exposure other than a sovereign exposure.⁶⁶ In addition, the obligor of the hedged exposure must not be an eligible double default guarantor, an affiliate of an eligible double default guarantor, or an affiliate of the guarantor.

The proposed rule defines eligible double default guarantor to include a depository institution (as defined in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813)); a bank holding company (as defined in section 2 of the Bank Holding Company Act (12 U.S.C. 1841)); a savings and loan holding company (as defined in 12 U.S.C. 1467a) provided all or substantially all of the holding company's activities are permissible for a financial holding company under 12 U.S.C. 1843(k)); a securities broker or dealer registered (under the Securities Exchange Act of 1934) with the Securities and Exchange Commission (SEC); an insurance company in the business of providing credit protection (such as a monoline bond insurer or reinsurer) that is subject to supervision by a state insurance regulator; a foreign bank (as defined in section 211.2 of the Federal Reserve Board's Regulation K (12 CFR 211.2)); a non-U.S. securities firm; or a non-U.S. based insurance company in the business of providing credit protection. To be an eligible double default guarantor, the entity must (i) have a bank-assigned PD that, at the time the guarantor issued the guarantee or credit derivative, was equal to or lower than the PD associated with a long-term external rating of at least the third highest investment grade rating category; and (ii) have a current bank-assigned PD that is equal to or lower than the PD associated with a long-term external rating of at least investment grade. In addition, a non-U.S. based bank, securities firm, or insurance company may qualify as an eligible double default guarantor only if the firm is subject to consolidated supervision and regulation comparable to that imposed on U.S. depository institutions, securities firms, or insurance companies (as the case may be) or has issued and outstanding an unsecured long-term debt security without credit enhancement that has a long-term applicable external rating in one of the

⁶⁶ The New Accord permits certain retail small business exposures to be eligible for double default treatment. Under this proposal, however, a bank must effectively desegment a retail small business exposure (thus rendering it a wholesale exposure) to make it eligible for double default treatment.

⁶⁴ New Accord, ¶ 206.

⁶⁵ *Id.*

three highest investment grade rating categories.

Effectively, the scope of an eligible double default guarantor is limited to financial firms whose normal business includes the provision of credit protection, as well as the management of a diversified portfolio of credit risk. This restriction arises from the agencies' concern to limit double default recognition to professional counterparties that have a high level of credit risk management expertise and that provide sufficient market disclosure. The restriction is also designed to limit the risk of excessive correlation between the creditworthiness of the guarantor and the obligor of the hedged exposure due to their performance depending on common economic factors beyond the systematic risk factor. As a result, hedged exposures to potential credit protection providers or affiliates of credit protection providers would not be eligible for the double default treatment. In addition, the agencies have excluded hedged exposures to sovereign entities from eligibility for double default treatment because of the potential high correlation between the creditworthiness of a sovereign and that of a guarantor.

In addition to limiting the types of guarantees, credit derivatives, guarantors, and hedged exposures eligible for double default treatment, the proposed rule limits wrong-way risk further by requiring a bank to implement a process to detect excessive correlation between the creditworthiness of the obligor of the hedged exposure and the protection provider. The bank must receive prior written approval from its primary Federal supervisor for this process in order to recognize double default benefits for risk-based capital purposes. To apply double default treatment to a particular hedged exposure, the bank must determine that there is not excessive correlation between the creditworthiness of the obligor of the hedged exposure and the protection provider. For example, the creditworthiness of an obligor and a protection provider would be excessively correlated if the obligor derives a high proportion of its income or revenue from transactions with the protection provider. If excessive correlation is present, the bank may not use the double default treatment for the hedged exposure.

The risk-based capital requirement for a hedged exposure subject to double default treatment is calculated by multiplying a risk-based capital requirement for the hedged exposure (as

if it were unhedged) by an adjustment factor that considers the PD of the protection provider (see section 34 of the proposed rule). Thus, the PDs of both the obligor of the hedged exposure and the protection provider are factored into the hedged exposure's risk-based capital requirement. In addition, as under the PD substitution treatment in section 33 of the proposed rule, the bank would be allowed to set LGD equal to the lower of the LGD of the unhedged exposure or the LGD of the guarantee or credit derivative if the guarantee or credit derivative provides the bank with the option to receive immediate payout on the occurrence of a credit event. Otherwise, the bank must set LGD equal to the LGD of the guarantee or credit derivative. In addition, the bank must set ELGD equal to the ELGD associated with the required LGD. Accordingly, in order to apply the double default treatment, the bank must estimate a PD for the protection provider and an ELGD and LGD for the guarantee or credit derivative. Finally, a bank using the double default treatment must make applicable adjustments to the protection amount of the guarantee or credit derivative to reflect maturity mismatches, currency mismatches, and lack of restructuring coverage (as under the PD substitution and LGD adjustment approaches in section 33 of the proposed rule).

6. Guarantees and Credit Derivatives That Cover Retail Exposures

The proposed rule provides a different treatment for guarantees and credit derivatives that cover retail exposures. The approach set forth above for guarantees and credit derivatives that cover wholesale exposures is an exposure-by-exposure approach consistent with the overall exposure-by-exposure approach the proposed rule takes to wholesale exposures. The agencies believe that a different treatment for guarantees that cover retail exposures is necessary and appropriate because of the proposed rule's segmentation approach to retail exposures. The approaches to retail guarantees described in this section generally apply only to guarantees of individual retail exposures. Guarantees of multiple retail exposures (such as pool private mortgage insurance (PMI)) are typically tranching (that is, they cover less than the full amount of the hedged exposures) and, therefore, would be securitization exposures.

The proposed rule does not specify the ways in which guarantees and credit derivatives may be taken into account in the segmentation of retail exposures. Likewise, the proposed rule does not

explicitly limit the extent to which a bank may take into account the credit risk mitigation benefits of guarantees and credit derivatives in its estimation of the PD, ELGD, and LGD of retail segments, except by the application of overall floors on certain PD and LGD assignments. This approach has the principal advantage of being relatively easy for banks to implement—the approach generally would not disrupt the existing retail segmentation practices of banks and would not interfere with banks' quantification of PD, ELGD, and LGD for retail segments. The agencies are concerned, however, that because this approach would provide banks with substantial discretion to incorporate double default and double recovery effects, the resulting treatment for guarantees of retail exposures would be inconsistent with the treatment for guarantees of wholesale exposures.

To address these concerns, the agencies are considering for purposes of the final rule two principal alternative treatments for guarantees of retail exposures. The first alternative would distinguish between eligible retail guarantees and all other (non-eligible) guarantees of retail exposures. Under this alternative, an eligible retail guarantee would be an eligible guarantee that applies to a single retail exposure and is (i) PMI issued by an insurance company that (A) has issued a senior unsecured long-term debt security without credit enhancement that has an applicable external rating in one of the two highest investment grade rating categories or (B) has a claims payment ability that is rated in one of the two highest rating categories by an NRSRO; or (ii) issued by a sovereign entity or a political subdivision of a sovereign entity. Under this alternative, PMI would be defined as insurance provided by a regulated mortgage insurance company that protects a mortgage lender in the event of the default of a mortgage borrower up to a predetermined portion of the value of a single one-to-four-family residential property.

Under this alternative, a bank would be able to recognize the credit risk mitigation benefits of eligible retail guarantees that cover retail exposures in a segment by adjusting its estimates of ELGD and LGD for the segment to reflect recoveries from the guarantor. However, the bank would have to estimate the PD of a segment without reflecting the benefit of guarantees; that is, a segment's PD would be an estimate of the stand-alone probability of default for the retail exposures in the segment, before taking account of any guarantees.

Accordingly, for this limited set of traditional guarantees of retail exposures by high credit quality guarantors, a bank would be allowed to recognize the benefit of the guarantee when estimating ELGD and LGD, but not when estimating PD. *Question 42: The agencies seek comment on this alternative approach's definition of eligible retail guarantee and treatment for eligible retail guarantees, and on whether the agencies should provide similar treatment for any other forms of wholesale credit insurance or guarantees on retail exposures, such as student loans, if the agencies adopt this approach.*

This alternative approach would provide a different treatment for non-eligible retail guarantees. In short, within the retail framework, a bank would not be able to recognize non-eligible retail guarantees when estimating PD, ELGD, and LGD for any segment of retail exposures. In other words, a bank would be required to estimate PD, ELGD, and LGD for segments containing retail exposures with non-eligible guarantees as if the exposures were not guaranteed. However, a bank would be permitted to recognize non-eligible retail guarantees provided by a wholesale guarantor by treating the hedged retail exposure as a direct exposure to the guarantor and applying the appropriate wholesale IRB risk-based capital formula. In other words, for retail exposures covered by non-eligible retail guarantees, a bank would be permitted to reflect the guarantee by "desegmenting" the retail exposures (which effectively would convert the retail exposures into wholesale exposures) and then applying the rules set forth above for guarantees that cover wholesale exposures. Thus, under this approach, a bank would not be allowed to recognize either double default or double recovery effects for non-eligible retail guarantees.

The agencies understand that this approach to non-eligible retail guarantees, while addressing the prudential concerns of the agencies, is conservative and may not harmonize with banks' internal risk measurement and management practices in this area. *Question 43: The agencies seek comment on the types of non-eligible retail guarantees banks obtain and the extent to which banks obtain credit risk mitigation in the form of non-eligible retail guarantees.*

A second alternative that the agencies are considering for purposes of the final rule would permit a bank to recognize the credit risk mitigation benefits of all eligible guarantees (whether eligible retail guarantees or not) that cover retail

exposures by adjusting its estimates of ELGD and LGD for the relevant segments, but would subject a bank's risk-based capital requirement for a segment of retail exposures that are covered by one or more non-eligible retail guarantees to a floor. Under this second alternative, the agencies could impose a floor on risk-based capital requirements of between 2 percent and 6 percent on such a segment of retail exposures.

Question 44: The agencies seek comment on both of these alternative approaches to guarantees that cover retail exposures. The agencies also invite comment on other possible prudential treatments for such guarantees.

D. Unsettled Securities, Foreign Exchange, and Commodity Transactions

Section 35 of the proposed rule sets forth the risk-based capital requirements for unsettled and failed securities, foreign exchange, and commodities transactions. Certain transaction types are excluded from the scope of this section, including:

(i) Transactions accepted by a qualifying central counterparty that are subject to daily marking-to-market and daily receipt and payment of variation margin (which do not have a risk-based capital requirement);⁶⁷

(ii) Repo-style transactions (the risk-based capital requirements of which are determined under sections 31 and 32 of the proposed rule);

(iii) One-way cash payments on OTC derivative contracts (the risk-based capital requirements of which are determined under sections 31 and 32 of the proposed rule); and

(iv) Transactions with a contractual settlement period that is longer than the normal settlement period (defined below), which transactions are treated as OTC derivative contracts and assessed a risk-based capital requirement under sections 31 and 32 of the proposed rule. The proposed rule also provides that, in the case of a system-wide failure of a settlement or clearing system, the bank's primary Federal supervisor may waive risk-based capital requirements for unsettled and failed transactions until the situation is rectified.

⁶⁷ The agencies consider a qualifying central counterparty to be the functional equivalent of an exchange, and have long exempted exchange-traded contracts from risk-based capital requirements. Transactions rejected by a qualifying central counterparty (because, for example, of a discrepancy in the details of the transaction such as in quantity, price, or in the underlying security, between the buyer and seller) potentially give rise to risk exposure to either party.

The proposed rule contains separate treatments for delivery-versus-payment (DvP) and payment-versus-payment (PvP) transactions with a normal settlement period, on the one hand, and non-DvP/non-PvP transactions with a normal settlement period, on the other hand. The proposed rule provides the following definitions of a DvP transaction, a PvP transaction, and a normal settlement period. A DvP transaction is a securities or commodities transaction in which the buyer is obligated to make payment only if the seller has made delivery of the securities or commodities and the seller is obligated to deliver the securities or commodities only if the buyer has made payment. A PvP transaction is a foreign exchange transaction in which each counterparty is obligated to make a final transfer of one or more currencies only if the other counterparty has made a final transfer of one or more currencies. A transaction has a normal settlement period if the contractual settlement period for the transaction is equal to or less than the market standard for the instrument underlying the transaction and equal to or less than five business days.

A bank must hold risk-based capital against a DvP or PvP transaction with a normal settlement period if the bank's counterparty has not made delivery or payment within five business days after the settlement date. The bank must determine its risk-weighted asset amount for such a transaction by multiplying the positive current exposure of the transaction for the bank by the appropriate risk weight in Table F. The positive current exposure of a transaction of a bank is the difference between the transaction value at the agreed settlement price and the current market price of the transaction, if the difference results in a credit exposure of the bank to the counterparty.

TABLE F.—RISK WEIGHTS FOR UNSETTLED DVP AND PVP TRANSACTIONS

Number of business days after contractual settlement date	Risk weight to be applied to positive current exposure (percent)
From 5 to 15	100
From 16 to 30	625
From 31 to 45	937.5
46 or more	1,250

A bank must hold risk-based capital against any non-DvP/non-PvP transaction with a normal settlement period if the bank has delivered cash, securities, commodities, or currencies to its counterparty but has not received its

corresponding deliverables by the end of the same business day. The bank must continue to hold risk-based capital against the transaction until the bank has received its corresponding deliverables. From the business day after the bank has made its delivery until five business days after the counterparty delivery is due, the bank must calculate its risk-based capital requirement for the transaction by treating the current market value of the deliverables owed to the bank as a wholesale exposure.

A bank may assign an internal obligor rating to a counterparty for which it is not otherwise required under the proposed rule to assign an obligor rating on the basis of the applicable external rating of any outstanding senior unsecured long-term debt security without credit enhancement issued by the counterparty. A bank may estimate loss severity ratings or ELGD and LGD for the exposure, or may use a 45 percent ELGD and LGD for the exposure provided the bank uses the 45 percent ELGD and LGD for all such exposures. Alternatively, a bank may use a 100 percent risk weight for the exposure as long as the bank uses this risk weight for all such exposures.

If, in a non-DvP/non-PvP transaction with a normal settlement period, the bank has not received its deliverables by the fifth business day after counterparty delivery was due, the bank must deduct the current market value of the deliverables owed to the bank 50 percent from tier 1 capital and 50 percent from tier 2 capital.

The total risk-weighted asset amount for unsettled transactions equals the sum of the risk-weighted asset amount for each DvP and PvP transaction with a normal settlement period and the risk-weighted asset amount for each non-DvP/non-PvP transaction with a normal settlement period.

E. Securitization Exposures

This section describes the framework for calculating risk-based capital requirements for securitization exposures under the proposed rule (the securitization framework). In contrast to the proposed framework for wholesale and retail exposures, the proposed securitization framework does not permit a bank to rely on its internal assessments of the risk parameters of a securitization exposure.⁶⁸ For

securitization exposures, which typically are tranching exposures to a pool of underlying exposures, such assessments would require implicit or explicit estimates of correlations among the losses on the underlying exposures and estimates of the credit risk consequences of tranching. Such correlation and tranching effects are difficult to estimate and validate in an objective manner and on a going-forward basis. Instead, the proposed securitization framework relies principally on two sources of information, where available, to determine risk-based capital requirements: (i) An assessment of the securitization exposure's credit risk made by an NRSRO; or (ii) the risk-based capital requirement for the underlying exposures as if the exposures had not been securitized (along with certain other objective information about the securitization exposure, such as the size and relative seniority of the exposure).

A bank must use the securitization framework for exposures to any transaction that involves the tranching of credit risk (with the exception of a tranching guarantee that applies only to an individual retail exposure), regardless of the number of underlying exposures in the transaction.⁶⁹ A single, unified approach to dealing with the tranching of credit risk is important to create a level playing field across the securitization, credit derivatives, and other financial markets. The agencies believe that basing the applicability of the proposed securitization framework on the presence of some minimum number of underlying exposures would complicate the proposed rule without any material improvement in risk sensitivity. The proposed securitization framework is designed specifically to deal with tranching exposures to credit risk, and the principal risk-based capital approaches of the proposed securitization framework take into account the effective number of underlying exposures.

1. Hierarchy of Approaches

The proposed securitization framework contains three general approaches for determining the risk-based capital requirement for a securitization exposure: A Ratings-Based Approach (RBA), an Internal Assessment Approach (IAA), and a Supervisory Formula Approach (SFA). Under the proposed rule, banks

generally must apply the following hierarchy of approaches to determine the risk-based capital requirement for a securitization exposure.

First, a bank must deduct from tier 1 capital any after-tax gain-on-sale resulting from a securitization and must deduct from total capital any portion of a CEIO that does not constitute a gain-on-sale, as described in section 42(c) of the proposed rule. Second, a bank must apply the RBA to a securitization exposure if the exposure qualifies for the RBA. As a general matter, an exposure qualifies for the RBA if the exposure has an external rating from an NRSRO or has an inferred rating (that is, the exposure is senior to another securitization exposure in the transaction that has an external rating from an NRSRO). For example, a bank generally must use the RBA approach to determine the risk-based capital requirement for an asset-backed security that has an applicable external rating of AA+ from an NRSRO and for another tranche of the same securitization that is unrated but senior in all respects to the asset-backed security that was rated. In this example, the senior unrated tranche would be treated as if it were rated AA+.

If a securitization exposure does not qualify for the RBA but is an exposure to an ABCP program—such as a credit enhancement or liquidity facility—the bank may apply the IAA (if the bank, the exposure, and the ABCP program qualify for the IAA) or the SFA (if the bank and the exposure qualify for the SFA) to the exposure. As a general matter, a bank would qualify for use of the IAA if the bank establishes and maintains an internal risk rating system for exposures to ABCP programs that has been approved by the bank's primary Federal supervisor. Alternatively, a bank may use the SFA if the bank is able to calculate a set of risk factors relating to the securitization, including the risk-based capital requirement for the underlying exposures as if they were held directly by the bank. A bank that chooses to use the IAA must use the IAA for all exposures that qualify for the IAA.

If a securitization exposure is not a gain-on-sale or a CEIO, does not qualify for the RBA and is not an exposure to an ABCP program, the bank may apply the SFA to the exposure if the bank is able to calculate the SFA risk factors for the securitization. In many cases an originating bank would use the SFA to determine its risk-based capital requirements for retained securitization exposures. If a securitization exposure is not a gain-on-sale or a CEIO and does not qualify for the RBA, the IAA, or the SFA, the bank must deduct the exposure

⁶⁸ Although the Internal Assessment Approach described below does allow a bank to use an internal-ratings-based approach to determine its risk-based capital requirement for an exposure to an ABCP program, banks are required to follow NRSRO rating criteria and therefore are required implicitly to use the NRSRO's determination of the

correlation of the underlying exposures in the ABCP program.

⁶⁹ As noted above, mortgage-backed pass-through securities guaranteed by Fannie Mae or Freddie Mac are also securitization exposures.

from total capital. Total risk-weighted assets for securitization exposures would be the sum of risk-weighted assets calculated under the RBA, IAA, and SFA, plus any risk-weighted asset amounts calculated under the early amortization provisions in section 47 of the proposed rule.

Numerous commenters criticized the complexity of the ANPR's treatment of approaches to securitization exposures and the different treatment accorded to originating banks versus investing banks. As discussed elsewhere in this section, the agencies have responded to these comments by eliminating most of the differences in treatment for originating banks and investing banks and by eliminating the "Alternative RBA" from the hierarchy of approaches. As discussed in more detail below, there is one difference in treatment between originating and investing banks in the RBA, consistent with the general risk-based capital rules.

Some commenters expressed dissatisfaction that the ANPR required banks to use the RBA to assess risk-based capital requirements against a securitization exposure with an external or inferred rating. These commenters argued that banks should be allowed to choose between the RBA and the SFA when both approaches are available. The agencies have not altered the proposed securitization framework to provide this element of choice to banks because the agencies believe it would likely create a means for regulatory capital arbitrage.

Exceptions to the general hierarchy of approaches. Under the proposed securitization framework, unless one or more of the underlying exposures does not meet the definition of a wholesale, retail, securitization, or equity exposure, the total risk-based capital requirement for all securitization exposures held by a single bank associated with a single securitization (including any regulatory capital requirement that relates to an early amortization provision, but excluding any capital requirements that relate to the bank's gain-on-sale or CEIOs associated with the securitization) cannot exceed the sum of (i) the bank's total risk-based capital requirement for the underlying exposures as if the bank directly held the underlying exposures; and (ii) the bank's total ECL for the underlying exposures. The ECL of the underlying exposures is included in this calculation because if the bank held the underlying exposures on its balance sheet, the bank would have had to estimate the ECL of the exposures and hold reserves or capital against the ECL. This cap ensures that a bank's effective risk-based

capital requirement for exposure to a pool of underlying exposures generally would not be greater than the applicable risk-based capital requirement if the underlying exposures were held directly by the bank, taking into consideration the agencies' safety and soundness concerns with respect to CEIOs.

This proposed maximum risk-based capital requirement would be different from the general risk-based capital rules. Under the general risk-based capital rules, banks generally are required to hold a dollar in capital for every dollar in residual interest, regardless of the effective risk-based capital requirement on the underlying exposures. The agencies adopted this dollar-for-dollar capital treatment for a residual interest to recognize that in many instances the relative size of the residual interest retained by the originating bank reveals market information about the quality of the underlying exposures and transaction structure that may not have been captured under the general risk-based capital rules. Given the significantly heightened risk sensitivity of the IRB framework, the agencies believe that the proposed maximum risk-based capital requirement in the proposed securitization framework is more appropriate.

In addition, the proposed rule would address various situations involving overlapping exposures. Consistent with the general risk-based capital rules, if a bank has multiple securitization exposures to an ABCP program that provide duplicative coverage of the underlying exposures of the program (such as when a bank provides a program-wide credit enhancement and multiple pool-specific liquidity facilities to an ABCP program), the bank is not required to hold duplicative risk-based capital against the overlapping position. Instead, the bank would apply to the overlapping position the applicable risk-based capital treatment under the securitization framework that results in the highest capital requirement. If different banks have overlapping exposures to an ABCP program, however, each bank must hold capital against the entire maximum amount of its exposure. Although duplication of capital requirements will not occur for individual banks, some systemic duplication may occur where multiple banks have overlapping exposures to the same ABCP program.

The proposed rule also addresses overlapping exposures that arise when a bank holds a securitization exposure in the form of a mortgage-backed security or participation certificate that results from a mortgage loan swap with recourse. In these situations, a bank

must determine a risk-based capital requirement for two separate exposures—the retained recourse obligation on the swapped loans and the percentage of the mortgage-backed security or participation certificate that is not covered by the recourse obligation. The total risk-based capital requirement is capped at the risk-based capital requirement for the underlying exposures as if they were held directly on the bank's balance sheet.

The proposed rule also addresses the risk-based capital treatment of a securitization of non-IRB assets. Specifically, if a bank has a securitization exposure and any underlying exposure of the securitization is not a wholesale, retail, securitization or equity exposure, the bank must (i) apply the RBA if the securitization exposure qualifies for the RBA and is not gain-on-sale or a CEIO; or (ii) otherwise, deduct the exposure from total capital. Music concert and film receivables are examples of types of assets that are not wholesale, retail, securitization, or equity exposures.

The proposed rule contains several additional exceptions to the general hierarchy. For example, in light of the substantial volatility in asset value related to prepayment risk and interest rate risk associated with interest-only mortgage-backed securities, the proposed rule provides that the risk weight for such a security may not be less than 100 percent. In addition, the proposed rule follows the general risk-based capital rules by allowing a sponsoring bank that qualifies as a primary beneficiary and must consolidate an ABCP program as a variable interest entity under GAAP to exclude the consolidated ABCP program assets from risk-weighted assets. In such cases, the bank would hold risk-based capital only against any securitization exposures of the bank to the ABCP program.⁷⁰ Moreover, the proposed rule follows the general risk-based capital rules and a Federal statute⁷¹ by including a special set of more lenient rules for the transfer of small business loans and leases with recourse by well-capitalized depository institutions.⁷²

⁷⁰ See Financial Accounting Standards Board, *Interpretation No. 46: Consolidation of Certain Variable Interest Entities* (Jan. 2003).

⁷¹ See 12 U.S.C. 1835, which places a cap on the risk-based capital requirement applicable to a well-capitalized depository institution that transfers small business loans with recourse.

⁷² The proposed rule does not expressly state that the agencies may permit adequately capitalized banks to use the small business recourse rule on a case-by-case basis because the agencies may do this under the general reservation of authority contained in section 1 of the rule.

Servicer cash advances. A traditional securitization typically employs a servicing bank that—on a day-to-day basis—collects principal, interest, and other payments from the underlying exposures of the securitization and forwards such payments to the securitization SPE or to investors in the securitization. Such servicing banks often provide to the securitization a credit facility under which the servicing bank may advance cash to ensure an uninterrupted flow of payments to investors in the securitization (including advances made to cover foreclosure costs or other expenses to facilitate the timely collection of the underlying exposures). These servicer cash advance facilities are securitization exposures, and a servicing bank must determine its risk-based capital requirement for the funded portion of any such facility by using the proposed securitization framework.

Consistent with the general risk-based capital rules with respect to residential mortgage servicer cash advances, however, a servicing bank would not be required to hold risk-based capital against the undrawn portion of an “eligible” servicer cash advance facility. Under the proposed rule, an eligible servicer cash advance facility is a servicer cash advance facility in which (i) the servicer is entitled to full reimbursement of advances (except that a servicer may be obligated to make non-reimbursable advances if any such advance with respect to any underlying exposure is limited to an insignificant amount of the outstanding principal balance of the underlying exposure); (ii) the servicer’s right to reimbursement is senior in right of payment to all other claims on the cash flows from the underlying exposures of the securitization; and (iii) the servicer has no legal obligation to, and does not, make advances to the securitization if the servicer concludes the advances are unlikely to be repaid. If these conditions are not satisfied, a bank that provides a servicer cash advance facility must determine its risk-based capital requirement for the undrawn portion of the facility in the same manner as the bank would determine its risk-based capital requirement for any other undrawn securitization exposure.

Amount of a securitization exposure. For all of the securitization approaches, the amount of an on-balance sheet securitization exposure is the bank’s carrying value, if the exposure is held-to-maturity or for trading, or the bank’s carrying value minus any unrealized gains and plus any unrealized losses on the exposure, if the exposure is available for sale. The amount of an off-

balance sheet securitization exposure is the notional amount of the exposure. For a commitment, such as a liquidity facility extended to an ABCP program, the notional amount may be reduced to the maximum potential amount that the bank currently would be required to fund under the arrangement’s documentation (that is, the amount that could be drawn given the assets held by the program). For an OTC derivative contract that is not a credit derivative, the notional amount is the EAD of the derivative contract (as calculated in section 32).

Implicit support. The proposed rule also sets forth the regulatory capital consequences if a bank provides support to a securitization in excess of the bank’s predetermined contractual obligation to provide credit support to the securitization. First, consistent with the general risk-based capital rules,⁷³ a bank that provides such implicit support must hold regulatory capital against all of the underlying exposures associated with the securitization as if the exposures had not been securitized, and must deduct from tier 1 capital any after-tax gain-on-sale resulting from the securitization. Second, the bank must disclose publicly (i) that it has provided implicit support to the securitization, and (ii) the regulatory capital impact to the bank of providing the implicit support. The bank’s primary Federal supervisor also may require the bank to hold regulatory capital against all the underlying exposures associated with some or all the bank’s other securitizations as if the exposures had not been securitized, and to deduct from tier 1 capital any after-tax gain-on-sale resulting from such securitizations.

Operational requirements for traditional securitizations. In a traditional securitization, an originating bank typically transfers a portion of the credit risk of exposures to third parties by selling them to an SPE. Banks engaging in a traditional securitization may exclude the underlying exposures from the calculation of risk-weighted assets only if each of the following conditions is met: (i) The transfer is a sale under GAAP; (ii) the originating bank transfers to third parties credit risk associated with the underlying exposures; and (iii) any clean-up calls relating to the securitization are eligible clean-up calls (as discussed below).

Originating banks that meet these conditions must hold regulatory capital against any securitization exposures they retain in connection with the securitization. Originating banks that

fail to meet these conditions must hold regulatory capital against the transferred exposures as if they had not been securitized and must deduct from tier 1 capital any gain-on-sale resulting from the transaction.

Clean-up calls. For purposes of these operational requirements, a clean-up call is a contractual provision that permits a servicer to call securitization exposures (for example, asset-backed securities) before the stated (or contractual) maturity or call date. In the case of a traditional securitization, a clean-up call is generally accomplished by repurchasing the remaining securitization exposures once the amount of underlying exposures or outstanding securitization exposures has fallen below a specified level. In the case of a synthetic securitization, the clean-up call may take the form of a clause that extinguishes the credit protection once the amount of underlying exposures has fallen below a specified level.

To satisfy the operational requirements for securitizations—and, therefore, to enable an originating bank to exclude the underlying exposures from the calculation of its risk-based capital requirements—any clean-up call associated with a securitization must be an eligible clean-up call. An eligible clean-up call is a clean-up call that:

(i) Is exercisable solely at the discretion of the servicer;

(ii) Is not structured to avoid allocating losses to securitization exposures held by investors or otherwise structured to provide credit enhancement to the securitization (for example, to purchase non-performing underlying exposures); and

(iii) (A) For a traditional securitization, is only exercisable when 10 percent or less of the principal amount of the underlying exposures or securitization exposures (determined as of the inception of the securitization) is outstanding.

(B) For a synthetic securitization, is only exercisable when 10 percent or less of the principal amount of the reference portfolio of underlying exposures (determined as of the inception of the securitization) is outstanding.

Over the last several years, the agencies have published a significant amount of supervisory guidance to assist banks with assessing the extent to which they have transferred credit risk and, consequently, may recognize any reduction in required regulatory capital as a result of a securitization or other

⁷³ Interagency Guidance on Implicit Recourse in Asset Securitizations, May 23, 2002.

form of credit risk transfer.⁷⁴ In general, the agencies would expect banks to continue to use this guidance, most of which remains applicable to the securitization framework. Banks are encouraged to consult with their primary Federal supervisor about transactions that require additional guidance.

2. Ratings-Based Approach (RBA)

Under the RBA, a bank would determine the risk-weighted asset amount for a securitization exposure that has an external rating or inferred rating by multiplying the amount of the exposure by the appropriate risk-weight provided in the tables in section 43 of the proposed rule. An originating bank must use the RBA if its retained securitization exposure has at least two external ratings or an inferred rating based on at least two external ratings; an investing bank must use the RBA if its securitization exposure has one or more external or inferred ratings. For purposes of the proposed rule, an originating bank means a bank that meets either of the following conditions: (i) The bank directly or indirectly originated or securitized the underlying exposures included in the securitization; or (ii) the securitization is an ABCP program and the bank serves as a sponsor of the ABCP program.

This two-rating requirement for originating banks is the only material difference between the treatment of originating banks and investing banks under the securitization framework. Although this two-rating requirement is not included in the New Accord, it is generally consistent with the treatment of originating and investing banks in the general risk-based capital rules. The agencies believe that the market discipline evidenced by a third party purchasing a securitization exposure obviates the need for a second rating for an investing bank. *Question 45: The agencies seek comment on this differential treatment of originating*

banks and investing banks and on alternative mechanisms that could be employed to ensure the reliability of external and inferred ratings of non-traded securitization exposures retained by originating banks.

Under the proposed rule, a bank also must use the RBA for securitization exposures with an inferred rating. Similar to the general risk-based capital rules, an unrated securitization exposure would have an inferred rating if another securitization exposure associated with the securitization transaction (that is, issued by the same issuer and backed by the same underlying exposures) has an external rating and the rated securitization exposure (i) is subordinated in all respects to the unrated securitization exposure; (ii) does not benefit from any credit enhancement that is not available to the unrated securitization exposure; and (iii) has an effective remaining maturity that is equal to or longer than the unrated securitization exposure. Under the RBA, securitization exposures with an inferred rating are treated the same as securitization exposures with an identical external rating. *Question 46: The agencies seek comment on whether they should consider other bases for inferring a rating for an unrated securitization position, such as using an applicable credit rating on outstanding long-term debt of the issuer or guarantor of the securitization exposure.*

Under the RBA, the risk-based capital requirement per dollar of securitization exposure would depend on four factors: (i) The applicable rating of the exposure; (ii) whether the rating reflects a long-term or short-term assessment of the exposure's credit risk; (iii) whether the exposure is a "senior" exposure; and (iv) a measure of the effective number ("N") of underlying exposures. For a securitization exposure with only one external or inferred rating, the applicable rating of the exposure is that external or inferred rating. For a securitization exposure with more than one external or inferred rating, the applicable rating of the exposure is the lowest external or inferred rating assigned to the exposure.

A "senior securitization exposure" is a securitization exposure that has a first priority claim on the cash flows from the underlying exposures, disregarding the claims of a service provider (such as a swap counterparty or trustee, custodian, or paying agent for a securitization) to fees from the securitization. A liquidity facility that supports an ABCP program is a senior securitization exposure if the liquidity facility provider's right to reimbursement of the drawn amounts is senior to all claims on the cash flow from the underlying exposures except claims of a service provider to fees. *Question 47: The agencies seek comment on the appropriateness of basing the risk-based capital requirement for a securitization exposure under the RBA on the seniority level of the exposure.*

Under the RBA, a bank must use Table G below when the securitization exposure's external rating represents a long-term credit rating or its inferred rating is based on a long-term credit rating. A bank must apply the risk weights in column 1 of Table G to the securitization exposure if the effective number of underlying exposures (N) is 6 or more and the securitization exposure is a senior securitization exposure. If the notional number of underlying exposures of a securitization is 25 or more or if all the underlying exposures are retail exposures, a bank may assume that N is 6 or more (unless the bank knows or has reason to know that N is less than 6). If the notional number of underlying exposures of a securitization is less than 25 and one or more of the underlying exposures is a non-retail exposure, the bank must compute N as described in the SFA section below. If N is 6 or more but the securitization exposure is not a senior securitization exposure, the bank must apply the risk weights in column 2 of Table G. A bank must apply the risk weights in column 3 of Table G to the securitization exposure if N is less than 6. *Question 48: The agencies seek comment on how well this approach captures the most important risk factors for securitization exposures of varying degrees of seniority and granularity.*

⁷⁴ See, e.g., OCC Bulletin 99-46 (Dec. 14, 1999) (OCC); FDIC Financial Institution Letter 109-99 (Dec. 13, 1999) (FDIC); SR Letter 99-37 (Dec. 13, 1999) (Board); CEO Ltr. 99-119 (Dec. 14, 1999) (OTS).

TABLE G.—LONG-TERM CREDIT RATING RISK WEIGHTS UNDER RBA AND IAA

Applicable rating (illustrative rating example)	Column 1	Column 2	Column 3
	Risk weights for senior securitization exposures backed by granular pools (percent)	Risk weights for non-senior securitization exposures backed by granular pools (percent)	Risk weights for securitization exposures backed by non-granular pools (percent)
Highest investment grade (for example, AAA)	7	12	20
Second highest investment grade (for example, AA)	8	15	25
Third-highest investment grade—positive designation (for example, A+)	10	18	35
Third-highest investment grade (for example, A)	12	20	.....
Third-highest investment grade—negative designation (for example, A–)	20	35	.....
Lowest investment grade—positive designation (for example, BBB+)	35	50	
Lowest investment grade (for example, BBB)	60	75	
Lowest investment grade—negative designation (for example, BBB–)	100		
One category below investment grade—positive designation (for example, BB+) ...	250		
One category below investment grade (for example, BB)	425		
One category below investment grade—negative designation (for example, BB–)	650		
More than one category below investment grade	Deduction from tier 1 and tier 2 capital.		

A bank must apply the risk weights in Table H when the securitization exposure's external rating represents a

short-term credit rating or its inferred rating is based on a short-term credit rating. A bank must apply the decision

rules outlined in the previous paragraph to determine which column of Table H applies.

TABLE H.—SHORT-TERM CREDIT RATING RISK WEIGHTS UNDER RBA AND IAA

Applicable rating (illustrative rating example)	Column 1	Column 2	Column 3
	Risk weights for senior securitization exposures backed by granular pools (percent)	Risk weights for non-senior securitization exposures backed by granular pools (percent)	Risk weights for securitization exposures backed by non-granular pools (percent)
Highest investment grade (for example, A1)	7	12	20
Second highest investment grade (for example, A2)	12	20	35
Third highest investment grade (for example, A3)	60	75	75
All other ratings	Deduction from tier 1 and tier 2 capital.		

Within tables G and H, risk weights increase as rating grades decline. Under column 2 of Table G, for example, the risk weights range from 12 percent for exposures with the highest investment grade rating to 650 percent for exposures rated one category below investment grade with a negative designation. This pattern of risk weights is broadly consistent with analyses employing standard credit risk models and a range of assumptions regarding correlation effects and the types of exposures being securitized.⁷⁵ These analyses imply that, compared with a corporate bond having a given level of stand-alone credit risk (for example, as

measured by its expected loss rate), a securitization tranche having the same level of stand-alone credit risk—but backed by a reasonably granular and diversified pool—will tend to exhibit more systematic risk.⁷⁶ This effect is most pronounced for below-investment-grade tranches and is the primary reason why the RBA risk-weights increase rapidly as ratings deteriorate over this range—much more rapidly than for similarly rated corporate bonds.

Under the RBA, a securitization exposure that has an investment grade rating and has fewer than six effective underlying exposures generally receives a higher risk weight than a similarly

rated securitization exposure with six or more effective underlying exposures. The agencies have designed the risk weights in this manner to discourage a bank from engaging in regulatory capital arbitrage by securitizing very high-quality wholesale exposures (that is, wholesale exposures with a low PD and LGD), obtaining external ratings on the securitization exposures issued by the securitization, and retaining essentially all the credit risk of the pool of underlying exposures.

Consistent with the ANPR, the proposed rule requires a bank to deduct from regulatory capital any securitization exposure with an external or inferred rating below one category below investment grade for long-term ratings or below investment grade for short-term ratings. Several commenters

⁷⁵ See Vladislav Peretyatkin and William Perraudin, "Capital for Asset-Backed Securities," Bank of England, February 2003.

⁷⁶ See, e.g., Michael Pykhtin and Ashish Dev, "Credit Risk in Asset Securitizations: An Analytical Model," *Risk* (May 2002) S16–S20.

argued that this deduction is excessive in light of the credit risk of such exposures. Although this proposed capital treatment is more conservative than suggested by credit risk modeling analyses, the agencies have decided to retain the deduction approach for low-non-investment grade exposures. The agencies believe that there are significant modeling uncertainties for such low-rated securitization tranches. Moreover, external ratings of these tranches are subject to less market discipline because these positions generally are retained by the bank.

The proposed RBA differs in several important respects from the RBA in the ANPR. First, under the ANPR, an originating bank (but not an investing bank) would have to deduct from regulatory capital the amount of any securitization exposure below the risk-based capital requirement for the underlying exposures as if they were held directly by the bank, regardless of whether the exposure would have qualified for a lower risk-based capital requirement under the RBA. The agencies took this position in the ANPR, in part, to provide incentives for originating banks to shed deeply subordinated, high risk, difficult-to-value securitization exposures. The agencies also were concerned that an external credit rating may be less reliable when the rating applies to a retained, non-traded exposure and is sought by an originating bank primarily for regulatory capital purposes. Numerous commenters criticized this aspect of the ANPR as lacking risk sensitivity and inconsistently treating originating and investing banks. After further review, the agencies have concluded that the risk sensitivity and logic of the securitization framework would be enhanced by permitting originating banks and investing banks to use the RBA on generally equal terms. The agencies have revised the RBA to permit originating banks to use the RBA even if the retained securitization exposure is below the risk-based capital requirement for the underlying exposures as if they were held directly by the bank.

In addition, the agencies have enhanced the risk sensitivity of the RBA in the ANPR by introducing more risk-weight gradations for securitization exposures with a long-term external or inferred rating in the third-highest investment grade rating category. Although the ANPR RBA applied the same risk weight to all securitization exposures with long-term external ratings in the third-highest investment grade rating category, the proposed rule provides three different risk weights to

securitization exposures that have long-term external ratings in the third-highest investment grade rating category depending on whether the rating has positive, negative, or no designation.

The agencies also have modified the ANPR RBA to expand the set of lower risk-weights applicable to the most senior tranches of reasonably granular securitizations to better reflect the low systematic risk of such tranches. For example, under the ANPR, certain relatively senior tranches of reasonably granular securitizations with long-term external ratings in the two highest investment grade rating categories received a lower risk-weight than more subordinated tranches of the same securitizations. Under the proposed rule, the most senior tranches of reasonably granular securitizations with long-term investment grade external ratings receive a more favorable risk-weight as compared to more subordinated tranches of the same securitizations. In addition, in response to comments, the agencies have reduced the granularity requirement for a senior securitization exposure to qualify for the lower risk weights. Under the ANPR RBA, only securitization exposures to a securitization that has an N of 100 or more could qualify for the lower risk-weights. Under the proposed rule, securitization exposures to a securitization that has an N of 6 or more would qualify for the lower risk weights.

Although the proposed rule's RBA expands the availability of the lower risk weights for senior securitization exposures in several respects, it also has a more conservative but simpler definition of a senior securitization exposure. The ANPR RBA imposed a mathematical test for determining the relative seniority of a securitization tranche. This test allowed the designation of multiple senior securitization tranches for a particular securitization. By contrast, the proposed RBA designates the most senior securitization tranche in a particular securitization as the only securitization tranche eligible for the lower risk weights.

In addition, some commenters argued that the ANPR RBA risk weights for highly-rated senior retail securitization exposures were excessive in light of the credit risk associated with such exposures. The agencies have determined that empirical research on this point (including that provided by commenters) is inconclusive and does not warrant a reduction in the RBA risk weights of these exposures.

3. Internal Assessment Approach (IAA)

The proposed rule permits a bank to compute its risk-based capital requirement for a securitization exposure to an ABCP program (such as a liquidity facility or credit enhancement) using the bank's internal assessment of the credit quality of the securitization exposure. To do so, the bank's internal assessment process and the ABCP program must meet certain qualification requirements in section 44 of the proposed rule, and the securitization exposure must initially be internally rated at least equivalent to investment grade. A bank that elects to use the IAA for any securitization exposure to an ABCP program must use the IAA to compute risk-based capital requirements for all securitization exposures that qualify for the IAA approach. Under the IAA, a bank would map its internal credit assessment of a securitization exposure to an equivalent external credit rating from an NRSRO. The bank would determine the risk-weighted asset amount for a securitization exposure by multiplying the amount of the exposure (using the methodology set forth above in the RBA section) by the appropriate risk weight provided in Table G or H above.

The agencies included the IAA for securitization exposures to ABCP programs in response to comments on the ANPR. The ANPR indicated that the agencies expected banks to use the SFA or a "Look-Through Approach" to determine risk-based capital requirements for exposures to ABCP programs. Under the Look-Through Approach, a bank would determine its risk-based capital requirement for an eligible liquidity facility provided to an ABCP program by multiplying (i) 8 percent; (ii) the maximum potential drawdown on the facility; (iii) an applicable conversion factor of between 50 and 100 percent; and (iv) the applicable risk weight (which would typically be 100 percent). Commenters expressed concern that ABCP program sponsors would not have sufficient data about the underlying exposures in the ABCP program to use the SFA and that the Look-Through Approach produced economically unreasonable capital requirements for these historically safe credit exposures. The agencies are proposing to replace the Look-Through Approach with the IAA, which is similar to an approach already available to qualifying banks under the general risk-based capital rules for credit enhancements to ABCP programs and which the agencies believe would provide a more risk-sensitive and economically appropriate risk-based

capital treatment for bank exposures to ABCP programs.

To use the IAA, a bank must receive prior written approval from its primary Federal supervisor. To receive such approval, the bank would have to demonstrate that its internal credit assessment process satisfies all the following criteria. The bank's internal credit assessments of securitization exposures to ABCP programs must be based on publicly available rating criteria used by an NRSRO for evaluating the credit risk of the underlying exposures. The bank's internal credit assessments of securitization exposures used for regulatory capital purposes must be consistent with those used in the bank's internal risk management process, capital adequacy assessment process, and management information reporting systems.

In addition, the bank's internal credit assessment process must have sufficient granularity to identify gradations of risk. Each of the bank's internal credit assessment categories must correspond to an external credit rating of an NRSRO. The proposed rule also requires that the bank's internal credit assessment process, particularly the stress test factors for determining credit enhancement requirements, be at least as conservative as the most conservative of the publicly available rating criteria of the NRSROs that have provided external credit ratings to the commercial paper issued by the ABCP program.

Moreover, the bank must have an effective system of controls and oversight that ensures compliance with these operational requirements and maintains the integrity of the internal credit assessments. The bank must review and update each internal credit assessment whenever new material information is available, but no less

frequently than annually. The bank must also validate its internal credit assessment process on an ongoing basis, but not less frequently than annually.

To use the IAA on a specific exposure to an ABCP program, the program must exhibit the following characteristics:

(i) All the commercial paper issued by the ABCP program must have an external rating.

(ii) The ABCP program must have robust credit and investment guidelines (that is, underwriting standards).

(iii) The ABCP program must perform a detailed credit analysis of the asset sellers' risk profiles.

(iv) The ABCP program's underwriting policy must establish minimum asset eligibility criteria that include a prohibition of the purchase of assets that are significantly past due or defaulted, as well as limitations on concentrations to an individual obligor or geographic area and the tenor of the assets to be purchased.

(v) The aggregate estimate of loss on an asset pool that the ABCP program is considering purchasing must consider all sources of potential risk, such as credit and dilution risk.

(vi) The ABCP program must incorporate structural features into each purchase of assets to mitigate potential credit deterioration of the underlying exposures. Such features may include wind-down triggers specific to a pool of underlying exposures.

4. Supervisory Formula Approach (SFA)

General requirements. Under the SFA, a bank would determine the risk-weighted asset amount for a securitization exposure by multiplying the SFA risk-based capital requirement for the exposure (as determined by the supervisory formula set forth below) by 12.5. If the SFA risk weight for a securitization exposure is 1,250 percent or greater, however, the bank must

deduct the exposure from total capital rather than risk weight the exposure. Deduction is consistent with the treatment of other high-risk securitization exposures, such as CEIOs.

The SFA capital requirement for a securitization exposure depends on the following seven inputs:

(i) The amount of the underlying exposures (UE);

(ii) The securitization exposure's proportion of the tranche in which it resides (TP);

(iii) The sum of the risk-based capital requirement and ECL for the underlying exposures as if they were held directly on the bank's balance sheet divided by the amount of the underlying exposures (K_{IRB});

(iv) The tranche's credit enhancement level (L);

(v) The tranche's thickness (T);

(vi) The securitization's effective number of underlying exposures (N); and

(vii) The securitization's exposure-weighted average loss given default (EWALGD).

A bank may only use the SFA to determine its risk-based capital requirement for a securitization exposure if the bank can calculate each of these seven inputs on an ongoing basis. In particular, if a bank cannot compute K_{IRB} because the bank cannot compute the risk-based capital requirement for all underlying exposures, the bank may not use the SFA to compute its risk-based capital requirement for the securitization exposure. In those cases, the bank would deduct the exposure from regulatory capital.

The SFA capital requirement for a securitization exposure is UE multiplied by TP multiplied by the greater of (i) $0.0056 * T$; or (ii) $S[L+T] - S[L]$, where:

$$(i) S[Y] = \begin{cases} Y & \text{when } Y \leq K_{IRB} \\ K_{IRB} + K[Y] - K[K_{IRB}] + \frac{d \cdot K_{IRB}}{20} \left(1 - e^{-\frac{20 \cdot (K_{IRB} - Y)}{K_{IRB}}} \right) & \text{when } Y > K_{IRB} \end{cases}$$

$$(ii) K[Y] = (1 - h) \cdot [(1 - \beta[Y; a, b]) \cdot Y + \beta[Y; a + 1, b] \cdot c]$$

$$(iii) h = \left(1 - \frac{K_{IRB}}{EWALGD} \right)^N$$

$$(iv) a = g \cdot c$$

$$(v) \ b = g \cdot (1 - c)$$

$$(vi) \ c = \frac{K_{IRB}}{1 - h}$$

$$(vii) \ g = \frac{(1 - c) \cdot c}{f} - 1$$

$$(viii) \ f = \frac{v + K_{IRB}^2}{1 - h} - c^2 + \frac{(1 - K_{IRB}) \cdot K_{IRB} - v}{(1 - h) \cdot 1000}$$

$$(ix) \ v = K_{IRB} \cdot \frac{(EWALGD - K_{IRB}) + .25 \cdot (1 - EWALGD)}{N}$$

$$(x) \ d = 1 - (1 - h) \cdot (1 - \beta[K_{IRB}; a, b])$$

In these expressions, $\beta[Y; a, b]$ refers to the cumulative beta distribution with parameters a and b evaluated at Y . In the case where $N=1$ and $EWALGD=100$ percent, $S[Y]$ in formula (1) must be calculated with $K[Y]$ set equal to the product of K_{IRB} and Y , and d set equal to $1 - K_{IRB}$. The major inputs to the SFA formula (UE , TP , K_{IRB} , L , T , $EWALGD$, and N) are defined below and in section 45 of the proposed rule.

The SFA formula effectively imposes a 56 basis point minimum risk-based capital requirement (8 percent of the 7 percent risk weight) per dollar of securitization exposure. A number of commenters on the ANPR contended that this floor capital requirement in the SFA would be excessive for many senior securitization exposures. Although such a floor may impose a capital requirement that is too high for some securitization exposures, the agencies continue to believe that some minimum prudential capital requirement is appropriate in the securitization context. This 7 percent risk-weight floor is also consistent with the lowest capital requirement available under the RBA and, thus, should reduce incentives for regulatory capital arbitrage.

The SFA formula is a blend of credit risk modeling results and supervisory judgment. The function $S[Y]$ incorporates two distinct features. First, a pure model-based estimate of the pool's aggregate systematic or non-diversifiable credit risk that is attributable to a first loss position covering losses up to and including Y . Because the tranche of interest covers losses over a specified range (defined in

terms of L and T), the tranche's systematic risk can be represented as $S[L+T] - S[L]$. The second feature involves a supervisory add-on primarily intended to avoid behavioral distortions associated with what would otherwise be a discontinuity in capital requirements for relatively thin mezzanine tranches lying just below and just above the K_{IRB} boundary: all tranches at or below K_{IRB} would be deducted from capital, whereas a very thin tranche just above K_{IRB} would incur a pure model-based percentage capital requirement that could vary between zero and one, depending on the number of effective underlying exposures (N). The supervisory add-on applies primarily to positions just above K_{IRB} , and its quantitative effect diminishes rapidly as the distance from K_{IRB} widens.

Under the SFA, a bank must deduct from regulatory capital any securitization exposures (or parts thereof) that absorb losses at or below the level of K_{IRB} . However, the specific securitization exposures that are subject to this deduction treatment under the SFA may change over time in response to variation in the credit quality of the pool of underlying exposures. For example, if the pool's IRB capital requirement were to increase after the inception of a securitization, additional portions of unrated securitization exposures may fall below K_{IRB} and thus become subject to deduction under the SFA. Therefore, if a bank owns an unrated first-loss securitization exposure well in excess of K_{IRB} , the

capital requirement on the exposure could climb rapidly in the event of marked deterioration in the credit quality of the underlying exposures.

Apart from the risk-weight floor and other supervisory adjustments described above, the supervisory formula attempts to be as consistent as possible with the parameters and assumptions of the IRB framework that would apply to the underlying exposures if held directly by a bank.⁷⁷ The specification of $S[Y]$ assumes that K_{IRB} is an accurate measure of the total systematic credit risk of the pool of underlying exposures and that a securitization merely redistributes this systematic risk among its various tranches. In this way, $S[Y]$ embodies precisely the same asset correlations as are assumed elsewhere within the IRB framework. In addition, this specification embodies the result that a pool's systematic risk (that is, K_{IRB}) tends to be redistributed toward more senior tranches as the effective number of underlying exposures in the pool (N) declines.⁷⁸ The importance of pool granularity depends on the pool's average loss severity rate, $EWALGD$. For small values of N , the framework implies that, as $EWALGD$ increases, systematic risk is shifted toward senior tranches. For highly granular pools, such as securitizations of retail exposures, $EWALGD$ would have no

⁷⁷ The conceptual basis for specification of $K[x]$ is developed in Michael B. Gordy and David Jones, "Random Tranches," *Risk*, (Mar. 2003) 78–83.

⁷⁸ See Michael Pykhtin and Ashish Dev, "Coarse-grained CDOs," *Risk* (Jan. 2003) 113–116.

influence on the SFA capital requirement.

Inputs to the SFA formula. The proposed rule provides the following definitions of the seven inputs into the SFA formula.

(i) *Amount of the underlying exposures (UE).* This input (measured in dollars) is the EAD of any underlying wholesale and retail exposures plus the amount of any underlying exposures that are securitization exposures (as defined in section 42(e) of the proposed rule) plus the adjusted carrying value of any underlying equity exposures (as defined in section 51(b) of the proposed rule). UE also would include any funded spread accounts, cash collateral accounts, and other similar funded credit enhancements.

(ii) *Tranche percentage (TP).* TP is the ratio of (i) the amount of the bank's securitization exposure to (ii) the amount of the securitization tranche that contains the bank's securitization exposure.

(iii) K_{IRB} . K_{IRB} is the ratio of (i) the risk-based capital requirement for the underlying exposures plus the ECL of the underlying exposures (all as determined as if the underlying exposures were directly held by the bank) to (ii) UE. The definition of K_{IRB} includes the ECL of the underlying exposures in the numerator because if the bank held the underlying exposures on its balance sheet, the bank also would hold reserves against the exposures.

The calculation of K_{IRB} must reflect the effects of any credit risk mitigant applied to the underlying exposures (either to an individual underlying exposure, a group of underlying exposures, or to the entire pool of underlying exposures). In addition, all assets related to the securitization are to be treated as underlying exposures for purposes of the SFA, including assets in a reserve account (such as a cash collateral account).

(iv) *Credit enhancement level (L).* L is the ratio of (i) the amount of all securitization exposures subordinated to the securitization tranche that contains the bank's securitization exposure to (ii) UE. Banks must determine L before considering the effects of any tranche-specific credit enhancements (such as third-party guarantees that benefit only a single tranche). Any after-tax gain-on-sale or CEIOs associated with the securitization may not be included in L.

Any reserve account funded by accumulated cash flows from the

underlying exposures that is subordinated to the tranche that contains the bank's securitization exposure may be included in the numerator and denominator of L to the extent cash has accumulated in the account. Unfunded reserve accounts (that is, reserve accounts that are to be funded from future cash flows from the underlying exposures) may not be included in the calculation of L.

In some cases, the purchase price of receivables will reflect a discount that provides credit enhancement (for example, first loss protection) for all or certain tranches. When this arises, L should be calculated inclusive of this discount if the discount provides credit enhancement for the securitization exposure.

(v) *Thickness of tranche (T).* T is the ratio of (i) the size of the tranche that contains the bank's securitization exposure to (ii) UE.

(vi) *Effective number of exposures (N).* As a general matter, the effective number of exposures would be calculated as follows:

$$N = \frac{\left(\sum_i EAD_i \right)^2}{\sum_i EAD_i^2}$$

where EAD_i represents the EAD associated with the i^{th} instrument in the pool of underlying exposures. For purposes of computing N, multiple exposures to one obligor must be treated as a single underlying exposure. In the case of a re-securitization (that is, a securitization in which some or all of the underlying exposures are themselves securitization exposures), a bank must treat each underlying securitization exposure as a single exposure and must not look through to the exposures that secure the underlying securitization exposures. The agencies recognize that this simple and conservative approach to re-securitizations may result in the differential treatment of economically similar securitization exposures. *Question 49: The agencies seek comment on suggested alternative approaches for determining the N of a re-securitization.*

N represents the granularity of a pool of underlying exposures using an "effective" number of exposures concept rather than a "gross" number of exposures concept to appropriately assess the diversification of pools that

have individual underlying exposures of different sizes. An approach that simply counts the gross number of underlying exposures in a pool treats all exposures in the pool equally. This simplifying assumption could radically overestimate the granularity of a pool with numerous small exposures and one very large exposure. The effective exposure approach captures the notion that the risk profile of such an unbalanced pool is more like a pool of several medium-sized exposures than like a pool of a large number of equally sized small exposures.

For example, suppose Pool A contains four loans with EADs of \$100 each. Under the formula set forth above, N for Pool A would be four, precisely equal to the actual number of exposures. Suppose Pool B also contains four loans: One loan with an EAD of \$100 and three loans with an EAD of \$1. Although both pools contain four loans, Pool B is much less diverse and granular than Pool A because Pool B is dominated by the presence of a single \$100 loan. Intuitively, therefore, N for Pool B should be closer to one than to four. Under the formula in the rule, N for Pool B is calculated as follows:

$$N = \frac{(100 + 1 + 1 + 1)^2}{100^2 + 1^2 + 1^2 + 1^2} = \frac{10,609}{10,003} = 1.06$$

(vii) *Exposure-weighted average loss given default (EWALGD).* The EWALGD is calculated as:

$$EWALGD = \frac{\sum_i LGD_i \cdot EAD_i}{\sum_i EAD_i}$$

where LGD_i represents the average LGD associated with all exposures to the i^{th} obligor. In the case of a re-securitization, an LGD of 100 percent must be assumed for any underlying exposure that is itself a securitization exposure.

Under certain conditions, a bank may employ the following simplifications to the SFA. First, for securitizations all of whose underlying exposures are retail exposures, a bank may set $h = 0$ and $v = 0$. In addition, if the share of a securitization corresponding to the largest underlying exposure (C_1) is no more than 0.03 (or 3 percent of the underlying exposures), then for purposes of the SFA the bank may set $EWALGD = 0.50$ and N equal to the following amount:

$$N = \frac{1}{C_1 C_m + \left(\frac{C_m - C_1}{m-1} \right) \max(1 - mC_1, 0)}$$

where C_m is the ratio of (i) the sum of the amounts of the largest 'm' underlying exposures of the securitization; to (ii) UE. A bank may select the level of 'm' in its discretion. For example, if the three largest underlying exposures of a securitization represent 15 percent of the pool of underlying exposures, C_3 for the securitization is 0.15. As an alternative simplification option, if only C_1 is available, and C_1 is no more than 0.03, then the bank may set EWALGD=0.50 and $N=1/C_1$.

5. Eligible Disruption Liquidity Facilities

The version of the SFA contained in the New Accord provides a more favorable capital treatment for eligible disruption liquidity facilities than for other securitization exposures. Under the New Accord, an eligible disruption liquidity facility is a liquidity facility that supports an ABCP program and that (i) is subject to an asset quality test that precludes funding of underlying exposures that are in default; (ii) can be used to fund only those exposures that have an investment grade external rating at the time of funding, if the underlying exposures that the facility must fund against are externally rated exposures at the time that the exposures are sold to the program; and (iii) may only be drawn in the event of a general market disruption. Under the New Accord, a bank that uses the SFA to compute its risk-based capital requirement for an eligible disruption liquidity facility may multiply the facility's SFA-determined risk weight by 20 percent. *Question 50: The agencies have not included this concept in the proposed rule but seek comment on the prevalence of eligible disruption liquidity facilities and a bank's expected use of the SFA to calculate risk-based capital requirements for such facilities.*

6. Credit Risk Mitigation for Securitization Exposures

An originating bank that has obtained a credit risk mitigant to hedge its securitization exposure to a synthetic or traditional securitization that satisfies the operational criteria in section 41 of the proposed rule may recognize the credit risk mitigant, but only as provided in section 46 of the proposed rule. An investing bank that has obtained a credit risk mitigant to hedge

a securitization exposure also may recognize the credit risk mitigant, but only as provided in section 46. A bank that has used the RBA or IAA to calculate its risk-based capital requirement for a securitization exposure whose external or inferred rating (or equivalent internal rating under the IAA) reflects the benefits of a particular credit risk mitigant provided to the associated securitization or that supports some or all of the underlying exposures, however, may not use the securitization credit risk mitigation rules to further reduce its risk-based capital requirement for the exposure based on that credit risk mitigant. For example, a bank that owns a AAA-rated asset-backed security that benefits, along with all the other securities issued by the securitization SPE, from an insurance wrap that is part of the securitization transaction would calculate its risk-based capital requirement for the security strictly under the RBA; no additional credit would be given for the presence of the insurance wrap. On the other hand, if a bank owns a BBB-rated asset-backed security and obtains a credit default swap from a AAA-rated counterparty to protect the bank from losses on the security, the bank would be able to apply the securitization CRM rules to recognize the risk mitigating effects of the credit default swap and determine the risk-based capital requirement for the position.

The proposed rule contains a separate treatment of CRM for securitization exposures (versus wholesale and retail exposures) because the wholesale and retail exposure CRM approaches rely on substitutions of, or adjustments to, the risk parameters of the hedged exposure. Because the securitization framework does not rely on risk parameters to determine risk-based capital requirements for securitization exposures, a different treatment of CRM for securitization exposures is necessary.

The securitization CRM rules, like the wholesale and retail CRM rules, address collateral separately from guarantees and credit derivatives. A bank is not permitted to recognize collateral other than financial collateral as a credit risk mitigant for securitization exposures. A bank may recognize financial collateral in determining the bank's risk-based capital requirement for a securitization

exposure using a collateral haircut approach. The bank's risk-based capital requirement for a collateralized securitization exposure is equal to the risk-based capital requirement for the securitization exposure as calculated under the RBA or the SFA multiplied by the ratio of adjusted exposure amount (E^*) to original exposure amount (E), where:

(i) $E^* = \max \{0, [E - C \times (1 - H_s - H_{fx})]\}$;

(ii) E = the amount of the securitization exposure (as calculated under section 42(e) of the proposed rule);

(iii) C = the current market value of the collateral;

(iv) H_s = the haircut appropriate to the collateral type; and

(v) H_{fx} = the haircut appropriate for any currency mismatch between the collateral and the exposure.

Where the collateral is a basket of different asset types or a basket of assets denominated in different currencies, the haircut on the basket will be

$$H = \sum_i a_i H_i,$$

where a_i is the current market value of the asset in the basket divided by the current market value of all assets in the basket and H_i is the haircut applicable to that asset.

With the prior written approval of its primary Federal supervisor, a bank may calculate haircuts using its own internal estimates of market price volatility and foreign exchange volatility, subject to the requirements for use of own-estimates haircuts contained in section 32 of the proposed rule. Banks that use own-estimates haircuts for collateralized securitization exposures must assume a minimum holding period (T_M) for securitization exposures of 65 business days.

A bank that does not qualify for and use own-estimates haircuts must use the collateral type haircuts (H_s) in Table 3 of this preamble and must use a currency mismatch haircut (H_{fx}) of 8 percent if the exposure and the collateral are denominated in different currencies. To reflect the longer-term nature of securitization exposures as compared to eligible margin loans and OTC derivative contracts, however, these standard supervisory haircuts (which are based on a 10-business-day holding period and daily marking-to-

market and remargining) must be adjusted to a 65-business-day holding period (the approximate number of business days in a calendar quarter) by multiplying them by the square root of 6.5 (2.549510). A bank also must adjust the standard supervisory haircuts upward on the basis of a holding period longer than 65 business days where and as appropriate to take into account the illiquidity of an instrument.

A bank may only recognize an eligible guarantee or eligible credit derivative provided by an eligible securitization guarantor in determining the bank's risk-based capital requirement for a securitization exposure. Eligible guarantee and eligible credit derivative are defined the same way as in the CRM rules for wholesale and retail exposures. An eligible securitization guarantor is defined to mean (i) a sovereign entity, the Bank for International Settlements, the International Monetary Fund, the European Central Bank, the European Commission, a Federal Home Loan Bank, the Federal Agricultural Mortgage Corporation (Farmer Mac), a multi-lateral development bank, a depository institution (as defined in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813)), a bank holding company (as defined in section 2 of the Bank Holding Company Act (12 U.S.C. 1841)), a savings and loan holding company (as defined in 12 U.S.C. 1467a) provided all or substantially all of the holding company's activities are permissible for a financial holding company under 12 U.S.C. 1843(k)), a foreign bank (as defined in section 211.2 of the Federal Reserve Board's Regulation K (12 CFR 211.2)), or a securities firm; (ii) any other entity (other than an SPE) that has issued and outstanding an unsecured long-term debt security without credit enhancement that has a long-term applicable external rating in one of the three highest investment grade rating categories; or (iii) any other entity (other than an SPE) that has a PD assigned by the bank that is lower than or equivalent to the PD associated with a long-term external rating in the third-highest investment grade rating category.

A bank may recognize an eligible guarantee or eligible credit derivative provided by an eligible securitization guarantor in determining the bank's risk-based capital requirement for the securitization exposure as follows. If the protection amount of the eligible guarantee or eligible credit derivative equals or exceeds the amount of the securitization exposure, then the bank may set the risk-weighted asset amount for the securitization exposure equal to the risk-weighted asset amount for a direct exposure to the eligible

securitization guarantor (as determined in the wholesale risk weight function described in section 31 of the proposed rule), using the bank's PD for the guarantor, the bank's ELGD and LGD for the guarantee or credit derivative, and an EAD equal to the amount of the securitization exposure (as determined in section 42(e) of the proposed rule).

If, on the other hand, the protection amount of the eligible guarantee or eligible credit derivative is less than the amount of the securitization exposure, then the bank must divide the securitization exposure into two exposures in order to recognize the guarantee or credit derivative. The risk-weighted asset amount for the securitization exposure is equal to the sum of the risk-weighted asset amount for the covered portion and the risk-weighted asset amount for the uncovered portion. The risk-weighted asset amount for the covered portion is equal to the risk-weighted asset amount for a direct exposure to the eligible securitization guarantor (as determined in the wholesale risk weight function described in section 31 of the proposed rule), using the bank's PD for the guarantor, the bank's ELGD and LGD for the guarantee or credit derivative, and an EAD equal to the protection amount of the credit risk mitigant. The risk-weighted asset amount for the uncovered portion is equal to the product of (i) 1.0 minus (the protection amount of the eligible guarantee or eligible credit derivative divided by the amount of the securitization exposure); and (ii) the risk-weighted asset amount for the securitization exposure without the credit risk mitigant (as determined in sections 42–45 of the proposed rule).

For any hedged securitization exposure, the bank must make applicable adjustments to the protection amount as required by the maturity mismatch, currency mismatch, and lack of restructuring provisions in paragraphs (d), (e), and (f) of section 33 of the proposed rule. If the risk-weighted asset amount for a guaranteed securitization exposure is greater than the risk-weighted asset amount for the securitization exposure without the guarantee or credit derivative, a bank may always elect not to recognize the guarantee or credit derivative.

When a bank recognizes an eligible guarantee or eligible credit derivative provided by an eligible securitization guarantor in determining the bank's risk-based capital requirement for a securitization exposure, the bank also must (i) calculate ECL for the exposure using the same risk parameters that it uses for calculating the risk-weighted asset amount of the exposure (that is,

the PD associated with the guarantor's rating grade, the ELGD and LGD of the guarantee, and an EAD equal to the protection amount of the credit risk mitigant); and (ii) add this ECL to the bank's total ECL.

7. Synthetic Securitizations

Background. In a synthetic securitization, an originating bank uses credit derivatives or guarantees to transfer the credit risk, in whole or in part, of one or more underlying exposures to third-party protection providers. The credit derivative or guarantee may be either collateralized or uncollateralized. In the typical synthetic securitization, the underlying exposures remain on the balance sheet of the originating bank, but a portion of the originating bank's credit exposure is transferred to the protection provider or covered by collateral pledged by the protection provider.

In general, the proposed rule's treatment of synthetic securitizations is identical to that of traditional securitizations. The operational requirements for synthetic securitizations are more detailed than those for traditional securitizations and are intended to ensure that the originating bank has truly transferred credit risk of the underlying exposures to one or more third-party protection providers.

Although synthetic securitizations typically employ credit derivatives, which might suggest that such transactions would be subject to the CRM rules in section 33 of the proposed rule, banks must first apply the securitization framework when calculating risk-based capital requirements for a synthetic securitization exposure. Banks may ultimately be redirected to the securitization CRM rules to adjust the securitization framework capital requirement for an exposure to reflect the CRM technique used in the transaction.

Operational requirements for synthetic securitizations. For synthetic securitizations, an originating bank may recognize for risk-based capital purposes the use of CRM to hedge, or transfer credit risk associated with, underlying exposures only if each of the following conditions is satisfied:

(i) The credit risk mitigant is financial collateral, an eligible credit derivative from an eligible securitization guarantor (defined above), or an eligible guarantee from an eligible securitization guarantor.

(ii) The bank transfers credit risk associated with the underlying exposures to third-party investors, and

the terms and conditions in the credit risk mitigants employed do not include provisions that:

(A) Allow for the termination of the credit protection due to deterioration in the credit quality of the underlying exposures;

(B) Require the bank to alter or replace the underlying exposures to improve the credit quality of the underlying exposures;

(C) Increase the bank's cost of credit protection in response to deterioration in the credit quality of the underlying exposures;

(D) Increase the yield payable to parties other than the bank in response to a deterioration in the credit quality of the underlying exposures; or

(E) Provide for increases in a retained first loss position or credit enhancement provided by the bank after the inception of the securitization.

(iii) The bank obtains a well-reasoned opinion from legal counsel that confirms the enforceability of the credit risk mitigant in all relevant jurisdictions.

(iv) Any clean-up calls relating to the securitization are eligible clean-up calls (as discussed above).

Failure to meet the above operational requirements for a synthetic securitization would prevent the originating bank from using the securitization framework and would require the originating bank to hold risk-based capital against the underlying exposures as if they had not been synthetically securitized. A bank that provides credit protection to a synthetic securitization must use the securitization framework to compute risk-based capital requirements for its exposures to the synthetic securitization even if the originating bank failed to meet one or more of the operational requirements for a synthetic securitization.

Consistent with the treatment of traditional securitization exposures, banks would be required to use the RBA for synthetic securitization exposures that have an appropriate number of external or inferred ratings. For an originating bank, the RBA would typically be used only for the most senior tranche of the securitization, which often would have an inferred rating. If a bank has a synthetic securitization exposure that does not have an external or inferred rating, the bank would apply the SFA to the exposure (if the bank and the exposure qualify for use of the SFA) without considering any CRM obtained as part of the synthetic securitization. Then, if the bank has obtained a credit risk mitigant on the exposure as part of the synthetic

securitization, the bank would apply the securitization CRM rules to reduce its risk-based capital requirement for the exposure. For example, if the credit risk mitigant is financial collateral, the bank must use the standard supervisory or own-estimates haircuts to reduce its risk-based capital requirement. If the bank is a protection provider to a synthetic securitization and has obtained a credit risk mitigant on its exposure, the bank would also apply the securitization CRM rules in section 46 of the proposed rule to reduce its risk-based capital requirement on the exposure. If neither the RBA nor the SFA is available, a bank would deduct the exposure from regulatory capital.

First-loss tranches. If a bank has a first-loss position in a pool of underlying exposures in connection with a synthetic securitization, the bank must deduct the position from regulatory capital unless (i) the position qualified for use of the RBA or (ii) the bank and the position qualified for use of the SFA and a portion of the position was above KIRB.

Mezzanine tranches. In a typical synthetic securitization, an originating bank obtains credit protection on a mezzanine, or second-loss, tranche of a synthetic securitization by either (i) obtaining a credit default swap or financial guarantee from a third-party financial institution; or (ii) obtaining a credit default swap or financial guarantee from an SPE whose obligations are secured by financial collateral.

For a bank that creates a synthetic mezzanine tranche by obtaining an eligible credit derivative or guarantee from an eligible securitization guarantor, the bank generally would treat the notional amount of the credit derivative or guarantee (as adjusted to reflect any maturity mismatch, lack of restructuring coverage, or currency mismatch) as a wholesale exposure to the protection provider and use the IRB framework for wholesale exposures to determine the bank's risk-based capital requirement for the exposure. A bank that creates the synthetic mezzanine tranche by obtaining a guarantee or credit derivative that is collateralized by financial collateral but provided by a non-eligible securitization guarantor generally would (i) first use the SFA to calculate the risk-based capital requirement on the exposure (ignoring the guarantee or credit derivative and the associated collateral); and (ii) then use the securitization CRM rules to calculate any reductions to the risk-based capital requirement resulting from the associated collateral. The bank may look only to the protection provider

from which it obtains the guarantee or credit derivative when determining its risk-based capital requirement for the exposure (that is, if the protection provider hedges the guarantee or credit derivative with a guarantee or credit derivative from a third party, the bank may not look through the protection provider to that third party when calculating its risk-based capital requirement for the exposure).

For a bank providing credit protection on a mezzanine tranche of a synthetic securitization, the bank would use the RBA to determine the risk-based capital requirement for the exposure if the exposure has an external or inferred rating. If the exposure does not have an external or inferred rating and the exposure qualifies for use of the SFA, the bank would use the SFA to calculate the risk-based capital requirement for the exposure. If neither the RBA nor the SFA are available, the bank would deduct the exposure from regulatory capital. If a bank providing credit protection on the mezzanine tranche of a synthetic securitization obtains a credit risk mitigant to hedge its exposure, the bank could apply the securitization CRM rules to reflect the risk reduction achieved by the credit risk mitigant.

Super-senior tranches. A bank that has the most senior position in a pool of underlying exposures in connection with a synthetic securitization would use the RBA to calculate its risk-based capital requirement for the exposure if the exposure has at least one external or inferred rating (in the case of an investing bank) or at least two external or inferred ratings (in the case of an originating bank). If the super-senior tranche does not have an external or inferred rating and the bank and the exposure qualify for use of the SFA, the bank would use the SFA to calculate the risk-based capital requirement for the exposure. If neither the RBA nor the SFA are available, the bank would deduct the exposure from regulatory capital. If an investing bank in the super-senior tranche of a synthetic securitization obtains a credit risk mitigant to hedge its exposure, however, the investing bank may apply the securitization CRM rules to reflect the risk reduction achieved by the credit risk mitigant.

8. Nth To Default Credit Derivatives

Credit derivatives that provide credit protection only for the nth defaulting reference exposure in a group of reference exposures (nth to default credit derivatives) are similar to synthetic securitizations that provide credit protection only after the first-loss

tranche has defaulted or become a loss. A simplified treatment is available to banks that purchase and provide such credit protection. A bank that obtains credit protection on a group of underlying exposures through a first-to-default credit derivative must determine its risk-based capital requirement for the underlying exposures as if the bank had synthetically securitized only the underlying exposure with the lowest capital requirement (K) (as calculated under Table 2 of the proposed rule) and had obtained no credit risk mitigant on the other (higher capital requirement) underlying exposures. If the bank purchases credit protection on a group of underlying exposures through an nth-to-default credit derivative (other than a first-to-default credit derivative), it may only recognize the credit protection for risk-based capital purposes either if it has obtained credit protection on the same underlying exposures in the form of first-through-(n-1)-to-default credit derivatives, or if n-1 of the underlying exposures have already defaulted. In such a case, the bank would again determine its risk-based capital requirement for the underlying exposures as if the bank had only synthetically securitized the n-1 underlying exposures with the lowest capital requirement (K) (as calculated under Table 2 of the proposed rule) and had obtained no credit risk mitigant on the other underlying exposures.

A bank that provides credit protection on a group of underlying exposures through a first-to-default credit derivative must determine its risk-weighted asset amount for the derivative by applying the RBA (if the derivative qualifies for the RBA) or, if the derivative does not qualify for the RBA, by setting its risk-weighted asset amount for the derivative equal to the product of (i) the protection amount of the derivative; (ii) 12.5; and (iii) the sum of the risk-based capital requirements (K) of the individual underlying exposures (as calculated under Table 2 of the proposed rule), up to a maximum of 100 percent. If a bank provides credit protection on a group of underlying exposures through an nth-to-default credit derivative (other than a first-to-default credit derivative), the bank must determine its risk-weighted asset amount for the derivative by applying the RBA (if the derivative qualifies for the RBA) or, if the derivative does not qualify for the RBA, by setting the risk-weighted asset amount for the derivative equal to the product of (i) the protection amount of the derivative; (ii) 12.5; and (iii) the sum of the risk-based capital requirements (K) of the individual

underlying exposures (as calculated under Table 2 of the proposed rule and excluding the n-1 underlying exposures with the lowest risk-based capital requirements), up to a maximum of 100 percent.

For example, a bank provides credit protection in the form of a second-to-default credit derivative on a basket of five reference exposures. The derivative is unrated and the protection amount of the derivative is \$100. The risk-based capital requirements of the underlying exposures are 2.5 percent, 5.0 percent, 10.0 percent, 15.0 percent, and 20 percent. The risk-weighted asset amount of the derivative would be $\$100 \times 12.5 \times (.05 + .10 + .15 + .20)$ or \$625. If the derivative were externally rated in the lowest investment grade rating category with a positive designation, the risk-weighted asset amount would be $\$100 \times 0.50$ or \$50.

9. Early Amortization Provisions

Background. Many securitizations of revolving credit facilities (for example, credit card receivables) contain provisions that require the securitization to be wound down and investors to be repaid if the excess spread falls below a certain threshold.⁷⁹ This decrease in excess spread may, in some cases, be caused by deterioration in the credit quality of the underlying exposures. An early amortization event can increase a bank's capital needs if new draws on the revolving credit facilities would need to be financed by the bank using on-balance sheet sources of funding. The payment allocations used to distribute principal and finance charge collections during the amortization phase of these transactions also can expose a bank to greater risk of loss than in other securitization transactions. To address the risks that early amortization of a securitization poses to originating banks, the agencies propose the capital treatment described below.

The proposed rule would define an early amortization provision as a provision in a securitization's governing documentation that, when triggered, causes investors in the securitization exposures to be repaid before the original stated maturity of the securitization exposure, unless the provision is solely triggered by events

not related to the performance of the underlying exposures or the originating bank (such as material changes in tax laws or regulations). Under the proposed rule, an originating bank must generally hold regulatory capital against the sum of the originating bank's interest and the investors' interest arising from a revolving securitization that contains an early amortization provision. An originating bank must compute its capital requirement for its interest using the hierarchy of approaches for securitization exposures as described above. The originating bank's risk-weighted asset amount with respect to the investors' interest in the securitization is equal to the product of the following four quantities: (i) The EAD associated with the investors' interest; (ii) the appropriate conversion factor (CF) as determined below; (iii) K_{IRB} ; and (iv) 12.5.

Under the proposed rule, as noted above, a bank is not required to hold regulatory capital against the investors' interest if early amortization is solely triggered by events not related to the performance of the underlying exposures or the originating bank, such as material changes in tax laws or regulation. Under the New Accord, a bank is also not required to hold regulatory capital against the investors' interest if (i) the securitization has a replenishment structure in which the individual underlying exposures do not revolve and the early amortization ends the ability of the originating bank to add new underlying exposures to the securitization; (ii) the securitization involves revolving assets and contains early amortization features that mimic term structures (that is, where the risk of the underlying exposures does not return to the originating bank); or (iii) investors in the securitization remain fully exposed to future draws by borrowers on the underlying exposures even after the occurrence of early amortization. *Question 51: The agencies seek comment on the appropriateness of these additional exemptions in the U.S. markets for revolving securitizations.*

Under the proposed rule, the investors' interest with respect to a revolving securitization captures both the drawn balances and undrawn lines of the underlying exposures that are allocated to the investors in the securitization. The EAD associated with the investors' interest is equal to the EAD of the underlying exposures multiplied by the ratio of the total amount of securitization exposures issued by the SPE to investors; divided by the outstanding principal amount of underlying exposures.

⁷⁹ The proposed rule defines excess spread for a period as gross finance charge collections (including market interchange fees) and other income received by the SPE over the period minus interest paid to holders of securitization exposures, servicing fees, charge-offs, and other senior trust similar expenses of the SPE over the period, all divided by the principal balance of the underlying exposures at the end of the period.

In general, the applicable CF would depend on whether the early amortization provision repays investors through a “controlled” or “non-controlled” mechanism and whether the underlying exposures are revolving retail credit facilities that are uncommitted—that is, unconditionally cancelable by the bank to the fullest extent of Federal law (for example, credit card receivables)—or are other revolving credit facilities (for example, revolving corporate credit facilities). Under the proposed rule, a “controlled” early amortization provision meets each of the following conditions:

(i) The originating bank has appropriate policies and procedures to ensure that it has sufficient capital and liquidity available in the event of an early amortization;

(ii) Throughout the duration of the securitization (including the early amortization period) there is the same pro rata sharing of interest, principal, expenses, losses, fees, recoveries, and other cash flows from the underlying exposures, based on the originating

bank's and the investors' relative shares of the underlying exposures outstanding measured on a consistent monthly basis;

(iii) The amortization period is sufficient for at least 90 percent of the total underlying exposures outstanding at the beginning of the early amortization period to have been repaid or recognized as in default; and

(iv) The schedule for repayment of investor principal is not more rapid than would be allowed by straight-line amortization over an 18-month period.

An early amortization provision that does not meet any of the above criteria is a “non-controlled” early amortization provision. *Question 52: The agencies solicit comment on the distinction between controlled and non-controlled early amortization provisions and on the extent to which banks use controlled early amortization provisions. The agencies also invite comment on the proposed definition of a controlled early amortization provision, including in particular the 18-month period set forth above.*

Controlled early amortization. To calculate the appropriate CF for a securitization of uncommitted revolving retail exposures that contains a *controlled* early amortization provision a bank must compare the three-month average excess spread for the securitization to the point at which the bank is required to trap excess spread under the securitization transaction. In securitizations that do not require excess spread to be trapped, or that specify a trapping point based primarily on performance measures other than the three-month average excess spread, the excess spread trapping point is 4.5 percent. The bank must divide the three-month average excess spread level by the excess spread trapping point and apply the appropriate CF from Table I.

Question 53: The agencies seek comment on the appropriateness of the 4.5 percent excess spread trapping point and on other types and levels of early amortization triggers used in securitizations of revolving retail exposures that should be considered by the agencies.

TABLE I.—CONTROLLED EARLY AMORTIZATION PROVISIONS

	Uncommitted	Committed
Retail Credit Lines	3-month average excess spread Conversion Factor (CF) 133.33% of trapping point or more 0% CF. less than 133.33% to 100% of trapping point 1% CF. less than 100% to 75% of trapping point 2% CF. less than 75% to 50% of trapping point 10% CF. less than 50% to 25% of trapping point 20% CF. less than 25% of trapping point 40% CF. 90% CF	90% CF.
Non-retail Credit Lines	90% CF	90% CF.

A bank must apply a 90 percent CF for all other revolving underlying exposures (that is, committed exposures and non-retail exposures) in securitizations containing a *controlled* early amortization provision. The CFs for uncommitted revolving retail credit lines are much lower than for committed retail credit lines or for non-retail credit lines because of the demonstrated ability of banks to monitor and, when appropriate, to curtail promptly uncommitted retail credit lines for customers of deteriorating credit quality. Such

account management tools are unavailable for committed lines, and banks may be less proactive about using such tools in the case of uncommitted non-retail credit lines owing to lender liability concerns and the prominence of broad-based, longer-term customer relationships.

Question 54: The agencies seek comment on and supporting empirical analysis of the appropriateness of a more simple alternative approach that would impose at all times a flat CF on the entire investors' interest of a revolving securitization with a

controlled early amortization provision, and on what an appropriate level of such a CF would be (for example, 10 or 20 percent).

Noncontrolled early amortization. To calculate the appropriate CF for securitizations of uncommitted revolving retail exposures that contain a *noncontrolled* early amortization provision, a bank must perform the excess spread calculations described in the controlled early amortization section above and then apply the CFs in Table 1.

TABLE J.—NON-CONTROLLED EARLY AMORTIZATION PROVISIONS

	Uncommitted	Committed
Retail Credit Lines	3-month average excess spread Conversion Factor (CF)	100% CF.

TABLE J.—NON-CONTROLLED EARLY AMORTIZATION PROVISIONS—Continued

	Uncommitted	Committed
	133.33% of trapping point or more 0% CF. less than 133.33% to 100% of trapping point 5% CF. less than 100% to 75% of trapping point 15% CF. less than 75% to 50% of trapping point 50% CF. less than 50% of trapping point 100% CF. 100% CF	
Non-retail Credit Lines	100% CF	100% CF.

A bank must use a 100 percent CF for all other revolving underlying exposures (that is, committed exposures and nonretail exposures) in securitizations containing a noncontrolled early amortization provision. In other words, no risk transference would be recognized for these transactions; an originating bank's IRB capital requirement would be the same as if the underlying exposures had not been securitized.

In circumstances where a securitization contains a mix of retail and nonretail exposures or a mix of committed and uncommitted exposures, a bank may take a pro rata approach to determining the risk-based capital requirement for the securitization's early amortization provision. If a pro rata approach is not feasible, a bank must treat the securitization as a securitization of nonretail exposures if a single underlying exposure is a nonretail exposure and must treat the securitization as a securitization of committed exposures if a single underlying exposure is a committed exposure.

F. Equity Exposures

1. Introduction and Exposure Measurement

This section describes the proposed rule's risk-based capital treatment for equity exposures. Under the proposed rule, a bank would have the option to use either a simple risk-weight approach (SRWA) or an internal models approach (IMA) for equity exposures that are not exposures to an investment fund. A bank would use a look-through approach for equity exposures to an investment fund. Under the SRWA, a bank would generally assign a 300 percent risk weight to publicly traded equity exposures and a 400 percent risk weight to non-publicly traded equity exposures. Certain equity exposures to sovereigns, multilateral institutions, and public sector enterprises would have a risk weight of 0 percent, 20 percent, or

100 percent; and certain community development equity exposures, hedged equity exposures, and, up to certain limits, non-significant equity exposures would receive a 100 percent risk weight.

Alternatively, a bank that meets certain minimum quantitative and qualitative requirements on an ongoing basis and obtains the prior written approval of its primary Federal supervisor could use the IMA to determine its risk-based capital requirement for all modeled equity exposures. A bank that qualifies to use the IMA may apply the IMA to its publicly traded and non-publicly traded equity exposures, or may choose to apply the IMA only to its publicly traded equity exposures. However, if the bank applies the IMA to its publicly traded equity exposures, it must apply the IMA to all such exposures. Similarly, if a bank applies the IMA to both publicly traded and non-publicly traded equity exposures, it must apply the IMA to all such exposures. If a bank does not qualify to use the IMA, or elects not to use the IMA, to compute its risk-based capital requirements for equity exposures, the bank must apply the SRWA to assign risk weights to its equity exposures.

The proposed rule defines a publicly traded equity exposure as an equity exposure traded on (i) any exchange registered with the SEC as a national securities exchange under section 6 of the Securities Exchange Act of 1934 (15 U.S.C. 78f) or (ii) any non-U.S.-based securities exchange that is registered with, or approved by, a national securities regulatory authority, provided that there is a liquid, two-way market for the exposure (that is, there are enough bona fide offers to buy and sell so that a sales price reasonably related to the last sales price or current bona fide competitive bid and offer quotations can be determined promptly and a trade can be settled at such a price within five business days). *Question 55:*

The agencies seek comment on this definition.

A bank using either the IMA or the SRWA must determine the adjusted carrying value for each equity exposure. The proposed rule defines the adjusted carrying value of an equity exposure as:

(i) For the on-balance sheet component of an equity exposure, the bank's carrying value of the exposure reduced by any unrealized gains on the exposure that are reflected in such carrying value but excluded from the bank's tier 1 and tier 2 capital;⁸⁰ and

(ii) 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 (i).

The agencies created the definition of the effective notional principal amount of the off-balance sheet portion of an equity exposure to provide a uniform method for banks to measure the on-balance sheet equivalent of an off-balance sheet exposure. For example, if the value of a derivative contract referencing the common stock of company X changes the same amount as the value of 150 shares of common stock of company X, for a small (for example, 1 percent) change in the value of the common stock of company X, the effective notional principal amount of the derivative contract is the current value of 150 shares of common stock of company X regardless of the number of shares the derivative contract

⁸⁰ The potential downward adjustment to the carrying value of an equity exposure reflects the fact that 100 percent of the unrealized gains on available-for-sale equity exposures are included in carrying value but only up to 45 percent of any such unrealized gains are included in regulatory capital.

references. The adjusted carrying value of the off-balance sheet component of the derivative is the current value of 150 shares of common stock of company X minus the adjusted carrying value of any on-balance sheet amount associated with the derivative. *Question 56: The agencies seek comment on the approach to adjusted carrying value for the off-balance sheet component of equity exposures and on alternative approaches that may better capture the market risk of such exposures.*

Hedge transactions. For purposes of determining risk-weighted assets under both the SRWA and the IMA, a bank may identify hedge pairs, which the proposed rule defines as 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. A bank may risk weight only the effective and ineffective portions of a hedge pair rather than the entire adjusted carrying value of each exposure that makes up the pair. 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 bank acquires at least one of the equity exposures); the documentation specifies the measure of effectiveness (E) the bank 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 bank must measure E at least quarterly and must use one of three alternative measures of E—the dollar-offset method, the variability-reduction method, or the regression method.

It is possible that only part of a bank's exposure to a particular equity instrument would be part of a hedge pair. For example, assume a bank has an equity exposure A with a \$300 adjusted carrying value and chooses to hedge a portion of that exposure with an equity exposure B with an adjusted carrying value of \$100. Also assume that the combination of equity exposure B and \$100 of the adjusted carrying value of equity exposure A form an effective hedge with an E of 0.8. In this situation the bank would treat \$100 of equity

exposure A and \$100 of equity exposure B as a hedge pair, and the remaining \$200 of its equity exposure A as a separate, stand-alone position.

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, whereas the ineffective portion is (1-E) multiplied by the greater of the adjusted carrying values of the equity exposures forming a hedge pair. In the above example, the effective portion of the hedge pair would be $0.8 \times \$100 = \$80$ and the ineffective portion of the hedge pair would be $(1 - 0.8) \times \$100 = \$20$.

Measures of hedge effectiveness. Under the dollar-offset method of measuring effectiveness, the bank must determine the ratio of the cumulative sum of the periodic changes in the value of one equity exposure to the cumulative sum of the periodic changes in the value of the other equity exposure, termed the ratio of value change (RVC). If the changes in the values of the two exposures perfectly offset each other, the RVC will be -1. If RVC is positive, implying that the values of the two equity exposures moved in the same direction, the hedge is not effective and E = 0. 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.

The variability-reduction method of measuring effectiveness compares changes in the value of the combined position of the two equity exposures in the hedge pair (labeled X) to changes in the value of one exposure as though that one exposure were not hedged (labeled A). This measure of E expresses the time-series variability in X as a proportion of the variability of A. As the variability described by the numerator becomes small relative to the variability described by the denominator, the measure of effectiveness improves, but is bounded from above by a value of 1. E can be computed as:

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

$$X_t = A_t - B_t$$

A = the value at time t of the one exposure in a hedge pair, and

B_t = the value at time t of the other exposure in a hedge pair.

The value of t will range from zero to T, where T is the length of the observation period for the values of A and B, and is comprised of shorter values each labeled t.

The regression method of measuring effectiveness is based on 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. E equals the coefficient of determination of this regression, which is the proportion of the variation in the dependent variable explained by variation in the independent variable. The closer the relationship between the values of the two exposures, the higher E will be.

2. Simple Risk-Weight Approach (SRWA)

Under the SRWA in section 52 of the proposed rule, a bank would determine the risk-weighted asset amount for each 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 described below, by the lowest applicable risk weight in Table K. A bank would determine the risk-weighted asset amount for an equity exposure to an investment fund as set forth below (and in section 54 of the proposed rule). Use of the SRWA would be most appropriate when a bank's equity holdings are principally composed of non-traded instruments.

If a bank exclusively uses the SRWA for its equity exposures, the bank's aggregate risk-weighted asset amount for its equity exposures (other than equity exposures to investment funds) would be equal to the sum of the risk-weighted asset amounts for each of the bank's individual equity exposures.

TABLE K

Risk weight	Equity exposure
0 Percent	An equity exposure to an entity whose credit exposures are exempt from the 0.03 percent PD floor.
20 Percent	An equity exposure to a Federal Home Loan Bank or Farmer Mac if the equity exposure is not publicly traded and is held as a condition of membership in that entity.
100	- Community development equity exposures⁸¹ - Equity exposures to a Federal Home Loan Bank or Farmer Mac not subject to a 20 percent risk weight.

TABLE K—Continued

Risk weight	Equity exposure
300 Percent	• The effective portion of a hedge pair. • Non-significant equity exposures to the extent less than 10 percent of tier 1 plus tier 2 capital.
400 Percent	A publicly traded equity exposure (including the ineffective portion of a hedge pair).
	An equity exposure that is not publicly traded.

Non-significant equity exposures. A bank may apply a 100 percent risk weight to non-significant equity exposures, which the proposed rule defines as equity exposures to the extent that the aggregate adjusted carrying value of the exposures does not exceed 10 percent of the bank's tier 1 capital plus tier 2 capital. To compute the aggregate adjusted carrying value of a bank's equity exposures for determining non-significance, the bank may exclude (i) equity exposures that receive less than a 300 percent risk weight under the SRWA (other than equity exposures determined to be non-significant), (ii) the equity exposure in a hedge pair with the smaller adjusted carrying value, and (iii) a proportion of each equity exposure to an investment fund equal to the proportion of the assets of the investment fund that are not equity exposures. If a bank does not know the actual holdings of the investment fund, the bank may calculate the proportion of the assets of the fund that are not equity exposures based on the terms of the prospectus, partnership agreement, or similar contract that defines the fund's permissible investments. If the sum of the investment limits for all exposure classes⁸¹ within the fund exceeds 100 percent, the bank must assume that the investment fund invests to the maximum extent possible in equity exposures.

When determining which of a bank's equity exposures qualify for a 100 percent risk weight based on non-significance, a bank must first include equity exposures to unconsolidated small business investment companies or

held through consolidated small business investment companies described in section 302 of the Small Business Investment Act of 1958 (15 U.S.C. 682) and then must include publicly traded equity exposures (including those held indirectly through investment funds) and then must include non-publicly traded equity exposures (including those held indirectly through investment funds).

3. Internal Models Approach (IMA)

The IMA is designed to provide banks with a more sophisticated and risk-sensitive mechanism for calculating risk-based capital requirements for equity exposures. To qualify to use the IMA, a bank must receive prior written approval from its primary Federal supervisor. To receive such approval, the bank must demonstrate to its primary Federal supervisor's satisfaction that the bank meets the following quantitative and qualitative criteria.

IMA qualification. First, the bank must have a model that (i) assesses the potential decline in value of its modeled equity exposures; (ii) is commensurate with the size, complexity, and composition of the bank's modeled equity exposures; and (iii) adequately captures both general market risk and idiosyncratic risks. Second, the bank'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 99.0 percent one-tailed confidence interval of the distribution of quarterly returns for a benchmark portfolio of equity exposures comparable to the bank's modeled equity exposures using a long-term sample period.

In addition, the number of risk factors and exposures in the sample and the data period used for quantification in the bank's model and benchmarking exercise must be sufficient to provide confidence in the accuracy and robustness of the bank's estimates. The bank's model and benchmarking exercise also must incorporate data that are relevant in representing the risk profile of the bank's modeled equity exposures, and must include data from at least one equity market cycle

containing adverse market movements relevant to the risk profile of the bank's modeled equity exposures. If the bank's model uses a scenario methodology, the bank must demonstrate that the model produces a conservative estimate of potential losses on the bank's modeled equity exposures over a relevant long-term market cycle. If the bank employs risk factor models, the bank must demonstrate through empirical analysis the appropriateness of the risk factors used.

The agencies also would require that daily market prices be available for all modeled equity exposures, either direct holdings or proxies. Finally, the bank must be able to demonstrate, using theoretical arguments and empirical evidence, that any proxies used in the modeling process are comparable to the bank's modeled equity exposures and that the bank has made appropriate adjustments for differences. The bank must derive any proxies for its modeled equity exposures or benchmark portfolio using historical market data that are relevant to the bank's modeled equity exposures or benchmark portfolio (or, where not, must use appropriately adjusted data), and such proxies must be robust estimates of the risk of the bank's modeled equity exposures.

In evaluating a bank's internal model for equity exposures, the bank's primary Federal supervisor would consider, among other factors, (i) the nature of the bank's equity exposures, including the number and types of equity exposures (for example, publicly traded, non-publicly traded, long, short); (ii) the risk characteristics and makeup of the bank's equity exposures, including the extent to which publicly available price information is obtainable on the exposures; and (iii) the level and degree of concentration of, and correlations among, the bank's equity exposures. Banks with equity portfolios containing equity exposures with values that are highly nonlinear in nature (for example, equity derivatives or convertibles) would have to employ an internal model designed to appropriately capture the risks associated with these instruments.

The agencies do not intend to dictate the form or operational details of a bank's internal model for equity

⁸¹ The proposed rule generally defines these exposures as exposures that would qualify as community development investments 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). For savings associations, community development investments would be defined to mean equity investments that are designed primarily to promote community welfare, including the welfare of low- and moderate-income communities or families, such as by providing services or jobs, and 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).

exposures. Accordingly, the agencies would not prescribe any particular type of model for determining risk-based capital requirements. Although the proposed rule requires a bank that uses the IMA to ensure that its internal model produces 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 99.0 percent one-tailed confidence interval of the distribution of quarterly returns for a benchmark portfolio of equity exposures, the proposed rule does not require a bank to use a VaR-based model. The agencies recognize that the type and sophistication of internal models will vary across banks due to differences in the nature, scope, and complexity of business lines in general and equity exposures in particular. The agencies recognize that some banks employ models for internal risk management and capital allocation purposes that can be more relevant to the bank's equity exposures than some VaR models. For example, some banks employ rigorous historical scenario analysis and other techniques for assessing the risk of their equity portfolios.

Banks that choose to use a VaR-based internal model under the IMA should use a historical observation period that includes a sufficient amount of data points to ensure statistically reliable and robust loss estimates relevant to the long-term risk profile of the bank's specific holdings. The data used to represent return distributions should reflect the longest sample period for which data are available and should meaningfully represent the risk profile of the bank's specific equity holdings. The data sample should be long-term in nature and, at a minimum, should encompass at least one complete equity market cycle containing adverse market movements relevant to the risk profile of the bank's modeled exposures. The data used should be sufficient to provide conservative, statistically reliable, and robust loss estimates that are not based purely on subjective or judgmental considerations.

The parameters and assumptions used in a VaR model must be subject to a rigorous and comprehensive regime of stress-testing. Banks utilizing VaR models must subject their internal model and estimation procedures, including volatility computations, to either hypothetical or historical scenarios that reflect worst-case losses given underlying positions in both publicly traded and non-publicly traded equities. At a minimum, banks that use a VaR model must employ stress tests to

provide information about the effect of tail events beyond the level of confidence assumed in the IMA.

Banks using non-VaR internal models that are based on stress tests or scenario analyses would have to estimate losses under worst-case modeled scenarios. These scenarios would have to reflect the composition of the bank's equity portfolio and should produce risk-based capital requirements at least as large as those that would be required to be held against a representative market index or other relevant benchmark portfolio under a VaR approach. For example, for a portfolio consisting primarily of publicly held equity securities that are actively traded, risk-based capital requirements produced using historical scenario analyses should be greater than or equal to risk-based capital requirements produced by a baseline VaR approach for a major index or sub-index that is representative of the bank's holdings. Similarly, non-publicly traded equity exposures may be benchmarked against a representative portfolio of publicly traded equity exposures.

The loss estimate derived from the bank's internal model would constitute the regulatory capital requirement for the modeled equity exposures. The equity capital requirement would be incorporated into a bank's risk-based capital ratio through the calculation of risk-weighted equivalent assets. To convert the equity capital requirement into risk-weighted equivalent assets, a bank would multiply the capital requirement by 12.5.

Question 57: The agencies seek comment on the proposed rule's requirements for IMA qualification, including in particular the proposed rule's use of a 99.0 percent, quarterly returns standard.

Risk-weighted assets under the IMA. As noted above, a bank may apply the IMA only to its publicly traded equity exposures or may apply the IMA to its publicly traded and non-publicly traded equity exposures. In either case, a bank is not allowed to apply the IMA to equity exposures that receive a 0 or 20 percent risk weight under Table 9, community development equity exposures, equity exposures to a Federal Home Loan Bank or Farmer Mac that receive a 100 percent risk weight, and equity exposures to investment funds (collectively, excluded equity exposures).

If a bank applies the IMA to both publicly traded and non-publicly traded equity exposures, the bank's aggregate risk-weighted asset amount for its equity exposures would be equal to the sum of the risk-weighted asset amount of each excluded equity exposure (calculated

outside of the IMA section of the proposed rule) and the risk-weighted asset amount of the non-excluded equity exposures (calculated under the IMA section of the proposed rule). The risk-weighted asset amount of the non-excluded equity exposures is generally set equal to the estimate of potential losses on the bank's non-excluded equity exposures generated by the bank's internal model multiplied by 12.5. To ensure that a bank holds a minimum amount of risk-based capital against its modeled equity exposures, however, the proposed rule contains a supervisory floor on the risk-weighted asset amount of the non-excluded equity exposures. As a result of this floor, the risk-weighted asset amount of the non-excluded equity exposures could not fall below the sum of (i) 200 percent multiplied by the aggregate adjusted carrying value or ineffective portion of hedge pairs, as appropriate, of the bank's non-excluded publicly traded equity exposures; and (ii) 300 percent multiplied by the aggregate adjusted carrying value of the bank's non-excluded non-publicly traded equity exposures.

If, on the other hand, a bank applies the IMA only to its publicly traded equity exposures, the bank's aggregate risk-weighted asset amount for its equity exposures would be equal to the sum of (i) the risk-weighted asset amount of each excluded equity exposure (calculated outside of the IMA section of the proposed rule); (ii) 400 percent multiplied by the aggregate adjusted carrying value of the bank's non-excluded non-publicly traded equity exposures; and (iii) the aggregate risk-weighted asset amount of its non-excluded publicly traded equity exposures. The risk-weighted asset amount of the non-excluded publicly traded equity exposures would be equal to the estimate of potential losses on the bank's non-excluded publicly traded equity exposures generated by the bank's internal model multiplied by 12.5. The risk-weighted asset amount for the non-excluded publicly traded equity exposures would be subject to a floor of 200 percent multiplied by the aggregate adjusted carrying value or ineffective portion of hedge pairs, as appropriate, of the bank's non-excluded publicly traded equity exposures. *Question 58: The agencies seek comment on the operational aspects of these floor calculations.*

4. Equity Exposures to Investment Funds

A bank must determine the risk-weighted asset amount for equity exposures to investment funds using

one of three approaches: the Full Look-Through Approach, the Simple Modified Look-Through Approach, or the Alternative Modified Look-Through Approach, unless the equity exposure to an investment fund is a community development equity exposure. Such equity exposures would be subject to a 100 percent risk weight. If an equity exposure to an investment fund is part of a hedge pair, a bank may use the ineffective portion of a hedge pair as the adjusted carrying value for the equity exposure to the investment fund. A bank may choose to apply a different approach to different equity exposures to investment funds; the proposed rule does not require a bank to apply the same approach to all of its equity exposures to investment funds.

The proposed rule defines an investment fund as a company all or substantially all of the assets of which are financial assets and which has no material liabilities. The agencies have proposed a separate treatment for equity exposures to an investment fund to prevent banks from arbitraging the proposed rule's high risk-based capital requirements for certain high-risk exposures and to ensure that banks do not receive a punitive risk-based capital

requirement for equity exposures to investment funds that hold only low-risk assets. *Question 59: The agencies seek comment on the necessity and appropriateness of the separate treatment for equity exposures to investment funds and the three approaches in the proposed rule. The agencies also seek comment on the proposed definition of an investment fund.*

Each of the approaches to equity exposures to investment funds imposes a 7 percent minimum risk weight on equity exposures to investment funds. This minimum risk weight is similar to the minimum 7 percent risk weight under the RBA for securitization exposures and the effective 56 basis point minimum risk-based capital requirement per dollar of securitization exposure under the SFA. The agencies believe that this minimum prudential capital requirement is appropriate for exposures not directly held by the bank.

Full look-through approach. A bank may use the full look-through approach only if the bank is able to compute a risk-weighted asset amount for each of the exposures held by the investment fund (calculated under the proposed rule as if the exposures were held directly by the bank). Under this

approach, a bank would set the risk-weighted asset amount of the bank's equity exposure to the investment fund equal to the greater of (i) the product of (A) the aggregate risk-weighted asset amounts of the exposures held by the fund as if they were held directly by the bank and (B) the bank's proportional ownership share of the fund; and (ii) 7 percent of the adjusted carrying value of the bank's equity exposure to the investment fund.

Simple modified look-through approach. Under this approach, a bank may set the risk-weighted asset amount for its equity exposure to an investment fund equal to the adjusted carrying value of the equity exposure multiplied by the highest risk weight in Table L that applies to any exposure the fund is permitted to hold under its prospectus, partnership agreement, or similar contract that defines the fund's permissible investments. The bank may exclude derivative contracts that are used for hedging, not speculative purposes, and do not constitute a material portion of the fund's exposures. A bank may not assign an equity exposure to an investment fund to an aggregate risk weight of less than 7 percent under this approach.

TABLE L.— MODIFIED LOOK-THROUGH APPROACHES FOR EQUITY EXPOSURES TO INVESTMENT FUNDS

Risk weight	Exposure class
0 percent	Sovereign exposures with a long-term external rating in the highest investment grade rating category and sovereign exposures of the United States.
20 percent	Exposures with a long-term external rating in the highest or second-highest investment grade rating category; exposures with a short-term external rating in the highest investment grade rating category; and exposures to, or guaranteed by, depository institutions, foreign banks (as defined in 12 CFR 211.2), or securities firms subject to consolidated supervision or regulation comparable to that imposed on U.S. securities broker-dealers that are repo-style transactions or bankers' acceptances.
50 percent	Exposures with a long-term external rating in the third- highest investment grade rating category or a short-term external rating in the second-highest investment grade rating category.
100 percent	Exposures with a long-term or short-term external rating in percent the lowest investment grade rating category.
200 percent	Exposures with a long-term external rating one rating category percent below investment grade.
300 percent	Publicly traded equity exposures.
400 percent	Non-publicly traded equity exposures; exposures with a long-percent term external rating two or more rating categories below investment grade; and unrated exposures (excluding publicly traded equity exposures).
1,250 percent	OTC derivative contracts and exposures that must be deducted percent from regulatory capital or receive a risk weight greater than 400 percent under this appendix.

Alternative modified look-through approach. Under this approach, a bank may assign the adjusted carrying value of an equity exposure to an investment fund on a pro rata basis to different risk-weight categories in Table L according to the investment limits in the fund's prospectus, partnership agreement, or similar contract that defines the fund's permissible investments. If the sum of the investment limits for all exposure classes within the fund exceeds 100 percent, the bank must assume that the fund invests to the maximum extent

permitted under its investment limits in the exposure class with the highest risk weight under Table L, and continues to make investments in the order of the exposure class with the next highest risk-weight under Table L until the maximum total investment level is reached. If more than one exposure class applies to an exposure, the bank must use the highest applicable risk weight. A bank may exclude derivative contracts held by the fund that are used for hedging, not speculative, purposes and do not constitute a material portion

of the fund's exposures. The overall risk weight assigned to an equity exposure to an investment fund under this approach may not be less than 7 percent.

VI. Operational Risk

This section describes features of the AMA framework for determining the risk-based capital requirement for operational risk. The proposed framework remains fundamentally similar to that described in the ANPR. Under this framework, a bank meeting the AMA qualifying criteria would use

its internal operational risk quantification system to calculate its risk-based capital requirement for operational risk.

Currently, the agencies' general risk-based capital rules do not include an explicit capital charge for operational risk. Rather, the existing risk-based capital rules were designed to cover all risks, and therefore implicitly cover operational risk. With the introduction of the IRB framework for credit risk in this NPR, which would result in a more risk-sensitive treatment of credit risk, there no longer would be an implicit capital buffer for other risks.

The agencies recognize that operational risk is a key risk in banks, and evidence indicates that a number of factors are driving increases in operational risk. These factors include greater use of automated technology, proliferation of new and highly complex products, growth of e-banking transactions and related business applications, large-scale acquisitions, mergers, and consolidations, and greater use of outsourcing arrangements. Furthermore, the recent experience of a number of high-profile, high-severity losses across the banking industry, including those resulting from legal settlements, highlight operational risk as a major source of unexpected losses. Because the implicit regulatory capital buffer for operational risk would be removed under the proposed rule, the agencies propose to require banks using the IRB framework for credit risk to use the AMA to address operational risk when computing a capital charge for regulatory capital purposes.

As defined previously, operational risk exposure is the 99.9th percentile of the distribution of potential aggregate operational losses as generated by the bank's operational risk quantification system over a one-year horizon. EOL is the expected value of the same distribution of potential aggregate operational losses. The ANPR specified that a bank's risk-based capital requirement for operational risk would be the sum of EOL and UOL unless the bank could demonstrate that an EOL offset would meet supervisory standards. The agencies described two approaches—reserving and budgeting—that might allow for some offset of EOL; however, the agencies expressed some reservation about both approaches. The agencies believed that reserves established for expected operational losses would likely not meet U.S. accounting standards and that budgeted funds might not be sufficiently capital-like to cover EOL.

While the proposed framework remains fundamentally similar to that

described in the ANPR and a bank would continue to be allowed to recognize (i) certain offsets for EOL, and (ii) the effect of risk mitigants such as insurance in calculating its regulatory capital requirement for operational risk, the agencies have clarified certain aspects of the proposed framework. In particular, the agencies have re-assessed the ability of banks to take prudent steps to offset EOL through internal business practices.

After further analysis and discussions with the industry, the agencies believe that certain reserves and other internal business practices could qualify as an EOL offset. Under the proposed rule, a bank's risk-based capital requirement for operational risk may be based on UOL alone if the bank can demonstrate it has offset EOL with eligible operational risk offsets, which are defined as amounts (i) generated by internal business practices to absorb highly predictable and reasonably stable operational losses, including reserves calculated in a manner consistent with GAAP; and (ii) available to cover EOL with a high degree of certainty over a one-year horizon. Eligible operational risk offsets may only be used to offset EOL, not UOL.

In determining whether to accept a proposed EOL offset, the agencies will consider whether the proposed offset would be available to cover EOL with a high degree of certainty over a one-year horizon. Supervisory recognition of EOL offsets will be limited to those business lines and event types with highly predictable, routine losses. Based on discussions with the industry and empirical data, highly predictable and routine losses appear to be limited to those relating to securities processing and to credit card fraud. *Question 60: The agencies are interested in commenters' views on other business lines or event types in which highly predictable, routine losses have been observed.*

In determining its operational risk exposure, the bank could also take into account the effects of risk mitigants such as insurance, subject to approval from its primary Federal supervisor. In order to recognize the effects of risk mitigants such as insurance for risk-based capital purposes, the bank must estimate its operational risk exposure with and without such effects. The reduction in a bank's risk-based capital requirement for operational risk due to risk mitigants may not exceed 20 percent of the bank's risk-based capital requirement for operational risk, after approved adjustments for EOL offsets. A bank must demonstrate that a risk mitigant is able to absorb losses with

sufficient certainty to warrant inclusion in the adjustment to the operational risk exposure. For a risk mitigant to meet this standard, it must be insurance that:

(i) Is provided by an unaffiliated company that has a claims paying ability that is rated in one of the three highest rating categories by an NRSRO;

(ii) Has an initial term of at least one year and a residual term of more than 90 days;

(iii) Has a minimum notice period for cancellation of 90 days;

(iv) Has no exclusions or limitations based upon regulatory action or for the receiver or liquidator of a failed bank; and

(v) Is explicitly mapped to an actual operational risk exposure of the bank.

The bank's methodology for recognizing risk mitigants must also capture, through appropriate discounts in the amount of risk mitigants, the residual term of the risk mitigant, where less than one year; the risk mitigant's cancellation terms, where less than one year; the risk mitigant's timeliness of payment; and the uncertainty of payment as well as mismatches in coverage between the risk mitigant and the hedged operational loss event. The bank may not recognize for regulatory capital purposes risk mitigants with a residual term of 90 days or less.

Commenters on the ANPR raised concerns that limiting the risk mitigating benefits of insurance to 20 percent of the bank's regulatory capital requirement for operational risk represents an overly prescriptive and arbitrary value. Concerns were raised that such a cap would inhibit development of this important risk mitigation tool. Commenters believed that the full contract amount of insurance should be recognized as the risk mitigating value. The agencies, however, believe that the 20 percent limit continues to be a prudent limit.

Currently, the primary risk mitigant available for operational risk is insurance. While certain securities products may be developed over time that could provide risk mitigation benefits, no specific products have emerged to-date that have characteristics sufficient to be considered a capital replacement for operational risk. However, as innovation in this field continues, a bank may be able to realize the benefits of risk mitigation through certain capital markets instruments with the approval of its primary Federal supervisor.

If a bank does not qualify to use or does not have qualifying operational risk mitigants, the bank's dollar risk-based capital requirement for operational risk would be its operational

risk exposure minus eligible operational risk offsets (if any). If a bank qualifies to use operational risk mitigants and has qualifying operational risk mitigants, the bank's dollar risk-based capital requirement for operational risk would be the greater of: (i) The bank's operational risk exposure adjusted for qualifying operational risk mitigants minus eligible operational risk offsets (if any); and (ii) 0.8 multiplied by the difference between the bank's operational risk exposure and its eligible operational risk offsets (if any). The dollar risk-based capital requirement for operational risk would be multiplied by 12.5 to convert it into an equivalent risk-weighted asset amount. The resulting amount would be added to the comparable amount for credit risk in calculating the institution's risk-based capital denominator.

VII. Disclosure

1. Overview

The agencies have long supported meaningful public disclosure by banks with the objective of improving market discipline. The agencies recognize the importance of market discipline in encouraging sound risk management practices and fostering financial stability.

Pillar 3 of the New Accord, market discipline, complements the minimum capital requirements and the supervisory review process by encouraging market discipline through enhanced and meaningful public disclosure. These proposed public disclosure requirements are intended to allow market participants to assess key information about an institution's risk profile and its associated level of capital.

The agencies view public disclosure as an important complement to the advanced approaches to calculating minimum regulatory risk-based capital requirements, which will be heavily based on internal systems and methodologies. With enhanced transparency of the advanced approaches, investors can better evaluate a bank's capital structure, risk exposures, and capital adequacy. With sufficient and relevant information, market participants can better evaluate a bank's risk management performance, earnings potential and financial strength.

Improvements in public disclosures come not only from regulatory standards, but also through efforts by bank management to improve communications to public shareholders and other market participants. In this

regard, improvements to risk management processes and internal reporting systems provide opportunities to significantly improve public disclosures over time. Accordingly, the agencies strongly encourage the management of each bank to regularly review its public disclosures and enhance these disclosures, where appropriate, to clearly identify all significant risk exposures—whether on- or off-balance sheet—and their effects on the bank's financial condition and performance, cash flow, and earnings potential.

Comments on ANPR. Some commenters to the ANPR indicated that the proposed disclosures were burdensome, excessive, and overly prescriptive. Other commenters believed that the information provided in the disclosures would not be comparable across banks because each bank will use distinct internal methodologies to generate the disclosures. These commenters also expressed concern that some disclosures could be misinterpreted or misunderstood by the public.

The agencies believe, however, the required disclosures would enable market participants to gain key insights regarding a bank's capital structure, risk exposures, risk assessment processes, and ultimately, the capital adequacy of the institution. Some of the proposed disclosure requirements will be new disclosures for banks. Nonetheless, the agencies believe that a significant amount of the proposed disclosure requirements are already required by or consistent with existing GAAP, SEC disclosure requirements, or regulatory reporting requirements for banks.

2. General Requirements

The public disclosure requirements would apply to the top-tier legal entity that is a core or opt-in bank within a consolidated banking group (that is, the top-tier BHC or DI that is a core or opt-in bank). In general, DIs that are a subsidiary of a BHC or another DI would not be subject to the disclosure requirements⁸² except that every DI must disclose total and tier 1 capital ratios and their components, similar to current requirements. If a DI is not a subsidiary of a BHC or another DI that must make the full set of disclosures, the DI must make these disclosures.

The risks to which a bank is exposed and the techniques that it uses to identify, measure, monitor, and control

those risks are important factors that market participants consider in their assessment of the institution.

Accordingly, each bank that is subject to the disclosure requirements must have a formal disclosure policy approved by the board of directors that addresses the institution's approach for determining the disclosures it should make. The policy should address the associated internal controls and disclosure controls and procedures. The board of directors and senior management would be expected to ensure that appropriate verification of the disclosures takes place and that effective internal controls and disclosure controls and procedures are maintained.

A bank should decide which disclosures are relevant for it based on the materiality concept. Information would be regarded as material if its omission or misstatement could change or influence the assessment or decision of a user relying on that information for the purpose of making investment decisions.

To the extent applicable, a bank would be able to fulfill its disclosure requirements under this proposed rule by relying on disclosures made in accordance with accounting standards or SEC mandates that are very similar to the disclosure requirements in this proposed rule. In these situations, a bank would explain material differences between the accounting or other disclosure and the disclosures required under this proposed rule.

Frequency/timeliness. Consistent with longstanding requirements in the United States for robust quarterly disclosures in financial and regulatory reports, and considering the potential for rapid changes in risk profiles, the agencies would require that quantitative disclosures be made quarterly. However, qualitative disclosures that provide a general summary of a bank's risk management objectives and policies, reporting system, and definitions may be disclosed annually, provided any significant changes to these are disclosed in the interim. The disclosures must be timely, that is, must be made no later than the reporting deadlines for regulatory reports (for example, FR Y-9C) and financial reports (for example, SEC Forms 10-Q and 10-K). When these deadlines differ, the later deadline would be used.

In some cases, management may determine that a significant change has occurred, such that the most recent reported amounts do not reflect the bank's capital adequacy and risk profile. In those cases, banks should disclose the general nature of these changes and briefly describe how they are likely to

⁸² The bank regulatory reports and Thrift Financial Reports will be revised to collect some additional Basel II-related information, as described below in the regulatory reporting section.

affect public disclosures going forward. These interim disclosures should be made as soon as practicable after the determination that a significant change has occurred.

Location of disclosures and audit/certification requirements. The disclosures would have to be publicly available (for example, included on a public Web site) for each of the last three years (that is, twelve quarters) or such shorter time period since the bank entered its first floor period. Except as discussed below, management would have some discretion to determine the appropriate medium and location of the disclosures required by this proposed rule. Furthermore, banks would have flexibility in formatting their public disclosures, that is, the agencies are not specifying a fixed format for these disclosures.

Management would be encouraged to provide all of the required disclosures in one place on the entity's public Web site. The public Web site address would be reported in a regulatory report (for example, the FR Y-9C).⁸³

Disclosure of tier 1 and total capital ratios must be provided in the footnotes to the year-end audited financial statements.⁸⁴ Accordingly, these disclosures must be tested by external auditors as part of the financial statement audit. Disclosures that are not included in the footnotes to the audited financial statements would not be required to be subject to external audit reports for financial statements or internal control reports from management and the external auditor. However, due to the importance of reliable disclosures, the agencies would require the chief financial officer to certify that the disclosures required by the proposed rule are appropriate and that the board of directors and senior management are responsible for establishing and maintaining an effective internal control structure over financial reporting, including the

information required by this proposed rule.

Proprietary and confidential information. The agencies believe that the proposed requirements strike an appropriate balance between the need for meaningful disclosure and the protection of proprietary and confidential information.⁸⁵ Accordingly, the agencies believe that banks would be able to provide all of these disclosures without revealing proprietary and confidential information. However, in rare cases, disclosure of certain items of information required in the proposed rule may prejudice seriously the position of a bank by making public information that is either proprietary or confidential in nature. In such cases, a reporting bank may request confidential treatment for the information if the bank believes that disclosure of specific commercial or financial information in the report would likely result in substantial harm to its competitive position, or that disclosure of the submitted information would result in unwarranted invasion of personal privacy.

Question 61: The agencies seek commenters' views on all of the elements proposed to be captured through the public disclosure requirements. In particular, the agencies seek comment on the extent to which the proposed disclosures balance providing market participants with sufficient information to appropriately assess the capital strength of individual institutions, fostering comparability from bank to bank, and reducing burden on the banks that are reporting the information.

3. Summary of Specific Public Disclosure Requirements

The public disclosure requirements are comprised of 11 tables that provide important information to market participants on the scope of application, capital, risk exposures, risk assessment processes, and, hence, the capital adequacy of the institution. Again, the agencies note that the substantive content of the tables is the focus of the disclosure requirements, not the tables themselves. The table numbers below refer to the table numbers in the proposed rule.

Table 11.1 disclosures, Scope of Application, include a description of the level in the organization to which the disclosures apply and an outline of any differences in consolidation for accounting and regulatory capital purposes, as well as a description of any restrictions on the transfer of funds and capital within the organization. These disclosures provide the basic context underlying regulatory capital calculations.

Table 11.2 disclosures, Capital Structure, provide information on various components of regulatory capital available to absorb losses and allow for an evaluation of the quality of the capital available to absorb losses within the bank.

Table 11.3 disclosures, Capital Adequacy, provide information about how a bank assesses the adequacy of its capital and require that the bank disclose its minimum capital requirements for significant risk areas and portfolios. The table also requires disclosure of the regulatory capital ratios of the consolidated group and each DI subsidiary. Such disclosures provide insight into the overall adequacy of capital based on the risk profile of the organization.

Tables 11.4, 11.5, and 11.7 disclosures, Credit Risk, provide market participants with insight into different types and concentrations of credit risk to which the bank is exposed and the techniques the bank uses to measure, monitor, and mitigate those risks. These disclosures are intended to enable market participants to assess the credit risk exposures under the IRB framework, without revealing proprietary information or duplicating the supervisor's fundamental review of the bank's IRB framework. Table 11.6 provides the disclosure requirements related to credit exposures from derivatives. This table was added as a supplement to the public disclosures initially in the New Accord as a result of the BCBS's additional efforts to address certain exposures arising from trading activities. See the July 2005 BCBS publication entitled "The Application of Basel II to Trading Activities and the Treatment of Double Default Effects."

Table 11.8 disclosures, Securitization, provide information to market participants on the amount of credit risk transferred and retained by the organization through securitization transactions and the types of products securitized by the organization. These disclosures provide users a better understanding of how securitization transactions impact the credit risk of the bank.

⁸³ Alternatively, banks would be permitted to provide the disclosures in more than one place, as some of them may be included in public financial reports (for example, in Management's Discussion and Analysis included in SEC filings) or other regulatory reports (for example, FR Y-9C Reports). The agencies would require such banks to provide a summary table on their public Web site that specifically indicates where all the disclosures may be found (for example, regulatory report schedules, page numbers in annual reports).

⁸⁴ These ratios are required to be disclosed in the footnotes to the audited financial statements pursuant to existing GAAP requirements in Chapter 17 of the "AICPA Audit and Accounting Guide for Depository and Lending Institutions: Banks, Savings Institutions, Credit unions, Finance companies and Mortgage companies."

⁸⁵ Proprietary information encompasses information that, if shared with competitors, would render a bank's investment in these products/systems less valuable, and, hence, could undermine its competitive position. Information about customers is often confidential, in that it is provided under the terms of a legal agreement or counterparty relationship.

Table 11.9 disclosures, Operational Risk, provide insight into the bank's application of the AMA for operational risk and what internal and external factors are considered in determining the amount of capital allocated to operational risk.

Table 11.10 disclosures, Equities, provide market participants with an understanding of the types of equity securities held by the bank and how they are valued. The table also provides information on the capital allocated to different equity products and the amount of unrealized gains and losses.

Table 11.11 disclosures, Interest Rate Risk in Non-Trading Activities, provide information about the potential risk of loss that may result from changes in interest rates and how the bank measures such risk.

4. Regulatory Reporting

In addition to the public disclosures that would be required by the consolidated banking organization subject to the advanced approaches, the agencies would require certain additional regulatory reporting from BHCs, their subsidiary DIs, and DIs applying the advanced approaches that are not subsidiaries of BHCs. The agencies believe that the reporting of key risk parameter estimates by each DI applying the advanced approaches will provide the primary Federal supervisor and other relevant supervisors with data important for assessing the reasonableness and accuracy of the institution's calculation of its minimum capital requirements under this rule and the adequacy of the institution's capital in relation to its risks. This information would be collected through regulatory reports. The agencies believe that requiring certain common reporting across banks will facilitate comparable application of the proposed rules.

In this regard, the agencies published for comment elsewhere in today's **Federal Register** a package of proposed reporting schedules. The package includes a summary schedule with aggregate data that would be available to the general public. It also includes supporting schedules that would be viewed as confidential supervisory information. These schedules are broken out by exposure category and would collect risk parameter and other pertinent data in a systematic manner. The agencies also are exploring ways to obtain information that would improve supervisors' understanding of the causes behind changes in risk-based capital requirements. For example, certain data would help explain whether movements are attributable to changes in key risk parameters or other factors. Under the

proposed rule, banks would begin reporting this information during their parallel run on a confidential basis. The agencies will share this information with each other for calibration and other analytical purposes. *Question 62: Comments on regulatory reporting issues may be submitted in response to this NPR as well as through the regulatory reporting request for comment noted above.*

List of Acronyms

ABCP	Asset Backed Commercial Paper
ALLL	Allowance for Loan and Lease Losses
AMA	Advanced Measurement Approaches
ANPR	Advance Notice of Proposed Rulemaking
AVC	Asset Value Correlation
BCBS	Basel Committee on Banking Supervision
BHC	Bank Holding Company
CF	Conversion Factor
CEIO	Credit-Enhancing Interest-Only Strip
CRM	Credit Risk Mitigation
DI	Depository Institution
DvP	Delivery versus Payment
E	Measure of Effectiveness
EAD	Exposure at Default
ECL	Expected Credit Loss
EL	Expected Loss
ELGD	Expected Loss Given Default
EOL	Expected Operational Loss
FDIC	Federal Deposit Insurance Corporation
FFIEC	Federal Financial Institutions Examination Council
FMI	Future Margin Income
GAAP	Generally Accepted Accounting Principles
HELOC	Home Equity Line of Credit
HOLA	Home Owners' Loan Act
HVCRE	High-Volatility Commercial Real Estate
IAA	Internal Assessment Approach
IMA	Internal Models Approach
IRB	Internal Ratings Based
KIRB	Capital Requirement for Underlying Pool of Exposures (securitizations)
LGD	Loss Given Default
LTV	Loan-to-Value Ratio
M	Effective Maturity
MRA	Market Risk Amendment
MRC	Minimum Risk-Based Capital
OCC	Office of the Comptroller of the Currency
OTC	Over-the-Counter
OTS	Office of Thrift Supervision
PCA	Prompt Corrective Action
PD	Probability of Default
PFE	Potential Future Exposure
PvP	Payment versus Payment
QIS-3	Quantitative Impact Study 3
QIS-4	Quantitative Impact Study 4
QIS-5	Quantitative Impact Study 5

QRE	Qualifying Revolving Exposure
RBA	Ratings-Based Approach
SFA	Supervisory Formula Approach
SME	Small and Medium-Size Enterprise
SPE	Special Purpose Entity
SRWA	Simple Risk-Weight Approach
UL	Unexpected Loss
UOL	Unexpected Operational Loss
VaR	Value-at-Risk

Regulatory Flexibility Act Analysis

The Regulatory Flexibility Act (RFA) requires an agency that is issuing a proposed rule to prepare and make available for public comment an initial regulatory flexibility analysis that describes the impact of the proposed rule on small entities. 5 U.S.C. 603(a). The RFA provides that an agency is not required to prepare and publish an initial regulatory flexibility analysis if the agency certifies that the proposed rule will not, if promulgated, have a significant economic impact on a substantial number of small entities. 5 U.S.C. 605(b).

Pursuant to section 605(b) of the RFA (5 U.S.C. 605(b)), the agencies certify that this proposed rule will not, if promulgated in final form, have a significant economic impact on a substantial number of small entities. Pursuant to regulations issued by the Small Business Administration (13 CFR 121-201), a "small entity" includes a bank holding company, commercial bank, or savings association with assets of \$165 million or less (collectively, small banking organizations). The proposed rule would require a bank holding company, national bank, state member bank, state nonmember bank, or savings association to calculate its risk-based capital requirements according to certain internal-ratings-based and internal model approaches if the bank holding company, bank, or savings association (i) has consolidated total assets (as reported on its most recent year-end regulatory report) equal to \$250 billion or more; (ii) has consolidated total on-balance sheet foreign exposures at the most recent year-end equal to \$10 billion or more; or (iii) is a subsidiary of a bank holding company, bank, or savings association that would be required to use the proposed rule to calculate its risk-based capital requirements.

The agencies estimate that zero small bank holding companies (out of a total of approximately 2,934 small bank holding companies), five small national banks (out of a total of approximately 1,090 small national banks), one small state member bank (out of a total of approximately 491 small state member banks), one small state nonmember bank

(out of a total of approximately 3,249 small state nonmember banks), and zero small savings associations (out of a total of approximately 446 small savings associations) would be subject to the proposed risk-based capital requirements on a mandatory basis. In addition, each of the small banking organizations subject to the proposed rule on a mandatory basis would be a subsidiary of a bank holding company with over \$250 billion in consolidated total assets or over \$10 billion in consolidated total on-balance sheet foreign exposure. Therefore, the agencies believe that the proposed rule will not, if promulgated in final form, result in a significant economic impact on a substantial number of small entities.

Paperwork Reduction Act

A. Request for Comment on Proposed Information Collection. In accordance with the requirements of the Paperwork Reduction Act of 1995, the agencies may not conduct or sponsor, and the respondent is not required to respond to, an information collection unless it displays a currently valid Office of Management and Budget (OMB) control number. The agencies are requesting comment on a proposed information collection. The agencies are also giving notice that the proposed collection of information has been submitted to OMB for review and approval.

Comments are invited on:

- Whether the collection of information is necessary for the proper performance of the agencies' functions, including whether the information has practical utility;
- The accuracy of the estimates of the burden of the information collection, including the validity of the methodology and assumptions used;
- Ways to enhance the quality, utility, and clarity of the information to be collected;
- Ways to minimize the burden of the information collection on respondents, including through the use of automated collection techniques or other forms of information technology; and
- Estimates of capital or start up costs and costs of operation, maintenance, and purchase of services to provide information.

Comments should be addressed to:

OCC: Communications Division, Office of the Comptroller of the Currency, Public Information Room, Mail stop 1-5, Attention: 1557-NEW, 250 E Street, SW., Washington, DC 20219. In addition, comments may be sent by fax to 202-874-4448, or by electronic mail to

regs.comments@occ.treas.gov. You can inspect and photocopy the comments at the OCC's Public Information Room, 250 E Street, SW., Washington, DC 20219. You can make an appointment to inspect the comments by calling 202-874-5043.

Board: You may submit comments, identified by Docket No. R-1261, by any of the following methods:

- **Agency Web Site:** <http://www.federalreserve.gov>. Follow the instructions for submitting comments on the <http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm>.
- **Federal eRulemaking Portal:** <http://www.regulations.gov>. Follow the instructions for submitting comments.
- **E-mail:** regs.comments@federalreserve.gov. Include docket number in the subject line of the message.

- **FAX:** 202-452-3819 or 202-452-3102.

- **Mail:** Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, NW., Washington, DC 20551.

All public comments are available from the Board's Web site at <http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm> as submitted, unless modified for technical reasons. Accordingly, your comments will not be edited to remove any identifying or contact information. Public comments may also be viewed electronically or in paper form in Room MP-500 of the Board's Martin Building (20th and C Streets, NW.) between 9 a.m. and 5 p.m. on weekdays.

FDIC: You may submit written comments, which should refer to 3064-AC73, by any of the following methods:

- **Agency Web Site:** <http://www.fdic.gov/regulations/laws/federal/propose.html>. Follow the instructions for submitting comments on the FDIC Web site.
- **Federal eRulemaking Portal:** <http://www.regulations.gov>. Follow the instructions for submitting comments.
- **E-mail:** Comments@FDIC.gov.
- **Mail:** Robert E. Feldman, Executive Secretary, Attention: Comments, FDIC, 550 17th Street, NW., Washington, DC 20429.

- **Hand Delivery/Courier:** Guard station at the rear of the 550 17th Street Building (located on F Street) on business days between 7 a.m. and 5 p.m.

Public Inspection: All comments received will be posted without change to <http://www.fdic.gov/regulations/laws/federal/propose/html> including any personal information provided. Comments may be inspected at the FDIC Public Information Center, Room 100,

801 17th Street, NW., Washington, DC, between 9 a.m. and 4:30 p.m. on business days.

A copy of the comments may also be submitted to the OMB desk officer for the agencies: By mail to U.S. Office of Management and Budget, 725 17th Street, NW., #10235, Washington, DC 20503 or by facsimile to 202-395-6974, Attention: Federal Banking Agency Desk Officer.

OTS: Information Collection Comments, Chief Counsel's Office, Office of Thrift Supervision, 1700 G Street, NW., Washington, DC 20552; send a facsimile transmission to (202) 906-6518; or send an e-mail to infocollection.comments@ots.treas.gov. OTS will post comments and the related index on the OTS Internet site at <http://www.ots.treas.gov>. In addition, interested persons may inspect the comments at the Public Reading Room, 1700 G Street, NW., by appointment. To make an appointment, call (202) 906-5922, send an e-mail to public.info@ots.treas.gov, or send a facsimile transmission to (202) 906-7755.

B. Proposed Information Collection. *Title of Information Collection:* Risk-Based Capital Standards: Advanced Capital Adequacy Framework.

Frequency of Response: event-generated.

Affected Public:

OCC: National banks and Federal branches and agencies of foreign banks.

Board: State member banks, bank holding companies, affiliates and certain non-bank subsidiaries of bank holding companies, uninsured state agencies and branches of foreign banks, commercial lending companies owned or controlled by foreign banks, and Edge and agreement corporations.

FDIC: Insured nonmember banks, insured state branches of foreign banks, and certain subsidiaries of these entities.

OTS: Savings associations and certain of their subsidiaries.

Abstract: The proposed rule sets forth a new risk-based capital adequacy framework that would require some banks and allow other qualifying banks to use an internal ratings-based approach to calculate regulatory credit risk capital requirements and advanced measurement approaches to calculate regulatory operational risk capital requirements.

The information collection requirements in the proposed rule are found in sections 21-23, 42, 44, 53, and 71. The collections of information are necessary in order to implement the proposed advanced capital adequacy framework.

Sections 21 and 22 require that a bank adopt a written implementation plan that addresses how it will comply with the proposed advanced capital adequacy framework's qualification requirements, including incorporation of a comprehensive and sound planning and governance process to oversee the implementation efforts. The bank must also develop processes for assessing capital adequacy in relation to an organization's risk profile. It must establish and maintain internal risk rating and segmentation systems for wholesale and retail risk exposures, including comprehensive risk parameter quantification processes and processes for annual reviews and analyses of reference data to determine their relevance. It must document its process for identifying, measuring, monitoring, controlling, and internally reporting operational risk; verify the accurate and timely reporting of risk-based capital requirements; and monitor, validate, and refine its advanced systems.

Section 23 requires a bank to notify its primary Federal supervisor when it makes a material change to its advanced systems and to develop an implementation plan after any mergers.

Section 42 outlines the capital treatment for securitization exposures. A bank must disclose publicly that it has provided implicit support to the securitization and the regulatory capital impact to the bank of providing such implicit support.

Section 44 describes the IAA. A bank must receive prior written approval from its primary Federal supervisor before it can use the IAA. A bank must review and update each internal credit assessment whenever new material is available, but at least annually. It must validate its internal credit assessment process on an ongoing basis and at least annually.

Section 53 outlines the IMA. A bank must receive prior written approval from its primary Federal supervisor before it can use the IMA.

Section 71 specifies that each consolidated bank must publicly disclose its total and tier 1 risk-based capital ratios and their components.

Estimated Burden: The burden estimates below exclude the following: (1) Any burden associated with changes to the regulatory reports of the agencies (such as the Consolidated Reports of Income and Condition for banks (FFIEC 031 and FFIEC 031; OMB Nos. 7100-0036, 3064-0052, 1557-0081) and the Thrift Financial Report for thrifts (TFR; OMB No. 1550-0023); (2) any burden associated with capital changes in the Basel II market risk rule; and (3) any burden associated with the Quantitative

Impact Study (QIS-4 survey, FR 3045; OMB No. 7100-0303). The agencies are concurrently publishing notices, which will address burden associated with the first item (published elsewhere in this issue), and jointly publishing a rulemaking which will address burden associated with the second item. For the third item, the Federal Reserve previously took burden for the QIS-4 survey, and some institutions may leverage the requirements of the QIS-4 survey to fulfill the requirements of this rule.

The burden associated with this collection of information may be summarized as follows:

OCC

Number of Respondents: 52.

Estimated Burden Per Respondent: 15,570 hours.

Total Estimated Annual Burden:

809,640 hours.

Board

Number of Respondents: 15.

Estimated Burden Per Respondent: 14,422 hours.

Total Estimated Annual Burden:

216,330 hours.

FDIC

Number of Respondents: 19.

Estimated Burden Per Respondent: 410 hours.

Total Estimated Annual Burden:

7,800 hours.

OTS

Number of Respondents: 4.

Estimated Burden Per Respondent: 15,000 hours.

Total Estimated Annual Burden:

60,000 hours.

Plain Language

Section 722 of the GLB Act requires the agencies to use "plain language" in all proposed and final rules published after January 1, 2000. In light of this requirement, the agencies have sought to present the proposed rule in a simple and straightforward manner. The agencies invite comments on whether there are additional steps the agencies could take to make the proposed rule easier to understand.

OCC Executive Order 12866

Executive Order 12866 requires Federal agencies to prepare a regulatory impact analysis for agency actions that are found to be "significant regulatory actions." "Significant regulatory actions" include, among other things, rulemakings that "have an annual effect on the economy of \$100 million or more or adversely affect in a material way the economy, a sector of the economy, productivity, competition, jobs, the environment, public health or safety, or State, local, or tribal governments or

communities."⁸⁶ Regulatory actions that satisfy one or more of these criteria are referred to as "economically significant regulatory actions."

The OCC anticipates that the proposed rule will meet the \$100 million criterion and therefore is an economically significant regulatory action. In conducting the regulatory analysis for an economically significant regulatory action, Executive Order 12866 requires each Federal agency to provide to the Administrator of the Office of Management and Budget's (OMB) Office of Information and Regulatory Affairs (OIRA):

- The text of the draft regulatory action, together with a reasonably detailed description of the need for the regulatory action and an explanation of how the regulatory action will meet that need;

- An assessment of the potential costs and benefits of the regulatory action, including an explanation of the manner in which the regulatory action is consistent with a statutory mandate and, to the extent permitted by law, promotes the President's priorities and avoids undue interference with State, local, and tribal governments in the exercise of their governmental functions;

- An assessment, including the underlying analysis, of benefits anticipated from the regulatory action (such as, but not limited to, the promotion of the efficient functioning of the economy and private markets, the enhancement of health and safety, the protection of the natural environment, and the elimination or reduction of discrimination or bias) together with, to the extent feasible, a quantification of those benefits;

- An assessment, including the underlying analysis, of costs anticipated from the regulatory action (such as, but not limited to, the direct cost both to the government in administering the regulation and to businesses and others in complying with the regulation, and any adverse effects on the efficient functioning of the economy, private markets (including productivity, employment, and competitiveness), health, safety, and the natural environment), together with, to the

⁸⁶ Executive Order 12866 (September 30, 1993), 58 FR 51735 (October 4, 1993), as amended by Executive Order 13258, 67 FR 9385 (February 28, 2002). For the complete text of the definition of "significant regulatory action," see E.O. 12866 at section 3(f). A "regulatory action" is "any substantive action by an agency (normally published in the *Federal Register*) that promulgates or is expected to lead to the promulgation of a final rule or regulation, including notices of inquiry, advance notices of proposed rulemaking, and notices of proposed rulemaking." E.O. 12866 at section 3(e).

extent feasible, a quantification of those costs; and

- An assessment, including the underlying analysis, of costs and benefits of potentially effective and reasonably feasible alternatives to the planned regulation, identified by the agencies or the public (including improving the current regulation and reasonably viable nonregulatory actions), and an explanation why the planned regulatory action is preferable to the identified potential alternatives. Set forth below is a summary of the OCC's regulatory impact analysis, which can be found in its entirety at <http://www.occ.treas.gov/law/basel.htm> under the link of "Regulatory Impact Analysis for Risk-Based Capital Standards: Revised Capital Adequacy Guidelines (Basel II), Office of the Comptroller of the Currency, International and Economic Affairs (2006)".

I. The Need for the Regulatory Action.

Federal banking law directs Federal banking agencies, including the OCC, to require banking organizations to hold adequate capital. The law authorizes Federal banking agencies to set minimum capital levels to ensure that banking organizations maintain adequate capital. The law also gives banking agencies broad discretion with respect to capital regulation by authorizing them to use any other methods that they deem appropriate to ensure capital adequacy.

Capital regulation seeks to address market failures that stem from several sources. Asymmetric information about the risk in a bank's portfolio creates a market failure by hindering the ability of creditors and outside monitors to discern a bank's actual risk and capital adequacy. Moral hazard creates market failure in which the bank's creditors fail to restrain the bank from taking excessive risks because deposit insurance either fully or partially protects them from losses. Public policy addresses these market failures because individual banks fail to adequately consider the positive externality or public benefit that adequate capital brings to financial markets and the economy as a whole.

Capital regulations cannot be static. Innovation in and transformation of financial markets require periodic reassessments of what may count as capital and what amount of capital is adequate. Continuing changes in financial markets create both a need and an opportunity to refine capital standards in banking. The Basel II framework, and its proposed implementation in the United States, reflects an appropriate step forward in addressing these changes.

II. Costs and Benefits of the Proposed Rule.

Under the proposed rule, current capital rules would remain in effect in 2008 during a parallel run using both current non-Basel II-based and new Basel II-based capital rules. For the following three years, the proposed rule would apply limits on the amount by which minimum required capital may decrease. This analysis, however, considers the costs and benefits of the proposed rule as fully phased in.

Cost and benefit analysis of changes in minimum capital requirements entails considerable measurement problems. On the cost side, it can be difficult to attribute particular expenditures incurred by institutions to the costs of implementation because banking organizations would likely incur some of these costs as part of their ongoing efforts to improve risk measurement and management systems. On the benefits side, measurement problems are even greater because the benefits of the proposal are more qualitative than quantitative. Measurement problems exist even with an apparently measurable benefit like lower minimum capital because lower minimum requirements do not necessarily mean lower capital. Healthy banking organizations generally hold capital well above regulatory minimums for a variety of reasons, and the effect of reducing the regulatory minimum is uncertain and may vary across regulated institutions.

A. Benefits of the Proposed Rule.

1. *Better allocation of capital and reduced impact of moral hazard through reduction in the scope for regulatory arbitrage:* By assessing the amount of capital required for each exposure or pool of exposures, the advanced approach does away with the simplistic risk buckets of current capital rules. Eliminating categorical risk weighting and assigning capital based on measured risk instead greatly curtails or eliminates the ability of troubled organizations to "game" regulatory capital requirements by finding ways to comply technically with the requirements while evading their intent and spirit.

2. *Improved signal quality of capital as an indicator of solvency:* The advanced approaches of the proposed rule are designed to more accurately align regulatory capital with risk, which should improve the quality of capital as an indicator of solvency. The improved signaling quality of capital will enhance banking supervision and market discipline.

3. *Encourages banking organizations to improve credit risk management:* One

of the principal objectives of the proposed rule is to more closely align capital charges and risk. For any type of credit, risk increases as either the probability of default or the loss given default increases. Under the proposed rule, risk weights depend on these risk measures and consequently capital requirements will more closely reflect risk. This enhanced link between capital requirements and risk will encourage banking organizations to improve credit risk management.

4. *More efficient use of required bank capital:* Increased risk sensitivity and improvements in risk measurement will allow prudential objectives to be achieved more efficiently. If capital rules can better align capital with risk across the system, a given level of capital will be able to support a higher level of banking activity while maintaining the same degree of confidence regarding the safety and soundness of the banking system. Social welfare is enhanced by either the stronger condition of the banking system or the increased economic activity the additional banking services facilitate.

5. *Incorporates and encourages advances in risk measurement and risk management:* The proposed rule seeks to improve upon existing capital regulations by incorporating advances in risk measurement and risk management made over the past 15 years. An objective of the proposed rule is to speed adoption of new risk management techniques and to promote the further development of risk measurement and management through the regulatory process.

6. *Recognizes new developments and accommodates continuing innovation in financial products by focusing on risk:* The proposed rule also has the benefit of facilitating recognition of new developments in financial products by focusing on the fundamentals behind risk rather than on static product categories.

7. *Better aligns capital and operational risk and encourages banking organizations to mitigate operational risk:* Introducing an explicit capital calculation for operational risk eliminates the implicit and imprecise "buffer" that covers operational risk under current capital rules. Introducing an explicit capital requirement for operational risk improves assessments of the protection capital provides, particularly at organizations where operational risk dominates other risks. The explicit treatment also increases the transparency of operational risk, which could encourage banking organizations

to take further steps to mitigate operational risk.

8. *Enhanced supervisory feedback:* Although U.S. banking organizations have long been subject to close supervision, aspects of all three pillars of the proposed rule aim to enhance supervisory feedback from Federal banking agencies to managers of banks and thrifts. Enhanced feedback could further strengthen the safety and soundness of the banking system.

9. *Incorporates market discipline into the regulatory framework:* The proposed rule seeks to introduce market discipline directly into the regulatory framework by requiring specific disclosures relating to risk measurement and risk management. Market discipline could complement regulatory supervision to bolster safety and soundness.

10. *Preserves the benefits of international consistency and coordination achieved with the 1988 Basel Accord:* An important objective of the 1988 Accord was competitive consistency of capital requirements for banking organizations competing in global markets. Basel II continues to pursue this objective. Because achieving this objective depends on the consistency of implementation in the United States and abroad, the Basel Committee has established an Accord Implementation Group to promote consistency in the implementation of Basel II.

11. *Ability to opt in offers long-term flexibility to nonmandatory banking organizations:* The proposed U.S. implementation of Basel II allows banking organizations outside of the mandatory group to individually judge when the benefits they expect to realize from adopting the advanced approaches outweigh their costs. Even though the cost and complexity of adopting the advanced approaches may present nonmandatory organizations with a substantial hurdle to opting in at present, the potential long-term benefits of allowing nonmandatory organizations to partake in the benefits described above may be similarly substantial.

B. Costs of the Proposed Rule.

Because banking organizations are constantly developing programs and systems to improve how they measure and manage risk, it is difficult to distinguish between expenditures explicitly caused by adoption of the proposed rule and costs that would have occurred irrespective of any new regulation. In an effort to identify how much banking organizations expect to spend to comply with the U.S. implementation of Basel II, the Federal banking agencies included several

questions related to compliance costs in QIS-4.⁸⁷

1. *Overall Costs:* According to the 19 out of 26 QIS-4 questionnaire respondents that provided estimates of their implementation costs, organizations will spend roughly \$42 million on average to adapt to capital requirements implementing Basel II. Not all of these respondents are likely mandatory organizations. Counting just the likely mandatory organizations, the average is approximately \$46 million, so there is little difference between organizations that meet a mandatory threshold and those that do not. Aggregating estimated expenditures from all 19 respondents indicates that these organizations will spend a total of \$791 million over several years to implement the proposed rule. Estimated costs for nine respondents meeting one of the mandatory thresholds come to \$412 million.

2. *Estimate of costs specific to the proposal:* Ten QIS-4 respondents provided estimates of the portion of costs they would have incurred even if current capital rules remain in effect. Those ten indicated that they would have spent 45 percent on average, or roughly half of their Basel II expenditures on improving risk management anyway. This suggests that of the \$42 million organizations expect to spend on implementation, approximately \$21 million may represent expenditures each institution would have undertaken even without Basel II. Thus, pure implementation costs may be closer to roughly \$395 million for the 19 QIS-4 respondents.

3. *Ongoing costs:* Seven QIS-4 respondents were able to estimate what their recurring costs might be under the proposed implementation of Basel II. On average, the seven organizations estimate that annual recurring expenses attributable to the proposed capital framework will be \$2.4 million. Organizations indicated that the ongoing costs to maintain related technology reflect costs for increased personnel and system maintenance. The larger one-time expenditures primarily involve money for system development and software purchases.

4. *Implicit costs:* In addition to explicit setup and recurring costs, banking organizations may also face implicit costs arising from the time and

inconvenience of having to adapt to new capital regulations. At a minimum this involves the increased time and attention required of senior bank and thrift management to introduce new programs and procedures and the need to closely monitor the new activities during the inevitable rough patches when the proposed rule first takes effect.

5. *Government administrative costs:* OCC expenditures fall into three broad categories: training, guidance, and supervision. Training includes expenses for AMA workshops, IRB workshops, and other training courses and seminars for examiners. Guidance expenses reflect expenditures on the development of IRB and AMA guidance. Supervision expenses reflect organization-specific supervisory activities related to the development and implementation of the Basel II framework. The largest OCC expenditures have been on the development of IRB and AMA policy guidance. The \$4.6 million spent on guidance represents 65 percent of the estimated total OCC Basel II-related expenditure of \$7.1 million through the 2005 fiscal year. In part, this large share reflects the absence of data for training and supervision costs for several years, but it also is indicative of the large guidance expenses in 2002 and 2003 when the Basel II framework was in development. To date, Basel II expenditures have not been a large part of overall OCC expenditures. The \$3 million spent on Basel II in fiscal year 2005 represents less than one percent of the OCC's \$519 million budget for the year.

6. *Total cost:* The OCC's estimate of the total cost of the proposed rule includes expenditures by banking organizations and the OCC from the present through 2011, the final year of the transition period. Combining expenditures by mandatory banking organizations and the OCC provides a present value estimate of \$545.9 million for the total cost of the proposed rule.

7. *Procyclicality:* Procyclicality refers to the possibility that banking organizations may reduce lending during economic downturns and increase lending during economic expansions as a consequence of minimum capital requirements. There is some concern that the risk-sensitivity of the IRB approach may cause capital requirements for credit risk to increase during an economic downturn. Although procyclicality may be inherent in banking to some extent, elements of the advanced approaches could reduce inherent procyclicality. Risk management and information systems may provide bank managers with more

⁸⁷ For more information on QIS-4, see Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, and Office of Thrift Supervision, "Summary Findings of the Fourth Quantitative Impact Study," February 2006, available online at <http://www.occ.treas.gov/ftp/release/2006-23a.pdf>.

forward-looking information about risk that would allow them to adjust portfolios gradually and with more foresight as the economic outlook changes over the business cycle. Regulatory stress-testing requirements included in the proposal also will help ensure that institutions anticipate cyclical changes in capital requirements to the greatest extent possible, reducing the potential economic impact of changes in capital requirements.

III. Competition Among Providers of Financial Services

One potential concern with any regulatory change is the possibility that it might create a competitive advantage for some organizations relative to others, a possibility that certainly applies to a change with the scope of this proposed rule. However, measurement difficulties described in the preceding discussion of costs and benefits also extend to any consideration of the impact on competition. Despite the inherent difficulty of drawing definitive conclusions, this section considers various ways in which competitive effects might be manifest, as well as available evidence related to those potential effects.

1. *Explicit Capital for Operational Risk:* Some have noted that the explicit computation of required capital for operational risk could lead to an increase in total minimum regulatory capital for U.S. "processing" banks, generally defined as banking organizations that tend to engage in a variety of activities related to securities clearing, asset management, and custodial services. Some have suggested that the increase in required capital could place such firms at a competitive disadvantage relative to competitors that do not face a similar capital requirement. A careful analysis by Fontnouvelle et al.⁸⁸ considers the potential competitive impact of the explicit capital requirement for operational risk. Overall, the study concludes that competitive effects from an explicit operational risk capital requirement should be, at most, extremely modest.

2. *Residential Mortgage Lending:* The issue of competitive effects has received substantial attention with respect to the residential mortgage market. The focus on the residential mortgage market stems from the size and importance of the market in the United States and the

fact that the proposed rule may lead to substantial reductions in credit-risk capital for residential mortgages. To the extent that corresponding operational-risk capital requirements do not offset these credit-risk-related reductions, overall capital requirements for residential mortgages could decline under the proposed rule. Studies by Calem and Follain⁸⁹ and Hancock, Lehnert, Passmore, and Sherlund⁹⁰ suggest that banking organizations operating under capital rules based on Basel II may increase their holdings of residential mortgages. Calem and Follain argue that the increase would be significant and come at the expense of general organizations. Hancock et al. foresee a more modest increase in residential mortgage holdings at institutions operating under the new Basel II-based rules, and they see this increase primarily as a shift away from the large government sponsored mortgage enterprises.

3. *Small Business Lending:* One potential avenue for competitive effects is small-business lending. Smaller banks—those that are less likely to adopt the advanced approaches to regulatory capital under the proposed rule—tend to rely more heavily on smaller loans within their commercial loan portfolios. To the extent that the proposed rule reduces required capital for such loans, general banking organizations not operating under the proposed rule might be placed at a competitive disadvantage. A study by Berger⁹¹ finds some potential for a relatively small competitive effect on smaller banks in small business lending. However, Berger concludes that the small business market for large banks is very different from the small business market for smaller banks. For instance, a "small business" at a larger banking organization is usually much larger than small businesses at community banking organizations.

⁸⁹Paul S. Calem and James R. Follain, "An Examination of How the Proposed Bifurcated Implementation of Basel II in the U.S. May Affect Competition Among Banking Organizations for Residential Mortgages," manuscript, January 14, 2005.

⁹⁰Diana Hancock, Andreas Lehnert, Wayne Passmore, and Shane M. Sherlund, "An Analysis of the Potential Competitive Impact of Basel II Capital Standards on U.S. Mortgage Rates and Mortgage Securitization", Federal Reserve Board manuscript, April 2005. Available at <http://www.federalreserve.gov/generalinfo/basel2/whitepapers.htm>.

⁹¹Allen N. Berger, "Potential Competitive Effects of Basel II on Banks in SME Credit Markets in the United States," Federal Reserve Board Finance and Economics Discussion Series, 2004–12. Available at <http://www.federalreserve.gov/generalinfo/basel2/whitepapers.htm>.

4. *Mergers and Acquisitions:* Another concern related to potential changes in competitive conditions under the proposed rule is that bifurcation of capital standards might change the landscape with regard to mergers and acquisitions in banking and financial services. For example, banking organizations operating under the new Basel II-based capital requirements might be placed in a better position to acquire other banking organizations operating under the non-Basel II-based rules, possibly leading to an undesirable consolidation of the banking sector. Research by Hannan and Pilloff⁹² suggests that the proposed rule is unlikely to have a significant impact on merger and acquisition activity in banking.

5. *Credit Card Competition:* The proposed U.S. implementation of Basel II might also affect competition in the credit card market. Overall capital requirements for credit card loans could increase under the proposed rule. This raises the possibility of a change in the competitive environment among banking organizations subject to the new Basel II-based capital rules, nonbank credit card issuers, and banking organizations not subject to the new Basel II-based capital rules. A study by Lang, Mester, and Vermilyea⁹³ finds that implementation of a rule based on Basel II will not affect credit card competition at most community and regional banking organizations. The authors also suggest that higher capital requirements for credit cards may only pose a modest disadvantage to institutions that are subject to rules based on Basel II.

Overall, the evidence regarding the impact of the proposed rule on competitive equity is mixed. The body of recent economic research discussed in the body of this report does not reveal persuasive evidence of any sizeable competitive effects. Nonetheless, the Federal banking agencies recognize the need to closely monitor the competitive landscape subsequent to any regulatory change. In particular, the OCC and other Federal banking agencies will be alert

⁹²Timothy H. Hannan and Steven J. Pilloff, "Will the Proposed Application of Basel II in the United States Encourage Increased Bank Merger Activity? Evidence from Past Merger Activity," Federal Reserve Board Finance and Economics Discussion Series, 2004–13. Available at <http://www.federalreserve.gov/generalinfo/basel2/whitepapers.htm>.

⁹³William W. Lang, Loretta J. Mester, and Todd A. Vermilyea, "Potential Competitive Effects on U.S. Bank Credit Card Lending from the Proposed Bifurcated Application of Basel II," manuscript, December 2005. Available at <http://www.federalreserve.gov/generalinfo/basel2/whitepapers.htm>.

⁸⁸Patrick de Fontnouvelle, Victoria Garrity, Scott Chu, and Eric Rosengren, "The Potential Impact of Explicit Operational Risk Capital Charges on Bank Processing Activities," Manuscript, Federal Reserve Bank of Boston, January 12, 2005. Available at <http://www.federalreserve.gov/generalinfo/basel2/whitepapers.htm>.

for early signs of competitive inequities that might result from this proposed rule. A multi-year transition period before full implementation of proposed rules based on Basel II should provide ample opportunity for the agencies to identify any emerging problems. To the extent that undesirable competitive inequities emerge, the agencies have the power to respond to them through many channels, including but not limited to suitable changes to the capital adequacy regulations.

IV. Analysis of Baseline and Alternatives.

Executive Order 12866 requires a comparison between the proposed rule, a baseline of what the world would look like without the proposed rule, and several reasonable alternatives to the proposed rule. In this regulatory impact analysis, we analyze two baselines and three alternatives to the proposed rule. We consider two baselines because of two very different outcomes that depend on the capital rules that other countries with internationally active banks might adopt absent the implementation of the Basel II framework in the United States.⁹⁴ The first baseline considers the possibility that neither the United States nor these other countries adopt capital rules based on the Basel II framework. The second baseline analyzes the situation where the United States does not adopt the proposed rule, but the other countries with internationally active banking organizations do adopt Basel II.

A. Presentation of Baselines and Alternatives.

1. *Baseline Scenario 1: Current capital standards based on the 1988 Basel Accord continue to apply both here and abroad:* Abandoning the Basel II framework in favor of current capital rules would eliminate essentially all of the benefits of the proposed rule described earlier. In place of these lost or diminished benefits, the only advantage of continuing to apply current capital rules to all banking organizations is that maintaining the status quo should alleviate concerns regarding competition among financial service providers. Although the effect of the proposed rule on competition is uncertain in our estimation, staying with current capital rules (or universally applying a revised rule that might emerge from the Basel IA ANPR) eliminates bifurcation and the explicit assignment of capital for operational

risk. Concerns regarding competition usually center on these two characteristics of the proposed rule. While continuing to use current capital rules eliminates most of the benefits of adopting the proposed capital rule, it does not eliminate many costs associated with Basel II. Because Basel II costs are difficult to separate from the banking organization's ordinary development costs and ordinary supervisory costs at the agencies, dropping the proposal to implement Basel II would reduce but not eliminate many of these costs associated with the proposed rule.⁹⁵

2. *Baseline Scenario 2: Current capital standards based on the 1988 Basel Accord continue to apply in the United States, but the rest of the world adopts the Basel II framework:* Like the first baseline scenario, abandoning a framework based on Basel II in favor of current capital rules would eliminate essentially all of the benefits of the proposed rule described earlier. Like the first baseline scenario, the one advantage of this scenario is that there would be no bifurcation of capital rules within the United States. However, the emergence of different capital rules across national borders would at least partially offset this advantage. Thus, while concerns regarding competition among U.S. financial service providers might diminish in this scenario, concerns regarding cross-border competition would likely increase. Just as the first baseline scenario eliminated most of the benefits of adopting the proposed rule, the same holds true for the second baseline scenario with one important distinction. Because the United States would be operating under a set of capital rules different from the rest of the world, U.S. banking organizations that are internationally active may face higher costs because they will have to track and comply with more than one set of capital requirements.

3. *Alternative A: Permit U.S. banking organizations to choose among all three Basel II credit risk approaches:* The principal benefit of Alternative A that the proposed rule does not achieve is the increased flexibility of the regulation for banking organizations that would be mandatory banking organizations under the proposed rule. Banking organizations that are not prepared for the adoption of the advanced IRB approach to credit risk under the proposed rule could choose to use the foundation IRB approach or

even the standardized approach. How Alternative A might affect benefits depends entirely on how many banking organizations select each of the three available options. The most significant drawback to Alternative A is the increased cost of applying a new set of capital rules to all U.S. banking organizations. The vast majority of banking organizations in the United States would incur no direct costs from new capital rules under the proposed rule. Under Alternative A, direct costs would increase for every U.S. banking organization that would have continued with current capital rules under the proposed rule. Although it is not clear how high these costs might be, general banking organizations would face higher costs because they would be changing capital rules regardless of which option they choose under Alternative A.

4. *Alternative B: Permit U.S. banking organizations to choose among all three Basel II operational risk approaches:* The operational risk approach that banking organizations ultimately selected would determine how the overall benefits of the new capital regulations would change under Alternative B. Just as Alternative A increases the flexibility of credit risk rules for mandatory banking organizations, Alternative B is more flexible with respect to operational risk. Because the Standardized Approach tries to be more sensitive to variations in operational risk than the Basic Indicator Approach and the AMA is more sensitive than the Standardized Approach, the effect of implementing Alternative B depends on how many banking organizations select the more risk sensitive approaches. As was the case with Alternative A, the most significant drawback to Alternative B is the increased cost of applying a new set of capital rules to all U.S. banking organizations. Under Alternative B, direct costs would increase for every U.S. banking organization that would have continued with current capital rules under the proposed rule. It is not clear how much it might cost banking organizations to adopt these capital measures for operational risk, but general banking organizations would face higher costs because they would be changing capital rules regardless of which option they choose under Alternative B.

5. *Alternative C: Use a different asset amount to determine a mandatory organization:* The number of mandatory banking organizations decreases slowly as the size thresholds increase, and the number of banking organizations grows more quickly as the thresholds decrease. Under Alternative C, the framework of

⁹⁴ In addition to the United States, members of the Basel Committee on Banking Supervision considering Basel II are Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, the Netherlands, Spain, Sweden, Switzerland, and the United Kingdom.

⁹⁵ Cost estimates for adopting a rule that might result from the Basel IA ANPR are not currently available.

the proposed rule would remain the same and only the number of mandatory banking organizations would change. Because the structure of the proposed implementation would remain intact, Alternative C would capture all of the benefits of the proposed rule. However, because these benefits derive from applying the proposed rule to individual banking organizations, changing the number of banking organizations affected by the rule will change the cumulative level of the benefits achieved. Generally, the benefits associated with the proposed rule will rise and fall with the number of mandatory banking organizations. Because Alternative C would change the number of mandatory banking organizations subject to the proposed rule, aggregate costs will also rise or fall with the number of mandatory banking organizations.

B. Overall Comparison of the Proposed Rule with Baselines and Alternatives.

The Basel II framework and its proposed U.S. implementation seek to incorporate risk measurement and risk management advances into capital requirements. On the basis of their analysis, the agencies believe that the benefits of the proposed rule are significant, durable, and hold the potential to increase with time. The offsetting costs of implementing the proposed rule are also significant, but appear to be largely because of considerable start-up costs. However, much of the apparent start-up costs reflect activities that the banking organizations would undertake as part of their ongoing efforts to improve the quality of their internal risk measurement and management, even in the absence of Basel II and this proposed rule. The advanced approaches seem to have fairly modest ongoing expenses. Against these costs, the significant benefits of Basel II suggest that the proposed rule offers an improvement over either of the two baseline scenarios.

With regard to the three alternative approaches we consider, the proposed rule seems to offer an important degree of flexibility while significantly restricting the cost of the proposed rule by limiting its application to large, complex, internationally active banking organizations. Alternatives A and B introduce more flexibility from the perspective of the large mandatory banking organizations, but each is less flexible with respect to other banking organizations. Either Alternative A or B would compel these banking organizations to select a new set of capital rules and require them to

undertake the time and expense of adjusting to these new rules. Alternative C would change the number of mandatory banking organizations. If the number of mandatory banking organizations increases, then the new rule would lose some of the flexibility the proposed rule achieves with the opt-in option. Furthermore, costs would increase as the new rule would compel more banking organizations to incur the expense of adopting the advanced approaches. Decreasing the number of mandatory banking organizations would decrease the aggregate social good of each benefit achieved with the proposed rule. The proposed rule seems to offer a better balance between costs and benefits than any of the three alternatives.

OTS Executive Order 12866 Determination. OTS commented on the development of, and concurs with, OCC's RIA. Rather than replicate that analysis, OTS drafted an RIA incorporating OCC's analysis by reference and adding appropriate material reflecting the unique aspects of the thrift industry. The full text of OTS's RIA is available at the locations for viewing the OTS docket indicated in the **ADDRESSES** section above. OTS believes that its analysis meets the requirements of Executive Order 12866. The following discussion supplements OCC's summary of its RIA.

The NPR would apply to approximately eight mandatory and potential opt-in savings associations representing approximately 46 percent of total thrift industry assets. Approximately 70 percent of the total assets in these eight institutions are concentrated in residential mortgage-related assets. By contrast, national banks tend to concentrate their assets in commercial loans and other kinds of non-mortgage loans. Only about 35 percent of national bank's total assets are residential mortgage-related assets. As a result, the costs and benefits of the NPR for OTS-regulated savings associations will differ in important ways from OCC-regulated national banks. These differences are the focus of OTS's analysis.

Benefits. Among the benefits of the NPR, OCC cites: (i) Better allocation of capital and reduced impact of moral hazard through reduction in the scope for regulatory arbitrage; (ii) improved signal quality of capital as an indicator of institution solvency; and (iii) more efficient use of required bank capital. From OTS's perspective, however, the NPR may not provide the degree of benefits anticipated by OCC from these sources.

Because of the low credit risk associated with residential mortgage-related assets, OTS believes that the risk-insensitive leverage ratio, rather than the risk-based capital ratio, may be more binding on its institutions.⁹⁶ As a result, these institutions may be required to hold more capital than would be required under proposed credit risk-based standards alone. Therefore, the NPR may cause these institutions to incur much the same implementation costs as banks with riskier assets, but with reduced benefits.

Costs. OTS adopts the OCC cost analysis with the following supplemental information on OTS's administrative costs. OTS did not incur a meaningful amount of direct expenditures until 2002 when it transitioned from a monitoring role to active involvement in Basel II. Thereafter, expenditures increased rapidly. The OTS expenditures fall into two broad categories: Policymaking expenses incurred in the development of the ANPR, this NPR, and related guidance; and supervision expenses that reflect institution-specific supervisory activities. OTS estimates that it incurred total expenses of \$3,780,000 for fiscal years 2002 through 2005, including \$2,640,000 in policymaking expenses and \$1,140,000 in supervision expenses. OTS anticipates that supervision expenses will continue to grow as a percentage of the total expense as it moves from policy development to implementation and training. To date, Basel II expenditures have not been a large part of overall expenditures.

Competition. OTS agrees with OCC's analysis of competition among providers of financial services. OTS adds, however, that some institutions with low credit risk portfolios face an existing competitive disadvantage because they are bound by a non-risk-based capital requirement—the leverage ratio. Thus, the agencies regulate a class of institutions that currently receive fewer capital benefits from risk-based capital rules because they are bound by the risk-insensitive leverage ratio. This anomaly will likely continue under the NPR.

⁹⁶ The leverage ratio is the ratio of core capital to adjusted total assets. Under prompt corrective action requirements, savings associations must maintain a leverage ratio of at least five percent to be well capitalized and at least four percent to be adequately capitalized. Basel II will primarily affect the calculation of risk-weighted assets, rather than the calculation of total assets and will have only a modest impact on the calculation of core capital. Thus, the proposed Basel II changes should not significantly affect the calculated leverage ratio and a savings association that is currently constrained by the leverage ratio would not significantly benefit from the Basel II changes.

In addition, the results from QIS-3 and QIS-4 suggest that the largest reductions in regulatory credit-risk capital requirements from the application of revised rules would occur in the residential mortgage loan area. Thus, to the extent regulatory credit-risk capital requirements affect pricing of such loans, it is possible that core and opt-in institutions who are not constrained by the leverage ratio may experience an improvement in their competitive standing vis-à-vis non-adopters and vis-à-vis adopters who are bound by the leverage ratio. Two research papers—one by Calem and Follain,⁹⁷ and another by Hancock, Lenhert, Passmore, and Sherlund⁹⁸ addressed this topic. The Calem and Follain paper argues that Basel II will significantly affect the competitive environment in mortgage lending; Hancock, et al. argue that it will not. Both papers are predicated, however, on the current capital regime for non-adopters. The agencies recently published an ANPR seeking comment on various modifications to the existing risk-based capital rules.⁹⁹ These changes may reduce the competitive disparities between adopters and non-adopters of Basel II by reducing the competitive advantage of Basel II adopters.

Further, residential mortgages are subject to substantial interest rate risk. The agencies will retain the authority to require additional capital to cover interest rate risk. If regulatory capital requirements affect asset pricing, a substantial regulatory capital interest rate risk component could mitigate any competitive advantages of the proposed rule. Moreover, the capital requirement for interest rate risk would be subject to interpretation by each agency. A consistent evaluation of interest rate risk by the supervisory agencies would present a level playing field among the adopters—an important consideration given the potential size of the capital requirement.

OCC Unfunded Mandates Reform Act of 1995 Determination. The Unfunded Mandates Reform Act of 1995 (Pub. L. 104-4) (UMRA) requires cost-benefit and other analyses for a rule that would include any Federal mandate that may

result in the expenditure by State, local, and tribal governments, in the aggregate, or by the private sector of \$100 million or more (adjusted annually for inflation) in any one year. The current inflation-adjusted expenditure threshold is \$119.6 million. The requirements of the UMRA include assessing a rule's effects on future compliance costs; particular regions or State, local, or tribal governments; communities; segments of the private sector; productivity; economic growth; full employment; creation of productive jobs; and the international competitiveness of U.S. goods and services. The proposed rule qualifies as a significant regulatory action under the UMRA because its Federal mandates may result in the expenditure by the private sector of \$119.6 million or more in any one year. As permitted by section 202(c) of the UMRA, the required analyses have been prepared in conjunction with the Executive Order 12866 analysis document titled *Regulatory Impact Analysis for Risk-Based Capital Standards: Revised Capital Adequacy Guidelines*. The analysis is available on the Internet at <http://www.occ.treas.gov/law/basel.htm> under the link of "Regulatory Impact Analysis for Risk-Based Capital Standards: Revised Capital Adequacy Guidelines (Basel II), Office of the Comptroller of the Currency, International and Economic Affairs (2006)".

OTS Unfunded Mandates Reform Act of 1995 Determination. The Unfunded Mandates Reform Act of 1995 (Pub. L. 104-4) (UMRA) requires cost-benefit and other analyses for a rule that would include any Federal mandate that may result in the expenditure by State, local, and tribal governments, in the aggregate, or by the private sector of \$100 million or more (adjusted annually for inflation) in any one year. The current inflation-adjusted expenditure threshold is \$119.6 million. The requirements of the UMRA include assessing a rule's effects on future compliance costs; particular regions or State, local, or tribal governments; communities; segments of the private sector; productivity; economic growth; full employment; creation of productive jobs; and the international competitiveness of U.S. goods and services. The proposed rule qualifies as a significant regulatory action under the UMRA because its Federal mandates may result in the expenditure by the private sector of \$119.6 million or more in any one year. As permitted by section 202(c) of the UMRA, the required analyses have been prepared in conjunction with the Executive Order 12866 analysis

document titled *Regulatory Impact Analysis for Risk-Based Capital Standards: Revised Capital Adequacy Guidelines*. The analysis is available at the locations for viewing the OTS docket indicated in the **ADDRESSES** section above.

Text of Common Appendix (All Agencies)

The text of the agencies' common appendix appears below:

[Appendix to Part ____]—Capital Adequacy Guidelines for [Bank]s;¹⁰⁰ Internal-Ratings-Based and Advanced Measurement Approaches

Part I General Provisions

- Section 1 Purpose, Applicability, and Reservation of Authority
- Section 2 Definitions
- Section 3 Minimum Risk-Based Capital Requirements

Part II Qualifying Capital

- Section 11 Additional Deductions
- Section 12 Deductions and Limitations Not Required
- Section 13 Eligible Credit Reserves

Part III Qualification

- Section 21 Qualification Process
- Section 22 Qualification Requirements
- Section 23 Ongoing Qualification

Part IV Risk-Weighted Assets for General Credit Risk

- Section 31 Mechanics for Calculating Total Wholesale and Retail Risk-Weighted Assets
- Section 32 Counterparty Credit Risk
- Section 33 Guarantees and Credit Derivatives: PD Substitution and LGD Adjustment Treatments
- Section 34 Guarantees and Credit Derivatives: Double Default Treatment
- Section 35 Risk-Based Capital Requirement for Unsettled Transactions

Part V Risk-Weighted Assets for Securitization Exposures

- Section 41 Operational Criteria for Recognizing the Transfer of Risk
- Section 42 Risk-Based Capital Requirement for Securitization Exposures
- Section 43 Ratings-Based Approach (RBA)
- Section 44 Internal Assessment Approach (IAA)
- Section 45 Supervisory Formula Approach (SFA)
- Section 46 Recognition of Credit Risk Mitigants for Securitization Exposures
- Section 47 Risk-Based Capital Requirement for Early Amortization Provisions

Part VI Risk-Weighted Assets for Equity Exposures

- Section 51 Introduction and Exposure Measurement
- Section 52 Simple Risk Weight Approach (SRWA)
- Section 53 Internal Models Approach (IMA)

¹ For simplicity, and unless otherwise noted, this NPR uses the term [bank] to include banks, savings associations, and bank holding companies. [AGENCY] refers to the primary Federal supervisor of the bank applying the rule.

⁹⁷ Paul S. Calem and James R. Follain, "An Examination of How the Proposed Bifurcated Implementation of Basel II in the U.S. May Affect Competition Among Banking Organizations for Residential Mortgages," manuscript, January 14, 2005.

⁹⁸ Diana Hancock, Andreas Lenhert, Wayne Passmore, and Shane M. Sherlund, "An Analysis of the Competitive Impacts of Basel II Capital Standards on U.S. Mortgage Rates and Mortgage Securitization, March 7, 2005, Board of Governors of the Federal Reserve System, working paper."

⁹⁹ 70 FR 61068 (Oct. 20, 2005).

Section 54	Equity Exposures to Investment Funds
Section 55	Equity Derivative Contracts
Part VII	Risk-Weighted Assets for Operational Risk
Section 61	Qualification Requirements for Incorporation of Operational Risk Mitigants
Section 62	Mechanics of Risk-Weighted Asset Calculation
Part VIII	Disclosure
Section 71	Disclosure Requirements

Part I. General Provisions

Section 1. Purpose, Applicability, and Reservation of Authority

(a) *Purpose.* This appendix establishes:

(1) Minimum qualifying criteria for [bank]s using [bank]-specific internal risk measurement and management processes for calculating risk-based capital requirements;

(2) Methodologies for such [bank]s to calculate their risk-based capital requirements; and

(3) Public disclosure requirements for such [bank]s.

(b) *Applicability.* (1) This appendix applies to a [bank] that:

(i) Has consolidated total assets, as reported on the most recent year-end Consolidated Report of Condition and Income (Call Report) or Thrift Financial Report (TFR), equal to \$250 billion or more;

(ii) Has consolidated total on-balance sheet foreign exposure at the most recent year-end equal to \$10 billion or more (where total on-balance sheet foreign exposure equals total cross-border claims less claims with head office or guarantor located in another country plus redistributed guaranteed amounts to the country of head office or guarantor plus local country claims on local residents plus revaluation gains on foreign exchange and derivative products, calculated in accordance with the Federal Financial Institutions Examination Council (FFIEC) 009 Country Exposure Report);

(iii) Is a subsidiary of a depository institution that uses 12 CFR part 3, Appendix C, 12 CFR part 208, Appendix F, 12 CFR part 325, Appendix D, or 12 CFR part 566, Appendix A, to calculate its risk-based capital requirements; or

(iv) Is a subsidiary of a bank holding company (as defined in 12 U.S.C. 1841) that uses 12 CFR part 225, Appendix F, to calculate its risk-based capital requirements.

(2) Any [bank] may elect to use this appendix to calculate its risk-based capital requirements.

(3) A [bank] that is subject to this appendix must use this appendix unless the [AGENCY] determines in writing that application of this appendix is not

appropriate in light of the [bank]'s asset size, level of complexity, risk profile, or scope of operations. In making a determination under this paragraph, the [AGENCY] will apply notice and response procedures in the same manner and to the same extent as the notice and response procedures in 12 CFR 3.12 (for national banks), 12 CFR 263.202 (for bank holding companies and state member banks), 12 CFR 325.6(c) (for state nonmember banks), and 12 CFR 567.3(d) (for savings associations).

(c) *Reservation of authority—(1) Additional capital in the aggregate.* The [AGENCY] may require a [bank] to hold an amount of capital greater than otherwise required under this appendix if the [AGENCY] determines that the [bank]'s risk-based capital requirement under this appendix is not commensurate with the [bank]'s credit, market, operational, or other risks. In making a determination under this paragraph, the [AGENCY] will apply notice and response procedures in the same manner and to the same extent as the notice and response procedures in 12 CFR 3.12 (for national banks), 12 CFR 263.202 (for bank holding companies and state member banks), 12 CFR 325.6(c) (for state nonmember banks), and 12 CFR 567.3(d) (for savings associations).

(2) *Specific risk-weighted asset amounts.* (i) If the [AGENCY] determines that the risk-weighted asset amount calculated under this appendix by the [bank] for one or more exposures is not commensurate with the risks associated with those exposures, the [AGENCY] may require the [bank] to assign a different risk-weighted asset amount to the exposures, to assign different risk parameters to the exposures (if the exposures are wholesale or retail exposures), or to use different model assumptions for the exposures (if the exposures are equity exposures under the Internal Models Approach (IMA) or securitization exposures under the Internal Assessment Approach (IAA)), all as specified by the [AGENCY].

(ii) If the [AGENCY] determines that the risk-weighted asset amount for operational risk produced by the [bank] under this appendix is not commensurate with the operational risks of the [bank], the [AGENCY] may require the [bank] to assign a different risk-weighted asset amount for operational risk, to change elements of its operational risk analytical framework, including distributional and dependence assumptions, or to make other changes to the [bank]'s operational risk management processes, data and

assessment systems, or quantification systems, all as specified by the [AGENCY].

(3) *Other supervisory authority.* Nothing in this appendix limits the authority of the [AGENCY] under any other provision of law or regulation to take supervisory or enforcement action, including action to address unsafe or unsound practices or conditions, deficient capital levels, or violations of law.

Section 2. Definitions

Advanced internal ratings-based (IRB) systems means a [bank]'s internal risk rating and segmentation system; risk parameter quantification system; data management and maintenance system; and control, oversight, and validation system for credit risk of wholesale and retail exposures.

Advanced systems means a [bank]'s advanced IRB systems, operational risk management processes, operational risk data and assessment systems, operational risk quantification systems, and, to the extent the [bank] uses the following systems, the counterparty credit risk model, double default excessive correlation detection process, IMA for equity exposures, and IAA for securitization exposures to ABCP programs.

Affiliate with respect to a company means any company that controls, is controlled by, or is under common control with, the company. For purposes of this definition, a person or company controls a company if it:

(1) Owns, controls, or holds with power to vote 25 percent or more of a class of voting securities of the company; or

(2) Consolidates the company for financial reporting purposes.

Applicable external rating means, with respect to an exposure, the lowest external rating assigned to the exposure by any NRSRO.

Asset-backed commercial paper (ABCP) program means a program that primarily issues commercial paper that:

(1) Has an external rating; and

(2) Is backed by underlying exposures held in a bankruptcy-remote SPÉ.

Asset-backed commercial paper (ABCP) program sponsor means a [bank] that:

(1) Establishes an ABCP program;

(2) Approves the sellers permitted to participate in an ABCP program;

(3) Approves the exposures to be purchased by an ABCP program; or

(4) Administers the ABCP program by monitoring the underlying exposures, underwriting or otherwise arranging for the placement of debt or other obligations issued by the program,

compiling monthly reports, or ensuring compliance with the program documents and with the program's credit and investment policy.

Backtesting means the comparison of a [bank]'s internal estimates with actual outcomes during a sample period not used in model development. In this context, backtesting is one form of out-of-sample testing.

Benchmarking means the comparison of a [bank]'s internal estimates with relevant internal and external data sources or estimation techniques.

Business environment and internal control factors means the indicators of a [bank]'s operational risk profile that reflect a current and forward-looking assessment of the [bank]'s underlying business risk factors and internal control environment.

Carrying value means, with respect to an asset, the value of the asset on the balance sheet of the [bank], determined in accordance with GAAP.

Clean-up call means a contractual provision that permits a servicer to call securitization exposures before their stated maturity or call date. See also *eligible clean-up call*.

Commodity derivative contract means a commodity-linked swap, purchased commodity-linked option, forward commodity-linked contract, or any other instrument linked to commodities that gives rise to similar counterparty credit risks.

Company means a corporation, partnership, limited liability company, depository institution, business trust, special purpose entity, association, or similar organization.

Credit derivative means a financial contract executed under standard industry credit derivative documentation that allows one party (the protection purchaser) to transfer the credit risk of one or more exposures (reference exposure) to another party (the protection provider). See also *eligible credit derivative*.

Credit-enhancing interest-only strip (CEIO) means an on-balance sheet asset that, in form or in substance:

- (1) Represents a contractual right to receive some or all of the interest and no more than a minimal amount of principal due on the underlying exposures of a securitization; and
- (2) Exposes the holder to credit risk directly or indirectly associated with the underlying exposures that exceeds a pro rata share of the holder's claim on the underlying exposures, whether through subordination provisions or other credit-enhancement techniques.

Credit-enhancing representations and warranties means representations and warranties that are made or assumed in

connection with a transfer of underlying exposures (including loan servicing assets) and that obligate a [bank] to protect another party from losses arising from the credit risk of the underlying exposures. Credit-enhancing representations and warranties include provisions to protect a party from losses resulting from the default or nonperformance of the obligors of the underlying exposures or from an insufficiency in the value of the collateral backing the underlying exposures. Credit-enhancing representations and warranties do not include:

- (1) Early default clauses and similar warranties that permit the return of, or premium refund clauses that cover, first-lien residential mortgage exposures for a period not to exceed 120 days from the date of transfer, provided that the date of transfer is within one year of origination of the residential mortgage exposure;

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

- (3) Warranties that permit the return of underlying exposures in instances of misrepresentation, fraud, or incomplete documentation.

Credit risk mitigant means collateral, a credit derivative, or a guarantee.

Credit-risk-weighted assets means 1.06 multiplied by the sum of:

- (1) Total wholesale and retail risk-weighted assets;
- (2) Risk-weighted assets for securitization exposures; and
- (3) Risk-weighted assets for equity exposures.

Current exposure means, with respect to a netting set, the larger of zero or the market value of a transaction or portfolio of transactions within the netting set that would be lost upon default of the counterparty, assuming no recovery on the value of the transactions. Current exposure is also called replacement cost.

Default—(1) *Retail*. (i) A retail exposure of a [bank] is in default if:

- (A) The exposure is 180 days past due, in the case of a residential mortgage exposure or revolving exposure;
- (B) The exposure is 120 days past due, in the case of all other retail exposures; or

- (C) The [bank] has taken a full or partial charge-off or write-down of principal on the exposure for credit-related reasons.

(ii) A retail exposure in default remains in default until the [bank] has reasonable assurance of repayment and performance for all contractual principal and interest payments on the exposure.

(2) *Wholesale*. (i) A [bank]'s obligor is in default if, for any wholesale exposure of the [bank] to the obligor, the [bank] has:

(A) Placed the exposure on non-accrual status consistent with the Call Report Instructions or the TFR and the TFR Instruction Manual;

(B) Taken a full or partial charge-off or write-down on the exposure due to the distressed financial condition of the obligor; or

(C) Incurred a credit-related loss of 5 percent or more of the exposure's initial carrying value in connection with the sale of the exposure or the transfer of the exposure to the held-for-sale, available-for-sale, trading account, or other reporting category.

(ii) An obligor in default remains in default until the [bank] has reasonable assurance of repayment and performance for all contractual principal and interest payments on all exposures of the [bank] to the obligor (other than exposures that have been fully written-down or charged-off).

Dependence means a measure of the association among operational losses across and within business lines and operational loss event types.

Depository institution is defined in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813).

Derivative contract means a financial contract whose value is derived from the values of one or more underlying assets, reference rates, or indices of asset values or reference rates. Derivative contracts include interest rate derivative contracts, exchange rate derivative contracts, equity derivative contracts, commodity derivative contracts, credit derivatives, and any other instrument that poses similar counterparty credit risks. Derivative contracts also include unsettled securities, commodities, and foreign exchange transactions with a contractual settlement or delivery lag that is longer than the lesser of the market standard for the particular instrument or 5 business days.

Early amortization provision means a provision in the documentation governing a securitization that, when triggered, causes investors in the securitization exposures to be repaid before the original stated maturity of the securitization exposures, unless the provision is triggered solely by events not directly related to the performance of the underlying exposures or the originating [bank] (such as material

changes in tax laws or regulations). An early amortization provision is a *controlled early amortization provision* if it meets all the following conditions:

(1) The originating [bank] has appropriate policies and procedures to ensure that it has sufficient capital and liquidity available in the event of an early amortization;

(2) Throughout the duration of the securitization (including the early amortization period), there is the same pro rata sharing of interest, principal, expenses, losses, fees, recoveries, and other cash flows from the underlying exposures based on the originating [bank]'s and the investors' relative shares of the underlying exposures outstanding measured on a consistent monthly basis;

(3) The amortization period is sufficient for at least 90 percent of the total underlying exposures outstanding at the beginning of the early amortization period to be repaid or recognized as in default; and

(4) The schedule for repayment of investor principal is not more rapid than would be allowed by straight-line amortization over an 18-month period.

Economic downturn conditions means, with respect to an exposure, those conditions in which the aggregate default rates for the exposure's wholesale or retail exposure subcategory (or subdivision of such subcategory selected by the [bank]) in the exposure's national jurisdiction (or subdivision of such jurisdiction selected by the [bank]) are significantly higher than average.

Effective maturity (M) of a wholesale exposure means:

(1) For wholesale exposures other than repo-style transactions, eligible margin loans, and OTC derivative contracts subject to a qualifying master netting agreement:

(i) The weighted-average remaining maturity (measured in years, whole or fractional) of the expected contractual cash flows from the exposure, using the undiscounted amounts of the cash flows as weights; or

(ii) The nominal remaining maturity (measured in years, whole or fractional) of the exposure.

(2) For repo-style transactions, eligible margin loans, and OTC derivative contracts subject to a qualifying master netting agreement, the weighted-average remaining maturity (measured in years, whole or fractional) of the individual transactions subject to the qualifying master netting agreement, with the weight of each individual transaction set equal to the notional amount of the transaction.

Effective notional amount means, for an eligible guarantee or eligible credit

derivative, the lesser of the contractual notional amount of the credit risk mitigant and the EAD of the hedged exposure, multiplied by the percentage coverage of the credit risk mitigant. For example, the effective notional amount of an eligible guarantee that covers, on a pro rata basis, 40 percent of any losses on a \$100 bond would be \$40.

Eligible clean-up call means a clean-up call that:

(1) Is exercisable solely at the discretion of the servicer;

(2) Is not structured to avoid allocating losses to securitization exposures held by investors or otherwise structured to provide credit enhancement to the securitization; and

(3) (i) For a traditional securitization, is only exercisable when 10 percent or less of the principal amount of the underlying exposures or securitization exposures (determined as of the inception of the securitization) is outstanding; or

(ii) For a synthetic securitization, is only exercisable when 10 percent or less of the principal amount of the reference portfolio of underlying exposures (determined as of the inception of the securitization) is outstanding.

Eligible credit derivative means a credit derivative in the form of a credit default swap, nth-to-default swap, or total return swap provided that:

(1) The contract meets the requirements of an eligible guarantee and has been confirmed by the protection purchaser and the protection provider;

(2) Any assignment of the contract has been confirmed by all relevant parties;

(3) If the credit derivative is a credit default swap or nth-to-default swap, the contract includes the following credit events:

(i) Failure to pay any amount due under the terms of the reference exposure (with a grace period that is closely in line with the grace period of the reference exposure); and

(ii) Bankruptcy, insolvency, or inability of the obligor on the reference exposure to pay its debts, or its failure or admission in writing of its inability generally to pay its debts as they become due, and similar events;

(4) The terms and conditions dictating the manner in which the contract is to be settled are incorporated into the contract;

(5) If the contract allows for cash settlement, the contract incorporates a robust valuation process to estimate loss reliably and specifies a reasonable period for obtaining post-credit event valuations of the reference exposure;

(6) If the contract requires the protection purchaser to transfer an

exposure to the protection provider at settlement, the terms of the exposure provide that any required consent to transfer may not be unreasonably withheld;

(7) If the credit derivative is a credit default swap or nth-to-default swap, the contract clearly identifies the parties responsible for determining whether a credit event has occurred, specifies that this determination is not the sole responsibility of the protection provider, and gives the protection purchaser the right to notify the protection provider of the occurrence of a credit event; and

(8) If the credit derivative is a total return swap and the [bank] records net payments received on the swap as net income, the [bank] records offsetting deterioration in the value of the hedged exposure (either through reductions in fair value or by an addition to reserves).

Eligible credit reserves means all general allowances that have been established through a charge against earnings to absorb credit losses associated with on-or off-balance sheet wholesale and retail exposures, including the allowance for loan and lease losses (ALLL) associated with such exposures but excluding allocated transfer risk reserves established pursuant to 12 U.S.C. 3904 and other specific reserves created against recognized losses.

Eligible double default guarantor, with respect to a guarantee or credit derivative obtained by a [bank], means:

(1) *U.S.-based entities*. A depository institution, a bank holding company (as defined in section 2 of the Bank Holding Company Act (12 U.S.C. 1841)), a savings and loan holding company (as defined in 12 U.S.C. 1467a) provided all or substantially all of the holding company's activities are permissible for a financial holding company under 12 U.S.C. 1843(k), a securities broker or dealer registered (under the Securities Exchange Act of 1934) with the SEC, an insurance company in the business of providing credit protection (such as a monoline bond insurer or re-insurer) that is subject to supervision by a State insurance regulator, if:

(i) At the time the guarantor issued the guarantee or credit derivative, the [bank] assigned a PD to the guarantor's rating grade that was equal to or lower than the PD associated with a long-term external rating in the third-highest investment grade rating category; and

(ii) The [bank] currently assigns a PD to the guarantor's rating grade that is equal to or lower than the PD associated with a long-term external rating in the lowest investment grade rating category; or

(2) *Non-U.S.-based entities.* A foreign bank (as defined in section 211.2 of the Federal Reserve Board's Regulation K (12 CFR 211.2)), a non-U.S. securities firm, or a non-U.S. based insurance company in the business of providing credit protection, if:

(i) The [bank] demonstrates that the guarantor is subject to consolidated supervision and regulation comparable to that imposed on U.S. depository institutions, securities broker-dealers, or insurance companies (as the case may be) or has issued and outstanding an unsecured long-term debt security without credit enhancement that has a long-term applicable external rating in one of the three highest investment grade rating categories;

(ii) At the time the guarantor issued the guarantee or credit derivative, the [bank] assigned a PD to the guarantor's rating grade that was equal to or lower than the PD associated with a long-term external rating in the third-highest investment grade rating category; and

(iii) The [bank] currently assigns a PD to the guarantor's rating grade that is equal to or lower than the PD associated with a long-term external rating in the lowest investment grade rating category.

Eligible guarantee means a guarantee that:

- (1) Is written and unconditional;
- (2) Covers all or a pro rata portion of all contractual payments of the obligor on the reference exposure;
- (3) Gives the beneficiary a direct claim against the protection provider;
- (4) Is non-cancelable by the protection provider for reasons other than the breach of the contract by the beneficiary;
- (5) Is legally enforceable against the protection provider in a jurisdiction where the protection provider has sufficient assets against which a judgment may be attached and enforced; and

(6) Requires the protection provider to make payment to the beneficiary on the occurrence of a default (as defined in the guarantee) of the obligor on the reference exposure without first requiring the beneficiary to demand payment from the obligor.

Eligible margin loan means an extension of credit where:

- (1) The extension of credit is collateralized exclusively by debt or equity securities that are liquid and readily marketable;
- (2) The collateral is marked to market daily, and the transaction is subject to daily margin maintenance requirements;
- (3) The extension of credit is conducted under an agreement that provides the [bank] the right to accelerate and terminate the extension

of credit and to liquidate or set off collateral promptly upon an event of default (including upon an event of bankruptcy, insolvency, or similar proceeding) of the counterparty, provided that, in any such case, any exercise of rights under the agreement will not be stayed or avoided under applicable law in the relevant jurisdictions;² and

(4) The [bank] has conducted and documented sufficient legal review to conclude with a well-founded basis that the agreement meets the requirements of paragraph (3) of this definition and is legal, valid, binding, and enforceable under applicable law in the relevant jurisdictions.

Eligible operational risk offsets means amounts, not to exceed expected operational loss, that:

(1) Are generated by internal business practices to absorb highly predictable and reasonably stable operational losses, including reserves calculated consistent with GAAP; and

(2) Are available to cover expected operational losses with a high degree of certainty over a one-year horizon.

Eligible purchased wholesale receivable means a purchased wholesale receivable that:

(1) The [bank] purchased from an unaffiliated seller and did not directly or indirectly originate;

(2) Was generated on an arm's-length basis between the seller and the obligor;³

(3) Provides the [bank] with a claim on all proceeds from the receivable or a pro-rata interest in the proceeds from the receivable; and

(4) Has an M of less than one year.

Eligible securitization guarantor means:

(1) A sovereign entity, the Bank for International Settlements, the International Monetary Fund, the European Central Bank, the European Commission, a Federal Home Loan Bank, Federal Agricultural Mortgage Corporation (Farmer Mac), a multi-lateral development bank, a depository institution, a bank holding company (as

² This requirement is met where all transactions under the agreement are (i) executed under U.S. law and (ii) constitute "securities contracts" or "repurchase agreements" under section 555 or 559, respectively, of the Bankruptcy Code (11 U.S.C. 555), qualified financial contracts under section 11(e)(8) of the Federal Deposit Insurance Act (12 U.S.C. 1821(e)(8)), or netting contracts between or among financial institutions under sections 401–407 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (12 U.S.C. 4401–4407) or the Federal Reserve Board's Regulation EE (12 CFR part 231).

³ Intercompany accounts receivable and receivables subject to contra-accounts between firms that buy and sell to each other do not satisfy this criterion.

defined in section 2 of the Bank Holding Company Act (12 U.S.C. 1841)), a savings and loan holding company (as defined in 12 U.S.C. 1467a) provided all or substantially all of the holding company's activities are permissible for a financial holding company under 12 U.S.C. 1843(k), a foreign bank (as defined in section 211.2 of the Federal Reserve Board's Regulation K (12 CFR 211.2)), or a securities firm;

(2) Any other entity (other than an SPE) that has issued and outstanding an unsecured long-term debt security without credit enhancement that has a long-term applicable external rating in one of the three highest investment grade rating categories; or

(3) Any other entity (other than an SPE) that has a PD assigned by the [bank] that is lower than or equal to the PD associated with a long-term external rating in the third highest investment grade rating category.

Eligible servicer cash advance facility means a servicer cash advance facility in which:

(1) The servicer is entitled to full reimbursement of advances, except that a servicer may be obligated to make non-reimbursable advances for a particular underlying exposure if any such advance is contractually limited to an insignificant amount of the outstanding principal balance of that exposure;

(2) The servicer's right to reimbursement is senior in right of payment to all other claims on the cash flows from the underlying exposures of the securitization; and

(3) The servicer has no legal obligation to, and does not, make advances to the securitization if the servicer concludes the advances are unlikely to be repaid.

Equity derivative contract means an equity-linked swap, purchased equity-linked option, forward equity-linked contract, or any other instrument linked to equities that gives rise to similar counterparty credit risks.

Equity exposure means:

(1) A security or instrument (whether voting or non-voting) that represents a direct or indirect ownership interest in, and a residual claim on, the assets and income of a company, unless:

(i) The issuing company is consolidated with the [bank] under GAAP;

(ii) The [bank] is required to deduct the ownership interest from tier 1 or tier 2 capital under this appendix;

(iii) The ownership interest is redeemable;

(iv) The ownership interest incorporates a payment or other similar obligation on the part of the issuing

company (such as an obligation to pay periodic interest); or

(v) The ownership interest is a securitization exposure;

(2) A security or instrument that is mandatorily convertible into a security or instrument described in paragraph (1) of this definition;

(3) An option or warrant that is exercisable for a security or instrument described in paragraph (1) of this definition; or

(4) Any other security or instrument (other than a securitization exposure) to the extent the return on the security or instrument is based on the performance of a security or instrument described in paragraph (1) of this definition.

Excess spread for a period means:

(1) Gross finance charge collections and other income received by a securitization SPE (including market interchange fees) over a period minus interest paid to the holders of the securitization exposures, servicing fees, charge-offs, and other senior trust or similar expenses of the SPE over the period; divided by

(2) The principal balance of the underlying exposures at the end of the period.

Exchange rate derivative contract means a cross-currency interest rate swap, forward foreign-exchange contract, currency option purchased, or any other instrument linked to exchange rates that gives rise to similar counterparty credit risks.

Excluded mortgage exposure means:

(1) Any one-to-four family residential pre-sold construction loan or multifamily residential loan that would receive a 50 percent risk weight under section 618(a)(1) or (b)(1) of the Resolution Trust Corporation Refinancing, Restructuring, and Improvement Act of 1991 (RTCRI Act) and under 12 CFR part 3, Appendix A, section 3(a)(3)(iii) (for national banks), 12 CFR part 208, Appendix A, section III.C.3. (for state member banks), 12 CFR part 225, Appendix A, section III.C.3. (for bank holding companies), 12 CFR part 325, Appendix A, section II.C.a. (for state nonmember banks), or 12 CFR 567.6(a)(1)(iii) and (iv) (for savings associations); and

(2) Any one-to-four family residential pre-sold construction loan for a residence for which the purchase contract is cancelled that would receive a 100 percent risk weight under section 618(a)(2) of the RTCRI Act and under 12 CFR part 3, Appendix A, section 3(a)(3)(iii) (for national banks), 12 CFR part 208, Appendix A, section III.C.3. (for state member banks), 12 CFR part 225, Appendix A, section III.C.3. (for bank holding companies), 12 CFR part

325, Appendix A, section II.C.a. (for state nonmember banks), or 12 CFR 567.6(a)(1)(iii) and (iv) (for savings associations).

Expected credit loss (ECL) means, for a wholesale exposure to a non-defaulted obligor or segment of non-defaulted retail exposures, the product of PD times ELGD times EAD for the exposure or segment. ECL for a wholesale exposure to a defaulted obligor or segment of defaulted retail exposures is equal to the [bank]'s impairment estimate for allowance purposes for the exposure or segment. Total ECL is the sum of expected credit losses for all wholesale and retail exposures other than exposures for which the [bank] has applied the double default treatment in section 34.

Expected exposure (EE) means the expected value of the probability distribution of credit risk exposures to a counterparty at any specified future date before the maturity date of the longest term transaction in the netting set.

Expected loss given default (ELGD) means:

(1) For a wholesale exposure, the [bank]'s empirically based best estimate of the default-weighted average economic loss, per dollar of EAD, the [bank] expects to incur in the event that the obligor of the exposure (or a typical obligor in the loss severity grade assigned by the [bank] to the exposure) defaults within a one-year horizon over a mix of economic conditions, including economic downturn conditions.

(2) For a segment of retail exposures, the [bank]'s empirically based best estimate of the default-weighted average economic loss, per dollar of EAD, the [bank] expects to incur on exposures in the segment that default within a one-year horizon over a mix of economic conditions (including economic downturn conditions).

(3) The economic loss on an exposure in the event of default is all material credit-related losses on the exposure (including accrued but unpaid interest or fees, losses on the sale of collateral, direct workout costs, and an appropriate allocation of indirect workout costs). Where positive or negative cash flows on a wholesale exposure to a defaulted obligor or a defaulted retail exposure (including proceeds from the sale of collateral, workout costs, and draw-downs of unused credit lines) occur after the date of default, the economic loss must reflect the net present value of cash flows as of the default date using a discount rate appropriate to the risk of the defaulted exposure.

Expected operational loss (EOL) means the expected value of the

distribution of potential aggregate operational losses, as generated by the [bank]'s operational risk quantification system using a one-year horizon.

Expected positive exposure (EPE) means the weighted average over time of expected (non-negative) exposures to a counterparty where the weights are the proportion of the time interval that an individual expected exposure represents. When calculating the minimum capital requirement, the average is taken over a one-year horizon.

Exposure at default (EAD).

(1) For the on-balance sheet component of a wholesale or retail exposure (other than an OTC derivative contract, repo-style transaction, or eligible margin loan), EAD means:

(i) If the exposure is held-to-maturity or for trading, the [bank]'s carrying value (including net accrued but unpaid interest and fees) for the exposure less any allocated transfer risk reserve for the exposure; or

(ii) If the exposure is available-for-sale, the [bank]'s carrying value (including net accrued but unpaid interest and fees) for the exposure less any allocated transfer risk reserve for the exposure, less any unrealized gains on the exposure, and plus any unrealized losses on the exposure.

(2) For the off-balance sheet component of a wholesale or retail exposure (other than an OTC derivative contract, repo-style transaction, or eligible margin loan) in the form of a loan commitment or line of credit, EAD means the [bank]'s best estimate of net additions to the outstanding amount owed the [bank], including estimated future additional draws of principal and accrued but unpaid interest and fees, that are likely to occur over the remaining life of the exposure assuming the exposure were to go into default. This estimate of net additions must reflect what would be expected during economic downturn conditions.

(3) For the off-balance sheet component of a wholesale or retail exposure (other than an OTC derivative contract, repo-style transaction, or eligible margin loan) in the form of anything other than a loan commitment or line of credit, EAD means the notional amount of the exposure.

(4) EAD for a segment of retail exposures is the sum of the EADs for each individual exposure in the segment.

(5) EAD for OTC derivative contracts, repo-style transactions, and eligible margin loans is calculated as described in section 32.

(6) For wholesale or retail exposures in which only the drawn balance has been securitized, the [bank] must reflect

its share of the exposures' undrawn balances in EAD. Undrawn balances of exposures for which the drawn balances have been securitized must be allocated between the seller's and investors' interests on a pro rata basis, based on the proportions of the seller's and investors' shares of the securitized drawn balances.

Exposure category means any of the wholesale, retail, securitization, or equity exposure categories.

External operational loss event data means, with respect to a [bank], gross operational loss amounts, dates, recoveries, and relevant causal information for operational loss events occurring at organizations other than the [bank].

External rating means a credit rating that is assigned by an NRSRO to an exposure, provided:

- (1) The credit rating fully reflects the entire amount of credit risk with regard to all payments owed to the holder of the exposure. If a holder is owed principal and interest on an exposure, the credit rating must fully reflect the credit risk associated with timely repayment of principal and interest. If a holder is owed only principal on an exposure, the credit rating must fully reflect only the credit risk associated with timely repayment of principal; and
- (2) The credit rating is published in an accessible form and is or will be included in the transition matrices made publicly available by the NRSRO that summarize the historical performance of positions rated by the NRSRO.

Financial collateral means collateral:

- (1) In the form of:
 - (i) Cash on deposit with the [bank] (including cash held for the [bank] by a third-party custodian or trustee);
 - (ii) Gold bullion;
 - (iii) Long-term debt securities that have an applicable external rating of one category below investment grade or higher;
 - (iv) Short-term debt instruments that have an applicable external rating of at least investment grade;
 - (v) Equity securities that are publicly traded;
 - (vi) Convertible bonds that are publicly traded; or
 - (vii) Money market mutual fund shares and other mutual fund shares if a price for the shares is publicly quoted daily; and
- (2) In which the [bank] has a perfected, first priority security interest or the legal equivalent thereof.

GAAP means U.S. generally accepted accounting principles.

Gain-on-sale means an increase in the equity capital (as reported on Schedule

RC of the Call Report, schedule HC of the FR Y-9C Report, or Schedule SC of the Thrift Financial Report) of a [bank] that results from a securitization (other than an increase in equity capital that results from the [bank]'s receipt of cash in connection with the securitization).

Guarantee means a financial guarantee, letter of credit, insurance, or other similar financial instrument (other than a credit derivative) that allows one party (beneficiary) to transfer the credit risk of one or more specific exposures (reference exposure) to another party (protection provider). See also *eligible guarantee*.

High volatility commercial real estate (HVCRE) exposure means a credit facility that finances or has financed the acquisition, development, or construction (ADC) of real property, unless the facility finances:

- (1) One-to four-family residential properties; or
- (2) Commercial real estate projects in which:
 - (i) The loan-to-value ratio is less than or equal to the applicable maximum supervisory loan-to-value ratio in the [AGENCY]'s real estate lending standards at 12 CFR part 34, Subpart D (OCC); 12 CFR part 208, Appendix C (Board); 12 CFR part 365, Subpart D (FDIC); and 12 CFR 560.100–560.101 (OTS);
 - (ii) The borrower has contributed capital to the project in the form of cash or unencumbered readily marketable assets (or has paid development expenses out-of-pocket) of at least 15 percent of the real estate's appraised "as completed" value; and
 - (iii) The borrower contributed the amount of capital required by paragraph (2)(ii) of this definition before the [bank] advances funds under the credit facility, and the capital contributed by the borrower, or internally generated by the project, is contractually required to remain in the project throughout the life⁴ of the project.

Inferred rating. A securitization exposure has an *inferred rating* equal to the external rating referenced in paragraph (2)(i) of this definition if:

- (1) The securitization exposure does not have an external rating; and
- (2) Another securitization exposure issued by the same issuer and secured by the same underlying exposures:
 - (i) Has an external rating;
 - (ii) Is subordinated in all respects to the unrated securitization exposure;

⁴ The life of a project concludes only when the credit facility is converted to permanent financing or is sold or paid in full. Permanent financing may be provided by the [bank] that provided the ADC facility as long as the permanent financing is subject to the [bank]'s underwriting criteria for long-term mortgage loans.

(iii) Does not benefit from any credit enhancement that is not available to the unrated securitization exposure; and

(iv) Has an effective remaining maturity that is equal to or longer than that of the unrated securitization exposure.

Interest rate derivative contract means a single-currency interest rate swap, basis swap, forward rate agreement, purchased interest rate option, when-issued securities, or any other instrument linked to interest rates that gives rise to similar counterparty credit risks.

Internal operational loss event data means, with respect to a [bank], gross operational loss amounts, dates, recoveries, and relevant causal information for operational loss events occurring at the [bank].

Investing [bank] means, with respect to a securitization, a [bank] that assumes the credit risk of a securitization exposure (other than an originating [bank] of the securitization). In the typical synthetic securitization, the investing [bank] sells credit protection on a pool of underlying exposures to the originating [bank].

Investment fund means a company:

- (1) All or substantially all of the assets of which are financial assets; and
- (2) That has no material liabilities.

Investors' interest EAD means, with respect to a securitization, the EAD of the underlying exposures multiplied by the ratio of:

- (1) The total amount of securitization exposures issued by the SPE to investors; divided by
- (2) The outstanding principal amount of underlying exposures.

Loss given default (LGD) means:

- (1) For a wholesale exposure:
 - (i) If the [bank] has received prior written approval from [AGENCY] to use internal estimates of LGD for the exposure's wholesale exposure subcategory, the greater of:

(A) The [bank]'s ELGD for the exposure (or for the typical exposure in the loss severity grade assigned by the [bank] to the exposure); or

(B) The [bank]'s empirically based best estimate of the economic loss, per dollar of EAD, the [bank] would expect to incur if the obligor (or a typical obligor in the loss severity grade assigned by the [bank] to the exposure) were to default within a one-year horizon during economic downturn conditions.

(ii) If the [bank] has not received such prior approval,

(A) For an exposure that is not a repo-style transaction, eligible margin loan, or OTC derivative contract, the sum of:

- (1) 0.08; and

(2) 0.92 multiplied by the [bank]'s ELGD for the exposure (or for the typical exposure in the loss severity grade assigned by the [bank] to the exposure); or

(B) For an exposure that is a repo-style transaction, eligible margin loan, or OTC derivative contract, the [bank]'s ELGD for the exposure (or for the typical exposure in the loss severity grade assigned by the [bank] to the exposure).

(2) For a segment of retail exposures:

(i) If the [bank] has received prior written approval from [AGENCY] to use internal estimates of LGD for the segment's retail exposure subcategory, the greater of:

(A) The [bank]'s ELGD for the segment of exposures; or

(B) The [bank]'s empirically based best estimate of the economic loss, per dollar of EAD, the [bank] would expect to incur on exposures in the segment that default within a one-year horizon during economic downturn conditions.

(ii) If the [bank] has not received such prior approval,

(A) For a segment of exposures that are not eligible margin loans, the sum of:

(1) 0.08; and

(2) 0.92 multiplied by the [bank]'s ELGD for the segment of exposures; or

(B) For a segment of exposures that are eligible margin loans, the [bank]'s ELGD for the segment of exposures.

(3) In approving a [bank]'s use of internal estimates of LGD for a wholesale or retail exposure subcategory, [AGENCY] will consider whether:

(A) The [bank]'s internal estimates of LGD are reliable and sufficiently reflective of economic downturn conditions; and

(B) The [bank] has rigorous and well-documented policies and procedures for identifying economic downturn conditions for the exposure subcategory, identifying material adverse correlations between the relevant drivers of default rates and loss rates given default, and incorporating identified correlations into internal LGD estimates.

(4) The economic loss on an exposure in the event of default is all material credit-related losses on the exposure (including accrued but unpaid interest or fees, losses on the sale of collateral, direct workout costs, and an appropriate allocation of indirect workout costs). Where positive or negative cash flows on a wholesale exposure to a defaulted obligor or a defaulted retail exposure (including proceeds from the sale of collateral, workout costs, and draw-downs of unused credit lines) occur after the date of default, the economic loss must reflect the net present value

of cash flows as of the default date using a discount rate appropriate to the risk of the defaulted exposure.

Main index means the Standard & Poor's 500 Index, the FTSE All-World Index, and any other index for which the [bank] can demonstrate to the satisfaction of [AGENCY] that the equities represented in the index have comparable liquidity, depth of market, and size of bid-ask spreads as equities in the Standard & Poor's 500 Index and FTSE All-World Index.

Multi-lateral development bank means any multi-lateral lending institution or regional development bank in which the U.S. government is a shareholder or contributing member.

Nationally recognized statistical rating organization (NRSRO) means an entity recognized by the Division of Market Regulation (or any successor division) of the SEC as a nationally recognized statistical rating organization for various purposes, including the SEC's net capital requirements for securities broker-dealers.

Netting set means a group of transactions with a single counterparty that are subject to a qualifying master netting agreement or qualifying cross-product master netting agreement. Each transaction that is not subject to such a master netting agreement is its own netting set.

Nth-to-default credit derivative means a credit derivative that provides credit protection only for the nth-defaulting reference exposure in a group of reference exposures.

Operational loss means a loss (excluding insurance or tax effects) resulting from an operational loss event. Operational loss includes all expenses associated with an operational loss event except for opportunity costs, forgone revenue, and costs related to risk management and control enhancements implemented to prevent future operational losses.

Operational loss event means an event that results in loss and is associated with internal fraud; external fraud;⁵ employment practices and workplace safety; clients, products, and business practices; damage to physical assets; business disruption and system failures; or execution, delivery, and process management.

Operational risk means the risk of loss resulting from inadequate or failed internal processes, people, and systems or from external events (including legal

risk but excluding strategic and reputational risk).

Operational risk exposure means the 99.9th percentile of the distribution of potential aggregate operational losses, as generated by the [bank]'s operational risk quantification system over a one-year horizon (and not incorporating eligible operational risk offsets or qualifying operational risk mitigants).

Originating [bank], with respect to a securitization, means a [bank] that:

(1) Directly or indirectly originated or securitized the underlying exposures included in the securitization; or

(2) Serves as an ABCP program sponsor to the securitization.

Other retail exposure means an exposure (other than a securitization exposure, an equity exposure, a residential mortgage exposure, an excluded mortgage exposure, a qualifying revolving exposure, or the residual value portion of a lease exposure) that is managed as part of a segment of exposures with homogeneous risk characteristics, not on an individual-exposure basis, and is either:

(1) An exposure to an individual for non-business purposes; or

(2) An exposure to an individual or company for business purposes if the [bank]'s consolidated business credit exposure to the individual or company is \$1 million or less.

Over-the-counter (OTC) derivative contract means a derivative contract that is not traded on an exchange that requires the daily receipt and payment of cash-variation margin.

Parallel run period means a period of at least four consecutive quarters after adoption of the [bank]'s implementation plan and before the [bank]'s first floor period during which the [bank] complies with all the qualification requirements in section 22 to the satisfaction of the [AGENCY].

Probability of default (PD) means:

(1) For a wholesale exposure to a non-defaulted obligor, the [bank]'s empirically based best estimate of the long-run average of one-year default rates for the rating grade assigned by the [bank] to the obligor, capturing the average default experience for obligors in a rating grade over a mix of economic conditions (including economic downturn conditions) sufficient to provide a reasonable estimate of the average one-year default rate over the economic cycle for the rating grade.

(2) For a segment of non-defaulted retail exposures for which seasoning effects are not material, or for a segment of non-defaulted retail exposures in a retail exposure subcategory for which seasoning effects are not material, the

⁵ Retail credit card losses arising from non-contractual, third-party initiated fraud (for example, identity theft) are external fraud operational losses. All other third-party initiated credit losses are to be treated as credit risk losses.

[bank]'s empirically based best estimate of the long-run average of one-year default rates for the exposures in the segment, capturing the average default experience for exposures in the segment over a mix of economic conditions (including economic downturn conditions) sufficient to provide a reasonable estimate of the average one-year default rate over the economic cycle for the segment.

(3) For any other segment of non-defaulted retail exposures, the [bank]'s empirically based best estimate of the annualized cumulative default rate over the expected remaining life of exposures in the segment, capturing the average default experience for exposures in the segment over a mix of economic conditions (including economic downturn conditions) sufficient to provide a reasonable estimate of the average performance over the economic cycle for the segment.

(4) For a wholesale exposure to a defaulted obligor or segment of defaulted retail exposures, 100 percent.

Protection amount (P) means, with respect to an exposure hedged by an eligible guarantee or eligible credit derivative, the effective notional amount of the guarantee or credit derivative as reduced to reflect any currency mismatch, maturity mismatch, or lack of restructuring coverage (as provided in section 33).

Publicly traded means traded on:

(1) Any exchange registered with the SEC as a national securities exchange under section 6 of the Securities Exchange Act of 1934 (15 U.S.C. 78f); or

(2) Any non-U.S.-based securities exchange that:

(i) Is registered with, or approved by, a national securities regulatory authority; and

(ii) Provides a liquid, two-way market for the instrument in question, meaning that there are enough independent bona fide offers to buy and sell so that a sales price reasonably related to the last sales price or current bona fide competitive bid and offer quotations can be determined promptly and a trade can be settled at such a price within five business days.

Qualifying central counterparty means a counterparty (for example, a clearing house) that:

(1) Facilitates trades between counterparties in one or more financial markets by either guaranteeing trades or novating contracts;

(2) Requires all participants in its arrangements to be fully collateralized on a daily basis; and

(3) The [bank] demonstrates to the satisfaction of [AGENCY] is in sound financial condition and is subject to

effective oversight by a national supervisory authority.

Qualifying cross-product master netting agreement means a qualifying master netting agreement that provides for termination and close-out netting across multiple types of financial transactions or qualifying master netting agreements in the event of a counterparty's default, provided that:

(1) The underlying financial transactions are OTC derivative contracts, eligible margin loans, or repo-style transactions; and

(2) The [bank] obtains a written legal opinion verifying the validity and enforceability of the agreement under applicable law of the relevant jurisdictions if the counterparty fails to perform upon an event of default, including upon an event of bankruptcy, insolvency, or similar proceeding.

Qualifying master netting agreement means any written, legally enforceable bilateral agreement, provided that:

(1) The agreement creates a single legal obligation for all individual transactions covered by the agreement upon an event of default, including bankruptcy, insolvency, or similar proceeding, of the counterparty;

(2) The agreement provides the [bank] the right to accelerate, terminate, and close-out on a net basis all transactions under the agreement and to liquidate or set off collateral promptly upon an event of default, including upon an event of bankruptcy, insolvency, or similar proceeding, of the counterparty, provided that, in any such case, any exercise of rights under the agreement will not be stayed or avoided under applicable law in the relevant jurisdictions;

(3) The [bank] has conducted and documented sufficient legal review to conclude with a well-founded basis that:

(i) The agreement meets the requirements of paragraph (2) of this definition; and

(ii) In the event of a legal challenge (including one resulting from default or from bankruptcy, insolvency, or similar proceeding) the relevant court and administrative authorities would find the agreement to be legal, valid, binding, and enforceable under the law of the relevant jurisdictions;

(4) The [bank] establishes and maintains procedures to monitor possible changes in relevant law and to ensure that the agreement continues to satisfy the requirements of this definition; and

(5) The agreement does not contain a walkaway clause (that is, a provision that permits a non-defaulting counterparty to make a lower payment

than it would make otherwise under the agreement, or no payment at all, to a defaulter or the estate of a defaulter, even if the defaulter or the estate of the defaulter is a net creditor under the agreement).

Qualifying revolving exposure (QRE) means an exposure (other than a securitization exposure or equity exposure) to an individual that is managed as part of a segment of exposures with homogeneous risk characteristics, not on an individual-exposure basis, and:

(1) Is revolving (that is, the amount outstanding fluctuates, determined largely by the borrower's decision to borrow and repay, up to a pre-established maximum amount);

(2) Is unsecured and unconditionally cancelable by the [bank] to the fullest extent permitted by Federal law; and

(3) Has a maximum exposure amount (drawn plus undrawn) of up to \$100,000.

Repo-style transaction means a repurchase or reverse repurchase transaction, or a securities borrowing or securities lending transaction, including a transaction in which the [bank] acts as agent for a customer and indemnifies the customer against loss, provided that:

(1) The transaction is based solely on liquid and readily marketable securities or cash;

(2) The transaction is marked-to-market daily and subject to daily margin maintenance requirements;

(3) The transaction is executed under an agreement that provides the [bank] the right to accelerate, terminate, and close-out the transaction on a net basis and to liquidate or set off collateral promptly upon an event of default (including upon an event of bankruptcy, insolvency, or similar proceeding) of the counterparty, provided that, in any such case, any exercise of rights under the agreement will not be stayed or avoided under applicable law in the relevant jurisdictions;⁶ and

(4) The [bank] has conducted and documented sufficient legal review to conclude with a well-founded basis that the agreement meets the requirements of paragraph (3) of this definition and is legal, valid, binding, and enforceable

⁶ This requirement is met where all transactions under the agreement are (i) executed under U.S. law and (ii) constitute "securities contracts" or "repurchase agreements" under section 555 or 559, respectively, of the Bankruptcy Code (11 U.S.C. 555 or 559), qualified financial contracts under section 11(e)(8) of the Federal Deposit Insurance Act (12 U.S.C. 1821(e)(8)), or netting contracts between or among financial institutions under sections 401–407 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (12 U.S.C. 4401–4407) or the Federal Reserve Board's Regulation EE (12 CFR part 231).

under applicable law in the relevant jurisdictions.

Residential mortgage exposure means an exposure (other than a securitization exposure, equity exposure, or excluded mortgage exposure) that is managed as part of a segment of exposures with homogeneous risk characteristics, not on an individual-exposure basis, and is:

- (1) An exposure that is primarily secured by a first or subsequent lien on one-to four-family residential property; or
- (2) An exposure with an original and outstanding amount of \$1 million or less that is primarily secured by a first or subsequent lien on residential property that is not one-to four-family.

Retail exposure means a residential mortgage exposure, a qualifying revolving exposure, or an other retail exposure.

Retail exposure subcategory means the residential mortgage exposure, qualifying revolving exposure, or other retail exposure subcategory.

Risk parameter means a variable used in determining risk-based capital requirements for wholesale and retail exposures, specifically probability of default (PD), expected loss given default (ELGD), loss given default (LGD), exposure at default (EAD), or effective maturity (M).

Scenario analysis means a systematic process of obtaining expert opinions from business managers and risk management experts to derive reasoned assessments of the likelihood and loss impact of plausible high-severity operational losses.

SEC means the U.S. Securities and Exchange Commission.

Securitization means a traditional securitization or a synthetic securitization.

Securitization exposure means:

- (1) An on-balance sheet or off-balance sheet credit exposure that arises from a traditional or synthetic securitization (including credit-enhancing representations and warranties); and
- (2) Mortgage-backed pass-through securities guaranteed by Fannie Mae or Freddie Mac.

Senior securitization exposure means a securitization exposure that has a first priority claim on the cash flows from the underlying exposures, disregarding the claims of a service provider (such as a swap counterparty or trustee, custodian, or paying agent for the securitization) to fees from the securitization. A liquidity facility that supports an ABCP program is a senior securitization exposure if the liquidity facility provider's right to reimbursement of the drawn amounts is senior to all claims on the cash flows

from the underlying exposures except claims of a service provider to fees.

Servicer cash advance facility means a facility under which the servicer of the underlying exposures of a securitization may advance cash to ensure an uninterrupted flow of payments to investors in the securitization, including advances made to cover foreclosure costs or other expenses to facilitate the timely collection of the underlying exposures. See also *eligible servicer cash advance facility*.

Sovereign entity means a central government (including the U.S. government) or an agency, department, ministry, or central bank of a central government.

Sovereign exposure means:

- (1) A direct exposure to a sovereign entity; or
- (2) An exposure directly and unconditionally backed by the full faith and credit of a sovereign entity.

Special purpose entity (SPE) means a corporation, trust, or other entity organized for the specific purpose of holding underlying exposures of a securitization, the activities of which are limited to those appropriate to accomplish this purpose, and the structure of which is intended to isolate the underlying exposures held by the entity from the credit risk of the seller of the underlying exposures to the entity.

Synthetic securitization means a transaction in which:

- (1) All or a portion of the credit risk of one or more underlying exposures is transferred to one or more third parties through the use of one or more credit derivatives or guarantees (other than a guarantee that transfers only the credit risk of an individual retail exposure);
- (2) The credit risk associated with the underlying exposures has been separated into at least two tranches reflecting different levels of seniority;
- (3) Performance of the securitization exposures depends upon the performance of the underlying exposures; and
- (4) All or substantially all of the underlying exposures are financial exposures (such as loans, commitments, credit derivatives, guarantees, receivables, asset-backed securities, mortgage-backed securities, other debt securities, or equity securities).

Tier 1 capital is defined in [the general risk-based capital rules], as modified in part II of this appendix.

Tier 2 capital is defined in [the general risk-based capital rules], as modified in part II of this appendix.

Total qualifying capital means the sum of tier 1 capital and tier 2 capital,

after all deductions required in this appendix.

Total risk-weighted assets means:

- (1) The sum of:
 - (i) Credit risk-weighted assets; and
 - (ii) Risk-weighted assets for operational risk; minus
- (2) The sum of:
 - (i) Excess eligible credit reserves not included in tier 2 capital; and
 - (ii) Allocated transfer risk reserves.

Total wholesale and retail risk-weighted assets means the sum of risk-weighted assets for wholesale exposures to non-defaulted obligors and segments of non-defaulted retail exposures; risk-weighted assets for wholesale exposures to defaulted obligors and segments of defaulted retail exposures; risk-weighted assets for assets not defined by an exposure category; and risk-weighted assets for non-material portfolios of exposures (all as determined in section 31) and risk-weighted assets for unsettled transactions (as determined in section 35) minus the amounts deducted from capital pursuant to [the general risk-based capital rules] (excluding those deductions reversed in section 12).

Traditional securitization means a transaction in which:

- (1) All or a portion of the credit risk of one or more underlying exposures is transferred to one or more third parties other than through the use of credit derivatives or guarantees;
- (2) The credit risk associated with the underlying exposures has been separated into at least two tranches reflecting different levels of seniority;
- (3) Performance of the securitization exposures depends upon the performance of the underlying exposures; and
- (4) All or substantially all of the underlying exposures are financial exposures (such as loans, commitments, credit derivatives, guarantees, receivables, asset-backed securities, mortgage-backed securities, other debt securities, or equity securities).

Tranche means all securitization exposures associated with a securitization that have the same seniority level.

Underlying exposures means one or more exposures that have been securitized in a securitization transaction.

Unexpected operational loss (UOL) means the difference between the [bank]'s operational risk exposure and the [bank]'s expected operational loss.

Unit of measure means the level (for example, organizational unit or operational loss event type) at which the [bank]'s operational risk quantification system generates a separate distribution of potential operational losses.

Value-at-Risk (VaR) means the estimate of the maximum amount that the value of one or more exposures could decline due to market price or rate movements during a fixed holding period within a stated confidence interval.

Wholesale exposure means a credit exposure to a company, individual, sovereign, or governmental entity (other than a securitization exposure, retail exposure, excluded mortgage exposure, or equity exposure). Examples of a wholesale exposure include:

(1) A non-tranched guarantee issued by a [bank] on behalf of a company;

(2) A repo-style transaction entered into by a [bank] with a company and any other transaction in which a [bank] posts collateral to a company and faces counterparty credit risk;

(3) An exposure that the [bank] treats as a covered position under [the market risk rule] for which there is a counterparty credit risk charge in section 32;

(4) A sale of corporate loans by a [bank] to a third party in which the [bank] retains full recourse;

(5) An OTC derivative contract entered into by a [bank] with a company;

(6) An exposure to an individual that is not managed by the [bank] as part of a segment of exposures with homogeneous risk characteristics; and

(7) A commercial lease.

Wholesale exposure subcategory means the HVCRE or non-HVCRE wholesale exposure subcategory.

Section 3. Minimum Risk-Based Capital Requirements

(a) Except as modified by paragraph (c) of this section or by section 23, each [bank] must meet a minimum ratio of:

(1) Total qualifying capital to total risk-weighted assets of 8.0 percent; and

(2) Tier 1 capital to total risk-weighted assets of 4.0 percent.

(b) Each [bank] must hold capital commensurate with the level and nature of all risks to which the [bank] is exposed.

(c) When a [bank] subject to [the market risk rule] calculates its risk-based capital requirements under this appendix, the [bank] must also refer to [the market risk rule] for supplemental rules to calculate risk-based capital requirements adjusted for market risk.

Part II. Qualifying Capital

Section 11. Additional Deductions

(a) *General.* A [bank] that uses this appendix must make the same deductions from its tier 1 capital and tier 2 capital required in [the general risk-based capital rules], except that:

(1) A [bank] is not required to deduct certain equity investments and CEOs (as explained in more detail in section 12); and

(2) A [bank] also must make the deductions from capital required by paragraphs (b) and (c) of this section.

(b) *Deductions from tier 1 capital.* A [bank] must deduct from tier 1 capital any gain-on-sale associated with a securitization exposure as provided in paragraph (a) of section 41 and paragraphs (a)(1), (c), (g)(1), and (h)(1) of section 42.

(c) *Deductions from tier 1 and tier 2 capital.* A [bank] must deduct the following exposures 50 percent from tier 1 capital and 50 percent from tier 2 capital. If the amount deductible from tier 2 capital exceeds the [bank]'s actual tier 2 capital, however, the [bank] must deduct the shortfall amount from tier 1 capital.

(1) *Credit-enhancing interest-only strips (CEIOs).* In accordance with paragraphs (a)(1) and (c) of section 42, any CEO that does not constitute gain-on-sale.

(2) *Non-qualifying securitization exposures.* In accordance with paragraphs (a)(4) and (c) of section 42, any securitization exposure that does not qualify for the Ratings-Based Approach, Internal Assessment Approach, or the Supervisory Formula Approach under sections 43, 44, and 45, respectively.

(3) *Securitizations of non-IRB exposures.* In accordance with paragraphs (c) and (g)(3) of section 42, certain exposures to a securitization any underlying exposure of which is not a wholesale exposure, retail exposure, securitization exposure, or equity exposure.

(4) *Low-rated securitization exposures.* In accordance with section 43 and paragraph (c) of section 42, any securitization exposure that qualifies for and must be deducted under the Ratings-Based Approach.

(5) *High-risk securitization exposures subject to the Supervisory Formula Approach.* In accordance with paragraph (b) of section 45 and paragraph (c) of section 42, any securitization exposure that qualifies for the Supervisory Formula Approach and has a risk weight equal to 1,250 percent as calculated under the Supervisory Formula Approach.

(6) *Eligible credit reserves shortfall.* In accordance with paragraph (a)(1) of section 13, any eligible credit reserves shortfall.

(7) *Certain failed capital markets transactions.* In accordance with paragraph (e)(3) of section 35, the

[bank]'s exposure on certain failed capital markets transactions.

Section 12. Deductions and Limitations Not Required

(a) *Deduction of CEOs.* A [bank] is not required to make the deductions from capital for CEOs in 12 CFR part 3, Appendix A, § 2(c) (for national banks), 12 CFR part 208, Appendix A, § II.B.1.e. (for state member banks), 12 CFR part 225, Appendix A, § II.B.1.e. (for bank holding companies), 12 CFR part 325, Appendix A, § II.B.5. (for state nonmember banks), and 12 CFR 567.5(a)(2)(iii) and 567.12(e) (for savings associations).

(b) *Deduction of certain equity investments.* A [bank] is not required to make the deductions from capital for nonfinancial equity investments in 12 CFR part 3, Appendix A, § 2(c) (for national banks), 12 CFR part 208, Appendix A, § II.B.5. (for state member banks), 12 CFR part 225, Appendix A, § II.B.5. (for bank holding companies), and 12 CFR part 325, Appendix A, § II.B. (for state nonmember banks).

Section 13. Eligible Credit Reserves

(a) *Comparison of eligible credit reserves to expected credit losses—(1) Shortfall of eligible credit reserves.* If a [bank]'s eligible credit reserves are less than the [bank]'s total expected credit losses, the [bank] must deduct the shortfall amount 50 percent from tier 1 capital and 50 percent from tier 2 capital. If the amount deductible from tier 2 capital exceeds the [bank]'s actual tier 2 capital, the [bank] must deduct the excess amount from tier 1 capital.

(2) *Excess eligible credit reserves.* If a [bank]'s eligible credit reserves exceed the [bank]'s total expected credit losses, the [bank] may include the excess amount in tier 2 capital to the extent that the excess amount does not exceed 0.6 percent of the [bank]'s credit-risk-weighted assets.

(b) *Treatment of allowance for loan and lease losses.* Regardless of any provision to the contrary in [general risk-based capital rules], ALLL is included in tier 2 capital only to the extent provided in paragraph (a)(2) of this section and paragraph (b) of section 23.

Part III. Qualification

Section 21. Qualification Process

(a) *Timing.* (1) A [bank] that is described in paragraph (b)(1) of section 1 must adopt a written implementation plan no later than six months after the later of the effective date of this appendix or the date the [bank] meets a criterion in that section. The plan must incorporate an explicit first floor period

start date no later than 36 months after the later of the effective date of this appendix or the date the [bank] meets at least one criterion under paragraph (b)(1) of section 1. [AGENCY] may extend the first floor period start date.

(2) A [bank] that elects to be subject to this appendix under paragraph (b)(2) of section 1 must adopt a written implementation plan and notify the [AGENCY] in writing of its intent at least 12 months before it proposes to begin its first floor period.

(b) *Implementation plan.* The [bank]'s implementation plan must address in detail how the [bank] complies, or plans to comply, with the qualification requirements in section 22. The [bank] also must maintain a comprehensive and sound planning and governance process to oversee the implementation efforts described in the plan. At a minimum, the plan must:

(1) Comprehensively address the qualification requirements in section 22 for the [bank] and each consolidated subsidiary (U.S. and foreign-based) of the [bank] with respect to all portfolios and exposures of the [bank] and each of its consolidated subsidiaries;

(2) Justify and support any proposed temporary or permanent exclusion of business lines, portfolios, or exposures from application of the advanced approaches in this appendix (which business lines, portfolios, and exposures must be, in the aggregate, immaterial to the [bank]);

(3) Include the [bank]'s self-assessment of:

(i) The [bank]'s current status in meeting the qualification requirements in section 22; and

(ii) The consistency of the [bank]'s current practices with the [AGENCY]'s supervisory guidance on the qualification requirements;

(4) Based on the [bank]'s self-assessment, identify and describe the areas in which the [bank] proposes to undertake additional work to comply with the qualification requirements in section 22 or to improve the consistency of the [bank]'s current practices with the [AGENCY]'s supervisory guidance on the qualification requirements (gap analysis);

(5) Describe what specific actions the [bank] will take to address the areas identified in the gap analysis required by paragraph (b)(4) of this section;

(6) Identify objective, measurable milestones, including delivery dates and a date when the [bank]'s implementation of the methodologies described in this appendix will be fully operational;

(7) Describe resources that have been budgeted and are available to implement the plan; and

(8) Receive board of directors approval.

(c) *Parallel run.* Before determining its risk-based capital requirements under this appendix and following adoption of the implementation plan, the [bank] must conduct a satisfactory parallel run. A satisfactory parallel run is a period of no less than four consecutive calendar quarters during which the [bank] complies with all of the qualification requirements in section 22 to the satisfaction of [AGENCY]. During the parallel run, the [bank] must report to the [AGENCY] on a calendar quarterly basis its risk-based capital ratios using [the general risk-based capital rules] and the risk-based capital requirements described in this appendix. During this period, the [bank] is subject to [the general risk-based capital rules].

(d) *Approval to calculate risk-based capital requirements under this appendix.* The [AGENCY] will notify the [bank] of the date that the [bank] may begin its first floor period following a determination by the [AGENCY] that:

(1) The [bank] fully complies with the qualification requirements in section 22;

(2) The [bank] has conducted a satisfactory parallel run under paragraph (c) of this section; and

(3) The [bank] has an adequate process to ensure ongoing compliance with the qualification requirements in section 22.

(e) *Transitional floor periods.* Following a satisfactory parallel run, a [bank] is subject to three transitional floor periods.

(1) *Risk-based capital ratios during the transitional floor periods—(i) Tier 1 risk-based capital ratio.* During a [bank]'s transitional floor periods, a [bank]'s tier 1 risk-based capital ratio is equal to the lower of:

(A) The [bank]'s floor-adjusted tier 1 risk-based capital ratio; or

(B) The [bank]'s advanced approaches tier 1 risk-based capital ratio.

(ii) *Total risk-based capital ratio.* During a [bank]'s transitional floor periods, a [bank]'s total risk-based capital ratio is equal to the lower of:

(A) The [bank]'s floor-adjusted total risk-based capital ratio; or

(B) The [bank]'s advanced approaches total risk-based capital ratio.

(2) *Floor-adjusted risk-based capital ratios.* (i) A [bank]'s floor-adjusted tier 1 risk-based capital ratio during a transitional floor period is equal to the [bank]'s tier 1 capital as calculated under [the general risk-based capital rules], divided by the product of:

(A) The [bank]'s total risk-weighted assets as calculated under [the general risk-based capital rules]; and

(B) The appropriate transitional floor percentage in Table 1.

(ii) A [bank]'s floor-adjusted total risk-based capital ratio during a transitional floor period is equal to the sum of the [bank]'s tier 1 and tier 2 capital as calculated under [the general risk-based capital rules], divided by the product of:

(A) The [bank]'s total risk-weighted assets as calculated under [the general risk-based capital rules]; and

(B) The appropriate transitional floor percentage in Table 1.

(iii) A [bank] that meets the criteria in paragraph (b)(1) or (b)(2) of section 1 as of the effective date of this rule must use [the general risk-based capital rules] effective immediately before this rule became effective during the parallel run and as the basis for its transitional floors.

TABLE 1—TRANSITIONAL FLOORS

Transitional floor period	Transitional floor percentage
First floor period	95 percent
Second floor period ...	90 percent
Third floor period	85 percent

(3) *Advanced approaches risk-based capital ratios.* (i) A [bank]'s advanced approaches tier 1 risk-based capital ratio equals the [bank]'s tier 1 risk-based capital ratio as calculated under this appendix (other than this section on transitional floor periods).

(ii) A [bank]'s advanced approaches total risk-based capital ratio equals the [bank]'s total risk-based capital ratio as calculated under this appendix (other than this section on transitional floor periods).

(4) *Reporting.* During the transitional floor periods, a [bank] must report to the [AGENCY] on a calendar quarterly basis both floor-adjusted risk-based capital ratios and both advanced approaches risk-based capital ratios.

(5) *Exiting a transitional floor period.* A [bank] may not exit a transitional floor period until the [bank] has spent a minimum of four consecutive calendar quarters in the period and the [AGENCY] has determined that the [bank] may exit the floor period. The [AGENCY]'s determination will be based on an assessment of the [bank]'s ongoing compliance with the qualification requirements in section 22.

Section 22. Qualification Requirements

(a) *Process and systems requirements.* (1) A [bank] must have a rigorous process for assessing its overall capital adequacy in relation to its risk profile

and a comprehensive strategy for maintaining an appropriate level of capital.

(2) The systems and processes used by a [bank] for risk-based capital purposes under this appendix must be consistent with the [bank]'s internal risk management processes and management information reporting systems.

(3) Each [bank] must have an appropriate infrastructure with risk measurement and management processes that meet the qualification requirements of this section and are appropriate given the [bank]'s size and level of complexity. Regardless of whether the systems and models that generate the risk parameters necessary for calculating a [bank]'s risk-based capital requirements are located at any affiliate of the [bank], the [bank] itself must ensure that the risk parameters and reference data used to determine its risk-based capital requirements are representative of its own credit risk and operational risk exposures.

(b) *Risk rating and segmentation systems for wholesale and retail exposures.* (1) A [bank] must have an internal risk rating and segmentation system that accurately and reliably differentiates among degrees of credit risk for the [bank]'s wholesale and retail exposures.

(2) For wholesale exposures, a [bank] must have an internal risk rating system that accurately and reliably assigns each obligor to a single rating grade (reflecting the obligor's likelihood of default). The [bank]'s wholesale obligor rating system must have at least seven discrete rating grades for non-defaulted obligors and at least one rating grade for defaulted obligors. Unless the [bank] has chosen to directly assign ELGD and LGD estimates to each wholesale exposure, the [bank] must have an internal risk rating system that accurately and reliably assigns each wholesale exposure to loss severity rating grades (reflecting the [bank]'s estimate of the ELGD and LGD of the exposure). A [bank] employing loss severity rating grades must have a sufficiently granular loss severity grading system to avoid grouping together exposures with widely ranging ELGDs or LGDs.

(3) For retail exposures, a [bank] must have a system that groups exposures into segments with homogeneous risk characteristics and assigns accurate and reliable PD, ELGD, and LGD estimates for each segment on a consistent basis. The [bank]'s system must group retail exposures into the appropriate retail exposure subcategory and must group the retail exposures in each retail exposure subcategory into separate segments. The [bank]'s system must

identify all defaulted retail exposures and group them in segments by subcategories separate from non-defaulted retail exposures.

(4) The [bank]'s internal risk rating policy for wholesale exposures must describe the [bank]'s rating philosophy (that is, must describe how wholesale obligor rating assignments are affected by the [bank]'s choice of the range of economic, business, and industry conditions that are considered in the obligor rating process).

(5) The [bank]'s internal risk rating system for wholesale exposures must provide for the review and update (as appropriate) of each obligor rating and (if applicable) each loss severity rating whenever the [bank] receives new material information, but no less frequently than annually. The [bank]'s retail exposure segmentation system must provide for the review and update (as appropriate) of assignments of retail exposures to segments whenever the [bank] receives new material information, but no less frequently than quarterly.

(c) *Quantification of risk parameters for wholesale and retail exposures.* (1) The [bank] must have a comprehensive risk parameter quantification process that produces accurate, timely, and reliable estimates of the risk parameters for the [bank]'s wholesale and retail exposures.

(2) Data used to estimate the risk parameters must be relevant to the [bank]'s actual wholesale and retail exposures, and of sufficient quality to support the determination of risk-based capital requirements for the exposures.

(3) The [bank]'s risk parameter quantification process must produce conservative risk parameter estimates where the [bank] has limited relevant data, and any adjustments that are part of the quantification process must not result in a pattern of bias toward lower risk parameter estimates.

(4) PD estimates for wholesale and retail exposures must be based on at least 5 years of default data. ELGD and LGD estimates for wholesale exposures must be based on at least 7 years of loss severity data, and ELGD and LGD estimates for retail exposures must be based on at least 5 years of loss severity data. EAD estimates for wholesale exposures must be based on at least 7 years of exposure amount data, and EAD estimates for retail exposures must be based on at least 5 years of exposure amount data.

(5) Default, loss severity, and exposure amount data must include periods of economic downturn conditions, or the [bank] must adjust its estimates of risk parameters to

compensate for the lack of data from periods of economic downturn conditions.

(6) The [bank]'s PD, ELGD, LGD, and EAD estimates must be based on the definition of default in this appendix.

(7) The [bank] must review and update (as appropriate) its risk parameters and its risk parameter quantification process at least annually.

(8) The [bank] must at least annually conduct a comprehensive review and analysis of reference data to determine relevance of reference data to [bank] exposures, quality of reference data to support PD, ELGD, LGD, and EAD estimates, and consistency of reference data to the definition of default contained in this appendix.

(d) *Counterparty credit risk model.* A [bank] must obtain the prior written approval of [AGENCY] under section 32 to use the internal models methodology for counterparty credit risk.

(e) *Double default treatment.* A [bank] must obtain the prior written approval of [AGENCY] under section 34 to use the double default treatment.

(f) *Securitization exposures.* A [bank] must obtain the prior written approval of [AGENCY] under section 44 to use the internal assessment approach for securitization exposures to ABCP programs.

(g) *Equity exposures model.* A [bank] must obtain the prior written approval of [AGENCY] under section 53 to use the internal models approach for equity exposures.

(h) *Operational risk—(1) Operational risk management processes.* A [bank] must:

(i) Have an operational risk management function that:

(A) Is independent of business line management; and

(B) Is responsible for designing, implementing, and overseeing the [bank]'s operational risk data and assessment systems, operational risk quantification systems, and related processes;

(ii) Have and document a process to identify, measure, monitor, and control operational risk in [bank] products, activities, processes, and systems (which process must capture business environment and internal control factors affecting the [bank]'s operational risk profile); and

(iii) Report operational risk exposures, operational loss events, and other relevant operational risk information to business unit management, senior management, and the board of directors (or a designated committee of the board).

(2) *Operational risk data and assessment systems.* A [bank] must have

operational risk data and assessment systems that capture operational risks to which the [bank] is exposed. The [bank]'s operational risk data and assessment systems must:

(i) Be structured in a manner consistent with the [bank]'s current business activities, risk profile, technological processes, and risk management processes; and

(ii) Include credible, transparent, systematic, and verifiable processes that incorporate the following elements on an ongoing basis:

(A) *Internal operational loss event data.* The [bank] must have a systematic process for capturing and using internal operational loss event data in its operational risk data and assessment systems.

(1) The [bank]'s operational risk data and assessment systems must include an historical observation period of at least five years for internal operational loss event data (or such shorter period approved by [AGENCY] to address transitional situations, such as integrating a new business line).

(2) The [bank] may refrain from collecting internal operational loss event data for individual operational losses below established dollar threshold amounts if the [bank] can demonstrate to the satisfaction of the [AGENCY] that the thresholds are reasonable, do not exclude important internal operational loss event data, and permit the [bank] to capture substantially all the dollar value of the [bank]'s operational losses.

(B) *External operational loss event data.* The [bank] must have a systematic process for determining its methodologies for incorporating external operational loss data into its operational risk data and assessment systems.

(C) *Scenario analysis.* The [bank] must have a systematic process for incorporating scenario analysis into its operational risk data and assessment systems.

(D) *Business environment and internal control factors.* The [bank] must incorporate business environment and internal control factors into its operational risk data and assessment systems. The [bank] must also periodically compare the results of its prior business environment and internal control factor assessments against its actual operational losses incurred in the intervening period.

(3) *Operational risk quantification systems.* (i) The [bank]'s operational risk quantification systems:

(A) Must generate estimates of the [bank]'s operational risk exposure using

its operational risk data and assessment systems; and

(B) Must employ a unit of measure that is appropriate for the [bank]'s range of business activities and the variety of operational loss events to which it is exposed, and that does not combine business activities or operational loss events with different risk profiles within the same loss distribution.

(C) May use internal estimates of dependence among operational losses within and across business lines and operational loss events if the [bank] can demonstrate to the satisfaction of [AGENCY] that its process for estimating dependence is sound, robust to a variety of scenarios, and implemented with integrity, and allows for the uncertainty surrounding the estimates. If the [bank] has not made such a demonstration, it must sum operational risk exposure estimates across units of measure to calculate its total operational risk exposure.

(D) Must be reviewed and updated (as appropriate) whenever the [bank] becomes aware of information that may have a material effect on the [bank]'s estimate of operational risk exposure, but no less frequently than annually.

(ii) With the prior written approval of [AGENCY], a [bank] may generate an estimate of its operational risk exposure using an alternative approach to that specified in paragraph (h)(3)(i) of this section. A [bank] proposing to use such an alternative operational risk quantification system must submit a proposal to [AGENCY]. In considering a [bank]'s proposal to use an alternative operational risk quantification system, [AGENCY] will consider the following principles:

(A) Use of the alternative operational risk quantification system will be allowed only on an exception basis, considering the size, complexity, and risk profile of a [bank];

(B) The [bank] must demonstrate that its estimate of its operational risk exposure generated under the alternative operational risk quantification system is appropriate and can be supported empirically; and

(C) A [bank] must not use an allocation of operational risk capital requirements that includes entities other than depository institutions or the benefits of diversification across entities.

(i) *Data management and maintenance.* (1) A [bank] must have data management and maintenance systems that adequately support all aspects of its advanced systems and the timely and accurate reporting of risk-based capital requirements.

(2) A [bank] must retain data using an electronic format that allows timely retrieval of data for analysis, validation, reporting, and disclosure purposes.

(3) A [bank] must retain sufficient data elements related to key risk drivers to permit adequate monitoring, validation, and refinement of its advanced systems.

(j) *Control, oversight, and validation mechanisms.* (1) The [bank]'s senior management must ensure that all components of the [bank]'s advanced systems function effectively and comply with the qualification requirements in this section.

(2) The [bank]'s board of directors (or a designated committee of the board) must at least annually evaluate the effectiveness of, and approve, the [bank]'s advanced systems.

(3) A [bank] must have an effective system of controls and oversight that:

(i) Ensures ongoing compliance with the qualification requirements in this section;

(ii) Maintains the integrity, reliability, and accuracy of the [bank]'s advanced systems; and

(iii) Includes adequate governance and project management processes.

(4) The [bank] must validate, on an ongoing basis, its advanced systems. The [bank]'s validation process must be independent of the advanced systems' development, implementation, and operation, or the validation process must be subjected to an independent review of its adequacy and effectiveness. Validation must include:

(i) The evaluation of the conceptual soundness of (including developmental evidence supporting) the advanced systems;

(ii) An on-going monitoring process that includes verification of processes and benchmarking; and

(iii) An outcomes analysis process that includes back-testing.

(5) The [bank] must have an internal audit function independent of business-line management that at least annually assesses the effectiveness of the controls supporting the [bank]'s advanced systems and reports its findings to the [bank]'s board of directors (or a committee thereof).

(6) The [bank] must periodically stress test its advanced systems. The stress testing must include a consideration of how economic cycles, especially downturns, affect risk-based capital requirements (including migration across rating grades and segments and the credit risk mitigation benefits of double default treatment).

(k) *Documentation.* The [bank] must adequately document all material aspects of its advanced systems.

Section 23. Ongoing Qualification

(a) *Changes to advanced systems.* A [bank] must meet all the qualification requirements in section 22 on an ongoing basis. A [bank] must notify the [AGENCY] when the [bank] makes any change to an advanced system that would result in a material change in the [bank]'s risk-weighted asset amount for an exposure type, or when the [bank] makes any significant change to its modeling assumptions.

(b) *Mergers and acquisitions—(1) Mergers and acquisitions of companies without advanced systems.* If a [bank] merges with or acquires a company that does not calculate its risk-based capital requirements using advanced systems, the [bank] may use [the general risk-based capital rules] to determine the risk-weighted asset amounts for, and deductions from capital associated with, the merged or acquired company's exposures for up to 24 months after the calendar quarter during which the merger or acquisition consummates. [AGENCY] may extend this transition period for up to an additional 12 months. Within 30 days of consummating the merger or acquisition, the [bank] must submit to [AGENCY] an implementation plan for using its advanced systems for the acquired company. During the period when [the general risk-based capital rules] apply to the merged or acquired company, any ALLL, net of allocated transfer risk reserves established pursuant to 12 U.S.C. 3904, associated with the merged or acquired company's exposures may be included in the [bank]'s tier 2 capital up to 1.25 percent of the acquired company's risk-weighted assets. All general reserves of the merged or acquired company must be excluded from the [bank]'s eligible credit reserves. In addition, the risk-weighted assets of the merged or acquired company are not included in the [bank]'s credit-risk-weighted assets but are included in total risk-weighted assets. If a [bank] relies on this paragraph, the [bank] must disclose publicly the amounts of risk-weighted assets and qualifying capital calculated under this appendix for the acquiring [bank] and under [the general risk-based capital rules] for the acquired company.

(2) *Mergers and acquisitions of companies with advanced systems.* If a [bank] merges with or acquires a company that calculates its risk-based capital requirements using advanced systems, the acquiring [bank] may use the acquired company's advanced systems to determine the risk-weighted asset amounts for, and deductions from capital associated with, the merged or

acquired company's exposures for up to 24 months after the calendar quarter during which the acquisition or merger consummates. [AGENCY] may extend this transition period for up to an additional 12 months. Within 30 days of consummating the merger or acquisition, the [bank] must submit to [AGENCY] an implementation plan for using its advanced systems for the merged or acquired company.

(c) *Failure to comply with qualification requirements.* If [AGENCY] determines that a [bank] that is subject to this appendix and has conducted a satisfactory parallel run fails to comply with the qualification requirements in section 22, [AGENCY] will notify the [bank] in writing of the [bank]'s failure to comply. The [bank] must establish a plan satisfactory to the [AGENCY] to return to compliance with the qualification requirements and must disclose to the public its failure to comply with the qualification requirements promptly after receiving notice from the [AGENCY]. In addition, if the [AGENCY] determines that the [bank]'s risk-based capital requirements are not commensurate with the [bank]'s credit, market, operational, or other risks, the [AGENCY] may require such a [bank] to calculate its risk-based capital requirements:

- (1) Under [the general risk-based capital rules]; or
- (2) Under this appendix with any modifications provided by the [AGENCY].

Part IV. Risk-Weighted Assets for General Credit Risk**Section 31. Mechanics for Calculating Total Wholesale and Retail Risk-Weighted Assets**

(a) *Overview.* A [bank] must calculate its total wholesale and retail risk-weighted asset amount in four distinct phases:

- (1) Phase 1—categorization of exposures;
- (2) Phase 2—assignment of wholesale obligors and exposures to rating grades and segmentation of retail exposures;
- (3) Phase 3—assignment of risk parameters to wholesale exposures and segments of retail exposures; and
- (4) Phase 4—calculation of risk-weighted asset amounts.

(b) *Phase 1—Categorization.* The [bank] must determine which of its exposures are wholesale exposures, retail exposures, securitization exposures, or equity exposures. The [bank] must categorize each retail exposure as a residential mortgage exposure, a QRE, or an other retail exposure. The [bank] must identify

which wholesale exposures are HVCRE exposures, sovereign exposures, OTC derivative contracts, repo-style transactions, eligible margin loans, eligible purchased wholesale receivables, unsettled transactions to which section 35 applies, and eligible guarantees or eligible credit derivatives that are used as credit risk mitigants. The [bank] must identify any on-balance sheet asset that does not meet the definition of a wholesale, retail, equity, or securitization exposure, as well as any non-material portfolio of exposures described in paragraph (e)(4) of this section.

(c) *Phase 2—Assignment of wholesale obligors and exposures to rating grades and retail exposures to segments—(1) Assignment of wholesale obligors and exposures to rating grades.*

(i) The [bank] must assign each obligor of a wholesale exposure to a single obligor rating grade and may assign each wholesale exposure to loss severity rating grades.

(ii) The [bank] must identify which of its wholesale obligors are in default.

(2) *Segmentation of retail exposures.* (i) The [bank] must group the retail exposures in each retail subcategory into segments that have homogeneous risk characteristics.

(ii) The [bank] must identify which of its retail exposures are in default. The [bank] must segment defaulted retail exposures separately from non-defaulted retail exposures.

(iii) If the [bank] determines the EAD for eligible margin loans using the approach in paragraph (a) of section 32, the [bank] must identify which of its retail exposures are eligible margin loans for which the [bank] uses this EAD approach and must segment such eligible margin loans separately from other retail exposures.

(3) *Eligible purchased wholesale receivables.* A [bank] may group its eligible purchased wholesale receivables that, when consolidated by obligor, total less than \$1 million into segments that have homogeneous risk characteristics. A [bank] must use the wholesale exposure formula in Table 2 in this section to determine the risk-based capital requirement for each segment of eligible purchased wholesale receivables.

(d) *Phase 3—Assignment of risk parameters to wholesale exposures and segments of retail exposures—(1) Quantification process.* Subject to the limitations in this paragraph (d), the [bank] must:

- (i) Associate a PD with each wholesale obligor rating grade;
- (ii) Associate an ELGD or LGD, as appropriate, with each wholesale loss

severity rating grade or assign an ELGD and LGD to each wholesale exposure;

(iii) Assign an EAD and M to each wholesale exposure; and

(iv) Assign a PD, ELGD, LGD, and EAD to each segment of retail exposures.

(2) *Floor on PD assignment.* The PD for each wholesale exposure or retail segment may not be less than 0.03 percent, except for exposures to or directly and unconditionally guaranteed by a sovereign entity, the Bank for International Settlements, the International Monetary Fund, the European Commission, the European Central Bank, or a multi-lateral development bank, to which the [bank] assigns a rating grade associated with a PD of less than 0.03 percent.

(3) *Floor on LGD estimation.* The LGD for each segment of residential mortgage exposures (other than segments of residential mortgage exposures for which all or substantially all of the principal of each exposure is directly and unconditionally guaranteed by the full faith and credit of a sovereign entity) may not be less than 10 percent.

(4) *Eligible purchased wholesale receivables.* A [bank] must assign a PD, ELGD, LGD, EAD, and M to each segment of eligible purchased wholesale receivables. If the [bank] can estimate ECL (but not PD or LGD) for a segment of eligible purchased wholesale receivables, the [bank] must assume that the ELGD and LGD of the segment equals 100 percent and that the PD of the segment equals ECL divided by EAD. The estimated ECL must be calculated for the receivables without regard to any assumption of recourse or guarantees from the seller or other parties.

(5) *Credit risk mitigation—credit derivatives, guarantees, and collateral.*

(i) A [bank] may take into account the risk reducing effects of eligible guarantees and eligible credit derivatives in support of a wholesale exposure by applying the PD substitution or LGD adjustment treatment to the exposure as provided in

section 33 or, if applicable, applying double default treatment to the exposure as provided in section 34. A [bank] may decide separately for each wholesale exposure that qualifies for the double default treatment under section 34 whether to apply the double default treatment or to use the PD substitution or LGD adjustment approach without recognizing double default effects.

(ii) A [bank] may take into account the risk reducing effects of guarantees and credit derivatives in support of retail exposures in a segment when quantifying the PD, ELGD, and LGD of the segment.

(iii) Except as provided in paragraph (d)(6) of this section, a [bank] may take into account the risk reducing effects of collateral in support of a wholesale exposure when quantifying the ELGD and LGD of the exposure and may take into account the risk reducing effects of collateral in support of retail exposures when quantifying the PD, ELGD, and LGD of the segment.

(6) *EAD for derivative contracts, repo-style transactions, and eligible margin loans.* (i) A [bank] must calculate its EAD for an OTC derivative contract as provided in paragraphs (b) and (c) of section 32. A [bank] may take into account the risk-reducing effects of financial collateral in support of a repo-style transaction or eligible margin loan through an adjustment to EAD as provided in paragraphs (a) and (c) of section 32. A [bank] that takes financial collateral into account through such an adjustment to EAD under section 32 may not adjust ELGD or LGD to reflect the financial collateral.

(ii) A [bank] may attribute an EAD of zero to:

(A) Derivative contracts that are publicly traded on an exchange that requires the daily receipt and payment of cash-variation margin;

(B) Derivative contracts and repo-style transactions that are outstanding with a qualifying central counterparty (but not for those transactions that a qualifying central counterparty has rejected); and

(C) Credit risk exposures to a qualifying central counterparty in the form of clearing deposits and posted collateral that arise from transactions described in paragraph (d)(6)(ii)(B) of this section.

(7) *Effective maturity.* An exposure's M must be no greater than five years and no less than one year, except that a [bank] may set the M of an exposure equal to the greater of one day or M if the exposure has an original maturity of less than one year and is not part of the [bank]'s ongoing financing of the obligor. An exposure is not part of a [bank]'s ongoing financing of the obligor if the [bank]:

(i) Has a legal and practical ability not to renew or roll over the exposure in the event of credit deterioration of the obligor;

(ii) Makes an independent credit decision at the inception of the exposure and at every renewal or roll over; and

(iii) Has no substantial commercial incentive to continue its credit relationship with the obligor in the event of credit deterioration of the obligor.

(e) *Phase 4—Calculation of risk-weighted assets—(1) Non-defaulted exposures.* (i) A [bank] must calculate the dollar risk-based capital requirement for each of its wholesale exposures to a non-defaulted obligor and segments of non-defaulted retail exposures (except eligible guarantees and eligible credit derivatives that hedge another wholesale exposure and exposures to which the [bank] applies the double default treatment in section 34) by inserting the assigned risk parameters for the wholesale obligor and exposure or retail segment into the appropriate risk-based capital formula specified in Table 2 and multiplying the output of the formula (K) by the EAD of the exposure or segment.⁷

⁷ A [bank] may instead apply a 300 percent risk weight to the EAD of an eligible margin loan if the [bank] is not able to assign a rating grade to the obligor of the loan.

Table 2 – IRB risk-based capital formulas for wholesale exposures to non-defaulted obligors and segments of non-defaulted retail exposures*

Retail	Capital Requirement (K) Non-Defaulted Exposures	$K = \left[LGD \times N \left(\frac{N^{-1}(PD) + \sqrt{R} \times N^{-1}(0.999)}{\sqrt{1-R}} \right) - (ELGD \times PD) \right]$
	Correlation Factor (R)	For residential mortgage exposures: $R = 0.15$
		For qualifying revolving exposures: $R = 0.04$
		For other retail exposures: $R = 0.03 + 0.13 \times e^{-35 \times PD}$
Wholesale	Capital Requirement (K) Non-Defaulted Exposures	$K = \left[LGD \times N \left(\frac{N^{-1}(PD) + \sqrt{R} \times N^{-1}(0.999)}{\sqrt{1-R}} \right) - (ELGD \times PD) \right] \times \left(\frac{1 + (M - 2.5) \times b}{1 - 1.5 \times b} \right)$
	Correlation Factor (R)	For HVCRE exposures:
		$R = 0.12 + 0.18 \times e^{-50 \times PD}$
		For wholesale exposures other than HVCRE exposures:
	Maturity Adjustment (b)	$R = 0.12 + 0.12 \times e^{-50 \times PD}$
		$b = (0.11852 - 0.05478 \times \ln(PD))^2$

* N(.) means the cumulative distribution function for a standard normal random variable. N⁻¹(.) means the inverse cumulative distribution function for a standard normal random variable. The symbol e refers to the base of the natural logarithms, and the function ln(.) refers to the natural logarithm of the expression within parentheses. The formulas apply when PD is greater than zero. If PD equals zero, the capital requirement K is set equal to zero.

(ii) The sum of all of the dollar risk-based capital requirements for each wholesale exposure to a non-defaulted obligor and segment of non-defaulted retail exposures calculated in paragraph (e)(1)(i) of this section and in paragraph (e) of section 34 equals the total dollar risk-based capital requirement for those exposures and segments.

(iii) The aggregate risk-weighted asset amount for wholesale exposures to non-defaulted obligors and segments of non-defaulted retail exposures equals the total dollar risk-based capital requirement calculated in paragraph (e)(1)(ii) of this section multiplied by 12.5.

(2) *Wholesale exposures to defaulted obligors and segments of defaulted retail exposures—(i) Wholesale exposures to defaulted obligors.*

(A) For each wholesale exposure to a defaulted obligor, the [bank] must compare:

(1) 0.08 multiplied by the EAD of the wholesale exposure, plus the amount of any charge-offs or write-downs on the exposure; and

(2) K for the wholesale exposure (as determined in Table 2 immediately before the obligor became defaulted), multiplied by the EAD of the wholesale exposure immediately before the obligor became defaulted.

(B) If the amount calculated in paragraph (e)(2)(i)(A)1 is equal to or greater than the amount calculated in paragraph (e)(2)(i)(A)2, the dollar risk-based capital requirement for the exposure is 0.08 multiplied by the EAD of the wholesale exposure.

(C) If the amount calculated in paragraph (e)(2)(i)(A)1 is less than the amount calculated in paragraph (e)(2)(i)(A)2, the dollar risk-based capital requirement for the exposure is K for the wholesale exposure (as determined in Table 2 immediately

before the obligor became defaulted) multiplied by the EAD of the wholesale exposure.

(ii) *Segments of defaulted retail exposures.* The dollar risk-based capital requirement for a segment of defaulted retail exposures equals 0.08 multiplied by the EAD of the segment.

(iii) The sum of all the dollar risk-based capital requirements for each wholesale exposure to a defaulted obligor calculated in paragraphs (e)(2)(i)(B) and (C) of this section plus the dollar risk-based capital requirements for each segment of defaulted retail exposures calculated in paragraph (e)(2)(ii) of this section equals the total dollar risk-based capital requirement for those exposures.

(iv) The aggregate risk-weighted asset amount for wholesale exposures to defaulted obligors and segments of defaulted retail exposures equals the total dollar risk-based capital

requirement calculated in paragraph (e)(2)(iii) of this section multiplied by 12.5.

(3) *Assets not included in a defined exposure category.* A [bank] may assign a risk-weighted asset amount of zero to cash owned and held in all offices of the [bank] or in transit and for gold bullion held in the [bank]'s own vaults, or held in another [bank]'s vaults on an allocated basis, to the extent it is offset by gold bullion liabilities. The risk-weighted asset amount for the residual value of a retail lease exposure equals such residual value. The risk-weighted asset amount for an excluded mortgage exposure is determined under 12 CFR part 3, Appendix A, section 3(a)(3)(iii) (for national banks), 12 CFR part 208, Appendix A, section III.C.3. (for state member banks), 12 CFR part 225, Appendix A, section III.C.3. (for bank holding companies), 12 CFR part 325, Appendix A, section II.C.a. (for state nonmember banks), and 12 CFR 567.6(a)(1)(iii) and (iv) (for savings associations). The risk-weighted asset amount for any other on-balance-sheet asset that does not meet the definition of a wholesale, retail, securitization, or equity exposure equals the carrying value of the asset.

(4) *Non-material portfolios of exposures.* The risk-weighted asset amount of a portfolio of exposures for which the [bank] has demonstrated to [AGENCY]'s satisfaction that the portfolio (when combined with all other portfolios of exposures that the [bank] seeks to treat under this paragraph) is not material to the [bank] is the sum of the carrying values of on-balance sheet exposures plus the notional amounts of off-balance sheet exposures in the portfolio. For purposes of this paragraph (e)(4), the notional amount of an OTC derivative contract that is not a credit derivative is the EAD of the derivative as calculated in section 32.

Section 32. Counterparty Credit Risk

This section describes two methodologies—a collateral haircut approach and an internal models methodology—that a [bank] may use instead of an ELGD/LGD estimation methodology to recognize the benefits of financial collateral in mitigating the

counterparty credit risk of repo-style transactions, eligible margin loans, and collateralized OTC derivative contracts, and single product netting sets of such transactions. A third methodology, the simple VaR methodology, is available for single product netting sets of repo-style transactions and eligible margin loans. This section also describes the methodology for calculating EAD for an OTC derivative contract or a set of OTC derivative contracts subject to a qualifying master netting agreement. A [bank] also may use the internal models methodology to estimate EAD for qualifying cross-product master netting agreements.

A [bank] may use any combination of the three methodologies for collateral recognition; however, it must use the same methodology for similar exposures. A [bank] may use separate methodologies for agency securities lending transactions—that is, securities lending transactions in which the [bank], acting as agent for a customer, lends the customer's securities and indemnifies the customer against loss—and all other repo-style transactions.

(a) *EAD for eligible margin loans and repo-style transactions—(1) General.* A [bank] may recognize the credit risk mitigation benefits of financial collateral that secures an eligible margin loan, repo-style transaction, or single-product group of such transactions with a single counterparty subject to a qualifying master netting agreement (netting set) by factoring the collateral into its ELGD and LGD estimates for the exposure. Alternatively, a [bank] may estimate an unsecured ELGD and LGD for the exposure and determine the EAD of the exposure using:

- (i) The collateral haircut approach described in paragraph (a)(2) of this section;
- (ii) For netting sets only, the simple VaR methodology described in paragraph (a)(3) of this section; or
- (iii) The internal models methodology described in paragraph (c) of this section.

(2) *Collateral haircut approach—(i) EAD equation.* A [bank] may determine EAD for an eligible margin loan, repo-style transaction, or netting set by setting $EAD = \max \{0, [(\Sigma E - \Sigma C) + \Sigma (E_s \times H_s) + (E_{fx} \times H_{fx})]\}$, where:

(A) ΣE equals the value of the exposure (that is, the sum of the current market values of all securities and cash the [bank] has lent, sold subject to repurchase, or posted as collateral to the counterparty under the transaction (or netting set));

(B) ΣC equals the value of the collateral (that is, the sum of the current market values of all securities and cash the [bank] has borrowed, purchased subject to resale, or taken as collateral from the counterparty under the transaction (or netting set));

(C) E_s = absolute value of the net position in a given security (where the net position in a given security equals the sum of the current market values of the particular security the [bank] has lent, sold subject to repurchase, or posted as collateral to the counterparty minus the sum of the current market values of that same security the [bank] has borrowed, purchased subject to resale, or taken as collateral from the counterparty);

(D) H_s = market price volatility haircut appropriate to the security referenced in E_s ;

(E) E_{fx} = absolute value of the net position of both cash and securities in a currency that is different from the settlement currency (where the net position in a given currency equals the sum of the current market values of any cash or securities in the currency the [bank] has lent, sold subject to repurchase, or posted as collateral to the counterparty minus the sum of the current market values of any cash or securities in the currency the [bank] has borrowed, purchased subject to resale, or taken as collateral from the counterparty); and

(F) H_{fx} = haircut appropriate to the mismatch between the currency referenced in E_{fx} and the settlement currency.

(ii) *Standard supervisory haircuts.* (A) Under the “standard supervisory haircuts” approach:

(1) A [bank] must use the haircuts for market price volatility (H_s) in Table 3, as adjusted in certain circumstances as provided in paragraph (a)(2)(ii)(A)(3) and (4) of this section;

TABLE 3.—STANDARD SUPERVISORY MARKET PRICE VOLATILITY HAIRCUTS*

Applicable external rating grade category for debt securities	Residual maturity for debt securities	Issuers exempt from the 3 b.p. floor	Other issuers
Two highest investment grade rating categories for long-term ratings/highest investment grade rating category for short-term ratings.	≤1 year	.005	.01
	>1 year, ≤5 years	.02	.04
	>5 years	.04	.08

TABLE 3.—STANDARD SUPERVISORY MARKET PRICE VOLATILITY HAIRCUTS*—Continued

Applicable external rating grade category for debt securities	Residual maturity for debt securities	Issuers exempt from the 3 b.p. floor	Other issuers
Two lowest investment grade rating categories for both short- and long-term ratings.	≤1 year	.01	.02
	>1 year, ≤5 years	.03	.06
	>5 years	.06	.12
One rating category below investment grade	All	.15	.25
Main index equities (including convertible bonds) and gold		.15	
Other publicly traded equities (including convertible bonds)		.25	
Mutual funds		Highest haircut applicable to any security in which the fund can invest.	
Cash on deposit with the [bank] (including a certificate of deposit issued by the [bank])		0	

*The market price volatility haircuts in Table 3 are based on a 10-business-day holding period.

(2) For currency mismatches, a [bank] must use a haircut for foreign exchange rate volatility (Hfx) of 8 percent, as adjusted in certain circumstances as provided in paragraph (a)(2)(ii)(A)(3) and (4) of this section.

(3) For repo-style transactions, a [bank] may multiply the supervisory haircuts provided in paragraphs (a)(2)(ii)(A)(1) and (2) by the square root of $\frac{1}{2}$ (which equals 0.707107).

(4) A [bank] must adjust the supervisory haircuts upward on the basis of a holding period longer than 10 business days (for eligible margin loans)

or 5 business days (for repo-style transactions) where and as appropriate to take into account the illiquidity of an instrument.

(iii) *Own estimates for haircuts.* With the prior written approval of [AGENCY], a [bank] may calculate haircuts (Hs and Hfx) using its own internal estimates of the volatilities of market prices and foreign exchange rates.

(A) To receive [AGENCY] approval to use internal estimates, a [bank] must satisfy the following minimum quantitative standards:

(1) A [bank] must use a 99th percentile one-tailed confidence interval.

(2) The minimum holding period for a repo-style transaction is 5 business days and for an eligible margin loan is 10 business days. When a [bank] calculates an own-estimates haircut on a T_N -day holding period, which is different from the minimum holding period for the transaction type, the applicable haircut (H_M) is calculated using the following square root of time formula:

$$H_M = H_N \sqrt{\frac{T_M}{T_N}}, \text{ where}$$

(i) $T_M = 5$ for repo-style transactions and 10 for eligible margin loans;

(ii) T_N = holding period used by the [bank] to derive H_N ; and

(iii) H_N = haircut based on the holding period T_N .

(3) A [bank] must adjust holding periods upwards where and as appropriate to take into account the illiquidity of an instrument.

(4) The historical observation period must be at least one year.

(5) A [bank] must update its data sets and recompute haircuts no less frequently than quarterly and must also reassess data sets and haircuts whenever market prices change materially.

(B) With respect to debt securities that have an applicable external rating of investment grade, a [bank] may calculate haircuts for categories of securities. For a category of securities, the [bank] must calculate the haircut on the basis of internal volatility estimates for securities in that category that are

representative of the securities in that category that the [bank] has actually lent, sold subject to repurchase, posted as collateral, borrowed, purchased subject to resale, or taken as collateral. In determining relevant categories, the [bank] must take into account:

- (1) The type of issuer of the security;
- (2) The applicable external rating of the security;
- (3) The maturity of the security; and
- (4) The interest rate sensitivity of the security.

(C) With respect to debt securities that have an applicable external rating of below investment grade and equity securities, a [bank] must calculate a separate haircut for each individual security.

(D) Where an exposure or collateral (whether in the form of cash or securities) is denominated in a currency that differs from the settlement currency, the [bank] must calculate a separate currency mismatch haircut for

its net position in each mismatched currency based on estimated volatilities of foreign exchange rates between the mismatched currency and the settlement currency.

(E) A [bank]'s own estimates of market price and foreign exchange rate volatilities may not take into account the correlations among securities and foreign exchanges rates on either the exposure or collateral side of a transaction (or netting set) or the correlations among securities and foreign exchange rates between the exposure and collateral sides of the transaction (or netting set).

(3) *Simple VaR methodology.* With the prior written approval of [AGENCY], a [bank] may estimate EAD for a netting set using a VaR model that meets the requirements in paragraph (a)(3)(iii) of this section. In such event, the [bank] must set $EAD = \max \{0, [(SE - \Sigma C) + PFE]\}$, where:

(i) ΣE equals the value of the exposure (that is, the sum of the current market values of all securities and cash the [bank] has lent, sold subject to repurchase, or posted as collateral to the counterparty under the netting set);

(ii) ΣC equals the value of the collateral (that is, the sum of the current market values of all securities and cash the [bank] has borrowed, purchased subject to resale, or taken as collateral from the counterparty under the netting set); and

(iii) PFE (potential future exposure) equals the [bank]'s empirically-based best estimate of the 99th percentile, one-tailed confidence interval for an increase in the value of $(\Sigma E - \Sigma C)$ over a 5-business-day holding period for repo-style transactions or over a 10-business-day holding period for eligible margin loans using a minimum one-year historical observation period of price data representing the instruments that the [bank] has lent, sold subject to repurchase, posted as collateral, borrowed, purchased subject to resale, or taken as collateral. The [bank] must validate its VaR model, including by establishing and maintaining a rigorous and regular back-testing regime.

(b) *EAD for OTC derivative contracts.* (1) A [bank] must determine the EAD for an OTC derivative contract that is not subject to a qualifying master netting agreement using the current exposure methodology in paragraph (b)(5) of this section or using the internal models methodology described in paragraph (c) of this section.

(2) A [bank] must determine the EAD for multiple OTC derivative contracts that are subject to a qualifying master netting agreement using the current exposure methodology in paragraph (b)(6) of this section or using the internal models methodology described in paragraph (c) of this section.⁸

(3) *Counterparty credit risk for credit derivatives.* Notwithstanding the above,

(i) A [bank] that purchases a credit derivative that is recognized under section 33 or 34 as a credit risk mitigant for an exposure that is not a covered position under [the market risk rule] need not compute a separate counterparty credit risk capital requirement under this section so long as it does so consistently for all such credit derivatives and either includes all or excludes all such credit derivatives that are subject to a master netting contract from any measure used to determine counterparty credit risk exposure to all relevant counterparties for risk-based capital purposes.

(ii) A [bank] that is the protection provider in a credit derivative must treat the credit derivative as a wholesale exposure to the reference obligor and need not compute a counterparty credit risk capital requirement for the credit derivative under this section, so long as it does so consistently for all such credit derivatives and either includes all or excludes all such credit derivatives that are subject to a master netting contract from any measure used to determine counterparty credit risk exposure to all relevant counterparties for risk-based capital purposes (unless the [bank] is treating the credit derivative as a covered position under [the market risk rule], in which case the [bank] must compute a supplemental counterparty credit risk capital requirement under this section).

(4) *Counterparty credit risk for equity derivatives.* A [bank] must treat an equity derivative contract as an equity exposure and compute a risk-weighted asset amount for the equity derivative contract under part VI (unless the [bank] is treating the contract as a covered position under [the market risk rule]). In addition, if the [bank] is treating the contract as a covered position under [the market risk rule] and in certain other cases described in section 55, the [bank] must also calculate a risk-based capital requirement for the counterparty

credit risk of an equity derivative contract under this part.

(5) *Single OTC derivative contract.* Except as modified by paragraph (b)(7) of this section, the EAD for a single OTC derivative contract that is not subject to a qualifying master netting agreement is equal to the sum of the [bank]'s current credit exposure and potential future credit exposure on the derivative contract.

(i) *Current credit exposure.* The current credit exposure for a single OTC derivative contract is the greater of the mark-to-market value of the derivative contract or zero.

(ii) *PFE.* The PFE for a single OTC derivative contract, including an OTC derivative contract with a negative mark-to-market value, is calculated by multiplying the notional principal amount of the derivative contract by the appropriate conversion factor in Table 4. For purposes of calculating either the potential future credit exposure under this paragraph or the gross potential future credit exposure under paragraph (b)(6) of this section for exchange rate contracts and other similar contracts in which the notional principal amount is equivalent to the cash flows, notional principal amount is the net receipts to each party falling due on each value date in each currency. For any OTC derivative contract that does not fall within one of the specified categories in Table 4, the potential future credit exposure must be calculated using the "other commodity" conversion factors. [Bank]s must use an OTC derivative contract's effective notional principal amount (that is, its apparent or stated notional principal amount multiplied by any multiplier in the OTC derivative contract) rather than its apparent or stated notional principal amount in calculating potential future credit exposure. PFE of the protection provider of a credit derivative is capped at the net present value of the amount of unpaid premiums.

TABLE 4.—CONVERSION FACTOR MATRIX FOR OTC DERIVATIVE CONTRACTS*

Remaining maturity**	Interest rate	Foreign exchange rate and gold	Credit (investment grade reference obligor)***	Credit (non-investment grade reference obligor)	Equity	Precious metals (except gold)	Other commodity
One year or less	0.00	0.01	0.05	0.10	0.06	0.07	0.10
Over one to five years	0.005	0.05	0.05	0.10	0.08	0.07	0.12
Over five years	0.015	0.075	0.05	0.10	0.10	0.08	0.15

* For an OTC derivative contract with multiple exchanges of principal, the conversion factor is multiplied by the number of remaining payments in the derivative contract.

⁸ For purposes of this determination, for OTC derivative contracts, a [bank] must maintain a

written and well reasoned legal opinion that this

agreement meets the criteria set forth in the definition of qualifying master netting agreement.

** For an OTC derivative contract that is structured such that on specified dates any outstanding exposure is settled and the terms are reset so that the market value of the contract is zero, the remaining maturity equals the time until the next reset date. For an interest rate derivative contract with a remaining maturity of greater than one year that meets these criteria, the minimum conversion factor is 0.005.

*** A [bank] must use column 4 of this table—"Credit (investment grade reference obligor)"—for a credit derivative whose reference obligor has an outstanding unsecured long-term debt security without credit enhancement that has a long-term applicable external rating of at least investment grade. A [bank] must use column 5 of the table for all other credit derivatives.

(6) *Multiple OTC derivative contracts subject to a qualifying master netting agreement.* Except as modified by paragraph (b)(7) of this section, the EAD for multiple OTC derivative contracts subject to a qualifying master netting agreement is equal to the sum of the net current credit exposure and the adjusted sum of the PFE exposure for all OTC derivative contracts subject to the qualifying master netting agreement.

(i) *Net current credit exposure.* The net current credit exposure is the greater of:

(A) The net sum of all positive and negative mark-to-market values of the individual OTC derivative contracts subject to the qualifying master netting agreement; or

(B) zero.

(ii) *Adjusted sum of the PFE.* The adjusted sum of the PFE is calculated as $Anet = (0.4 \times Agross) + (0.6 \times NGR \times Agross)$, where:

(A) $Anet$ = the adjusted sum of the PFE;

(B) $Agross$ = the gross PFE (that is, the sum of the PFE amounts (as determined under paragraph (b)(5)(ii) of this section) for each individual OTC derivative contract subject to the qualifying master netting agreement); and

(C) NGR = the net to gross ratio (that is, the ratio of the net current credit exposure to the gross current credit exposure). In calculating the NGR , the gross current credit exposure equals the sum of the positive current credit exposures (as determined under paragraph (b)(5)(i) of this section) of all individual OTC derivative contracts subject to the qualifying master netting agreement.

(7) *Collateralized OTC derivative contracts.* A [bank] may recognize the credit risk mitigation benefits of financial collateral that secures an OTC derivative contract or single-product set of OTC derivatives subject to a qualifying master netting agreement (netting set) by factoring the collateral into its ELGD and LGD estimates for the contract or netting set. Alternatively, a [bank] may recognize the credit risk mitigation benefits of financial collateral that secures such a contract or netting set that is marked to market on a daily basis and subject to a daily margin maintenance requirement by estimating an unsecured ELGD and LGD for the contract or netting set and adjusting the EAD calculated under paragraph (b)(5) or (b)(6) of this section using the collateral haircut approach in paragraph (a)(2) of this section. The [bank] must substitute the EAD calculated under paragraph (b)(5) or (b)(6) of this section for ΣE in the equation in paragraph (a)(2)(i) of this section and must use a 10-business-day minimum holding period ($T_M = 10$).

(c) *Internal models methodology.* (1) With prior written approval from [AGENCY], a [bank] may use the internal models methodology in this paragraph (c) to determine EAD for counterparty credit risk for OTC derivative contracts (collateralized or uncollateralized) and single-product netting sets thereof, for eligible margin loans and single-product netting sets thereof, and for repo-style transactions and single-product netting sets thereof. A [bank] that uses the internal models methodology for a particular transaction type (OTC derivative contracts, eligible margin loans, or repo-style transactions) must use the internal models

methodology for all transactions of that transaction type. A [bank] may choose to use the internal models methodology for one or two of these three types of exposures and not the other types. A [bank] may also use the internal models methodology for OTC derivative contracts, eligible margin loans, and repo-style transactions subject to a qualifying cross-product netting agreement if:

(i) The [bank] effectively integrates the risk mitigating effects of cross-product netting into its risk management and other information technology systems; and

(ii) The [bank] obtains the prior written approval of the [AGENCY].

A [bank] that uses the internal models methodology for a type of exposures must receive approval from the [AGENCY] to cease using the methodology for that type of exposures or to make a material change to its internal model.

(2) Under the internal models methodology, a [bank] uses an internal model to estimate the expected exposure (EE) for a netting set and then calculates EAD based on that EE.

(i) The [bank] must use its internal model's probability distribution for changes in the market value of an exposure or netting set that are attributable to changes in market variables to determine EE. The [bank] may include financial collateral currently posted by the counterparty as collateral when calculating EE.

(ii) Under the internal models methodology, $EAD = \alpha \times \text{effective EPE}$, or, subject to [AGENCY] approval as provided in paragraph (c)(7), a more conservative measure of EAD.

$$(A) \text{ EffectiveEPE}_{t_k} = \sum_{k=1}^n \text{EffectiveEE}_{t_k} * \Delta t_k$$

(that is, effective EPE is the time-weighted average of effective EE where the weights are the proportion that an individual effective EE represents in a one year time interval) where:

(1) $\text{Effective EE}_{t_k} = \max(\text{EffectiveEE}_{t_k-1}, \text{EE}_{t_k})$ (that is, for a specific date t_k , effective EE is the greater of EE at that date or the effective EE at the previous date); and

(2) t_k represents the k^{th} future time period in the model and there are n time periods represented in the model over the first year; and

(B) $\alpha = 1.4$ except as provided in paragraph (c)(6), or when [AGENCY] has determined that the [bank] must set α higher based on the [bank]'s specific characteristics of counterparty credit risk.

(3) To obtain [AGENCY] approval to calculate the distributions of exposures upon which the EAD calculation is based, the [bank] must demonstrate to the satisfaction of [AGENCY] that it has been using for at least one year an internal model that broadly meets the following minimum standards, with which the [bank] must maintain compliance:

(i) The model must have the systems capability to estimate the expected exposure to the counterparty on a daily basis (but is not expected to estimate or report expected exposure on a daily basis).

(ii) The model must estimate expected exposure at enough future dates to accurately reflect all the future cash flows of contracts in the netting set.

(iii) The model must account for the possible non-normality of the exposure distribution, where appropriate.

(iv) The [bank] must measure, monitor, and control current counterparty exposure and the exposure to the counterparty over the whole life of all contracts in the netting set.

(v) The [bank] must measure and manage current exposures gross and net

of collateral held, where appropriate. The [bank] must estimate expected exposures for OTC derivative contracts both with and without the effect of collateral agreements.

(vi) The [bank] must have procedures to identify, monitor, and control specific wrong-way risk throughout the life of an exposure. Wrong-way risk in this context is the risk that future exposure to a counterparty will be high when the counterparty's probability of default is also high.

(vii) The model must use current market data to compute current exposures. When estimating model parameters based on historical data, at least three years of historical data that cover a wide range of economic conditions must be used and must be

updated quarterly or more frequently if market conditions warrant. The [bank] should consider using model parameters based on forward-looking measures such as implied volatilities, where appropriate.

(viii) A [bank] must subject its internal model to an initial validation and annual model review process. The model review should consider whether the inputs and risk factors, as well as the model outputs, are appropriate.

(4) *Maturity.* (i) If the remaining maturity of the exposure or the longest-dated contract in the netting set is greater than one year, the [bank] must set M for the exposure or netting set equal to the lower of 5 years or M(EPE), where:

$$(A) M(EPE) = 1 + \frac{\sum_{t_k > 1 \text{ year}}^{maturity} EE_k \times \Delta t_k \times df_k}{\sum_{k=1}^{t_k \leq 1 \text{ year}} \text{effective } EE_k \times \Delta t_k \times df_k};$$

(B) df_k is the risk-free discount factor for future time period t_k ; and

(C) $\Delta t_k = t_k - t_{k-1}$.

(ii) If the remaining maturity of the exposure or the longest-dated contract in the netting set is one year or less, the [bank] must set M for the exposure or netting set equal to 1 year, except as provided in paragraph (d)(7) of section 31.

(5) *Collateral agreements.* A [bank] may capture the effect on EAD of a collateral agreement that requires receipt of collateral when exposure to the counterparty increases but may not capture the effect on EAD of a collateral agreement that requires receipt of collateral when counterparty credit quality deteriorates. For this purpose, a collateral agreement means a legal contract that specifies the time when, and circumstances under which, the counterparty is required to exchange collateral with the [bank] for a single financial contract or for all financial contracts covered under a qualifying master netting agreement and confers upon the [bank] a perfected, first priority security interest, or the legal equivalent thereof, in the collateral posted by the counterparty under the agreement. This security interest must provide the [bank] with a right to close out the financial positions and the collateral upon an event of default of, or failure to perform by, the counterparty under the collateral agreement. A contract would not satisfy this requirement if the [bank]'s exercise of

rights under the agreement may be stayed or avoided under applicable law in the relevant jurisdictions. Two methods are available to capture the effect of a collateral agreement:

(i) With prior written approval from [AGENCY], a [bank] may include the effect of a collateral agreement within its internal model used to calculate EAD. The [bank] may set EAD equal to the expected exposure at the end of the margin period of risk. The margin period of risk means, with respect to a netting set subject to a collateral agreement, the time period from the most recent exchange of collateral with a counterparty until the next required exchange of collateral plus the period of time required to sell and realize the proceeds of the least liquid collateral that can be delivered under the terms of the collateral agreement, and, where applicable, the period of time required to re-hedge the resulting market risk, upon the default of the counterparty. The minimum margin period of risk is 5 business days for repo-style transactions and 10 business days for other transactions when liquid financial collateral is posted under a daily margin maintenance requirement. This period should be extended to cover any additional time between margin calls; any potential closeout difficulties; any delays in selling collateral, particularly if the collateral is illiquid; and any impediments to prompt re-hedging of any market risk.

(ii) A [bank] that can model EPE without collateral agreements but cannot achieve the higher level of modeling sophistication to model EPE with collateral agreements can set effective EPE for a collateralized counterparty equal to the lesser of:

(A) The threshold, defined as the exposure amount at which the counterparty is required to post collateral under the collateral agreement, if the threshold is positive, plus an add-on that reflects the potential increase in exposure over the margin period of risk. The add-on is computed as the expected increase in the netting set's exposure beginning from current exposure of zero over the margin period of risk. The margin period of risk must be at least five business days for exposures or netting sets consisting only of repo-style transactions subject to daily re-margining and daily marking-to-market, and 10 business days for all other exposures or netting sets; or

(B) Effective EPE without a collateral agreement.

(6) *Own estimate of alpha.* With prior written approval of [AGENCY], a [bank] may calculate alpha as the ratio of economic capital from a full simulation of counterparty exposure across counterparties that incorporates a joint simulation of market and credit risk factors (numerator) and economic capital based on EPE (denominator), subject to a floor of 1.2. For purposes of this calculation, economic capital is the unexpected losses for all counterparty

credit risks measured at a 99.9 percent confidence level over a one-year horizon. To receive approval, the [bank] must meet the following minimum standards to the satisfaction of [AGENCY]:

(i) The [bank]'s own estimate of alpha must capture in the numerator the effects of:

(A) The material sources of stochastic dependency of distributions of market values of transactions or portfolios of transactions across counterparties;

(B) Volatilities and correlations of market risk factors used in the joint simulation, which must be related to the credit risk factor used in the simulation to reflect potential increases in volatility or correlation in an economic downturn, where appropriate; and

(C) The granularity of exposures, that is, the effect of a concentration in the proportion of each counterparty's exposure that is driven by a particular risk factor.

(ii) The [bank] must assess the potential model risk in its estimates of alpha.

(iii) The [bank] must calculate the numerator and denominator of alpha in a consistent fashion with respect to modeling methodology, parameter specifications, and portfolio composition.

(iv) The [bank] must review and adjust as appropriate its estimates of the numerator and denominator on at least a quarterly basis and more frequently when the composition of the portfolio varies over time.

(7) *Other measures of counterparty exposure.* With prior written approval of [AGENCY], a [bank] may set EAD equal to a measure of counterparty credit risk exposure, such as peak EAD, that is more conservative than an alpha of 1.4 (or higher under the terms of paragraph (c)(2)(ii)(B)) times EPE for every counterparty whose EAD will be measured under the alternative measure of counterparty exposure. The [bank] must demonstrate the conservatism of the measure of counterparty credit risk exposure used for EAD.

Section 33. Guarantees and Credit Derivatives: PD Substitution and LGD Adjustment Treatments

(a) *Scope.* (1) This section applies to wholesale exposures for which:

(i) Credit risk is fully covered by an eligible guarantee or eligible credit derivative; and

(ii) Credit risk is covered on a pro rata basis (that is, on a basis in which the [bank] and the protection provider share losses proportionately) by an eligible guarantee or eligible credit derivative.

(2) Wholesale exposures on which there is a tranching of credit risk (reflecting at least two different levels of seniority) are securitization exposures subject to the securitization framework in part V.

(3) A [bank] may elect to recognize the credit risk mitigation benefits of an eligible guarantee or eligible credit derivative covering an exposure described in paragraph (a)(1) of this section by using the PD substitution approach or the LGD adjustment approach in paragraph (c) of this section or using the double default treatment in section 34 (if the transaction qualifies for the double default treatment in section 34). A [bank]'s PD and LGD for the hedged exposure may not be lower than the PD and LGD floors described in paragraphs (d)(2) and (d)(3) of section 31.

(4) A [bank] must use the same risk parameters for calculating ECL as it uses for calculating the risk-based capital requirement for the exposure.

(b) *Rules of recognition.* (1) A [bank] may only recognize the credit risk mitigation benefits of eligible guarantees and eligible credit derivatives.

(2) A [bank] may only recognize the credit risk mitigation benefits of an eligible credit derivative to hedge an exposure that is different from the credit derivative's reference exposure used for determining the derivative's cash settlement value, deliverable obligation, or occurrence of a credit event if:

(i) The reference exposure ranks *pari passu* (that is, equally) with or is junior to the hedged exposure; and

(ii) The reference exposure and the hedged exposure share the same obligor (that is, the same legal entity), and legally enforceable cross-default or cross-acceleration clauses are in place.

(c) *Risk parameters for hedged exposures*—(1) *PD substitution approach*—(i) *Full coverage.* If an eligible guarantee or eligible credit derivative meets the conditions in paragraphs (a) and (b) of this section and the protection amount (P) of the guarantee or credit derivative is greater than or equal to the EAD of the hedged exposure, a [bank] may recognize the guarantee or credit derivative in determining the [bank]'s risk-based capital requirement for the hedged exposure by substituting the PD associated with the rating grade of the protection provider for the PD associated with the rating grade of the obligor in the risk-based capital formula in Table 2 and using the appropriate ELGD and LGD as described in paragraphs (c)(1)(iii) and (iv) of this section. If the [bank] determines that full substitution of the protection

provider's PD leads to an inappropriate degree of risk mitigation, the [bank] may substitute a higher PD than that of the protection provider.

(ii) *Partial coverage.* If an eligible guarantee or eligible credit derivative meets the conditions in paragraphs (a) and (b) of this section and the protection amount (P) of the guarantee or credit derivative is less than the EAD of the hedged exposure, the [bank] must treat the hedged exposure as two separate exposures (protected and unprotected) in order to recognize the credit risk mitigation benefit of the guarantee or credit derivative.

(A) The [bank] must calculate its risk-based capital requirement for the protected exposure under section 31, where PD is the protection provider's PD, ELGD and LGD are determined under paragraphs (c)(1)(iii) and (iv) of this section, and EAD is P. If the [bank] determines that full substitution leads to an inappropriate degree of risk mitigation, the [bank] may use a higher PD than that of the protection provider.

(B) The [bank] must calculate its risk-based capital requirement for the unprotected exposure under section 31, where PD is the obligor's PD, ELGD is the hedged exposure's ELGD (not adjusted to reflect the guarantee or credit derivative), LGD is the hedged exposure's LGD (not adjusted to reflect the guarantee or credit derivative), and EAD is the EAD of the original hedged exposure minus P.

(C) The treatment in this paragraph (c)(1)(ii) is applicable when the credit risk of a wholesale exposure is covered on a pro rata basis or when an adjustment is made to the effective notional amount of the guarantee or credit derivative under paragraphs (d), (e), or (f) of this section.

(iii) *LGD of hedged exposures.* The LGD of a hedged exposure under the PD substitution approach is equal to:

(A) 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 [bank] with the option to receive immediate payout upon triggering the protection; or

(B) The LGD of the guarantee or credit derivative, if the guarantee or credit derivative does not provide the [bank] with the option to receive immediate payout upon triggering the protection.

(iv) *ELGD of hedged exposures.* The ELGD of a hedged exposure under the PD substitution approach is equal to the ELGD associated with the LGD determined under paragraph (c)(1)(iii) of this section.

(2) *LGD adjustment approach*—(i) *Full coverage*. If an eligible guarantee or eligible credit derivative meets the conditions in paragraphs (a) and (b) of this section and the protection amount (P) of the guarantee or credit derivative is greater than or equal to the EAD of the hedged exposure, the [bank]'s risk-based capital requirement for the hedged exposure would be the greater of:

(A) The risk-based capital requirement for the exposure as calculated under section 31, with the ELGD and LGD of the exposure adjusted to reflect the guarantee or credit derivative; or

(B) The risk-based capital requirement for a direct exposure to the protection provider as calculated under section 31, using the PD for the protection provider, the ELGD and LGD for the guarantee or credit derivative, and an EAD equal to the EAD of the hedged exposure.

(ii) *Partial coverage*. If an eligible guarantee or eligible credit derivative meets the conditions in paragraphs (a) and (b) of this section and the protection amount (P) of the guarantee or credit derivative is less than the EAD of the hedged exposure, the [bank] must treat the hedged exposure as two separate exposures (protected and unprotected) in order to recognize the credit risk mitigation benefit of the guarantee or credit derivative.

(A) The [bank]'s risk-based capital requirement for the protected exposure would be the greater of:

(1) The risk-based capital requirement for the protected exposure as calculated under section 31, with the ELGD and LGD of the exposure adjusted to reflect the guarantee or credit derivative and EAD set equal to P; or

(2) The risk-based capital requirement for a direct exposure to the guarantor as calculated under section 31, using the PD for the protection provider, the ELGD and LGD for the guarantee or credit derivative, and an EAD set equal to P.

(B) The [bank] must calculate its risk-based capital requirement for the unprotected exposure under section 31, where PD is the obligor's PD, ELGD is the hedged exposure's ELGD (not adjusted to reflect the guarantee or credit derivative), LGD is the hedged exposure's LGD (not adjusted to reflect the guarantee or credit derivative), and EAD is the EAD of the original hedged exposure minus P.

(3) *M of hedged exposures*. The M of the hedged exposure is the same as the M of the exposure if it were unhedged.

(d) *Maturity mismatch*. (1) A [bank] that recognizes an eligible guarantee or eligible credit derivative in determining its risk-based capital requirement for a

hedged exposure must adjust the protection amount of the credit risk mitigant to reflect any maturity mismatch between the hedged exposure and the credit risk mitigant.

(2) A maturity mismatch occurs when the residual maturity of a credit risk mitigant is less than that of the hedged exposure(s). When a credit risk mitigant covers multiple hedged exposures that have different residual maturities, the longest residual maturity of any of the hedged exposures must be taken as the residual maturity of the hedged exposures.

(3) The residual maturity of a hedged exposure is the longest possible remaining time before the obligor is scheduled to fulfill its obligation on the exposure. If a credit risk mitigant has embedded options that may reduce its term, the [bank] (protection purchaser) must use the shortest possible residual maturity for the credit risk mitigant. If a call is at the discretion of the protection provider, the residual maturity of the credit risk mitigant is at the first call date. If the call is at the discretion of the [bank] (protection purchaser), but the terms of the arrangement at origination of the credit risk mitigant contain a positive incentive for the [bank] to call the transaction before contractual maturity, the remaining time to the first call date is the residual maturity of the credit risk mitigant. For example, where there is a step-up in cost in conjunction with a call feature or where the effective cost of protection increases over time even if credit quality remains the same or improves, the residual maturity of the credit risk mitigant will be the remaining time to the first call.

(4) A credit risk mitigant with a maturity mismatch may be recognized only if its original maturity is greater than or equal to one year and its residual maturity is greater than three months.

(5) When a maturity mismatch exists, the [bank] must apply the following adjustment to reduce the protection amount of the credit risk mitigant: $P_m = E \times (t - 0.25) / (T - 0.25)$, where:

(i) P_m = protection amount of the credit risk mitigant, adjusted for maturity mismatch;

(ii) E = effective notional amount of the credit risk mitigant;

(iii) t = the lesser of T or the residual maturity of the credit risk mitigant, expressed in years; and

(iv) T = the lesser of 5 or the residual maturity of the hedged exposure, expressed in years.

(e) *Credit derivatives without restructuring as a credit event*. If a [bank] recognizes an eligible credit

derivative that does not include as a credit event a restructuring of the hedged exposure involving forgiveness or postponement of principal, interest, or fees that results in a credit loss event (that is, a charge-off, specific provision, or other similar debit to the profit and loss account), the [bank] must apply the following adjustment to reduce the protection amount of the credit derivative: $P_r = P_m \times 0.60$, where:

(1) P_r = protection amount of the credit derivative, adjusted for lack of restructuring event (and maturity mismatch, if applicable); and

(2) P_m = effective notional amount of the credit derivative (adjusted for maturity mismatch, if applicable).

(f) *Currency mismatch*. (1) If a [bank] recognizes an eligible guarantee or eligible credit derivative that is denominated in a currency different from that in which the hedged exposure is denominated, the protection amount of the guarantee or credit derivative is reduced by application of the following formula: $P_c = P_r \times (1 \times H_{FX})$, where:

(i) P_c = protection amount of the guarantee or credit derivative, adjusted for currency mismatch (and maturity mismatch and lack of restructuring event, if applicable);

(ii) P_r = effective notional amount of the guarantee or credit derivative (adjusted for maturity mismatch and lack of restructuring event, if applicable); and

(iii) H_{FX} = haircut appropriate for the currency mismatch between the guarantee or credit derivative and the hedged exposure.

(2) A [bank] must set H_{FX} equal to 8 percent unless it qualifies for the use of and uses its own internal estimates of foreign exchange volatility based on a 10-business day holding period and daily marking-to-market and remargining. A [bank] qualifies for the use of its own internal estimates of foreign exchange volatility if it qualifies for:

(i) The own-estimates haircuts in paragraph (a)(2)(iii) of section 32;

(ii) The simple VaR methodology in paragraph (a)(3) of section 32; or

(iii) The internal models methodology in paragraph (c) of section 32.

(3) A [bank] must adjust H_{FX} calculated in paragraph (f)(2) of this section upward if the [bank] revalues the guarantee or credit derivative less frequently than once every 10 business days using the square root of time formula provided in paragraph (a)(2)(iii)(A)(2) of section 32.

Section 34. Guarantees and Credit Derivatives: Double Default Treatment

(a) *Eligibility and operational criteria for double default treatment.* A [bank] may recognize the credit risk mitigation benefits of a guarantee or credit derivative covering an exposure described in paragraph (a)(1) of section 33 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 paragraph (b)(2) of section 33 and 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 paragraph (m) of section 42).

(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 [bank] 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.

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

(b) *Full coverage.* If the 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 [bank] may determine its risk-weighted asset amount for the hedged exposure under paragraph (e) of this section.

(c) *Partial coverage.* If the 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 [bank] 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 [bank] must set EAD equal to P and calculate its risk-weighted asset amount as provided in paragraph (e) of this section.

(2) For the unprotected exposure, the [bank] must set EAD equal to the EAD of the original exposure minus P and then calculate its risk-weighted asset amount as provided in section 31.

(d) *Mismatches.* For any hedged exposure to which a [bank] applies double default treatment, the [bank] must make applicable adjustments to the protection amount as required in paragraphs (d), (e), and (f) of section 33.

(e) *The double default dollar risk-based capital requirement.* The dollar risk-based capital requirement for a hedged exposure to which a [bank] has applied double default treatment is K_{DD} multiplied by the EAD of the exposure. K_{DD} is calculated according to the following formula: $K_{DD} = K_o \times (0.15 + 160 \times PD_g)$, where:

$$(1) K_o = \left[LGD_g \times N \left(\frac{N^{-1}(PD_o) + N^{-1}(0.999)\sqrt{\rho_{os}}}{\sqrt{1-\rho_{os}}} \right) - (ELGD_g \times PD_o) \right] \times \left[\frac{1 + (M - 2.5) \times b}{1 - 1.5 \times b} \right]$$

(2) PD_g = PD of the protection provider.

(3) PD_o = PD of the obligor of the hedged exposure.

(4) LGD_g = (i) The lower of the LGD of the unhedged exposure and the LGD of the guarantee or credit derivative, if the guarantee or credit derivative provides the [bank] 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 [bank] with the option to receive immediate payout on triggering the protection.

(5) $ELGD_g$ = The ELGD associated with LGD_g .

(6) ρ_{os} (asset value correlation of the obligor) is calculated according to the appropriate formula for (R) provided in Table 2 in section 31, with PD equal to PD_o .

(7) b (maturity adjustment coefficient) is calculated according to the formula for b provided in Table 2 in section 31, with PD equal to the lesser of PD_o and PD_g .

(8) 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.

Section 35. Risk-Based Capital Requirement for Unsettled Transactions

(a) *Definitions.* For purposes of this section:

(1) *Delivery-versus-payment (DvP) transaction* means a securities or commodities transaction in which the buyer is obligated to make payment only if the seller has made delivery of the securities or commodities and the seller is obligated to deliver the securities or commodities only if the buyer has made payment.

(2) *Payment-versus-payment (PvP) transaction* means a foreign exchange transaction in which each counterparty is obligated to make a final transfer of one or more currencies only if the other counterparty has made a final transfer of one or more currencies.

(3) *Normal settlement period.* A transaction has a *normal settlement*

period if the contractual settlement period for the transaction is equal to or less than the market standard for the instrument underlying the transaction and equal to or less than 5 business days.

(4) *Positive current exposure.* The positive current exposure of a [bank] for a transaction is the difference between the transaction value at the agreed settlement price and the current market price of the transaction, if the difference results in a credit exposure of the [bank] to the counterparty.

(b) *Scope.* This section applies to all transactions involving securities, foreign exchange instruments, and commodities that have a risk of delayed settlement or delivery. This section does not apply to:

(1) Transactions accepted by a qualifying central counterparty that are subject to daily marking-to-market and daily receipt and payment of variation margin;

(2) Repo-style transactions (which are addressed in sections 31 and 32);⁹

(3) One-way cash payments on OTC derivative contracts (which are addressed in sections 31 and 32); or

(4) Transactions with a contractual settlement period that is longer than the normal settlement period (which are treated as OTC derivative contracts and addressed in sections 31 and 32).

(c) *System-wide failures.* In the case of a system-wide failure of a settlement or clearing system, the [AGENCY] may waive risk-based capital requirements for unsettled and failed transactions until the situation is rectified.

(d) *Delivery-versus-payment (DvP) and payment-versus-payment (PvP) transactions.* A [bank] must hold risk-based capital against any DvP or PvP transaction with a normal settlement period if the [bank]'s counterparty has not made delivery or payment within five business days after the settlement date. The [bank] must determine its risk-weighted asset amount for such a transaction by multiplying the positive current exposure of the transaction for the [bank] by the appropriate risk weight in Table 5.

TABLE 5.—RISK WEIGHTS FOR UNSETTLED DVP AND PVP TRANSACTIONS

Number of business days after contractual settlement date	Risk weight to be applied to positive current exposure (percent)
From 5 to 15	100
From 16 to 30	625
From 31 to 45	937.5
46 or more	1,250

(e) *Non-DvP/non-PvP (non-delivery-versus-payment/non-payment-versus-payment) transactions.* (1) A [bank] must hold risk-based capital against any non-DvP/non-PvP transaction with a normal settlement period if the [bank] has delivered cash, securities, commodities, or currencies to its counterparty but has not received its corresponding deliverables by the end of the same business day. The [bank] must continue to hold risk-based capital against the transaction until the [bank] has received its corresponding deliverables.

(2) From the business day after the [bank] has made its delivery until five business days after the counterparty delivery is due, the [bank] must calculate its risk-based capital requirement for the transaction by treating the current market value of the

deliverables owed to the [bank] as a wholesale exposure.

(i) A [bank] may assign an obligor rating to a counterparty for which it is not otherwise required under this rule to assign an obligor rating on the basis of the applicable external rating of any outstanding unsecured long-term debt security without credit enhancement issued by the counterparty.

(ii) A [bank] may use a 45 percent ELGD and LGD for the transaction rather than estimating ELGD and LGD for the transaction provided the [bank] uses the 45 percent ELGD and LGD for all transactions described in paragraphs (e)(1) and (e)(2) of this section.

(iii) A [bank] may use a 100 percent risk weight for the transaction provided the [bank] uses this risk weight for all transactions described in paragraphs (e)(1) and (e)(2) of this section.

(3) If the [bank] has not received its deliverables by the fifth business day after counterparty delivery was due, the [bank] must deduct the current market value of the deliverables owed to the [bank] 50 percent from tier 1 capital and 50 percent from tier 2 capital.

(f) *Total risk-weighted assets for unsettled transactions.* Total risk-weighted assets for unsettled transactions is the sum of the risk-weighted asset amounts of all DvP, PvP, and non-DvP/non-PvP transactions.

Part V. Risk-Weighted Assets for Securitization Exposures

Section 41. Operational Criteria for Recognizing the Transfer of Risk

(a) *Operational criteria for traditional securitizations.* A [bank] that transfers exposures it has originated or purchased to an SPE or other third party in connection with a traditional securitization may exclude the exposures from the calculation of its risk-weighted assets only if each of the conditions in this paragraph (a) is satisfied. A [bank] that meets these conditions must hold risk-based capital against any securitization exposures it retains in connection with the securitization. A [bank] that fails to meet these conditions must hold risk-based capital against the transferred exposures as if they had not been securitized and must deduct from tier 1 capital any after-tax gain-on-sale resulting from the transaction. The conditions are:

(1) The transfer is considered a sale under GAAP;

(2) The [bank] has transferred to third parties credit risk associated with the underlying exposures; and

(3) Any clean-up calls relating to the securitization are eligible clean-up calls.

(b) *Operational criteria for synthetic securitizations.* For synthetic securitizations, a [bank] may recognize for risk-based capital purposes the use of a credit risk mitigant to hedge underlying exposures only if each of the conditions in this paragraph (b) is satisfied. A [bank] that fails to meet these conditions must hold risk-based capital against the underlying exposures as if they had not been synthetically securitized. The conditions are:

(1) The credit risk mitigant is financial collateral, an eligible credit derivative from an eligible securitization guarantor, or an eligible guarantee from an eligible securitization guarantor;

(2) The [bank] transfers credit risk associated with the underlying exposures to third parties, and the terms and conditions in the credit risk mitigants employed do not include provisions that:

(i) Allow for the termination of the credit protection due to deterioration in the credit quality of the underlying exposures;

(ii) Require the [bank] to alter or replace the underlying exposures to improve the credit quality of the pool of underlying exposures;

(iii) Increase the [bank]'s cost of credit protection in response to deterioration in the credit quality of the underlying exposures;

(iv) Increase the yield payable to parties other than the [bank] in response to a deterioration in the credit quality of the underlying exposures; or

(v) Provide for increases in a retained first loss position or credit enhancement provided by the [bank] after the inception of the securitization;

(3) The [bank] obtains a well-reasoned opinion from legal counsel that confirms the enforceability of the credit risk mitigant in all relevant jurisdictions; and

(4) Any clean-up calls relating to the securitization are eligible clean-up calls.

Section 42. Risk-Based Capital Requirement for Securitization Exposures

(a) *Hierarchy of approaches.* Except as provided elsewhere in this section:

(1) A [bank] must deduct from tier 1 capital any after-tax gain-on-sale resulting from a securitization and must deduct from total capital in accordance with paragraph (c) of this section the portion of any CEIO that does not constitute gain-on-sale.

(2) If a securitization exposure does not require deduction under paragraph (a)(1) of this section and qualifies for the Ratings-Based Approach in section 43, a [bank] must apply the Ratings-Based Approach to the exposure.

⁹ Unsettled repo-style transactions are treated as repo-style transactions under sections 31 and 32.

(3) If a securitization exposure does not require deduction under paragraph (a)(1) of this section and does not qualify for the Ratings-Based Approach, the [bank] may either apply the Internal Assessment Approach in section 44 to the exposure (if the [bank] and the relevant ABCP program qualify for the Internal Assessment Approach) or the Supervisory Formula Approach in section 45 to the exposure (if the [bank] and the exposure qualify for the Supervisory Formula Approach).

(4) If a securitization exposure does not require deduction under paragraph (a)(1) of this section and does not qualify for the Ratings-Based Approach, the Internal Assessment Approach, or the Supervisory Formula Approach, the [bank] must deduct the exposure from total capital in accordance with paragraph (c) of this section.

(b) *Total risk-weighted assets for securitization exposures.* A [bank]'s total risk-weighted assets for securitization exposures is equal to the sum of its risk-weighted assets calculated using the Ratings-Based Approach in section 43, the Internal Assessment Approach in section 44, and the Supervisory Formula Approach in section 45, and its risk-weighted assets amount for early amortization provisions calculated in section 47.

(c) *Deductions.* (1) If a [bank] must deduct a securitization exposure from total capital, the [bank] must take the deduction 50 percent from tier 1 capital and 50 percent from tier 2 capital. If the amount deductible from tier 2 capital exceeds the [bank]'s tier 2 capital, the [bank] must deduct the excess from tier 1 capital.

(2) A [bank] may calculate any deduction from regulatory capital for a securitization exposure net of any deferred tax liabilities associated with the securitization exposure.

(d) *Maximum risk-based capital requirement.* Regardless of any other provisions of this part, unless one or more underlying exposures does not meet the definition of a wholesale, retail, securitization, or equity exposure, the total risk-based capital requirement for all securitization exposures held by a single [bank] associated with a single securitization (including any risk-based capital requirements that relate to an early amortization provision of the securitization but excluding any risk-based capital requirements that relate to the [bank]'s gain-on-sale or CEIOs associated with the securitization) may not exceed the sum of:

(1) The [bank]'s total risk-based capital requirement for the underlying exposures as if the [bank] directly held the underlying exposures; plus

(2) The total ECL of the underlying exposures.

(e) *Amount of a securitization exposure.* (1) The amount of an on-balance sheet securitization exposure is:

(i) The [bank]'s carrying value, if the exposure is held-to-maturity or for trading; or

(ii) The [bank]'s carrying value minus any unrealized gains and plus any unrealized losses on the exposure, if the exposure is available-for-sale.

(2) The amount of an off-balance sheet securitization exposure is the notional amount of the exposure. For a commitment, such as a liquidity facility extended to an ABCP program, the notional amount may be reduced to the maximum potential amount that the [bank] currently would be required to fund under the arrangement's documentation. For an OTC derivative contract that is not a credit derivative, the notional amount is the EAD of the derivative contract (as calculated in section 32).

(f) *Overlapping exposures—*(1) *ABCP programs.* If a [bank] has multiple securitization exposures to an ABCP program that provide duplicative coverage of the underlying exposures of a securitization (such as when a [bank] provides a program-wide credit enhancement and multiple pool-specific liquidity facilities to an ABCP program), the [bank] is not required to hold duplicative risk-based capital against the overlapping position. Instead, the [bank] may apply to the overlapping position the applicable risk-based capital treatment that results in the highest risk-based capital requirement.

(2) *Mortgage loan swaps.* If a [bank] holds a mortgage-backed security or participation certificate as a result of a mortgage loan swap with recourse, and the transaction is a securitization exposure, the [bank] must determine a risk-weighted asset amount for the recourse obligation plus the percentage of the mortgage-backed security or participation certificate that is not covered by the recourse obligation. The total risk-weighted asset amount for the transaction is capped at the risk-weighted asset amount for the underlying exposures as if they were held directly on the [bank]'s balance sheet.

(g) *Securitizations of non-IRB exposures.* Regardless of paragraph (a) of this section, if a [bank] has a securitization exposure where any underlying exposure is not a wholesale exposure, retail exposure, securitization exposure, or equity exposure, the [bank] must:

(1) If the [bank] is an originating [bank], deduct from tier 1 capital any

after-tax gain-on-sale resulting from the securitization and deduct from total capital in accordance with paragraph (c) of this section the portion of any CEIO that does not constitute gain-on-sale;

(2) If the securitization exposure does not require deduction under paragraph (g)(1), apply the RBA in section 43 to the securitization exposure if the exposure qualifies for the RBA; and

(3) If the securitization exposure does not require deduction under paragraph (g)(1) and does not qualify for the RBA, deduct the exposure from total capital in accordance with paragraph (c) of this section.

(h) *Implicit support.* If a [bank] provides support to a securitization in excess of the [bank]'s contractual obligation to provide credit support to the securitization (implicit support):

(1) The [bank] must hold regulatory capital against all of the underlying exposures associated with the securitization as if the exposures had not been securitized and must deduct from tier 1 capital any after-tax gain-on-sale resulting from the securitization; and

(2) The [bank] must disclose publicly:

(i) That it has provided implicit support to the securitization; and

(ii) The regulatory capital impact to the [bank] of providing such implicit support.

(i) *Eligible servicer cash advance facilities.* Regardless of any other provisions of this part, a [bank] is not required to hold risk-based capital against the undrawn portion of an eligible servicer cash advance facility.

(j) *Interest-only mortgage-backed securities.* Regardless of any other provisions of this part, the risk weight for a non-credit enhancing interest-only mortgage-backed security may not be less than 100 percent.

(k) *Small-business loans and leases on personal property transferred with recourse.* (1) Regardless of any other provisions of this appendix, a [bank] that has transferred small-business loans and leases of personal property (small-business obligations) with recourse must include in risk-weighted assets only the contractual amount of retained recourse if all the following conditions are met:

(i) The transaction is a sale under GAAP.

(ii) The [bank] establishes and maintains, pursuant to GAAP, a non-capital reserve sufficient to meet the [bank]'s reasonably estimated liability under the recourse arrangement.

(iii) The loans and leases are to businesses that meet the criteria for a small-business concern established by the Small Business Administration

under section 3(a) of the Small Business Act.

(iv) The [bank] is well capitalized, as defined in the [AGENCY]'s prompt corrective action regulation—12 CFR part 6 (for national banks), 12 CFR part 208, subpart D (for state member banks or bank holding companies), 12 CFR part 325, subpart B (for state nonmember banks), and 12 CFR part 565 (for savings associations). For purposes of determining whether a [bank] is well capitalized for purposes of paragraph (k) of this section, the [bank]'s capital ratios must be calculated without regard to the preferential capital treatment for transfers of small-business obligations with recourse specified in paragraph (k)(1) of this section.

(2) The total outstanding amount of recourse retained by a [bank] on transfers of small-business obligations receiving the preferential capital treatment specified in paragraph (k)(1) of this section cannot exceed 15 percent of the [bank]'s total qualifying capital.

(3) If a [bank] ceases to be well capitalized or exceeds the 15 percent capital limitation, the preferential capital treatment specified in paragraph (k)(1) of this section will continue to apply to any transfers of small-business obligations with recourse that occurred during the time that the [bank] was well capitalized and did not exceed the capital limit.

(4) The risk-based capital ratios of the [bank] must be calculated without regard to the preferential capital treatment for transfers of small-business obligations with recourse specified in paragraph (k)(1) of this section as provided in 12 CFR part 3, Appendix A (for national banks), 12 CFR part 208, Appendix A (for state member banks), 12 CFR part 225, Appendix A (for bank holding companies), 12 CFR part 325, Appendix A (for state nonmember banks), and 12 CFR 567.6(b)(5)(v) (for savings associations).

(l) *Consolidated ABCP programs*—(1) A [bank] that qualifies as a primary beneficiary and must consolidate an ABCP program as a variable interest entity under GAAP may exclude the consolidated ABCP program assets from risk-weighted assets if the [bank] is the sponsor of the ABCP program. If a [bank] excludes such consolidated ABCP program assets from risk-weighted assets, the [bank] must hold risk-based capital against any securitization exposures of the [bank] to the ABCP program in accordance with this part.

(2) If a [bank] either is not permitted, or elects not, to exclude consolidated ABCP program assets from its risk-

weighted assets, the [bank] must hold risk-based capital against the consolidated ABCP program assets in accordance with this appendix but is not required to hold risk-based capital against any securitization exposures of the [bank] to the ABCP program.

(m) *Nth-to-default credit derivatives*—(1) *First-to-default credit derivatives*—(i) *Protection purchaser*. A [bank] that obtains credit protection on a group of underlying exposures through a first-to-default credit derivative must determine its risk-based capital requirement for the underlying exposures as if the [bank] synthetically securitized the underlying exposure with the lowest risk-based capital requirement (K) (as calculated under Table 2) and had obtained no credit risk mitigant on the other underlying exposures.

(ii) *Protection provider*. A [bank] that provides credit protection on a group of underlying exposures through a first-to-default credit derivative must determine its risk-weighted asset amount for the derivative by applying the RBA in section 43 (if the derivative qualifies for the RBA) or, if the derivative does not qualify for the RBA, by setting its risk-weighted asset amount for the derivative equal to the product of:

(A) The protection amount of the derivative;

(B) 12.5; and

(C) The sum of the risk-based capital requirements (K) of the individual underlying exposures (as calculated under Table 2), up to a maximum of 100 percent.

(2) *Second-or-subsequent-to-default credit derivatives*—(i) *Protection purchaser*. (A) A [bank] that obtains credit protection on a group of underlying exposures through a nth-to-default credit derivative (other than a first-to-default credit derivative) may recognize the credit risk mitigation benefits of the derivative only if:

(1) The [bank] also has obtained credit protection on the same underlying exposures in the form of first-through-(n-1)-to-default credit derivatives; or

(2) If n-1 of the underlying exposures have already defaulted.

(B) If a [bank] satisfies the requirements of paragraph (m)(2)(i)(A) of this section, the [bank] must determine its risk-based capital requirement for the underlying exposures as if the [bank] had only synthetically securitized the underlying exposure with the nth lowest risk-based capital requirement (K) (as calculated under Table 2) and had obtained no credit risk mitigant on the other underlying exposures.

(ii) *Protection provider*. A [bank] that provides credit protection on a group of

underlying exposures through a nth-to-default credit derivative (other than a first-to-default credit derivative) must determine its risk-weighted asset amount for the derivative by applying the RBA in section 43 (if the derivative qualifies for the RBA) or, if the derivative does not qualify for the RBA, by setting its risk-weighted asset amount for the derivative equal to the product of:

(A) The protection amount of the derivative;

(B) 12.5; and

(C) The sum of the risk-based capital requirements (K) of the individual underlying exposures (as calculated under Table 2 and excluding the n-1 underlying exposures with the lowest Ks), up to a maximum of 100 percent.

Section 43. Ratings-Based Approach (RBA)

(a) *Eligibility requirements for use of the RBA*—(1) *Originating [bank]*. An originating [bank] must use the RBA to calculate its risk-based capital requirement for a securitization exposure if the exposure has two or more external ratings or an inferred rating based on two or more external ratings (and may not use the RBA if the exposure has fewer than two external ratings or an inferred rating based on fewer than two external ratings).

(2) *Investing [bank]*. An investing [bank] must use the RBA to calculate its risk-based capital requirement for a securitization exposure if the exposure has one or more external or inferred ratings (and may not use the RBA if the exposure has no external or inferred rating).

(b) *Ratings-based approach*. (1) A [bank] must determine the risk-weighted asset amount for a securitization exposure by multiplying the amount of the exposure (as defined in paragraph (e) of section 42) by the appropriate risk weight provided in the tables in this section.

(2) The applicable rating of a securitization exposure that has more than one external or inferred rating is the lowest rating.

(3) A [bank] must apply the risk weights in Table 6 when the securitization exposure's external or inferred rating represents a long-term credit rating, and must apply the risk weights in Table 7 when the securitization exposure's external or inferred rating represents a short-term credit rating.

(i) A [bank] must apply the risk weights in column 1 of Table 6 or 7 to the securitization exposure if:

(A) N (as calculated under paragraph (e)(6) of section 45) is 6 or more (for

purposes of this section 43 only, if the notional number of underlying exposures is 25 or more or if all of the underlying exposures are retail exposures, a [bank] may assume that N is 6 or more unless the [bank] knows or

has reason to know that N is less than 6); and

(B) The securitization exposure is a senior securitization exposure.

(ii) A [bank] must apply the risk weights in column 3 of Table 6 or 7 to

the securitization exposure if N is less than 6, regardless of the seniority of the securitization exposure.

(iii) Otherwise, a [bank] must apply the risk weights in column 2 of Table 6 or 7.

TABLE 6.—LONG-TERM CREDIT RATING RISK WEIGHTS UNDER RBA AND IAA

Applicable rating (illustrative rating example)	Column 1	Column 2	Column 3
	Risk weights for senior securitization exposures backed by granular pools (percent)	Risk weights for non-senior securitization exposures backed by granular pools (percent)	Risk weights for securitization exposures backed by non-granular pools (percent)
Highest investment grade (for example, AAA)	7	12	20
Second highest investment grade (for example, AA)	8	15	25
Third-highest investment grade—positive designation (for example, A+)	10	18	35
Third-highest investment grade—for example, A)	12	20	.....
Third-highest investment grade—negative designation (for example, A–)	20	35	.....
Lowest investment grade—positive designation (for example, BBB+)	35	50	
Lowest investment grade (for example, BBB)	60	75	
Lowest investment grade—negative designation (for example, BBB–)	100		
One category below investment grade—positive designation (for example, BB+) ...	250		
One category below investment grade (for example, BB)	425		
One category below investment grade—negative designation (for example, BB–) ..	650		
More than one category below investment grade	Deduction from tier 1 and tier 2 capital.		

TABLE 7.—SHORT-TERM CREDIT RATING RISK WEIGHTS UNDER RBA AND IAA

Applicable Rating (illustrative rating example)	Column 1	Column 2	Column 3
	Risk weights for senior securitization exposures backed by granular pools (percent)	Risk weights for non-senior securitization exposures backed by granular pools (percent)	Risk weights for securitization exposures backed by non-granular pools (percent)
Highest investment grade (for example, A1)	7	12	20
Second highest investment grade (for example, A2)	12	20	35
Third highest investment grade (for example, A3)	60	75	75
All other ratings	Deduction from tier 1 and tier 2 capital.		

Section 44. Internal Assessment Approach (IAA)

(a) *Eligibility requirements.* A [bank] may apply the IAA to calculate the risk-weighted asset amount for a securitization exposure that the [bank] has to an ABCP program (such as a liquidity facility or credit enhancement) if the [bank], the ABCP program, and the exposure qualify for use of the IAA.

(1) *[Bank] qualification criteria.* A [bank] qualifies for use of the IAA if the [bank] has received the prior written approval of the [AGENCY]. To receive such approval, the [bank] must demonstrate to the [AGENCY]'s satisfaction that the [bank]'s internal assessment process meets the following criteria:

(i) The [bank]'s internal credit assessments of securitization exposures

must be based on publicly available rating criteria used by an NRSRO.

(ii) The [bank]'s internal credit assessments of securitization exposures used for risk-based capital purposes must be consistent with those used in the [bank]'s internal risk management process, management information reporting systems, and capital adequacy assessment process.

(iii) The [bank]'s internal credit assessment process must have sufficient granularity to identify gradations of risk. Each of the [bank]'s internal credit assessment categories must correspond to an external rating of an NRSRO.

(iv) The [bank]'s internal credit assessment process, particularly the stress test factors for determining credit enhancement requirements, must be at least as conservative as the most conservative of the publicly available

rating criteria of the NRSROs that have provided external ratings to the commercial paper issued by the ABCP program.

(A) Where the commercial paper issued by an ABCP program has an external rating from two or more NRSROs and the different NRSROs' benchmark stress factors require different levels of credit enhancement to achieve the same external rating equivalent, the [bank] must apply the NRSRO stress factor that requires the highest level of credit enhancement.

(B) If one of the NRSROs that provides an external rating to the ABCP program's commercial paper changes its methodology (including stress factors), the [bank] must consider the NRSRO's revised rating methodology in evaluating whether the internal credit assessments assigned by the [bank] to

securitization exposures must be revised.

(v) The [bank] must have an effective system of controls and oversight that ensures compliance with these operational requirements and maintains the integrity and accuracy of the internal credit assessments. The [bank] must have an internal audit function independent from the ABCP program business line and internal credit assessment process that assesses at least annually whether the controls over the internal credit assessment process function as intended.

(vi) The [bank] must review and update each internal credit assessment whenever new material information is available, but no less frequently than annually.

(vii) The [bank] must validate its internal credit assessment process on an ongoing basis and at least annually.

(2) *ABCP-program qualification criteria.* An ABCP program qualifies for use of the IAA if the ABCP program meets the following criteria:

(i) All commercial paper issued by the ABCP program must have an external rating.

(ii) The ABCP program must have robust credit and investment guidelines (that is, underwriting standards).

(iii) The ABCP program must perform a detailed credit analysis of the asset sellers' risk profiles.

(iv) The ABCP program's underwriting policy must establish minimum asset eligibility criteria that

include the prohibition of the purchase of assets that are significantly past due or defaulted, as well as limitations on concentration to individual obligor or geographic area and the tenor of the assets to be purchased.

(v) The aggregate estimate of loss on an asset pool that the ABCP program is considering purchasing must consider all sources of potential risk, such as credit and dilution risk.

(vi) The ABCP program must incorporate structural features into each purchase of assets to mitigate potential credit deterioration of the underlying exposures. Such features may include wind-down triggers specific to a pool of underlying exposures.

(3) *Exposure qualification criteria.* A securitization exposure qualifies for use of the IAA if the [bank] initially rated the exposure at least the equivalent of investment grade.

(b) *Mechanics.* A [bank] that elects to use the IAA to calculate the risk-based capital requirement for any securitization exposure must use the IAA to calculate the risk-based capital requirements for all securitization exposures that qualify for the IAA approach. Under the IAA, a [bank] must map its internal assessment of such a securitization exposure to an equivalent external rating from an NRSRO. Under the IAA, a [bank] must determine the risk-weighted asset amount for such a securitization exposure by multiplying the amount of the exposure (as defined in paragraph (e) of section 42) by the

appropriate risk weight in the RBA tables in paragraph (b) of section 43.

Section 45. Supervisory Formula Approach (SFA)

(a) *Eligibility requirements.* A [bank] may use the SFA to determine its risk-based capital requirement for a securitization exposure only if the [bank] can calculate on an ongoing basis each of the SFA parameters in paragraph (e) of this section.

(b) *Mechanics.* Under the SFA, a [bank] must determine the risk-weighted asset amount for a securitization exposure by multiplying the SFA risk-based capital requirement for the exposure (as determined in paragraph (c) of this section) by 12.5. If the SFA risk weight for a securitization exposure is 1,250 percent or greater, however, the [bank] must deduct the exposure from total capital under paragraph (c) of section 42 rather than risk weight the exposure. The SFA risk weight for a securitization exposure is equal to 1,250 percent multiplied by the ratio of the securitization exposure's SFA risk-based capital requirement to the amount of the securitization exposure (as defined in paragraph (e) of section 42).

(c) *The SFA risk-based capital requirement.* The SFA risk-based capital requirement for a securitization exposure is UE multiplied by TP multiplied by the greater of:

(1) $0.0056 \cdot T$; or

(2) $S[L+T] - S[L]$.

(d) *The supervisory formula:*

$$(1) S[Y] = \begin{cases} Y & \text{when } Y \leq K_{IRB} \\ K_{IRB} + K[Y] - K[K_{IRB}] + \frac{d \cdot K_{IRB}}{20} \left(1 - e^{\frac{20 \cdot (K_{IRB} - Y)}{K_{IRB}}} \right) & \text{when } Y > K_{IRB} \end{cases}$$

$$(2) K[Y] = (1-h) \cdot [(1-\beta[Y;a,b]) \cdot Y + \beta[Y;a+1,b] \cdot c]$$

$$(3) h = \left(1 - \frac{K_{IRB}}{EWALGD} \right)^N$$

$$(4) a = g \cdot c$$

$$(5) b = g \cdot (1-c)$$

$$(6) c = \frac{K_{IRB}}{1-h}$$

$$(7) g = \frac{(1-c) \cdot c}{f} - 1$$

$$(8) f = \frac{v + K_{IRB}^2}{1-h} - c^2 + \frac{(1-K_{IRB}) \cdot K_{IRB} - v}{(1-h) \cdot 1000}$$

$$(9) v = K_{IRB} \cdot \frac{(EWALGD - K_{IRB}) + .25 \cdot (1 - EWALGD)}{N}$$

$$(10) d = 1 - (1-h) \cdot (1 - \beta[K_{IRB}; a, b])$$

(11) In these expressions, $\beta[Y; a, b]$ refers to the cumulative beta distribution with parameters a and b evaluated at Y . In the case where $N = 1$ and $EWALGD = 100$ percent, $S[Y]$ in formula (1) must be calculated with $K[Y]$ set equal to the product of K_{IRB} and Y , and d set equal to $1 - K_{IRB}$.

(e) *SFA Parameters*—(1) *Amount of the underlying exposures (UE)*. UE is the EAD of any underlying wholesale and retail exposures (including the amount of any funded spread accounts, cash collateral accounts, and other similar funded credit enhancements) plus the amount of any underlying exposures that are securitization exposures (as defined in paragraph (e) of section 42) plus the adjusted carrying value of any underlying equity exposures (as defined in paragraph (b) of section 51).

(2) *Tranche percentage (TP)*. TP is the ratio of the amount of the [bank]'s securitization exposure to the amount of the tranche that contains the securitization exposure.

(3) *Capital requirement on underlying exposures (K_{IRB})*. (i) K_{IRB} is the ratio of:

(A) The sum of the risk-based capital requirements for the underlying exposures plus the expected credit losses of the underlying exposures (as determined under this appendix as if the underlying exposures were directly held by the [bank]); to

(B) UE.

(ii) The calculation of K_{IRB} must reflect the effects of any credit risk mitigant applied to the underlying exposures (either to an individual underlying exposure, a group of underlying exposures, or to the entire pool of underlying exposures).

(iii) All assets related to the securitization are treated as underlying exposures, including assets in a reserve account (such as a cash collateral account).

(4) *Credit enhancement level (L)*. (i) L is the ratio of:

(A) The amount of all securitization exposures subordinated to the tranche that contains the [bank]'s securitization exposure; to (B) UE.

(ii) [Bank]s must determine L before considering the effects of any tranche-specific credit enhancements.

(iii) Any gain-on-sale or CEIO associated with the securitization may not be included in L .

(iv) Any reserve account funded by accumulated cash flows from the underlying exposures that is subordinated to the tranche in question may be included in the numerator and denominator of L to the extent cash has accumulated in the account. Unfunded reserve accounts (that is, reserve accounts that are to be funded from future cash flows from the underlying exposures) may not be included in the calculation of L .

(v) In some cases, the purchase price of receivables will reflect a discount that provides credit enhancement (for example, first loss protection) for all or certain tranches of the securitization. When this arises, L should be calculated inclusive of this discount if the discount provides credit enhancement for the securitization exposure.

(5) *Thickness of tranche (T)*. T is the ratio of:

(i) The amount of the tranche that contains the [bank]'s securitization exposure; to

(ii) UE.

(6) *Effective number of exposures (N)*. (i) Unless the [bank] elects to use the formula provided in paragraph (f),

$$N = \frac{\left(\sum_i EAD_i \right)^2}{\sum_i EAD_i^2}$$

where EAD_i represents the EAD associated with the i th instrument in the pool of underlying exposures.

(ii) Multiple exposures to one obligor must be treated as a single underlying exposure.

(iii) In the case of a re-securitization (that is, a securitization in which some or all of the underlying exposures are themselves securitization exposures), the [bank] must treat each underlying exposure as a single underlying exposure and must not look through to the originally securitized underlying exposures.

(7) *Exposure-weighted average loss given default (EWALGD)*. EWALGD is calculated as:

$$EWALGD = \frac{\sum_i LGD_i \cdot EAD_i}{\sum_i EAD_i}$$

where LGD_i represents the average LGD associated with all exposures to the i th obligor. In the case of a re-securitization, an LGD of 100 percent must be assumed for the underlying exposures that are themselves securitization exposures.

(f) *Simplified method for computing N and EWALGD*. (1) If all underlying exposures of a securitization are retail exposures, a [bank] may apply the SFA using the following simplifications:

(i) $h = 0$; and

(ii) $v = 0$.

(2) Under the conditions in paragraphs (f)(3) and (f)(4), a [bank] may employ a simplified method for calculating N and EWALGD.

(3) If C_1 is no more than 0.03, a [bank] may set EWALGD = 0.50 and N equal to the following amount:

$$N = \frac{1}{C_1 C_m + \left(\frac{C_m - C_1}{m-1} \right) \max(1 - mC_1, 0)}$$

Where:

- (i) C_m is the ratio of the sum of the amounts of the 'm' largest underlying exposures to UE; and
- (ii) The level of m is to be selected by the [bank].

(4) Alternatively, if only C_1 is available and C_1 is no more than 0.03, the [bank] may set EWALGD = 0.50 and $N = 1/C_1$.

Section 46. Recognition of Credit Risk Mitigants for Securitization Exposures

(a) *General.* An originating [bank] that has obtained a credit risk mitigant to hedge its securitization exposure to a synthetic or traditional securitization that satisfies the operational criteria in section 41 may recognize the credit risk mitigant, but only as provided in this section. An investing [bank] that has obtained a credit risk mitigant to hedge a securitization exposure may recognize the credit risk mitigant, but only as provided in this section. A [bank] that has used the RBA in section 43 or the IAA in section 44 to calculate its risk-based capital requirement for a securitization exposure whose external or inferred rating (or equivalent internal rating under the IAA) reflects the benefits of a particular credit risk mitigant provided to the associated securitization or that supports some or all of the underlying exposures may not use the credit risk mitigation rules in this section to further reduce its risk-based capital requirement for the exposure to reflect that credit risk mitigant.

(b) *Collateral—(1) Rules of recognition.* A [bank] may recognize financial collateral in determining the [bank]'s risk-based capital requirement for a securitization exposure as follows. The [bank]'s risk-based capital requirement for the collateralized securitization exposure is equal to the risk-based capital requirement for the securitization exposure as calculated under the RBA in section 43 or the SFA in section 45 multiplied by the ratio of adjusted exposure amount (E^*) to original exposure amount (E), where:

- (i) $E^* = \max\{0, [E - C \times (1 - H_s - H_{fx})]\}$;
- (ii) E = the amount of the securitization exposure calculated under paragraph (e) of section 42;
- (iii) C = the current market value of the collateral;
- (iv) H_s = the haircut appropriate to the collateral type; and

(v) H_{fx} = the haircut appropriate for any currency mismatch between the collateral and the exposure.

(2) *Mixed collateral.* Where the collateral is a basket of different asset types or a basket of assets denominated in different currencies, the haircut on the basket will be

$$(A) \text{ EffectiveEPE}_{t_k} = \sum_{k=1}^n \text{EffectiveEE}_{t_k} * \Delta t_k$$

where a_i is the current market value of the asset in the basket divided by the current market value of all assets in the basket and H_i is the haircut applicable to that asset.

(3) *Standard supervisory haircuts.* Unless a [bank] qualifies for use of and uses own-estimates haircuts in paragraph (b)(4) of this section:

- (i) A [bank] must use the collateral type haircuts (H_s) in Table 3;
- (ii) A [bank] must use a currency mismatch haircut (H_{fx}) of 8 percent if the exposure and the collateral are denominated in different currencies;
- (iii) A [bank] must multiply the supervisory haircuts obtained in paragraphs (b)(3)(i) and (ii) by the square root of 6.5 (which equals 2.549510); and
- (iv) A [bank] must adjust the supervisory haircuts upward on the basis of a holding period longer than 65 business days where and as appropriate to take into account the illiquidity of the collateral.

(4) *Own estimates for haircuts.* With the prior written approval of the [AGENCY], a [bank] may calculate haircuts using its own internal estimates of market price volatility and foreign exchange volatility, subject to the provisions of paragraph (a)(2)(iii) of section 32. The minimum holding period (T_M) for securitization exposures is 65 business days.

(c) *Guarantees and credit derivatives—(1) Limitations on recognition.* A [bank] may only recognize an eligible guarantee or eligible credit derivative provided by an eligible securitization guarantor in determining the [bank]'s risk-based capital requirement for a securitization exposure.

(2) *ECL for securitization exposures.* When a [bank] recognizes an eligible guarantee or eligible credit derivative provided by an eligible securitization guarantor in determining the [bank]'s risk-based capital requirement for a

securitization exposure, the [bank] must also:

(i) Calculate ECL for the exposure using the same risk parameters that it uses for calculating the risk-weighted asset amount of the exposure as described in paragraph (c)(3) of this section; and

(ii) Add the exposure's ECL to the [bank]'s total ECL.

(3) *Rules of recognition.* A [bank] may recognize an eligible guarantee or eligible credit derivative provided by an eligible securitization guarantor in determining the [bank]'s risk-based capital requirement for the securitization exposure as follows:

(i) *Full coverage.* If the protection amount of the eligible guarantee or eligible credit derivative equals or exceeds the amount of the securitization exposure, then the [bank] may set the risk-weighted asset amount for the securitization exposure equal to the risk-weighted asset amount for a direct exposure to the eligible securitization guarantor (as determined in the wholesale risk weight function described in section 31), using the [bank]'s PD for the guarantor, the [bank]'s ELGD and LGD for the guarantee or credit derivative, and an EAD equal to the amount of the securitization exposure (as determined in paragraph (e) of section 42).

(ii) *Partial coverage.* If the protection amount of the eligible guarantee or eligible credit derivative is less than the amount of the securitization exposure, then the [bank] may set the risk-weighted asset amount for the securitization exposure equal to the sum of:

(A) *Covered portion.* The risk-weighted asset amount for a direct exposure to the eligible securitization guarantor (as determined in the wholesale risk weight function described in section 31), using the [bank]'s PD for the guarantor, the [bank]'s ELGD and LGD for the guarantee or credit derivative, and an EAD equal to the protection amount of the credit risk mitigant; and

(B) *Uncovered portion.* (1) 1.0 minus (the protection amount of the eligible guarantee or eligible credit derivative divided by the amount of the securitization exposure); multiplied by (2) The risk-weighted asset amount for the securitization exposure without the credit risk mitigant (as determined in sections 42–45).

(4) *Mismatches*. For any hedged securitization exposure, the [bank] must make applicable adjustments to the protection amount as required in paragraphs (d), (e), and (f) of section 33.

Section 47. Risk-Based Capital Requirement for Early Amortization Provisions

(a) *General*. (1) An originating [bank] must hold risk-based capital against the sum of the originating [bank]'s interest and the investors' interest in a securitization that:

(i) Includes one or more underlying exposures in which the borrower is permitted to vary the drawn amount within an agreed limit under a line of credit; and

(ii) Contains an early amortization provision.

(2) For securitizations described in paragraph (a)(1) of this section, an

originating [bank] must calculate the risk-based capital requirement for the originating [bank]'s interest under sections 42–45, and the risk-based capital requirement for the investors' interest under paragraph (b) of this section.

(b) *Risk-weighted asset amount for investors' interest*. The originating [bank]'s risk-weighted asset amount for the investors' interest in the securitization is equal to the product of the following four quantities:

(1) The investors' interest EAD;

(2) The appropriate conversion factor in paragraph (c) of this section;

(3) K_{irb} (as defined in paragraph (e)(3) of section 45); and

(4) 12.5.

(c) *Conversion factor*. To calculate the appropriate conversion factor discussed in paragraph (b)(2) of this section, a [bank] must use Table 8 for a

securitization that contains a controlled early amortization provision and must use Table 9 for a securitization that contains a non-controlled early amortization provision. A [bank] must use the "uncommitted" column of Tables 8 and 9 if all or substantially all of the underlying exposures of the securitization are unconditionally cancelable by the [bank] to the fullest extent permitted by Federal law. Otherwise, a [bank] must use the "committed" column of the tables. To calculate the trapping point described in the tables, a [bank] must divide the three-month excess spread level of the securitization by the excess spread trapping point in the securitization structure.¹⁰

TABLE 8.—CONTROLLED EARLY AMORTIZATION PROVISIONS

	Uncommitted	Committed
Retail Credit Lines	3-month average excess spread Conversion Factor (CF) 133.33% of trapping point or more 0% CF. less than 133.33% to 100% of trapping point 1% CF. less than 100% to 75% of trapping point 2% CF. less than 75% to 50% of trapping point 10% CF. less than 50% to 25% of trapping point 20% CF. less than 25% of trapping point 40% CF.	90% CF.
Non-retail Credit Lines	90% CF	90% CF

TABLE 9.—NON-CONTROLLED EARLY AMORTIZATION PROVISIONS

	Uncommitted	Committed
Retail Credit Lines	3-month average excess spread Conversion Factor (CF) 133.33% of trapping point or more 0% CF. less than 133.33% to 100% of trapping point 5% CF. less than 100% to 75% of trapping point 15% CF. less than 75% to 50% of trapping point 50% CF. less than 50% of trapping point 100% CF.	100% CF.
Non-retail Credit Lines	100% CF	100% CF

Part VI. Risk-Weighted Assets for Equity Exposures

Section 51. Introduction and Exposure Measurement

(a) *General*. To calculate its risk-weighted asset amounts for equity exposures that are not equity exposures to investment funds, a [bank] may apply either the Simple Risk Weight Approach (SRWA) in section 52 or, if it qualifies to do so, the Internal Models Approach (IMA) in section 53. A [bank] must use the look-through approaches in section 54 to calculate its risk-weighted asset amounts for equity exposures to investment funds.

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

(1) For the on-balance sheet component of an equity exposure, the [bank]'s carrying value of the exposure reduced by any unrealized gains on the exposure that are reflected in such carrying value but excluded from the [bank]'s tier 1 and tier 2 capital; and

(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.

¹⁰In securitizations that do not require excess spread to be trapped, or that specify trapping points based primarily on performance measures other than the three-month average excess spread, the excess spread trapping point is 4.5 percent.

Section 52. Simple Risk Weight Approach (SRWA)

(a) *In general.* Under the SRWA, a [bank]'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 [bank]'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 [bank]'s individual equity exposures to an investment fund as determined in section 54.

(b) *SRWA computation for individual equity exposures.* A [bank] 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 paragraph (b).

(1) *0 percent risk weight equity exposures.* An equity exposure to an entity whose credit exposures are exempt from the 0.03 percent PD floor in paragraph (d)(2) of section 31 is assigned a 0 percent risk weight.

(2) *20 percent risk weight equity exposures.* An equity exposure to a Federal Home Loan Bank or Farmer Mac that is not publicly traded and is held as a condition of membership in that entity 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.* 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).

(ii) *Certain equity exposures to a Federal Home Loan Bank and Farmer Mac.* An equity exposure to a Federal Home Loan Bank or Farmer Mac that is not assigned a 20 percent risk weight.

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

(iv) *Non-significant equity exposures.* Equity exposures to the extent that the aggregate adjusted carrying value of the exposures does not exceed 10 percent of the [bank]'s tier 1 capital plus tier 2 capital.

(A) To compute the aggregate adjusted carrying value of a [bank]'s equity exposures for purposes of this paragraph (b)(3)(iv), the [bank] may exclude equity exposures described in paragraphs (b)(1), (b)(2), and (b)(3)(i), (ii), and (iii) of this section, the equity exposure in a hedge pair with the smaller adjusted carrying value, and a proportion of each equity exposure to an investment fund equal to the proportion of the assets of the investment fund that are not equity exposures. If a [bank] does not know the actual holdings of the investment fund, the [bank] may calculate the proportion of the assets of the fund that are not equity exposures based on the terms of the prospectus, partnership agreement, or similar contract that defines the fund's permissible investments. If the sum of the investment limits for all exposure classes within the fund exceeds 100 percent, the [bank] must assume for purposes of this paragraph (b)(3)(iv) that the investment fund invests to the maximum extent possible in equity exposures.

(B) When determining which of a [bank]'s equity exposures qualify for a 100 percent risk weight under this paragraph, a [bank] must first include equity exposures to unconsolidated small business investment companies or held through consolidated small business investment companies described in section 302 of the Small Business Investment Act of 1958 (15 U.S.C. 682) and then must include publicly traded equity exposures (including those held indirectly through investment funds) and then must include non-publicly traded equity exposures (including those held indirectly through investment funds).

(4) *300 percent risk weight equity exposures.* A publicly traded equity exposure (including the ineffective portion of a hedge pair) is assigned a 300 percent risk weight.

(5) *400 percent risk weight equity exposures.* An equity exposure that is not publicly traded is assigned a 400 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 have a remaining maturity of at least three months; the hedge relationship is formally documented in a prospective manner (that is, before the [bank] acquires at least one of the equity

exposures); the documentation specifies the measure of effectiveness (E) the [bank] 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 [bank] 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 [bank] must determine the ratio of value change (RVC), that 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 $E = 0$. 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.

(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.

Section 53. Internal Models Approach (IMA)

This section describes the two ways that a [bank] may calculate its risk-weighted asset amount for equity exposures using the IMA. A [bank] may model publicly traded and non-publicly traded equity exposures (in accordance with paragraph (b) of this section) or model only publicly traded equity exposure (in accordance with paragraph (c) of this section).

(a) *Qualifying criteria.* To qualify to use the IMA to calculate risk-based

capital requirements for equity exposures, a [bank] must receive prior written approval from the [AGENCY]. To receive such approval, the [bank] must demonstrate to the [AGENCY]'s satisfaction that the [bank] meets the following criteria:

(1) The [bank] must have a model that:

- (i) Assesses the potential decline in value of its modeled equity exposures;
- (ii) Is commensurate with the size, complexity, and composition of the [bank]'s modeled equity exposures; and
- (iii) Adequately captures both general market risk and idiosyncratic risk.

(2) The [bank]'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 99.0 percent, one-tailed confidence interval of the distribution of quarterly returns for a benchmark portfolio of equity exposures comparable to the [bank]'s modeled equity exposures using a long-term sample period.

(3) The number of risk factors and exposures in the sample and the data period used for quantification in the [bank]'s model and benchmarking exercise must be sufficient to provide confidence in the accuracy and robustness of the [bank]'s estimates.

(4) The [bank]'s model and benchmarking process must incorporate data that are relevant in representing the risk profile of the [bank]'s modeled equity exposures, and must include data from at least one equity market cycle containing adverse market movements relevant to the risk profile of the [bank]'s modeled equity exposures. If the [bank]'s model uses a scenario methodology, the [bank] must demonstrate that the model produces a conservative estimate of potential losses on the [bank]'s modeled equity exposures over a relevant long-term market cycle. If the [bank] employs risk factor models, the [bank] must demonstrate through empirical analysis the appropriateness of the risk factors used.

(5) Daily market prices must be available for all modeled equity exposures, either direct holdings or proxies.

(6) The [bank] must be able to demonstrate, using theoretical arguments and empirical evidence, that any proxies used in the modeling process are comparable to the [bank]'s modeled equity exposures and that the [bank] has made appropriate adjustments for differences. The [bank] must derive any proxies for its modeled equity exposures and benchmark

portfolio using historical market data that are relevant to the [bank]'s modeled equity exposures and benchmark portfolio (or, where not, must use appropriately adjusted data), and such proxies must be robust estimates of the risk of the [bank]'s modeled equity exposures.

(b) *Risk-weighted assets calculation for a [bank] modeling publicly traded and non-publicly traded equity exposures.* If a [bank] models publicly traded and non-publicly traded equity exposures, the [bank]'s aggregate risk-weighted asset amount for its equity exposures is equal to the sum of:

(1) The risk-weighted asset amount of each equity exposure that qualifies for a 0–100 percent risk weight under paragraphs (b)(1) through (b)(3)(ii) of section 52 (as determined under section 52) and each equity exposure to an investment fund (as determined under section 54); and

(2) The greater of:

(i) The estimate of potential losses on the [bank]'s equity exposures (other than equity exposures referenced in paragraph (b)(1) of this section) generated by the [bank]'s internal equity exposure model multiplied by 12.5; or

(ii) The sum of:

(A) 200 percent multiplied by the aggregate adjusted carrying value of the [bank]'s publicly traded equity exposures that do not belong to a hedge pair, do not qualify for a 0–100 percent risk weight under paragraphs (b)(1) through (b)(3)(ii) of section 52, and are not equity exposures to an investment fund;

(B) 200 percent multiplied by the aggregate ineffective portion of all hedge pairs; and

(C) 300 percent multiplied by the aggregate adjusted carrying value of the [bank]'s equity exposures that are not publicly traded, do not qualify for a 0–100 percent risk weight under paragraphs (b)(1) through (b)(3)(ii) of section 52, and are not equity exposures to an investment fund.

(c) *Risk-weighted assets calculation for a [bank] using the IMA only for publicly traded equity exposures.* If a [bank] models only publicly traded equity exposures, the [bank]'s aggregate risk-weighted asset amount for its equity exposures is equal to the sum of:

(1) The risk-weighted asset amount of each equity exposure that qualifies for a 0–100 percent risk weight under paragraphs (b)(1) through (b)(3)(ii) of section 52 (as determined under section 52), each equity exposure that qualifies for a 400 percent risk weight under paragraph (b)(5) of section 52 (as determined under section 52), and each

equity exposure to an investment fund (as determined under section 54); and

(2) The greater of:

(i) The estimate of potential losses on the [bank]'s equity exposures (other than equity exposures referenced in paragraph (c)(1) of this section) generated by the [bank]'s internal equity exposure model multiplied by 12.5; or

(ii) The sum of:

(A) 200 percent multiplied by the aggregate adjusted carrying value of the [bank]'s publicly traded equity exposures that do not belong to a hedge pair, do not qualify for a 0–100 percent risk weight under paragraphs (b)(1) through (b)(3)(ii) of section 52, and are not equity exposures to an investment fund; and

(B) 200 percent multiplied by the aggregate ineffective portion of all hedge pairs.

Section 54. Equity Exposures to Investment Funds

(a) *Available approaches.* A [bank] must determine the risk-weighted asset amount of an equity exposure to an investment fund under the Full Look-Through Approach in paragraph (b) of this section, the Simple Modified Look-Through Approach in paragraph (c) of this section, or the Alternative Modified Look-Through Approach in paragraph (d) of this section unless the exposure would meet the requirements for a community development equity exposure in paragraph (b)(3)(i) of section 52. The risk-weighted asset amount of such an equity exposure to an investment fund would be its adjusted carrying value. If an equity exposure to an investment fund is part of a hedge pair, a [bank] may use the ineffective portion of the hedge pair as determined under paragraph (c) of section 52 as the adjusted carrying value for the equity exposure to the investment fund.

(b) *Full look-through approach.* A [bank] that is able to calculate a risk-weighted asset amount for each exposure held by the investment fund (as calculated under this appendix as if the exposures were held directly by the [bank]) may set the risk-weighted asset amount of the [bank]'s exposure to the fund equal to the greater of:

(1) The product of:

(i) The aggregate risk-weighted asset amounts of the exposures held by the fund (as calculated under this appendix) as if the exposures were held directly by the [bank]; and

(ii) The [bank]'s proportional ownership share of the fund; or

(2) 7 percent of the adjusted carrying value of the [bank]'s equity exposure to the fund.

(c) *Simple modified look-through approach.* Under this approach, the risk-weighted asset amount for a [bank]'s equity exposure to an investment fund equals the adjusted carrying value of the equity exposure multiplied by the greater of:

(1) The highest risk weight in Table 10 that applies to any exposure the fund is permitted to hold under its prospectus, partnership agreement, or similar contract that defines the fund's permissible investments (excluding derivative contracts that are used for

hedging rather than speculative purposes and do not constitute a material portion of the fund's exposures); or
(2) 7 percent.

TABLE 10.—MODIFIED LOOK-THROUGH APPROACHES FOR EQUITY EXPOSURES TO INVESTMENT FUNDS

Risk weight	Exposure class
0 percent	Sovereign exposures with a long-term applicable external rating in the highest investment grade rating category and sovereign exposures of the United States.
20 percent	Exposures with a long-term applicable external rating in the highest or second-highest investment grade rating category; exposures with a short-term applicable external rating in the highest investment grade rating category; and exposures to, or guaranteed by, depository institutions, foreign banks (as defined in 12 CFR 211.2), or securities firms subject to consolidated supervision and regulation comparable to that imposed on U.S. securities broker-dealers that are repo-style transactions or bankers' acceptances.
50 percent	Exposures with a long-term applicable external rating in the third-highest investment grade rating category or a short-term applicable external rating in the second-highest investment grade rating category.
100 percent	Exposures with a long-term or short-term applicable external rating in the lowest investment grade rating category.
200 percent	Exposures with a long-term applicable external rating one rating category below investment grade.
300 percent	Publicly traded equity exposures.
400 percent	Non-publicly traded equity exposures; exposures with a long-term applicable external rating two rating categories or more below investment grade; and exposures without an external rating (excluding publicly traded equity exposures).
1,250 percent	OTC derivative contracts and exposures that must be deducted from regulatory capital or receive a risk weight greater than 400 percent under this appendix.

(d) *Alternative Modified Look-Through Approach.* Under this approach, a [bank] may assign the adjusted carrying value of an equity exposure to an investment fund on a pro rata basis to different risk weight categories in Table 10 according to the investment limits in the fund's prospectus, partnership agreement, or similar contract that defines the fund's permissible investments. If the sum of the investment limits for exposure classes within the fund exceeds 100 percent, the [bank] must assume that the fund invests to the maximum extent permitted under its investment limits in the exposure class with the highest risk weight under Table 10, and continues to make investments in order of the exposure class with the next highest risk weight under Table 10 until the maximum total investment level is reached. If more than one exposure class applies to an exposure, the [bank] must use the highest applicable risk weight. A [bank] may not assign an equity exposure to an investment fund to an aggregate risk weight of less than 7 percent. A [bank] may exclude derivative contracts held by the fund that are used for hedging rather than speculative purposes and do not constitute a material portion of the fund's exposures.

Section 55. Equity Derivative Contracts

Under the IMA, in addition to holding risk-based capital against an equity

derivative contract under this part, a [bank] must hold risk-based capital against the counterparty credit risk in the equity derivative contract by also treating the equity derivative contract as a wholesale exposure and computing a supplemental risk-weighted asset amount for the contract under part IV. Under the SRWA, a [bank] may choose not to hold risk-based capital against the counterparty credit risk of equity derivative contracts, as long as it does so for all such contracts. Where the equity derivative contracts are subject to a qualified master netting agreement, a [bank] using the SRWA must either include all or exclude all of the contracts from any measure used to determine counterparty credit risk exposure.

Part VII. Risk-Weighted Assets for Operational Risk

Section 61. Qualification Requirements for Incorporation of Operational Risk Mitigants

(a) *Qualification to use operational risk mitigants.* A [bank] may adjust its estimate of operational risk exposure to reflect qualifying operational risk mitigants if:

(1) The [bank]'s operational risk quantification system is able to generate an estimate of the [bank]'s operational risk exposure (which does not incorporate qualifying operational risk mitigants) and an estimate of the [bank]'s operational risk exposure

adjusted to incorporate qualifying operational risk mitigants; and

(2) The [bank]'s methodology for incorporating the effects of insurance, if the [bank] uses insurance as an operational risk mitigant, captures through appropriate discounts to the amount of risk mitigation:

(i) The residual term of the policy, where less than one year;

(ii) The cancellation terms of the policy, where less than one year;

(iii) The policy's timeliness of payment;

(iv) The uncertainty of payment by the provider of the policy; and

(v) Mismatches in coverage between the policy and the hedged operational loss event.

(b) *Qualifying operational risk mitigants.* Qualifying operational risk mitigants are:

(1) Insurance that:

(i) Is provided by an unaffiliated company that has a claims payment ability that is rated in one of the three highest rating categories by a NRSRO;

(ii) Has an initial term of at least one year and a residual term of more than 90 days;

(iii) Has a minimum notice period for cancellation by the provider of 90 days;

(iv) Has no exclusions or limitations based upon regulatory action or for the receiver or liquidator of a failed depository institution; and

(v) Is explicitly mapped to a potential operational loss event; and

(2) Operational risk mitigants other than insurance for which the [AGENCY] has given prior written approval. In evaluating an operational risk mitigant other than insurance, [AGENCY] will consider whether the operational risk mitigant covers potential operational losses in a manner equivalent to holding regulatory capital.

Section 62. Mechanics of Risk-Weighted Asset Calculation

(a) If a [bank] does not qualify to use or does not have qualifying operational risk mitigants, the [bank]'s dollar risk-based capital requirement for operational risk is its operational risk exposure minus eligible operational risk offsets (if any).

(b) If a [bank] qualifies to use operational risk mitigants and has qualifying operational risk mitigants, the [bank]'s dollar risk-based capital requirement for operational risk is the greater of:

(1) The [bank]'s operational risk exposure adjusted for qualifying operational risk mitigants minus eligible operational risk offsets (if any); or

(2) 0.8 multiplied by the difference between:

(i) The [bank]'s operational risk exposure; and

(ii) Eligible operational risk offsets (if any).

(c) The [bank]'s risk-weighted asset amount for operational risk equals the [bank]'s dollar risk-based capital requirement for operational risk determined under paragraph (a) or (b) of this section multiplied by 12.5.

Part VIII. Disclosure

Section 71. Disclosure Requirements

(a) Each [bank] must publicly disclose each quarter its total and tier 1 risk-based capital ratios and their components (that is, tier 1 capital, tier 2 capital, total qualifying capital, and total risk-weighted assets).¹¹

[Disclosure paragraph (b)]

[Disclosure paragraph (c)]

End of common rule.

[End of common text]

List of Subjects

12 CFR Part 3

Administrative practices and procedure, Capital, National banks, Reporting and recordkeeping requirements, Risk.

12 CFR Part 208

Confidential business information, Crime, Currency, Federal Reserve

System, Mortgages, reporting and recordkeeping requirements, Securities.

12 CFR Part 225

Administrative practice and procedure, Banks, banking, Federal Reserve System, Holding companies, Reporting and recordkeeping requirements, Securities.

12 CFR Part 325

Administrative practice and procedure, Banks, banking, Capital Adequacy, Reporting and recordkeeping requirements, Savings associations, State nonmember banks.

12 CFR Part 566

Capital, reporting and recordkeeping requirements, Savings associations.

Authority and Issuance

Adoption of Common Appendix

The adoption of the proposed common rules by the agencies, as modified by agency-specific text, is set forth below:

Department of the Treasury

Office of the Comptroller of the Currency

12 CFR Chapter I

Authority and Issuance

For the reasons stated in the common preamble, the Office of the Comptroller of the Currency proposes to amend Part 3 of chapter I of Title 12, Code of Federal Regulations as follows:

PART 3—MINIMUM CAPITAL RATIOS; ISSUANCE OF DIRECTIVES

1. The authority citation for part 3 continues to read as follows:

Authority: 12 U.S.C. 93a, 161, 1818, 1828(n), 1828 note, 1831n note, 1835, 3907, and 3909.

2. New Appendix C to part 3 is added as set forth at the end of the common preamble.

3. Appendix C to part 3 is amended as set forth below:

a. Remove “[AGENCY]” and add “OCC” in its place wherever it appears.

b. Remove “[bank]” and add “bank” in its place wherever it appears, and remove “[Bank]” and add “Bank” in its place wherever it appears.

c. Remove “[Appendix __ to Part __]” and add “Appendix C to Part 3” in its place wherever it appears.

d. Remove “[the general risk-based capital rules]” and add “12 CFR part 3, Appendix A” in its place wherever it appears.

e. Remove “[the market risk rule]” and add “12 CFR part 3, Appendix B” in its place wherever it appears.

f. Remove “[Disclosure paragraph (b)]” and add in its place “(b) A bank must comply with paragraph (c) of section 71 of appendix F to the Federal Reserve Board’s Regulation Y (12 CFR part 225, appendix F) unless it is a consolidated subsidiary of a bank holding company or depository institution that is subject to these requirements.”

g. Remove “[Disclosure paragraph (c)].”

Board of Governors of the Federal Reserve System

12 CFR Chapter II

Authority and Issuance

For the reasons stated in the common 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, 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, 6801, and 6805; 31 U.S.C. 5318; 42 U.S.C. 4012a, 4104a, 4104b, 4106, and 4128.

2. New Appendix F to part 208 is added as set forth at the end of the common preamble.

3. Appendix F to part 208 is amended as set forth below:

a. Remove “[AGENCY]” and add “Board” in its place wherever it appears.

b. Remove “[bank]” and add “bank” in its place wherever it appears, and remove “[Bank]” and add “Bank” in its place wherever it appears.

c. Remove “[Appendix __ to Part __]” and add “Appendix F to Part 208” in its place wherever it appears.

d. Remove “[the general risk-based capital rules]” and add “12 CFR part 208, Appendix A” in its place wherever it appears.

e. Remove “[the market risk rule]” and add “12 CFR part 208, Appendix E” in its place wherever it appears.

f. Remove “[Disclosure paragraph (b)]” and add in its place “(b) A bank must comply with paragraph (c) of section 71 of appendix F to the Federal Reserve Board’s Regulation Y (12 CFR part 225, appendix F) unless it is a

¹¹ Other public disclosure requirements continue to apply—for example, Federal securities law and regulatory reporting requirements.

consolidated subsidiary of a bank holding company or depository institution that is subject to these requirements.”

g. Remove “[Disclosure paragraph (c)].”

PART 225—BANK HOLDING COMPANIES AND CHANGE IN BANK CONTROL (REGULATION Y)

1. The authority citation for part 225 continues to read as follows:

Authority: 12 U.S.C. 1817(j)(13), 1818, 1828(o), 1831i, 1831p–1, 1843(c)(8), 1844(b), 1972(1), 3106, 3108, 3310, 3331–3351, 3907, and 3909; 15 U.S.C. 6801 and 6805.

2. New Appendix G to part 225 is added as set forth at the end of the common preamble.

3. Appendix G to part 225 is amended as set forth below:

a. Remove “[AGENCY]” and add “Board” in its place wherever it appears.

b. Remove “[bank]” and add in its place “bank holding company” wherever it appears, and remove “[Bank]” and add “Bank holding company” in its place wherever it appears.

c. Remove “[Appendix __ to Part __]” and add “Appendix G to Part 225” in its place wherever it appears.

d. Remove “[the general risk-based capital rules]” and add “12 CFR part 225, Appendix A” in its place wherever it appears.

e. Remove “[the market risk rule]” and add “12 CFR part 225, Appendix E” in its place wherever it appears.

f. Remove the text of section 1(b)(1)(i) and add in its place: “Is a U.S.-based bank holding company that has total consolidated assets (excluding assets held by an insurance underwriting subsidiary), as reported on the most recent year-end FR Y–9C, equal to \$250 billion or more;”.

g. Remove the text of section 1(b)(1)(iii) and add in its place: “Has a

subsidiary depository institution (as defined in 12 U.S.C. 1813) that is required, or has elected, to use 12 CFR part 3, Appendix C, 12 CFR part 208, Appendix F, 12 CFR part 325, Appendix F, or 12 CFR 556 to calculate its risk-based capital requirements;”.

h. At the end of section 11(b)(1) add the following sentence: “A bank holding company also must deduct an amount equal to the minimum regulatory capital requirement established by the regulator of any insurance underwriting subsidiary of the holding company. For U.S.-based insurance underwriting subsidiaries, this amount generally would be 200 percent of the subsidiary’s Authorized Control Level as established by the appropriate state regulator of the insurance company.”

i. Remove section 22(h)(3)(ii).

j. In section 31(e)(3), remove “A bank may assign a risk-weighted asset amount of zero to cash owned and held in all offices of the bank or in transit and for gold bullion held in the bank’s own vaults, or held in another bank’s vaults on an allocated basis, to the extent it is offset by gold bullion liabilities” and add in its place “A bank holding company may assign a risk-weighted asset amount of zero to cash owned and held in all offices of subsidiary depository institutions or in transit and for gold bullion held in either a subsidiary depository institution’s own vaults, or held in another’s vaults on an allocated basis, to the extent it is offset by gold bullion liabilities.”

k. Remove “[Disclosure paragraph (b)].”

l. Remove “[Disclosure paragraph (c)].”

m. In section 71, add new paragraph (b) to read as follows:

Section 71. * * *

(b)(1) Each consolidated bank holding company that has successfully completed its parallel run must provide timely public disclosures each calendar

quarter of the information in tables 11.1–11.11 below. If a significant change occurs, such that the most recent reported amounts are no longer reflective of the bank holding company’s capital adequacy and risk profile, then a brief discussion of this change and its likely impact must be provided as soon as practicable thereafter. Qualitative disclosures that typically do not change each quarter (for example, a general summary of the bank holding company’s risk management objectives and policies, reporting system, and definitions) may be disclosed annually, provided any significant changes to these are disclosed in the interim. Management is encouraged to provide all of the disclosures required by this appendix in one place on the bank holding company’s public Web site.¹² The bank holding company must make these disclosures publicly available for each of the last three years (that is, twelve quarters) or such shorter period since it began its first floor period.

(2) Each bank holding company is required to have a formal disclosure policy approved by the board of directors that addresses its approach for determining the disclosures it makes. The policy must address the associated internal controls and disclosure controls and procedures. The board of directors and senior management must ensure that appropriate verification of the disclosures takes place and that effective internal controls and disclosure controls and procedures are maintained. The chief financial officer of the bank holding company must certify that the disclosures required by this appendix are appropriate, and the board of directors and senior management are responsible for establishing and maintaining an effective internal control structure over financial reporting, including the disclosures required by this appendix.

TABLE 11.1.—SCOPE OF APPLICATION

Qualitative Disclosures	(a) The name of the top corporate entity in the group to which the appendix applies. (b) An outline of differences in the basis of consolidation for accounting and regulatory purposes, with a brief description of the entities ¹³ within the group (a) that are fully consolidated; (b) that are deconsolidated and deducted; (c) for which the regulatory capital requirement is deducted; and (d) that are neither consolidated nor deducted (for example, where the investment is risk-weighted).
Quantitative Disclosures	(c) Any restrictions, or other major impediments, on transfer of funds or regulatory capital within the group. (d) The aggregate amount of surplus capital of insurance subsidiaries (whether deducted or subjected to an alternative method) included in the regulatory capital of the consolidated group. (e) The aggregate amount of capital deficiencies ¹⁴ in all subsidiaries and the name(s) of such subsidiaries.

¹² Alternatively, a bank holding company may provide the disclosures in more than one place, as some of them may be included in public financial reports (for example, in Management’s Discussion and Analysis included in SEC filings) or other regulatory reports. The bank holding company must

provide a summary table on its public Web site that specifically indicates where all the disclosures may be found (for example, regulatory report schedules, page numbers in annual reports).

¹³ Entities include securities, insurance and other financial subsidiaries, commercial subsidiaries

(where permitted), significant minority equity investments in insurance, financial and commercial entities.

¹⁴ A capital deficiency is the amount by which actual regulatory capital is less than the minimum regulatory capital requirement.

TABLE 11.2.—CAPITAL STRUCTURE

Qualitative Disclosures	(a) Summary information on the terms and conditions of the main features of all capital instruments, especially in the case of innovative, complex or hybrid capital instruments.
Quantitative Disclosures	(b) The amount of tier 1 capital, with separate disclosure of: • Common stock/surplus; • Retained earnings; • Minority interests in the equity of subsidiaries; • Restricted core capital elements as defined in 12 CFR part 225, Appendix A; • Regulatory calculation differences deducted from tier 1 capital;¹⁵ and • Other amounts deducted from tier 1 capital, including goodwill and certain intangibles.
	(c) The total amount of tier 2 capital.
	(d) Other deductions from capital. ¹⁶
	(e) Total eligible capital.

TABLE 11.3.—CAPITAL ADEQUACY

Qualitative Disclosures	(a) A summary discussion of the bank holding company's approach to assessing the adequacy of its capital to support current and future activities.
Quantitative Disclosures	(b) Risk-weighted assets for credit risk from: • Wholesale exposures; • Residential mortgage exposures; • Qualifying revolving exposures; • Other retail exposures; • Securitization exposures; • Equity exposures: • Equity exposures subject to simple risk weight approach; and • Equity exposures subject to internal models approach.
	(c) Risk-weighted assets for market risk as calculated under [the market risk rule]: ¹⁷ • Standardized approach for specific risk; and • Internal models approach for specific risk.
	(d) Risk-weighted assets for operational risk.
	(e) Total and tier 1 risk-based capital ratios: ¹⁸ • For the top consolidated group; and • For each DI subsidiary.

General Qualitative Disclosure Requirement

For each separate risk area described in tables 11.4 through 11.11, the bank holding company must describe its risk

management objectives and policies, including:

- Strategies and processes;
- The structure and organization of the relevant risk management function;

- The scope and nature of risk reporting and/or measurement systems;
- Policies for hedging and/or mitigating risk and strategies and processes for monitoring the continuing effectiveness of hedges/mitigants.

TABLE 11.4.¹⁹—CREDIT RISK: GENERAL DISCLOSURES

Qualitative Disclosures	(a) The general qualitative disclosure requirement with respect to credit risk (excluding counterparty credit risk disclosed in accordance with Table 11.6), including: • Definitions of past due and impaired (for accounting purposes); • Description of approaches followed for allowances, including statistical methods used where applicable; • Discussion of the bank holding company's credit risk management policy.
Quantitative Disclosures	(b) Total gross credit risk exposures, ²⁰ and average gross credit risk exposures, over the period broken down by major types of credit exposure. ²¹
	(c) Geographic ²² distribution of exposures, broken down in significant areas by major types of credit exposure.
	(d) Industry or counterparty type distribution of exposures, broken down by major types of credit exposure.
	(e) Remaining contractual maturity breakdown (for example, one year or less) of the whole portfolio, broken down by major types of credit exposure.
	(f) By major industry or counterparty type: • Amount of impaired loans; • Amount of past due loans;²³ • Allowances; and, • Charge-offs during the period.
	(g) Amount of impaired loans and, if available, the amount of past due loans broken down by significant geographic areas including, if practical, the amounts of allowances related to each geographical area. ²⁴
	(h) Reconciliation of changes in the allowance for loan and lease losses. ²⁵

¹⁵ Representing 50% of the amount, if any, by which total expected credit losses as calculated within the IRB framework exceed eligible credit reserves, which must be deducted from Tier 1 capital.

¹⁶ Including 50% of the amount, if any, by which total expected credit losses as calculated within the IRB framework exceed eligible credit reserves, which must be deducted from Tier 2 capital.

¹⁷ Risk-weighted assets determined under [the market risk rule] are to be disclosed only for the approaches used.

¹⁸ Total risk-weighted assets should also be disclosed.

TABLE 11.5.—CREDIT RISK: DISCLOSURES FOR PORTFOLIOS SUBJECT TO IRB RISK-BASED CAPITAL FORMULAS

Qualitative disclosures	(a) Explanation and review of the: • Structure of internal rating systems and relation between internal and external ratings; • Use of risk parameter estimates other than for regulatory capital purposes; • Process for managing and recognizing credit risk mitigation; and • Control mechanisms for the rating system, including discussion of independence, accountability, and rating systems review. (b) Description of the internal ratings process, provided separately for the following: • Wholesale category; • Retail subcategories: • Residential mortgage exposures; • Qualifying revolving exposures; and • Other retail exposures. For each category and subcategory the description should include: • The types of exposure included in the category subcategories; • The definitions, methods and data for estimation and validation of PD, ELGD, LGD, and EAD, including assumptions employed in the derivation of these variables.²⁶
Quantitative disclosures: Risk assessment.	(c) For wholesale exposures, present the following information across a sufficient number of PD grades (including default) to allow for a meaningful differentiation of credit risk:²⁷ • Total EAD;²⁸ • Exposure-weighted average ELGD and LGD (percentage); • Exposure weighted-average capital requirement (K); and • Amount of undrawn commitments and exposure-weighted average EAD for wholesale exposures. For each retail subcategory, present the disclosures outlined above across a sufficient number of segments to allow for a meaningful differentiation of credit risk.
Quantitative disclosures: historical results.	(d) Actual losses in the preceding period for each category and subcategory and how this differs from past experience. A discussion of the factors that impacted the loss experience in the preceding period—for example, has the bank holding company experienced higher than average default rates, loss rates or EADs. (e) Comparison of risk parameter estimates against actual outcomes over a longer period.²⁹ At a minimum, this should include information on estimates of losses against actual losses in the wholesale category and each retail subcategory over a period sufficient to allow for a meaningful assessment of the performance of the internal rating processes for each category/subcategory.³⁰ Where appropriate, the bank holding company should further decompose this to provide analysis of PD, ELGD, LGD, and EAD outcomes against estimates provided in the quantitative risk assessment disclosures above.³¹

¹⁹ Table 4 does not include equity exposures.

²⁰ That is, after accounting offsets in accordance with U.S. GAAP (for example, FASB Interpretations 39 and 41) and without taking into account the effects of credit risk mitigation techniques, for example collateral and netting.

²¹ For example, banks could apply a breakdown similar to that used for accounting purposes. Such a breakdown might, for instance, be (a) loans, off-balance sheet commitments, and other non-derivative off-balance sheet exposures, (b) debt securities, and (c) OTC derivatives.

²² Geographical areas may comprise individual countries, groups of countries or regions within countries. A bank holding company might choose to define the geographical areas based on the way the company's portfolio is geographically managed. The criteria used to allocate the loans to geographical areas must be specified.

²³ A bank holding company is encouraged also to provide an analysis of the aging of past-due loans.

²⁴ The portion of general allowance that is not allocated to a geographical area should be disclosed separately.

²⁵ The reconciliation should include the following: A description of the allowance; the opening balance of the allowance; charge-offs taken against the allowance during the period; amounts provided (or reversed) for estimated probable loan losses during the period; any other adjustments (for example, exchange rate differences, business

combinations, acquisitions and disposals of subsidiaries), including transfers between allowances; and the closing balance of the allowance. Charge-offs and recoveries that have been recorded directly to the income statement should be disclosed separately.

²⁶ This disclosure does not require a detailed description of the model in full—it should provide the reader with a broad overview of the model approach, describing definitions of the variables, and methods for estimating and validating those variables set out in the quantitative risk disclosures below. This should be done for each of the four category/subcategories. The bank holding company should disclose any significant differences in approach to estimating these variables within each category/subcategories.

²⁷ The PD, ELGD, LGD and EAD disclosures in Table 11.5(c) should reflect the effects of collateral, qualifying master netting agreements, eligible guarantees and eligible credit derivatives as defined in Part 1. Disclosure of each PD grade should include the exposure weighted-average PD for each grade. Where a bank holding company aggregates PD grades for the purposes of disclosure, this should be a representative breakdown of the distribution of PD grades used for regulatory capital purposes.

²⁸ Outstanding loans and EAD on undrawn commitments can be presented on a combined basis for these disclosures.

²⁹ These disclosures are a way of further informing the reader about the reliability of the information provided in the “quantitative disclosures: Risk assessment” over the long run. The disclosures are requirements from year-end 2010; in the meantime, early adoption is encouraged. The phased implementation is to allow a bank holding company sufficient time to build up a longer run of data that will make these disclosures meaningful.

³⁰ This regulation is not prescriptive about the period used for this assessment. Upon implementation, it might be expected that a bank holding company would provide these disclosures for as long run of data as possible—for example, if a bank holding company has 10 years of data, it might choose to disclose the average default rates for each PD grade over that 10-year period. Annual amounts need not be disclosed.

³¹ A bank holding company should provide this further decomposition where it will allow users greater insight into the reliability of the estimates provided in the “quantitative disclosures: Risk assessment.” In particular, it should provide this information where there are material differences between estimates of PD, ELGD, LGD or EAD compared to actual outcomes over the long run. The bank holding company should also provide explanations for such differences.

TABLE 11.6.—GENERAL DISCLOSURE FOR COUNTERPARTY CREDIT RISK-RELATED EXPOSURES

Qualitative Disclosures	(a) The general qualitative processes for disclosure requirement with respect to OTC derivatives, eligible margin loans, and repo-style transactions, including: • Discussion of methodology used to assign economic capital and credit limits for counterparty credit exposures; • Discussion of policies and securing collateral, valuing and managing collateral, and establishing credit reserves; • Discussion of the primary types of collateral taken; • Discussion of policies with respect to wrong-way risk exposures; and • Discussion of the impact of the amount of collateral the bank would have to provide given a credit rating downgrade.
Quantitative Disclosures	(b) Gross positive fair value of contracts, netting benefits, netted current credit exposure, collateral held (including type, for example, cash, government securities), and net unsecured credit exposure.³² Also report measures for EAD used for regulatory capital for these transactions, the notional value of credit derivative hedges purchased for counterparty credit risk protection, and the distribution of current credit exposure by types of credit exposure.³³ (c) Notional amount of purchased and sold credit derivatives, segregated between use for the institution's own credit portfolio, as well as in its intermediation activities, including the distribution of the credit derivative products used, broken down further by protection bought and sold within each product group. (d) The estimate of alpha if the bank holding company has received supervisory approval to estimate alpha.

TABLE 11.7.—CREDIT RISK MITIGATION ^{34, 35, 36}

Qualitative Disclosure	(a) The general qualitative disclosure requirement with respect to credit risk mitigation including: • Policies and processes for, and an indication of the extent to which the bank holding company uses, on- and off-balance sheet netting; • Policies and processes for collateral valuation and management; • A description of the main types of collateral taken by the bank holding company; • The main type of guarantors/credit derivative counterparties and their creditworthiness; and • Information about (market or credit) risk concentrations within the mitigation taken.
Quantitative Disclosure	(b) For each separately disclosed portfolio, the total exposure (after, where applicable, on- or off-balance sheet netting) that is covered by guarantees/credit derivatives and the risk-weighted asset amount associated with that exposure.

TABLE 11.8.—SECURITIZATION

Qualitative disclosures	(a) The general qualitative disclosure requirement disclosures with respect to securitization (including synthetics), including a discussion of: • The bank holding company's objectives relating to securitization activity, including the extent to which these activities transfer credit risk of the underlying exposures away from the bank holding company to other entities; • The roles played by the bank holding company in the securitization process³⁷ and an indication of the extent of the bank holding company's involvement in each of them; and • The regulatory capital approaches (for example, RBA, IAA and SFA) that the bank holding company follows for its securitization activities. (b) Summary of the bank holding company's accounting policies for securitization activities, including: • Whether the transactions are treated as sales or financings; • Recognition of gain-on-sale; • Key assumptions for valuing retained interests, including any significant changes since the last reporting period and the impact of such changes; and • Treatment of synthetic securitizations. (c) Names of NRSROs used for securitizations and the types of securitization exposure for which each agency is used.
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³² Net unsecured credit exposure is the credit exposure after considering both the benefits from legally enforceable netting agreements and collateral arrangements without taking into account haircuts for price volatility, liquidity, etc.

³³ This may include interest rate derivative contracts, foreign exchange derivative contracts, equity derivative contracts, credit derivatives, commodity or other derivative contracts, repo-style transactions, and eligible margin loans.

³⁴ At a minimum, a bank holding company must give the disclosures in Table 11.7 in relation to credit risk mitigation that has been recognized for the purposes of reducing capital requirements under this Appendix. Where relevant, bank holding companies are encouraged to give further information about mitigants that have not been recognized for that purpose.

³⁵ Credit derivatives that are treated, for the purposes of this Appendix, as synthetic

securitization exposures should be excluded from the credit risk mitigation disclosures and included within those relating to securitization.

³⁶ Counterparty credit risk-related exposures disclosed pursuant to Table 11.6 should be excluded from the credit risk mitigation disclosures in Table 11.7.

TABLE 11.8.—SECURITIZATION—Continued

Quantitative disclosures	(d) The total outstanding exposures securitized by the bank holding company in securitizations that meet the operation criteria in Section 41 (broken down into traditional/synthetic), by underlying exposure type.^{38, 39, 40} (e) For exposures securitized by the bank holding company in securitizations that meet the operational criteria in Section 41: • Amount of securitized assets that are impaired/past due; and • Losses recognized by the bank holding company during the current period⁴¹ broken down by exposure type. (f) Aggregate amount of securitization exposures broken down by underlying exposure type. (g) Aggregate amount of securitization exposures and the associated IRB capital charges for these exposures broken down into a meaningful number of risk weight bands. Exposures that have been deducted from capital should be disclosed separately by type of underlying asset. (h) For securitizations subject to the early amortisation treatment, the following items by underlying asset type for securitized facilities: • The aggregate drawn exposures attributed to the seller's and investors' interests; and • The aggregate IRB capital charges incurred by the bank holding company against the investor's shares of drawn balances and undrawn lines. (i) Summary of current year's securitization activity, including the amount of exposures securitized (by exposure type), and recognised gain or loss on sale by asset type.
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TABLE 11.9.—OPERATIONAL RISK

Qualitative disclosures	(a) The general qualitative disclosure requirement for operational risk. (b) Description of the AMA, including a discussion of relevant internal and external factors considered in the bank holding company's measurement approach. (c) A description of the use of insurance for the purpose of mitigating operational risk.
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TABLE 11.10.—EQUITIES NOT SUBJECT TO MARKET RISK RULE

Qualitative Disclosures	(a) The general qualitative disclosure requirement with respect to equity risk, including: • Differentiation between holdings on which capital gains are expected and those taken under other objectives including for relationship and strategic reasons; and • Discussion of important policies covering the valuation of and accounting for equity holdings in the banking book. This includes the accounting techniques and valuation methodologies used, including key assumptions and practices affecting valuation as well as significant changes in these practices.
Quantitative Disclosures	(b) Value disclosed in the balance sheet of investments, as well as the fair value of those investments; for quoted securities, a comparison to publicly-quoted share values where the share price is materially different from fair value. (c) The types and nature of investments, including the amount that is: • Publicly traded; and • Non-publicly traded. (d) The cumulative realized gains (losses) arising from sales and liquidations in the reporting period. (e) Total unrealized gains (losses);⁴² • Total latent revaluation gains (losses);⁴³ and • Any amounts of the above included in tier 1 and/or tier 2 capital. (f) Capital requirements broken down by appropriate equity groupings, consistent with the bank holding company's methodology, as well as the aggregate amounts and the type of equity investments subject to any supervisory transition regarding regulatory capital requirements.⁴⁴

TABLE 11.11.—INTEREST RATE RISK FOR NON-TRADING ACTIVITIES

Qualitative disclosures	(a) The general qualitative disclosure requirement, including the nature of interest rate risk for non-trading activities and key assumptions, including assumptions regarding loan prepayments and behavior of non-maturity deposits, and frequency of measurement of interest rate risk for non-trading activities.
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³⁷ For example: originator, investor, servicer, provider of credit enhancement, sponsor of asset backed commercial paper facility, liquidity provider, swap provider.

³⁸ Underlying exposure types may include, for example, 1–4 family residential loans, home equity lines, credit card receivables, and auto loans.

³⁹ Securitization transactions in which the originating bank holding company does not retain any securitization exposure should be shown

separately but need only be reported for the year of inception.

⁴⁰ Where relevant, a bank holding company is encouraged to differentiate between exposures resulting from activities in which they act only as sponsors, and exposures that result from all other bank holding company securitization activities.

⁴¹ For example, charge-offs/allowances (if the assets remain on the bank holding company's

balance sheet) or write-downs of I/O strips and other residual interests.

⁴² Unrealized gains (losses) recognized in the balance sheet but not through earnings.

⁴³ Unrealized gains (losses) not recognized either in the balance sheet or through earnings.

⁴⁴ This disclosure should include a breakdown of equities that are subject to the 0%, 20%, 100%, 300%, and 400% risk weights, as applicable.

TABLE 11.11.—INTEREST RATE RISK FOR NON-TRADING ACTIVITIES—Continued

Quantitative disclosures	(b) The increase (decline) in earnings or economic value (or relevant measure used by management) for upward and downward rate shocks according to management's method for measuring interest rate risk for non-trading activities, broken down by currency (as appropriate).
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Federal Deposit Insurance Corporation
12 CFR Chapter III
Authority and Issuance

For the reasons stated in the common preamble, the Federal Deposit Insurance Corporation proposes to amend part 325 of chapter III of title 12 of the Code of Federal Regulations as follows:

PART 325—CAPITAL MAINTENANCE

1. The authority citation for part 325 continues to read as follows:

Authority: 12 U.S.C. 1815(a), 1815(b), 1816, 1818(a), 1818(b), 1818(c), 1818(t), 1819(Tenth), 1828(c), 1828(d), 1828(i), 1828(n), 1828(o), 1831o, 1835, 3907, 3909, 4808; Pub. L. 102–233, 105 Stat. 1761, 1789, 1790 (12 U.S.C. 1831n note); Pub. L. 102–242, 105 Stat. 2236, 2355, 2386 (12 U.S.C. 1828 note).

2. New Appendix D to part 325 is added as set forth at the end of the common preamble.

3. Appendix D to part 325 is amended as set forth below:

a. Remove “[AGENCY]” and add “FDIC” in its place wherever it appears.

b. Remove “[bank]” and add “bank” in its place wherever it appears, and remove “[Bank]” and add “Bank” in its place wherever it appears.

c. Remove “[Appendix ____ to Part ____]” and add “Appendix D to Part 325” in its place wherever it appears.

d. Remove “[the general risk-based capital rules]” and add “12 CFR part 325, Appendix A” in its place wherever it appears.

e. Remove “[the market risk rule]” and add “12 CFR part 325, Appendix C” in its place wherever it appears.

f. Remove “[Disclosure paragraph (b)]” and add in its place “(b) A bank must comply with paragraph (c) of section 71 of appendix F to the Federal Reserve Board’s Regulation Y (12 CFR part 225, appendix F) unless it is a consolidated subsidiary of a bank holding company or depository institution that is subject to these requirements.”

g. Remove “Disclosure paragraph (c).”

Department of the Treasury

Office of Thrift Supervision

12 CFR Chapter V

Authority and Issuance

For the reasons stated in the common preamble, the Office of Thrift Supervision proposes to amend part 566 of chapter V of title 12 of the Code of Federal Regulations as follows:

1. Add a new part 566 to read as follows:

PART 566—ADVANCED CAPITAL ADEQUACY FRAMEWORK AND MARKET RISK ADJUSTMENT

Sec.

566.1 Purpose

Authority: 12 U.S.C. 1462, 1462a, 1463, 1464, 1467a, 1828(note).

§ 566.1 Purpose.

(a) *Advanced Capital Framework.* Appendix A of this part establishes: minimum qualifying criteria for savings associations using internal risk measurement and management processes for calculating risk based capital requirements, methodologies for these savings associations to calculate their risk-based capital requirement, and public disclosure requirements for these savings associations.

(b) [Reserved]

2. Appendix A to part 566 is added to read as set forth at the end of the common preamble.

3. Appendix A to part 566 is amended as set forth below:

a. Remove “[AGENCY]” and add “OTS” in its place wherever it appears.

b. Remove “[bank]” and add “savings association” in its place wherever it appears, and remove “[Bank]” and add “Savings association” in its place wherever it appears.

c. Remove “[Appendix ____ to Part ____]” and add “Appendix A to Part 566” in its place wherever it appears.

d. Remove “[the general risk-based capital rules]” and add “12 CFR part 567” in its place wherever it appears.

e. Remove “[the market risk rule]” and add “12 CFR part 566, Subpart B” in its place wherever it appears.

f. Remove the text of section 12(b) and add in its place: “A savings association is not required to deduct equity securities from capital under 12 CFR 567.5(c)(2)(ii). However, it must continue to deduct equity investments

in real estate under that section. See 12 CFR 567.1, which defines equity investments, including equity securities and equity investments in real estate.”

g. Remove the text of section 52(b)(3)(i) and add in its place: “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 jobs, 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).”

h. Remove “[Disclosure paragraph (b)]” and add in its place “(b) A savings association must comply with paragraph (c) of section 71 unless it is a consolidated subsidiary of a depository institution or bank holding company that is subject to these requirements.”

i. Remove “[Disclosure paragraph (c)].”

j. In section 71, add new paragraph (c) to read as follows:

Section 71 * * *

* * * * *

(c)(1) Each consolidated savings association described in paragraph (b) of this section that has successfully completed its parallel run must provide timely public disclosures each calendar quarter of the information in tables 11.1–11.11 below. If a significant change occurs, such that the most recent reported amounts are no longer reflective of the savings association’s capital adequacy and risk profile, then a brief discussion of this change and its likely impact must be provided as soon as practicable thereafter. Qualitative disclosures that typically do not change each quarter (for example, a general summary of the savings association’s risk management objectives and policies, reporting system, and definitions) may be disclosed annually, provided any significant changes to these are disclosed in the interim. Management is encouraged to provide all of the disclosures required by this appendix in one place on the savings association’s public Web site.⁴⁵ The

⁴⁵ Alternatively, a savings association may provide the disclosures in more than one place, as

Continued

savings association must make these disclosures publicly available for each of the last three years (that is, twelve quarters) or such shorter period since it began its first floor period.

(2) Each savings association is required to have a formal disclosure policy approved by the board of directors that addresses its approach for determining the disclosures it makes.

The policy must address the associated internal controls and disclosure controls and procedures. The board of directors and senior management must ensure that appropriate verification of the disclosures takes place and that effective internal controls and disclosure controls and procedures are maintained. The chief financial officer

of the savings association must certify that the disclosures required by this appendix are appropriate, and the board of directors and senior management are responsible for establishing and maintaining an effective internal control structure over financial reporting, including the disclosures required by this appendix.

TABLE 11.1.—SCOPE OF APPLICATION

Qualitative Disclosures	(a) The name of the top corporate entity in the group to which the appendix applies. (b) An outline of differences in the basis of consolidation for accounting and regulatory purposes, with a brief description of the entities ⁴⁶ within the group (a) that are fully consolidated; (b) that are deconsolidated and deducted; (c) for which the regulatory capital requirement is deducted; and (d) that are neither consolidated nor deducted (for example, where the investment is risk-weighted).
Quantitative Disclosures	(c) Any restrictions, or other major impediments, on transfer of funds or regulatory capital within the group. (d) The aggregate amount of surplus capital of insurance subsidiaries (whether deducted or subjected to an alternative method) included in the regulatory capital of the consolidated group. (e) The aggregate amount of capital deficiencies ⁴⁷ in all subsidiaries and the name(s) of such subsidiaries.

TABLE 11.2.—CAPITAL STRUCTURE

Qualitative disclosures	(a) Summary information on the terms and conditions of the main features of all capital instruments, especially in the case of innovative, complex or hybrid capital instruments.
Quantitative disclosures	(b) The amount of tier 1 capital, with separate disclosure of: • Common stock/surplus; • Retained earnings; • Minority interests in the equity of subsidiaries; regulatory calculation differences deducted from tier 1 capital;⁴⁸ and • Other amounts deducted from tier 1 capital, including goodwill and certain intangibles. (c) The total amount of tier 2 capital. (d) Other deductions from capital. ⁴⁹ (e) Total eligible capital.

TABLE 11.3.—CAPITAL ADEQUACY

Qualitative disclosures	(a) A summary discussion of the savings association's approach to assessing the adequacy of its capital to support current and future activities.
Quantitative disclosures	(b) Risk-weighted assets for credit risk from: • Wholesale exposures; • Residential mortgage exposures; • Qualifying revolving exposures; • Other retail exposures; • Securitization exposures; and • Equity exposures: • Equity exposures subject to simple risk weight approach; and • Equity exposures subject to internal models approach. (c) Risk-weighted assets for market risk as calculated under [the market risk rule]: ⁵⁰ • Standardized approach for specific risk; and • Internal models approach for specific risk. (d) Risk-weighted assets for operational risk. (e) Total and tier 1 risk-based capital ratios: ⁵¹

some of them may be included in public financial reports (for example, in Management's Discussion and Analysis included in SEC filings) or other regulatory reports. The savings association must provide a summary table on its public Website that specifically indicates where all the disclosures may be found (for example, regulatory report schedules, page numbers in annual reports).

⁴⁶ Entities include securities, insurance and other financial subsidiaries, commercial subsidiaries (where permitted), significant minority equity investments in insurance, financial and commercial entities.

⁴⁷ A capital deficiency is the amount by which actual regulatory capital is less than the minimum regulatory capital requirements.

⁴⁸ Representing 50% of the amount, if any, by which total expected credit losses as calculated within the IRB framework exceed eligible credit reserves, which must be deducted from Tier 1 capital.

⁴⁹ Including 50% of the amount, if any, by which total expected credit losses as calculated within the IRB framework exceed eligible credit reserves, which must be deducted from Tier 2 capital.

TABLE 11.3.—CAPITAL ADEQUACY—Continued

	• For the top consolidated group; and • For each DI subsidiary.
General Qualitative Disclosure Requirement	management objectives and policies, including: • Strategies and processes; • The structure and organization of the relevant risk management function; For each separate risk area described in tables 11.4 through 11.11, the savings association must describe its risk
	• The scope and nature of risk reporting and/or measurement systems; • Policies for hedging and/or mitigating risk and strategies and processes for monitoring the continuing effectiveness of hedges/mitigants.

TABLE 11.4.⁵²—CREDIT RISK: GENERAL DISCLOSURES

Qualitative Disclosures	(a) The general qualitative disclosure requirement with respect to credit risk (excluding counterparty credit risk disclosed in accordance with Table 11.6), including: • Definitions of past due and impaired (for accounting purposes); • Description of approaches followed for allowances, including statistical methods used where applicable; • Discussion of the savings association's credit risk management policy.
Quantitative Disclosures	(b) Total gross credit risk exposures,⁵³ and average gross credit risk exposures, over the period broken down by major types of credit exposure.⁵⁴ (c) Geographic⁵⁵ distribution of exposures, broken down in significant areas by major types of credit exposure. (d) Industry or counterparty type distribution of exposures, broken down by major types of credit exposure. (e) Remaining contractual maturity breakdown (for example, one year or less) of the whole portfolio, broken down by major types of credit exposure. (f) By major industry or counterparty type: • Amount of impaired loans; • Amount of past due loans;⁵⁶ • Allowances; and • Charge-offs during the period. (g) Amount of impaired loans and, if available, the amount of past due loans broken down by significant geographic areas including, if practical, the amounts of allowances related to each geographical area.⁵⁷ (h) Reconciliation of changes in the allowance for loan and lease losses.⁵⁸

TABLE 11.5.—CREDIT RISK: DISCLOSURES FOR PORTFOLIOS SUBJECT TO IRB RISK-BASED CAPITAL FORMULAS

Qualitative disclosures	(a) Explanation and review of the: • Structure of internal rating systems and relation between internal and external ratings; • Use of risk parameter estimates other than for regulatory capital purposes; • Process for managing and recognizing credit risk mitigation; and • Control mechanisms for the rating system, including discussion of independence, accountability, and rating systems review. (b) Description of the internal ratings process, provided separately for the following: • Wholesale category; and • Retail subcategories: residential mortgage exposures; • Qualifying revolving exposures; and • Other retail exposures. For each category and subcategory the description should include: • The types of exposure included in the category/subcategories; • The definitions, methods and data for estimation and validation of PD, ELGD, LGD, and EAD, including assumptions employed in the derivation of these variables.⁵⁹
Quantitative Disclosures: Risk Assessment.	(c) For wholesale exposures, present the following information across a sufficient number of PD grades (including default) to allow for a meaningful differentiation of credit risk:⁶⁰ • Total EAD; • Exposure-weighted average ELGD and LGD (percentage); • Exposure weighted-average capital requirement (K); and

⁵⁰ Risk-weighted assets determined under [the market risk rule] are to be disclosed only for the approaches used.

⁵¹ Total risk-weighted assets should also be disclosed.

⁵² Table 4 does not include equity exposures.

⁵³ That is, after accounting offsets in accordance with US GAAP (for example, FASB Interpretations 39 and 41) and without taking into account the effects of credit risk mitigation techniques, for example collateral and netting.

⁵⁴ For example, banks could apply a breakdown similar to that used for accounting purposes. Such a breakdown might, for instance, be (a) loans, off-

balance sheet commitments, and other non-derivative off-balance sheet exposures, (b) debt securities, and (c) OTC derivatives.

⁵⁵ Geographical areas may comprise individual countries, groups of countries or regions within countries. A savings association might choose to define the geographical areas based on the way the company's portfolio is geographically managed. The criteria used to allocate the loans to geographical areas must be specified.

⁵⁶ A savings association is encouraged also to provide an analysis of the aging of past-due loans.

⁵⁷ The portion of general allowance that is not allocated to a geographical area should be disclosed separately.

⁵⁸ The reconciliation should include the following: A description of the allowance; the opening balance of the allowance; charge-offs taken against the allowance during the period; amounts provided (or reversed) for estimated probable loan losses during the period; any other adjustments (for example, exchange rate differences, business combinations, acquisitions and disposals of subsidiaries), including transfers between allowances; and the closing balance of the allowance. Charge-offs and recoveries that have been recorded directly to the income statement should be disclosed separately.

TABLE 11.5.—CREDIT RISK: DISCLOSURES FOR PORTFOLIOS SUBJECT TO IRB RISK-BASED CAPITAL FORMULAS—Continued

Quantitative disclosures: historical results.	• Amount of undrawn commitments and exposure-weighted average EAD for wholesale exposures. For each retail subcategory, present the disclosures outlined above across a sufficient number of segments to allow for a meaningful differentiation of credit risk. (d) Actual losses in the preceding period for each category and subcategory and how this differs from past experience. A discussion of the factors that impacted the loss experience in the preceding period—for example, has the savings association experienced higher than average default rates, loss rates or EADs. (e) Comparison of risk parameter estimates against actual outcomes over a longer period.⁶² At a minimum, this should include information on estimates of losses against actual losses in the wholesale category and each retail subcategory over a period sufficient to allow for a meaningful assessment of the performance of the internal rating processes for each category/subcategory.⁶³ Where appropriate, the savings association should further decompose this to provide analysis of PD, ELGD, LGD, and EAD outcomes against estimates provided in the quantitative risk assessment disclosures above.⁶⁴
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TABLE 11.6.—GENERAL DISCLOSURE FOR COUNTERPARTY CREDIT RISK-RELATED EXPOSURES

Qualitative Disclosures	(a) The general qualitative disclosure requirement with respect to OTC derivatives, eligible margin loans, and repo-style transactions, including: • Discussion of methodology used to assign economic capital and credit limits for counterparty credit exposures; • Discussion of policies for securing collateral, valuing and managing collateral, and establishing credit reserves; • Discussion of the primary types of collateral taken; • Discussion of policies with respect to wrong-way risk exposures; and • Discussions of the impact of the amount of collateral the bank would have to provide given a credit rating downgrade.
Quantitative Disclosures	(b) Gross positive fair value of contracts, netting benefits, netted current credit exposure, collateral held (including type, for example, cash, government securities), and net unsecured credit exposure.⁶⁵ Also report measures for EAD used for regulatory capital for these transactions, the notional value of credit derivative hedges purchased for counterparty credit risk protection, and the distribution of current credit exposure by types of credit exposure.⁶⁶ (c) Notional amount of purchased and sold credit derivatives, segregated between use for the institution's own credit portfolio, as well as in its intermediation activities, including the distribution of the credit derivative products used, broken down further by protection bought and sold within each product group. (d) The estimate of alpha if the savings association has received supervisory approval to estimate alpha.

TABLE 11.7.—CREDIT RISK MITIGATION^{67 68 69}

Qualitative Disclosures	(a) The general qualitative disclosure requirement with respect to credit risk mitigation including: • Policies and processes for, and an indication of the extent to which the savings association uses, on- and off-balance sheet netting; • Policies and processes for collateral valuation and management; • A description of the main types of collateral taken by the savings association; • The main types of guarantors/credit derivative counterparties and their creditworthiness; and • Information about (market or credit) risk concentrations within the mitigation taken.
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⁵⁹ This disclosure does not require a detailed description of the model in full—it should provide the reader with a broad overview of the model approach, describing definitions of the variables, and methods for estimating and validating those variables set out in the quantitative risk disclosures below. This should be done for each of the four category/subcategories. The savings association should disclose any significant differences in approach to estimating these variables within each category/subcategories.

⁶⁰ The PD, ELGD, LGD and EAD disclosures in Table 11.5(c) should reflect the effects of collateral, qualifying master netting agreements, eligible guarantees and eligible credit derivatives as defined in Part 1. Disclosure of each PD grade should include the exposure weighted-average PD for each grade. Where a savings association aggregates PD grades PD for the purposes of disclosure, this should be a representative breakdown of the

distribution of PD grades used for regulatory capital purposes.

⁶¹ Outstanding loans and EAD on undrawn commitments can be presented on a combined basis for these disclosures.

⁶² These disclosures are a way of further informing the reader about the reliability of the information provided in the “quantitative disclosures: risk assessment” over the long run. The disclosures are requirements from year-end 2010; in the meantime, early adoption is encouraged. The phased implementation is to allow a savings association sufficient time to build up a longer run of data that will make these disclosures meaningful.

⁶³ This regulation is not prescriptive about the period used for this assessment. Upon implementation, it might be expected that a savings association would provide these disclosures for as long run of data as possible—for example, if a savings association has 10 years of data, it might choose to disclose the average default rates

⁶⁴ A savings association should provide this further decomposition where it will allow users greater insight into the reliability of the estimates provided in the “quantitative disclosures: risk assessment.” In particular, it should provide this information where there are material differences between its estimates of PD, ELGD, LGD or EAD compared to actual outcomes over the long run. The savings association should also provide explanations for such differences.

⁶⁵ Net unsecured credit exposure is the credit exposure after considering both the benefits from legally enforceable netting agreements and collateral arrangements without taking into account haircuts for price volatility, liquidity, etc.

⁶⁶ This may include interest rate derivative contracts, foreign exchange derivative contracts, equity derivative contracts, credit derivatives, commodity or other derivative contracts, repo-style transactions, and eligible margin loans.

TABLE 11.7.—CREDIT RISK MITIGATION^{67 68 69}—Continued

Quantitative Disclosures	(b) For each separately disclosed portfolio, the total exposure (after, where applicable, on- or off-balance sheet netting) that is covered by guarantees/credit derivatives and the risk-weighted asset amount associated with that exposure.
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TABLE 11.8.—SECURITIZATION

Qualitative Disclosures	(a) The general qualitative disclosure requirement with respect to securitization (including synthetics), including a discussion of: • The savings association's objectives relating to securitization activity, including the extent to which these activities transfer credit risk of the underlying exposures away from the savings association to other entities; • The roles played by the savings association in the securitization process⁷⁰ and an indication of the extent of the savings association's involvement in each of them; and • The regulatory capital approaches (for example, RBA, IAA and SFA) that the savings association follows for its securitization activities. (b) Summary of the savings association's accounting policies for securitization activities, including: • Whether the transactions are treated as sales or financings; • Recognition of gain-on-sale; • Key assumptions for valuing retained interests, including any significant changes since the last reporting period and the impact of such changes; and • Treatment of synthetic securitizations. (c) Names of NRSROs used for securitizations and the types of securitization exposure for which each agency is used.
Quantitative Disclosures	(d) The total outstanding exposures securitized by the savings association in securitizations that meet the operation criteria in Section 41 (broken down into traditional/synthetic), by underlying exposure type.^{71,72,73} (e) For exposures securitized by the savings association in securitizations that meet the operational criteria in Section 41: • Amount of securitized assets that are impaired/past due; and • Losses recognized by the savings association during the current period⁷⁴ broken down by exposure type. (f) Aggregate amount of securitization exposures broken down by underlying exposure type. (g) Aggregate amount of securitization exposures and the associated IRB capital charges for these exposures broken down into a meaningful number of risk weight bands. Exposures that have been deducted from capital should be disclosed separately by type of underlying asset. (h) For securitizations subject to the early amortisation treatment, the following items by underlying asset type for securitized facilities: • The aggregate drawn exposures attributed to the seller's and investors' interests; and • The aggregate IRB capital charges incurred by the savings association against the investor's shares of drawn balances and undrawn lines. (i) Summary of current year's securitization activity, including the amount of exposures securitized (by exposure type), and recognised gain or loss on sale by asset type.

TABLE 11.9.—OPERATIONAL RISK

Qualitative Disclosures	(a) The general qualitative disclosure requirement for disclosures operational risk. (b) Description of the AMA, including a discussion of relevant internal and external factors considered in the savings association's measurement approach. (c) A description of the use of insurance for the purpose of mitigating operational risk.
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⁶⁷ At a minimum, a savings association must give the disclosures in Table 11.7 in relation to credit risk mitigation that has been recognized for the purposes of reducing capital requirements under this Appendix. Where relevant, savings associations are encouraged to give further information about mitigants that have not been recognized for that purpose.

⁶⁸ Credit derivatives that are treated, for the purposes of this Appendix, as synthetic securitization exposures should be excluded from the credit risk mitigation disclosures and included within those relating to securitization.

⁶⁹ Counterparty credit risk-related exposures disclosed pursuant to Table 11.6 should be excluded from the credit risk mitigation disclosures in Table 11.7.

⁷⁰ For example: Originator, investor, servicer, provider of credit enhancement, sponsor of asset backed commercial paper facility, liquidity provider, swap provider.

⁷¹ Underlying exposure types may include, for example, 1–4 family residential loans, from equity lines, credit card receivables, and auto loans.

⁷² Securitization transactions in which the originating savings association does not retain any

securitization exposure should be shown separately but need only be reported for the year of inception.

⁷³ Where relevant, a savings association is encouraged to differentiate between exposures resulting from activities in which they act only as sponsors, and exposures that result from all other savings association securitization activities.

⁷⁴ For example, charge-offs/allowances (if the assets remain on the savings association's balance sheet) or write-downs of I/O strips and other residual interests.

TABLE 11.10.—EQUITIES NOT SUBJECT TO MARKET RISK RULE

Qualitative Disclosures	(a) The general qualitative disclosure requirement with respect to equity risk, including: • Differentiation between holdings on which capital gains are expected and those taken under other objectives including for relationship and strategic reasons; and • Discussion of important policies covering the valuation of and accounting for equity holdings in the banking book. This includes the accounting techniques and valuation methodologies used, including key assumptions and practices affecting valuation as well as significant changes in these practices.
Quantitative Disclosures	(b) Value disclosed in the balance sheet of investments, as well as the fair value of those investments; for quoted securities, a comparison to publicly-quoted share values where the share price is materially different from fair value. (c) The types and nature of investments, including the amount that is: • Publicly traded; and • Non-publicly traded. (d) The cumulative realized gains (losses) arising from sales and liquidations in the reporting period. (e) Total unrealized gains (losses); ⁷⁵ • Total latent revaluation gains (losses);⁷⁶ and • Any amounts of the above included in tier 1 and/or tier 2 capital. (f) Capital requirements broken down by appropriate equity groupings, consistent with the savings association's methodology, as well as the aggregate amounts and the type of equity investments subject to any supervisory transition regarding regulatory capital requirements. ⁷⁷

TABLE 11.11.—INTEREST RATE RISK FOR NON-TRADING ACTIVITIES

Qualitative disclosures	(a) The general qualitative disclosure requirement, including the nature of interest rate risk for non-trading activities and key assumptions, including assumptions regarding loan prepayments and behavior of non-maturity deposits, and frequency of measurement of interest rate risk for non-trading activities.
Quantitative disclosures	(b) The increase (decline) in earnings or economic disclosures value (or relevant measure used by management) for upward and downward rate shocks according to management's method for measuring interest rate risk for non-trading activities, broken down by currency (as appropriate).

* * * *

Dated: September 5, 2006.

John C. Dugan,*Comptroller of the Currency.*

By order of the Board of Governors of the Federal Reserve System, September 11, 2006.

Jennifer J. Johnson,*Secretary of the Board.*

Dated at Washington, DC, this 5th day of September, 2006.

By order of the Board of Directors.

Federal Deposit Insurance Corporation.

Robert E. Feldman,*Executive Secretary.*

Dated: September 5, 2006.

By the Office of Thrift Supervision.

John M. Reich,*Director.*

[FR Doc. 06-7656 Filed 9-22-06]

BILLING CODES 4810-33-P, 6210-01-P, 6714-01-P, 6720-01-P

DEPARTMENT OF THE TREASURY**Office of the Comptroller of the Currency****12 CFR Part 3****[Docket No. 06-10]****RIN 1557-AC99****FEDERAL RESERVE SYSTEM****12 CFR Parts 208 and 225****[Regulations H and Y; Docket No. R-1266]****FEDERAL DEPOSIT INSURANCE CORPORATION****12 CFR Part 325****RIN 3064-AD10****DEPARTMENT OF THE TREASURY****Office of Thrift Supervision****12 CFR Part 566****[Docket No. 2006-34]****RIN 1550-AC02****Risk-Based Capital Standards: Market Risk**

AGENCIES: Office of the Comptroller of the Currency, Treasury; Board of Governors of the Federal Reserve System; Federal Deposit Insurance

Corporation, and Office of Thrift Supervision, Treasury.

ACTION: Joint notice of proposed rulemaking.

SUMMARY: The Office of the Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve System (Board), and the Federal Deposit Insurance Corporation (FDIC) are proposing revisions to the market risk capital rule to enhance its risk sensitivity and introduce requirements for public disclosure of certain qualitative and quantitative information about the market risk of a bank or bank holding company. The Office of Thrift Supervision (OTS) currently does not apply a market risk capital rule to savings associations and is proposing in this notice a market risk capital rule for savings associations. The proposed rules for each agency are substantively identical.

DATES: Comments must be received on or before January 23, 2007.

ADDRESSES: Comments should be directed to:

OCC: You should include OCC and Docket Number 06-10 in your comment.

⁷⁵ Unrealized gains (losses) recognized in the balance sheet but not through earnings.

⁷⁶ Unrealized gains (losses) not recognized either in the balance sheet or through earnings.

⁷⁷ This disclosure should include a breakdown of equities that are subject to the 0%, 20%, 100%, 300%, and 400% risk weights, as applicable.

You may submit comments by any of the following methods:

- **Federal eRulemaking Portal:** <http://www.regulations.gov>. Follow the instructions for submitting comments.

- **OCC Web Site:** <http://www.occ.treas.gov>. Click on "Contact the OCC," scroll down and click on "Comments on Proposed Regulations."

- **E-mail address:** regs.comments@occ.treas.gov.

- **Fax:** (202) 874-4448.
- **Mail:** Office of the Comptroller of the Currency, 250 E Street, SW., Mail Stop 1-5, Washington, DC 20219.

- **Hand Delivery/Courier:** 250 E Street, SW., Attn: Public Information Room, Mail Stop 1-5, Washington, DC 20219.

Instructions: All submissions received must include the agency name (OCC) and docket number or Regulatory Information Number (RIN) for this notice of proposed rulemaking. In general, OCC will enter all comments received into the docket without change, including any business or personal information that you provide. You may review comments and other related materials by any of the following methods:

- **Viewing Comments Personally:** You may personally inspect and photocopy comments at the OCC's Public Information Room, 250 E Street, SW, Washington, DC. You can make an appointment to inspect comments by calling (202) 874-5043.

Board: You may submit comments, identified by Docket No. R-1265, by any of the following methods:

- **Agency Web site:** <http://www.Federalreserve.gov>. Follow the instructions for submitting comments on the <http://www.Federalreserve.gov/generalinfo/foia/ProposedRegs.cfm>.

- **Federal eRulemaking Portal:** <http://www.regulations.gov>. Follow the instructions for submitting comments.

- **E-mail:** regs.comments@Federalreserve.gov. Include docket number in the subject line of the message.

- **FAX:** (202) 452-3819 or (202) 452-3102.

- **Mail:** Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, NW., Washington, DC 20551.

All public comments are available from the Board's Web site at <http://www.Federalreserve.gov/generalinfo/foia/ProposedRegs.cfm> as submitted, unless modified for technical reasons. Accordingly, your comments will not be edited to remove any identifying or contact information. Public comments may also be viewed electronically or in

paper form in Room MP-500 of the Board's Martin Building (20th and C Streets, NW.) between 9 a.m. and 5 p.m. on weekdays.

FDIC: You may submit written comments, identified by RIN number, by any of the following methods:

- **Agency Web site:** <http://www.fdic.gov/regulations/laws/federal/propose.html>. Follow the instructions for submitting comments on the FDIC Web site.

- **Federal eRulemaking Portal:** <http://www.regulations.gov>. Follow the instructions for submitting comments.

- **E-mail:** comments@FDIC.gov. Include the RIN number in the subject line of the message.

- **Mail:** Robert E. Feldman, Executive Secretary, Attention: Comments, Federal Deposit Insurance Corporation, 550 17th Street, NW., Washington, DC 20429.

- **Hand Delivery/Courier:** Guard station at rear of the 550 17th Street Building (located on F Street) on business days between 7 a.m. and 5 p.m.

Instructions: All submissions received must include the agency name and RIN number for this rulemaking. All comments received will be posted without change to <http://www.fdic.gov/regulations/laws/federal/propose.html> including any personal information provided. Comments may be inspected at the FDIC Public Information Center, Room E-1002, 3502 Fairfax Drive, Arlington, VA, 22226, between 9 a.m. and 5 p.m. on business days.

OTS: You may submit comments, identified by No. 2006-34 by any of the following methods:

- **Federal eRulemaking Portal:** <http://www.regulations.gov>. Follow the instructions for submitting comments.

- **E-mail address:** regs.comments@ots.treas.gov. Please include No. 2006-34 in the subject line of the message and include your name and telephone number in the message.

- **Fax:** (202) 906-6518.
- **Mail:** Regulation Comments, Chief Counsel's Office, Office of Thrift Supervision, 1700 G Street, NW., Washington, DC 20552, Attention: No. 2006-34.

- **Hand Delivery/Courier:** Guard's Desk, East Lobby Entrance, 1700 G Street, NW., from 9 a.m. to 4 p.m. on business days, Attention: Regulation Comments, Chief Counsel's Office, No. 2006-34.

Instructions: All submissions received must include the agency name and docket number or Regulatory Information Number (RIN) for this rulemaking. All comments received will be posted without change to the OTS Internet Site at <http://www.ots.treas.gov/pagehtml.cfm?catNumber=67&an=1>,

including any personal information provided.

Docket: For access to the docket to read background documents or comments received, go to <http://www.ots.treas.gov/pagehtml.cfm?catNumber=67&an=1>. In addition, you may inspect comments at the Public Reading Room, 1700 G Street, NW., by appointment. To make an appointment for access, call (202) 906-5922, send an e-mail to public.info@ots.treas.gov, or send a facsimile transmission to (202) 906-7755. (Prior notice identifying the materials you will be requesting will assist us in serving you.) We schedule appointments on business days between 10 a.m. and 4 p.m. In most cases, appointments will be available the next business day following the date we receive a request.

FOR FURTHER INFORMATION CONTACT:

OCC: Margot Schwadron, Risk Expert, Capital Policy (202-874-6022) or Ron Shimabukuro, Special Counsel, Legislative and Regulatory Activities Division, (202-874-5090).

Board: Barbara Bouchard, Deputy Associate Director (202-452-3072 or barbara.bouchard@frb.gov), Mary Frances Monroe, Manager (202-452-5231 or mary.f.monroe@frb.gov), or Anna Lee Hewko, Senior Supervisor Financial Analyst, (202-530-6260 or anna.hewko@frb.gov), Division of Banking Supervision and Regulation; or Allison Breault, Attorney (202-452-3124 or allison.breault@frb.gov), Legal Division. For users of Telecommunications Device for the Deaf ("TDD") only, contact (202-263-4869).

FDIC: Jason C. Cave, Associate Director (202-898-3548), Gloria Ikosi, Senior Quantitative Risk Analyst (202-898-3997), or Karl R. Reitz, Financial Analyst (202-898-3857), Capital Markets Branch, Division of Supervision and Consumer Protection; or Michael B. Phillips, Counsel, (202-898-3581), or Benjamin W. McDonough, Attorney (202-898-7411), Supervision and Legislation Branch, Legal Division.

OTS: Michael D. Solomon, Director, Capital Policy (202-906-5654), Austin Hong, Senior Analyst (202-906-6389), Christine A. Smith, Program Manager (202-906-5740) or Karen Osterloh, Special Counsel, Regulations and Legislation Division (202-906-6639).

SUPPLEMENTARY INFORMATION:

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I. Introduction

A. Background

The first international capital framework for banks¹ entitled, *International Convergence of Capital Measurement and Capital Standards* (1988 Capital Accord), was developed by the Basel Committee on Banking Supervision (BCBS)² and endorsed by the G-10 governors in 1988. The OCC, the Board, the FDIC, and the OTS (collectively, the agencies) implemented the 1988 Capital Accord in 1989. In 1996, the BCBS amended the 1988 Capital Accord to require banks to measure and hold capital to cover their exposure to market risk associated with foreign exchange and commodity

positions and positions located in the trading account (the Market Risk Amendment or MRA). The OCC, Board, and FDIC implemented the MRA effective January 1, 1997 (market risk capital rule).³

In June 2004, the BCBS issued a final text of a revised regulatory capital framework for banks entitled, *International Convergence of Capital Measurement and Capital Standards: A Revised Framework* (New Accord), which was intended for use by individual countries as the basis for national consultation and implementation. The New Accord sets forth a “three pillar” framework encompassing (1) minimum risk-based capital requirements for credit risk, market risk, and operational risk; (2) supervisory review of capital adequacy; and (3) market discipline through enhanced public disclosures. The changes to the capital framework for credit and operational risks are the subject of the agencies’ Notice of Proposed Rulemaking published elsewhere in today’s **Federal Register** (proposed advanced capital adequacy framework).⁴

For market risk, the New Accord generally retains the approach contained in the MRA. However, in releasing the New Accord, the BCBS announced that work would continue on the treatment of double default effects in the New Accord and that improvements to the MRA would be developed immediately, especially with respect to the treatment of specific risk. Given the interest of both banks and securities firms in this issue, the BCBS worked jointly with the International Organization of Securities Commissions (IOSCO) on this effort, which culminated in the July 2005 publication of *The Application of Basel II to Trading Activities and the Treatment of Double Default Effects* by the BCBS and IOSCO.⁵ The July 2005 publication is now incorporated in the New Accord and follows its “three pillar” structure. With respect to market risk, the Pillar 1 changes clarify the types of positions that are subject to the market risk capital framework and revise modeling standards; the Pillar 2 changes require banks to conduct internal assessments of their capital adequacy with respect to

market risk, taking into account the output of their internal models, valuation adjustments, and stress tests; and the Pillar 3 changes require banks to disclose quantitative and qualitative information on their valuation techniques for covered positions, the soundness standard they employ for modeling purposes, and the methodologies they use to make the internal capital adequacy assessment.

In this proposal, the OCC, Board, and FDIC are proposing to amend their market risk capital rules to implement the BCBS’s 2005 changes to the market risk capital rule. The OTS has not yet implemented a market risk capital rule for savings associations and is proposing such a rule in this NPR to ensure that savings associations with significant market risk measure this exposure and hold commensurate amounts of regulatory capital. The proposed rules will be substantively identical for each of the agencies, and in this NPR the agencies are publishing a common rule text with certain agency-specific text which appears at the end of the common preamble.

Section I.B of this preamble summarizes the current market risk capital rule and provides background information for banks and other readers that are not currently subject to or not familiar with the market risk capital rule. Part II of this preamble describes proposed revisions to the market risk capital rule. The effective date of any final rule associated with the proposed revisions to the market risk capital rule would be January 1, 2008, with certain exceptions described below.

B. Summary of the Current Market Risk Capital Rule

The current market risk capital rule supplements the general risk-based capital rules⁶ by requiring any bank subject to the rule to adjust its risk-based capital ratio to reflect explicitly market risk in its trading activities. The rule applies to a bank with worldwide, consolidated trading activity equal to at least 10 percent of total assets or \$1 billion. The primary Federal supervisor of a bank may generally apply the market risk capital rule to a bank or exempt a bank from application of the rule if the supervisor deems it necessary

¹ For simplicity, and unless otherwise indicated, this notice of proposed rulemaking (NPR) uses the term “bank” to include banks, savings associations, and bank holding companies (BHCs). The terms “bank holding company” and “BHC” refer only to bank holding companies regulated by the Board.

² The BCBS is a committee of banking supervisory authorities, which was established by the central bank governors of the G-10 countries in 1975. It consists of senior representatives of bank supervisory authorities and central banks from Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, the Netherlands, Spain, Sweden, Switzerland, the United Kingdom, and the United States. Publications of the BCBS, including the 1988 Capital Accord, the market risk amendment (and amendments thereto in 1997 and 2005), the New Accord, and the Trading Book Improvements (discussed later in this preamble) are available through the Bank for International Settlements Web site at <http://www.bis.org>.

³ 61 FR 47358 (September 6, 1996). The agencies’ implementing regulations are available at 12 CFR part 3, Appendices A and B (national banks), 12 CFR part 208, Appendices A and E (state member banks), 12 CFR part 225, Appendices A and E (bank holding companies), and 12 CFR part 325, Appendices A and C (state nonmember banks).

⁴ FR _____ September 25, 2006.

⁵ The treatment of double default effects is discussed in section V.C.5 of the proposed advanced capital adequacy framework.

⁶ The agencies’ general risk-based capital rules are at 12 CFR part 3, Appendix A (national banks); 12 CFR part 208, Appendix A (state member banks); 12 CFR part 225, Appendix A (bank holding companies); 12 CFR part 325, Appendix A (state nonmember banks); and 12 CFR part 567 (savings associations). For purposes of this preamble, credit risk capital rules refers to the general risk-based capital rules and the proposed advanced capital adequacy framework, as applicable to the bank applying the proposed rule.

or appropriate for safe and sound banking practices.

1. Covered Positions

The market risk capital rule requires a bank to maintain capital against the market risk of its covered positions. Covered positions are defined as all on- and off-balance sheet positions in the bank's trading account (as defined in the instructions to the Consolidated Reports of Condition and Income (Call Report) or FR Y-9C Consolidated Financial Statements for Bank Holding Companies (FR Y-9C)), and all foreign exchange and commodity positions, whether or not in the trading account. Covered positions exclude all positions in the trading account that, in form or substance, act as liquidity facilities that provide liquidity support to asset-backed commercial paper.

2. Capital Requirement for Market Risk

The market risk capital rule defines market risk as the risk of loss resulting from movements in market prices. Market risk consists of general market risk and specific risk components. General market risk is defined as changes in the market value of positions resulting from broad market movements, such as changes in the general level of interest rates, equity prices, foreign exchange rates, or commodity prices. Specific risk is defined as changes in the market value of a position due to factors other than broad market movements and includes event and default risk as well as idiosyncratic variations. Event risk is the risk of loss on a position that could result from sudden and unexpected large changes in market prices or specific events other than default of the issuer. Default risk is the risk of loss on a position that could result from the failure of an obligor to make timely payments of principal or interest on its debt obligation, and the risk of loss that could result from bankruptcy, insolvency, or similar proceeding. For credit derivatives, default risk means the risk of loss on a position that could result from the default of the reference exposures.

A bank that is subject to the market risk capital rule is required to use an internal model to calculate a value-at-risk (VaR)-based measure of its exposure to market risk. A bank's total risk-based capital requirement for covered positions generally consists of a VaR-based capital requirement plus an add-on for specific risk, if specific risk is not captured in the bank's internal model.⁷

A VaR-based capital requirement is one that is based on an estimate of the maximum amount that the value of one or more positions could decline during a fixed holding period within a stated confidence interval. A bank may determine its capital requirement for specific risk using a standard specific risk approach or, with supervisory approval, may use internal models to determine its capital requirement for specific risk.

3. Internal Models-Based Capital Requirement

In calculating the capital requirement for market risk, a bank is required to use an internal model that meets specified qualitative and quantitative criteria. The qualitative requirements reflect basic components of sound market risk management. For example, the current rule requires an independent risk control unit that reports directly to senior management and an internal risk measurement model that is integrated into the daily management process. The quantitative criteria include the use of a VaR-based measure based on a 99 percent, one-tailed confidence level. The VaR-based measure must be based on a price shock equivalent to a ten-business-day movement in rates or prices. Price changes estimated using shorter time periods must be adjusted to the ten-business-day standard. The minimum effective historical observation period for deriving the rate or price changes is one year and data sets must be updated at least quarterly or more frequently if market conditions warrant. For many types of covered positions it is appropriate for a bank to update its data sets more frequently than quarterly. In all cases a bank must have the capability to update its data sets more frequently than quarterly in anticipation of market conditions that would require such updating.

A bank need not employ a single model to calculate its VaR-based measure. A bank's internal model may use any generally accepted approach, such as variance-covariance models, historical simulations, or Monte Carlo simulations. However, the level of sophistication of the bank's internal model must be commensurate with the nature and size of the positions it covers. The internal model must use risk factors sufficient to measure the market risk inherent in all covered positions. The risk factors must address interest rate risk, equity price risk, foreign exchange rate risk, and commodity price risk.

so long as the techniques adequately measure associated market risk.

The market risk capital rule imposes backtesting requirements that must be calculated quarterly. A bank must compare its daily VaR-based measure for each of the preceding 250 business days against its actual daily trading profit or loss, which typically includes realized and unrealized gains and losses on portfolio positions as well as fee income and commissions associated with trading activities. If the quarterly backtesting shows that the bank's daily net trading loss exceeded its corresponding daily VaR-based measure, a backtesting exception has occurred. If a bank experiences more than four backtesting exceptions over the preceding 250 business days, it is generally required to apply a multiplication factor in excess of 3 when it calculates its risk-based capital ratio (see section I.B.5 of this preamble).

A bank subject to the market risk capital rule is also required to conduct stress tests to gain information about the impact of adverse market events on its positions. Specific stress testing methodologies are not prescribed.

4. Specific Risk

A bank may use an internal model to measure its exposure to specific risk if it has demonstrated to its primary Federal supervisor that the model measures the specific risk, including event and default risk, as well as idiosyncratic variations, of its covered debt and equity positions. A bank that incorporates specific risk in its internal model but fails to demonstrate that the model adequately measures all aspects of specific risk for covered debt and equity positions, including event and default risk, is subject to a specific risk add-on. If the bank can validly separate its VaR-based measure into a specific risk portion and a general market risk portion, the add-on is equal to the previous day's specific risk portion. If the bank cannot separate the VaR-based measure into a specific risk portion and a general market risk portion, the add-on is equal to the sum of the previous day's VaR-based measures for subportfolios of covered debt and equity positions that contain specific risk.

If the bank does not model specific risk, it must calculate its specific risk capital requirement, termed an add-on, using the standard approach. Under the standard approach for specific risk, the specific risk add-on for covered debt positions is calculated by multiplying the absolute value of the current market value of each net long or short debt position by the appropriate specific risk weighting factor in the rule. The specific risk weighting factor ranges from zero to 8 percent and is based on the identity

⁷ The primary Federal supervisor of a bank may also permit the use of alternative techniques to measure the market risk of *de minimis* exposures

of the obligor, and in the case of some positions, the credit rating and remaining contractual maturity of the position. Derivative instruments are risk-weighted according to the market value of the effective notional amount of the relevant underlying position. A bank may net long and short identical debt positions (including derivatives) with exactly the same issuer, coupon, currency, and maturity. A bank may also offset a matched position in a derivative and its corresponding underlying instrument.

Under the standard approach, the specific risk add-on for covered equity positions is the sum of the bank's long and short equity positions, multiplied by a specific risk-weighting factor. A bank may net long and short positions (including derivatives) in identical equity issues or equity indices in the same market. The standard specific risk add-on is 8 percent of the net equity position, unless the bank's portfolio is both liquid and well-diversified, in which case the add-on is 4 percent.⁸ For positions that are index contracts comprising a well-diversified portfolio of equities, the specific risk add-on is 2 percent of the net long or short position in the index.⁹

5. Calculation of the Risk-Based Capital Ratio

A bank subject to the market risk capital rule must calculate its adjusted risk-based capital ratios as follows. First the bank must calculate its adjusted risk-weighted assets, which equals its risk-weighted assets calculated under the general risk-based capital rule excluding the risk-weighted amounts of covered positions (except foreign exchange positions held outside the trading account and over-the-counter derivative instruments) and cash-

secured securities borrowing receivables that meet the criteria of the market risk capital rule.¹⁰

The bank next must calculate its measure for market risk, which equals the sum of the VaR-based capital requirement for market risk, the specific risk add-on (if any), and the capital requirement for *de minimis* exposures (if any). The VaR-based capital requirement equals the higher of (i) the previous day's VaR-based measure, and (ii) the average of the daily VaR-based measures for each of the preceding 60 business days multiplied by three, or such higher multiplier as may be required under the backtesting requirements of the market risk capital rule. The measure for market risk is multiplied by 12.5 to calculate market-risk-equivalent assets. The market-risk-equivalent assets are added to adjusted risk-weighted assets to compute the bank's risk-based capital ratio denominator.

To calculate the numerator, the bank must allocate tier 1 and tier 2 capital equal to 8 percent of adjusted risk-weighted assets, and further allocate excess tier 1, excess tier 2, and tier 3¹¹ capital equal to the measure for market risk. The sum of tier 2 and tier 3 capital allocated for market risk may not exceed 250 percent of tier 1 capital. As a result, tier 1 capital must equal at least 28.6 percent of the measure for market risk. The sum of tier 2 (both allocated and excess) and allocated tier 3 capital may not exceed 100 percent of tier 1 capital (both allocated and excess). Term subordinated debt and intermediate-term preferred stock and related surplus included in tier 2 capital (both allocated and excess) may not exceed 50 percent of tier 1 capital (both allocated and excess). The sum of tier 1 and tier 2 capital (both allocated and excess) and allocated tier 3 capital is the bank's total risk-based capital numerator.

II. Proposed Revisions to the Market Risk Capital Rule

A. Objectives of the Proposed Revisions

The key objectives of the proposed revisions to the current market risk

capital rule are to enhance the rule's sensitivity to risks that are not adequately captured in the current methodologies of the rule, to enhance modeling requirements consistent with advances in risk management since the initial implementation of the MRA nearly 10 years ago, and to modify the definition of covered position to better capture positions for which the market risk capital rule is appropriate. The objective of enhancing the risk sensitivity of the rule reflects the growth in traded credit products, such as credit default swaps and tranches of collateralized debt obligations, other structured products, and less liquid products. The risks of these products are not adequately captured in current VaR models and are not fully reflected in a 10-business-day, 99 percent confidence level soundness standard.

The growth in traded credit products has given rise to an increase in default risks that should be captured in a capital requirement for specific risk but have proved difficult to capture adequately with current specific risk models. Other structured and less liquid products may give rise to risks that were not entirely contemplated when the market risk capital rule was first adopted. Moreover, concentration risk may not be adequately reflected in a VaR-based framework, especially when banks rely on proxies to capture the risks of actual holdings. Therefore, the agencies propose to implement an incremental default risk capital requirement for a bank that models specific risk for one or more portfolios of covered positions and to require the consideration of liquidity and concentration risks in that requirement and in the bank's stress tests and internal assessment of capital adequacy. In addition, to address the agencies' concerns about appropriate treatment of covered positions with limited price transparency, the agencies propose to require banks to have a well-defined valuation process for all covered positions. The specific proposals are discussed below.

B. Description of the Proposed Revisions to the Market Risk Capital Rule

1. Scope

With the exception of the addition of savings associations, the proposed revisions to the market risk capital rule would not change the set of banks to which the rule applies. Thus, the proposed rule would continue to apply to any bank with aggregate trading assets and liabilities equal to 10 percent or more of total assets, or \$1 billion or more. The proposed revisions would

⁸ Under the current market risk capital rule, a portfolio is liquid and well-diversified if: (i) It is characterized by a limited sensitivity to price changes of any single equity issue or closely related group of equity issues held in the portfolio; (ii) the volatility of the portfolio's value is not dominated by the volatility of any individual equity issue or by equity issues from any single industry or economic sector; (iii) it contains a large number of individual equity positions, with no single position representing a substantial portion of the portfolio's total market value; and (iv) it consists mainly of issues traded on organized exchanges or in well-established over-the-counter markets.

⁹ In addition, for futures contracts on broadly based indices that are matched by offsetting equity baskets, a bank may apply a two percent specific risk requirement to the futures and stock basket positions if the basket comprises at least 90 percent of the capitalization of the index. The two percent specific risk requirement applies to only one side of certain futures-related arbitrage strategies when either: (i) the long and short positions are in exactly the same index at different dates or in different markets; or (ii) the long and short positions are in different but similar indices at the same date.

¹⁰ See 71 FR 8932 (February 22, 2006).

¹¹ Tier 1 and tier 2 capital are defined in the general risk-based capital rules. Tier 3 capital is subordinated debt that is unsecured, is fully paid up, has an original maturity of at least two years, is not redeemable before maturity without prior approval by the primary Federal supervisor, includes a lock-in clause precluding payment of either interest or principal (even at maturity) if the payment would cause the issuing bank's risk-based capital ratio to fall or remain below the minimum required under the credit risk capital rules, and does not contain and is not covered by any covenants, terms, or restrictions that are inconsistent with safe and sound banking practices.

apply to a bank meeting the market risk capital rule applicability threshold regardless of whether the bank would adopt the proposed advanced capital adequacy framework or remain under the general risk-based capital rule. Question 1: The agencies seek comment on the thresholds for the application of the market risk capital rule and, if they should be changed, on what appropriate thresholds might be.

The primary Federal supervisor of a bank that does not meet the threshold criteria may apply the market risk capital rule to the bank if the supervisor deems it necessary or appropriate given the level of market risk of the bank or to ensure safe and sound banking practices. A bank that does not meet the threshold criteria may request that its primary Federal supervisor apply the market risk capital rule to it. A primary Federal supervisor may also exclude a bank that meets the threshold criteria from the rule if appropriate based on the level of market risk of the bank and provided such exemption would be consistent with safe and sound banking practices.

2. Reservation of Authority

The proposed rule would contain a reservation of authority that affirms the authority of a bank's primary Federal supervisor to require the bank to hold an overall amount of capital greater than would otherwise be required under the rule if the supervisor determines that the bank's risk-based capital requirements under the rule are not commensurate with the market risk of the bank's covered positions. In addition, the agencies anticipate that there may be instances when the proposed rule generates a risk-based capital requirement for a specific covered position or portfolio of covered positions that is not commensurate with the risks posed by such exposures. In these cases, a bank's primary Federal supervisor may require the bank to assign a different risk-based capital requirement to the covered position or portfolio of covered positions that better reflects the risk of the position or portfolio. The proposed rule also would provide authority for a bank's primary Federal supervisor to require the bank to calculate capital requirements for specific positions or portfolios under the market risk capital rule or under the credit risk capital rule to more accurately reflect the risks of the positions. Any agency that exercises this reservation of authority would notify each of the other agencies of its determination.

3. Modification of the Definition of Covered Position

The NPR modifies the definition of a covered position to include only trading assets and trading liabilities (as reported on schedule RC-D of the Call Report, Schedule HC-D of the Consolidated Financial Statements for Bank Holding Companies, or as defined in the instructions to the Thrift Financial Report) that are trading positions. The definition also includes trading assets and liabilities that hedge covered positions. In addition, the trading asset or liability must be free of any restrictive covenants on its tradability or the bank must be able to hedge its material risk elements in a two-way market. A trading position would be defined as a position that is held by the bank for the purpose of short-term resale or with the intent of benefiting from actual or expected price movements or to lock in arbitrage profits. The proposed definition of a trading position recognizes that the accounting definition of trading assets and liabilities includes positions that are not held with the intent or ability to trade.

A trading asset or liability that hedges a trading position is a covered position only if the hedge is within the scope of the bank's hedging strategy (discussed below). The agencies encourage the sound risk management of trading positions and therefore include hedges that offset their risk in the definition of covered position and thus in the measure for market risk. The agencies are concerned, however, that a bank could craft its hedging strategies in order to bring non-trading positions that are more appropriately treated under the credit risk capital rules into the bank's covered positions. The agencies will scrutinize a bank's hedging strategies to ensure that they are not being manipulated in this manner. For example, mortgage-backed securities that are not held with the intent to trade, but that are hedged with interest rate swaps to mitigate interest rate risk, would be subject to the credit risk capital rules. *Question 2: The agencies request comment on all aspects of the proposed definition of covered position. The agencies are particularly interested in comment on additional safeguards that the agencies might implement to prevent abuse of the hedge component of the definition of covered position and increase transparency for supervisors.*

Consistent with the current definition, a covered position also would include any foreign exchange or commodity position, whether or not a trading asset or trading liability. With prior supervisory approval a bank could

exclude any structural position in a foreign currency.¹²

Also consistent with the current rule, the definition of a covered position would explicitly exclude any position that, in form or substance, acts as a liquidity facility that provides support to asset-backed commercial paper. In addition, under the proposed rule the definition of covered position would exclude any intangible asset, including any servicing asset. Intangible assets are excluded from the definition of covered position because their risks are explicitly addressed in the credit risk capital rules, generally through deduction from capital.

In addition, under the proposed rule, a credit derivative recognized as a guarantee for risk-weighted asset amount calculation purposes under the credit risk capital rules¹³ used to hedge a position that is not a covered position (for example, a credit derivative hedge of a loan that is not a covered position) would be excluded from the definition of a covered position. This would require the bank to include the credit derivative in its risk-based capital measure for credit risk and exclude it from its VaR-based measure for market risk. The proposed treatment of a credit derivative hedge for regulatory capital purposes would avoid the mismatch that arises when the hedged position (for example, a loan) is not a covered position and the credit derivative hedge is a covered position. This mismatch has the potential to inflate the VaR-based measure of market risk because only one side of the transaction is reflected in that measure. *Question 3: The agencies request comment on whether there is a better approach that matches more effectively the true economic impact of these transactions.*

A similar distortion of the VaR-based measure may arise in the context of interest rate risk. Some banks manage their interest rate risk on a portfolio basis without distinguishing between

¹² Structural foreign currency positions include positions designed to hedge a bank's capital ratios against the effect of adverse exchange rate movements on (1) subordinated debt, equity, or minority interests in consolidated subsidiaries and capital assigned to foreign branches that are denominated in foreign currencies, and (2) any positions related to unconsolidated subsidiaries and other items that are deducted from an institution's capital when calculating its capital base.

¹³ See 12 CFR part 3, section 3 (national banks); 12 CFR part 208, Appendix A, section II.B (state member banks); 12 CFR part 225, Appendix A, section II.B (bank holding companies); 12 CFR part 325, Appendix A, section II.B.3 (state nonmember banks); 12 CFR part 567.6 (savings associations). The treatment of guarantees is described in sections 33 and 34 of the proposed advanced capital adequacy framework and discussed in section V.C.5 of the framework's preamble.

covered and noncovered positions by using interest rate derivatives with external third parties that are covered positions under the market risk capital rule.¹⁴ The interest rate derivatives hedge the interest rate risk of covered and noncovered positions together; however, only the covered positions are included in the bank's VaR-based measure. This may result in a regulatory capital requirement that does not appropriately reflect the interest rate risk of all of the offsetting transactions. This problem would not exist for interest rate derivatives that are direct hedges of noncovered positions because, under the proposed definition of covered position, the interest rate derivative would not be a covered position. *Question 4: The agencies request comment on the extent and materiality of any distortion of the VaR-based measure due to the inclusion of some, but not all, offsetting transactions, and on any appropriate approaches to address this distortion in the final rule, including, subject to certain restrictions, (1) permitting a bank to include in its VaR-based measure the interest rate risk associated with certain noncovered positions that are hedged by covered positions (while remaining subject to a credit risk capital requirement for the noncovered positions) or (2) permitting a bank to include in its VaR-based measure certain internal interest rate derivatives hedging noncovered positions. The agencies also request comment on any operational considerations such approaches would entail.*

Under the proposed rule, the definition of a covered position would exclude any securitization position that is a residual securitization position,¹⁵ subject to a limited market maker exception. The market maker exception would permit these securitization positions to be included as covered positions only upon a determination by the bank's primary Federal supervisor that: (i) A two-way market exists for the

securitization position, or in the case of a securitization position that relies solely on credit derivatives, for the securitization position or all of its material risk components; (ii) the bank holds itself out as ready to buy or sell these securitization positions for its own account on a regular and continuous basis at a quoted price, (iii) the bank's internal models fully capture the general market risk and specific risks of its securitization positions and sufficient market data are available to model these risks reliably; and (iv) the bank has adequate internal systems and controls for the trading of securitization positions.

The general exclusion of these securitization positions from the definition of covered position provides a capital treatment for these positions that is appropriate for their risk. The agencies recognize, however, that a bank may be an active market maker in these securitization positions and may have the models and internal controls capacity to capture the risk of these positions in the bank's VaR-based measure of market risk. The agencies also note that positions that meet the definition of a residual securitization position might be different for a bank that is subject to the proposed advanced capital adequacy framework than for a bank that is subject to the general risk-based capital rules. *Question 5: The agencies seek comment on the proposed definition of residual securitization position, and on the market maker exception and the conditions to use that exception. With respect to positions that do not qualify for the market maker exception, the agencies request comment on the treatment of those positions under the credit risk capital rules and whether such treatment could give rise to any operational or other issues.*

4. Requirements for the Identification of Trading Positions and Management of Covered Positions

The proposal introduces new requirements for the identification of trading positions and the management of covered positions. The agencies believe that these new requirements are warranted based on the trend towards the inclusion of more credit risk-related, less liquid, and less actively traded products in banks' covered positions. The risks of these positions may not be fully reflected in the requirements of the market risk capital rule and may be more appropriately captured under the credit risk capital rules.

A bank would be required to have clearly defined policies and procedures for determining which of its trading

assets and trading liabilities are trading positions. In determining the scope of trading positions, the bank would be required to consider (i) the extent to which a position (or a hedge of its material risks) could be marked-to-market daily by reference to a two-way market, and (ii) possible impairments to the liquidity of a position.

In addition, the bank must have clearly defined trading and hedging strategies. The bank's trading and hedging strategies for its trading positions must be approved by senior management. The trading strategy must articulate the expected holding period of and the market risk associated with each portfolio of trading positions. The trading strategy must also articulate whether the purpose of each portfolio of trading positions is to accommodate customer flow, to engage in proprietary trading, or to make a market in the positions. The hedging strategy must articulate for each portfolio the level of market risk the bank is willing to accept and must detail the instruments, techniques, and strategies the bank will use to hedge the risk of the portfolio. The hedging strategy must clearly articulate which positions are being hedged and which positions serve as hedging instruments.

A bank would be required to have clearly defined policies and procedures for actively managing all covered positions. In the context of nontraded commodities and foreign exchange positions, active management could focus on managing the risks of those positions within the bank's risk limits. For all covered positions, these policies and procedures would be required to address, at a minimum, marking positions to market or model on a daily basis; assessing on a daily basis the bank's ability to hedge position and portfolio risks and the extent of market liquidity; and the establishment and daily monitoring of position limits by a risk control unit independent of the trading business unit. Senior management would be required to monitor all of this information on a daily basis. The policies and procedures would be required to provide for reassessment by senior management of established position limits on at least an annual basis, as well as annual assessments by qualified personnel of the quality of market inputs to the valuation process, the soundness of key assumptions, the reliability of parameter estimation in pricing models, and the stability and accuracy of model calibration under alternative market scenarios. *Question 6: The agencies seek comment on these requirements and on whether different or additional policies*

¹⁴ Only transactions with external third parties are covered positions because only such transactions are trading assets and liabilities for consolidated reporting purposes. Internal transactions, such as an interest rate derivative between a bank's treasury function and its trading desk, are not covered positions.

¹⁵ A residual securitization position is any securitization position subject to deduction under the proposed advanced capital adequacy framework or subject to the following provisions under the general risk-based capital rules: 12 CFR part 3, Appendix A, sections 4 (b) and (f) (national banks); 12 CFR part 208, Appendix A.III.B.3.b and III.B.3.e (State member banks); 12 CFR part 225, Appendix A.III.B.3.b and III.B.3.e (bank holding companies); 12 CFR part 325, Appendix A.II.B.5 (state nonmember banks); and 12 CFR 567.6(b)(1) and (2) (savings associations).

and procedures would be beneficial for ensuring appropriate identification of positions to which the market risk capital rule should be applied and appropriate risk management of covered positions.

The proposal introduces new requirements for the prudent valuation of covered positions that include policies and procedures on position valuation, marking to market or model, independent price verification, and valuation adjustments or reserves. The valuation process would be required to consider, as appropriate, unearned credit spreads, close-out costs, early termination, investing and funding costs, future administrative costs, liquidity, and model risk. These new valuation requirements reflect the agencies' concerns about possible shortcomings in the valuation of less liquid trading positions, especially in light of the historical focus of the market risk capital rule on a 10-business-day time horizon and a 99 percent confidence level, which may be inadequate to reflect the full extent of the risks of less liquid positions.

5. Requirements for Internal Models in General

As under the current market risk capital rule, a bank would be required to use one or more internal models to calculate a daily VaR-based measure that reflects general market risk for all covered positions. The daily VaR-based measure may also reflect the bank's specific risk for one or more portfolios of covered debt or equity positions. The requirements for internal models are discussed below.

Model Use Requirements. The proposed revisions would specify that a bank must receive the prior written approval of its primary Federal supervisor before using any internal model to calculate its risk-based capital requirement for market risk and before extending the use of a model for which it has received prior written approval to an additional business line or product type. A bank would also be required to notify its primary Federal supervisor promptly if it makes any changes to its internal models that would result in a material change in the bank's risk-weighted asset amount for a portfolio or when the bank makes any material change to its modeling assumptions. The bank's primary Federal supervisor could rescind its approval, in whole or in part, of the use of any internal model if it determines that the model no longer complies with the market risk capital rule or fails to reflect accurately the risks of the bank's covered positions. For example, if adverse market events or

other developments reveal that a material assumption in a bank's approved model is flawed, a primary Federal supervisor may require the bank to revise its model assumptions and resubmit the model specifications for review by the supervisor.

Factors and Risks Reflected in Models. As is the case under the current rule, a bank would be required to integrate its internal models into its daily risk management process, and the level of sophistication of a bank's models would need to be commensurate with the nature and size of its covered positions. The internal models used by a bank are required to capture all material risks, including basis and prepayment risks. The proposed revisions add credit spread risk to the list of risk factors required to be captured as appropriate under the current rule (that is, in addition to interest rate risk, equity price risk, foreign exchange rate risk, and commodity price risk). Under the current rule, a bank that has material exposure to credit spread, basis, or prepayment risks should be capturing those risks in its internal model. In the proposed revisions, the agencies decided to specifically enumerate these risks to stress their importance in light of the growth of traded credit products and products with prepayment or basis risk at banks since the current rule was adopted. The proposed revisions would require risks arising from less liquid positions and positions with limited price transparency to be modeled conservatively under realistic market scenarios.

The agencies are concerned that certain covered positions, especially securitization positions, may contain prepayment risk that is not adequately captured in the VaR-based measure of market risk. Prepayment risk is the risk of loss to holders of debt exposures arising from the repayment of principal differing from the expected or scheduled principal repayment. The agencies recognize that the VaR-based measure may capture a portion of prepayment risk for positions as potential changes in the value of positions due to interest rate risk. However, the agencies question the degree to which interest rate volatility over the 10-business-day horizon adequately captures prepayment risk associated with positions that are subject to significant levels of prepayment. The agencies also recognize that complete models of prepayment include pool and security-specific factors that are not easily incorporated or modeled in daily calculations of a VaR-based measure.

Question 7: *The agencies request comment on all aspects of prepayment risk, including the extent and materiality of prepayment risk, whether material prepayment risk may warrant a further explicit requirement that banks hold capital against prepayment risk over a one-year horizon under both the internal models and standard approaches to specific risk, and the interplay between prepayment risk and default risk for purposes of determining the bank's overall measure for market risk. The agencies also seek comment on how an explicit capital requirement for prepayment risk could be designed.*

The proposed rule also requires a bank to have a rigorous process for reestimation, reevaluation and updating of its models to ensure continued applicability and relevance. Further, the proposed rule would continue to require models to include risks arising from the nonlinear price characteristics of option positions, and to incorporate empirical correlations across and within risk factors.

Quantitative Requirements for VaR-Based Measure. The proposed rule includes the same quantitative requirements for the VaR-based measure as the current market risk capital rule with respect to daily computations, the one-tailed, 99 percent confidence level, the 10-business-day holding period, and the one-year historical observation period.

The current market risk capital rule requires a bank to include in its VaR-based measure only covered positions. In contrast, the proposed revisions would allow residual securitization positions that are trading assets or liabilities and term repo-style transactions to be included in the VaR-based measure even though these positions may not be included within the definition of a covered position. A term repo-style transaction would be defined as a repurchase or reverse repurchase transaction or a securities borrowing or securities lending transaction with an original maturity in excess of one day, provided that, (i) the transaction is based solely on liquid and readily marketable securities or cash, (ii) the transaction is marked-to-market daily and subject to daily margin maintenance requirements, (iii) the transaction is executed under an agreement that provides certain rights of acceleration, termination, close-out, and set-off, and (iv) the bank has conducted and documented sufficient legal review to conclude that the agreement includes these rights and is legally binding. While repo-style transactions typically are close adjuncts to trading activities, Generally Accepted Accounting

Principles (GAAP) traditionally has not permitted companies to report them as trading assets or liabilities. Repo-style transactions included in the VaR-based measure will continue to be subject to the credit risk capital requirements in order to capture counterparty credit risks.

The agencies believe that residual securitization positions should be subject to the credit risk capital requirements. The agencies also recognize, however, that these positions may be hedged by covered positions and believe that it is appropriate to allow banks to recognize the hedge in calculating their VaR-based measures. Residual securitization positions even if included in the VaR-based measure will continue to be subject to the credit risk capital requirements. A bank may choose whether or not to include all residual securitization positions that are trading assets or liabilities or all term repo-style transactions in its VaR-based measure, and must choose whether or not to include them consistently over time.

Control, Oversight, and Validation Mechanisms. The proposed rule would continue the requirement that a bank have a risk control unit that reports directly to senior management and is independent of its business trading units. In addition, the proposed rule would impose specific model validation standards that are similar to the standards in the proposed advanced capital adequacy framework. A bank would be required to validate its internal models initially and on an ongoing basis. The validation process must be independent of the internal model development, implementation, and operation, or the validation process must be subject to an independent review of its adequacy and effectiveness. The review personnel must be independent of internal model development, implementation, and operation personnel, but not necessarily external to the bank.

Validation would include evaluation of the conceptual soundness of the internal models; an ongoing monitoring process that includes verification of processes and the comparison of the bank's model outputs with relevant internal and external data sources or estimation techniques; and an outcomes analysis process that includes the comparison of a bank's internal estimates with actual outcomes during a sample period not used in model development. The evaluation of conceptual soundness should include evaluation of empirical evidence and documentation supporting the methodologies used, important model

assumptions and their limitations, adequacy and robustness of empirical data used in parameter estimation and model calibration, and evidence of the model's strengths and weaknesses.

A comparison of the bank's model outputs with relevant internal and external data sources or estimation techniques is helpful to draw inferences about the performance of model outputs. Results of this comparison can be a valuable diagnostic tool in identifying potential weaknesses in a bank's model. As part of this comparison, the bank should investigate the source of any differences between the model estimates and the relevant internal or external data or estimation techniques and whether the extent of the differences is appropriate.

The proposed revisions expand upon the current market risk capital rule's stress testing requirement. Specifically, the proposed rule would require a bank to stress test the market risk of its covered positions at a frequency appropriate to the portfolio, and in no case less frequently than quarterly. The stress tests must take into account concentration risk, illiquidity under stressed market conditions, and other risks that may not be captured adequately in the bank's VaR-based measure of market risk. For example, it may be appropriate for a bank to include in its stress testing gapping of prices, one-way markets, non-linear or deep out-of-the-money products, jumps-to-default, or significant shifts in correlation. With respect to concentration risk, the relevant types include concentration by name, industry, sector, country, and market. Market concentration occurs when a bank holds a position that represents a concentrated share of the market for a security. A market concentration is a position that is so large, relative to the liquidity typically available in the market, that it requires a longer than usual liquidity horizon to liquidate the position without moving the market. A bank's primary Federal supervisor would evaluate the robustness and appropriateness of a bank's stress tests through the supervisory review process.

The bank would be required to have an internal audit function independent of business-line management that at least annually assesses the effectiveness of the controls supporting the bank's market risk measurement systems, including the activities of the business trading units and of the independent risk control unit, and compliance with policies and procedures. At least annually, internal audit should review the validation processes, including validation procedures, responsibilities,

results, timeliness, and responsiveness to findings. Further, internal audit should evaluate the depth, scope, and quality of the risk management system review process and conduct appropriate testing to ensure that the conclusions of these reviews are well founded.

Internal Assessment of Capital Adequacy. The proposed revisions include a requirement that a bank have a rigorous process for assessing its overall capital adequacy in relation to its market risk. The assessment must take into account market concentration and liquidity risks under stressed market conditions, as well as other risks that may not be captured appropriately in the VaR-based measure.

Documentation. A bank would be required to document adequately all material aspects of its internal models, the management and valuation of covered positions, its control, oversight, and validation mechanisms, and its internal assessment of capital adequacy. This documentation would facilitate the supervisory review process as well as the bank's internal audit or other review procedures.

Backtesting. The proposal modifies the regulatory backtesting framework for determining the multiplication factor based on the number of backtesting exceptions. Under the current market risk rule, a bank must compare its daily VaR-based measure to its actual daily trading profit or loss, which typically includes realized and unrealized gains and losses on portfolio positions as well as fee income and commissions associated with trading activities. Under the proposed rule, a bank would be required to compare its actual daily trading profit or loss excluding fees, commissions, reserves and net interest income to its daily VaR-based measure. These excluded components of trading profit and loss are not modeled as part of the VaR-based measure and excluding them will improve the accuracy of the backtesting and provide a better assessment of the bank's internal model. The agencies believe that bank trading and reporting systems have improved sufficiently to allow this type of backtesting.

As noted above, the proposal also imposes specific model validation standards that include outcomes analysis. The agencies expect that outcomes analysis used for model validation would include hypothetical backtesting, that is, comparison of the daily VaR-based measure to hypothetical changes in portfolio value that would occur if there were no intra-period changes. The hypothetical changes in portfolio value would exclude the effects of changes in

positions due to intraday trading, new positions, or other sources of intra-period changes, and also exclude fees, commissions, reserves and net interest income. *Question 8: The agencies request comment on the exclusion of fees, commissions, reserves, and net interest income for the trading profit or loss used for regulatory backtesting, including the appropriateness and feasibility of these exclusions, and whether additional items should also be excluded. The agencies also request comment on the role of hypothetical backtesting—specifically, whether hypothetical backtesting is feasible as part of model validation; whether other forms of backtesting should also be used; and whether regulatory backtesting should be based on hypothetical backtesting.*

6. Revised Modeling Standards for Specific Risk

The proposed rule would more clearly specify the modeling standards for specific risk and, after a transition period, eliminate the current option for a bank to model some but not all material aspects of specific risk for an individual portfolio of covered debt or equity positions. As under the current market risk capital rule, a bank may use one or more internal models to measure specific risk. The internal model would be required to explain the historical price variation in the portfolio, be responsive to changes in market conditions, be robust to an adverse environment, and capture all material aspects of specific risk for covered debt and equity positions. Specifically, the proposed revisions would require that a bank's internal models capture default risk, event risk, and idiosyncratic variations; capture concentrations and demonstrate sensitivity to changes in portfolio construction or concentrations; and capture material basis risk and demonstrate sensitivity to material idiosyncratic differences between similar, but not identical, positions. The requirement to capture default and event risk specifies that for debt positions, migration risk must be captured, and for equity positions, events reflected in large changes or jumps in prices must be reflected.

Under the current market risk capital rule, if a bank incorporates specific risk in its internal model but fails to demonstrate to its primary Federal supervisor that its internal model adequately measures all aspects of specific risk for covered debt and equity positions, including event and default risk, it is subject to a specific risk add-on. On and after January 1, 2010, the proposed rule would require a bank that

does not have an approved internal model that captures all material aspects of specific risk for a particular portfolio to use the standard specific risk add-on for that portfolio. This proposed change reflects the agencies' interest in creating incentives for more robust specific risk modeling, while providing banks with a reasonable period of time in which to improve current modeling techniques.

The proposed phase-out of partial modeling of specific risk would not preclude a bank from using an internal model to calculate the specific risk of some, but not all, portfolios of covered debt and equity positions and using the standard approach to calculate the specific risk of other portfolios. Rather, effective January 1, 2010, a bank would not be permitted to use an internal model to calculate the specific risk add-on of a portfolio if the model did not capture all material aspects of specific risk for that portfolio. The bank would be required to use the standard approach to calculate the specific risk add-on for the portfolio until it receives written approval from its primary Federal supervisor to measure the specific risk for the portfolio using its internal model. *Question 9: The agencies request comment on the proposed timeframe for phasing out partial modeling of specific risk and on whether it would allow banks enough time to implement the proposed changes.*

While the proposed rule would continue to provide for flexibility and a combination of approaches to measure market risk, including the use of different models to measure general market risk and the specific risk of one or more portfolios of covered debt and equity positions, the agencies strongly encourage banks to develop and implement models that integrate the measurement of VaR for general market risk and specific risk. A bank's use of a combination of approaches would be subject to supervisory review to ensure that the overall capital requirement for market risk is commensurate with the risks of the bank's covered positions.

The proposed rule does not contain explicit specific risk capital requirements for exposures to commodities and foreign exchange positions. *Question 10: The agencies seek comment on the extent and materiality of specific risk for commodities and foreign exchange positions and on whether and how a specific risk capital requirement for those positions could be developed under both the internal models and standard approaches.*

7. Standard Specific Risk Capital Requirement

The standard specific risk add-ons are largely unchanged from the current market risk capital rule, as summarized above. The proposed rule would make the following modifications to the treatment of covered debt positions, largely to parallel the increased recognition of external ratings in the New Accord. The government category would be expanded to include all sovereign debt, and the risk weight for sovereign debt would change from zero percent to a range from zero to 12 percent based on the external rating of the obligor and remaining contractual maturity of the covered debt position. The proposed rule would change the qualifying category to include all non-sovereign covered debt positions that are (i) rated investment grade by at least two nationally recognized statistical rating organizations (NRSROs); (ii) rated investment grade by one NRSRO and not rated less than investment grade by any other NRSRO; and (iii) unrated debt of financial firms and of other firms that have publicly traded securities or instruments, provided the bank deems the debt to have credit risk comparable to that of investment grade. The risk weight in the other category would be raised from 8 percent to 12 percent for covered debt positions rated more than two categories below investment grade.

Finally, the proposed rule would expand the recognition of netting effects for covered debt positions. In this regard, there would be no standard specific risk add-on when a covered debt position is fully hedged by a total return swap (or similar instrument where there is a matching of payments and changes in market value of the position) and there is an exact match between the reference obligation of the swap and the covered debt position and between the maturity of the swap and the covered debt position.

If a set of transactions consisting of a covered debt position and its credit derivative hedge does not meet these criteria for no specific risk add-on, the add-on would be equal to 20 percent of the specific risk capital requirement for the side of the transaction with the higher specific risk add-on when the credit risk of the position is fully hedged by a total return swap, credit default swap or similar instrument and there is an exact match in terms (including maturity) of the reference obligation of the credit hedge and the covered debt position, and of the currency of the credit derivative and the covered debt position.

For a set of transactions that consists of a covered debt position and its credit hedge but do not meet the criteria for full offset or the 80 percent offset above, the standard specific risk add-on for the set would be the standard specific risk add-on for the side of the transaction with the higher specific risk capital requirement.

8. Incremental Default Risk Capital Requirement

Under the proposed rule, a bank that models specific risk for one or more portfolios of covered positions would be required to measure the incremental default risk of those positions. Incremental default risk would be defined as the default risk of a covered position that is not reflected in the bank's VaR-based measure because it reflects risk beyond a 10-business-day horizon and a 99 percent confidence level. In the case of a securitization exposure, incremental default risk includes the risk of losses that could result from default of the assets underlying the securitization exposure. A bank would be required to measure incremental default risk for both covered debt and equity positions.

Under the proposed rule, a bank may use one or more internal models to measure its incremental default risk. The agencies propose to set the soundness standard for the incremental default risk capital requirement at the 99.9th percentile, rather than the 99th percentile generally used to capture market risk. Incremental default risk would be measured consistent with a one-year time horizon and a one-tailed, 99.9 percent confidence level (that is, comparable to the internal ratings-based approach under the proposed advanced capital adequacy framework), under the assumption of a constant level of risk and adjusted where appropriate to reflect the impact of liquidity, concentrations, hedging, and optionality. An incremental default risk capital requirement would be consistent with an internal ratings-based capital requirement for credit risk if it produced a default risk measure for an infinitely granular portfolio over a one-year time horizon that roughly equals the credit risk charge under the proposed advanced capital adequacy framework.

The proposed assumption of a constant level of risk reflects that a bank makes decisions about capital and business planning over a horizon that is longer than the liquidity horizon of many of its trading portfolios. It assumes that, while the bank would likely change its mix of positions in the event of market losses, it would not automatically reduce its aggregate level

of risk-taking. The agencies believe that this assumption is more realistic than assuming that a bank's trading positions at a point in time would be held constant over a longer horizon.

The agencies are evaluating how a bank should adjust the incremental default risk capital requirement to adjust for the impact of liquidity, concentrations, hedging, and optionality. One possible approach to liquidity would be to measure default risk out to an appropriate liquidity horizon. The liquidity horizon of a position or portfolio is the amount of time it takes to sell the position or hedge all of its material risks. To produce a prudent measure of incremental default risk, a bank would set the liquidity horizon in a conservative manner reflecting stressed market conditions and the bank's own policies and procedures for identifying stale positions. Some covered debt and equity positions such as publicly traded equities may have a liquidity horizon shorter than the VaR-based measure's 10-business-day horizon and thus would not have an incremental default risk capital requirement.

The proposed adjustment of the incremental default risk measure for concentrations of positions would require a bank to consider all types of concentrations, including name concentration and market concentration, when measuring incremental default risk. The adjustment for hedging would reflect offsets of short and long positions in a single instrument when they are expected to be maintained at least over the liquidity horizon. The incremental default risk measure could include the effects of optionality by reflecting the nonlinearity of options or other nonlinear positions when it has a material impact on default risk. The agencies note that nonlinearity would be relevant for products such as synthetic collateralized debt tranches or nth to default baskets, where the loss upon the default of one name depends on which other names are defaulting in the same time period. *Question 11: The agencies request comment on how a bank should adjust the incremental default risk capital requirement to adjust for the impact of liquidity, concentrations, hedging, and optionality.*

The proposed rule would provide flexibility to a bank in developing an approach for the calculation of any incremental default risk capital requirement for a covered position. At present, the agencies anticipate that most, if not all, banks would utilize a separate model for calculating the incremental default risk capital

requirement, given the difficulties of modeling to two different soundness standards. *Question 12: The agencies request comment on all aspects of the proposal to reflect in the market risk capital requirement a measure of incremental default risk. Specifically, the agencies seek comment on the feasibility of measuring incremental default risk at a one-year, 99.9 percent confidence level and the appropriateness of the assumption of a constant level of risk.*

A bank's primary Federal supervisor would review its internal model for incremental default risk and approve its use for regulatory capital purposes. The incremental default risk capital requirement would not be subject to the multiplier described in paragraphs (a)(2)(B) and (c) of section 4 of the proposed rule. A bank could adjust its incremental default capital requirement to minimize double-counting of default risk already reflected in the 10-business-day, 99 percent confidence level VaR-based measure using an approach agreed upon with its primary Federal supervisor.

In order to provide sufficient time for banks to develop methodologies to capture fully incremental default risk, a bank would have until January 1, 2010 to obtain the approval of its primary Federal supervisor to adopt an approach to measure incremental default risk. Early adoption would be encouraged. If a bank subject to the general risk-based capital rules is unable to develop internal models for incremental default risk on or after January 1, 2010, it would be required to use the standard method for specific risk. If a bank subject to the proposed advanced capital adequacy framework is unable to develop an approach to incremental default risk on or after January 1, 2010, it would be required to use the proposed advanced capital adequacy framework to calculate its incremental default risk capital requirement.

The agencies note that they are working with the banking industry through the Accord Implementation Group of the BCBS to develop guidance on acceptable approaches to determining the incremental default risk capital charge. *Question 13: The agencies request comment on the extent to which banks, at present, measure incremental default risk and the prospects for development of methodologies to capture this risk fully in internal models by the proposed January 1, 2010 deadline. The agencies also request comment on the fallback methods proposed for banks unable to develop an internal model to capture*

incremental default risk by January 1, 2010.

9. Disclosure Requirements

The proposed revisions would impose disclosure requirements designed to improve market discipline on the top-tier consolidated bank that is subject to the market risk capital rule. The agencies recognize the importance of market discipline in encouraging sound risk management practices and fostering financial stability. With sufficient relevant information, market participants can better evaluate a bank's risk management performance, earnings potential, and financial strength. Many of the proposed disclosure requirements reflect information already disclosed publicly by the banking industry. A bank would be encouraged, but not required, to make these disclosures in a central location on its Web site.

Consistent with the proposed advanced capital adequacy framework, the proposed revisions would require a bank to comply with the requirements of section 8 of the proposed rule unless it is a consolidated subsidiary of another depository institution or bank holding company that is subject to the disclosure requirements. A bank subject to section 8 would be required to adopt a formal disclosure policy approved by its board of directors that addresses the bank's approach for determining the disclosures it makes. The policy must address the associated internal controls and disclosure controls and procedures. The board of directors and senior management must verify that the bank has made all required disclosures and maintains effective internal controls and disclosure controls and procedures. The chief financial officer would be required to certify that disclosures required by the proposed rule are appropriate, and the board of directors and senior management are responsible for establishing and maintaining an effective internal control structure over financial reporting, including the information required by this proposed rule.

The proposed revisions would require a bank, at least quarterly, to disclose publicly for each portfolio of covered positions (i) the high, low, and mean VaR-based measures over the reporting period; (ii) separate VaR-based measures for interest rate risk, credit spread risk, equity price risk, foreign exchange rate risk, and commodity price risk; and (iii) a comparison of VaR-based measures with actual results and analysis of important outliers. A bank would be required to make qualitative disclosures at least annually, or more frequently in the event of material changes, of the

following information: (i) The composition of material portfolios of covered positions; (ii) the bank's valuation policies, procedures, and methodologies; (iii) the characteristics of its internal models; (iv) a description of its approaches for validating the accuracy of its internal models and modeling processes; (v) a description of the stress tests applied to each market risk factor; (vi) the results of a comparison of the bank's internal estimates with actual outcomes during a sample period not used in model development; and (vii) the soundness standard on which its internal capital adequacy assessment is based, including a description of the methodologies used to achieve a capital adequacy assessment that is consistent with the soundness standard and the requirements of the market risk capital rule.

In addition to the public disclosures that would be required by the consolidated bank, the agencies would require certain regulatory reporting from all banks applying the market risk capital rule in order to assess the reasonableness and accuracy of the bank's calculation of its minimum capital requirements under this rule and the adequacy of the bank's capital in relation to its risks. The agencies believe that requiring certain common reporting across banks would facilitate comparable application of the proposed rule. Proposed regulatory reporting requirements for banks subject to the rule are the subject of a separate joint notice and request for comment by the agencies [reference].

Question 14: The agencies seek comment on all aspects of the proposed public disclosure requirements.

Regulatory Flexibility Act Analysis

The Regulatory Flexibility Act (RFA) requires an agency that is issuing a proposed rule to prepare and make available for public comment an initial regulatory flexibility analysis that describes the impact of the proposed rule on small entities. 5 U.S.C. 603(a). The RFA provides that an agency is not required to prepare and publish an initial regulatory flexibility analysis if the agency certifies that the proposed rule will not, if promulgated, have a significant economic impact on a substantial number of small entities. 5 U.S.C. 605(b).

Under regulations issued by the Small Business Administration (13 CFR 121.201), a "small entity" includes a bank holding company, commercial bank, or savings association with assets

of \$165 million or less.¹⁶ The proposed rule would require a bank holding company, bank, or savings association to maintain regulatory capital against the market risk of covered positions. The proposed rule would apply only if the bank holding company, bank, or savings association has aggregated trading assets and liabilities equal to 10 percent or more of quarter end total assets, or \$1 billion or more. The agencies estimate that no small bank holding company, bank, or savings association would satisfy these criteria, and that no small entities would be subject to this rule. Accordingly, each agency certifies that the proposed rule will not, if promulgated in final form, have a significant economic impact on a substantial number of small entities.

OCC/OTS Executive Order 12866

Executive Order 12866 requires Federal agencies to prepare a regulatory impact analysis for agency actions that are found to be "significant regulatory actions." "Significant regulatory actions" include, among other things, rulemakings that "have an annual effect on the economy of \$100 million or more or adversely affect in a material way the economy, a sector of the economy, productivity, competition, jobs, the environment, public health or safety, or State local, or tribal governments or communities. The OCC and OTS each has determined that its portion of the rule is not a significant regulatory action.

OCC/OTS Unfunded Mandates Reform Act of 1995 Determination

The Unfunded Mandates Reform Act of 1995 (Pub. L. 104-4) (UMRA) requires that an agency prepare a budgetary impact statement before promulgating a rule that includes a Federal mandate that may result in the expenditure by state, local, and tribal governments, in the aggregate, or by the private sector of \$100 million or more (adjusted annually for inflation) in any one year. The current inflation-adjusted expenditure threshold is \$119.6 million. If a budgetary impact statement is required, section 205 of the UMRA also requires an agency to identify and consider a reasonable number of regulatory alternatives before promulgating a rule. The OCC and OTS each have determined that their respective proposed rule will not result in expenditure by state, local, and tribal governments, or by the private sector, of

¹⁶ Currently, there are approximately 2,934 small bank holding companies, 1,090 small national banks, 491 small State member banks, 3,249 small State nonmember banks, and 446 small savings Associations.

\$119.6 million or more. Accordingly, neither the OCC nor OTS has prepared a budgetary impact statement or specifically addressed the regulatory alternatives considered.

Paperwork Reduction Act

A. Request for Comment on Proposed Information Collection

In accordance with the requirements of the Paperwork Reduction Act of 1995, the agencies may not conduct or sponsor, and the respondent is not required to respond to, an information collection unless it displays a currently valid Office of Management and Budget (OMB) control number. The agencies are requesting comment on a proposed information collection. The agencies are also giving notice that the proposed collection of information has been submitted to OMB for review and approval.

Comments are invited on:

(a) Whether the collection of information is necessary for the proper performance of the agencies' functions, including whether the information has practical utility;

(b) The accuracy of the estimates of the burden of the information collection, including the validity of the methodology and assumptions used;

(c) Ways to enhance the quality, utility, and clarity of the information to be collected;

(d) Ways to minimize the burden of the information collection on respondents, including through the use of automated collection techniques or other forms of information technology; and

(e) Estimates of capital or start up costs and costs of operation, maintenance, and purchase of services to provide information.

Comments should be addressed to:

OCC: Communications Division, Office of the Comptroller of the Currency, Public Information Room, Mail stop 1-5, Attention: 1557-NEW, 250 E Street, SW., Washington, DC 20219. In addition, comments may be sent by fax to 202-874-4448, or by electronic mail to regs.comments@occ.treas.gov. You can inspect and photocopy the comments at the OCC's Public Information Room, 250 E Street, SW., Washington, DC 20219. You can make an appointment to inspect the comments by calling 202-874-5043.

Board: You may submit comments, identified by the Docket number, by any of the following methods:

- **Agency Web site:** <http://www.federalreserve.gov>. Follow the instructions for submitting comments

on the <http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm>.

- **Federal eRulemaking Portal:** <http://www.regulations.gov>. Follow the instructions for submitting comments.

- **E-mail:** regs.comments@federalreserve.gov. Include docket number in the subject line of the message.

- **Fax:** 202-452-3819 or 202-452-3102.

- **Mail:** Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, NW., Washington, DC 20551. All public comments are available from the Board's Web site at <http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm> as submitted, unless modified for technical reasons. Accordingly, your comments will not be edited to remove any identifying or contact information. Public comments may also be viewed electronically or in paper form in Room MP-500 of the Board's Martin Building (20th and C Streets, NW.) between 9 a.m. and 5 p.m. on weekdays.

FDIC: You may submit written comments, which should refer to 3064-AD10, by any of the following methods:

- **Agency Web site:** <http://www.fdic.gov/regulations/laws/federal/propose.html>. Follow the instructions for submitting comments on the FDIC Web site.

- **Federal eRulemaking Portal:** <http://www.regulations.gov>. Follow the instructions for submitting comments.

- **E-mail:** Comments@FDIC.gov.

- **Mail:** Steve Hanft, PRA Clearance Officer, Legal Division, FDIC, 550 17th Street, NW., Washington, DC 20429.

- **Hand Delivery/Courier:** Guard station at the rear of the 550 17th Street Building (located on F Street) on business days between 7 a.m. and 5 p.m.

Public Inspection: All comments received will be posted without change to <http://www.fdic.gov/regulations/laws/federal/propose/html> including any personal information provided.

Comments may be inspected at the FDIC Public Information Center, Room 100, 801 17th Street, NW., Washington, DC, between 9 a.m. and 4:30 p.m. on business days.

OTS: Information Collection Comments, Chief Counsel's Office, Office of Thrift Supervision, 1700 G Street, NW., Washington, DC 20552; send a facsimile transmission to (202) 906-6518; or send an e-mail to infocollection.comments@ots.treas.gov. OTS will post comments and the related index on the OTS Internet site at <http://www.ots.treas.gov>. In addition, interested persons may inspect the comments at the Public Reading Room,

1700 G Street, NW., by appointment. To make an appointment, call (202) 906-5922, send an e-mail to public.info@ots.treas.gov, or send a facsimile transmission to (202) 906-7755.

A copy of the comments may also be submitted to the OMB desk officer for the agencies: By mail to U.S. Office of Management and Budget, 725 17th Street, NW., #10235, Washington, DC 20503 or by facsimile to 202-395-6974, attention: Federal Banking Agency Desk Officer.

B. Proposed Information Collection

Title of Information Collection: Risk-Based Capital Standards: Market Risk.

Frequency of Response: Varied—some requirements are done at least quarterly and some at least annually.

Affected Public:

OCC: National banks and Federal branches and agencies of foreign banks.

Board: State member banks and bank holding companies.

FDIC: Insured State non-member banks, insured State branches of foreign banks, and certain subsidiaries of these entities.

OTS: Savings associations and certain of their subsidiaries.

Abstract: The information collection requirements are found in sections 3, 5, 6, and 9 of the proposed rule. They will enhance risk sensitivity and introduce requirements for public disclosure of certain qualitative and quantitative information about a bank's or bank holding companies' market risk. The collection of information is necessary to ensure capital adequacy according to the level of market risk.

Section-by-section Analysis. Section 3 sets forth the requirements for applying the market risk framework. Section 3(a)(1)(i) requires clearly defined policies and procedures for determining which trading assets are trading positions and specifies what must be taken into account. Section 3(a)(2) requires a clearly defined trading and hedging strategy for trading positions approved by senior management and specifies what the strategy must articulate. Section 3(b)(1) requires clearly defined policies and procedures for actively managing all covered positions and specifies the minimum that they must require.

Section 5(b)(1) specifies what internal models must include and address. Sections 6(a) and 6(b) require prior written approvals for incremental default risk. Section 8(b) requires a formal disclosure policy approved by the board of directors that addresses the bank's approach for determining the market risk disclosures it makes.

Estimated Burden

The burden associated with this collection of information may be summarized as follows:

OCC

Number of Respondents: 10.

Estimated Burden Per Respondent: 680 hours.

Total Estimated Annual Burden: 6,800 hours.

Board

Number of Respondents: 22.

Estimated Burden Per Respondent: 680 hours.

Total Estimated Annual Burden: 14,960 hours.

FDIC

Number of Respondents: 2.

Estimated Burden Per Respondent: 680 hours.

Total Estimated Annual Burden: 1,360 hours.

OTS

Number of Respondents: 1.

Estimated Burden Per Respondent: 2088 hours.

Total Estimated Annual Burden: 2088 hours.

Text of the Proposed Common Rules (All Agencies)

The text of the proposed common rules appears below:

[Rule] is revised to read as follows:

- Section 1 Purpose, Applicability, and Reservation of Authority
- Section 2 Definitions
- Section 3 Requirements for Application of the Market Risk Capital Rule
- Section 4 Adjustments to the Risk-Based Capital Ratio Calculations
- Section 5 Specific Risk
- Section 6 Incremental Default Risk
- Section 7 Standard Method for Specific Risk
- Section 8 Market Risk Disclosures

Section 1. Purpose, Applicability, and Reservation of Authority

(a) *Purpose.* This rule establishes risk-based capital requirements for banks with significant exposure to market risk and provides methods for these banks to calculate their risk-based capital requirements for market risk. This rule supplements and adjusts the risk-based capital calculations under [the general risk-based capital rules] and [the proposed advanced capital adequacy framework] and establishes public disclosure requirements.

(b) *Applicability.*—(1) This rule applies to any bank with aggregate trading assets and liabilities (as reported in the bank's most recent quarterly Consolidated Report of Condition and

Income (Call Report) or as defined in the Instructions to the Thrift Financial Report and as computed at the end of the most recent calendar quarter), equal to:

(i) 10 percent or more of quarter-end total assets as reported on the most recent quarterly Call Report or Thrift Financial Report; or

(ii) \$1 billion or more.

(2) The [Agency] may apply this rule to any bank if the [Agency] deems it necessary or appropriate because of the level of market risk of the bank or to ensure safe and sound banking practices.

(3) The [Agency] may exclude a bank that meets the criteria of paragraph (b)(1) of this section from coverage under this rule if the [Agency] determines that the exclusion is appropriate based on the level of market risk of the bank and is consistent with safe and sound banking practices.

(c) *Reservation of authority.*—(1) The [Agency] may require a bank to hold an amount of capital greater than otherwise required under this rule if the [Agency] determines that the bank's capital requirement for market risk as calculated under this rule is not commensurate with the market risk of the bank's covered positions. In making determinations under this paragraph, the [Agency] will apply notice and response procedures generally in the same manner as the notice and response procedures described in [12 CFR 3.12, 12 CFR 263.202, 12 CFR 325.6(c), 12 CFR 567.3(d)].

(2) If the [Agency] determines that the risk-based capital requirement calculated under this rule by the bank for one or more covered positions or portfolios of covered positions is not commensurate with the risks associated with those positions or portfolios, the [Agency] may require the bank to assign a different risk-based capital requirement to the positions or portfolios that more accurately reflects the risk of the positions or portfolios.

(3) The [Agency] may also require a bank to calculate risk-based capital requirements for specific positions or portfolios under this rule, or under [the proposed advanced capital adequacy framework] or [the general risk-based capital rules], as appropriate, to more accurately reflect the risks of the positions.

(4) Nothing in this rule limits the authority of the [Agency] under any other provision of law or regulation to take supervisory or enforcement action, including action to address unsafe or unsound practices or conditions, deficient capital levels, or violations of law.

Section 2. Definitions

For purposes of this rule, the following definitions apply:

Bank holding company is defined in section 2(a) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(a)).

Commodity position means a position for which price risk arises from changes in the value of a commodity.

Covered position means the following positions:

(1) A trading asset or trading liability (whether on- or off-balance sheet),¹ as reported on Schedule RC-D of the Call Report, Schedule HC-D of the Consolidated Financial Statements for Bank Holding Companies, or as defined in the Instructions to the Thrift Financial Report, that meets the following conditions:

(i) The position is a trading position or hedges another covered position² and

(ii) The position is free of any restrictive covenants on its tradability or the bank is able to hedge the material risk elements of the position in a two-way market.

(2) A foreign exchange or commodity position, whether or not a trading asset or trading liability (excluding any structural position in a foreign currency that the bank chooses to exclude with prior supervisory approval).

(3) Notwithstanding paragraphs (1) and (2) of this definition, a covered position does not include:

(i) An intangible asset, including any servicing asset;

(ii) Any hedge of a trading position that the [Agency] determines to be outside the scope of the bank's hedging strategy required in paragraph (a)(2) of section 3;

(iii) Any position that, in form or substance, acts as a liquidity facility that provides support to asset-backed commercial paper;

(iv) A credit derivative recognized as a guarantee for risk-weighted asset amount calculation purposes under [the proposed advanced capital adequacy framework] or [the general risk-based capital rules], as applicable, used to hedge a position that is not a covered position; or

(v) A securitization position that is a residual securitization position, unless the [Agency] has determined in writing that:

(A) A two-way market exists for the securitization position or, in the case of

¹ Securities subject to repurchase and lending agreements are included as if they are still owned by the lender.

² A position that hedges a trading position must be within the scope of the bank's hedging strategy described in paragraph (a)(2) of section (3).

a securitization that relies solely on credit derivatives, for the securitization position or all of its material risk components;

(B) The bank holds itself out as ready to buy and sell these securitization positions for its own account on a regular and continuous basis at a quoted price;

(C) The bank's internal models fully capture the general market risk and specific risks of the bank's securitization positions and sufficient market data are available to model these risks reliably; and

(D) The bank has adequate internal systems and controls for the trading of securitization positions.

Credit derivative means a financial contract executed under standard industry documentation that allows one party (the protection purchaser) to transfer the credit risk of one or more exposures (reference exposure) to another party (the protection provider).

Debt position means:

(1) Any security or similar instrument (such as a bond, debenture, or note) that is not an equity position and evidences a liability of the issuer;

(2) Preferred stock that is not an equity position; and

(3) A derivative for which the underlying position is described in paragraph (1) or (2) of this definition.

Default risk means the risk of loss on a position that could result from the failure of an obligor to make timely payments of principal or interest on its debt obligation, and the risk of loss that could result from bankruptcy, insolvency, or similar proceeding. In the case of credit derivatives, default risk means the risk of losses that could result from the default of the reference exposures.

Depository institution is defined in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813).

Equity position means:

(1) A security or instrument, whether voting or non-voting, that represents a direct or indirect ownership interest in, and a residual claim on, the assets or income of a company;

(2) A security or instrument that is mandatorily convertible into a security or instrument described in paragraph (1) of this definition; and

(3) Any other security or instrument, to the extent its return is based on the performance of one or more securities or instruments described in paragraph (1) of this definition.

Event risk means the risk of loss on a position that could result from sudden and unexpected large changes in market prices or specific events other than default of the issuer.

Financial firm means a depository institution, a bank holding company, a savings and loan holding company (as defined in section 10(a)(1)(D) of the Home Owners' Loan Act (12 U.S.C. 1467a(a)(1)(D))), a securities broker or dealer registered with the SEC, or a banking or securities firm that the bank has determined is subject to consolidated supervision and regulation comparable to that imposed on U.S. banks or securities broker-dealers.

Foreign exchange position means a position for which price risk arises from changes in foreign exchange rates.

General market risk means the risk of loss that could result from broad market movements, such as changes in the general level of interest rates, credit spreads, equity prices, foreign exchange rates, or commodity prices.

Hedge means a position that offsets all or substantially all of the price risk of another position.

Idiosyncratic variation means variation in the value of a position that results from factors unique to that position.

Incremental default risk means the default risk of a position that is not reflected in the bank's VaR-based measure under paragraph (c) of section 3 of this rule. In the case of securitization positions, incremental default risk includes the risk of losses that could result from the default of the underlying assets.

Market risk means the risk of loss on a position that could result from movements in market prices.

Nationally Recognized Statistical Rating Organization (NRSRO) means an entity recognized by the Division of Market Regulation (or any successor division) of the SEC as a nationally recognized statistical rating organization for various purposes, including SEC Rule 15c3-1 (broker-dealer net capital requirements).

Over-the-counter (OTC) derivative means a derivative contract that is not traded on an exchange that requires the daily receipt and payment of cash-variation margin.

Publicly traded means a financial instrument that is traded on:

(1) Any exchange registered with the SEC as a national securities exchange under section 6 of the Securities Exchange Act of 1934 (15 U.S.C. 78f); or

(2) Any non-U.S.-based securities exchange that:

(i) Is registered with, or approved by, a national securities regulatory authority; and

(ii) Provides a liquid, two-way market for the financial instrument.

Qualifying securities borrowing transaction means a cash-collateralized

securities borrowing transaction that meets the following conditions:

(1) The transaction is based on liquid and readily marketable securities;

(2) The transaction is marked-to-market daily;

(3) The transaction is subject to daily margin maintenance requirements; and

(4)(i) The transaction is a securities contract for the purposes of section 555 of the Bankruptcy Code (11 U.S.C. 555), a qualified financial contract for the purposes of section 11(e)(8) of the Federal Deposit Insurance Act (12 U.S.C. 1821(e)(8)), or a netting contract between or among financial institutions for the purposes of sections 401–407 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (12 U.S.C. 4401–4407), or the Board's Regulation EE (12 CFR part 231); or

(ii) If the transaction does not meet the criteria in paragraph (4)(i) of this definition, either:

(A) The bank has conducted sufficient legal review to reach a well-founded conclusion that:

(1) The securities borrowing agreement executed in connection with the transaction provides the bank the right to accelerate, terminate, and close-out on a net basis all transactions under the agreement and to liquidate or set off collateral promptly upon an event of counterparty default, including in a bankruptcy, insolvency, or other similar proceeding of the counterparty; and

(2) Under applicable law of the relevant jurisdiction, its rights under the agreement are legal, valid, binding, and enforceable and any exercise of rights under the agreement will not be stayed or avoided; or

(B) The transaction is either overnight or unconditionally cancelable at any time by the bank, and the bank has conducted sufficient legal review to reach a well-founded conclusion that:

(1) The securities borrowing agreement executed in connection with the transaction provides the bank the right to accelerate, terminate, and close-out on a net basis all transactions under the agreement and to liquidate or set off collateral promptly upon an event of counterparty default; and

(2) Under the law governing the agreement, its rights under the agreement are legal, valid, binding, and enforceable.

Residual securitization position means any securitization position subject to deduction under [the proposed advanced capital adequacy framework] or subject to the following provisions under [the general risk-based capital rules]: 12 CFR part 3, Appendix A, sections 4 (b) and (f) (national banks); 12 CFR part 208, Appendix A, section

III.B.3.b and III.B.3.e (state member banks); 12 CFR part 225, Appendix A.III.B.3.b and III.B.3.e (bank holding companies); 12 CFR part 325, Appendix A.II.B.5 (state nonmember banks); and 12 CFR 567.6(b)(1) and (2) (savings associations)

SEC means the U.S. Securities and Exchange Commission.

Securitization position means:

(1) An on- or off-balance sheet position arising from a transaction in which:

(i) All or a portion of the credit risk of one or more underlying positions is transferred to one or more third parties (other than through a guarantee that transfers only the credit risk of an individual residential mortgage);

(ii) The credit risk associated with the underlying positions has been separated into at least two tranches reflecting different levels of seniority;

(iii) Performance of the securitization positions depends upon the performance of the underlying positions; and

(iv) All, or substantially all, of the underlying positions are financial positions (such as loans, commitments, credit derivatives, guarantees, receivables, asset-backed securities, mortgage-backed securities, corporate bonds, or equity securities); and

(2) A mortgage-backed pass-through security guaranteed by Fannie Mae or Freddie Mac.

Sovereign entity means a central government (including the U.S. government) or an agency, department, ministry, or central bank of a central government.

Specific risk means the risk of loss on a position that could result from factors other than broad market movements and includes event and default risk, and idiosyncratic variations in rates, spreads, prices, or other risk factors.

Term repo-style transaction means a repurchase or reverse repurchase transaction, or a securities borrowing or securities lending transaction, including a transaction in which the bank acts as agent for a customer and indemnifies the customer against loss, that has an original maturity in excess of one business day, provided that:

(1) The transaction is based solely on liquid and readily marketable securities or cash;

(2) The transaction is marked-to-market daily and subject to daily margin maintenance requirements;

(3) The transaction is executed under an agreement that provides the bank the right to accelerate, terminate, and close-out the transaction on a net basis and to liquidate or set off collateral promptly upon an event of default (including

bankruptcy, insolvency, or similar proceeding) of the counterparty, provided that, in any such case, any exercise of rights under the agreement will not be stayed or avoided under applicable law in the relevant jurisdictions;³ and

(4) The bank has conducted and documented sufficient legal review to conclude with a well-founded basis that the agreement meets the requirements of paragraph (3) of this definition and is legal, valid, binding, and enforceable under applicable law in the relevant jurisdictions.

Tier 1 capital is defined in [the general risk-based capital rules] or [the proposed advanced capital adequacy framework], as applicable.

Tier 2 capital is defined in [the general risk-based capital rules] or [the proposed advanced capital adequacy framework], as applicable.

Tier 3 capital is subordinated debt that is unsecured, is fully paid up, has an original maturity of at least two years, is not redeemable before maturity without prior approval of the [Agency], includes a lock-in clause precluding payment of either interest or principal (even at maturity) if the payment would cause the issuing bank's risk-based capital ratio to fall or remain below the minimum required under [the general risk-based capital rules] or [the proposed advanced capital adequacy framework], as applicable, and does not contain and is not covered by any covenants, terms, or restrictions that are inconsistent with safe and sound banking practices.

Trading position means a position that is held by the bank for the purpose of short-term resale or with the intent of benefiting from actual or expected price movements or to lock in arbitrage profits.

Two-way market means a market where there are enough independent bona fide offers to buy and sell so that a price reasonably related to the last sales price or current bona fide competitive bid and offer quotations can be determined within one day and settled at such price within a relatively short period of time conforming to trade custom.

³ This requirement is met where all transactions under the agreement are (i) executed under U.S. law and (ii) constitute "securities contracts" or "repurchase agreements" under section 555 or 559, respectively, of the Bankruptcy Code (11 U.S.C. 555 or 559), qualified financial contracts under section 11(e)(8) of the Federal Deposit Insurance Act (12 U.S.C. 1821(e)(8)), or netting contracts between or among financial institutions under sections 401–407 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (12 U.S.C. 4407), or the Federal Reserve Board's Regulation EE (12 CFR part 231).

Value-at-risk (VaR) means the estimate of the maximum amount that the value of one or more positions could decline due to market price or rate movements during a fixed holding period within a stated confidence interval.

Section 3. Requirements for Application of the Market Risk Capital Rule

(a) *Trading positions*—(1)

Identification of trading positions. A bank must have clearly defined policies and procedures for determining which of its trading assets and trading liabilities are trading positions. These policies and procedures must take into account:

(i) The extent to which a position, or a hedge of its material risks, can be marked-to-market daily by reference to a two-way market; and

(ii) Possible impairments to the liquidity of a position or its hedge.

(2) *Trading and hedging strategies.* A bank must have clearly defined trading and hedging strategies for its trading positions that are approved by senior management of the bank.

(i) The trading strategy must articulate the expected holding period of, and the market risk associated with, each portfolio of trading positions. The trading strategy must also articulate whether the purpose of each portfolio of trading positions is to accommodate customer flow, to engage in proprietary trading, or to make a market in the positions.

(ii) The hedging strategy must articulate for each portfolio the level of market risk the bank is willing to accept and must detail the instruments, techniques, and strategies the bank will use to hedge the risk of the portfolio.

(b) *Management of covered positions*—(1) *Active management.* A bank must have clearly defined policies and procedures for actively managing all covered positions. At a minimum, these policies and procedures must require:

(i) Marking positions to market or to model on a daily basis;

(ii) Daily assessment of the bank's ability to hedge position and portfolio risks, and of the extent of market liquidity;

(iii) Establishment and daily monitoring of limits on positions by a risk control unit independent of the trading business unit;

(iv) Daily monitoring by senior management of information described in paragraphs (b)(1)(i) through (b)(1)(iii) of this section;

(v) At least annual reassessment of established limits on positions by senior management; and

(vi) At least annual assessments by qualified personnel of the quality of market inputs to the valuation process, the soundness of key assumptions, the reliability of parameter estimation in pricing models, and the stability and accuracy of model calibration under alternative market scenarios.

(2) *Valuation of covered positions.* The bank must have a process for prudent valuation of its covered positions that includes policies and procedures on the valuation of positions, marking to market or to model, independent price verification, and valuation adjustments or reserves. The valuation process must consider, as appropriate, unearned credit spreads, close-out costs, early termination, investing and funding costs, future administrative costs, liquidity, and model risk.

(c) *Internal models.* A bank must use one or more internal models to calculate daily a VaR-based measure that reflects its general market risk for all covered positions. The daily VaR-based measure may also reflect the bank's specific risk for one or more portfolios of covered debt and equity positions, if the internal models meet the requirements of paragraph (b)(1) of section 5.

(1) A bank must obtain the prior written approval of the [Agency] before using any internal model to calculate its risk-based capital requirement under this rule or extending the use of a model for which it has received prior written approval to an additional business line or product type.

(2) A bank must meet all of the requirements of this section on an ongoing basis. The bank must promptly notify the [Agency] when the bank makes any change to any internal model used to calculate risk-based capital requirements under this rule that would result in a material change in the bank's risk-weighted asset amount for a portfolio of covered positions, or when the bank makes any material change to its modeling assumptions. The [Agency] may rescind its approval, in whole or in part, of the use of any internal model if it determines that the model no longer complies with this rule or fails to reflect accurately the risks of the bank's covered positions.

(3) The bank must integrate its internal models into the daily risk management process.

(4) The level of sophistication of a bank's internal models must be commensurate with the nature and size of its covered positions. A bank's internal models may use any of the

generally accepted approaches, such as variance-covariance models, historical simulations, or Monte Carlo simulations, to measure market risk.

(5) The bank's internal models must use risk factors sufficient to measure the market risk inherent in all covered positions. The risk factors must include, as appropriate, interest rate risk, credit spread risk, equity price risk, foreign exchange risk, and commodity price risk. For material positions in the major currencies and markets, modeling techniques must incorporate enough segments of the yield curve—in no case less than six—to capture differences in volatility and less than perfect correlation of rates along the yield curve.

(6) The bank's internal models must properly measure all of the material risks in its covered positions, including basis risks and prepayment risks.

(7) The bank's internal models must conservatively assess the risks arising from less liquid positions and positions with limited price transparency under realistic market scenarios.

(8) The bank must have a rigorous and well-defined process for reestimation, reevaluation, and updating of its internal models to ensure continued applicability and relevance.

(9) The VaR-based measure may incorporate empirical correlations within and across risk factors, provided that the bank's process for measuring correlations is sound. If the VaR-based measure does not incorporate empirical correlations, the bank must add the separate VaR-based measures for the appropriate market risk factors (interest rate risk, credit spread risk, equity price risk, foreign exchange rate risk, and/or commodity price risk) to determine its aggregate VaR-based measure.

(10) The VaR-based measure must include the risks arising from the non-linear price characteristics of options positions or positions with embedded optionality and the sensitivity of the market value of the positions to changes in the volatility of the underlying rates, prices, or other key risk factors. A bank with a large or complex options portfolio must measure the volatility of options positions or positions with embedded optionality by different maturities and/or strikes, where material.

(11) If a bank uses internal models to measure specific risk, the internal models must satisfy the requirements in paragraph (b)(1) of section 5.

(d) *Quantitative requirements for VaR-based measure.* (1) A bank must calculate a VaR-based measure of the general market risk of its covered positions and, if applicable under

section 5, its specific risk for one or more portfolios of covered debt and equity positions. A bank may elect to include in its VaR-based measure term repo-style transactions and residual securitization positions that are trading assets or liabilities provided that the bank includes all such term repo-style transactions or securitization positions and that it includes them consistently over time.

(2) The VaR-based measure must be calculated on a daily basis using a one-tailed, 99.0 percent confidence level, and a holding period equivalent to a ten-business-day movement in underlying risk factors, such as rates, spreads, and prices. To calculate VaR-based measures using a ten-business-day holding period, the bank may calculate ten-business-day measures directly or may convert VaR-based measures using holding periods other than ten business days to the equivalent of a ten-business-day holding period.

(3) The VaR-based measure must be based on a historical observation period of at least one year. Data used to determine the VaR-based measure must be relevant to the bank's actual exposures and of sufficient quality to support the determination of risk-based capital requirements. For banks that use a weighting scheme or other method for the historical observation period, the effective observation period must be at least one year. The bank must update data sets at least once every three months or more frequently as market conditions warrant.

(e) *Control, oversight, and validation mechanisms.* (1) The bank must have a risk control unit that reports directly to senior management and is independent from the business trading units.

(2) The bank must validate its internal models initially and on an ongoing basis. The bank's validation process must be independent of the internal models' development, implementation, and operation, or the validation process must be subjected to an independent review of its adequacy and effectiveness. Validation must include:

(i) Evaluation of the conceptual soundness of (including developmental evidence supporting) the internal models;

(ii) An ongoing monitoring process that includes verification of processes and the comparison of the bank's model outputs with relevant internal and external data sources or estimation techniques; and

(iii) An outcomes analysis process that includes the comparison of a bank's internal estimates with actual outcomes during a sample period not used in model development.

(3) The bank must stress-test the market risk of its covered positions at a frequency appropriate to each portfolio, and in no case less frequently than quarterly. The stress tests must take into account concentration risk (including but not limited to concentrations in single issuers, industries, sectors, or markets), illiquidity under stressed market conditions, and risks arising from the bank's trading activities that may not be adequately captured in the bank's internal models.

(4) The bank must have an internal audit function independent of business-line management that at least annually assesses the effectiveness of the controls supporting the bank's market risk measurement systems, including the activities of the business trading units and of the independent risk control unit, and compliance with policies and procedures.

(f) *Internal assessment of capital adequacy.* The bank must have a rigorous process for assessing its overall capital adequacy in relation to its market risk. The assessment must take into account concentration and liquidity risk under stressed market conditions as well as other risks that may not be captured appropriately in the VaR-based measure.

(g) *Documentation.* The bank must adequately document all material aspects of its internal models, management and valuation of covered positions, control, oversight, and validation mechanisms, and internal assessment of capital adequacy.

Section 4. Adjustments to the Risk-Based Capital Ratio Calculations

(a) *Risk-based capital ratio denominator.* The bank must calculate its risk-based capital ratio denominator as follows:

(1) *Adjusted risk-weighted assets.* The bank must calculate adjusted risk-weighted assets, which equal risk-weighted assets (as determined in accordance with [the proposed advanced capital adequacy framework] or [the general risk-based capital rules], as applicable), with the following adjustments:

(i) The bank must exclude the risk-weighted asset amounts of all covered positions (except foreign exchange positions that are not trading positions and over-the-counter derivative positions).

(ii) A bank subject to [the general risk-based capital rules] may exclude receivables that arise from the posting of cash collateral and are associated with qualifying securities borrowing transactions to the extent the receivable

is collateralized by the market value of the borrowed securities;

(2) *Measure for market risk.* The bank must calculate the measure for market risk which equals the sum of the following:

(i) *VaR-based capital requirement.* The VaR-based capital requirement equals the higher of:

(A) The previous day's VaR-based measure; and

(B) The average of the daily VaR-based measures for each of the preceding 60 business days multiplied by three, except as provided in paragraph (c) of section 4 of this rule.

(ii) *Any specific risk add-on.* The specific risk add-on is calculated in accordance with sections 5 and 7 of this rule.

(iii) *Any incremental default risk capital requirement.* The incremental default risk capital requirement is calculated under section 6 of this rule.

(iv) *Any capital requirement for de minimis exposures.* The [Agency] may grant prior written approval to a bank to calculate a capital requirement for *de minimis* exposures and risks using alternative techniques that adequately measure associated market risk.

(3) *Market risk equivalent assets.* The bank must calculate market risk equivalent assets as the measure for market risk (as calculated in paragraph (a)(2) of this section) multiplied by 12.5.

(4) *Denominator calculation.* The bank must add market risk equivalent assets (as calculated in paragraph (a)(3) of this section) to adjusted risk-weighted assets (as calculated in paragraph (a)(1) of this section). The resulting sum is the bank's risk-based capital ratio denominator.

(b) *Risk-based capital ratio numerator.* The bank must calculate its risk-based capital ratio numerator by allocating capital as follows:

(1) *Credit risk allocation.* The bank must allocate tier 1 and tier 2 capital equal to 8.0 percent of adjusted risk-weighted assets (as calculated in paragraph (a)(1) of this section). A bank may not allocate tier 3 capital to support credit risk (as calculated under [the proposed advanced capital adequacy framework] or [the general risk-based capital rules]).

(2) *Market risk allocation.* The bank must allocate tier 1, tier 2, and tier 3 capital equal to the measure for market risk as calculated in paragraph (a)(2) of this section. The sum of tier 2 and tier 3 capital allocated for market risk must not exceed 250 percent of tier 1 capital allocated for market risk. As a result, tier 1 capital allocated in this paragraph (b)(2) must equal at least 28.6 percent of the measure for market risk.

(3) *Restrictions.* (i) The sum of tier 2 capital (both allocated and excess) and tier 3 capital (allocated under paragraph (b)(2) of this section) may not exceed 100 percent of tier 1 capital (both allocated and excess). Excess tier 1 capital means tier 1 capital that has not been allocated in paragraphs (b)(1) and (b)(2) of this section. Excess tier 2 capital means tier 2 capital that has not been allocated in paragraph (b)(1) and (b)(2) of this section, subject to the restrictions in paragraph (b)(3) of this section.

(ii) Term subordinated debt (and intermediate-term preferred stock and related surplus) included in tier 2 capital (both allocated and excess) may not exceed 50 percent of tier 1 capital (both allocated and excess).

(4) *Numerator calculation.* The bank must add tier 1 capital (both allocated and excess), tier 2 capital (both allocated and excess), and tier 3 capital (allocated under paragraph (b)(2) of this section). The resulting sum is the bank's risk-based capital ratio numerator.

(c) *Backtesting.* A bank must compare each of its most recent 250 business days' actual trading profit or loss (excluding fees, commissions, reserves, and net interest income) with the corresponding daily VaR-based measures and calibrated to a one-day holding period and a one-tailed, 99.0 percent confidence level.

(1) Once each quarter, the bank must identify the number of exceptions (that is, the number of business days for which the actual daily net trading loss, if any, exceeds the corresponding daily VaR-based measure) that have occurred over the preceding 250 business days.

(2) A bank must use the multiplication factor in Table 1 of this rule to determine its VaR-based capital requirement for market risk under paragraph (a)(2)(i) of this section until it obtains the next quarter's backtesting results, unless the [Agency] advises the bank in writing that a different adjustment or other action is appropriate.

TABLE 1.—MULTIPLICATION FACTORS BASED ON RESULTS OF BACKTESTING

Number of exceptions	Multiplication factor
4 or fewer	3.00
5	3.40
6	3.50
7	3.65
8	3.75
9	3.85
10 or more	4.00

Section 5. Specific Risk

(a) *General requirement.* A bank must use one of the methods in this section to measure the specific risk for each of its portfolios of covered debt and equity positions.

(b) *Modeled specific risk.* A bank may use one or more internal models to measure the specific risk of covered debt and equity positions.

(1) *Requirements for specific risk modeling.* If a bank uses internal models to measure the specific risk of a portfolio of covered debt or equity positions, the internal models must:

(i) Explain the historical price variation in the portfolio;

(ii) Be responsive to changes in market conditions;

(iii) Be robust to an adverse environment, including signaling rising risk in an adverse environment; and

(iv) Capture all material components of specific risk for the covered debt and equity positions in the portfolio, except as permitted under the transitional rule described in paragraph (d) of this section. Specifically, the internal models must:

(A) Capture default risk, event risk, and idiosyncratic variations, including, for debt positions, migration risk, and for equity positions, events that are reflected in large changes or jumps in prices;

(B) Capture material basis risks and demonstrate sensitivity to material idiosyncratic differences between positions that are similar but not identical; and

(C) Capture concentrations (magnitude and changes in composition) and demonstrate sensitivity to changes in portfolio composition or concentrations.

(2) *Specific risk fully modeled for all portfolios.* If the bank's VaR-based measure captures all material aspects of specific risk for all of its portfolios of covered debt and equity positions, the bank has no specific risk add-on for purposes of paragraph (a)(2)(ii) of section 4.

(3) *Specific risk fully modeled for some but not all portfolios.* If the bank's VaR-based measure captures all material aspects of specific risk for one or more of its portfolios of covered debt and equity positions, the bank has no specific risk add-on for those portfolios for purposes of paragraph (a)(2)(ii) of section 4. The bank must calculate a specific risk add-on under the standard method as described in section 7 of this rule for any portfolio of covered debt or equity positions for which the bank's VaR-based measure does not capture all material aspects of specific risk.

(c) *Specific risk not modeled.* If the bank's VaR-based measure does not capture all material aspects of specific risk for any of its portfolios of covered debt and equity positions, the bank must calculate a specific-risk add-on for all portfolios of covered debt and equity positions under the standard method as described in section 7 of this rule.

(d) *Transitional Rule—Specific risk partially modeled for one or more portfolios.* Until January 1, 2010, if a bank has received the [Agency's] prior written approval to model the specific risk of one or more portfolios of covered debt or equity positions but the [Agency] has determined that the internal models do not adequately measure all material aspects of specific risk for covered debt and equity positions in the portfolio, including event and default risk, the bank must calculate a specific risk add-on for the partially modeled portfolios using one of the following methods:

(1) If the [Agency] has determined that the bank can validly separate its VaR-based measure into a specific risk portion and a general market risk portion, the specific risk add-on is equal to the higher of:

(i) The previous day's specific risk portion; or

(ii) The average of the daily specific risk portions for each of the preceding 60 business days.

(2) If the [Agency] has determined that the bank cannot validly separate its VaR-based measure into a specific risk portion and a general market risk portion, the specific risk add-on equals the higher of:

(i) The sum of the previous day's VaR-based measures for portfolios of covered debt and equity positions; or

(ii) The average of the sum of the daily VaR-based measures for portfolios of covered debt and equity positions for each of the preceding 60 business days.

Section 6. Incremental Default Risk

(a) *General requirement.* On and after January 1, 2010, a bank that models specific risk for one or more portfolios of covered debt or equity positions must use one of the methods in this section to measure the incremental default risk of those portfolios. With the prior written approval of the [Agency], a bank may adjust its incremental default risk capital requirement to minimize double-counting of default risk already reflected in the 10-business-day, 99 percent confidence level VaR-based measure. The incremental default risk capital requirement is not subject to the multiplier described in paragraphs (a)(2)(i)(B) and (c) of section 4.

(b) *Modeled incremental default risk.* With prior written approval of [Agency], a bank may use one or more internal models to measure its incremental default risk capital requirement. A bank that models its incremental default risk must measure the incremental default risk of its portfolios of covered debt or equity positions, consistent with a one-year time horizon and a one-tailed, 99.9 percent confidence level, under the assumption of a constant level of risk and adjusted where appropriate to reflect the impact of liquidity, concentrations, hedging, and optionality.

(c) *Alternative for banks subject to [the proposed advanced capital adequacy framework].* If a bank subject to [the proposed advanced capital adequacy framework] does not have a model that meets the criteria of paragraph (b) of this section for a portfolio of covered debt or equity positions, the bank's incremental default risk capital requirement for the portfolio is equal to the capital requirement calculated for those positions under [the proposed advanced capital adequacy framework].

(d) *Alternative for banks subject to [the general risk-based capital rules].* If a bank subject to [the general risk-based capital rules] does not have a model that meets the criteria in paragraph (b) of this section for a portfolio of covered debt or equity positions, the bank must calculate a specific risk add-on for the portfolio using the standard method under section 7. A bank that calculates a specific risk add-on using the standard method described in section 7 for a portfolio is not subject to an incremental default risk capital requirement for that portfolio.

Section 7. Standard Method for Specific Risk

(a) *General requirement.* A bank using the standard method of calculating the specific risk add-on must calculate it in accordance with this section.

(b) *Covered debt positions.* The standard specific risk add-on for covered debt positions is the sum of the risk-weighted asset amounts for individual covered debt positions, as computed under this paragraph. A bank must multiply the absolute value of the current market value of each net long or short covered debt position by the appropriate specific risk weighting factor in Table 2, subject to the following requirements:

(1) For covered debt positions that are non-option derivatives, a bank must risk-weight the market value of the effective notional amount of the underlying debt instrument or index

portfolio. Swaps must be included as the notional positions in the underlying debt instrument or portfolio, with a receiving side treated as a long position and a paying side treated as a short position. For covered debt positions that are options, whether long or short, a bank must risk-weight the market value of the effective notional amount of the underlying debt instrument or portfolio multiplied by the option's delta;

(2) A bank may net long and short covered debt positions (including derivatives) in identical debt issues or indices;

(3) There is no standard specific risk add-on when a covered debt position is

fully hedged by a total return swap (or similar instrument where there is a matching of payments and changes in market value of the position) and there is an exact match between the reference obligation of the swap and the covered debt position and between the maturity of the swap and the covered debt position;

(4) The standard specific risk add-on for a set of transactions consisting of a covered debt position and its credit derivative hedge that do not meet the criteria of paragraph (b)(3) of this section is equal to 20 percent of the specific risk add-on for the side of the transaction with the higher specific risk

add-on when the credit risk of the position is fully hedged by a total return swap, credit default swap or similar instrument and there is an exact match in terms (including maturity) of the reference obligation of the credit hedge and the covered debt position, and of the currency of the credit derivative and the covered debt position.

(5) The standard specific risk add-on for a set of transactions consisting of a covered debt position and its hedge that do not meet the criteria of either paragraph (b)(3) or (b)(4) of this section is equal to the specific risk add-on for the side of the transaction with the higher specific risk add-on.

TABLE 2.—SPECIFIC RISK WEIGHTING FACTORS FOR COVERED DEBT POSITIONS

Category	Applicable NRSRO rating (illustrative rating example)	Remaining contractual maturity	Specific risk risk weight (percent)
Sovereign	Highest investment grade to second highest investment grade (for example, AAA to AA-).	.....	0
	Third highest investment grade to lowest investment grade (for example, A+ to BBB-).	Residual term to final maturity 6 months or less	0.25
	.....	Residual term to final maturity greater than 6 and up to and including 24 months.	1.00
	.....	Residual term to final maturity exceeding 24 months	1.60
	One category below investment grade to two categories below investment grade (for example, BB+ to B-).	.....	8.00
	More than two categories below investment grade.	.....	12.00
Qualifying	Unrated .....	.....	8.00
	Not applicable	Residual term to final maturity 6 months or less	0.25
		Residual term to final maturity greater than 6 and up to and including 24 months.	1.00
		Residual term to final maturity exceeding 24 months.	1.60
Other	One category below investment grade to two categories below investment grade (for example, BB+ to B-).	.....	8.00
	More than two categories below investment grade.	.....	12.00
	Unrated .....	.....	8.00

(c) The following definitions apply to this section:

(1) The *sovereign* category includes all debt instruments issued or guaranteed by sovereign entities.

(2) The *qualifying* category includes debt instruments not issued or guaranteed by sovereign entities that are:

(i) Rated investment grade by at least two NRSROs;

(ii) Rated investment grade by one NRSRO and not rated less than investment grade by any other NRSRO; or

(iii) Unrated, but the bank deems to be of credit risk comparable to that of investment grade and either:

(A) The issuer is a financial firm; or

(B) The issuer has publicly traded securities or instruments.

(3) The *other* category includes debt positions that are not included in the sovereign or qualifying categories.

(d) *Covered equity positions.* The standard specific risk add-on for covered equity positions is the sum of the risk-weighted asset amounts of individual covered equity positions, as computed under this paragraph (d):

(1) For covered equity positions that are non-option derivatives, a bank must risk-weight the market value of the effective notional amount of the underlying equity instrument or equity portfolio. Swaps must be included as the effective notional position in the underlying equity instrument or portfolio, with a receiving side treated

as a long position and a paying side treated as a short position.

(2) For covered equity positions that are options, whether long or short, a bank must risk-weight the market value of the effective notional amount of the underlying equity instrument or portfolio multiplied by the option's delta.

(3) A bank may net long and short covered equity positions (including derivatives) in identical equity issues or identical equity indices. A bank may also net positions in depository receipts against an opposite position in an identical equity in different markets, provided that the bank includes the costs of conversion.

(4)(i) The bank must multiply the absolute value of the current market

value of each net long or short covered equity position by a risk weighting factor of 8.0 percent, or 4.0 percent if the equity is held in a portfolio that is both liquid and well-diversified.⁴ For covered equity positions that are index contracts comprising a well-diversified portfolio of equity instruments, the absolute value of the current market value of each net long or short position is multiplied by a risk-weighting factor of 2.0 percent.

(ii) For covered equity positions arising from the following futures-related arbitrage strategies, a bank may apply a 2.0 percent risk-weighting factor to one side (long or short) of each position with the opposite side exempt from a specific risk add-on:

(A) Long and short positions in exactly the same index at different dates or in different market centers; or

(B) Long and short positions in index contracts at the same date in different but similar indices.

(iii) For futures contracts on broadly based indices that are matched by offsetting positions in a basket of stocks comprising the index, a bank may apply a 2.0 percent risk weighting factor to the futures and stock basket positions (long and short), provided that such trades are deliberately entered into and separately controlled, and that the basket of stocks is comprised of stocks representing at least 90 percent of the capitalization of the index.

Section 8. Market Risk Disclosures

(a) *Scope.* A bank must comply with this section unless it is a consolidated subsidiary of a bank holding company or a depository institution that is subject to these requirements.

(b) *Disclosure policy.* The bank must have a formal disclosure policy approved by the board of directors that addresses the bank's approach for determining the market risk disclosures it makes. The policy must address the associated internal controls and disclosure controls and procedures. The board of directors and senior management must ensure that appropriate verification of the disclosures takes place and that

effective internal controls and disclosure controls and procedures are maintained. The chief financial officer of the bank must certify that the disclosures required by this section are appropriate, and the board of directors and senior management are responsible for establishing and maintaining an effective internal control structure over financial reporting, including the disclosures required by this section.

(c) *Quantitative disclosures for internal models.* For each portfolio of covered positions, the bank must publicly disclose the following information at least quarterly:

(1) The high, low, and mean VaR-based measures over the reporting period;

(2) Separate VaR-based measures for interest rate risk, credit spread risk, equity price risk, foreign exchange risk, and commodity price risk; and

(3) A comparison of VaR-based estimates with actual gains or losses experienced by the bank, with analysis of important outliers.

(d) *Qualitative disclosures for internal models.* The bank must publicly disclose the following information at least annually, or more frequently in the event of material changes:

(1) The composition of material portfolios of covered positions;

(2) The bank's valuation policies, procedures, and methodologies for covered positions;

(3) The characteristics of the internal models used for purposes of this rule;

(4) A description of the approach used for validating and evaluating the accuracy of the internal models and modeling processes for purposes of this rule;

(5) For each market risk factor (that is, interest rate risk, credit spread risk, equity price risk, foreign exchange risk, and commodity price risk), a description of the stress tests applied to the positions subject to the factor;

(6) The results of a comparison of the bank's internal estimates for purposes of this rule with actual outcomes during a sample period not used in model development; and

(7) The soundness standard on which the bank's internal capital adequacy assessment under this rule is based, including a description of the methodologies used to achieve a capital adequacy assessment that is consistent with the soundness standard and the requirements of this rule.

[END OF COMMON TEXT]

List of Subjects

12 CFR Part 3

Administrative practices and procedure, Capital, National banks,

Reporting and recordkeeping requirements, Risk.

12 CFR Part 208

Confidential business information, Crime, Currency, Federal Reserve System, Mortgages, reporting and recordkeeping requirements, Securities.

12 CFR Part 225

Administrative practice and procedure, Banks, banking, Federal Reserve System, Holding companies, Reporting and recordkeeping requirements, Securities.

12 CFR Part 325

Administrative practice and procedure, Banks, banking, Capital Adequacy, Reporting and recordkeeping requirements, Savings associations, State non-member banks.

12 CFR Part 566

Capital, reporting and recordkeeping requirements, Savings associations, Authority and Issuance

Adoption of Common Rule

The adoption of the proposed common rules by the agencies, as modified by agency-specific text, is set forth below:

Office of the Comptroller of the Currency

12 CFR Chapter I

Authority and Issuance

For the reasons set forth in the common preamble, part 3 of chapter I of title 12 of the Code of Federal Regulations is amended as follows:

PART 3—MINIMUM CAPITAL RATIOS; ISSUANCE OF DIRECTIVES

1. The authority citation for part 3 continues to read as follows:

Authority: 12 U.S.C. 93a, 161, 1818, 3907 and 3909.

2. Appendix B to part 3 is revised to read as set forth at the end of the common preamble:

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

3. Appendix B is further amended by:

a. Removing “[Agency]” wherever it appears and adding in its place “OCC”;

b. Removing “[the proposed advanced capital adequacy framework]” wherever it appears and adding in its place 12 CFR part 3, Appendix C;

c. Removing “[Rule]” wherever it appears and adding in its place “Appendix B to Part 3—Risk-Based Capital Guidelines; Market Risk Adjustment”; and

⁴ A portfolio is liquid and well-diversified if: (i) It is characterized by a limited sensitivity to price changes of any single equity issue or closely related group of equity issues held in the portfolio; (ii) the volatility of the portfolio's value is not dominated by the volatility of any individual equity issue or by equity issues from any single industry or economic sector; (iii) it contains a large number of individual equity positions, with no single position representing a substantial portion of the portfolio's total market value; (iv) it consists mainly of issues traded on organized exchanges or in well-established over-the-counter markets; and (v) a two-way market exists for all or substantially all of the positions in the portfolio.

d. Removing “[the general risk-based capital rules]” wherever it appears and adding in its place 12 CFR part 3, Appendix A.

Federal Reserve System

12 CFR Chapter II

Authority and Issuance

For the reasons set forth in the common preamble, part 208 of chapter II of title 12 of the Code of Federal Regulations is amended as follows:

PART 208—MINIMUM CAPITAL RATIOS; ISSUANCE OF DIRECTIVES

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

Authority: Subpart A of Regulation H (12 CFR part 208, Subpart A) is issued by the Board of Governors of the Federal Reserve System (Board) under 12 U.S.C. 24, 36; sections 9, 11, 21, 25 and 25A of the Federal Reserve Act (12 U.S.C. 321–338a, 248(a), 248(c), 481–486, 601 and 611); sections 1814, 1816, 1818, 1831o, 1831p–l, 1831r–l and 1835a of the Federal Deposit Insurance Act (FDI Act) (12 U.S.C. 1814, 1816, 1818, 1831o, 1831p–l, 1831r–l and 1835); and 12 U.S.C. 3906–3909.

2. Appendix E to part 208 is revised to read as set forth at the end of the common preamble:

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

3. Appendix E is further amended by:

- Removing “[Agency]” wherever it appears and adding in its place “Board”;

- Removing “[the proposed advanced capital adequacy framework]” wherever it appears and adding in its place “Appendix F”;

- Removing “[Rule]” wherever it appears and adding in its place “Appendix E to Part 208—Capital Adequacy Guidelines for State Member Banks: Market Risk Measure”; and

- Removing “[the general risk-based capital rules]” wherever it appears and adding in its place 12 CFR part 208, Appendix A.

12 CFR Chapter II

Authority and Issuance

For the reasons set forth in the common preamble, part 225 of chapter II of title 12 of the Code of Federal Regulations is amended as follows:

PART 225—MINIMUM CAPITAL RATIOS; ISSUANCE OF DIRECTIVES

1. The authority citation for part 225 continues to read as follows:

Authority: This part 1 (Regulation Y) is issued by the Board of Governors of the

Federal Reserve System (Board) under section 5(b) of the Bank Holding Company Act of 1956, as amended (12 U.S.C. 1844(b)) (BHC Act); sections 8 and 13(a) of the International Banking Act of 1978 (12 U.S.C. 3106 and 3108); section 7(j)(13) of the Federal Deposit Insurance Act, as amended by the Change in Bank Control Act of 1978 (12 U.S.C. 1817(j)(13)) (Bank Control Act); section 8(b) of the Federal Deposit Insurance Act (12 U.S.C. 1818(b)); section 914 of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (12 U.S.C. 1831i); section 106 of the Bank Holding Company Act Amendments of 1970 (12 U.S.C. 1972); and the International Lending Supervision Act of 1983 (Pub. L. 98–181, title IX). The BHC Act is codified at 12 U.S.C. 1841, *et seq.*

2. Appendix E to part 225 is revised to read as set forth at the end of the common preamble:

Appendix E to Part 225—Capital Adequacy Guidelines for Bank Holding Companies: Risk-Based Measure

3. Appendix E is further amended by:

- Removing “[Agency]” wherever it appears and adding in its place “Board”;

- Removing “[the proposed advanced capital adequacy framework]” wherever it appears and adding in its place “Appendix F”;

- Removing “[Rule]” wherever it appears and adding in its place “Appendix E to Part 225—Capital Adequacy Guidelines for Bank Holding Companies: Market Risk Measure”; and

- Removing “[the general risk-based capital rules]” wherever it appears and adding in its place 12 CFR part 225, Appendix A.

Federal Deposit Insurance Corporation 12 CFR Chapter III

Authority and Issuance

For the reasons set forth in the common preamble, part 325 of chapter III of title 12 of the Code of Federal Regulations is amended as follows:

PART 325—CAPITAL MAINTENANCE

1. The authority citation for part 325 continues to read as follows:

Authority: 12 U.S.C. 1815(a), 1815(b), 1816, 1818(a), 1818(b), 1818(c), 1818(t), 1819(Tenth), 1828(c), 1828(d), 1828(i), 1828(n), 1828(o), 1831o, 1835, 3907, 3909, 4808; Pub. L. 102–233, 105 Stat. 1761, 1789, 1790 (12 U.S.C. 1831n note); Pub. L. 102–242, 105 Stat. 2236, 2355, as amended by Pub. L. 103–325, 108 Stat. 2160, 2233 (12 U.S.C. 1828 note); Pub. L. 102–242, 105 Stat. 2236, 2386, as amended by Pub. L. 102–550, 106 Stat. 3672, 4089 (12 U.S.C. 1828 note).

2. Appendix C to part 325 is revised to read as set forth at the end of the common preamble:

Appendix C to Part 325—Risk-Based Capital for State Nonmember Banks: Market Risk

3. Appendix C is further amended by:

- Removing “[Agency]” wherever it appears and adding in its place “FDIC”;

- Removing “[the proposed advanced capital adequacy framework]” wherever it appears and adding in its place “Appendix D”;

- Removing “[Rule]” wherever it appears and adding in its place “Appendix C to Part 325—Risk-Based Capital for State Nonmember Banks: Market Risk”; and

- Removing “[the general risk-based capital rules]” wherever it appears and adding in its place “12 CFR part 325, Appendix A.”

Office of Thrift Supervision

2 CFR Chapter V

Authority and Issuance

For the reasons set forth in the common preamble, the Office of Thrift Supervision proposes to add part 566 of chapter V of title 12 of the Code of Federal Regulations to read as follows:

1. Add a new part 566 to read as follows:

PART 566—ADVANCED CAPITAL ADEQUACY FRAMEWORK AND MARKET RISK ADJUSTMENT

Sec.

566.1 Purpose

Appendix A to Part 566 [Reserved]

Authority: 12 U.S.C. 1462, 1462a, 1463, 1464, 1467a, and 1828(note).

§ 566.1 Purpose

(a) [Reserved]

(b) *Market Risk.* Appendix B of this part establishes risk-based capital requirements for banks with significant exposure to market risk, provides methods for these banks to calculate their risk-based capital requirements for market risk, and prescribes public disclosure requirements regarding market risk for these savings associations.

Appendix A to Part 566 [Reserved]

2. Appendix B to part 566 is added and revised to read as set forth at the end of the common preamble.

3. Appendix B to part 566 is further amended by:

- Removing “[Agency]” wherever it appears and adding in its place “OTS”;

- Removing “[the proposed advanced capital adequacy framework]” wherever it appears and adding in its place “12 CFR part 566, Appendix A”;

- Removing “[Rule]” wherever it appears and adding in its place

“Appendix B to Part 566—Market Risk Adjustment”; and

d. Removing “[the general risk-based capital rules]” wherever it appears and adding in its place 12 CFR part 567.

Dated: September 5, 2006.

John C. Dugan,

Comptroller of the Currency.

By order of the Board of Governors of the Federal Reserve System, September 11, 2006.

Jennifer J. Johnson,

Secretary of the Board.

Dated at Washington, DC, this 5th day of September 2006.

By order of the Board of Directors.

Federal Deposit Insurance Corporation.

Robert E. Feldman,

Executive Secretary.

Dated: August 31, 2006.

By the Office of Thrift Supervision.

John M. Reich,

Director.

[FR Doc. 06–7673 Filed 9–22–06; 8:45 am]

BILLING CODE 4810–33–P, 6210–01–P, 6714–01–P, 6720–01–P

DEPARTMENT OF THE TREASURY**Office of the Comptroller of the Currency****FEDERAL RESERVE SYSTEM****FEDERAL DEPOSIT INSURANCE CORPORATION****DEPARTMENT OF THE TREASURY****Office of Thrift Supervision****Proposed Agency Information Collection Activities; Comment Request**

AGENCIES: Office of the Comptroller of the Currency (OCC), Treasury; Board of Governors of the Federal Reserve System (Board); Federal Deposit Insurance Corporation (FDIC); and Office of Thrift Supervision (OTS), Treasury.

ACTION: Joint notice and request for comment.

SUMMARY: In accordance with the requirements of the Paperwork Reduction Act of 1995 (44 U.S.C. chapter 35), the OCC, the Board, the FDIC, and the OTS (collectively, the agencies) may not conduct or sponsor, and the respondent is not required to respond to, an information collection unless it displays a currently valid Office of Management and Budget (OMB) control number. The Federal Financial Institutions Examination Council (FFIEC), of which the agencies are members, has approved the agencies' publication for public comment of proposed new regulatory reporting requirements for banks¹ that qualify for and adopt the Advanced Capital Adequacy Framework to calculate their risk-based capital requirement or are in the parallel run stage of qualifying to adopt this framework. The proposal describes the scope of reporting and the proposed reporting requirements. At the end of the comment period, the comments and recommendations received will be analyzed to determine the extent to which the FFIEC should modify the proposed reporting requirements prior

¹ For simplicity, and unless otherwise indicated, this notice uses the term "bank" to include banks, savings associations, and bank holding companies (BHCs). The terms "bank holding company" and "BHC" refer only to bank holding companies regulated by the Board and do not include savings and loan holding companies regulated by the OTS. For a detailed description of the institutions covered by this notice, refer to Part I, Section 1, of the proposed regulatory text in the notice of proposed rulemaking entitled Risk-Based Capital Standards: Advanced Capital Adequacy Framework.

to giving its final approval. The agencies will then submit the proposed reporting requirements to OMB for review and approval and, upon approval, OMB will assign control numbers.

DATES: Comments must be received on or before January 23, 2007.

ADDRESSES: Interested parties are invited to submit written comments to any or all of the agencies. All comments will be shared among the agencies.

OCC: You may submit comments, identified by "OMB Control No. 1557-NEW," by any of the following methods:

- E-mail: regs.comments@occ.treas.gov. Include "OMB Control No. 1557-NEW" in the subject line of the message.

- Fax: (202) 874-4448.
- Mail: Public Information Room, Office of the Comptroller of the Currency, 250 E Street, SW., Mailstop 1-5, Washington, DC 20219; Attention: OMB Control No. 1557-NEW.

Public Inspection: You may inspect and photocopy comments at the Public Information Room. You can make an appointment to inspect the comments by calling (202) 874-5043.

Board: You may submit comments, which should refer to "Advanced Capital Adequacy Framework Regulatory Reporting Requirements," by any of the following methods:

- Agency Web Site: <http://www.federalreserve.gov>. Follow the instructions for submitting comments on the <http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm>.

- Federal eRulemaking Portal: <http://www.regulations.gov>. Follow the instructions for submitting comments.

- E-mail: regs.comments@federalreserve.gov. Include "Advanced Capital Adequacy Framework Regulatory Reporting Requirements" in the subject line of the message.

- FAX: 202-452-3819 or 202-452-3102.

- Mail: Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, NW., Washington, DC 20551.

All public comments are available from the Board's Web site at <http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm> as submitted, unless modified for technical reasons. Accordingly, your comments will not be edited to remove any identifying or contact information. Public comments may also be viewed electronically or in paper in Room MP-500 of the Board's Martin Building (20th and C Streets, NW.) between 9 a.m. and 5 p.m. on weekdays.

FDIC: You may submit comments, which should refer to "Advanced Capital Adequacy Framework Regulatory Reporting Requirements," by any of the following methods:

- <http://www.FDIC.gov/regulations/laws/federal/notices.html>.

- E-mail: comments@FDIC.gov. Include "Advanced Capital Adequacy Framework Regulatory Reporting Requirements" in the subject line of the message.

- Mail: Steven F. Hanft, Clearance Officer (202-898-3907), Legal Division, Federal Deposit Insurance Corporation, 550 17th Street, NW., Washington, DC 20429.

- Hand Delivery: Comments may be hand delivered to the guard station at the rear of the 550 17th Street Building (located on F Street) on business days between 7 a.m. and 5 p.m.

Public Inspection: All comments received will be posted without change to <http://www.fdic.gov/regulations/laws/federal/propose.html> including any personal information provided. Comments may be inspected at the FDIC Public Information Center, Room E-1002, 3502 North Fairfax Drive, Arlington, VA 22226, between 9 a.m. and 5 p.m. on business days.

OTS: You may submit comments, identified by "Advanced Capital Adequacy Framework Regulatory Reporting Requirements (1550-NEW)," by any of the following methods:

- Federal eRulemaking Portal: <http://www.regulations.gov>. Follow the instructions for submitting comments.
- E-mail address: infocollection.comments@ots.treas.gov.

Please include "Advanced Capital Adequacy Framework Regulatory Reporting Requirements (1550-NEW)" in the subject line of the message and include your name and telephone number in the message.

- Fax: (202) 906-6518.

- Mail: Information Collection Comments, Chief Counsel's Office, Office of Thrift Supervision, 1700 G Street, NW., Washington, DC 20552, Attention: "Advanced Capital Adequacy Framework Regulatory Reporting Requirements (1550-NEW)."

- Hand Delivery/Courier: Guard's Desk, East Lobby Entrance, 1700 G Street, NW., from 9 a.m. to 4 p.m. on business days, Attention: Information Collection Comments, Chief Counsel's Office, Attention: "Advanced Capital Adequacy Framework Regulatory Reporting Requirements (1550-NEW)."

Instructions: All submissions received must include the agency name and "Advanced Capital Adequacy Framework Regulatory Reporting Requirements (1550-NEW)." All

comments received will be posted without change to the OTS Internet Site at <http://www.ots.treas.gov/pagehtml.cfm?catNumber=67&an=1>, including any personal information provided.

Docket: For access to the docket to read background documents or comments received, go to <http://www.ots.treas.gov/pagehtml.cfm?catNumber=67&an=1>. In addition, you may inspect comments at the Public Reading Room, 1700 G Street, NW., by appointment. To make an appointment for access, call (202) 906-5922, send an e-mail to public.info@ots.treas.gov, or send a facsimile transmission to (202) 906-7755. (Prior notice identifying the materials you will be requesting will assist us in serving you.) We schedule appointments on business days between 10 a.m. and 4 p.m. In most cases, appointments will be available the next business day following the date we receive a request.

A copy of the comments may also be submitted to the OMB desk officer for the agencies by mail to the Office of Information and Regulatory Affairs, U.S. Office of Management and Budget, New Executive Office Building, Room 10235, 725 17th Street, NW., Washington, DC 20503, or by fax to (202) 395-6974.

FOR FURTHER INFORMATION CONTACT: For further information about the proposed regulatory reporting requirements discussed in this notice, please contact any of the agency clearance officers whose names appear below. In addition, copies of reporting schedules and instructions can be obtained at each agency's Web site as well as the FFIEC's Web site.²

OCC: Please direct substantive questions to Lorey Hoffman, Large Bank Director, Large Bank Supervision, (202) 874-4595, and requests for copies of the collection to Mary Gottlieb, OCC Clearance Officer, or Camille Dickerson, (202-874-5090), Legislative and Regulatory Activities Division, Office of the Comptroller of the Currency, 250 E Street, SW., Washington, DC 20219.

Board: Michelle Long, Federal Reserve Board Clearance Officer, Division of Research and Statistics, Board of Governors of the Federal Reserve System, Washington, DC 20551 (202-452-3829).

FDIC: Steven F. Hanft, Clearance Officer, at shanft@fdic.gov, (202-898-3907), Legal Division, Federal Deposit

Insurance Corporation, 550 17th Street, NW., Washington, DC 20429.

OTS: Marilyn K. Burton, OTS Clearance Officer, at marilyn.burton@ots.treas.gov, (202) 906-6467, or facsimile number (202) 906-6518, Litigation Division, Chief Counsel's Office, Office of Thrift Supervision, 1700 G Street, NW., Washington, DC 20552.

SUPPLEMENTARY INFORMATION: The agencies are proposing to implement the following new information collections.

Report Title: Advanced Capital Adequacy Framework Regulatory Reporting Requirements.

Form Numbers: FFIEC 101.

Frequency of Response: Quarterly.

Affected Public: Business or other for-profit.

OCC

OMB Number: 1557-NEW.

Estimated Number of Respondents: 52 national banks.

Estimated Time per Response: 280 hours.

Estimated Total Annual Burden: 58,240 hours.

Board

OMB Number: 7100-NEW.

Estimated Number of Respondents: 6 state member banks.

Estimated Time per Response: 280 hours.

Estimated Total Annual Burden: 6,720 hours.

OMB Number: 7100-NEW.

Estimated Number of Respondents: 15 BHCs.

Estimated Time per Response: 280 hours.

Estimated Total Annual Burden: 16,800 hours.

FDIC

OMB Number: 3064-NEW.

Estimated Number of Respondents: 19 state nonmember banks.

Estimated Time per Response: 280 hours.

Estimated Total Annual Burden: 21,280 hours.

OTS

OMB Number: 1550-NEW.

Estimated Number of Respondents: 5 savings associations.

Estimated Time per Response: 280 hours.

Estimated Total Annual Burden: 5,600 hours.

General Description of Reports

These information collections would be mandatory for banks using the Advanced Capital Adequacy Framework: 12 U.S.C. 161 (for national

banks), 12 U.S.C. 324 and 12 U.S.C. 1844(c) (for state member banks and BHCs, respectively), 12 U.S.C. 1817 (for insured state nonmember commercial and savings banks), and 12 U.S.C. 1464 (for savings associations). These information collections would be given confidential treatment (5 U.S.C. 552(b)(4)) except for selected data items to be released for data collected from a reporting entity during periods subsequent to its parallel run period (Schedules A and B, and data items 1-7 of Schedule V).

Abstract

Each bank that qualifies for and applies the advanced internal ratings-based approach for credit risk and the advanced measurement approach for operational risk would file quarterly regulatory data for the agencies' use in assessing and monitoring the levels and components of each reporting entity's risk-based capital requirements and the adequacy of the entity's capital under the Advanced Capital Adequacy Framework. These data also would support the agencies' efforts to evaluate the quantitative impact and competitive implications of the Advanced Capital Adequacy Framework on individual reporting entities and on an industry-wide basis. The reporting schedules would also assist banks in understanding expectations surrounding the system development necessary for implementation and validation of the Advanced Capital Adequacy Framework. The submitted data that is released publicly would also provide other interested parties with information about banks' risk-based capital. In addition, the submitted data would supplement on-site examination processes.

Current Actions; Risk-Based Capital Standards; Advanced Capital Adequacy Framework; Regulatory Reporting Requirements

I. Background

The agencies have today published a joint notice of proposed rulemaking entitled Risk-Based Capital Standards: Advanced Capital Adequacy Framework (the NPR).³ The NPR describes a new regulatory capital framework for U.S. banks that qualify for and adopt the advanced internal ratings-based (AIRB) approach for credit risk and the advanced measurement approach (AMA) for operational risk (together, the advanced approaches). Included within the NPR are requirements for public

² For the OCC: <http://www.occ.treas.gov>; for the FDIC: <http://www.fdic.gov>; for the OTS: <http://www.ots.treas.gov>; for the Board: <http://www.federalreserve.gov/boarddocs/reportforms/review.cfm>; and for the FFIEC: http://www.ffiec.gov/ffiec_report_forms.htm.

³ Terms used in this text and in the proposed regulatory reporting schedules and instructions are used as defined in the NPR.

disclosure of certain information at the consolidated banking organization level as well as a reference to certain additional regulatory reporting requirements for depository institutions (DIs) and BHCs. The additional regulatory reporting requirements referenced within the NPR, and described more fully herein, comprise the agencies' proposed regulatory reporting requirements.

The agencies, all of which would have access to both the public and confidential data submitted in these schedules by each bank, would use the data collected through this proposal to:

- Assess the components of each bank's risk-based capital requirements;
- Assess each bank's capital relative to inherent risks and the agencies' minimum capital requirements;
- Monitor the levels and components of the risk-based capital requirements for banks through peer, outlier, and risk trend analyses;
- Evaluate the quantitative impact and competitive implications of the implementation of the Advanced Capital Adequacy Framework on risk-based capital levels within reporting banks and on an overall industry basis;
- Provide market participants, depositors, the public, supervisors, and other interested parties with information about banks' risk-based capital; and

- Supplement on-site examination processes and decisions pertaining to the allocation of supervisory resources.

In addition, this proposal would assist supervised institutions in understanding expectations surrounding the system development necessary for implementation and validation of the Advanced Capital Adequacy Framework.

The agencies require the ability to monitor and assess individual banks' conformance with capital adequacy standards and understand the capital resulting from the implementation of the Advanced Capital Adequacy Framework. The current regulatory capital data submitted by banks would not provide relevant information regarding risk-based capital under the Advanced Capital Adequacy Framework. As a result, the agencies outline in this notice their proposed changes in regulatory capital reporting for banks using the Advanced Capital Adequacy Framework within the United States. Because the NPR includes transitional arrangements that involve capital floors linked to the general risk-based capital rules (as defined in the NPR), the agencies believe it is necessary to require data submissions under both the general risk-based

capital rules and advanced risk-based capital frameworks for as long as a bank is subject to risk-based capital floors.

As noted in the NPR, the agencies intend to conduct analyses to gauge the impact of the Advanced Capital Adequacy Framework, and the preparedness of banks to compute risk-based capital consistent with those requirements, during the parallel run and transitional floor periods. Data submitted through this proposal, combined with dual reporting requirements for the general risk-based capital data,⁴ would provide quantitative support for these impact analyses. Such analyses would also help the agencies evaluate the competitive and cyclical implications of the Advanced Capital Adequacy Framework relative to capital requirements for banks subject to the general risk-based capital rules and the adequacy of capital generated under the Advanced Capital Adequacy Framework.

A bank that applies the proposed advanced approaches would generally use its internal risk measurement systems to estimate risk parameters for credit risk exposures and to estimate operational risk exposure. The bank would use specific risk-based capital formulas to transform the risk parameters into risk-weighted asset amounts for each wholesale credit exposure and segment of retail credit exposures. For each wholesale credit exposure and segment of retail credit exposures, a bank would assign three quantitative risk parameter estimates: Probability of default (PD), which measures the likelihood that an obligor will default over a one-year horizon; loss given default (LGD), which is an estimate of the economic loss if a default occurs during downturn economic conditions; and exposure at default (EAD), which is measured in dollars and is an estimate of the amount that would be owed to the bank at the time of default. For each wholesale credit exposure, the bank would also determine effective maturity (M), which is measured in years and reflects the effective remaining maturity of the exposure. These risk parameters are the drivers of the bank's regulatory capital requirement for wholesale and retail

credit exposures and the focus of much of the proposed regulatory reporting.

Under the advanced approaches, a bank would employ simple risk weights to determine regulatory capital requirements for certain equity and securitization exposures, and may use internal models to determine regulatory capital requirements for other equity and securitization exposures, as well as for operational risk. The associated proposed regulatory reporting schedules primarily relate to data on inputs to and outputs from these internal models and risk-weight functions.

Under the advanced approaches, a bank would use its internal systems and processes to assess its exposure to operational risk. The proposed operational risk reporting schedule would capture some of the critical inputs used by the bank to estimate its operational risk exposure.

The agencies believe it is necessary to develop surveillance tools to assist in monitoring banks' risk-based capital measures. Such surveillance tools include the ability to perform bank-to-bank comparisons of the risk-based capital drivers underlying banks' capital measures, the ability to identify potential outliers through bank-to-peer comparisons, and the ability to monitor banks' capital measures over time relative to trends in other risk indicators.

The agencies believe that certain information about banks' risk-based capital calculations that would be submitted under this proposal should be publicly available to market participants and that such disclosures at the bank level are consistent with the agencies' objectives of promoting market discipline as described in part VII of the preamble of the NPR. The agencies intend that the public data items contained within this proposal would provide market participants with basic, summary-level standardized information about the main components of banks' risk-based capital requirements. The standardized regulatory reporting information that would be available to the public should augment the disclosures required for other public financial reporting purposes.

As is true for any off-site surveillance system, the collection of advanced risk-based capital data is unlikely to capture the full range and complexity of bank activities. As a result, the agencies recognize that it will often not be possible to draw definitive conclusions from an analysis of data submissions without further follow-up through on-site supervisory activities. Nevertheless, the agencies believe that off-site

⁴ General risk-based capital data under the existing risk-based capital standards are currently captured in the Consolidated Reports of Condition and Income (Call Report) for banks (Form FFIEC 031 or FFIEC 041; OMB No. 1557-0081 for the OCC, 7100-0036 for the Board, and 3064-0052 for the FDIC), the Thrift Financial Report (TFR) for savings associations (OTS Form 1313; OMB No. 1550-0023), and the Consolidated Financial Statements for Bank Holding Companies (Board Form FR Y-9C; OMB No. 7100-0128).

analyses of the data described in this proposal would be helpful in focusing the activities of on-site examiners and deploying supervisory resources most effectively.

In developing this proposal, the agencies weighed several considerations. The factors the agencies considered included several trade-offs between reporting burden and the information needs of bank supervisors and market participants (for example, the level of reporting granularity necessary to produce meaningful comparisons of portfolio-level risks while minimizing reporting compliance costs and the potential for collected information to promote more informed decisions by market participants against the sensitive and confidential nature of risk estimates embedded within the advanced approaches). The agencies have also tried to anticipate and include data that meet their long-term data needs because comprehensive requests for data at the inception of a new reporting regime typically would be less costly to reporting institutions than the addition of items at a later date. The agencies believe this proposal appropriately balances these, and other, competing considerations.

The agencies are publishing the NPR and the regulatory reporting proposal described herein at the same time as their notice of proposed rulemaking for the Market Risk Framework and its associated regulatory reporting proposal so that the industry, and other interested parties, may assess the full impact of the proposed rules. Part of this assessment includes an understanding of the requirements of compliant data systems, including the ability to produce certain high-level capital information for the public and more detailed, but still aggregated, summary information about each bank's capital risk estimates to augment supervisory processes.

II. Scope and Frequency of Reporting

The proposed regulatory reporting requirements associated with the NPR described herein would apply, on a consolidated basis, to each BHC and each DI that qualifies for and applies the advanced approaches (see Part I, Section 1, of the proposed regulatory text in the NPR for a detailed description of the institutions covered by this notice) as well as to those banks in the parallel run stage of qualifying to use the advanced approaches (see Part III, Section 21(c) of the proposed regulatory text in the NPR). Reporting BHCs and DIs would submit data quarterly because efforts to monitor banks' progress toward, and actions under, the Advanced Capital

Adequacy Framework require regular and consistent reports from all of the institutions adopting this framework.

The agencies expect that the report due dates for the proposal described herein would be the same as the report due dates currently required of banks, savings associations, and BHCs when filing their respective Call Report, TFR, or BHC FR Y-9C report. In addition, the agencies expect all banks to meet the existing reporting standards for accuracy and other requirements as currently mandated by their primary Federal supervisor.

The first reporting period for Schedules A through V for each reporting entity seeking to qualify for the advanced approaches would correspond to the first quarter of its parallel run period. All data collected from each reporting entity on Schedules A through V, including those data items identified as public data items below, would remain confidential during the entity's parallel run period. The data items identified below as public data elements would be available to the public for each reporting entity for data collected during reporting periods subsequent to the entity's parallel run period.

Reporting banks would be required to submit capital information under both this reporting proposal and under the existing risk-based capital reporting requirements during both the relevant parallel run period and subsequent transitional floor periods.⁵ The purpose of this dual reporting requirement is threefold: (1) It would facilitate dialogue between supervisors and banks as banks bring their systems and data into compliance with supervisory expectations; (2) it would allow the agencies to monitor and ensure compliance with existing risk-based capital rules during the parallel run period and with those rules that would be in effect during subsequent transitional floor periods; and (3) it would aid in supervisors' development of comparisons of risk-based capital results between the Advanced Capital Adequacy Framework and the existing risk-based capital frameworks for individual institutions and for the banking industry in the aggregate.

III. Overview of the Data Collection Proposal

The agencies believe that banks would produce the data necessary to support supervisory analyses as part of their calculation of regulatory capital requirements. Accordingly, the regulatory reporting proposal requires

certain data that would be publicly available and other data that would not be publicly available. Although this reporting proposal has not been designed to satisfy the NPR's Pillar 3 public disclosure requirements, banks may be able to use certain data items submitted through this proposal to help satisfy certain public disclosure requirements established in the Advanced Capital Adequacy Framework.

A. Publicly Available Risk-Based Capital Data for the Advanced Approaches

Regulatory reporting disclosures that would be publicly available for data collected from a reporting bank during periods subsequent to its parallel run period comprise various aggregated portfolio drivers of reporting banks' risk-based capital levels. The intent of these disclosures is to provide market participants, depositors, supervisors, the public, and other interested parties with a sufficient level of detail (comparable, in principle, to risk-based capital information collected currently) about banks' major capital and risk-weighted asset components as well as summary information about the composition of regulatory capital and the risk parameters that underlie risk-weighted asset calculations.

Proposed Schedules A and B (and data items 1-7 of proposed Schedule V, Operational Risk) show the data items that would be publicly available for each reporting entity for reporting periods subsequent to its parallel run period. Schedule A contains information about the components of Tier 1 capital, Tier 2 capital, and adjustments to regulatory capital as defined within the NPR.⁶ Schedule B contains summary information about risk-weighted assets by risk type, and, in the case of credit risk exposures, outstanding balances and aggregated information about the drivers and

⁶ One version of Schedule A would apply to banks and BHCs and another version of Schedule A would apply to savings associations. The version for banks and BHCs is modeled after the portion of the Call Report and BHC FR Y-9C report used to capture information on the components of and adjustments to Tier 1 and Tier 2 capital under the existing risk-based capital standards. Similarly, the version of Schedule A for savings associations is modeled after the portion of the TFR used to capture such information under the existing standards. In addition, to the extent the information collected in the Call Report, BHC FR Y-9C report, and TFR on the components of and adjustments to Tier 1 and Tier 2 capital under the existing standards is revised, e.g., for changes in the fair value of liabilities to which a fair value option is applied that are attributable to changes in a reporting entity's own creditworthiness, corresponding revisions would be made to Schedule A.

⁵ See footnote 4.

estimates that underlie the calculation of risk-weighted assets. The general exposure breakdowns in Schedule B are as follows: Wholesale Exposures (including separate reporting for the following types of exposures: Corporate; Bank; Sovereign; Construction Income Producing Real Estate; High Volatility Commercial Real Estate; Income Producing Real Estate; Eligible Margin Loans, Repo-Style Transactions, and OTC Derivatives with Cross Product Netting; Eligible Margin Loans, Repo-Style Transactions, and OTC Derivatives without Cross Product Netting); Retail Exposures (including separate reporting for the following types of exposures: Residential Mortgage Closed-end First Liens, Residential Mortgage Closed-end Junior Liens, Residential Mortgage Revolving Exposures, Qualifying Revolving Exposures Credit Cards, Qualifying Revolving Exposures All Other, Other Retail Small Business, and Other Retail All Other); Securitization Exposures; Equity Exposures; and Operational Risk. The aggregate data items submitted in Schedule B are derived from information contained in the more detailed confidential supporting schedules described below. The exposures and risk parameters used to calculate these aggregations would apply the definitions contained in the NPR. The data contained in Schedule B describe the main summary-level components of banks' risk-weighted assets, but would not allow users to exactly replicate banks' risk-weighted asset calculations since the data are averaged, weighted, and rounded.

B. Non-Publicly Available Risk-Based Capital Data for the Advanced Approaches

The confidential data submitted in these schedules by each bank would be shared among the four agencies but would not be released to the public. Data items that would not be publicly available comprise additional, but still aggregated, detail about the main data items and drivers of reporting banks' risk-based capital levels. With respect to credit portfolios, the focus of these more detailed reports is to collect information at the level of supervisory PD bands that broadly reflect risk segments within each portfolio. The proposed reports would enable supervisors to conduct off-site assessments of banks' regulatory capital calculations, perform trend analyses of capital changes, conduct peer analyses of capital and risk parameters, and focus on-site examination efforts.

The data items contained in Schedules C through V describe the main components of banks' risk-

weighted assets and are essentially expanded detail of the more summary information contained in the public data items shown in Schedule B. The data submitted in these schedules would not be made available to the public (except for data items 1–7 of Schedule V, Operational Risk, which are proposed to become public information for each reporting entity for data collected during periods subsequent to its parallel run reporting period). Supervisors are requesting these data to support comparisons of certain critical capital drivers across banks and across time. For the reasons cited previously, however, the information contained in the columns of the tables would not allow users to exactly replicate banks' risk-weighted asset calculations.

A brief description of the content of Schedules C through V follows. As with the publicly available information described above, the exposures and risk parameters used to calculate these aggregations would apply the definitions contained in the NPR.

Wholesale Exposures

Schedules C through K show data items within the wholesale exposure category that would be submitted under this proposal. Each schedule represents a sub-portfolio of the wholesale exposure category as listed on the public Schedule B. For each reported sub-portfolio, the schedule groups exposures into sub-portfolio segments using supervisor-defined PD ranges. The reported cells within these schedules then describe the main risk parameters and characteristics of each sub-portfolio segment.

Retail Exposures

Schedules L through R show data items within the retail exposure category that would be submitted under this proposal. Again, each schedule represents a sub-portfolio of the retail exposure category as listed on the public Schedule B. PD ranges are used to sub-divide each sub-portfolio into segments.⁷ The reported cells within these schedules then describe the main risk parameters and characteristics of each sub-portfolio segment. The retail schedules also incorporate risk characteristics that are believed to be commonly used drivers within banks' risk management and measurement processes, including the distribution of each sub-portfolio segment by loan-to-value ranges (applies only to real estate exposures), weighted average credit

bureau score, and weighted average account age.⁸

Securitization Exposures

Schedules S and T show data items within the securitization exposure class that would be submitted under this proposal. Schedule S provides information by rating categories about exposures subject to either the Ratings-Based Approach (RBA) or the Internal Assessment Approach (IAA). Schedule T provides certain memoranda information about unrated securitization exposures, exposures treated under the Supervisory Formula Approach, synthetic securitizations, and risk-weighted assets relating to early amortization features of securitizations as prescribed in the NPR.⁹

Equities

Schedule U provides information about a bank's equity exposures by type of exposure and by approach to measuring required capital. Schedule U also provides information on equity exposures subject to specific risk weights and equity exposures to investment funds. A bank would also complete the appropriate section of the schedule based on whether it uses a simple risk-weight approach, a full internal models approach, or a partially modeled approach to measuring required capital for equity exposures.

Operational Risk

Schedule V shows the data items within the operational risk exposure class that banks would submit under this proposal. Data items submitted in this schedule include various details about historical operational losses, on a stand-alone and group-wide basis, for the current reporting period and those historical operational losses used to model operational risk capital. The schedule also contains data items related to scenarios, distribution assumptions, and loss caps used to model operational risk capital.

IV. Request for Comment

Public comment is requested on all aspects of this joint notice. The agencies wish to encourage banks and other interested parties to comment on such matters as data availability, data alternatives, and reporting thresholds for each proposal for new data. The agencies are particularly interested in responses to the questions that follow

⁸ For qualifying and other non-mortgage retail exposures, the EAD of accounts under two years old is reported instead of weighted average age for each sub-portfolio exposure segment.

⁹ Amounts are further broken down by retail and non-retail.

⁷ Unlike the wholesale credit exposure reporting schedules, the PD ranges for retail exposures differ from sub-portfolio to sub-portfolio.

relating to certain key aspects of the proposal and potential data collection alternatives.

(1) The agencies seek comment from the industry concerning the feasibility of collecting certain additional information beyond that described in this proposal. The purpose of this additional information is to help identify the causes of changes in credit risk regulatory capital requirements (for example, due to changes in exposure mix or changes in the bank's assessment of risk).

To facilitate such analyses, reporting banks would be required to submit additional data items that summarize current and previous risk parameters for exposures that were in wholesale and retail credit portfolios as of the previous reporting period (for example, prior quarter, prior year)—the “lookback” portfolio. The intent of this lookback-portfolio approach would be to allow the agencies to better identify reasons for observed changes in regulatory credit risk capital requirements and allow for peer comparisons of changes from period to period.

A lookback-portfolio approach would require additional data collection and processing. For example, banks would need to retain data on the internal risk rating category to which each exposure was previously assigned, and the previous EAD of each exposure. The agencies believe that this data maintenance requirement is consistent with supervisory expectations described in the NPR and proposed AIRB guidance in that banks subject to the Advanced Capital Adequacy Framework are expected to be able to evaluate and explain changes in risk parameters in order to assess their risk parameter estimation procedures.

The agencies specifically seek industry comment on the following questions:

- What aggregate summary information might banks submit that best describes or characterizes period-to-period migration across internal rating grades or retail segments?
- If such information were required, are there particular formats or other considerations that would reduce the reporting burden for banks?

(2) The agencies are considering another alternative reporting treatment with respect to the wholesale and retail portions of the above proposal (Schedules C–R). This alternative treatment would complement the lookback-portfolio approach just described but could be implemented whether or not the lookback-portfolio approach was implemented. Under this approach, banks would submit data

according to each of their internal obligor rating grades or segments, rather than in the fixed bands defined in the current regulatory reporting proposal. In this case, each reporting bank could submit a different number of rows corresponding to the number of internal risk rating/segmentation categories employed by that bank for the given portfolio.

The agencies specifically seek industry comment on the following question:

- Would reporting burden be lessened if banks submitted data using internally-defined obligor grades or segments, rather than aggregating the grades or segments in supervisory reporting bands?

(3) The agencies request comment on the appropriateness of making the data items on Schedules A and B and data items 1 through 7 of the operational risk reporting schedule (Schedule V) available to the public for each reporting entity for data collected during periods subsequent to its parallel run reporting periods as currently proposed. Comments are requested on the extent to which banks are already providing these data to the public or are planning to make such data public as well as the timing of these disclosures. In addition, comments are requested on the perceived risks associated with public reporting of these data items.

(4) What changes in the proposed regulatory reporting requirements for the Advanced Capital Adequacy Framework, including additional data or definitions, would better assist the agencies in reaching their stated goals? In this regard, the agencies also seek input on possible alternative ways to capture the requested information and the appropriateness of the requested data given the stated purposes of the information collections and the associated reporting burden.

Paperwork Reduction Act

The agencies seek comment on:

(a) Whether the proposed collections of information are necessary for the proper performance of the agencies' functions, including whether the information has practical utility;

(b) The accuracy of the agencies' estimates of the burden of the proposed information collections, including the validity of the methodology and assumptions used;

(c) Ways to enhance the quality, utility, and clarity of the information to be collected;

(d) Ways to minimize the burden of the information collections on respondents, including through the use of automated collection techniques or

other forms of information technology; and

(e) Estimates of capital or start up costs and costs of operation, maintenance, and purchase of services to provide information.

Comments submitted in response to this joint notice will be shared among the agencies and will be summarized or included in the agencies' requests for OMB approval. All comments will become a matter of public record.

Dated: September 6, 2006.

Stuart E. Feldstein,

Assistant Director, Legislative and Regulatory Activities Division, Office of the Comptroller of the Currency.

Board of Governors of the Federal Reserve System, September 11, 2006.

Jennifer J. Johnson,

Secretary of the Board.

Dated at Washington, DC, this 8th day of September, 2006.

Federal Deposit Insurance Corporation.

Robert E. Feldman,

Executive Secretary.

Dated: September 7, 2006.

Deborah Dakin,

Senior Deputy Chief Counsel, Regulations and Legislation Division, Office of Thrift Supervision.

[FR Doc. 06–7674 Filed 9–22–06; 8:45 am]

BILLING CODE 4810–33–P; 6210–01–P; 6714–01–P; 6720–01–P

DEPARTMENT OF THE TREASURY

Office of the Comptroller of the Currency

FEDERAL RESERVE SYSTEM

FEDERAL DEPOSIT INSURANCE CORPORATION

DEPARTMENT OF THE TREASURY

Office of Thrift Supervision

Proposed Agency Information Collection Activities; Comment Request

AGENCIES: Office of the Comptroller of the Currency (OCC), Treasury; Board of Governors of the Federal Reserve System (Board); Federal Deposit Insurance Corporation (FDIC); and Office of Thrift Supervision (OTS), Treasury.

ACTION: Joint notice and request for comment.

SUMMARY: In accordance with the requirements of the Paperwork Reduction Act of 1995 (44 U.S.C.

chapter 35), the OCC, the Board, the FDIC, and the OTS (collectively, the agencies) may not conduct or sponsor, and the respondent is not required to respond to, an information collection unless it displays a currently valid Office of Management and Budget (OMB) control number. The Federal Financial Institutions Examination Council (FFIEC), of which the agencies are members, has approved the agencies' publication for public comment of proposed new regulatory reporting requirements for banks¹ that are subject to the agencies' revised market risk capital rules. The proposal describes the scope of reporting and the proposed reporting requirements. At the end of the comment period, the comments and recommendations received will be analyzed to determine the extent to which the FFIEC should modify the proposed reporting requirements prior to giving its final approval. The agencies will then submit the proposed reporting requirements to OMB for review and approval and, upon approval, OMB will assign control numbers.

DATES: Comments must be received on or before January 23, 2007.

ADDRESSES: Interested parties are invited to submit written comments to any or all of the agencies. All comments will be shared among the agencies.

OCC: You may submit comments, identified by "OMB Control No. 1557-NEW," by any of the following methods:

- **E-mail:**

regs.comments@occ.treas.gov. Include "OMB Control No. 1557-NEW" in the subject line of the message.

- **Fax:** (202) 874-4448.

- **Mail:** Public Information Room, Office of the Comptroller of the Currency, 250 E Street, SW., Mailstop 1-5, Washington, DC 20219; Attention: OMB Control No. 1557-NEW.

Public Inspection: You may inspect and photocopy comments at the Public Information Room. You can make an appointment to inspect the comments by calling (202) 874-5043.

Board: You may submit comments, which should refer to "Market Risk Framework Regulatory Reporting Requirements," by any of the following methods:

- **Agency Web Site:** <http://www.federalreserve.gov>. Follow the instructions for submitting comments on the <http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm>.

- **Federal eRulemaking Portal:** <http://www.regulations.gov>. Follow the instructions for submitting comments.

- **E-mail:**

regs.comments@federalreserve.gov. Include "Market Risk Framework Regulatory Reporting Requirements" in the subject line of the message.

- **Fax:** 202-452-3819 or 202-452-3102.

- **Mail:** Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, NW., Washington, DC 20551.

All public comments are available from the Board's Web site at <http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm> as submitted, unless modified for technical reasons. Accordingly, your comments will not be edited to remove any identifying or contact information. Public comments may also be viewed electronically or in paper in Room MP-500 of the Board's Martin Building (20th and C Streets, NW.) between 9 a.m. and 5 p.m. on weekdays.

FDIC: You may submit comments, which should refer to "Market Risk Framework Regulatory Reporting Requirements," by any of the following methods:

- <http://www.FDIC.gov/regulations/laws/federal/notices.html>.

- **E-mail:** comments@FDIC.gov.

Include "Market Risk Framework Regulatory Reporting Requirements" in the subject line of the message.

- **Mail:** Steven F. Hanft, Clearance Officer (202-898-3907), Legal Division, Federal Deposit Insurance Corporation, 550 17th Street, NW., Washington, DC 20429.

- **Hand Delivery:** Comments may be hand delivered to the guard station at the rear of the 550 17th Street Building (located on F Street) on business days between 7 a.m. and 5 p.m.

Public Inspection: All comments received will be posted without change to <http://www.fdic.gov/regulations/laws/federal/propose.html> including any personal information provided.

Comments may be inspected at the FDIC Public Information Center, Room E-1002, 3502 North Fairfax Drive, Arlington, VA 22226, between 9 a.m. and 5 p.m. on business days.

OTS: You may submit comments, identified by "Market Risk Framework Regulatory Reporting Requirements (1550-NEW)," by any of the following methods:

- **Federal eRulemaking Portal:** <http://www.regulations.gov>. Follow the instructions for submitting comments.

- **E-mail address:**

infocollection.comments@ots.treas.gov. Please include "Market Risk Framework Regulatory Reporting Requirements (1550-NEW)" in the subject line of the message and include your name and telephone number in the message.

- **Fax:** (202) 906-6518.

- **Mail:** Information Collection Comments, Chief Counsel's Office, Office of Thrift Supervision, 1700 G Street, NW., Washington, DC 20552, Attention: "Market Risk Framework Regulatory Reporting Requirements (1550-NEW)."

- **Hand Delivery/Courier:** Guard's Desk, East Lobby Entrance, 1700 G Street, NW., from 9 a.m. to 4 p.m. on business days, Attention: Information Collection Comments, Chief Counsel's Office, Attention: "Market Risk Framework Regulatory Reporting Requirements (1550-NEW)."

Instructions: All submissions received must include the agency name and "Market Risk Framework Regulatory Reporting Requirements (1550-NEW)." All comments received will be posted without change to the OTS Internet Site at <http://www.ots.treas.gov/pagehtml.cfm?catNumber=67&an=1>, including any personal information provided.

Docket: For access to the docket to read background documents or comments received, go to <http://www.ots.treas.gov/pagehtml.cfm?catNumber=67&an=1>.

In addition, you may inspect comments at the Public Reading Room, 1700 G Street, NW., by appointment. To make an appointment for access, call (202) 906-5922, send an e-mail to public.info@ots.treas.gov, or send a facsimile transmission to (202) 906-7755. (Prior notice identifying the materials you will be requesting will assist us in serving you.) We schedule appointments on business days between 10 a.m. and 4 p.m. In most cases, appointments will be available the next business day following the date we receive a request.

A copy of the comments may also be submitted to the OMB desk officer for the agencies by mail to the Office of Information and Regulatory Affairs, U.S. Office of Management and Budget, New Executive Office Building, Room 10235, 725 17th Street, NW., Washington, DC 20503, or by fax to (202) 395-6974.

FOR FURTHER INFORMATION CONTACT: For further information about the proposed regulatory reporting requirements discussed in this notice, please contact

¹For simplicity, and unless otherwise indicated, this notice uses the term "bank" to include banks, savings associations, and bank holding companies (BHCs). The terms "bank holding company" and "BHC" refer only to bank holding companies regulated by the Board and do not include savings and loan holding companies regulated by the OTS. For a detailed description of the institutions covered by this notice, refer to Section 1(b) of the proposed regulatory text in the notice of proposed rulemaking entitled Risk-Based Capital Standards: Market Risk.

any of the agency clearance officers whose names appear below. In addition, copies of the reporting schedule and instructions can be obtained at each agency's web site as well as the FFIEC's Web site.²

OCC: Please direct substantive questions to Margot Schwadron, Risk Expert, Capital Policy Division, (202) 874-6022, and requests for copies of the collection to Mary Gottlieb, OCC Clearance Officer, or Camille Dickerson, (202) 874-5090, Legislative and Regulatory Activities Division, Office of the Comptroller of the Currency, 250 E Street, SW., Washington, DC 20219.

Board: Michelle Long, Federal Reserve Board Clearance Officer, Division of Research and Statistics, Board of Governors of the Federal Reserve System, Washington, DC 20551 (202-452-3829).

FDIC: Steven F. Hanft, Clearance Officer, at shanft@fdic.gov, (202-898-3907), Legal Division, Federal Deposit Insurance Corporation, 550 17th Street, NW., Washington, DC 20429.

OTS: Marilyn K. Burton, OTS Clearance Officer, at marilyn.burton@ots.treas.gov, (202) 906-6467, or facsimile number (202) 906-6518, Litigation Division, Chief Counsel's Office, Office of Thrift Supervision, 1700 G Street, NW., Washington, DC 20552.

SUPPLEMENTARY INFORMATION: The agencies are proposing to implement the following new information collections.

Report Title: Market Risk Regulatory Reporting Requirements.

Form Numbers: FFIEC 102.

Frequency of Response: Quarterly.

Affected Public: Business or other for-profit.

OCC

OMB Number: 1557-NEW.

Estimated Number of Respondents: 10 national banks.

Estimated Time per Response: 11.75 burden hours.

Estimated Total Annual Burden: 470 hours.

Board

OMB Number: 7100-NEW.

Estimated Number of Respondents: 4 state member banks.

Estimated Time per Response: 11.75 hours.

Estimated Total Annual Burden: 188 hours.

OMB Number: 7100-NEW.

² For the OCC: <http://www.occ.treas.gov>; for the FDIC: <http://www.fdic.gov>; for the OTS: <http://www.ots.treas.gov>; for the Board: <http://www.federalreserve.gov/boarddocs/reportforms/review.cfm>; and for the FFIEC: http://www.ffiec.gov/ffiec_report_forms.htm.

Estimated Number of Respondents: 18 BHCs.

Estimated Time per Response: 11.75 hours.

Estimated Total Annual Burden: 846 hours.

FDIC

OMB Number: 3064-NEW.

Estimated Number of Respondents: 3 state nonmember banks.

Estimated Time per Response: 11.75 burden hours.

Estimated Total Annual Burden: 141 hours.

OTS

OMB Number: 1550-NEW.

Estimated Number of Respondents: 1 savings association.

Estimated Time per Response: 11.75 hours.

Estimated Total Annual Burden: 47 hours.

General Description of Reports

These information collections would be mandatory for banks that meet the market risk requirements within the agencies' risk-based capital standards: 12 U.S.C. 161 (for national banks), 12 U.S.C. 324 and 12 U.S.C. 1844(c) (for state member banks and BHCs, respectively), 12 U.S.C. 1817 (for insured state nonmember commercial and savings banks), and 12 U.S.C. 1464 (for savings associations). These information collections would be given confidential treatment (5 U.S.C. 552(b)(4)).

Abstract

Each bank that meets the market risk requirements within the agencies' risk-based capital standards would file quarterly regulatory reports for the agencies' use in assessing the reasonableness and accuracy of a reporting entity's calculation of its minimum capital requirements under the market risk rules and in evaluating an entity's capital in relation to its risks.

Current Actions

Risk-Based Capital Standards: Market Risk Framework: Regulatory Reporting Requirements

I. Background

The agencies have today published a joint notice of proposed rulemaking entitled Risk-Based Capital Standards: Market Risk (the Market Risk NPR).³ The Market Risk NPR, which would apply to all banks that meet the market risk requirements, describes proposed

changes to the agencies' existing market risk rules.⁴ Included within the Market Risk NPR are requirements for public disclosure of certain information at the consolidated banking organization level as well as a reference to certain additional regulatory reporting by depository institutions (DIs) and BHCs. The additional regulatory reporting referenced within the Market Risk NPR, and described more fully herein, comprise the agencies' proposed regulatory reporting requirements.

The agencies are publishing the Market Risk NPR and the regulatory reporting proposal described herein at the same time as their notice of proposed rulemaking for the Advanced Capital Adequacy Framework for risk-based capital and its associated regulatory reporting proposal so that the industry, and other interested parties, may assess the full impact of the two proposed rules.

At present, banks and BHCs that are subject to the existing market risk rules report the amount of their market risk equivalent assets in their respective quarterly regulatory reports.⁵ This current reporting requirement reveals only the end result of the market risk calculations without providing any information concerning the key inputs to the measure for market risk.

Accordingly, the agencies are proposing the standardized regulatory reporting requirements described herein in order to assess the reasonableness and accuracy of a bank's calculation of its minimum capital requirements under the proposed revised Market Risk rule and to evaluate a bank's capital in relation to its risks. Importantly, the new reports will allow the agencies to better track growth in more credit-risk related, less liquid, and less actively traded products in the trading book that, in the past, have had risks that have been difficult to capture and measure. These reports should assist the agencies in ensuring that these risks are adequately reflected for safety and soundness purposes.

In this regard, the reported data will enable the agencies to monitor the levels

⁴ For the OTS, the Market Risk NPR provides a new framework for assessing capital for market risk.

⁵ For banks, the Consolidated Reports of Condition and Income (Call Report) (Form FFIEC 031 or FFIEC 041; OMB No. 1557-0081 for the OCC, 7100-0036 for the Board, and 3064-0052 for the FDIC) and, for BHCs, the Consolidated Financial Statements for Bank Holding Companies (Board Form FR Y-9C; OMB No. 7100-0128). As mentioned in footnote 4, for the OTS, the Market Risk NPR provides a new framework for assessing capital for market risk. As a consequence, savings associations currently are not subject to a regulatory reporting requirement related to market risk in the Thrift Financial Report (OTS Form 1313; OMB No. 1550-0023).

³ Terms used in this text and in the proposed regulatory reporting schedule and instructions are used as defined in the Market Risk NPR.

of and trends in components that comprise the market risk measure under the proposed revised rule within and across reporting banks. Such component reporting will allow supervisors to better understand, on an ongoing basis, model implied diversification benefits for individual banks. The agencies also will gain the ability to perform bank-to-bank comparisons of the drivers underlying banks' measures for market risk, identify potential outliers through bank-to-peer comparisons, track these drivers at banks over time relative to trends in other risk indicators, and focus onsite examination efforts. Furthermore, the agencies believe that requiring certain common reporting across banks would facilitate comparable application of the proposed revised Market Risk rule.

Scope and Frequency of Regulatory Reporting

The proposed regulatory reporting requirements associated with the Market Risk NPR would apply, on a consolidated basis, to each BHC and each DI that is required to calculate its risk-based capital using the market risk rules (see Section 1(b) of the proposed regulatory text in the Market Risk NPR for a detailed description of the institutions covered by this notice). Reporting BHCs and DIs would submit reports quarterly because efforts to monitor banks' progress toward, and actions under, the Market Risk rules require regular and consistent reports from all of the institutions subject to this rule.

The agencies expect that the report due dates for the proposal described herein would be the same as the report due dates currently required by banks, savings associations, and bank holding companies when filing their respective quarterly regulatory reports. In addition, the agencies expect all banks to meet the existing reporting standards for accuracy and other requirements as currently mandated by their primary Federal supervisor.

Schedule 1, for market risk, would first be reported at the end of the first calendar quarter in which the market risk rule becomes effective.

II. Overview of the Data Collection Proposal

Schedule 1 shows the data elements within the market risk exposure class that would be reported under the Market Risk NPR. The data submitted in Schedule 1 will be shared among the four agencies but will not be released to the public. The schedule is subdivided into sections. The first section contains data elements relating to banks' approved regulatory market risk models including details of value at risk (VaR) measures (as of the reporting date and averaged over 60 days) broken down by associated risk categories (interest rate, equity, foreign exchange, commodities, and credit) and specific risk charges. The second section contains data elements relating to market risk exposures covered under the standard method broken down by covered debt and equity positions. Other sections contain data elements relating to summary information on default risk charges and valuation adjustments.

In developing this proposal, the agencies considered several trade-offs between reporting burden and the information needs of bank supervisors. One issue that the agencies identified was that banks have exposures in certain products that might fit into more than one of the specified risk categories (interest rate, equity, foreign exchange, commodities, and credit). For example, convertible securities will mostly be subject to interest rate risk unless their value converges with that of the underlying equity. Similarly, foreign exchange swaps are primarily interest rate positions, but it is possible that a bank might classify some as foreign exchange risk. As a result, the agencies propose that banks may classify their exposures in the same categories in which they are reported internally for purposes of calculating the VaRs for this reporting schedule. Similarly, the agencies, for purposes of this reporting schedule, have defined correlation benefit as any adjustment to VaR that a bank makes to reflect statistical correlation between the values of the underlying positions. The agencies also recognize that some banks may not adjust for correlation benefits in their VaR estimates, and in that case a bank need not estimate it for purposes of this reporting schedule.

III. Request for Comment

Public comment is requested on all aspects of this joint notice. The agencies wish to encourage banks and other interested parties to comment on such matters as data availability and data alternatives. In addition, comments are invited on:

(a) Whether the proposed collections of information are necessary for the proper performance of the agencies' functions, including whether the information has practical utility;

(b) The accuracy of the agencies' estimates of the burden of the proposed information collections, including the validity of the methodology and assumptions used;

(c) Ways to enhance the quality, utility, and clarity of the information to be collected;

(d) Ways to minimize the burden of information collections on respondents, including through the use of automated collection techniques or other forms of information technology; and

(e) Estimates of capital or start up costs and costs of operation, maintenance, and purchase of services to provide information.

Comments submitted in response to this joint notice will be shared among the agencies and will be summarized or included in the agencies' requests for OMB approval. All comments will become a matter of public record.

Dated: September 6, 2006.

Stuart E. Feldstein,

Assistant Director, Legislative and Regulatory Activities Division, Office of the Comptroller of the Currency.

Board of Governors of the Federal Reserve System, September 11, 2006.

Jennifer J. Johnson

Secretary of the Board.

Federal Deposit Insurance Corporation.

Dated at Washington, DC, this 8th day of September, 2006.

Robert E. Feldman,

Executive Secretary.

Dated: September 7, 2006.

Deborah Dakin,

Senior Deputy Chief Counsel, Regulations and Legislation Division, Office of Thrift Supervision.

[FR Doc. 06-7675 Filed 9-22-06; 8:45 am]

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Potato research and promotion plan; published 8-25-06

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Makhnati Island area; subsistence management jurisdiction; published 8-24-06

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Shipping and transportation; technical, organizational, and conforming amendments; published 9-25-06

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LIST OF PUBLIC LAWS

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S. 3534/P.L. 109-281

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200-499	(869-060-00075-5)	50.00	Apr. 1, 2006
500-699	(869-060-00076-3)	30.00	Apr. 1, 2006
700-1699	(869-060-00077-1)	61.00	Apr. 1, 2006
1700-End	(869-060-00078-0)	30.00	Apr. 1, 2006
25	(869-060-00079-8)	64.00	Apr. 1, 2006
26 Parts:			
§§ 1.0-1.160	(869-060-00080-1)	49.00	Apr. 1, 2006
§§ 1.61-1.169	(869-060-00081-0)	63.00	Apr. 1, 2006
§§ 1.170-1.300	(869-060-00082-8)	60.00	Apr. 1, 2006
§§ 1.301-1.400	(869-060-00083-6)	47.00	Apr. 1, 2006
§§ 1.401-1.440	(869-060-00084-4)	56.00	Apr. 1, 2006
§§ 1.441-1.500	(869-060-00085-2)	58.00	Apr. 1, 2006
§§ 1.501-1.640	(869-060-00086-1)	49.00	Apr. 1, 2006
§§ 1.641-1.850	(869-060-00087-9)	61.00	Apr. 1, 2006
§§ 1.851-1.907	(869-060-00088-7)	61.00	Apr. 1, 2006
§§ 1.908-1.1000	(869-060-00089-5)	60.00	Apr. 1, 2006
§§ 1.1001-1.1400	(869-060-00090-9)	61.00	Apr. 1, 2006
§§ 1.1401-1.1550	(869-060-00091-2)	58.00	Apr. 1, 2006
§§ 1.1551-End	(869-060-00092-5)	50.00	Apr. 1, 2006
2-29	(869-060-00093-3)	60.00	Apr. 1, 2006
30-39	(869-060-00094-1)	41.00	Apr. 1, 2006
40-49	(869-060-00095-0)	28.00	Apr. 1, 2006
50-299	(869-060-00096-8)	42.00	Apr. 1, 2006

Title	Stock Number	Price	Revision Date	Title	Stock Number	Price	Revision Date
300-499	(869-060-00097-6)	61.00	Apr. 1, 2006	63 (63.6580-63.8830)	(869-056-00150-9)	32.00	July 1, 2005
500-599	(869-060-00098-4)	12.00	⁵ Apr. 1, 2006	63 (63.8980-End)	(869-056-00151-7)	35.00	⁷ July 1, 2005
600-End	(869-060-00099-2)	17.00	Apr. 1, 2006	*64-71	(869-060-00152-2)	29.00	July 1, 2006
27 Parts:				72-80	(869-056-00153-5)	62.00	July 1, 2005
1-399	(869-060-00100-0)	64.00	Apr. 1, 2006	*81-85	(869-060-00154-9)	60.00	July 1, 2006
400-End	(869-060-00101-8)	18.00	Apr. 1, 2006	86 (86.1-86.599-99)	(869-060-00155-7)	58.00	July 1, 2006
28 Parts:				86 (86.600-1-End)	(869-056-00156-8)	50.00	July 1, 2005
0-42	(869-060-00102-6)	61.00	July 1, 2006	87-99	(869-056-00157-6)	60.00	July 1, 2005
43-End	(869-060-00103-4)	60.00	July 1, 2006	100-135	(869-056-00158-4)	45.00	July 1, 2005
29 Parts:				136-149	(869-056-00159-2)	61.00	July 1, 2005
0-99	(869-060-00104-2)	50.00	July 1, 2006	150-189	(869-056-00160-6)	50.00	July 1, 2005
100-499	(869-060-00105-1)	23.00	July 1, 2006	190-259	(869-060-00161-1)	39.00	July 1, 2006
500-899	(869-060-00106-9)	61.00	July 1, 2006	*260-265	(869-060-00162-0)	50.00	July 1, 2006
900-1899	(869-060-00107-7)	36.00	⁷ July 1, 2006	266-299	(869-056-00163-1)	50.00	July 1, 2005
1900-1910 (§§ 1900 to				*300-399	(869-060-00164-6)	42.00	July 1, 2006
1910.999)	(869-060-00108-5)	61.00	July 1, 2006	400-424	(869-056-00165-7)	56.00	⁸ July 1, 2005
1910 (§§ 1910.1000 to				425-699	(869-056-00166-5)	61.00	July 1, 2005
end)	(869-060-00109-3)	46.00	July 1, 2006	700-789	(869-056-00167-3)	61.00	July 1, 2005
1911-1925	(869-060-00110-7)	30.00	July 1, 2006	790-End	(869-056-00168-1)	61.00	July 1, 2005
1926	(869-060-00111-5)	50.00	July 1, 2006	41 Chapters:			
1927-End	(869-060-00112-3)	62.00	July 1, 2006	1, 1-1 to 1-10		13.00	³ July 1, 1984
30 Parts:				1, 1-11 to Appendix, 2 (2 Reserved)		13.00	³ July 1, 1984
*1-199	(869-060-00113-1)	57.00	July 1, 2006	3-6		14.00	³ July 1, 1984
200-699	(869-056-00114-2)	50.00	July 1, 2005	7		6.00	³ July 1, 1984
700-End	(869-060-00115-8)	58.00	July 1, 2006	8		4.50	³ July 1, 1984
31 Parts:				9		13.00	³ July 1, 1984
0-199	(869-060-00116-6)	41.00	July 1, 2006	10-17		9.50	³ July 1, 1984
200-499	(869-060-00117-4)	46.00	July 1, 2006	18, Vol. I, Parts 1-5		13.00	³ July 1, 1984
*500-End	(869-060-00118-2)	62.00	July 1, 2006	18, Vol. II, Parts 6-19		13.00	³ July 1, 1984
32 Parts:				18, Vol. III, Parts 20-52		13.00	³ July 1, 1984
1-39, Vol. I		15.00	² July 1, 1984	19-100		13.00	³ July 1, 1984
1-39, Vol. II		19.00	² July 1, 1984	1-100	(869-056-00169-0)	24.00	July 1, 2005
1-39, Vol. III		18.00	² July 1, 1984	101	(869-060-00170-1)	21.00	¹¹ July 1, 2006
*1-190	(869-060-00119-1)	61.00	July 1, 2006	102-200	(869-056-00171-1)	56.00	July 1, 2005
191-399	(869-056-00120-7)	63.00	July 1, 2005	201-End	(869-056-00172-0)	24.00	July 1, 2005
400-629	(869-060-00121-2)	50.00	July 1, 2006	42 Parts:			
*630-699	(869-060-00122-1)	37.00	July 1, 2006	1-399	(869-056-00173-8)	61.00	Oct. 1, 2005
700-799	(869-056-00123-1)	46.00	July 1, 2005	400-429	(869-056-00174-6)	63.00	Oct. 1, 2005
800-End	(869-060-00124-7)	47.00	July 1, 2006	430-End	(869-056-00175-4)	64.00	Oct. 1, 2005
33 Parts:				43 Parts:			
1-124	(869-056-00125-8)	57.00	July 1, 2005	1-999	(869-056-00176-2)	56.00	Oct. 1, 2005
125-199	(869-056-00126-6)	61.00	July 1, 2005	1000-end	(869-056-00177-1)	62.00	Oct. 1, 2005
200-End	(869-056-00127-4)	57.00	July 1, 2005	44	(869-056-00178-9)	50.00	Oct. 1, 2005
34 Parts:				45 Parts:			
1-299	(869-060-00128-0)	50.00	July 1, 2006	1-199	(869-056-00179-7)	60.00	Oct. 1, 2005
300-399	(869-060-00129-8)	40.00	July 1, 2006	200-499	(869-056-00180-1)	34.00	Oct. 1, 2005
400-End & 35	(869-060-00130-1)	61.00	July 1, 2006	500-1199	(869-056-00171-9)	56.00	Oct. 1, 2005
36 Parts:				1200-End	(869-056-00182-7)	61.00	Oct. 1, 2005
1-199	(869-060-00131-0)	37.00	July 1, 2006	46 Parts:			
200-299	(869-060-00132-8)	37.00	July 1, 2006	1-40	(869-056-00183-5)	46.00	Oct. 1, 2005
300-End	(869-056-00133-9)	61.00	July 1, 2005	41-69	(869-056-00184-3)	39.00	⁹ Oct. 1, 2005
37	(869-056-00134-7)	58.00	July 1, 2005	70-89	(869-056-00185-1)	14.00	⁹ Oct. 1, 2005
38 Parts:				90-139	(869-056-00186-0)	44.00	Oct. 1, 2005
0-17	(869-060-00135-2)	60.00	July 1, 2006	140-155	(869-056-00187-8)	25.00	Oct. 1, 2005
18-End	(869-060-00136-1)	62.00	July 1, 2006	156-165	(869-056-00188-6)	34.00	⁹ Oct. 1, 2005
39	(869-060-00137-9)	42.00	July 1, 2006	166-199	(869-056-00189-4)	46.00	Oct. 1, 2005
40 Parts:				200-499	(869-056-00190-8)	40.00	Oct. 1, 2005
1-49	(869-056-00138-0)	60.00	July 1, 2005	500-End	(869-056-00191-6)	25.00	Oct. 1, 2005
50-51	(869-060-00139-5)	45.00	July 1, 2006	47 Parts:			
*52 (52.01-52.1018)	(869-060-00140-9)	60.00	July 1, 2006	0-19	(869-056-00192-4)	61.00	Oct. 1, 2005
52 (52.1019-End)	(869-056-00141-0)	61.00	July 1, 2005	20-39	(869-056-00193-2)	46.00	Oct. 1, 2005
53-59	(869-060-00142-5)	31.00	July 1, 2006	40-69	(869-056-00194-1)	40.00	Oct. 1, 2005
*60 (60.1-End)	(869-060-00143-3)	58.00	July 1, 2006	70-79	(869-056-00195-9)	61.00	Oct. 1, 2005
60 (Apps)	(869-060-00144-7)	57.00	July 1, 2006	80-End	(869-056-00196-7)	61.00	Oct. 1, 2005
61-62	(869-060-00145-0)	45.00	July 1, 2006	48 Chapters:			
63 (63.1-63.599)	(869-056-00146-1)	58.00	July 1, 2005	1 (Parts 1-51)	(869-056-00197-5)	63.00	Oct. 1, 2005
63 (63.600-63.1199)	(869-056-00147-9)	50.00	July 1, 2005	1 (Parts 52-99)	(869-056-00198-3)	49.00	Oct. 1, 2005
63 (63.1200-63.1439)	(869-056-00148-7)	50.00	July 1, 2005	2 (Parts 201-299)	(869-056-00199-1)	50.00	Oct. 1, 2005
63 (63.1440-63.6175)	(869-056-00149-5)	32.00	July 1, 2005	3-6	(869-056-00200-9)	34.00	Oct. 1, 2005
				7-14	(869-056-00201-7)	56.00	Oct. 1, 2005
				15-28	(869-056-00202-5)	47.00	Oct. 1, 2005

Title	Stock Number	Price	Revision Date
29-End	(869-056-00203-3)	47.00	Oct. 1, 2005
49 Parts:			
1-99	(869-056-00204-1)	60.00	Oct. 1, 2005
100-185	(869-056-00205-0)	63.00	Oct. 1, 2005
186-199	(869-056-00206-8)	23.00	Oct. 1, 2005
200-299	(869-056-00207-6)	32.00	Oct. 1, 2005
300-399	(869-056-00208-4)	32.00	Oct. 1, 2005
400-599	(869-056-00209-2)	64.00	Oct. 1, 2005
600-999	(869-056-00210-6)	19.00	Oct. 1, 2005
1000-1199	(869-056-00211-4)	28.00	Oct. 1, 2005
1200-End	(869-056-00212-2)	34.00	Oct. 1, 2005
50 Parts:			
1-16	(869-056-00213-1)	11.00	Oct. 1, 2005
17.1-17.95(b)	(869-056-00214-9)	32.00	Oct. 1, 2005
17.95(c)-end	(869-056-00215-7)	32.00	Oct. 1, 2005
17.96-17.99(h)	(869-056-00215-7)	61.00	Oct. 1, 2005
17.99(i)-end and 17.100-end	(869-056-00217-3)	47.00	Oct. 1, 2005
18-199	(869-056-00218-1)	50.00	Oct. 1, 2005
200-599	(869-056-00218-1)	45.00	Oct. 1, 2005
600-End	(869-056-00219-0)	62.00	Oct. 1, 2005
CFR Index and Findings			
Aids	(869-060-00050-0)	62.00	Jan. 1, 2006
Complete 2006 CFR set	1,398.00		2006
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¹ Because Title 3 is an annual compilation, this volume and all previous volumes should be retained as a permanent reference source.

² The July 1, 1985 edition of 32 CFR Parts 1-189 contains a note only for Parts 1-39 inclusive. For the full text of the Defense Acquisition Regulations in Parts 1-39, consult the three CFR volumes issued as of July 1, 1984, containing those parts.

³ The July 1, 1985 edition of 41 CFR Chapters 1-100 contains a note only for Chapters 1 to 49 inclusive. For the full text of procurement regulations in Chapters 1 to 49, consult the eleven CFR volumes issued as of July 1, 1984 containing those chapters.

⁴ No amendments to this volume were promulgated during the period January 1, 2005, through January 1, 2006. The CFR volume issued as of January 1, 2005 should be retained.

⁵ No amendments to this volume were promulgated during the period April 1, 2000, through April 1, 2006. The CFR volume issued as of April 1, 2000 should be retained.

⁶ No amendments to this volume were promulgated during the period April 1, 2005, through April 1, 2006. The CFR volume issued as of April 1, 2004 should be retained.

⁷ No amendments to this volume were promulgated during the period July 1, 2004, through July 1, 2005. The CFR volume issued as of July 1, 2004 should be retained.

⁸ No amendments to this volume were promulgated during the period July 1, 2004, through July 1, 2005. The CFR volume issued as of July 1, 2003 should be retained.

⁹ No amendments to this volume were promulgated during the period October 1, 2004, through October 1, 2005. The CFR volume issued as of October 1, 2004 should be retained.

¹⁰ No amendments to this volume were promulgated during the period April 1, 2005, through April 1, 2006. The CFR volume issued as of April 1, 2005 should be retained.

¹¹ No amendments to this volume were promulgated during the period July 1, 2005, through July 1, 2006. The CFR volume issued as of July 1, 2005 should be retained.