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The U.S. Basel III Endgame Reproposal: Analysis of the Securitization Framework

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On March 19, 2026, the Board of Governors of the Federal Reserve System ("**FRB**"), the Office of the Comptroller of the Currency (the "**OCC**"), and the Federal Deposit Insurance Corporation (the "**FDIC**") (collectively, the "**Agencies**") issued three concurrent notices of proposed rulemaking (collectively, the "**Reproposal**") that would substantially revise the risk-based capital framework for U.S. banking organizations.

The Reproposal would revise the U.S. implementation of the final components of the Basel III framework, commonly referred to as "Basel III Endgame," and consists of the following:

1. The "**ERBA NPR**" (jointly issued by all three Agencies)[1] would introduce a new framework for calculating risk-weighted assets, referred to as the "expanded risk-based approach" ("**ERBA**") that would be mandatory for Category I and II banking organizations and available on an opt-in basis for other banking organizations.

    - *This NPR replaces and rescinds the July 2023 Basel III Endgame proposal (the "**2023 NPR**").*[2]

    - *ERBA would replace the advanced approaches under the current capital rule.*

2. The "**SA NPR**" (jointly issued by all three Agencies)[3] would revise the standardized approach (the "**Revised Standardized Approach**") applicable to all banking organizations other than those that are required to, or elect to use, ERBA.[4]

3. The "**GSIB Surcharge NPR**" (issued solely by the FRB)[5] would amend the framework for identifying and establishing risk-based capital surcharges for U.S. global systemically important bank holding companies.

    - *This NPR replaces and rescinds the Board's September 2023 GSIB surcharge proposal.*[6]

The Reproposal would eliminate the current "dual stack" for Category I and II banking organizations. Instead of requiring those firms to calculate risk-based capital under both the standardized approach and the advanced approaches, the reproposal would require Category I and II banking organizations to use ERBA, while the Revised Standardized Approach would continue to apply to other banking organizations unless they elect to adopt the New ERBA Approach.

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[1]Regulatory Capital Rule: Category I and II Banking Organizations, Banking Organizations With Significant Trading Activity, and Optional Adoption for Other Banking Organizations, 91 Fed. Reg. 14952 (March 27, 2026).

[2]88 Fed. Reg. 64028 (Sept. 18, 2023). Our summary of the 2023 NPR can be found here.

[3]Regulatory Capital Rules: Regulatory Capital and Standardized Approach for Risk-Weighted Assets, 91 Fed. Reg. 15332 (March 27, 2026).

[4]Neither ERBA nor the Revised Standardized Approach would apply to (1) qualifying community banks who have elected to use the community bank leverage ratio (CBLR) Framework or (2) small bank holding companies that are subject to the Small Bank Holding Company and Savings and Loan Holding Company Policy Statement.

[5]Regulatory Capital Rule (Regulation Q): Risk-Based Capital Surcharges for Global Systemically Important Bank Holding Companies; Systemic Risk Report (FR Y–15), 91 Fed. Reg. 14908 (March 27, 2026).

[6]88 Fed. Reg. 60385 (Sept. 1, 2023).

The Reproposal addresses a wide range of topics and would revise many components of the risk-based capital framework.[7] In this memorandum, we focus on the Reproposal's treatment of securitization exposures under both the ERBA and the Revised Standardized Approach.

Comments on the Reproposal are due on **June 18, 2026**.

Appendix A of this memorandum contains the list of questions posed by the Agencies regarding the securitization framework and related credit risk mitigation provisions. We note that the Reproposal contains many more questions regarding the securitization framework than did the 2023 NPR or the NPRs relating to the initial Basel III standards implemented in 2013.

Appendices B-1 through B-4 of this memorandum contain the revised underlying risk weights for commonly-securitized assets, as well as the junior and senior tranche sizes consistent with the risk weight floor.[8]

- The Agencies have not specified a target date for issuing a final rule. A final rule later in 2026 is possible, but timing remains uncertain.

- The Reproposal does not propose an effective date, but the ERBA NPR asks for comment as to the "appropriate amount of time between the publication of any final rule and its effective date."[9]

[7]For a general overview of the Reproposal, see Federal Banking Agencies Issue Long-Awaited Basel III Endgame Reproposal (March 26, 2026), where is available here.

[8]The appendices assume that none of the underlying assets are past due.

[9]*See* the ERBA NPR, at p. 14957 (Question 2). The SA NPR does not separately pose this question, although it does propose to provide Category III and IV banking organizations that do not currently recognize AOCI in their regulatory capital with a phase-in for reflecting AOCI in their regulatory capital over a five-year period from the effective date of any final rule.

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Executive Summary

The Reproposal significantly revises the securitization capital framework applicable to U.S. banking organizations. The key changes include:

- **SEC-SA.** The Reproposal would replace the current bifurcated securitization capital framework (the simplified supervisory formula approach ("**SSFA**") and the gross-up approach under the standardized approach, and supervisory formula approach ("**SFA**") under the advanced approaches) with a single securitization standardized approach ("**SEC-SA**") methodology under both ERBA and the Revised Standardized Approach.

  The most significant change from the 2023 NPR is the retention of the p-factor at 0.5 for non-resecuritization exposures, rather than the previously-proposed increase to 1.0. The Reproposal also lowers the general risk weight floor from 20% to 15%, while imposing a 100% risk weight floor for resecuritization exposures and non-performing loan securitization exposures.

  The Reproposal makes a number of targeted, but important, revisions to the SEC-SA inputs, including K_G, W, A, and D.

  Underlying risk weights for commonly securitized assets have changed materially and will significantly affect securitization capital requirements through the K_G input.

- **Exceptions to SEC-SA.** The Reproposal introduces a look-through approach for senior securitization exposures that are not resecuritization exposures (risk weight equal to the weighted-average risk weight of the underlying exposures, floored at 15%), a dedicated 100% risk weight for certain senior securitization exposures to qualifying non-performing loan ("**NPL**") securitizations, revised treatment for nth-to-default credit derivatives that bypasses SEC-SA, expanded treatment for overlapping exposures, and a common equity tier 1 ("**CET1**") deduction (rather than a 1,250% risk weight) for the portion of a credit-enhancing interest-only ("**CEIO**") strip that does not constitute after-tax gain on sale.

- **Revised Securitization Definitions.** The Reproposal generally retains the existing definitions of traditional and synthetic securitization, but would add prepaid credit protection arrangements to the synthetic definition, provide that traditional securitizations can transfer credit *or equity* risk, and require that securitization exposures "depend solely" on the performance of the underlying exposures. The "depends solely" change, if read literally, could exclude many common traditional securitizations from the securitization framework.

- **New Operational Criteria for Synthetic Securitizations.** The Reproposal generally retains the existing operational criteria for synthetic securitizations, but adds several important changes. The eligible credit risk mitigation ("**CRM**") list now includes eligible prepaid credit protection arrangements" and excludes nth-to-default credit derivatives.

  The operational criteria also include a prohibition on synthetic excess spread, a minimum payment threshold requirement, and a restriction on synthetic securitizations that include both revolving exposures and an early amortization provision.

  The definition of "eligible clean-up call" is expanded to cover certain regulatory and tax events.

- **Eligible Prepaid Credit Protection Arrangements; Other Changes to the Credit Risk Mitigation Framework.** The Reproposal introduces eligible prepaid credit protection arrangements as a new CRM category, providing a codified pathway for directly issued credit-linked notes which replaces the current reservation of authority process. The 40% restructuring haircut for eligible credit derivatives is relaxed, subject to specified conditions. Financial collateral recognition under the simple

approach is expanded to permit mismatched collateral, subject to applicable maturity- and currency-mismatch adjustments.

- **Changes to Credit Conversion Factors ("CCFs"); New Definition of Commitment.** CCFs for commitments that are not unconditionally cancelable are set at 40% regardless of maturity. ERBA introduces a 10% CCF for unconditionally cancelable commitments, while the Revised Standardized Approach retains a 0% CCF for such exposures. Off-balance sheet securitization exposures continue to be subject to a separate exposure-amount rule that generally produces an effective 100% CCF.

  The definition of "commitment" is significantly broadened to include contractual arrangements even where the banking organization is not obligated to extend credit or may refuse to do so with or without cause.

- **Other Changes Relevant to Securitization.** The Reproposal would eliminate the threshold-based CET1 deduction for mortgage servicing assets ("**MSAs**") and instead apply a 250% risk weight regardless of size.

  Under ERBA, securitization-related noninterest income and expenses would generally be included in the business-indicator calculation for operational risk; the reproposal does not provide a securitization-specific carve-out.

- **Comments and Implementation.** Comments on the Reproposal are due on June 18, 2026. The Reproposal does not propose an effective date, but the ERBA NPR asks for comment as to the "appropriate amount of time between the publication of any final rule and its effective date."

I. THE NEW SECURITIZATION STANDARDIZED APPROACH (SEC-SA)

The Reproposal would replace the current bifurcated securitization capital framework (SSFA and the gross-up approach under the standardized approach, and SFA under the advanced approaches) with a single SEC-SA methodology under both ERBA and the Revised Standardized Approach. The most significant change from the 2023 NPR is the retention of the p-factor at 0.5 for non-resecuritization exposures, rather than the previously-proposed increase to 1.0. The Reproposal also lowers the general risk weight floor from 20% to 15%, while imposing a 100% risk weight floor for resecuritization exposures and non-performing loan securitization exposures. The Reproposal makes a number of targeted, but important, revisions to the SEC-SA inputs, including K_G, W, A, and D. Underlying risk weights for commonly securitized assets have changed materially and will significantly affect securitization capital requirements through the K_G input.

Under the current capital rule, securitization exposures are risk weighted using different methodologies depending on the applicable framework: the simplified supervisory formula approach ("**SSFA**") and the gross-up approach[10] under the standardized approach, and the supervisory formula approach ("**SFA**") under the advanced approaches.[11] The Reproposal consolidates these into a single methodology, the SEC-SA, that would apply under both ERBA and the Revised Standardized Approach.

A. Overview

Like the SSFA, SEC-SA is a mathematical model that uses five inputs for calculating the risk weight for a given securitization exposure.

1. $\boldsymbol{K_G}$: The weighted average capital requirement associated with the underlying exposures (*i.e.*, the securitized assets) expressed as a decimal between zero and one.

2. $\boldsymbol{W}$: The proportion of underlying defaulted exposures expressed as a decimal between zero and one.

3. $\boldsymbol{A}$: The attachment point of the securitization exposure, or the point in the capital structure of the securitization at which the tranche begins to absorb losses.

4. $\boldsymbol{D}$: The detachment point of the securitization exposure, or the point in the capital structure of the securitization at which the tranche ceases to absorb losses.

5. $\boldsymbol{p}$: A supervisory calibration parameter that is equal to 0.5 (or 1.5 if the securitization exposure is a resecuritization exposure).

The values of $\boldsymbol{K_G}$ and $\boldsymbol{W}$ are then used to calculate $\boldsymbol{K_A}$, or the weighted average capital requirement for the underlying exposures adjusted to reflect any adverse performance: $K_A = (1 - W) * K_G + (0.5 * W)$.

SEC-SA uses the same mathematical approach as SSFA. The risk weight for a given securitization exposure is determined by the exposure's position relative to K_A, the adjusted capital requirement of the underlying pool,

[10]Under the existing standardized approach, a banking organization that is not a market risk banking organization may use the gross-up approach for risk weighting its securitization exposures. If the banking organization cannot or chooses not to apply the SSFA or the gross-up approach, it must assign a 1,250% risk weight to its securitization exposures.

[11]Under the advanced approaches, if a banking organization does not qualify for SFA, it must use SSFA or otherwise assign a 1,250% risk weight to the securitization exposure.

which serves as the threshold between the "dollar-for-dollar" capital region and the exponential decay region of the formula. Specifically, the SEC-SA risk weight is the average value of a piecewise function evaluated over the range [A, D].

1. If the securitization exposure is entirely junior to K_A (*i.e.*, $D < K_A$), then the exposure is assigned a risk weight of 1250%.[12]

2. If the securitization exposure is entirely senior to K_A (*i.e.*, $A > K_A$), then the exposure is assigned a risk weight of 1250% times a function (K_{SEC-SA}) that calculates the risk weight using an exponential decay that decreases with tranche seniority.

3. If the securitization exposure straddles K_A (*i.e.*, $A < K_A < D$), the risk weight is a weighted average: 1250% for the portion of the tranche below K_A and 1250% * K_{SEC-SA}, for the portion above.

The risk weight for a given securitization exposure is subject to a 15% risk-weight floor under SEC-SA (as compared to a 20% floor under SSFA). This is a material constraint since the risk weight for many senior securitization exposures would otherwise be well below 15%.

B. The Supervisory Calibration Parameter, p

The most consequential change from the 2023 NPR is the reduction in the supervisory calibration parameter, p (the "***p*-factor**"), from 1.0 to 0.5 for non-resecuritization exposures. This single recalibration reverses what was widely regarded as the most punitive securitization-related feature of the original proposal.[13]

Notably, the Reproposal does not adopt any form of preferential treatment for "simple, transparent, and comparable" ("**STC**") securitizations, including the proposal of market participants to establish a lower p-factor (0.25) for "qualifying securitization transactions" ("**QSTs**"). The QST proposal is a streamlined version of the STC framework adopted in other jurisdictions.[14]

The p-factor for resecuritizations remains at 1.5 under the Reproposal.[15]

	Current SSFA	2023 NPR	Industry Comments on 2023 NPR	Reproposal
Securitizations	0.5	1.0	QST: 0.25	0.5

[12]A 1250% risk weight is sometimes referred to as a "dollar-for-dollar" capital requirement (1250% * 8% = 100%).

[13]For a discussion of the impact of a 1.0 p-factor, *see* Frame, W. Scott and Horn, Christopher, *U.S. Banking Regulators Propose Markedly Higher Credit Risk Weights for Securitization* (January 31, 2025) (available here).

[14]To qualify as a "qualifying securitization transaction," a securitization would need to satisfy criteria including: the underlying exposures must be of the same asset class; junior liabilities may not have payment preference over senior liabilities that are due and payable; the originator and servicer must each have a minimum of five years of experience; at least five years of historical performance data for substantially similar exposures must be evaluated; no underlying exposure may be more than 30 days delinquent or in default at the final cut-off date; monthly performance reporting is required; revolving structures must include early amortization triggers; and legal isolation opinions (for traditional securitizations) or enforceability opinions (for synthetic securitizations) must be delivered. *See,* the 2023 NPR comment letters of the Structured Finance Association, (available here) (the "**SFA Comment Letter**"), at p. 33. *See, also*, the International Association of Credit Portfolio Managers (available here) (the "**IACPM Comment Letter**"), at p. 10.

[15]A resecuritization is defined as "a securitization which has more than one underlying exposure and in which one or more of the underlying exposures is a securitization exposure. *See* current §217.2. While the Reproposal does not seek to change this definition, market participants may wish to consider advocating for a revision to prevent a securitization from being characterized as a resecuritization if only a small portion of the underlying pool consists of securitization exposures.

	Current SSFA	2023 NPR	Industry Comments on 2023 NPR	Reproposal
			Non-QST: 0.5	
Resecuritizations	1.5	1.5	--	1.5

The p-factor governs the rate at which securitization risk weights decline as tranche seniority increases.[16] The value of the p-factor determines the amount of the securitization capital surcharge imposed by the SSFA and SEC-SA models; that is, the percentage amount by which a bank's capital requirement would increase if it held every tranche of a securitization rather than holding the underlying exposures directly. Where $p = 0.5$, the securitization capital surcharge is 50%. While this represents a significant improvement over the 2023 NPR's proposed surcharge of 100% (at $p = 1.0$), the 0.5 p-factor remains punitive.[17]

C. Risk Weight Floors

The Reproposal reduces the risk weight floor for securitization exposures from 20% under the current SSFA to 15% under the SEC-SA. For resecuritization exposures and NPL securitization exposures, the floor increases from 20% to 100%.[18]

The following table summarizes the risk weight floors under the current SSFA, the 2023 NPR, the Reproposal, and the positions taken by industry commenters.

	Current SSFA	2023 NPR	Industry Comments on 2023 NPR	Reproposal
Securitizations	20%	15%	QST: 10% Non-QST: 15% Look-through approach: no floor[19]	15%

[16]The p-factor appears in the decay rate of the exponential function underlying the proposed SEC-SA and current SSFA models. The decay rate is $\frac{1}{pK_A}$, where K_A is the weighted average capital requirement of the underlying exposures, adjusted for adverse performance. As p and K_A are in the denominator of the decay rate term, the rate at which risk weights decrease as tranche seniority increases is inversely proportional to the product of p and K_A.

[17]A U.S. Treasury report observed that "Dodd-Frank and various rulemakings implemented to address pre-crisis structural weaknesses in the securitization market may have gone too far toward discouraging securitization. By imposing excessive capital … requirements on securitizers, recent financial regulation has created significant disincentives to securitization." *See* U.S. Department of the Treasury, A Financial System That Creates Economic Opportunities – Capital Markets (October 2017) (the "**2017 Treasury Report**") (available here), at p. 8. The 2017 Treasury Report went on to recommend that "U.S. banking regulators should adjust the parameters of both the SSFA and the SFA. The *p* factor, already set at a punitive level that assesses a 50% surcharge on securitization exposures, should, at minimum, not be increased." *Id.*, at p. 100. Similarly, the European Commission's 2025 final proposal to amend the EU Securitisation Regulation observed that "[t]he experience with the [securitization] framework indicates that it is too conservative and limits the potential use of securitisations in the EU. High operational costs and overly conservative capital requirements keep many issuers and investors out of the securitisation market." *See* Proposal for a Regulation of the European Parliament and of the Council (June 17, 2025) (the "EU Proposal") (available here), at p. 1.

[18]As noted above, a resecuritization is defined as "a securitization which has more than one underlying exposure and in which one or more of the underlying exposures is a securitization exposure. *See* current §217.2. Given the 100% risk weight floor that the Reproposal would impose on resecuritizations, market participants may wish to seek a revision to prevent a securitization from being characterized as a resecuritization if only a small portion of the underlying pool consists of securitization exposures.

[19]The SFA recommended that the look-through approach for senior securitization exposures should not be subject to the 15% risk weight floor. The SFA argued that applying the floor to the look-through approach contradicts the Agencies' own stated rationale for the approach ("the credit risk associated with each dollar of a senior securitization exposure generally

	Current SSFA	2023 NPR	Industry Comments on 2023 NPR	Reproposal
Resecuritizations	20%	100%	Should not apply where both the resecuritization exposure and the underlying exposures are senior securitization exposures.[20]	100%
NPL Securitizations	20%[21]	100%	--	100%[22]

D. Attachment and Detachment Points; NRPPD

The attachment point (A) and detachment point (D) define the securitization exposure's position in the capital structure; *i.e.*, the thresholds at which losses in the underlying pool begin to erode the exposure (A) and at which losses would result in a total loss of principal (D). The following table compares the definitions and related adjustments across the current SSFA, the 2023 NPR, and the Reproposal.

	Current SSFA	2023 NPR	Reproposal
A (attachment point)	Ratio of "**current dollar amount**" of underlying exposures subordinated to the bank's exposure to the "**current dollar amount**" of underlying exposures.	Same basic formula, but uses "**outstanding balance**" as the unit of measurement (tracking the Basel Committee on Bank Supervision ("**BCBS**") standard at CRE 44.14).	Reverts to "**current dollar amount**" as the unit of measurement (consistent with the current SSFA).
D (detachment point)	A plus the ratio of the current dollar amount of pari passu securitization exposures to the "**current dollar amount**" of underlying exposures.	Same basic formula, but uses "**outstanding balance**" as the unit of measurement (tracking the BCBS standard at CRE 44.14).	Reverts to "**current dollar amount**" (consistent with the current SSFA).

will not be greater than the credit risk associated with each dollar of the underlying assets, because the non-senior tranches of a securitization provide credit enhancement to the senior tranche"). The SFA further noted that the 2023 NPR deviates from the Basel standard on this point: the BCBS standard provides that "[w]here the risk weight cap [*i.e.*, the look-through] results in a lower risk weight than the floor risk weight of 15%, the risk weight resulting from the cap should be used." *See* SFA Comment Letter, Part X, at pp. 57-60. The Reproposal does not adopt this recommendation.

[20]The SFA argued that the 100% resecuritization floor should not apply if both the resecuritization exposure and the underlying exposures are senior securitization exposures. The SFA cited the example of resecuritizations of servicer advance reimbursement rights in RMBS transactions, observing that these are senior securitization exposures for which a 100% floor "is disproportionate to the actual risk" and would limit the ability of mortgage servicers to provide future forbearance in times of need (as they did during the COVID pandemic). *See* SFA Comment Letter, Part IV, at pp. 42-44. The Reproposal does not adopt this recommendation.

[21]There is no NPL-specific treatment in the current rule; NPL securitizations are subject to the same 20% floor as all other securitization exposures. In practice, however, the SSFA risk weight for an NPL securitization would typically be well in excess of 20%, because the high levels of delinquency and default in the underlying pool would produce a large W parameter, significantly increasing K_A and the resulting risk weight.

[22]The Agencies seek comment on the proposed 100% risk weight floor. *See* Question 78 in the ERBA NPR, and Question 52 in the SA NPR.

	Current SSFA	2023 NPR	Reproposal
Adjustments to ***A*** and ***D***	Reserve accounts funded by accumulated cash flows and subordinated to the bank's exposure may be included in A to the extent cash is present.	Reserve accounts must be included.	Same as 2023 NPR.
	No exclusion for derivatives or cash collateral accounts.	Interest rate/FX derivative contracts and related cash collateral accounts excluded from A and D.	Same as 2023 NPR.
	No NRPPD provision.	NRPPD must be included in numerator and denominator of A and D.	Same as 2023 NPR.
NRPPD (non-refundable purchase price discount)	No NRPPD concept in SSFA.	**Nonrefundable purchase price discount (NRPPD)** means the difference between the initial outstanding balance of the exposures in the underlying pool and the price at which these exposures are sold by the originator to the securitization SPE, when neither originator nor the original lender are reimbursed for this difference. In cases where the originator underwrites tranches of a NPL securitization for subsequent sale, the NRPPD may include the differences between the notional amount of the tranches and the price at which these tranches are first sold to unrelated third parties. For any given piece of a securitization tranche, only its initial sale from the originator to investors is taken into account in the determination of NRPPD. The purchase prices of subsequent re-sales are not considered.	**Nonrefundable purchase price discount (NRPPD)** means the difference between the ~~initial~~ outstanding principal balance of the **underlying** exposures ~~in the underlying pool~~ **at the time of sale** and the price at which these exposures are sold by the originator to ~~the securitization SPE~~ **a company the activities of which are limited to those appropriate for the specific purpose of holding the underlying exposures of a securitization**,[23] when neither originator nor the original lender are reimbursed for this difference. In cases where the originator underwrites tranches of ~~a~~ **an** NPL securitization for subsequent sale, the NRPPD may include the differences between the ~~notional amount of the tranches~~ **outstanding principal balance of the underlying exposures at the time of sale** and the price at which ~~these~~ **all of the** tranches are

[23]This substitution reflects the removal of the "securitization SPE" defined term.

	Current SSFA	2023 NPR	Reproposal
			first sold to unrelated third parties. For any given piece of a securitization tranche, only its initial sale from the originator to investors is taken into account in the determination of NRPPD. The purchase prices of subsequent re-sales **of a securitization tranche** are not considered.

The Reproposal does not explain why the unit of measurement in the attachment and detachment points was changed from "outstanding balance" under the 2023 NPR to "current dollar amount." The Reproposal stresses that the securitization framework can apply even if all or substantially all of the underlying assets are equity exposures.[24] As equity exposures generally do not have "outstanding balances," the Agencies may have decided to simply revert to the existing "current dollar amount" standard in an attempt to cover both credit and equity exposures. Market participants may wish to seek clarification that "current dollar amount" means outstanding balance, in the case of credit exposures, or fair value (or other appropriate measurement), in the case of equity exposures.[25]

E. K_G, K_A, and Parameter W

	Current SSFA	2023 NPR	Industry Comments on 2023 NPR	Reproposal
K_G	K_G is the weighted-average (with unpaid principal used as the weight for each exposure) total capital requirement of the underlying exposures calculated using this subpart.[26]	K_G is the weighted average (with the outstanding balance used as the weight for each exposure) total capital requirement of the underlying exposures calculated using this subpart, adjusted as indicated below.	*See discussion below.*	Same as 2023 NPR, except that the average is weighted on the basis of "unpaid principal" in the case of each credit exposure and "fair value" in the case of each equity exposure.

[24] *See* ERBA NPR, at p. 14995; SA NPR, at p. 15354.

[25] The Agencies made this clarification in the proposed definition of K_G, which is the weighted average capital requirement of the underlying exposures "with unpaid principal used as the weight for each credit exposure and fair value used for each equity exposure."

[26] K_G is expressed as a decimal value between zero and one (that is, an average risk weight of 100 percent represents a value of K_G equal to 0.08).

	Current SSFA	2023 NPR	Industry Comments on 2023 NPR	Reproposal
	Adjustments: None	Adjustments: (i) For interest rate derivative contracts and exchange rate derivative contracts, the "positive current exposure" times the risk weight of the counterparty multiplied by 0.08 must be included in the numerator of K_G but must be excluded from the denominator of K_G. (ii) If a bank transfers credit risk via a synthetic securitization to a securitization SPE and if the securitization SPE issues funded obligations to investors, the bank must include the total capital requirement (exposure amount multiplied by risk weight multiplied by 0.08) of any collateral held by the securitization SPE in the numerator of K_G. The denominator of K_G is calculated without recognition of the collateral.	*See discussion below.*	Adjustments: (i) For interest rate derivative contracts and exchange rate derivative contracts, the "positive current exposure" times the risk weight of the counterparty multiplied by 0.08 must be included in the numerator of K_G but must be excluded from the denominator of K_G. (*Same as 2023 NPR*) (ii) For purposes of K_G, the determination of the capital requirement associated with an underlying exposure that is an equity exposure cannot use the favorable 100% risk weight for the non-significant equity exposure category in §__.141(b)(3)(iii). *(The adjustment under the 2023 NPR with respect to collateral in a synthetic securitization is not included in the Reproposal.)*
$\boldsymbol{K_A}$	$(1-W)*K_G+(0.5*W)$	*Same as SSFA.*	*See discussion below.*	*Same as SSFA and 2023 NPR.*
$\boldsymbol{W}$	Ratio of the "dollar amounts" of nonperforming underlying exposures (90+ days past due, in bankruptcy, in foreclosure, held as	Same nonperformance criteria as SSFA, but (i) excludes underlying exposures that are themselves	*See discussion below.*	Same as 2023 NPR, except: (i) reverts to "dollar amounts" in the numerator (while retaining "outstanding balance" in the

	Current SSFA	2023 NPR	Industry Comments on 2023 NPR	Reproposal
	REO, in default, or with contractually deferred payments for 90+ days) to the dollar amount of all underlying exposures.	securitization exposures; and (ii) uses "outstanding balance" rather than "dollar amounts" as the unit of measurement.		denominator);[27] and (ii) adds a new exclusion permitting exposures directly and unconditionally guaranteed by the U.S. Government, its central bank, or a U.S. Government agency to be excluded from W up to the amount of the guarantee.

- Both ERBA and the Revised Standardized Approach make significant revisions to the risk weights of assets that are commonly securitized, including residential mortgage loans, commercial mortgage loans, corporate loans, and retail loans. These underlying risk weights enter the SEC-SA calculation through the K_G input and will have a significant impact on securitization risk weights.

- **Appendices B-1** through **B-4** contain tables showing the thinnest junior tranche / thickest senior tranche sizes consistent with the 15% risk weight floor using the proposed risk weights for various types of commonly-securitized assets.

In their comments to the 2023 NPR, market participants raised several concerns regarding the SEC-SA formula parameters that remain unaddressed in the Reproposal. While technical in nature, these concerns are consequential, not only because they affect the SEC-SA risk weight calculation itself, but also because a bank's ability to use SEC-SA at all is conditioned on having "accurate information" on A, D, W, and K_G.[28]

1. Calculation of K_G

The table below depicts the calculation of K_G under the Reproposal, as well as some related Agency commentary.

$K_G = \frac{\sum(UPB_i * RW_i * 0.08) + \sum(FV_j * RW_j * 0.08) + \sum(PCE_k * RW_{cpty,k} * 0.08)}{\sum UPB_i + \sum FV_j}$	
UPB_i =unpaid principal balance of underlying credit exposure i RW_i =risk weight of underlying credit exposure i under the general framework	The Reproposal states: "Consistent with the current capital rule, the proposal would require banking organizations to treat any assets that are included in a reserve account as underlying exposures of the securitization exposure, which must be reflected in parameters A and D as well as K_G and the W parameter."[29]
FV_j =fair value of underlying equity exposure j	

[27] Whether this asymmetry is intentional or a drafting error is unclear; market participants may wish to seek clarification.

[28] *See* ERBA NPR, at p. 14997; SA NPR, at p. 15356.

[29] *See* ERBA NPR, at p. 14998 (fn. 174); SA NPR, at p. 15357 (fn. 87).

$\boldsymbol{RW_j}$ =risk weight of underlying equity exposure j under the general framework, excluding the non-significant equity exposure risk weight.[31]	The Reproposal asks: "[W]hat are the advantages and disadvantages of a modification that would clarify that banking organizations could apply the same credit conversion factors ... when calculating the components of the SEC-SA (K_G, W, A and D) for a securitization exposure where the underlying exposures are off-balance sheet exposures?"[30]
$\boldsymbol{PCE_k}$ =positive current exposure of interest rate or exchange rate derivative contract k (*i.e.*, the larger of zero and the fair value of the derivative that would be lost upon default of the counterparty) $\boldsymbol{RW_{cpty,k}}$ =risk weight of the counterparty to derivative contract k	

Positive current exposure. The Reproposal carries forward the 2023 NPR's requirement that the positive current exposure of each interest rate and exchange rate derivative (referred to above as PCE_k**)**, adjusted for the counterparty's credit risk (referred to above as $RW_{cpty,k}$), be included in the numerator, but not the denominator, of K_G. The securitization framework does not separately define "positive current exposure," but the capital rules define "current exposure" as "the larger of zero or the fair value of a transaction ... that would be lost upon default of the counterparty, assuming no recovery on the value of the transaction[]."[32]

This change, if adopted, would make the calculation of K_G significantly more difficult, as it would require an ongoing reassessment of the fair value of each interest rate and exchange rate derivative to which the SPE is a party, as well as the risk weight of the derivative counterparty. As the SFA pointed out in its comment letter on the 2023 NPR:

> requiring banks to calculate the positive current exposure of any interest rate or exchange rate derivate contract presents a significant operational burden. The information necessary to calculate the positive current exposure is not readily available from the other sources of information used to calculate risk weights generally, such as monthly servicing reports, trustee reports, or data from providers such as Intex and Bloomberg.[33]

As was the case in the 2023 NPR, the Reproposal does not explain why the positive current exposure of interest rate and exchange rate derivatives should be included in the calculation of K_G.[34] Rather, the Reproposal states that such exposure should be included in the numerator only, because including it in the denominator "could

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[31]The non-significant equity exposure risk weight is the favorable 100% risk weight for equity exposures to the extent the banking organization's aggregate adjusted carrying value of equity exposures does not exceed 10% of total capital. *See* §___.141(b)(3)(iii) (ERBA NPR, at p. 15187); 12 C.F.R. §217.52(b)(3)(iii) (current rule).

[30] *See* Question 70 in the ERBA NPR; Question 44 in the SA NPR.

[32] *See* 12 C.F.R. §217.2 (definition of "current exposure").

[33] *See* SFA Comment Letter, Part III.E., at p. 40.

[34]The BCBS standards state that "in the case of swaps other than credit derivatives, the numerator of K_{SA} [the BCBS equivalent of K_G] must include the positive current market value times the risk weight of the swap provider times 8%. In contrast, the denominator should not take into account such a swap, as such a swap would not provide a credit enhancement to any tranche." *See* CRE 41.3, fn. 1. Article 255(7) of the EU CRR and the UK CRR states the general principle that SPE exposures related to the securitisation should be treated as underlying exposures, but does not implement the specific asymmetric treatment of swaps in the K_{SA} numerator and denominator referred to in the BCBS footnote.

reduce the capital requirement of securitization exposures even though interest rate and exchange rate derivative contracts do not provide any credit enhancement to a securitization."[35]

While interest rate and exchange rate derivatives are not credit derivatives, payments under them are a component of excess spread, which is the source of first-loss credit protection in most securitizations.[36] Consider a securitization SPE that holds fixed-rate assets (such as auto loans paying 6%) and issues floating-rate debt (such as notes paying SOFR + 50 basis points). The SPE enters into an interest rate swap under which it pays fixed and receives floating, converting its fixed-rate asset cash flows into floating-rate payments that match its liabilities. The difference between the swap-adjusted asset yield and the note coupon (the excess spread) provides the first layer of credit protection to investors, absorbing credit losses before overcollateralization is eroded.

If floating rates increase, the swap becomes "in the money" for the SPE, in that the SPE is receiving larger floating payments from the swap counterparty than it is paying out in fixed. The positive current exposure of the swap (the amount the SPE would lose if the counterparty defaulted) increases. By including the positive current exposure term in the numerator, the K_G formula would capture only the potential counterparty risk without recognizing the offsetting benefit that the derivative is simultaneously preserving excess spread that would otherwise be eroded by floating rate increases. Including the positive exposure amount in both the numerator and denominator would result in the derivative entering K_G on the same terms as the underlying exposures; that is, proportionally weighted by its size, contributing to the weighted-average capital requirement based on its own risk characteristics (here, the counterparty's risk weight).

Including the positive current exposure, whether in the numerator alone or in both the numerator and the denominator, would introduce considerable complexity to the calculation of K_G as noted above. It would also introduce volatility to the calculation of securitization risk weights under SEC-SA, as K_G would be directly affected by changes in interest rates and exchange rates. Moreover, the inclusion of positive current exposure may not promote comparability across banking organizations due to differences in their respective methods for calculating the positive current exposure amount.

Double counting of past due underlying exposures. For many types of underlying exposures, the general framework imposes one risk weight (*e.g.*, 100%) when the underlying exposure is performing and a higher risk weight (*e.g.*, 150%) when the underlying exposure becomes nonperforming (*e.g.*, 90+ days past due). When plugged into $K_A = (1 - W) * K_G + (0.5 * W)$, nonperforming underlying exposures are effectively counted twice – once inside K_G and again via the $0.5 * W$ term.[37] Market participants sought to eliminate this duplication by

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[35] *See* ERBA NPR, at p. 14999; SA NPR, at p. 15358. Including the positive exposure amount in the both the numerator and denominator would result in: $K_G = \frac{\sum(UPB_i * RW_i * 0.08) + \sum(FV_j * RW_j * 0.08) + \sum(PCE_k * RW_{cpty,k} * 0.08)}{\sum UPB_i + \sum FV_j + \sum PCE_k}$. If the risk weight of the derivative counterparty is less than the risk weight of the underlying exposures, then including the positive exposure amount term in both the numerator and the denominator would result in a somewhat lower K_G, and vice versa if the risk weight of the counterparty is greater than the risk weight of the underlying exposures. Including the positive exposure amount in the numerator but excluding it from the denominator would result in a higher K_G regardless of the counterparty's risk weight.

[36] As the SFA explained, "without such derivatives, the credit enhancement provided by excess spread could be eliminated by unfavorable changes in interest rates or exchange rates." *See* SFA Comment Letter, Part III.E., at p. 40.

[37] For example, in a securitization of loans subject to an underlying 100% risk weight (8% risk-based capital requirement), if 10% of the pool becomes delinquent, not only does W increase from 0 to 10%, but K_G increases from 8% to 8.4%, which is the weighted average capital requirement across the performing portion (8%) and the delinquent portion (12%) (the risk weight for unsecured delinquent exposures is 150%, which corresponds to a capital requirement of 12%).

defining K_G as the capital charge on performing exposures only so that delinquent underlying exposures enter the K_A calculation solely through parameter W.[38]

The Reproposal does not adopt this recommendation, but the Reproposal seeks further comment on the topic.[39] We note that the EU Proposal seeks to eliminate this double counting of delinquent exposures.[40]

2. Parameter W

Proposed changes. Parameter W measures the portion of the underlying exposures that 90 or more days past due or exhibit other specified indicia of nonperformance. The Reproposal retains the current rule's definition of W with two modifications:

(i) An exposure that is directly and unconditionally guaranteed by the U.S. Government, its central bank, or a U.S. Government agency may be excluded from the calculation of W, up to the amount of the guarantee.[41] This is a welcome exclusion as it recognizes that a government-guaranteed exposure presents no credit risk to the securitization. It also resolves a mismatch with K_G, which already reflects the effect of the guarantee through the lower risk weight assigned to government-guaranteed exposures under the general credit risk framework. For example, mortgage loans insured by the Federal Housing Administration or guaranteed by the Department of Veterans Affairs may be excluded from W and where all underlying exposures are unconditionally guaranteed by the U.S. Government, a banking organization may set W equal to zero.

(ii) For resecuritization exposures, any underlying exposure that is itself a securitization exposure is included only in the denominator (not the numerator) of the W ratio.[42] The rationale is that the SEC-SA risk weight assigned to the underlying securitization exposure already reflects the impact of any delinquent or nonperforming loans within that underlying securitization. Including such exposures in the numerator of W would double-count the delinquency effect.[43]

Application to equity exposures. The Reproposal also solicits comment on the application of parameter W to underlying exposures that are equity exposures. The Reproposal asks about the appropriateness of including equity exposures in parameter W where the issuer is subject to a bankruptcy proceeding or has an obligation to the bank that is 90 days or more past due.[44]

Subpool approach where delinquency status is unknown. As in the 2023 NPR, the Reproposal acknowledges that banking organizations may not always know the delinquency status of each underlying exposure and seeks comment on a subpool approach. Under the approach described, a banking organization that knows the delinquency status of most but not all of the underlying exposures (for example, 95%) would: (1) split the pool into two subpools; (2) calculate K_A for the subpool for which delinquency status is known using the standard formula; (3) assign a K_A of 1.0 to the subpool for which delinquency status is unknown (effectively applying a 100% capital requirement); and (4) calculate K_A for the entire pool as the weighted average of the

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[38] *See* SFA Comment Letter, Part III, at p. 36. The EU Proposal also seeks to eliminate this double counting of delinquent exposures. *See* EU Proposal, p. 17.

[39] *See* Question 73 in the ERBA NPR; Question 47 in the SA NPR.

[40] *See* EU Proposal, p. 17.

[41] *See* ERBA NPR, at p. 15186; SA NPR, at p. 15416.

[42] *See* ERBA NPR, at p. 15185; SA NPR, at p. 15416 ("W equals the ratio … of the sum of the dollar amounts of any underlying exposures of the securitization *that are not securitization exposures* and that meet any of the criteria in paragraphs (b)(1)(i) through (vii) of this section to the outstanding balance of all underlying exposures").

[43] *See* ERBA NPR, at p. 14999; SA NPR, at p. 15358.

[44] *See* Question 71 in the ERBA NPR; Question 45 in the SA NPR.

two subpool K_A values.[45] While a subpool approach would generally be welcome, the effective 100% capital requirement for the status-unknown pool is extremely punitive (equivalent to a 1,250% risk weight).[46] It is also unclear why the size of the status-unknown subpool would need to be subject to a cap, particularly given the severity of the treatment applied to it.

Punitive 0.5 scalar applied to parameter W. In its comment letter to the 2023 NPR, SFA noted the punitive 0.5 scalar applied to parameter W in $K_A = (1 - W) * K_G + (0.5 * W)$.[47] This value assigns the equivalent of a 625% risk weight to past due exposures,[48] whereas past due exposures under general framework generally receive a 150% risk weight. The SFA comment letter sought to reduce the scalar from 0.5 to 0.12, which is credit requirement corresponding to a 150% risk weight.[49] The Reproposal does not address this point, nor does it offer a rationale for the 0.5 scalar.

3. Exclusion of delinquent underlying exposures that serve as excess collateral

In many securitization structures, delinquent underlying exposures cease to be borrowing-base eligible but remain in the SPE and continue to serve as excess collateral. SFA argued that including those exposures in K_G and K_A leads to a punitive risk weight on the bank's securitization exposure even after the relevant advances or securities balance have already been reduced. This incentivizes banks to remove delinquent underlying exposures from SPEs, despite their continuing to have economic value and servicing as excess collateral for the bank's protection. SFA therefore recommended excluding such defaulted exposures from K_G and K_A, and the related attachment and detachment points, A and D.[50] The Reproposal neither acknowledges nor adopts this recommendation.

F. Risk Weighting Interest Rate and Exchange Rate Derivatives that are Securitization Exposures

A banking organization that acts as counterparty to an interest rate or exchange rate derivative with a securitization SPE holds a securitization exposure. Because the derivative counterparty's claim on the SPE's cash flows is typically senior to all investor tranches in the waterfall, the derivative's attachment and detachment points are effectively equal (both at the top of the capital structure), rendering the SSFA and SEC-SA formulas inoperable. The current rule and the Reproposal address this problem differently, as summarized below.

	Current SSFA	**2023 NPR**	**Industry Comments on 2023 NPR**	**Reproposal**
Scope	Derivative contracts (other than credit derivatives) that have a "first priority claim on the cash flows from the underlying exposures, notwithstanding	Same scope. Applies to any securitization exposure that is an interest rate or exchange rate derivative contract, or a cash collateral	--	Same as 2023 NPR

[45] *See* Question 72 in the ERBA NPR; Question 46 in the SA NPR.

[46] *See* SFA Letter, at p. 59, which advocated a K_A value of 0.12 for the status-unknown subpool, which is equivalent to the 150% risk weight that the general framework applies to most past-due exposures.

[47] *See* SFA Comment Letter, Part III.B., at pp. 36-37.

[48] As K_G and K_A are denominated in capital requirement terms, a value of 0.5 is equivalent to a 625% (0.5/8%) risk weight.

[49] *See* SFA Comment Letter, Part III.B., at p. 37.

[50] *See* SFA Comment Letter, Part III.C., at p. 37.

	Current SSFA	2023 NPR	Industry Comments on 2023 NPR	Reproposal
	amounts due under interest rate or currency derivative contracts, fees, or other similar payments."	account related to such a contract.[51]		
Risk Weight	The bank may elect to set the risk-weighted asset amount equal to the exposure amount (effectively a 100% risk weight). §217.42(a)(4). The exposure amount is calculated under §217.34 using the current exposure methodology (CEM), or SA-CCR if the bank has elected to use that methodology under §217.132(c).[52] If the bank does not elect this option, it must apply SSFA, which fails (because A = D), causing the	Eliminates the SSFA's option approach.[54] The bank must assign the SEC-SA risk weight of a *pari passu* securitization exposure, or if no *pari passu* exposure exists, the risk weight of "any subordinate securitization exposure."[55]	Market participants raised a policy concern: where no *pari passu* tranche exists, using a subordinated tranche would cause misalignment between the risk weight calculation and the derivative's actual position in the capital structure. Market participants recommended that the bank should be permitted to use the derivative contract's exposure at default (EAD) as an alternative method for determining tranche size, allowing the bank to define attachment and detachment points for the derivative and	Same as 2023 NPR. Does not adopt the EAD-based tranche sizing recommendation.

[51]The current rule at §217.42(a)(4) limits its scope to derivative contracts that have a "first priority claim on the cash flows from the underlying exposures, notwithstanding amounts due under interest rate or currency derivative contracts, fees, or other similar payments." The reproposed rule text contains no such limitation: §__.132(a)(2) / §217.43(a)(2) applies to any interest rate or exchange rate derivative that is a securitization exposure, regardless of its waterfall priority. The preamble continues to describe these derivatives as having a first priority claim, but this qualifying language does not appear in the rule text. The broader scope of the rule text could capture derivatives that are not senior to all investor tranches. Market participants should consider whether the rule text should be narrowed to match the preamble's description, or whether the broader formulation is appropriate given that any derivative securitization exposure (regardless of waterfall priority) would face the same A = D problem if the derivative does not correspond to a defined tranche.

[52]Under CEM, the exposure amount reflects the derivative's current mark-to-market value (floored at zero) plus an add-on for potential future exposure. SA-CCR uses a conceptually similar but more risk-sensitive approach, incorporating replacement cost, potential future exposure, and a supervisory multiplier to produce an exposure at default (EAD) for the derivative.

[54]But see Question 75 in the ERBA NPR; Question 49 in the SA NPR.

[55]Note that the preamble refers to the "next subordinated tranche of the securitization exposure" rather than "any subordinate securitization exposure." *See* the ERBA NPR, at p. 15001; SA NPR, at p. 15361. Market participants should consider seeking clarification in the rule text.

	Current SSFA	2023 NPR	Industry Comments on 2023 NPR	Reproposal
	bank to fall through to 1,250%.[53]		calculate a SEC-SA risk weight directly.[56]	

Under the Reproposal, SA-CCR EAD is mandatory under ERBA but CEM remains the default methodology under the Revised Standardized Approach. Market participants subject to the Revised Standardized Approach should consider whether to advocate for extending the EAD-based tranche sizing proposal to encompass CEM exposure amounts as well.

[53] See §217.42(a)(3), which provides that if a bank cannot, or chooses not to, apply the SSFA to the exposure, the bank must assign a risk weight as described in §217.44. That section requires a bank to apply a 1,250% risk weight to a securitization exposure to which neither SSFA nor the gross up approach applies.

[56] *See* SFA Comment Letter, Part X, at pp. 57-58. Under the proposal, the EAD would be used to construct a tranche for the derivative. The tranche's thickness (T) would be EAD ÷ pool balance. If no securitization exposure is senior to the derivative, then the detachment point (D) for the derivative contract's tranche would be 1 and the attachment point (A) would be 1 – T. If there is a securitization exposure senior to the derivative, then D for the derivative contract would be the attachment point of the immediately senior tranche, and A for the derivative contract would be D – T.

II. EXCEPTIONS TO THE SEC-SA

The Reproposal introduces a look-through approach for senior securitization exposures that are not resecuritization exposures (risk weight equal to the weighted-average risk weight of the underlying exposures, floored at 15%), a dedicated 100% risk weight for certain senior securitization exposures to qualifying NPL securitizations, revised treatment for nth-to-default credit derivatives that bypasses SEC-SA, expanded treatment for overlapping exposures, and a CET1 deduction (rather than a 1,250% risk weight) for the portion of a CEIO strip that does not constitute after-tax gain on sale.

For most securitization exposures, a banking organization must determine the applicable risk weight under the SEC-SA. If the banking organization cannot, or chooses not to, apply the SEC-SA, the securitization exposure generally receives a 1,250% risk weight. The Reproposal, however, retains certain exceptions and adds several new or expanded exceptions for securitization exposures where SEC-SA is inoperable or is not well calibrated to the risk of the exposure.

A. Look-Through Approach for Senior Securitization Exposures

The Reproposal introduces a "look-through" approach that permits a banking organization to assign to a "senior securitization exposure" that is not a resecuritization exposure a risk weight equal to the weighted-average risk weight of the underlying exposures (using the unpaid principal balance as the weight), subject to a 15% risk weight floor.[57]

- The look-through approach is available only if the banking organization "has knowledge of the composition of all of the underlying exposures."[58]

- A "senior securitization exposure" is defined as a securitization exposure that has a first-priority claim on the cash flows from the underlying exposures, disregarding amounts due under interest rate derivative, currency derivative, and servicer cash advance facility contracts, fees, and other similar payments.[59]

The look-through approach is useful in the unusual case that a bank does not have the data required to use SEC-SA to calculate the risk weight of a senior securitization exposure. Without the look-through approach, the bank could be required to apply a 1,250% risk weight to the exposure.

The look-through approach is also useful where the weighted-average risk weight of the underlying pool is lower than the SEC-SA risk weight for the senior tranche. At origination, this is typically not the case; that is, a senior securitization exposure tranche will typically receive an SEC-SA risk weight well below the pool's weighted-average risk weight. However, as parameter W (the portion of the underlying pool that is 90 or more days past due or otherwise nonperforming) increases during the life of the transaction, the SEC-SA risk weight rises sharply because the 0.5 scalar in K_A implies a 625% risk weight on underlying exposures in the W bucket, amplifying the effect of delinquencies under SEC-SA. The look-through approach, by contrast, rises only modestly, reflecting the higher but less punitive risk weights assigned to past due exposures under the general credit risk framework.

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[57] The Agencies seek comment about the advantages and disadvantages of the 15% floor. *See* Question 77 in the ERBA NPR; Question 51 in the SA NPR.

[58] *See* ERBA NPR, at p. 15185; SA NPR, at p. 15415.

[59] *See* ERBA NPR, at p. 15157; SA NPR, at p. 15404.

B. Senior Securitization Exposures to Certain NPL Securitizations

The Reproposal introduces a dedicated framework for NPL securitizations. An NPL securitization is defined as traditional securitization, other than a resecuritization, for which parameter *W* is greater than or equal to 90% at the origination cut-off date and at any subsequent date on which exposures are added to or removed from the pool due to replenishment or restructuring.[60] The Agencies explain that the SEC-SA is "calibrated on the assumption that the underlying exposures at origination at origination are generally performing" and is therefore inappropriate for securitizations of heavily defaulted pools.[61]

For a senior securitization exposure to an NPL securitization, the Reproposal provides a flat 100% risk weight if two conditions are met: (i) the securitization must be a traditional securitization rather than a synthetic securitization, and (ii) the nonrefundable purchase price discount ("**NRPPD**")[62] for the NPL securitization must be greater than or equal to 50 percent of the outstanding balance of the pool of exposures at inception of the transaction.[63] The Agencies explain that the NRPPD "functions as the effective first-loss position in the capital structure."[64] Where an originator sells a pool of non-performing loans to a securitization vehicle at 50 cents on the dollar, the 50% discount absorbs losses before the senior tranche is impacted.

If the senior securitization exposure does not meet these conditions (for example, if the NRPPD is less than 50%) or if the exposure is a not a senior securitization exposure, the banking organization must apply the SEC-SA (including by reflecting all delinquent exposures in the calculation of parameter *W*), but with a 100% risk weight floor rather than the ordinary 15% floor applicable to non-NPL securitizations.[65]

C. Credit Derivatives that are Securitization Exposures

The Reproposal largely retains the current framework for credit derivatives that are securitization exposures, while clarifying certain points and extending the protection-provider rule to prepaid credit protection arrangements.

Bank as protection provider. A banking organization that provides a guarantee, credit derivative (other than an nth-to-default credit derivative), or prepaid credit protection arrangement covering the full amount or a pro rata share of a securitization exposure's principal and interest must risk-weight the protection as if it held the portion of the securitization exposure covered by the guarantee, credit derivative, or prepaid credit protection arrangement.[66] This is consistent with the current rule, but extends this substitution treatment to prepaid credit protection arrangements.

Bank as protection purchaser (recognized CRM). A banking organization that purchases a credit derivative (other than an nth-to-default credit derivative) that is recognized as a credit risk mitigant (including where recognition is based on collateral supporting the credit derivative) must replace the SEC-SA risk weight

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[60] *See* ERBA NPR, at p. 15274; SA NPR, at p. 15420.

[61] *See* ERBA NPR, at p. 15003; SA NPR, at pp. 15362-15363.

[62] Nonrefundable purchase price discount (NRPPD) means the difference between the initial outstanding balance of the exposures in the underlying pool and the price at which these exposures are sold by the originator to the securitization SPE, when neither originator nor the original lender are reimbursed for this difference. In cases where the originator underwrites tranches of a NPL securitization for subsequent sale, the NRPPD may include the differences between the notional amount of the tranches and the price at which these tranches are first sold to unrelated third parties. For any given piece of a securitization tranche, only its initial sale from the originator to investors is taken into account in the determination of NRPPD. The purchase prices of subsequent re-sales are not considered. *See* ERBA NPR, at p. 15274; SA NPR, at p. 15420.

[63] *See* ERBA NPR, at p. 15185; SA NPR, at p. 15415.

[64] *See* ERBA NPR, at p. 15004; SA NPR, at p. 15363.

[65] *See* ERBA NPR, at p. 15003; SA NPR, at p. 15363.

[66] *See* ERBA NPR, at p. 15184; SA NPR, at p. 15415.

that would otherwise apply to the securitization exposure with the risk weight of the protection provider under the applicable general credit risk framework. The banking organization is not required to compute a separate counterparty credit risk capital requirement under SA-CCR (ERBA) or CEM (Revised Standardized Approach) for the credit derivative contract.[67] This treatment is consistent with current rule.

Bank as protection purchaser (unrecognized CRM). As under the current rule, where a banking organization cannot, or chooses not to, recognize a purchased credit derivative as a credit risk mitigant, the Reproposal requires the banking organization to determine the exposure amount of the credit derivative under the applicable counterparty credit risk methodology (SA-CCR under ERBA, or CEM under the Revised Standardized Approach). The applicable risk weight is then determined under either the general credit risk framework or the securitization framework, depending on the nature of the counterparty.[68] This treatment is substantively unchanged from the current rule.

D. Nth-to-Default Credit Derivatives

The Reproposal would continue to treat nth-to-default credit derivatives[69] as securitization exposures, but would no longer permit a banking organization acting as protection purchaser to recognize any risk-mitigating benefit for such a derivative. Instead, the protection purchaser would calculate risk-weighted assets for counterparty credit risk using the exposure amount produced by SA-CCR (ERBA) or CEM (Revised Standardized Approach), as applicable, multiplied by the risk weight applicable to the protection provider under the general risk-weight framework.[70]

For a banking organization acting as protection provider, the Reproposal would prohibit use of SEC-SA and instead generally require the banking organization to calculate the risk-weighted asset amount by multiplying the notional amount of protection provided by the nth-to-default derivative by the sum of the risk weights applicable to the reference exposures, subject to a 1,250% cap. For a first-to-default derivative, all reference exposure risk weights are aggregated. For a second-or-later-to-default derivative, the banking organization may exclude the (n−1) reference exposures with the lowest risk weights from that aggregation.[71]

E. Overlapping Exposures

The Reproposal retains the current rule's treatment permitting banking organizations to avoid holding duplicative risk-based capital against overlapping securitization exposures (for example, where a banking organization provides a program-wide credit enhancement and multiple pool-specific liquidity facilities to an ABCP program). In such cases, the banking organization may apply to the overlapping position the applicable risk-based capital treatment that results in the highest capital requirement.[72]

The Reproposal expands this treatment in two respects.

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[67] *See* ERBA NPR, at p. 15184; SA NPR, at p. 15415.

[68] Market participants should note the apparent drafting error in §__.132(j)(2)(ii) and §217.43(j)(2)(ii). Subclauses (A) and (B) both refer to credit protection purchased "from a counterparty the activities of which are limited to those appropriate for the specific purpose of holding the underlying exposures of a securitization" but direct the bank to different sections to calculate the risk weight (the general credit framework, in the case of subclause (A), and the securitization framework, in the case of subclause (B)). Presumably, subclause (A) should refer to a counterparty other than a counterparty the activities of which are limited to those appropriate for the specific purpose of holding the underlying exposures of a securitization.

[69] Nth-to-default credit derivatives provide credit protection on a group of reference exposures only after a specific number (n) of the reference exposures default.

[70] *See* ERBA NPR, at p. 15184; SA NPR, at p. 15415.

[71] *See* ERBA NPR, at p. 15184; SA NPR, at p. 15415.

[72] *See* ERBA NPR, at p. 15183; SA NPR, at p. 15414.

First, it introduces provisions for partially overlapping exposures. Where two or more securitization exposures partially overlap, the banking organization may treat them as overlapping, provided it can demonstrate that one of its securitization exposures can fully absorb losses arising from its other securitization exposures. In such cases, the banking organization must include in risk-weighted assets the risk-weighted asset amount for a hypothetical securitization exposure that would fully overlap with all of the partially overlapping exposures.[73]

Second, the Reproposal permits recognition of overlap between a securitization exposure in the banking book and a securitization exposure that is a market risk covered position. The banking organization may assign the applicable treatment under whichever framework results in the highest capital requirement.[74]

F. Credit-Enhancing Interest Only (CEIO) Strips

The Reproposal requires a banking organization to deduct from CET1 any after-tax gain-on-sale resulting from a securitization, as well as the portion of a CEIO[75] that does not constitute gain-on-sale, regardless of whether the securitization exposure satisfies the operational requirements.[76] Under the current standardized approach, a banking organization must deduct from CET1 any after-tax gain-on-sale result from a securitization, but apply a 1,250% risk weight, rather than a CET1 deduction, to the portion of a CEIO that does not constitute gain-on-sale.[77]

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[73] *See* ERBA NPR, at p. 15183; SA NPR, at p. 15414. In an example provided by the Agencies "if a banking organization provides a program-wide credit enhancement to an ABCP conduit that covers only the portion of the losses above the seller-provided protection and the banking organization also holds commercial paper issued by the ABCP conduit, the banking organization would be permitted to reflect the risk-weighted asset amount only for the program-wide credit enhancement, provided the banking organization demonstrates, for purposes of calculating risk-based capital requirements, that the program-wide credit enhancement would require the banking organization to fully absorb any losses arising from the ABCP conduit. As the risk-based capital requirement for the program-wide credit enhancement would be treated as covering any losses on the commercial paper, the proposal would not require the banking organization to also maintain additional risk-based capital against the securitization exposure(s) arising from the commercial paper." *See* ERBA NPR, at p. 15002; SA NPR, at p. 15361.

[74] *See* ERBA NPR, at p. 15183; SA NPR, at p. 15414. The Agencies seek comment as to what challenges, if any, the option to recognize an overlap between market risk covered and noncovered positions would introduce.

[75] A credit-enhancing interest-only strip (CEIO) is "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 of the CEIO 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." *See* 12 C.F.R. §217.2.

[76] *See* ERBA NPR, at p. 15183; SA NPR, at p. 15414.

[77] *See* §217.42(a)(1). The Agencies explain that "While a deduction is generally equivalent to a 1,250 percent risk weight when the banking organization maintains an 8 percent risk-based capital ratio, given the various capital ratios, buffers, and add-ons applicable to banking organizations ..., applying a deduction provides a more consistent treatment across capital ratios and greater consistency with the Basel standards." *See* ERBA NPR, at p. 15003; SA NPR, at 15362.

III. REVISED DEFINITIONS OF SYNTHETIC SECURITIZATION AND TRADITIONAL SECURITIZATION

The Reproposal generally retains the existing definitions of traditional and synthetic securitization, but would add prepaid credit protection arrangements to the synthetic definition, provide that traditional securitizations can transfer credit *or equity* risk, and require that securitization exposures "depend solely" on the performance of the underlying exposures. The "depends solely" change, if read literally, could exclude many common traditional securitizations from the securitization framework.

The table below sets forth the definitional requirements for synthetic securitizations and traditional securitizations, as revised by the Reproposal. These changes would apply under both ERBA and the Revised Standardized Approach.

	Definitional Requirements	
	Synthetic Securitization	**Traditional Securitization**
Financial Exposure Requirement *(See Part III.A. below.)*	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).	
Credit Risk Transfer Requirement *(See Part III.B. below.)*	All or a portion of the credit risk of one or more underlying exposures is retained or 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)**, or prepaid credit protection arrangements**.	All or a portion of the credit **or equity** risk of one or more underlying exposures is retained or transferred to one or more third parties other than through the use of one or more credit derivatives**,** ~~or~~ guarantees**, or prepaid credit protection arrangements**.
Tranching Requirement *(See Part III.C. below.)*	The credit risk associated with the underlying exposures has been separated into at least two tranches reflecting different levels of seniority.	
Performance Depends Requirement *(See Part III.D. below.)*	Performance of the securitization exposures depends **solely** upon the performance of the underlying exposures.	
Not Owned by Operating Company Requirement *(See Part III.E. below.)*	N/A	The underlying exposures are not owned by an operating company.

	Definitional Requirements	
	Synthetic Securitization	**Traditional Securitization**
Not an Investment Fund Requirement *(See Part III.E. below.)*	N/A	The transaction is not an "investment fund," defined as a company (1) where all or substantially all of the assets of the company are financial assets and (2) that has no material liabilities.
Other Requirements	N/A	Other various definitional requirements.[78]

A. The Financial Exposure Requirement

The financial exposure requirement, which is common to both synthetic and traditional securitizations, remains unchanged in the rule text. While the term "financial exposure" is not formally defined under the capital rules, the examples given are "loans, commitments, credit derivatives, guarantees, receivables, ABS, MBS, other debt securities, and equity securities."[79] As noted below, the Reproposal places some emphasis that the securitization framework can apply where all or substantially all of the underlying exposures are equity exposures.

B. The Credit Risk Transfer Requirement

1. Inclusion of "or equity" for traditional securitizations

The Reproposal states that the securitization framework applies where "the underlying exposures are primarily financial exposures (including when all or substantially all of the underlying assets are equity exposures)."[80]

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[78]The other definitional requirements for traditional securitizations are: **(1)** The underlying exposures are not owned by a small business investment company defined in section 302 of the Small Business Investment Act; **(2)** The underlying exposures are not owned by a firm an investment in which qualifies as a community development investment under section 24(Eleventh) of the National Bank Act; **(3)** The Board may determine that a transaction in which the underlying exposures are owned by an investment firm that exercises substantially unfettered control over the size and composition of its assets, liabilities, and off-balance sheet exposures is not a traditional securitization based on the transaction's leverage, risk profile, or economic substance; **(4)** The Board may deem a transaction that meets the definition of a traditional securitization, notwithstanding the requirement that the underlying exposures are not owned by an operating company and notwithstanding the requirement in clause (1) above, or clause (2) above, to be a traditional securitization based on the transaction's leverage, risk profile, or economic substance; and **(5)** The transaction is not: ***(i)*** A collective investment fund (as defined in 12 CFR 208.34); ***(ii)*** An employee benefit plan (as defined in ERISA), a "governmental plan" (as defined in 29 U.S.C. 1002(32)) that complies with the tax deferral qualification requirements provided in the Internal Revenue Code, or any similar employee benefit plan established under the laws of a foreign jurisdiction; ***(iii)*** A synthetic exposure to the capital of a financial institution to the extent deducted from capital under §217.22; or ***(iv)*** Registered with the SEC under the Investment Company Act of 1940 or foreign equivalents thereof. No changes are proposed to these other definitional requirements.

[79]The adopting release for the capital rules contains further guidance: "Examples of financial exposures include loans, commitments, credit derivatives, guarantees, receivables, asset-backed securities, mortgage-backed securities, other debt securities, or equity securities. Based on their cash flow characteristics, the agencies also consider asset classes such as lease residuals and entertainment royalties to be financial assets. The securitization framework is not designed, however, to apply to tranched credit exposures to commercial or industrial companies or nonfinancial assets or to amounts deducted from capital under section 22 of the final rule. Accordingly, a specialized loan to finance the construction or acquisition of large-scale projects (for example, airports or 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 are nonfinancial assets (the facility, object, or commodity being financed)." *See* 78 Fed. Reg. 62018 (Oct. 11, 2013) (the "**Basel III Adopting Release**"), at 62112.

[80]*See* ERBA NPR, at p. 14995; SA NPR, at p. 15354.

Accordingly, the Reproposal seeks to clarify that a traditional securitization involves the transfer of the credit *or equity* risk of underlying exposures.

The Agencies solicit comment on the advantages or disadvantages of making a similar change to the definition of synthetic securitization.[81]

2. Prepaid credit protection arrangements

For synthetic securitizations, the Reproposal allows for the transfer of credit risk using "prepaid credit protection arrangements," in addition to credit derivatives or guarantees. *See* Part V.A. for a discussion of prepaid credit protection arrangements.

C. The Tranching Requirement

This requirement remains unchanged in the rule text. However, the following footnote in the Reproposal warrants careful consideration by market participants:

> For example, assume a banking organization extends a loan to a bankruptcy remote special purpose entity which holds financial exposures (including equity securities) and the fair value of the underlying financial assets exceeds that of the loan. Under this transaction, the underlying financial exposures are pledged as collateral to the lender. As the excess collateral would initially absorb any losses arising from non-payment on the loan (after which the banking organization would be exposed to any subsequent losses), the loan would generally be viewed as tranched and could qualify as a securitization exposure under the proposal, if the transaction satisfies all of the other applicable requirements. *Consistent with the current capital rule, to the extent the fair value of the collateral declines such that it no longer exceeds the outstanding principal balance of the banking organization's exposure to the borrower, the transaction would no longer involve tranching of credit or equity risk – and thus would not qualify as a securitization exposure under the proposal*. Rather, the banking organization would be required to calculate risk-based capital requirements for the exposure using the general credit risk framework....[82]

Presumably, this footnote is intended to apply to underlying exposures that are equity exposures, not credit exposures.[83] The Agencies "seek comment on the appropriateness of requiring covered banking organizations to use the general risk-weight framework for certain overcollateralized exposures if the fair value of underlying *equity* exposures declines such that there is no longer overcollateralization."[84]

D. The "Performance Depends" Requirement

The Reproposal would modify the "performance depends" requirement to provide that the securitization exposure must depend "**solely**" upon the performance of the underlying exposures. The Reproposal characterizes this proposed change as a "technical modification," stating that the purpose is to

> clarify that the performance of the securitization exposure is *expected to depend solely* upon the performance of the underlying exposures, aside from the performance of common supporting transaction participants such as servicers and trustees. For example, a transaction

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[81] *See* Question 63 in the ERBA NPR; and Question 37 in the SA NPR

[82] *See* ERBA NPR, at p. 14994 (fn. 165); SA NPR, at p. 15353 (fn. 77) (emphasis added).

[83] The Reproposal is more precise in its proposed definition of K_G, which refers to "unpaid principal" with respect to credit exposures and "fair value" with respect to equity exposures.

[84] *See* Question 64 in the ERBA NPR; Question 38 in the SA NPR.

> would not satisfy this criterion if there is an expectation that any sources outside of the underlying exposures would fund the interest or principal payments due on the securitization exposures.[85]

The discrepancy between the proposed rule text ("depends solely") and the preamble ("expected to depend solely," with carveouts for reliance on supporting transaction parties), together with the Agencies' request for comments and suggestions on the "performance depends" requirement,[86] indicate that the Agencies remain open to making clarifying changes.

The "depends solely" proposal is surprising because it is common for securitizations to include various forms of credit enhancement. As the Agencies noted in 2002, "In many cases, the originating institution retains significant credit exposure through the credit enhancements it provides. These enhancements represent contractual obligations that protect investors who have purchased the securities generated by the asset securitization from incurring some level of credit losses."[87]

These features are not unusual; rather, they are standard structural components of many securitization transactions, including those registered with the SEC. Regulation AB (17 C.F.R. §229.1114) requires disclosure of common structural features "designed to affect or ensure timely payment of the asset-backed securities" (and thus features that the "depends solely" requirement could call into question), including:

1. Any external credit enhancement designed to ensure that the asset-backed securities or pool assets will pay in accordance with their terms, such as bond insurance, letters of credit or guarantees.

2. Any mechanisms to ensure that payments on the asset-backed securities are timely, such as liquidity facilities, lending facilities, guaranteed investment contracts and minimum principal payment agreements.

3. Any derivatives whose primary purpose is to provide credit enhancement related to pool assets or the asset-backed securities.

In addition, many securitizations include originator or seller guarantees whose primary purpose is not to provide credit enhancement upon which investors or bank lenders rely from a credit perspective, but as mechanisms to align interests by ensuring that originators/sellers retain economic exposure to the quality of the loans they originate and sell ("skin in the game"). Uncertainty about the "depends solely" requirement would lead to uncertainty about whether securitizations featuring these common alignment mechanisms fall within the securitization framework. This uncertainty would create a perverse incentive to remove originator/seller accountability from securitization structures in order to satisfy the definitional requirement.

Rather than a technical modification, the "depends solely" change would represent a significant departure from the existing standard.

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[85] *See* ERBA NPR, at p. 14994; SA NPR, at p. 15353 (emphasis added).

[86] *See* Question 62 in the ERBA NPR; Question 36 in the SA NPR.

[87] *See* Interagency Guidance on Implicit Recourse in Asset Securitizations (May 23, 2002) (available here).

BCBS Standard	EU Implementation	UK Implementation
"Payments to the investors depend upon the performance of the specified underlying exposures, *as opposed to being derived from an obligation of the entity originating those exposures*."[88]	"Payments in the transaction or scheme are dependent upon the performance of the exposure or of the pool of exposures."[89]	"Payments in the transaction or scheme are dependent upon the performance of the exposure or of the pool of exposures."[90]

As the FRB noted in its Basel Coordination Committee Bulletin 13-2 ("**BCC 13-2**"), "the definition of traditional securitization captures a *broader* set of exposures than those commonly understood by banking organization and other market participants to be a securitization."[91] Introducing a requirement that the performance of the securitization exposure must depend "solely" on the performance of the underlying exposures would make the "traditional securitization" definition much *narrower* than the commonly-understood (and regulatorily prescribed) definitions of securitization. Those definitions utilize a "primarily"-based test rather than a "solely"-based test.

Canonical Definitions of "Asset-Backed Security"

Securities Exchange Act of 1934	Regulation AB
"A fixed-income or other security collateralized by any type of self-liquidating financial asset (including a loan, a lease, a mortgage, or a secured or unsecured receivable) that allows the holder of the security to receive payments that depend ***primarily*** on cash flow from the asset ..."[92]	"A security that is ***primarily*** serviced by the cash flows of a discrete pool of receivables or other financial assets, either fixed or revolving, that by their terms convert into cash within a finite time period ..."[93]

If adopted, the "depends solely" test could create at least two distortions. First, banks would face a choice between foregoing otherwise standard forms of credit protection in order to qualify for SEC-SA treatment, or retaining such protections and accepting a potentially higher risk weight under the general framework. Second, the "depends solely" test could incentivize banks to invest in riskier tranches of non-qualifying structures. If a transaction that includes standard external credit enhancement features does not qualify as a securitization, its tranches would be risk-weighted under the general framework potentially at much lower risk weights than the SEC-SA would assign to mezzanine or subordinated positions.

Finally, we note that there is some tension between the proposed "solely" change and the Agencies' stated view that the performance of a securitization exposure depends on various factors, including the securitization

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[88] *See* CRE 40.2.

[89] *See* Regulation (EU) 2017/2402, Article 2(1)(a). Neither CRR3 (Regulation (EU) 2024/1623) nor the June 2025 EU Securitisation Package (COM(2025) 825 and COM(2025) 826) modifies this definition.

[90] *See* Securitisation Regulations 2024 (SI 2024/102), Regulation 3(1)(a).

[91] *See* BCC 13-2 (March 21, 2013) (available here), at p. 1 (emphasis added). The principle noted in BCC 13-2 that the definition of traditional securitization under the capital rules is intended to be broader than transactions commonly understood to be securitizations is otherwise reinforced by the Reproposal's statement that the securitization framework applies even "when all or substantially all of the underlying assets are equity exposures." *See* ERBA NPR, at p. 14995; SA NPR, at p. 15354. As equity exposures are generally not "self-liquidating financial assets" and do not "by their terms convert into cash within a finite time period," a transaction where all or substantially all of the underlying assets are equity exposures would generally not be a securitization under the canonical securitization definitions set forth above.

[92] *See* 15 U.S.C. §78c(a)(79). This definition was added by the Dodd-Frank Act.

[93] *See* Item 1100(c) of Regulation AB (emphasis added). The "primarily" standard is also used in Rule 3a-7 under the Investment Company Act, which creates an exemption from registration for issuers of asset-backed securities.

process itself.[94] If the definition of a securitization under the U.S. rule is narrowed to refer to an exposure whose performance depends solely upon the performance of the underlying exposures, there would be no policy rationale for maintaining the 50% securitization capital surcharge.

E. The "Not an Operating Company" and "Not an Investment Fund" Requirements

The Reproposal stresses that:

- The securitization framework generally applies to exposures to companies with material liabilities that are not operating companies and whose underlying exposures are all or substantially all financial exposures "unless the primary Federal supervisor determines that the exposure is not a traditional securitization based on the transaction's leverage, risk profile or economic substance".[95]

- The equity framework generally applies to exposures to "investment funds," which are companies with *no* material liabilities and whose underlying exposures are all or substantially all financial exposures.[96]

There are two points of clarification that may warrant attention from market participants.

Material liabilities. The distinction between "material" and "no material" liabilities can determine whether an exposure falls within the securitization framework or the equity framework and therefore whether it receives a SEC-SA risk weight (which could be as low as 15% for a senior securitization exposure) or an equity risk weight (which could be as high as 400% for a non-publicly-traded equity exposure). The Reproposal does not define "material" in this context, and market participants may wish to seek clarification on the threshold.

Supervisory override. The Reproposal's statement regarding the supervisor's authority to exclude a transaction from the securitization framework based on its leverage, risk profile or economic substance appears to be based on paragraph (8) of the definition of "traditional securitization," which states that:

> (8) The [Agency] may determine that a transaction in which the underlying exposures are owned by an investment firm that exercises substantially unfettered control over the size and composition of its assets, liabilities, and off-balance sheet exposures is not a traditional securitization based on the transaction's leverage, risk profile, or economic substance.

In BCC 13-2, FRB staff stated it would recommend to the FRB that an exposure to an investment firm ***not*** be considered a tradition securitization under the FRB's paragraph (8) supervisory authority if the investment firm has the following characteristics:

1. The investment firm is actively managed by one or more investment advisers such that the composition of its investment portfolio can change over time in furtherance of the firm's investment strategy, and is not static;

2. The investment firm, as managed by its investment adviser, retains broad discretion to execute or change the manner in which it executes its investment strategy, including with respect to the

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[94] *See* ERBA NPR, at p. 14994; SA NPR, at p. 15353 ("The risk and complexity posed by securitizations differ relative to direct exposures to the underlying financial exposures because the credit risk of those exposures is divided into different levels of risk using a wide range of structural mechanisms. The performance of a securitization exposure depends not only on the structure of the securitization, but also on the performance of the underlying exposures and certain parties to the securitization structure, including the asset servicer and liquidity facility provider. Such structural features and the involvement of these parties makes securitization exposures susceptible to additional risks as compared to direct exposures to the underlying financial exposures").

[95] *See* ERBA NPR, at p. 14995; SA NPR, at p. 15354.

[96] *See* ERBA NPR, at p. 14995 (fn. 168); SA NPR, at p. 15354 (fn. 80). The risk weight for equity exposures to investment funds is generally determined under the look-through approach described in §__.142.

composition of its investment portfolio and the type and amount of leverage employed in its investment strategy;

3. The investment firm, as managed by its investment adviser, retains broad discretion to use a variety of instruments and transactions to execute its investment strategy;

4. The investment firm, as managed by its investment adviser, has the broad discretion and ability to control the size of the firm through the issuance of variable amounts of debt, or through the issuance and redemption of shares or ownership interests; and

5. The investment firm, as managed by its investment adviser, retains broad discretion to distribute or reinvest cash proceeds generated by the firm's underlying assets.

Market participants may wish to seek confirmation that:

- where an investment firm *has* unfettered control under the BCC 13-2 test, the banking organization would be permitted to treat the exposure as an equity or corporate exposure, as applicable, without the need for the applicable Agency to affirmatively exercise its paragraph (8) authority on a case-by-case basis; and

- where an investment firm *lacks* unfettered control under the BCC 13-2 test, the banking organization would be permitted to treat the exposure as a traditional securitization exposure, provided all the other definitional criteria are met.

IV. REVISED OPERATIONAL CRITERIA FOR SYNTHETIC SECURITIZATIONS

The Reproposal generally retains the existing operational criteria for synthetic securitizations, but adds several important changes. The eligible CRM list now includes eligible prepaid credit protection arrangements" and excludes nth-to-default credit derivatives.

The operational criteria also include a prohibition on synthetic excess spread, a minimum payment threshold requirement, and a restriction on synthetic securitizations that include both revolving exposures and an early amortization provision.

The definition of "eligible clean-up call" is expanded to cover certain regulatory and tax events.

The Reproposal retains the existing operational criteria for synthetic securitizations and introduces several new requirements. These changes are particularly relevant for bank synthetic risk transfer (SRT) transactions. This section summarizes the key changes.

	Operational Requirements for Synthetic Securitizations
Credit Risk Mitigant Requirement	The credit risk mitigant is: (i) financial collateral; (ii) a guarantee that meets all criteria as set forth in the definition of "eligible guarantee", except for the criteria in paragraph (3) of that definition; ~~or~~ (iii) a credit derivative **that is not an nth-to-default credit derivative[97] and** that meets all criteria as set forth in the definition of "**eligible credit derivative**", except for the criteria in paragraph (3) of the definition of "eligible guarantee~~;~~" **or** **(iv) a prepaid credit protection arrangement that meets all criteria as set forth in the definition of "eligible prepaid credit protection arrangement," except for the criteria in paragraph (3) of that definition.[98]**
Risk Transfer Requirement	The bank transfers credit risk associated with the underlying exposures to one or more 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 underlying exposures;

[97]The Reproposal adds an explicit exclusion of nth-to-default credit derivatives from the list of eligible credit risk mitigants for synthetic securitizations. The Agencies' rationale is that nth-to-default credit derivatives provide protection only against a specified number of defaults within a basket of reference exposures and do not provide continuous or comprehensive coverage of credit risk for the entire pool.

[98]The Reproposal introduces prepaid credit protection arrangements as a new category of eligible credit risk mitigant for synthetic securitizations, alongside financial collateral, eligible guarantees, and eligible credit derivatives. Among other things, this new CRM greatly facilitates the issuance of credit linked notes issued directly by banks. This new CRM category is discussed in Part V.A. of this paper.

	Operational Requirements for Synthetic Securitizations
	(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.
Legal Opinion Requirement	The bank obtains a well-reasoned opinion from legal counsel that confirms the enforceability of the credit risk mitigant in all relevant jurisdictions.
No Synthetic Excess Spread Requirement	**No synthetic excess spread is permitted within the synthetic securitization.**
Minimum Payment Threshold Requirement	**Any applicable minimum payment threshold for the credit risk mitigant is consistent with standard market practice.**
No Revolving Assets with Early Amortization Requirement	**The securitization may not have both (1) 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 (2) an early amortization provision.** **"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:** **(1) 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); or** **(2) leaves investors fully exposed to future draws by borrowers on the underlying exposures even after the provision is triggered.**
Eligible Clean-Up Call Requirement	Any clean-up calls[99] relating to the securitization are eligible clean-up calls.
	Changes to "eligible clean up call" definition. An "eligible clean-up call" means a clean-up call that: (1) is exercisable solely at the discretion of the originating bank or 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) **is only exercisable:** (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~~

[99]A "clean-up call" means a contractual provision that permits a banking organization or servicer to call securitization exposures before their stated maturity or call date. The Reproposal does not propose any changes to this definition.

	Operational Requirements for Synthetic Securitizations
	(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~~.~~**;** **(iii) Upon the occurrence of a regulatory event that significantly changes the risk-weighted asset amount for the securitization exposure under this part; or** **(iv) Upon the occurrence of a tax event that significantly changes the tax treatment of the securitization exposure under applicable tax laws.**

A. Prohibition on Synthetic Excess Spread

The Reproposal prohibits synthetic excess spread within a synthetic securitization. Synthetic excess spread is defined as any contractual provision in a synthetic securitization that is designed to absorb losses prior to any of the tranches of the securitization structure.

The Agencies view synthetic excess spread as a form of credit enhancement provided by the originating banking organization to investors, against which the originating banking organization should maintain capital.[100] However, rather than imposing a specific capital charge on synthetic excess spread (which the Agencies worry may not be determinable with sufficient precision), the Reproposal simply disallows synthetic excess spread. That is, if a synthetic securitization includes synthetic excess spread, the banking organization must maintain capital against all the underlying exposures as if they had not been synthetically securitized, effectively derecognizing the credit risk mitigating benefits of the synthetic securitization.

This prohibition is carried over from the 2023 NPR. The SFA argued that excess spread is generated by the interest income on the reference assets (with interest rates on riskier assets being commensurately higher to compensate for expected credit losses) and therefore should not be treated as a separate form of credit enhancement provided by the bank. Even if the Agencies view synthetic excess spread as bank-provided credit enhancement against which the bank must hold capital, the SFA argued that this is not a reason to disqualify the entire transaction. Rather, the SFA recommended that the funded amount of synthetic excess spread be subject to a 1,250% risk weight while permitting the bank to recognize the risk-mitigating benefits of the synthetic securitization.[101] The Reproposal does not adopt this recommendation.

B. Minimum Payment Threshold

The Reproposal introduces a new requirement that any applicable minimum payment threshold for the credit risk mitigant be consistent with standard market practice.[102] A minimum payment threshold is the delinquency condition that must exist before a credit event is deemed to have occurred under the terms of the credit protection. The requirement is intended to prevent an originating banking organization from structuring the credit protection so that the payment threshold is large enough to allow material losses to occur without triggering a payout, effectively undermining the risk transfer. The preamble notes that for derivative contracts written under ISDA Master Agreement documentation, standard market practice would generally be $1 million or its equivalent in other currencies.[103]

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[100] *See* ERBA NPR, at p. 14996; SA NPR, at p. 15355.

[101] *See* SFA Comment Letter, Part VI, at p. 45.

[102] *See* ERBA NPR, at p. 15182; SA NPR, at p. 15413.

[103] *See* ERBA NPR, at p. 14996 (fn. 172); SA NPR, at p. 15355 (fn. 84) (citing ISDA Credit Derivatives Definitions Section 4.5 ("Failure to Pay") and Section 4.9(d) ("Payment Requirement")).

C. Revolving Exposures with Early Amortization Provisions

The Reproposal extends to synthetic securitizations a restriction that currently applies only to traditional securitizations: a synthetic securitization may not include both (1) 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 (2) an early amortization provision.[104] An "early amortization provision" is defined as:

> 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:
>
> (1) Is triggered solely by events not directly related to the performance of the underlying exposures or the originating [banking organization] (such as material changes in tax laws or regulations); or
>
> (2) Leaves investors fully exposed to future draws by borrowers on the underlying exposures even after the provision is triggered.[105]

The Agencies' stated concern is that when a revolving pool is subject to early amortization, the originating bank may be forced to fund future draws on the underlying exposures even as the credit protection provided by the synthetic securitization is winding down.[106] However, the Agencies do not explain why diminishing credit protection on future draws should prevent recognition of the credit protection provided on current draws.

D. Expanded Definition of Eligible Clean-Up Call

The Reproposal expands the definition of "eligible clean-up call" to permit exercise upon two additional triggering events. Under the current rule, an eligible clean-up call may only be exercised when 10% or less of the principal amount of the initial pool of underlying or reference exposures remains outstanding.[107] The Reproposal would also permit exercise upon the occurrence of (1) a **regulatory event** that significantly changes the risk-weighted asset amount for the securitization exposure under applicable capital standards, or (2) a **tax event** that significantly changes the tax treatment of the securitization exposure under applicable tax laws. The preamble specifies that these events must represent final actions (such as a final rule adopted by the agencies or a law enacted by Congress) and that proposed rules or legislative bills would not suffice.[108]

The remaining requirements for an eligible clean-up call are unchanged: the call must be exercisable solely at the discretion of the originator or servicer and must not be structured to avoid allocating losses to investors or to provide credit enhancement. Because both the traditional and synthetic securitization operational criteria require that any clean-up call be an "eligible clean-up call," the expanded definition applies to both types of securitizations.

Note on Operational Criteria for Traditional Securitizations. The operational criteria for traditional securitizations continue to require that the transferred exposures are "not reported on the [banking organization]'s consolidated balance sheet under GAAP." In their comment letters on the 2023 NPR, the SFA and other market participants recommended replacing this GAAP derecognition requirement with a legal isolation standard, consistent with the BCBS framework, which conditions securitization treatment on the legal

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[104] *See* ERBA NPR, at p. 15182; SA NPR, at p. 15413.

[105] *See* 12 C.F.R. §217.2 (definition of "early amortization provision"). The Reproposal does not seek to change this definition.

[106] *See* ERBA NPR, at pp. 14995-14996; SA NPR, at pp. 15354-15355.

[107] *See* ERBA NPR, at p. 15272; SA NPR, at p. 15402.

[108] *See* ERBA NPR, at p. 14997; SA NPR, at p. 15356.

separation of the underlying exposures from the originator rather than on their accounting treatment.[109] The Reproposal does not adopt this recommendation.

[109] *See* SFA Comment Letter, Part V., at p. 44.

V. REVISIONS TO THE CREDIT RISK MITIGATION FRAMEWORK

The Reproposal introduces eligible prepaid credit protection arrangements as a new CRM category, providing a codified pathway for directly issued CLNs which replaces the current reservation of authority process. The 40% restructuring haircut for eligible credit derivatives is relaxed, subject to specified conditions. Financial collateral recognition under the simple approach is expanded to permit mismatched collateral, subject to applicable maturity- and currency-mismatch adjustments.

A. New CRM: Eligible Prepaid Credit Protection Arrangements

The Reproposal introduces a new category of credit risk mitigant, the "eligible prepaid credit protection arrangement," that provides a codified pathway for banking organizations to obtain regulatory capital recognition for directly issued credit-linked notes ("**Directly-Issued CLNs**") without the need for prior supervisory approval or a reservation of authority.[110] Like eligible guarantees, eligible credit derivatives, and financial collateral, eligible prepaid credit protection arrangements are a general credit risk mitigation tool under the Reproposal and are not limited to securitization exposures. [111]

This new framework addresses a structural issue under the current capital rules, under which Directly-Issued CLNs do not fit neatly within the existing categories of financial collateral, eligible guarantees, or eligible credit derivatives. Addressing this structural issue was one of the most important topics raised in the comment letters in response to the 2023 NPR,[112] as well as the fourth joint notice of regulatory review and request for comment under Section 2222 of the Economic Growth and Regulatory Paperwork Reduction Act of 1996 ("**EGRPRA**").[113]

Rather than treating Directly-Issued CLNs as cash-collateralized transactions[114] or otherwise forcing Directly-Issued CLNs into one of the existing CRM categories, the Reproposal creates an entirely new category called "eligible prepaid credit protection arrangement" that is intended to capture the economic substance of these arrangements. The framework has three components: (1) a base definition of "prepaid credit protection arrangement," (2) an eight-part eligibility test to qualify as an "*eligible* prepaid credit protection arrangement,"

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[110]Recognizing that Directly-Issued CLNs can effectively transfer credit risk despite not fitting neatly into the financial collateral, eligible credit derivative or eligible guarantee category, the FRB created a process by which banks could submit a request for the FRB to exercise its "reservation of authority" under the capital rules to permit use on a case-by-case basis. *See* "Frequently Asked Questions about Regulation Q" (available here). While some banks have utilized the reservation of authority process, its usefulness has been limited by timing and outcome uncertainty, as well as the $20 billion issuance cap imposed by the FRB.

[111]*See* ERBA NPR, at p. 14989; SA NPR, at p. 15345. Thus, a banking organization may use an eligible prepaid credit protection arrangement to obtain CRM benefits for any credit exposure provided the eligibility criteria are met. This paper focuses on prepaid credit protection in the securitization context, where the interaction with the synthetic securitization operational criteria and the SEC-SA risk weight framework make the new CRM category particularly consequential.

[112]*See, e.g.*, the SFA Comment Letter and the IACPM Comment Letter).

[113]*See, e.g.*, the EGRPRA comment letters of the Structured Finance Association (available here) and the International Association of Credit Portfolio Managers (available here). The Agencies stated that the eligible prepaid credit protection arrangement is "consistent with comments received under EGRPRA as commenters requested recognition of the risk-mitigation benefits of credit-linked notes." *See* ERBA NPR, at p. 14992 (fn. 160); SA NPR, at p. 15350 (fn. 72).

[114]The Basel Committee's framework provides in CRE 22.34, footnote 3, that "cash-funded credit-linked notes issued by the bank against exposures in the banking book that fulfil the criteria for credit derivatives are treated as cash-collateralised transactions." The EU CRR implements this provision directly in Article 218 ("Investments in credit linked notes issued by the lending institution may be treated as cash collateral for the purpose of calculating the effect of funded credit protection in accordance with this Sub-section …").

and (3) rules specifying the capital treatment. A bank is not required to obtain regulatory approval in connection with using an eligible prepaid credit protection arrangement.

1. The base definition

The Reproposal defines a "prepaid credit protection arrangement" as:

> a contractual arrangement under which a protection purchaser transfers the credit risk of one or more reference exposures to a protection provider where: (1) The protection provider pays an initial principal amount in cash to the protection purchaser at the inception of the transaction; and (2) The protection purchaser is obligated to repay the initial principal amount to the protection provider on or before the maturity date of the transaction, less any losses that the protection purchaser realizes or otherwise recognizes due to nonpayment of all contractual payments due to be paid on the reference exposure or reference exposures by the obligors.[115]

The Agencies explain that "[i]n this type of arrangement, the amount paid by the protection provider is not collateral that secures a future obligation of the protection provider; rather, it is consideration for a right to future payments, contingent on the performance of the protected exposure(s), from the protection purchaser."[116] The bank receives cash up front and repays it over time, minus any credit losses. The economic effect is equivalent to a fully funded credit hedge.

The Agencies seek comment on whether the definition is sufficiently broad.[117]

2. The eight eligibility criteria

To qualify as an *eligible* prepaid credit protection arrangement and thus receive capital recognition, the arrangement must satisfy eight conditions.[118] The eight conditions are set forth below.

#	Criterion	Observation
1	Is written	This parallels the eligible guarantee and eligible credit derivative requirement.
2	Is unconditional	This parallels the eligible guarantee and eligible credit derivative requirement.
3	Covers all or a pro rata portion of all contractual payments due to be paid on the reference exposure(s)	This parallels the eligible guarantee and eligible credit derivative requirement. Note that for purposes of the synthetic securitization operational criteria, this requirement is waived.[119]

[115] *See* ERBA NPR, at p. 15274; SA NPR, at p. 15403.

[116] *See* ERBA NPR, at p. 14991; SA NPR, at p. 15350.

[117] *See* Question 60 in the ERBA NPR; Question 33 in the SA NPR.

[118] *See* ERBA NPR, at p. 15273; SA NPR, at p. 15403.

[119] *See* ERBA NPR, at p. 15182; SA NPR, at p. 15413.

#	Criterion	Observation
4	Provides that the amount and timing of payments due from the protection purchaser to the protection provider are incorporated into the arrangement and the arrangement only allows these terms to change in the event of a breach of the arrangement by the protection purchaser	New requirement specific to prepaid credit protection arrangements.
5	Provides that entry of the protection provider into receivership, insolvency, liquidation, conservatorship, or similar proceeding does not change the amounts or timing of payments due to be paid by the protection purchaser under the arrangement	New requirement specific to prepaid credit protection arrangements.[120]
6	Is legally valid and enforceable under applicable law of the relevant jurisdictions	This parallels the eligible guarantee and eligible credit derivative requirement.
7	Upon a failure by the obligor on the reference exposure(s) to make a contractually required payment, or the occurrence of other credit events as described in the arrangement, allows the protection purchaser promptly to reduce the outstanding balance of the initial principal amount due to the protection provider by the loss of the protection purchaser on the reference exposures without input from the protection provider	Neither bankruptcy of the obligor nor restructuring are required credit events. Analogous to the eligible guarantee definition, which requires timely payment by the protection provider upon a default without requiring the beneficiary first to take legal action against the obligor.[121] The Agencies seek comment on loss recognition timing.[122]
8	Does not increase the protection purchaser's cost of credit protection in response to deterioration in the credit quality of any of the reference exposures.	This parallels the eligible guarantee and eligible credit derivative requirement.

The Reproposal does not impose any restrictions on how the bank holds or uses the proceeds of an eligible prepaid credit protection arrangement. As the preamble explains, "the amount paid by the protection provider is not collateral that secures a future obligation of the protection provider; rather, it is consideration for a right to future payments, contingent on the performance of the protected exposure(s), from the protection purchaser."[123] Thus, the transfer of credit risk to the protection provider (*e.g.*, the investor in a Directly-Issued CLN) is effected

[120]It is unclear how an insolvency event relating to the protection provider would change the amount or timing of payments due by the protection purchaser. A contractual provision that changes the amount or timing of payments due by the bank to the protection provider upon the protection provider's insolvency would generally be unenforceable as an ipso facto clause under the Bankruptcy Code.

[121]In the prepaid credit protection context, the mechanism operates differently: instead of requiring the protection provider to make a payment, the bank (protection purchaser) unilaterally reduces the amount it owes back to the protection provider.

[122]Question 58 in the ERBA NPR; and Question 31 in the SA NPR,

[123]*See* ERBA NPR, at p. 14991; SA NPR, at p. 15350.

through the bank's contractual right to reduce its repayment obligation under the instrument (*e.g.*, by writing down the outstanding balance of the CLN) as the bank incurs losses on the reference exposure(s).[124]

3. Capital treatment of eligible prepaid credit protection arrangements

Under an eligible prepaid credit protection arrangement, the banking organization may assign a **zero percent risk weight** to the reference exposure if the protection amount (P)[125] is greater than or equal to the exposure amount of the reference exposure. If the protection amount (P) is less than the exposure amount, the bank must split the reference exposure into a protected portion (to which a zero percent risk weight may be applied) and an unprotected portion (which retains the applicable risk weight under the relevant rules).[126]

The protection amount (P) is subject to reduction by the applicable maturity mismatch or currency mismatch adjustment.[127] Unlike the case of eligible credit derivatives, the absence of restructuring as a credit event does not result in a reduction of the protection amount (P) under an eligible prepaid credit protection arrangement.[128]

Absent a reduction due to maturity or currency mismatch, a **zero percent risk weight** would apply to the protected tranche in a synthetic securitization in which an eligible prepaid credit protection arrangement is the credit risk mitigant. As the preamble explains, an eligible prepaid credit protection arrangement "effectively transfers credit risk to the protection provider" because the banking organization's liability under the arrangement is reduced as the banking organization incurs losses on the reference exposures.[129]

4. Question about fair value of a directly-issued CLN

Market participants should carefully consider Question 59 in the ERBA NPR / Question 32 in the SA NPR, which asks whether the Agencies should consider defining the protection amount of an eligible prepaid credit protection arrangement by reference to its carrying value rather than its notional amount, which would imply that the protection amount is limited to the instrument's fair value if the instrument is accounted for on a fair value basis.

> Question 59 / 32: The proposal would define the protection amount of an eligible prepaid credit protection arrangement to mean the effective notional amount of the prepaid credit protection. Certain credit-linked notes that may qualify as eligible prepaid credit protection under the proposal, are **sometimes accounted for on a fair value basis**. The fair value of such credit-linked notes may be affected by factors other than losses or credit events (for example, a change in interest rates) in respect of the reference exposure. **As a result, at the time that credit losses in respect of the reference exposure are realized, the fair value of the credit-linked note, and the amount by which the banking organization may set off its losses in respect of the reference exposure, may be less than the notional amount of the note.** What, if any, modifications to the proposal should the agencies consider to address the risk that a banking organization may not be able to set off losses on

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[124] *See* ERBA NPR, at p. 14991; SA NPR, at p. 15350 ("This form of credit risk mitigant effectively transfers credit risk to the protection provider, as the banking organization's liability created by the prepaid credit protection arrangement generally would be reduced at the same time the banking organization incurs a loss on the protected exposure(s)").

[125] The "protection amount (P)" is the effective notional amount of the prepaid credit protection arrangement, reduced to reflect any maturity or currency mismatch. The "effective notional amount" means the lesser of the contractual notional amount of the credit risk mitigant and the exposure amount of the hedged exposure, multiplied by the percentage coverage of the credit risk mitigant. *See* ERBA NPR, at p. 15274; SA NPR, at p. 15426.

[126] *See* ERBA NPR, at p. 15180; SA NPR, at p. 15426.

[127] *See* ERBA NPR, at p. 15181; SA NPR, at p. 15426. Question 61 (see Appendix A) seeks comment on the maturity mismatch adjustment.

[128] *See* ERBA NPR, at p. 15179; SA NPR, at p. 15442. The absence of restructuring adjustment applies only in the context of eligible credit derivatives.

[129] *See* ERBA NPR, at p. 14991; SA NPR, at p. 15350.

a reference exposure against the full notional amount of a prepaid credit protection instrument? What would be the advantages and disadvantages of defining the protection amount of an eligible prepaid credit protection instrument to be the instrument's carrying value (For example, the fair value if the banking organizations elects this accounting treatment)?[130]

We find this question confusing because, at issuance, the bank receives cash proceeds equal to the full notional amount of the CLN, and the bank's right to reduce the outstanding balance of the CLN upon a credit event is contractual and operates by reference to notional value, not fair value. If the protection amount were defined as the CLN's fair value rather than its notional amount, the amount of recognized credit protection would fluctuate with the credit spreads applicable to the issuing bank and the underlying exposures, introducing volatility into the capital calculation. Moreover, the CLN's fair value could decline if those credit spreads widen, thus reducing recognition of the protection precisely when it is most valuable the bank.

B. Eligible Guarantors and Credit Risk Insurance

The Reproposal retains the substitution approach from the current rule, under which a banking organization may substitute the risk weight of the protection provider for that of the hedged exposure. To recognize the risk-mitigating benefits of a guarantee, the protection provider must continue to qualify as an "eligible guarantor," which generally requires, among other criteria, that the entity has issued and outstanding an unsecured debt security without credit enhancement that is investment grade.

The IACPM Comment Letter urged the Agencies to revise the eligible guarantor framework to better accommodate credit risk insurance provided by regulated multiline insurers. Credit insurance is a type of insurance that protects banks and other creditors from losses due to the non-payment by their customers. As the IACPM explained in a joint white paper with the IFTA (the "**White Paper**"),[131] while credit insurance issued by multiline insurers is a permitted form of "eligible guarantee" under the capital rule, the rule does not fully recognize the credit risk mitigating benefits of such insurance. Consistent with the White Paper's recommendations, the IACPM urged that the Agencies:

- **Recognize prudentially regulated insurers be recognized as *per se* eligible guarantors**. Under the current capital rule, even a highly-rated multiline insurer is treated as an ordinary corporate guarantor and therefore attracts a 100% substitution risk-weight, which eliminates the economic effect of the guarantee at precisely the moment it is needed. The IACPM argued that Agencies should add multi-line insurers that are subject to supervision and prudential capital and liquidity requirements to the list of *per se* eligible guarantors, acknowledging that these firms, like banks, actively assume and manage principal credit risk. This is consistent with the Basel Framework, which includes not only banks, but also "prudentially regulated insurance companies" in the list of per se eligible guarantors.[132]

- **Allow the "issued and outstanding investment grade debt" requirement to be met at the holding-company level**. Regulated insurance operating companies rarely issue bonds directly; their debt is typically issued at the parent holding company. Counting the parent's listed, investment-grade securities toward the "issued and outstanding" requirement would prevent technically sound guarantors from being disqualified for structural reasons and align the U.S. capital rule with the Basel Framework, which expressly permits the test to be met by the credit protection provider or its parent company."[133]

- **Apply bank-equivalent risk weights to qualifying insurers**. Under the existing capital rule, an exposure covered by even an AA-rated insurer is still slotted into the 100 percent corporate bucket,

[130] *See* ERBA NPR, at p. 14992 (emphasis added).

[131] *See* Credit Insurance as a Credit Risk Mitigant to Diversify Risk under the Capital Rules, July 2023, which is appended to the IACPM Comment Letter.

[132] *See* CRE 22.76 (fn. 11).

[133] *See* CRE 22.76(3)(a)(i).

nullifying much of the guarantee's capital value. Assigning prudentially regulated insurers the same standardized weights that apply to banks (down to 20 percent for short-term, low-risk counterparties) would better reflect their solvency regime and more closely align with the Basel Framework.[134]

Disappointingly, the Reproposal does not adopt these requested changes. However, the Agencies seek comment on the requirement that the entity has issued and outstanding investment grade unsecured debt without credit enhancement,[135] suggesting that the Agencies may remain open to revising the "eligible guarantor" definition in the final rule.

C. Eligible Credit Derivatives

The Reproposal largely preserves the current rule's treatment of eligible credit derivatives, including the requirement that the protection provider be an eligible guarantor. Under the current rule, where a credit derivative does not include debt restructuring as a credit event, the effective notional amount is reduced by 40 percent. The Reproposal relaxes this requirement: the 40% haircut would not apply if (i) the terms of the reference obligations permit amendment of key terms (such as maturity, principal, coupon, currency, or seniority) outside of insolvency only by the unanimous consent of all parties,[136] and (ii) the banking organization has conducted a legal review confirming that the reference obligations are subject to the U.S. Bankruptcy Code or a similar domestic or foreign insolvency regime.[137] If these conditions are not met, the 40% haircut continues to apply.

D. Financial Collateral

The Reproposal makes two modifications to the recognition of financial collateral under the simple approach.

- Legal enforceability standard. The current rule's prescriptive requirement for a collateral agreement containing specific rights (including liquidation or possession upon default) is replaced with a more principles-based standard. The collateral arrangement must be legally enforceable and must provide the banking organization with the ability to exercise its rights in a timely manner upon default.[138]

- Recognition of mismatched collateral. The Reproposal permits recognition under the simple approach of financial collateral subject to maturity or currency mismatch. This is a departure from the current rule, which generally disallows such recognition. Under the Reproposal, the recognized protection amount is adjusted through (i) a maturity mismatch factor based on the ratio of remaining collateral tenor to remaining exposure tenor (subject to minimum maturity requirements), and (ii) an 8% haircut for currency mismatches.[139]

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[134] *See* CRE 20.40 ("Exposures to securities firms and other financial institutions will be treated as exposures to banks provided that these firms are subject to prudential standards and a level of supervision equivalent to those applied to banks (including capital and liquidity requirements).").

[135] *See* Question 51 in the ERBA NPR; Question 22 in the SA NPR.

[136] *See* ERBA NPR, at p. 15179; SA NPR, at p. 15408. For certain asset classes (e.g., most retail exposures), this requirement would clearly be met in that the key terms of the loan generally cannot be changed without the consent of all the parties thereto (*i.e.*, the lender and the borrower). For other asset classes (*e.g.*, syndicated corporate loans), due diligence of the portfolio may be required in order to assess whether this requirement is satisfied.

[137] *See* ERBA NPR, at p. 15179; SA NPR, at p. 15408.

[138] *See* ERBA NPR, at p. 15180; SA NPR, at p. 15408.

[139] *See* ERBA NPR, at pp. 15180-15181; SA NPR, at pp. 15408-15409.

VI. CHANGES TO CREDIT CONVERSION FACTORS (CCFS) AND THE DEFINITION OF "COMMITMENT"

CCFs for commitments that are not unconditionally cancelable are set at 40% regardless of maturity. ERBA introduces a 10% CCF for unconditionally cancelable commitments, while the Revised Standardized Approach retains a 0% CCF for such exposures. Off-balance sheet securitization exposures continue to be subject to a separate exposure-amount rule that generally produces an effective 100% CCF.

The definition of "commitment" is significantly broadened to include contractual arrangements even where the banking organization is not obligated to extend credit or may refuse to do so with or without cause.

Under the general credit risk framework, a bank's off-balance sheet exposure amount is generally determined by multiplying the off-balance-sheet component by the applicable CCF. The applicable risk weight is then applied to the resulting exposure amount to determine the risk-weighted asset amount of the off-balance sheet exposure. For example, if a bank has a commitment that is not unconditionally cancelable to lend $150 to a corporation and the maturity of that commitment is greater than one year, the CCF under the current rule is 50%. Thus, the exposure amount is $75 (50% * $150), and the risk-weighted asset amount is $75 (100% corporate risk weight * $75 exposure amount).

While a bank's commitment to lend to a securitization SPE is an off-balance sheet exposure, the general CCF framework does not govern the exposure amount of securitization exposures.[140] Under the securitization framework, the exposure amount of an off-balance sheet securitization exposure is generally the full notional amount of the exposure.[141] Thus, for exposure-amount purposes, the securitization framework generally treats a commitment to lend to an SPE the same as a loan actually made to the SPE. The SFA pointed out this notable discrepancy in its comment letter on the 2023 NPR, but the Reproposal does not resolve it.[142]

CCFs continue to be relevant in the securitization context where the underlying exposures include off-balance sheet exposures, such as unfunded commitments. In that context, the Reproposal asks:

> What, if any, clarifications should the agencies consider regarding the determination of the exposure amount for securitization exposures where one or more of the underlying exposures are off-balance sheet exposures (such as unfunded commitments)? Specifically, what are the advantages and disadvantages of a modification that would clarify that banking organizations could apply the same credit conversion factors.[143]

[140] Paragraph (4) of the definition of "exposure amount" provides that "For the off-balance sheet component of an exposure (other than … a securitization exposure), the notional amount of the off-balance sheet component multiplied by the appropriate credit conversion factor (CCF) in §217.33." *See* 12 C.F.R. §217.2 (definition of "exposure amount").

[141] *See* 12 C.F.R. §217.42(c)(3)(i).

[142] *See* SFA Comment Letter, Part VII, at p. 47.

[143] *See* Question 70 in the ERBA NPR; Question 44 in the SA NPR.

A. Revised CCFs

The Reproposal would make the following changes to the CCFs under the general credit risk framework:[144]

Commitment Type	Current Rule	Revised Standardized Approach	ERBA
Unconditionally cancelable	0%	0%	10%
Not unconditionally cancelable, ≤ 1 year	20%	40%	40%
Not unconditionally cancelable, > 1 year	50%	40%	40%

B. New Definition of "Commitment"

The Reproposal would also change (and significantly broaden) the definition of "commitment":

- **Current Definition:** "any legally binding arrangement that obligates a banking organization to extend credit or to purchase assets."

- **Proposed Definition:** "any contractual arrangement under which a banking organization and an obligor agree to terms applicable to one or more future extensions of credit, purchases of assets, or issuances of credit substitutes, *whether or not* such arrangement is unconditionally cancelable."[145]

The Reproposal further provides that "[a] commitment is unconditionally cancelable if, by its terms, it either (a) provides that a banking organization is not obligated to extend credit, purchase assets, or issue credit substitutes; or (b) permits a banking organization, at any time, with or without cause, to refuse to extend credit, purchase assets, or issue credit substitutes under the arrangement (to the extent permitted under applicable law.)"[146]

Under this definition, a "commitment" would include contractual arrangements under which a banking organization and an obligor have agreed to the material terms applicable to one or more future extensions of credit even if, under those terms, the banking organization (i) is not obligated to extend credit or (ii) may refuse to extend credit with or without cause. The proposal specifically says that this can include advised lines and "uncommitted" facilities.[147]

This expansion is especially consequential for banks subject to ERBA given the proposed 10% CCF for unconditionally cancellable commitments. We expect that this expanded definition of "commitment" will be a recurring theme in the comment letters submitted by banks, particularly those subject to ERBA.

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[144] *See* ERBA NPR, at pp. 14978–14979; SA NPR, at p. 15343.

[145] *See* ERBA NPR, at p. 15272; SA NPR, at p. 15402.

[146] *See* ERBA NPR, at p. 15272; SA NPR, at p. 15402.

[147] *See* ERBA NPR, at p. 14978; SA NPR at p. 15342.

VII. OTHER CHANGES RELEVANT TO SECURITIZATION

The Reproposal would eliminate the threshold-based CET1 deduction for MSAs and instead apply a 250% risk weight regardless of size.

Under ERBA, securitization-related noninterest income and expenses would generally be included in the business-indicator calculation for operational risk; the reproposal does not provide a securitization-specific carve-out.

A. Mortgage Servicing Assets

The Reproposal would eliminate the current requirement to deduct mortgage servicing assets ("**MSAs**")[148] from CET1 capital above the applicable threshold(s). Under the current rule, non-deducted MSAs receive a 250% risk weight.[149] Under the Reproposal, the threshold-based deduction would be eliminated entirely, and all MSAs would receive a 250% risk weight regardless of size.[150] This change would apply under both the ERBA and the Revised Standardized Approach.[151]

The preamble explains that the change would reduce the regulatory disincentive to hold MSAs, notes that MSAs can serve as a natural hedge against interest-rate risk because their value generally increases when rates rise, and observes that retaining servicing rights can preserve customer relationships and support cross-selling.[152]

The Reproposal seeks comment on whether the 250% risk weight appropriately reflects the risk of MSAs.[153] We expect that this will remain a point of focus for industry participants. In its comment letter on the 2023 NPR, the Mortgage Bankers Association argued that the 250% risk weight on MSAs has contributed to banks' retreat from the mortgage servicing market and urged the agencies to reduce that risk weight to no more than 130%.[154]

B. Operational Risk Capital Charge on Securitization Income (ERBA Only)

The Reproposal imposes an operational risk framework under ERBA, under which a banking organization's operational risk capital requirement is based on a business indicator that includes an interest/lease/dividend component and a noninterest component. To the extent securitization-related servicing fees and other securitization-related income and expense are reflected in consolidated noninterest income and expense, they would generally flow into that business-indicator calculation. The proposal does not include a securitization-specific exclusion or carve-out.[155]

The SFA argued in its comment letter on the 2023 NPR that the Federal Reserve's own research found no statistically significant relationship between securitization income and operational losses, and that U.S. banks

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[148] MSAs are defined as "the contractual rights owned by a [banking organization] to service for a fee mortgage loans that are owned by others." *See* 217 C.F.R. §217.2 (current rule).

[149] *See* 217 C.F.R. §217.22(d) (current rule).

[150] *See* ERBA NPR, at pp. 39–41; SA NPR, at pp. 120–121.

[151] *See* ERBA NPR, at pp. 14955-56, 14962; SA NPR, at pp. 15334-15336.

[152] *See* ERBA NPR, at p 14962; SA NPR, at pp. 15335-15336.

[153] *See* ERBA NPR, at p. 14962 (Question 11); SA NPR, at 15336 (Question 1).

[154] *See* MBA comment letter, dated January 16, 2024, on the initial Basel III Endgame proposal (available here), at pp. 9, 12.

[155] *See* ERBA NPR, at pp. 15012–14, 15189.

are already capitalized for operational risk through stress testing.[156] As noted above, the Reproposal does not adopt a carve-out for securitization-related income.

[156] *See* SFA Comment Letter, Part VIII, at pp. 49-51.

VIII. CONCLUSION

The Reproposal is the culmination of a long effort to implement the final components of the Basel III standards in the United States. The retention of the p-factor at 0.5, although widely recognized as punitive, is far less punitive than the 2023 NPR's proposed doubling to 1.0 and avoids the significant increase in securitization capital requirements that market participants uniformly opposed.

The introduction of eligible prepaid credit protection arrangements provides, for the first time, a codified pathway for banking organizations to obtain capital recognition for directly issued credit-linked notes without prior supervisory approval, resolving a longstanding structural gap in the capital rules and removing a significant barrier to bank credit risk transfer transactions.

At the same time, the Reproposal retains some punitive features of the current securitization framework, including the p-factor of 0.5 and the 0.5 scalar applied to parameter W (which implies a 625% risk weight on past due underlying exposures), and introduces new ones, such as the prohibition on synthetic excess spread and the inclusion of the positive current exposure of non-credit derivatives in the numerator of K_G. The Reproposal also leaves a number of significant issues unresolved and poses a large number of questions on which the Agencies are actively seeking comment. Market participants should review these questions carefully and consider providing substantive responses on all questions during the comment period, which closes on June 18, 2026. Once a final rule is adopted, it is reasonable to assume that the securitization capital framework will not be the subject of material revision for many years.

Appendix A

Questions Asked in the Reproposal[157]

Eligible Guarantor (Question 51)	
Question 51 (*Eligible guarantor: investment grade debt requirement*)	The agencies seek comment on the requirement that the entity has issued and outstanding an unsecured debt security without credit enhancement that is investment grade to meet the definition of an eligible guarantor. What, if any, alternatives to this requirement should the agencies consider to help to ensure that eligible guarantors can be expected to perform on guarantees and what would the pros and cons of those alternatives be?
Eligible Credit Derivatives (Questions 52-54)	
Question 52 (*Credit derivatives: recognition without restructuring as credit event*)	The agencies seek comment on allowing banking organizations to recognize in full the effective notional amount of credit derivatives that do not include restructuring as a credit event, if certain conditions are met. What are the cost and benefits of this approach? What, if any, less restrictive conditions for receiving full recognition should the agencies consider that would more appropriately capture credit derivatives that provide similar protection as those that include restructuring as a credit event receive and why? For example, what would be the advantages and disadvantages of requiring the consent of all parties directly and adversely affected by a restructuring, rather than the unanimous consent of all parties? What would be the advantages and disadvantages of requiring the consent of all parties affected by any change in lien position or priority in the hedged or referenced exposure?
Question 53 (*Credit derivatives: relevance of restructuring treatment outside the US*)	To what extent is the proposed treatment of eligible credit derivatives that do not include restructuring of the reference exposure as a credit event relevant outside of the United States and how should this be considered for purposes of the proposal?
Question 54 (*Credit derivatives: cross-entity reference exposure recognition*)	In order for a banking organization to recognize the credit risk mitigation benefits of an eligible credit derivative, the current capital rule requires that legally-enforceable cross-default or cross-acceleration clauses be in place and that the reference exposure and the hedged exposure be to the same legal entity. What would be the advantages and disadvantages of allowing recognition of credit derivatives where (1) the reference exposure is to a different legal entity than the hedged exposure, (2) the reference exposure's legal entity is guaranteed by its parent company, and (3) the parent company is subject to a binding cross-default or cross-acceleration provision related to the hedged exposure's debt?
Financial Collateral (Questions 55-57)	
Question 55	Under the simple approach, the current capital rule requires that collateral be revalued at least every six months. The agencies recognize that, in practice, most collateral agreements

[157]Notes: (1) The question numbers correspond to those in the ERBA NPR. The same questions appear in the SA NPR. (2) This memo focuses on the securitization-related changes to the credit risk rule. There are questions under the market risk rule that are relevant to securitization positions in the trading book (*e.g.*, questions 173 and 174).

(*Collateral revaluation*)	for liquid collateral provide for more frequent valuation. The proposal would remove the requirement for collateral agreements. Given that financial collateral is generally liquid, what would be the advantages and disadvantages of requiring a more frequent minimum revaluation interval—such as quarterly—under the simple approach? Please provide rationale supporting or opposing a more frequent revaluation requirement.
Question 56 (*Definition of "financial collateral"*)	The proposal would maintain the current capital rule's definition of financial collateral and allow banking organizations to recognize the risk-mitigating benefits of cash on deposit, including cash held by a third-party custodian or trustee. The agencies invite comment on whether the definition of financial collateral is sufficiently clear with respect to cash collateral held for a banking organization by a third-party custodian or trustee. What would be the advantages or disadvantages of revising the "cash on deposit" prong of the definition of financial collateral to explicitly recognize cash on deposit at any third-party depository institution, regardless of whether it is a custodian or trustee? In addition, what would be the appropriate risk weight for the collateralized exposure where the financial collateral is, directly or indirectly, in the form of a deposit claim on a third-party depository institution and why? What would be the advantages and disadvantages of subjecting the collateralized exposure to the 20 percent risk weight floor? What, if any, other alternative approaches should the agencies consider and why?
Question 57 (*Market price volatility haircuts*)	The agencies seek comment on the appropriateness of the calibration of the market price volatility haircuts. Commenters are encouraged to submit data with their response.
Eligible Prepaid Credit Protection Arrangements (Questions 58-61)	
Question 58 (*Loss recognition timing*)	Under the definition of eligible prepaid credit protection arrangement, the proposal would require that a protection purchaser be able to reduce the outstanding balance due to the protection provider promptly upon realizing or otherwise recognizing a loss on the reference exposure, in the event that the obligor on one or more reference exposures fails to make a contractually required payment, or the occurrence of other credit events as described in the arrangement. What, if any, are the exposure types in respect of which, or circumstances when, a protection purchaser may be exposed to losses before such losses are manifested in a way that would permit a reduction in the protection purchaser's repayment obligation? For example, what would be the instances where nonpayment or other loss on the reference exposure may not always result in an accounting write-down of the eligible prepaid credit protection arrangement at the same time? What, if any, changes to the proposed definitions of prepaid credit protection arrangement and eligible prepaid credit protection arrangement should the agencies consider to further ensure that a protection purchaser would be able to reduce its repayment obligation on a prepaid credit protection arrangement as contemporaneously as possible with the manifestation of losses in respect of a reference exposure?

Question 59 (*Protection amount measurement*)	The proposal would define the protection amount of an eligible prepaid credit protection arrangement to mean the effective notional amount of the prepaid credit protection. Certain credit-linked notes that may qualify as eligible prepaid credit protection under the proposal, are sometimes accounted for on a fair value basis. The fair value of such credit-linked notes may be affected by factors other than losses or credit events (for example, a change in interest rates) in respect of the reference exposure. As a result, at the time that credit losses in respect of the reference exposure are realized, the fair value of the credit-linked note, and the amount by which the banking organization may set off its losses in respect of the reference exposure, may be less than the notional amount of the note. What, if any, modifications to the proposal should the agencies consider to address the risk that a banking organization may not be able to set off losses on a reference exposure against the full notional amount of a prepaid credit protection instrument? What would be the advantages and disadvantages of defining the protection amount of an eligible prepaid credit protection instrument to be the instrument's carrying value (For example, the fair value if the banking organizations elects this accounting treatment)?
Question 60 (*Scope of covered credit protection arrangements*)	The definition of prepaid credit protection requires that the protection purchaser is obligated to repay the initial principal amount to the protection provider on or before the maturity date of the transaction, less any losses that the protection purchaser realizes or otherwise recognizes due to nonpayment of all contractual payments due to be paid on the reference exposure by the obligors. The agencies seek comment as to whether the definition is sufficiently broad to capture the types of prepaid credit protection arrangements that banking organizations may enter into to transfer credit risk. For example, may prepaid credit protection arrangements be structured to allow for a reduction in the initial principal amount of the arrangement upon the recognition of losses on one or more reference exposures due to credit quality deterioration of the exposures, even in the absence of any nonpayment. If so, what if any changes to the definition of prepaid credit protection should the agencies consider?
Question 61 (*Maturity mismatch*)	The agencies seek comment on the effectiveness of the credit risk mitigation of collateral and eligible prepaid credit protection arrangement when there is a maturity mismatch between the credit risk mitigant and the hedged reference portfolio, for example, longer-dated assets that are protected by a shorter-dated prepaid credit protection arrangement. The agencies seek comment on whether the banking organization has effectively mitigated credit risk if the losses on the assets are estimated to occur after the expiration of the prepaid credit protection arrangement. Does the proposed maturity mismatch adjustment sufficiently capitalize for the residual risks of hedging longer-dated assets with shorter-term prepaid credit protection arrangement? Please provide supporting data and analysis.
Securitization Definitions (Questions 62-64)	
Question 62 (*Performance depends*	What additional clarifications, if any, should the agencies consider for the proposed modification to paragraph (3) of the definition of traditional and synthetic securitization and why?

"solely" requirement)	
Question 63 (*Transfer of credit or equity risk clarification*)	What additional clarifications, if any, should the agencies consider for the proposed modification to paragraph (1) of the definition of traditional securitization and why? What would be the advantages and disadvantages of making similar changes to paragraph (1) of the definition of synthetic securitization?
Question 64 (*Equity-backed securitizations and O/C*)	The agencies seek comment on the appropriateness of requiring covered banking organizations to use the general risk-weight framework for certain overcollateralized exposures if the fair value of underlying equity exposures declines such that there is no longer overcollateralization[.] What would be the advantages and disadvantages of requiring covered banking organizations to use the general risk-weight framework (rather than the securitization framework) to determine the applicable risk weight for securitization exposures where the underlying exposures are primarily equity exposures and the fair value of the underlying equity exposures has significantly declined? What criteria should the agencies consider to capture only those securitization exposures for which such an approach would more appropriately capture the risk and why?
Securitization Operational Requirements (Questions 65-69)	
Question 65 (*Early amortization exceptions*)	What, if any, additional exceptions to the early amortization provision definition should the agencies consider and why, provided such exceptions would not incentivize a banking organization to provide implicit support to a securitization exposure? In particular, is the current rule's exception where early amortization "is triggered solely by events not directly related to the performance of the underlying exposures or the originating institution (such as material changes in tax laws or regulations)" sufficiently clear? What types of early termination events should qualify as events not directly related to either the performance of the underlying exposures or the originating banking organization? Should events not directly related to the performance of the underlying exposures or the originating banking organization include customary provisions designed to protect against non-performance of various contractual obligations by one of the parties facilitating the securitization (including the originating banking organization, if it has such a transaction facilitating role, for example by acting as a servicer)? Commenters are also asked to describe under what circumstances could a provision in a revolving loan securitization that, when triggered, causes investors in the securitization exposures to be repaid before the original stated maturity of the securitization exposures, leaves investors "fully exposed to future draws by borrowers on the underlying exposures even after the provision is triggered", or otherwise should be deemed not to be an early amortization provision. What are the advantages and disadvantages of "fully exposed" encompassing only cash-funded exposures versus also including exposures in the form of contractual commitments to provide funding?
Question 66 (*Synthetic excess spread definition*)	What clarifications or modifications should the agencies consider for the above proposed definition of synthetic excess spread and why?

Question 67 (*Treatment of synthetic securitizations with synthetic excess spread*)	What are the advantages and disadvantages of the proposed treatment of synthetic securitizations with synthetic excess spread? If the agencies were to permit originating banking organizations to recognize the credit risk-mitigation benefits of securitizations with synthetic excess spread, how should the exposure amount of the synthetic excess spread be calculated, and what would be the appropriate capital requirement for synthetic excess spread?
Question 68 (*Minimum Payment Threshold*)	What are the benefits and drawbacks of the proposed minimum payment threshold criterion? What, if any, additional criteria or clarifications should the agencies consider and why?
Question 69 (*Eligible Clean-Up Calls*)	What, if any, other modifications should the agencies consider for the definition of an eligible clean-up call and why?
Exposure Amount and CCF Treatment (Question 70)	
Question 70 (*CCFs for underlying exposures in SEC-SA calculations*)	What, if any, clarifications should the agencies consider regarding the determination of the exposure amount for securitization exposures where one or more of the underlying exposures are off-balance sheet exposures (such as unfunded commitments)? Specifically, what are the advantages and disadvantages of a modification that would clarify that banking organizations could apply the same credit conversion factors ... when calculating the components of the SEC-SA (K_G, W parameter, attachment point A and detachment point D) for a securitization exposure where one or more of the underlying exposures are off-balance sheet exposures? What would be the effect of such a clarification on the volatility of the capital requirements?
SEC-SA Parameters: W, K_G, and K_A (Questions 71-73)	
Question 71 (*W parameter: treatment of equity exposures*)	The agencies seek comment on the appropriateness of requiring banking organizations to only include equity exposures when the issuer is subject to a bankruptcy or insolvency proceeding in the W parameter calculation. What, if any, alternative approaches (such as requiring banking organizations to include equity exposures when the issuer has an obligation to the banking organization that is 90 days or more past due) should the agencies consider that would more appropriately capture the proportion of underlying exposures that are not performing or are delinquent and why? What, if any, operational concerns could such alternatives pose?
Question 72 (*Partial delinquency information: subpool approach*)	Recognizing that banking organizations may not always know the delinquency status of each underlying exposure, what would be the benefits and drawbacks of allowing a banking organization to use the SEC-SA if the banking organization knows the delinquency status for most, but not all, of the underlying exposures? For example, if the banking organization knew the delinquency status of 95 percent of the exposures, what would be the benefits and drawbacks of allowing the banking organization to (1) split the underlying exposures into two subpools, (2) calculate a weighted average of the K_A of the subpool comprising the underlying exposures for which the delinquency status is known, (3) assign a value of 1 for KA of the other subpool comprising exposures for which the delinquency status is unknown, and (4) assign a KA for the entire pool equal to the weighted average of the KA for each subpool?

	What other approaches, if any, should the agencies consider and why?
Question 73 (*K_G / W double-counting of past due exposures*)	The agencies seek comment on the appropriateness of requiring banking organizations to reflect underlying past due exposures in both the K_G and the W parameter components when calculating K_A. To what extent could including past due exposures in both components result in overly punitive capital requirements for such exposures under SEC-SA? What, if any, alternatives (such as not applying the heightened 150 risk weight for past due exposures for purposes of calculating K_G) should the agencies consider and why? Commenters are encouraged to provide specific examples, including calculations and supporting data.
Risk Weight Floors (Question 74, 77-78)	
Question 74 (*Re-securitization 100% floor*)	The agencies seek comment on the proposed 100 percent risk-weight floor for resecuritization exposures. What modifications, if any, should the agencies consider to the 100 percent risk-weight floor for resecuritization exposures and why? For example, what would be the pros and cons of excluding certain types of resecuritization exposures—such as resecuritizations of servicer cash advance receivables—from the 100 percent risk-weight floor and why? Commenters are encouraged to provide data (such as loss history) to support their recommendations.
Question 77 (*Look-through approach 15% floor*)	What are the advantages and disadvantages of the proposed 15 percent risk weight floor in the look-through approach and why?
Question 78 (*NPL securitization 100% floor*)	The agencies seek comment on the proposed 100 percent risk-weight floor for non-performing loan securitization exposures. What modifications, if any, should the agencies consider to the 100 percent risk-weight floor for non-performing loan securitization exposures and why? Commenters are encouraged to provide data (such as loss history) to support their recommendations.
Derivative Contracts as Securitization Exposures (Question 75)	
Question 75 (*100% risk weight on senior derivative contracts*)	The current capital rule provides banking organizations the option to assign a 100 percent risk weight to securitization exposures that are derivative contracts (other than protection provided by a banking organization in the form of a credit derivative) that have a first priority claim on the cash flows from the underlying exposures (notwithstanding amounts due under interest rate or currency derivative contracts, fees, or other similar payments). The agencies seek comment on the advantages and disadvantages of retaining this option. What, if any, operational burden would banking organizations face if this option were retained or eliminated? What, if any, clarifications should the agencies consider regarding the determination of the attachment point and detachment point for such securitization exposures, and why?
Overlapping Exposures (Question 76)	

Question 76 (*Overlap between market risk covered and noncovered positions*)	What challenges, if any, would the option to recognize an overlap between market risk covered and noncovered positions introduce? To what degree do banking organizations anticipate recognizing overlaps between market risk covered and noncovered positions?

Appendix B-1

Risk Weights for Residential Real Estate; Tranche Sizing to Reach RW Floor on the Senior Tranche

CURRENT STANDARDIZED APPROACH			
Residential Mortgage Type	**Risk Weight**	**Junior Tranche**	**Senior Tranche (RW = 20%)**
FHA- or VA-guaranteed	20%	0.81%	99.19%
Qualifying first-lien	50%	4.54%	95.46%
All other residential mortgage	100%	12.18%	87.82%

ERBA			
Residential Mortgage Type	**Risk Weight**	**Junior Tranche**	**Senior Tranche (RW = 15%)**
FHA- or VA-guaranteed	20%	1.21%	98.79%
Regulatory Residential Real Estate Exposures – Not Dependent on Cash Flows			
LTV ≤ 50%	20%	1.21%	98.79%
50% < LTV ≤ 60%	25%	1.82%	98.18%
60% < LTV ≤ 80%	30%	2.43%	97.57%
80% < LTV ≤ 90%	40%	3.72%	96.28%
90% < LTV ≤ 100%	50%	5.13%	94.87%
100% < LTV	70%	8.21%	91.79%
Regulatory Residential Real Estate Exposures – Dependent on Cash Flows			
LTV ≤ 50%	30%	2.43%	97.57%
50% < LTV ≤ 60%	35%	3.06%	96.94%
60% < LTV ≤ 80%	45%	4.41%	95.59%
80% < LTV ≤ 90%	60%	6.63%	93.37%
90% < LTV ≤ 100%	75%	9.03%	90.97%
100% < LTV	105%	14.31%	85.69%
Other Residential			
Residential mortgage not dependent on cash flows	100%	13.39%	86.61%
All other residential mortgage	150%	23.24%	76.76%

REVISED STANDARDIZED APPROACH			
Residential Mortgage Type	**Risk Weight**	**Junior Tranche**	**Senior Tranche (RW = 15%)**
FHA- or VA-guaranteed	20%	1.21%	98.79%
Qualifying First-Lien Residential Real Estate Exposures – Not Dependent on Cash Flows			
LTV ≤ 50%	25%	1.82%	98.18%
50% < LTV ≤ 60%	30%	2.43%	97.57%
60% < LTV ≤ 80%	35%	3.06%	96.94%
80% < LTV ≤ 90%	45%	4.41%	95.59%
90% < LTV ≤ 100%	55%	5.87%	94.13%
100% < LTV	75%	9.03%	90.97%
Qualifying First-Lien Residential Real Estate Exposures – Dependent on Cash Flows			
LTV ≤ 50%	35%	3.06%	96.94%
50% < LTV ≤ 60%	40%	3.72%	96.28%
60% < LTV ≤ 80%	50%	5.13%	94.87%
80% < LTV ≤ 90%	65%	7.41%	92.59%
90% < LTV ≤ 100%	80%	9.87%	90.13%
100% < LTV	110%	15.24%	84.76%
Other Residential	100%	13.39%	86.61%

ERBA: Regulatory Residential Real Estate Exposures	Revised Standardized Approach: Qualifying Residential Real Estate Exposures
First-lien residential mortgage exposure that is not an ADC exposure, a pre-sold construction loan, a statutory multifamily mortgage, or an HVCRE exposure.	First-lien residential mortgage exposure.
Is secured by a property that is either owner-occupied or rented.	Is secured by a property that is either owner-occupied or rented.
Is made in accordance with prudent underwriting standards, including standards relating to the loan amount as a percent of the value of the property.	Is made in accordance with prudent underwriting standards, including relating to the loan amount as a percent of the appraised value of the property.
Involves a loan, for which the [BANKING ORGANIZATION] applied underwriting policies that took into account the ability of the borrower to repay in a timely manner based on clear and measurable underwriting standards that enable the [BANKING ORGANIZATION] to evaluate these credit factors, during underwriting of the loan.	Is not 90 days or more past due or carried in nonaccrual status.
Is secured by property that is valued in accordance with the requirements included in the LTV calculation ratio.	
Involves a loan that has not been restructured or modified, provided that a loan modified or restructured solely pursuant to the U.S. Treasury's Home Affordable Mortgage Program is not modified or restructured for purposes of this section.	Involves a loan that has not been restructured or modified, provided that a loan modified or restructured solely pursuant to the U.S. Treasury's Home Affordable Mortgage Program is not modified or restructured for purposes of this section.
When a [BANKING ORGANIZATION] holds the first-lien and junior-lien(s) mortgage exposure, and no other party holds an intervening lien, the [BANKING ORGANIZATION] must treat the exposures as a single regulatory residential real estate exposure.	If [BANKING ORGANIZATION] holds the first-lien and junior-lien(s) residential mortgage exposure, and no other party holds an intervening lien, the [BANKING ORGANIZATION] must combine the exposures and treat them as a single first-lien residential real estate exposure.

LTV is calculated as the extension of credit divided by the value of the property. The extension of credit component includes the total outstanding amount of the loan and any undrawn committed amount. The value of the property would mean the **value at the time of origination of all real estate properties securing the extension of credit**, including the increased estimated value of the property if the property is being improved by an extension of credit.[158]

Note that the LTV is dynamic. The Agencies state that "The extension of credit would mean the total outstanding amount of the loan including the notional total of any undrawn committed amount of the loan. The total outstanding amount of the loan would reflect the current amortized balance as the loan pays down, which would allow a banking organization to assign a lower risk weight to a loan over time as the principal is repaid. Similarly, if an extension of credit increases, a banking organization would reflect that increase in the LTV ratio."[159]

"Dependent on the cash flows generated by the real estate" means that the underwriting, at the time of origination, considers the cash flows generated by lease, rental, or sale of the real estate securing the loan as a source of repayment. For purposes of this definition, a residential mortgage exposure that is secured by the borrower's principal residence is deemed not dependent on the cash flows generated by the real estate.[160]

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[158] *See* ERBA NPR, at p. 14970. The value of the property also includes the fair value of any readily marketable or otherwise acceptable collateral as defined in the real estate lending guidelines.

[159] *See* ERBA NPR, at p. 14970.

[160] *See* §__.101 under ERBA.

Appendix B-2

Risk Weights for Commercial Real Estate; Tranche Sizing to Reach RW Floor on the Senior Tranche

CURRENT STANDARDIZED APPROACH			
Commercial Mortgage Type	**Risk Weight**	**Junior Tranche**	**Senior Tranche (RW = 20%)**
Statutory multifamily	50%	4.54%	95.46%
Pre-sold construction	50%[161]	4.54%	95.46%
HVCRE	150%	21.37%	78.63%
All other commercial mortgage	100%	12.18%	87.82%

ERBA			
Commercial Mortgage Type	**Risk Weight**	**Junior Tranche**	**Senior Tranche (RW = 15%)**
Statutory multifamily	50%	5.13%	94.87%
Pre-sold construction	50%[162]	5.13%	94.87%
ADC (not HVCRE)	100%	13.39%	86.61%
HVCRE	150%	23.24%	76.76%
Regulatory CRE Exposures — Not Dependent on Cash Flows			
LTV ≤ 60%	Lesser of 60% and borrower RW	6.63% (assuming 60% RW)	93.37% (assuming 60% RW)
LTV > 60% (IG borrower)	65%[163]	7.41%	92.59%
LTV > 60% (non-IG borrower)	100%	13.39%	86.61%
Regulatory CRE Exposures — Dependent on Cash Flows			
LTV ≤ 60%	70%	8.21%	91.79%
60% < LTV ≤ 80%	90%	11.60%	88.40%
LTV > 80%	110%	15.24%	84.76%
Other CRE Exposures	150%[164]	23.24%	76.76%

[161]The risk weight increases to 100% if the purchase contract is cancelled.

[162]The risk weight increases to 100% if the purchase contract is cancelled.

[163]Investment grade corporate borrowers have a 65% risk weight under ERBA, whereas non-investment grade corporate borrowers have a 100% risk weight under ERBA. Note that "investment grade" status is based on the bank's own internal credit risk rating system, not external credit ratings.

[164]Treated as an "other real estate exposure" under §__.111(f)(7).

REVISED STANDARDIZED APPROACH			
Commercial Mortgage Type	**Risk Weight**	**Junior Tranche**	**Senior Tranche (RW = 15%)**
Statutory multifamily	50%	5.13%	94.87%
Pre-sold construction	50%[165]	5.13%	94.87%
HVCRE	150%	23.24%	76.76%
Other CRE Exposures			
CRE exposure to corporate	95%	12.49%	87.51%
CRE exposure to natural person	90%	11.60%	88.40%

[165]The risk weight increases to 100% if the purchase contract is cancelled.

ERBA: Regulatory Commercial Real Estate Exposures	Revised Standardized Approach: Commercial Real Estate Exposures
A "**regulatory commercial real estate exposure**" is a real estate exposure that is not a regulatory residential real estate exposure, an ADC exposure, a pre-sold construction loan, a statutory multifamily mortgage, or an HVCRE exposure, and that meets the following criteria: **(1)** The exposure must be primarily secured by fully completed real estate; **(2)** The [BANKING ORGANIZATION] holds a first priority security interest in the property that is legally enforceable in all relevant jurisdictions; provided that when the [BANKING ORGANIZATION] also holds a junior security interest in the same property and no other party holds an intervening security interest, the [BANKING ORGANIZATION] must treat the exposures as a single regulatory commercial real estate exposure; **(3)** The exposure is made in accordance with prudent underwriting standards, including standards relating to the loan amount as a percent of the value of the property; **(4)** During underwriting of the loan, the [BANKING ORGANIZATION] must have applied underwriting policies that took into account the ability of the borrower to repay in a timely manner based on clear and measurable underwriting standards that enable the [BANKING ORGANIZATION] to evaluate relevant credit factors; **(5)** The property must be valued in accordance with the requirements included in the LTV calculation ratio; and **(6)** Involves a loan that has not been restructured or modified.[166]	This is not a separate category under the Revised Standardized Approach. A CRE-type exposure that is not statutory multifamily, pre-sold construction, or HVCRE receives a 95% risk weight, if the exposure is to a corporate entity, or a 90% risk weight, if the exposure is to a natural person.
"**Statutory multifamily mortgage**" means a loan secured by a multifamily residential property that meets the requirements under section 618(b)(1) of the Resolution Trust Corporation Refinancing, Restructuring, and Improvement Act of 1991, and that meets the following criteria: **(1)** The loan is made in accordance with prudent underwriting standards; **(2)** The principal amount of the loan at origination does not exceed 80 percent of the value of the property (or 75 percent of the value of the property if the loan is based on an interest rate that changes over the term of the loan) where the value of the property is the lower of the acquisition cost of the property or the appraised (or, if appropriate, evaluated) value of the property; **(3)** All principal and interest payments on the loan must have been made on a timely basis in accordance with the terms of the loan for at least one year prior to applying a 50 percent risk weight to the loan, or in the case where an existing owner is refinancing a loan on the property, all principal and interest payments on the loan being refinanced must have been made on a timely basis in accordance with the terms of the loan for at least one year prior to applying a 50 percent risk weight to the loan; **(4)** Amortization of principal and interest on the loan must occur over a period of not more than 30 years and the minimum original maturity for repayment of principal must not be less than 7 years; **(5)** Annual net operating income (before making any payment on the loan) generated by the property securing the loan during its most recent fiscal year must not be less than 120 percent of the loan's current annual debt service (or 115 percent of current annual debt service if the loan is based on an interest rate that changes over the term of the loan) or, in the case of a cooperative or other not-for-profit housing project, the property must generate sufficient cash flow	

[166] *See* §__.101 under ERBA.

to provide comparable protection to the Board-regulated institution; and **(6)** The loan is not more than 90 days past due, or on nonaccrual. {*The Reproposal does not change this definition. It continues to apply under ERBA and the Revised Standardized Approach.*}	
"**Pre-sold construction loan**" means any one-to-four family residential construction loan to a builder that meets the requirements of section 618(a)(1) or (2) of the Resolution Trust Corporation Refinancing, Restructuring, and Improvement Act of 1991 (12 U.S.C. 1831n note) and the following criteria: **(1)** The loan is made in accordance with prudent underwriting standards, meaning that the Board-regulated institution has obtained sufficient documentation that the buyer of the home has a legally binding written sales contract and has a firm written commitment for permanent financing of the home upon completion; **(2)** The purchaser is an individual(s) that intends to occupy the residence and is not a partnership, joint venture, trust, corporation, or any other entity (including an entity acting as a sole proprietorship) that is purchasing one or more of the residences for speculative purposes; **(3)** The purchaser has entered into a legally binding written sales contract for the residence; **(4)** The purchaser has not terminated the contract; however, if the purchaser terminates the sales contract, the Board must immediately apply a 100 percent risk weight to the loan and report the revised risk weight in the next quarterly Call Report, for a state member bank, or the FR Y–9C, for a bank holding company or savings and loan holding company, as applicable, **(5)** The purchaser has made a substantial earnest money deposit of no less than 3 percent of the sales price, which is subject to forfeiture if the purchaser terminates the sales contract; provided that, the earnest money deposit shall not be subject to forfeiture by reason of breach or termination of the sales contract on the part of the builder; **(6)** The earnest money deposit must be held in escrow by the Board-regulated institution or an independent party in a fiduciary capacity, and the escrow agreement must provide that in an event of default arising from the cancellation of the sales contract by the purchaser of the residence, the escrow funds shall be used to defray any cost incurred by the Board-regulated institution; **(7)** The builder must incur at least the first 10 percent of the direct costs of construction of the residence (that is, actual costs of the land, labor, and material) before any drawdown is made under the loan; **(8)** The loan may not exceed 80 percent of the sales price of the presold residence; and **(9)** The loan is not more than 90 days past due, or on nonaccrual. {*The Reproposal does not change this definition. It continues to apply under ERBA and the Revised Standardized Approach.*}	
"**High volatility commercial real estate (HVCRE) exposure**" means a credit facility secured by land or improved real property that (i) primarily finances, has financed, or refinances the acquisition, development, or construction of real property; (ii) has the purpose of providing financing to acquire, develop, or improve such real property into income-producing real property; and (iii) depends upon future income or sales proceeds from, or refinancing of, such real property for the repayment of such credit facility. There are various exclusions to the HVCRE category, including certain one-to-four family residential ADC loans and certain commercial real estate ADC loans. *See* 12 C.F.R. §217.2 for the full definition. {*The Reproposal does not change this definition. It continues to apply under ERBA and the Revised Standardized Approach.*}	
"**Acquisition, development, or construction (ADC) exposure**" means a loan secured by real estate for the purpose of acquiring, developing, or constructing residential or commercial real estate properties, as well as all land development loans, and all other land loans.	This is not a separate category under the Revised Standardized Approach.

- LTV is calculated as the extension of credit divided by the value of the property. Notably, the extension of credit component includes the total outstanding amount of the loan and any undrawn committed amount. The value of the property would mean the value **at the time of origination of all real estate properties securing the extension of credit**, including the increased estimated value of the property if the property is being improved by an extension of credit. The value of the property would also include the fair value of any readily marketable or otherwise acceptable collateral as defined in the real estate lending guidelines.[167]

  Note that the LTV is dynamic. The Agencies state that "The extension of credit would mean the total outstanding amount of the loan including the notional total of any undrawn committed amount of the loan. The total outstanding amount of the loan would reflect the **current amortized balance as the loan pays down**, which would allow a banking organization to assign a lower risk weight to a loan over time as the principal is repaid. Similarly, if an extension of credit increases, a banking organization would reflect that increase in the LTV ratio."[168]

- "Dependent on the cash flows generated by the real estate" means that the underwriting, at the time of origination, considers the cash flows generated by lease, rental, or sale of the real estate securing the loan as a source of repayment.[169]

[167] *See* ERBA NPR, at p. 14970.

[168] *See* ERBA NPR, at p. 14970.

[169] *See* §__.101 under ERBA.

Appendix B-3

Risk Weights for Corporate Exposures; Tranche Sizing to Reach RW Floor on the Senior Tranche

CURRENT STANDARDIZED APPROACH			
Corporate Exposure Type	**Risk Weight**	**Junior Tranche**	**Senior Tranche (RW = 20%)**
Any type of corporate exposure	100%	12.18%	87.82%

ERBA			
Corporate Exposure Type	**Risk Weight**	**Junior Tranche**	**Senior Tranche (RW = 15%)**
Investment grade obligor	65%	7.41%	92.59%
Non-investment grade obligor	100%	13.39%	86.61%
Subordinated exposure	150%	23.24%	76.76%

REVISED STANDARDIZED APPROACH			
Corporate Exposure Type	**Risk Weight**	**Junior Tranche**	**Senior Tranche (RW = 15%)**
Any type of corporate exposure	95%	12.49%	87.51%

ERBA: Corporate Exposures	Revised Standardized Approach: Corporate Exposures
Corporate exposure means an exposure to a company that is not: (1) An exposure to a sovereign, a specified supranational entity, a multilateral development bank (MDB), a depository institution, a foreign bank, a credit union, or a public sector entity (PSE); (2) An exposure to a Government-Sponsored Enterprise (GSE); (3) A pre-sold construction loan; (4) A statutory multifamily mortgage; (5) A high volatility commercial real estate (HVCRE) exposure; (6) A cleared transaction; (7) A default fund contribution; (8) A securitization exposure; (9) An equity exposure; (10) An unsettled transaction; (11) A policy loan; (12) A separate account; or (13) A Paycheck Protection Program covered loan.	
Under the ERBA, the corporate exposure definition also excludes "real estate exposures" and "retail exposures," which receive their own risk weight treatment.	Under the Revised Standardized Approach, the definition also excludes residential mortgage exposures, but does not separately exclude non-residential real estate exposures or retail exposures. Exposures to companies, including SMEs, that are not otherwise assigned to a more specific category generally fall within the corporate category and receive the 95% corporate risk weight, whereas comparable exposures to natural persons generally fall within the residual 90% other-assets category.
The 65% investment grade risk weight may not be applied to a corporate exposure that is a subordinated exposure. Under the capital rules, "investment grade" means that the entity to which the banking organization is exposed through a loan or security, or the reference entity with respect to a credit derivative, has adequate capacity to meet financial commitments for the projected life of the asset or exposure. Such an entity or reference entity has adequate capacity to meet financial commitments if the risk of its default is low and the full and timely repayment of principal and interest is expected. To assign the 65% investment grade risk weight to a corporate exposure, a banking organization must determine that the obligor is investment grade using one or more **internal credit risk rating systems** that satisfy five requirements, each of which is paraphrased below: (1) **Business use.** The system must be used to inform material business and risk management decisions, not just capital decisions. (2) **Investment grade mapping.** The system must define which of its rating grades correspond to "investment grade" as defined in the rule (adequate capacity to meet financial commitments, low default risk, full and timely repayment expected).	There is no investment grade distinction under the Revised Standardized Approach. All corporate exposures receive a 95% risk weight.

(3) **Accuracy and timeliness.** The system must assign rating grades based on clearly defined criteria, assign a grade to each obligor at least annually, and update the grade whenever the bank receives new material information about the obligor's creditworthiness. (4) **No sole reliance on third parties.** The system cannot rely solely on third-party credit assessments (such as rating agency opinions). It must incorporate both quantitative and qualitative factors, including historical and projected payment patterns, financial performance, and relevant developments affecting creditworthiness. (5) **Annual validation.** At least annually, the bank must validate the system's robustness, consistency, and reliability using data covering at least one full credit cycle, and must remediate any deficiencies. The validation must include certain specific elements as set forth in the rule.	
Subordinated exposure: An exposure (including preferred stock that is not an equity exposure) that in the event of default or liquidation of the obligor, the holder of which is entitled to receive payments of outstanding principal and interest only after all claims of creditors senior to the holder have been satisfied and discharged.	There is no subordinated exposure category under the Revised Standardized Approach. All corporate exposures receive a 95% risk weight.

Appendix B-4

Risk Weights for Retail Exposures; Tranche Sizing to Reach RW Floor on the Senior Tranche

CURRENT STANDARDIZED APPROACH			
Retail Exposure Type	**Risk Weight**	**Junior Tranche**	**Senior Tranche (RW = 20%)**
Any type of retail exposure	100%	12.18%	87.82%

ERBA			
Retail Exposure Type	**Risk Weight**	**Junior Tranche**	**Senior Tranche (RW = 15%)**
Regulatory Retail Exposures			
Transactor exposure	45%	4.41%	95.59%
Other regulatory retail	75%	9.03%	90.97%
Other Retail Exposures	100%	13.39%	86.61%

REVISED STANDARDIZED APPROACH			
Retail Exposure Type	**Risk Weight**	**Junior Tranche**	**Senior Tranche (RW = 15%)**
Retail exposure to natural person(s)	90%	11.60%	88.40%
Retail exposure to companies (*e.g.*, SMEs)	95%	12.49%	87.51%

ERBA: Retail Exposures	Revised Standardized Approach: Retail Exposures
Retail exposure: An exposure that is not a real estate exposure and that meets the following criteria: 1. The exposure is to a natural person or persons, or 2. The exposure is to an SME[170] and satisfies the criteria in paragraphs (1) through (2) of the definition of regulatory retail exposure.	The Revised Standardized Approach does not have a separate retail exposure category with distinct risk weights. Retail exposures to natural persons are generally treated as other assets (90% risk weight). Retail exposures to companies (including SMEs) are generally treated as corporate exposures (95% risk weight).
Regulatory retail exposure: A retail exposure that meets both of the following criteria: 1. Product criterion. The exposure is a revolving credit or line of credit or a term loan or lease; and 2. Aggregate limit. The sum of the notional amount of the exposure and the notional amounts of all other retail exposures to the obligor and to its affiliates does not exceed $1 million, as adjusted pursuant to §__.4 (inflation indexing provision).	No corresponding category.
Transactor exposure: A regulatory retail exposure that is a credit facility where the balance has been repaid in full at each scheduled repayment date for the previous 12 months or an overdraft facility where there has been no drawdown over the previous 12 months.	No corresponding category.

[170]Small or medium-sized entity (SME) means an entity in which the reported annual revenues or sales for the consolidated group of which the entity is a part are less than or equal to $50 million, as adjusted pursuant to §__.4 (inflation indexing provision), for the most recent fiscal year.

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