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WHITE PAPER

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Federal Reserve Board Proposes New Single-Counterparty Credit Exposure Limits for Large Banking Organizations

On March 4, 2016, the Federal Reserve Board ("the Board") proposed a rule that would limit the credit exposures of large banking organizations to a single counterparty. The proposal implements part of the Dodd-Frank Act and is designed to mitigate risks to the financial stability of the United States that can result from interconnectivity among major financial institutions. The proposal would apply increasingly stringent single-counterparty credit limits to U.S. bank holding companies ("BHC"), intermediate holding companies ("IHC"), and foreign banking organizations ("FBO") with total consolidated assets of $50 billion or more as systemic importance increases.

The new proposal builds on two Board proposals issued in 2011 for domestic BHCs and in 2012 for FBOs while reflecting some revisions based upon public comments and incorporating many features of the Basel Committee on Banking Supervision's large exposures framework issued in 2014. In conjunction with the new proposal, the Board released a White Paper, Calibrating the Single-Counterparty Credit Limit between Systemically Important Financial Institutions, that provides support for the Board's more stringent single counterparty credit exposure limit between the largest financial institutions.

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A principal tenet of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010[1] ("Dodd-Frank Act") was creation of a comprehensive approach for mitigating threats to the financial stability of the United States ("U.S.") posed by systemically important financial institutions ("SIFI").

The Dodd-Frank Act mandates a comprehensive set of regulatory reforms designed to address threats to U.S. financial stability. These reforms cover enhanced prudential regulation of large bank holding companies ("BHC") and nonbank companies that are designated by the Financial Stability Oversight Council ("FSOC") for additional oversight by the Board; enhanced regulation of over-the-counter derivatives and other core financial markets and financial market utilities; and orderly liquidation authority for financial companies, among other important reforms.

While the federal financial regulators have adopted key macroprudential rules to fulfill the requirements of the Dodd-Frank Act, several significant rules are still under development. Chief among these is the adoption of a rule setting credit exposure limits for large domestic and foreign banking organizations. The Board originally proposed rules on single-counterparty credit exposure limits in 2011 for domestic BHCs and in 2012 for FBO and U.S. IHC as part of a proposal to establish a set of enhanced prudential standards, but the Board did not adopt these proposed rules (collectively, the "Original Proposals") in the final rule on enhanced prudential standards.[2]

On March 4, 2016, the Board invited public comments on a new proposal (the "New Proposal"),[3] pursuant to Section 165(e) of the Dodd-Frank Act ("Section 165(e)"),[4] that would apply increasingly stringent single-counterparty credit exposure limits to large domestic and foreign banking organizations as their systemic significance increases, in accordance with the following framework:

- First Category: A domestic BHC, FBO, and U.S. IHC with total consolidated assets of $50 billion or more[5] would be prohibited from having aggregate net credit exposure to a single counterparty in excess of 25 percent of the company's total regulatory capital plus allowance for loan and lease losses ("ALLL") not included in Tier 2 capital. This is the limit set by Section 165(e).
- Second Category: A domestic BHC, FBO, and U.S. IHC with total consolidated assets of $250 billion or more, or $10 billion or more in on-balance-sheet foreign exposures, would be prohibited from having aggregate net credit exposure to a single counterparty in excess of 25 percent of the company's Tier 1 capital.
- Third Category: A domestic BHC that is a global systemically important banking organization ("G-SIB"), any U.S. IHC with total consolidated assets of $500 billion or more, and any FBO with total worldwide consolidated assets of $500 billion or more—defined collectively as a "*major covered company*"—would be prohibited from having aggregate net credit exposure to a "*major counterparty*" in excess of 15 percent of the major covered company's Tier 1 capital. A "*major counterparty*" would include a major covered company, any other FBO that has the characteristics of a G-SIB, and any nonbank financial company designated by the FSOC for additional oversight by the Board.

The New Proposal is designed to "enhance the resiliency and stability" of the U.S. financial system by setting a "bright line on total credit exposures between one large [BHC] and another large bank or major counterparty."[6] Overall, the Board intends the New Proposal to mitigate risks to financial stability that can arise from the interconnectivity among major financial institutions because "trouble at one big bank will [often] bring down other big banks."[7] In her opening statement on the Board's consideration of the New Proposal, Board Chair Yellen explained:

> In the financial crisis, we learned that the largest and most complex banks and financial institutions lent or promised to pay large amounts to other institutions that were also very large and complex. These credit extensions and promises did not eliminate risk, and in many cases they magnified it.[8]

The limits on single-counterparty credit exposures in the New Proposal are thus intended to be "tailored to the systemic footprint of covered companies"[9] by imposing increasingly stringent limits as the systemic significance of a covered company increases. The New Proposal would not apply to credit exposures of any nonbank SIFI that the FSOC has designated for additional oversight by the Board; however, these nonbank SIFIs are considered counterparties for purposes of measuring credit exposure limits for major covered companies, the largest and most complex financial firms.[10]

The Board has invited public comments on all aspects of the New Proposal through June 3, 2016, and has raised specific questions and alternatives for comment throughout the New Proposal.

This *White Paper* describes key features of the New Proposal, highlights important changes made to the New Proposal, and explains differences between the New Proposal and the Basel Committee on Banking Supervision's ("Basel Committee") large exposures framework for internationally active banks ("Large Exposures Framework") issued in 2014.[11]

KEY FEATURES OF THE NEW PROPOSAL

Statutory and Regulatory Background

Section 165 of the Dodd-Frank Act directs the Board to establish enhanced prudential standards for BHCs with total consolidated assets of $50 billion or more.[12] These enhanced prudential standards must include requirements for risk-based capital, leverage capital, stress testing, liquidity, risk management, and single-counterparty credit limits.[13]

Section 165(e) authorizes the Board to establish single-counterparty credit limits for domestic BHCs and FBOs with total consolidated assets of $50 billion or more in order to limit the risks posed to a covered company by the failure of any individual company.[14] This section prohibits domestic BHCs and FBOs with total consolidated assets of $50 billion or more from having credit exposure to any unaffiliated company that exceeds 25 percent of the company's capital stock and surplus, or such lower amount as the Board may determine by regulation to be necessary to mitigate risks to U.S. financial stability.[15] In 2014, the Board adopted a final rule to implement enhanced prudential standards for risk-based and leverage capital, capital planning and stress testing, risk management, and liquidity. As part of that final rule implementing the enhanced prudential standards contained in section 165 of the Dodd-Frank Act, the Board required that FBOs with total consolidated assets of $50 billion or more and total non-branch U.S. assets of $50 billion or more consolidate U.S. subsidiary activities under a U.S. IHC that would be subject to the same enhanced prudential standards as BHCs.[16] The Board's notices of proposed rulemaking[17] that preceded adoption of the final rule on enhanced prudential standards[18] included single-counterparty credit limits that ultimately were not adopted while the Board considered public comments, considered the revised lending limit rules applicable to nationals banks[19], conducted empirical analyses of the quantitative impacts of credit exposures, and consulted with the Basel Committee, which adopted the Large Exposures Framework in April 2014.[20]

The Original Proposals established a two-tier structure for setting limits on single-counterparty exposures. Under those proposals, a domestic BHC, FBO and U.S. IHC ("covered company") with $50 billion or more in total consolidated assets generally would have been prohibited from having aggregate net credit exposure to a single counterparty in excess of 25 percent of the covered company's total regulatory capital plus ALLL not counted in Tier 2 capital.[21] This definition of capital stock and surplus is consistent with the definition of the same term that appears in the Board's Regulation O on loans to executive officers, directors, and principal shareholders of member banks; the Board's Regulation W on affiliate transactions; and the Office of the Comptroller of the Currency's ("OCC") national bank lending limit regulation.[22] In addition, a covered company with $500 billion or more in total consolidated assets would have been prohibited from having aggregate net credit exposure to another banking organization with $500 billion or more in total consolidated assets, or to a nonbank financial company designated by the FSOC for additional Board oversight, in excess of 10 percent of the covered company's total regulatory capital plus ALLL not counted in Tier 2 capital under the capital adequacy guidelines applicable to that BHC under the Board's Regulation Y on BHCs and change in bank control.[23]

The Board received 48 comments, representing approximately 60 parties, on the Original Proposal related to BHCs, and 35 comments, representing more than 45 organizations, on the Original Proposal related to FBOs. Staff of the Board also met with industry representatives and government representatives to discuss issues relating to the Original Proposals. While some commenters expressed support for the broader goals of the Original Proposals, most commenters were critical of the approach to almost every aspect of the Original Proposals and to the absence of a stated foundation to support many parts of the Original Proposals.

Generally, commenters on both Original Proposals were critical of the same features. Industry commenters criticized the Original Proposals for taking an overly broad approach to credit exposures, which, they argued, would constrain market liquidity, decrease lending capacity, and push banking activities to the so-called shadow banking companies. One industry study estimated that counterparty exposures exceeding the proposed limits of the Original Proposals on domestic BHCs would have totaled nearly $1.3 trillion.[24] Some industry commenters characterized the foundational focus on interconnectivity losses as conceptually flawed and asserted that losses during the financial crisis were not due to the actual interconnectedness of financial institutions but were attributable to investor anxiety that financial institutions had similar shared investments and risk issues.

INCREASINGLY STRINGENT LIMITS BASED UPON SYSTEMIC IMPORTANCE

The New Proposal would establish three increasingly stringent single-counterparty credit limits, whereas the Original Proposals would have established two limits. As with the Original Proposals, the baseline standard would prohibit a covered company with $50 billion or more in total consolidated assets from having aggregate net credit exposure to a single counterparty in excess of 25 percent of the covered company's *total regulatory capital* plus ALLL not included in Tier 2 capital. The New Proposal, however, would establish a new second category of credit limits that would apply to covered companies that have $250 billion or more in total consolidated assets or $10 billion or more in cross-border exposures. Covered companies that fall within this second category of credit limits would be prohibited from having aggregate net credit exposure to a single counterparty in excess of 25 percent of their *Tier 1 capital*. This change to the eligible capital base against which the single-counterparty credit exposures are measured for these particular covered companies is a change from the Original Proposals, which set the eligible capital base as all regulatory capital plus ALLL not included in Tier 2 for *all* covered companies.

Section 165(e) does not define how capital and surplus are to be measured. In the Original Proposals, the Board defined "capital and surplus" in the same way for all covered companies—total regulatory capital plus ALLL not counted in Tier 2 capital. The Board's movement away from this definition for larger covered companies is significant because measuring single-counterparty credit exposures against Tier 1 capital imposes a stricter limit than using total regulatory capital plus ALLL not included in Tier 2 capital. Therefore, while the percentage of single-counterparty exposures for covered companies with $250 billion or more in consolidated assets remains unchanged from the Original Proposals, these second category companies could face stricter single-counterparty exposure limits overall because of the more limited measure of Tier 1 capital. The preamble to the New Proposal indicates that Tier 1 capital represents, on average, about 82 percent of total regulatory capital plus ALLL not included in Tier 2 for these covered companies.[25]

The third category of credit limits in the New Proposal would apply to U.S. G-SIBs[26] and U.S. IHCs with total consolidated assets of $500 billion or more, as well as FBOs with total consolidated worldwide assets of $500 billion or more. Whereas the Original Proposals prohibited these major covered companies from having aggregate net credit exposure to any entity that is a major counterparty, in excess of 10 percent of total regulatory capital, plus ALLL not included in Tier 2 capital, the New Proposal would set the limit at 15 percent of Tier 1 capital, even though many commenters recommended aligning the exposure limits with the statutory limits and criticized the Original Proposals for failing to provide adequate reasons for departing from the 25 percent limit set forth in Section 165(e) for major covered companies. The aggregate net credit exposure limit that would apply to major covered companies' exposures to other counterparties would be set at 25 percent of Tier 1 capital.

In conjunction with the issuance of the New Proposal, the Board released a White Paper that explains the rationale for a more stringent single-counterparty credit limit and the calibration of the proposed limit of 15 percent of Tier 1 capital for the largest and most systemically important institutions.[27] The White Paper responds to commenters who were critical of the Board's Original Proposals for failing to expressly provide a foundation for deviating from the 25 percent single-counterparty credit exposure limits set forth in Section 165(e) for covered companies with total consolidated assets above the $500 billion threshold.

According to the White Paper, separate SIFIs often share common business lines and funding sources, and as a result, they often exhibit similar economic performance. Thus, factors that adversely affect one SIFI would also likely adversely affect another SIFI, and default by a SIFI borrower and a SIFI lender would cause greater adverse consequences to the stability of the financial markets than would the default of a non-SIFI borrower to a single SIFI lender.

The White Paper analyzes data on the default correlation between SIFIs as well as data on the default correlation between SIFIs and a sample of non-SIFI companies. The analysis supports a finding that the correlation between SIFIs—and hence, the correlation between major covered companies and major counterparties—is measurably higher than the correlation between SIFIs and other counterparties. According to the White Paper, this finding further supports the view that credit extensions of major covered companies to major counterparties present a higher degree of risk than credit extensions between a major covered company and other counterparties.[28]

The three-category approach in the New Proposal reflects both a tightening and a loosening of the credit limits imposed on the largest institutions under the Original Proposals. While smaller covered companies in the first and second categories generally face fewer restrictions than GSIBs in the third category, the New Proposal would place stricter limits on the covered companies in the second and third categories than the Original Proposals would have. Under the Original Proposals, all covered companies with less than $500 billion in assets were treated the same and were prohibited from lending more than 25 percent of their total regulatory capital, plus ALLL not included in Tier 2 capital, to a single counterparty. The New Proposal adds a third category for companies with assets between $250 billion to $500 billion and applies a more stringent capital base against which to measure these companies' single counterparty credit exposure—Tier 1 capital as opposed to total regulatory capital and surplus, plus ALLL not included in Tier 2 capital.

The following chart summarizes the single-counterparty credit limits for covered companies in the New Proposal:[29]

Category of Covered Company	Applicable Credit Exposure Limit
Covered companies—**U.S. BHCs, FBOs, and U.S. IHCs**—that have: between $50 billion and $250 billion in total consolidated assets, and less than $10 billion in on-balance-sheet foreign exposures	For **U.S. BHCs**, aggregate net credit exposure to a counterparty cannot exceed 25 percent of a covered company's total regulatory capital plus ALLL not included in Tier 2 capital. For **U.S. IHCs**, aggregate net credit exposure cannot exceed 25 percenwwt of a covered company's total regulatory capital plus the balance of its ALLL not included in Tier 2 capital under the capital adequacy guidelines in 12 C.F.R. part 252. For **FBOs with respect to U.S. combined operations**, aggregate net credit exposure cannot exceed 25 percent of the FBOs' total regulatory capital on a consolidated basis.
Covered companies—**U.S. BHCs, FBOs, and U.S. IHCs**—that have: more than $250 billion in total consolidated assets, or more than $10 billion in on-balance-sheet foreign exposures, but are not major covered companies	For **U.S. BHCs and U.S. IHCs**, aggregate net credit exposure to a counterparty cannot exceed 25 percent of a covered company's Tier 1 capital. For **FBOs with respect to U.S. combined operations**, aggregate net credit exposure to a counterparty cannot exceed 25 percent of the FBOs' worldwide Tier 1 capital.
Major covered companies— **U.S. G-SIBs, U.S. IHCs** that have total consolidated assets of $500 billion or more, **FBOs** with total worldwide consolidated assets of $500 billion or more	For **U.S. BHCs, U.S. IHCs, and FBOs with respect to combined U.S. operations**, aggregate net credit exposure to a **major counterparty** cannot exceed 15 percent of a major covered company's Tier 1 capital. For **U.S. BHCs, U.S. IHCs, and FBOs with respect to its combined U.S. operations**, aggregate net credit exposure to **other counterparties** cannot exceed 25 percent of a major covered company's Tier 1 capital.

Aggregate Net Credit Exposure

The New Proposal would set limits on a company's "*aggregate net credit exposure*" to a single counterparty. Aggregate net credit exposure would be defined as "the sum of all net credit exposures of a covered company to a single counterparty."[30] Under the New Proposal, a covered company would be required to first calculate its "*gross credit exposure*" resulting from credit transactions with that counterparty. "Gross credit exposure" would be defined to mean, with respect to any credit transaction, the credit exposure of the covered company to the counterparty before adjusting for the effect of any qualifying master netting agreements, eligible collateral, eligible guarantees, eligible credit derivatives and eligible equity derivatives, and other eligible hedges (*i.e.*, a short position in the counterparty's debt or equity securities).

The New Proposal sets forth the method for calculating gross credit exposure for each type of covered credit transaction.[31] In general, the methodologies contained in the New Proposal are similar to those used to calculate credit exposure under the standardized risk-based capital rules for BHCs.

Second, a covered company would next reduce its gross credit exposure amount based on eligible credit risk mitigants, such as collateral, guarantees, credit or equity derivatives, and other hedges, to determine its net credit exposure for each credit transaction with a counterparty. Finally, a covered company would then sum all of its net credit exposures to the counterparty to calculate the covered company's aggregate net credit exposure to a counterparty.

The credit exposure limits in the New Proposal are identical to the credit exposures set forth in Section 165(e) and would apply to:

- Extensions of credit;
- Repurchase or reverse repurchase agreements;
- Securities lending or securities borrowing transactions;
- Guarantees, acceptances, and letters of credit;
- The purchase of, or investment in, securities issued by the counterparty;
- Credit exposures in connection with certain derivative transactions; and
- Any transaction that is the functional equivalent of the above as well as any similar transaction that the Board determines to be a credit transaction.

The lending limits rule adopted by the OCC for national banks applies to similar types of extensions of credit following amendments made to cover derivatives transactions, repurchase and reverse repurchase agreements, and securities lending or securities borrowing transactions pursuant to Section 610 of the Dodd-Frank Act.[32]

Covered Counterparties

Under the New Proposal, a counterparty would include:

- A natural person and the person's immediate family;
- An unaffiliated company and all persons that the company (i) owns, controls, or holds with power to vote 25 percent or more of a class of voting securities; (ii) owns or controls 25 percent or more of the total equity of the person; or (iii) consolidates for financial reporting purposes, collectively;
- A U.S. State and any of its agencies and instrumentalities, and political subdivisions;
- Any foreign sovereign entity that is not assigned a risk weight greater than zero under the Board's capital rules[33] (and all of its agencies and instrumentalities, but not political subdivisions, collectively); and
- A political subdivision of a foreign sovereign entity such as states, provinces, and municipalities; any political subdivision of a foreign sovereign entity; and all of such political subdivision's agencies and instrumentalities, collectively.[34]

A credit exposure to a counterparty would also include a credit exposure to any person the counterparty owns or controls and any credit exposure to counterparties that are "economically interdependent." This aspect of the New Proposal is significant because identifying economically interdependent counterparties and counterparties where a control relationship may exist by way of a "controlling influence" is likely to present significant operational challenges to covered companies that may not have access to that type of information. In this regard, the New Proposal expressly raises questions for commenters concerning the operational and other challenges that covered companies may face in identifying economically interdependent counterparties and asks whether companies have access to the information needed to complete the analysis of economic interdependence.[35]

Despite numerous comments criticizing the Original Proposals for creating substantial compliance burdens by treating individuals as covered counterparties, the New Proposal continues to treat "a natural person and the person's immediate family" as a counterparty. In the preamble to the New Proposal, the Board indicates its belief that large credit exposures to individuals can create risks similar to those created by large credit exposures to companies.

Applies to Covered Companies on a Consolidated Basis

Like the Original Proposals, the New Proposal would apply to the credit exposures of a covered BHC and U.S. IHC to any unaffiliated counterparty on a consolidated basis, including any subsidiaries. As part of the enhanced prudential standards adopted by the Board in 2014, an FBO that has total consolidated assets of $50 billion or more and total non-branch U.S. assets of $50 billion or more must establish a U.S. IHC to hold its interests in U.S. bank and nonbank subsidiaries.[36] Credit exposure limits as applied to an FBO *as opposed to an IHC or BHC* would apply only with respect to credit exposures of that FBO's combined U.S. operations (*i.e.*, any branch or agency of the FBO; exposures of the U.S. subsidiaries of the FBO, including any U.S. IHC; and any subsidiaries of such subsidiaries (other than any companies held under Section 2(h)(2) of the Bank Holding Company Act of 1956 ("Bank Holding Company Act")),[37] although the FBO's total consolidated assets on a worldwide basis would determine whether the credit exposure limits apply in the first instance.[38] In determining whether a U.S. IHC complies with the single-counterparty limits, exposures of the U.S. IHC itself and its subsidiaries would need to be taken into account.[39] While the New Proposal is silent about whether a U.S. IHC must consider the exposures of its branches and agencies, the fact that the Board explicitly requires FBOs to do so suggests that U.S. IHCs need not.

Under the New Proposal, a subsidiary of a covered company would mean a company that is directly or indirectly controlled by the covered company for purposes of the Bank Holding Company Act. Under the Bank Holding Company Act, a company has control of a bank or another company if:

- The company directly, indirectly, or acting through one or more other persons owns, controls, or has power to vote 25 percent or more of any class of voting securities of the bank or company;
- The company controls in any manner the election of a majority of the directors or trustees of the bank or company; or
- The Board determines, after notice and opportunity for hearing, that the company directly or indirectly exercises a controlling influence over the management or policies of the bank or company.[40]

In the preamble to the New Proposal, the Board reasons that "[a] bank holding company should be able to monitor and control ... the credit exposures of its subsidiaries" and that single-counterparty credit limits must apply at the consolidated level in order to "avoid evasion of the rule's purposes."[41] This expansion of the meaning of subsidiary could pose operational challenges by capturing a broad scope of companies for which credit exposures may not otherwise be consolidated with the covered company and for which the covered company and the subsidiary may not have common, integrated systems. Under the *Original Proposals*, the scope of subsidiaries would have been narrower under what the Board had viewed as a "simpler, more objective" definition of "control" than that in the Bank Holding Company Act.[42] In the Original Proposals, a subsidiary of a covered company would have captured only those where the company (i) owns, controls, or holds with power to vote 25 percent or more of a class of a company's voting stock; (ii) owns or controls 25 percent or more of a company's total equity; or (iii) is consolidated for financial reporting purposes.[43]

Separate and Independent from Bank Investment and Lending Limits

Section 165(e) is a separate and independent limit from the investment securities and lending limits that apply to insured depository institutions under the National Bank Act and the Federal Reserve Act[44] and through rules for federal- and state-chartered banks. The total amount of investment securities of any one obligor that a national bank may purchase for its own account is generally limited to no more than 10 percent of the bank's capital stock and surplus.[45] The total amount of outstanding loans and extensions of credit to a single borrower may not exceed 15 percent of national bank's capital stock and surplus, plus an additional 10 percent of the bank's capital and surplus, if that amount is fully secured by readily marketable collateral. Similar limits generally apply to state-chartered banks.

The New Proposal would require covered companies to apply single-counterparty credit exposure limits on a consolidated basis, and for this reason, the proposed exposure limits could diminish a subsidiary bank's lending and other extensions of credit that would otherwise be permitted under applicable lending limit rules.[46]

Compliance Requirements and Effective Date

The New Proposal would phase-in compliance and reporting with less time offered for larger covered companies to come into compliance. Covered companies with $250 billion or less in total consolidated assets or $10 billion or less of total on-balance-sheet foreign exposures would have two years from the effective date of a final rule to comply on a quarterly basis and submit a report demonstrating compliance on a quarterly basis.

Covered companies with $250 billion or more in total consolidated assets, or $10 billion or more of total on-balance-sheet foreign exposures, would have one year from the effective date of a final rule to comply on a daily basis and submit a report demonstrating compliance on a monthly basis, unless the Board determines that more frequent compliance and reporting is necessary.

Under the New Proposal, covered companies that fail to comply with the final rule for a very limited set of reasons may be granted a "temporary exception" from enforcement actions for a period of 90 days (or a different period as determined by the Board to preserve safety and soundness or U.S. financial stability) as long as the company uses reasonable efforts to return to compliance during the period of time that the temporary exception is in place. A covered company may be granted a temporary exception from enforcement actions based upon a decrease in the company's capital stock and surplus, in the case of certain mergers of two companies or unaffiliated counterparties, and in other appropriate circumstances as determined by the Board.

A covered company that is subject to the 90-day temporary exception period would be prohibited from engaging in any additional credit transactions with a counterparty in contravention of the rule during that period, except where the Board determines that "such credit transactions are necessary or appropriate to preserve the safety and soundness of the covered company or financial stability."[47]

Despite commenters having suggested the addition of a compliance transition period for any company that becomes a major covered company or major counterparty, the New Proposal does not add such a feature, and there is no articulated consideration of these comments in the preamble to the New Proposal.

IMPORTANT CHANGES FROM THE ORIGINAL PROPOSALS

Covered companies should see the New Proposal as an improvement over the Original Proposals due to the reduction in the overall number and aggregate amount of counterparty exposures that would exceed the limit. Based upon the estimate of the impact of the New Proposal provided by staff of the Board, the total amount of excess credit exposure of U.S. BHCs would be less than $100 billion, with most of this exposure between the largest BHCs and the largest counterparties.[48] Nonetheless, some troublesome features of the New Proposal remain intact, and some parts of the New Proposal are more stringent than what was originally proposed. Covered companies will incur compliance costs and burdens in order to attain full compliance if the New Proposal is adopted without change.

Measure of the Eligible Capital Base Against which Exposure Limits Would Be Determined

Section 165(e) directs the Board to set single-counterparty credit limits based on a company's "capital stock and surplus" and allows the Board to set "such lower amount as the Board may determine by regulation to be necessary to mitigate risks to the financial stability of the United States." Section 165(e) does not define the measure of "capital stock and surplus" against which the single-counterparty credit exposure applies. The Original Proposals defined "capital stock and surplus" broadly to mean, for BHCs, total regulatory capital and any ALLL that does not count as Tier 2 capital, and for IHCs as the "sum of the [U.S. IHC's] total regulatory capital as calculated under the risk-based capital adequacy guidelines applicable to the [U.S. IHC], plus the balance of the ALLL of the U.S. IHC not included in Tier 2 capital under the capital adequacy guidelines."[49] For an FBO, "capital stock and surplus" was defined as "the total regulatory capital of the [FBO] on a consolidated basis, as determined in accordance with [enhanced risk based capital and leverage requirements]."[50]

The Basel Committee's Large Exposures Framework employs the more stringent Tier 1 capital measure for all companies. The Board highlighted that at least one commenter to the Original Proposals noted that a central finding of the financial crisis was that only common equity was reliably loss absorbing, and further observed that the Basel III capital standards reflect this through redefinition of capital instruments. This commenter also argued that there are advantages to coordinating regulatory capital definitions around a limited number of capital definitions that include only instruments that are reliably loss absorbing.[51]

The New Proposal reflects consideration of both the Basel Committee's Large Exposures Framework and public comments filed in response to the Original Proposals. The relevant capital base in the New Proposal distinguishes between BHCs that are internationally active and those that are not. For BHCs that are internationally active, the New Proposal would apply the stricter Tier 1 capital measure adopted in the Basel Committee's Large Exposures Framework. BHCs with $50 billion or more in total consolidated assets that are not internationally active would use total regulatory capital plus ALLL not included in Tier 2 capital as the eligible capital base.

The New Proposal would use Tier 1 capital as the eligible capital base against which single-counterparty credit limits would be measured for the covered companies in the second and third categories. This is based upon the Board's stated concern that the failure of a large, complex institution is more likely to have an adverse impact on the financial stability of other financial institutions. Tier 1 capital is a higher-quality, more reliable form of capital that can absorb losses on a going-concern basis. Total regulatory capital plus the ALLL not included in Tier 2 capital includes capital elements that do not absorb losses on a going-concern basis, such as subordinated debt, which is senior in the creditor hierarchy to equity and takes losses only after a company's equity is gone.

Credit Exposure Limits Between SIFIs

The New Proposal applies a tighter credit exposure limit between SIFIs—15 percent as opposed to 25 percent for other exposures. The 15 percent limit is an expansion from the 10 percent limit in the Original Proposals. Commenters criticized the Original Proposals for failing to provide adequate reasons for selecting a $500 billion asset threshold as the cutoff for the higher 25 percent limit set by Section 165(e) of the Dodd-Frank Act.

With the New Proposal, the Board included a White Paper describing the reasons for imposing stricter single-counterparty credit limits on larger institutions.[52]

Broader Scope of Covered Subsidiaries

As with the Original Proposals, the New Proposal applies to the credit exposures of a covered company on a consolidated basis, including any subsidiaries, to any unaffiliated counterparty.[53] However, where the Original Proposal adopted what amounts to a more a modest approach to identifying subsidiaries to those where the company (i) owns, controls, or holds with power to vote 25 percent or more of a class of a company's voting stock; (ii) owns or controls 25 percent or more of a company's total equity; or (iii) is consolidated for accounting purposes, the New Proposal expands the definition of subsidiary to include entities to which a covered company has "a controlling influence" over the entity's management or policies. Commenters had recommended a more simplified approach where the aggregate exposure of a company would be based on accounting consolidation only.

The New Proposal does not include as subsidiaries any investment funds or vehicles advised or sponsored by the company, but the Board has requested comment on whether those types of companies should be included.

Broader Scope of Covered Counterparties with More Complexity to Making Determinations

Economic Interdependence of Counterparties. Under the New Proposal, a covered company would be required to aggregate exposures to counterparties that are considered "economically interdependent."[54] Economically interdependent counterparties are those where the failure or distress of one counterparty would cause the failure or distress of the other.[55] All covered companies would be required to assess the economic interdependence of counterparties, in accordance with a proposed list of factors, when a covered company's exposure to one of the counterparties exceeds 5 percent of the covered company's eligible capital (Tier 1 capital for covered companies with $250 billion or more in assets and total regulatory capital plus ALLL not included in Tier 2 capital for companies with $50 billion or more in assets). The concept of economic interdependence and the 5 percent threshold is derived from the Basel Committee's Large Exposures Framework, but the factors are slightly different under the New Proposal. A comparison of the factors is set forth in the chart below:[56]

New Proposal	Basel Committee's Large Exposures Framework
Whether 50 percent or more of one counterparty's gross revenue or gross expenditures are derived from transactions with the other counterparty	Same
Whether one counterparty (counterparty A) has fully or partly guaranteed the credit exposure of the other counterparty (counterparty B), or is liable by other means, and the credit exposure is significant enough that counterparty B is likely to default if presented with a claim relating to the guarantee or liability	Same
Whether **25 percent or more** of one counterparty's production or output is sold to the other counterparty, which cannot easily be replaced by other customers	Where a **significant part** of one counterparty's *production/ output* is sold to another counterparty, which cannot easily be replaced by other customers
Whether one counterparty (counterparty A) has **made a loan** to the other counterparty (counterparty B) and is relying on repayment of that loan in order to satisfy its obligations to the covered company, and counterparty A does not have another source of income that it can use to satisfy its obligations to the covered company	When the expected source of funds to repay each **loan** one counterparty makes to another is the same and the counterparty does not have another source of income from which the loan may be fully repaid
Whether the expected source of funds to repay **any credit exposure** between the counterparties is the same and at least one of the counterparties does not have another source of income from which the extension of credit may be fully repaid	No mirror provision; Basel refers only to "loans" and funding
Whether the **financial distress** of one counterparty (counterparty A) is likely to impair the ability of the other counterparty (counterparty B) to fully and timely repay counterparty B's liabilities	Where it is likely that the **financial problems** of one counterparty would cause difficulties for the other counterparties in terms of full and timely repayment of liabilities
No mirror provision; "financial distress" provision likely includes insolvency or default	Where the insolvency or default of one counterparty is likely to be associated with the insolvency or default of the other(s)
When both counterparties rely on the same source of the majority of their funding and, in the event of the common provider's default, an alternative provider cannot be found	When two or more counterparties rely on the same source for the majority of their funding and, in the event of the common provider's default, an alternative provider *cannot be found*, the funding problems of one counterparty are likely to spread to another due to a one way or two-way dependence on the same main funding source
Any other indicia of interdependence that the covered company determines to be relevant to this analysis	No similar provision

Critics of the Large Exposures Framework have argued that the factors are subjective and will likely require fact-intensive reviews of counterparty interconnectedness. This would require extensive due diligence, which can be especially burdensome for smaller-sized covered companies.

Control Relationships of Counterparties. The New Proposal would require companies to add exposures to counterparties that are connected by certain control relationships, including the presence of voting agreements, a counterparty's influence over another counterparty's management or policies (applying the Bank Holding Company Act's "controlling influence" test),[57] and the ability of a counterparty to appoint or dismiss members of another counterparty's management or board.[58] This may be a significant undertaking for covered companies, particularly smaller covered companies, which may not have access to this information. Moreover, even though investment funds and vehicles advised or sponsored by a counterparty would not need to be aggregated under the New Proposal, the analysis that covered institutions must perform is likely to capture these entities anyway.

Statutory Attribution Rule

Like the Original Proposals, the New Proposal includes the statutory attribution rule, which provides that a covered company must treat a transaction with any person as a credit exposure to a counterparty to the extent the proceeds of the transaction are used for the benefit of, or transferred to, that counterparty.[59] In the Original Proposals, the Board recognized that "an overly broad interpretation of the attribution rule … would lead to inappropriate results and would create a daunting tracking exercise for covered companies"[60] and proposed to minimize the scope of the application of the attribution rule but did not set forth how it would do that.

As part of the New Proposal, the Board states its "intention to avoid interpreting the attribution rule in a manner that would impose undue burden on covered companies by requiring firms to monitor and trace the proceeds of transactions made in the ordinary course of business" and, therefore, "credit exposures from transactions made in the ordinary course of business will not be subject to the attribution rule."[61] Again, however, the Board fails to provide any guidance on how covered companies should determine which transactions are "made in the ordinary course of business."[62]

Exposure Methodology for Derivatives Transactions

The Original Proposals required the use of a "current exposure method" ("CEM") of measuring derivatives counterparty credit risk. A substantial number of commenters objected to the use of the CEM measure on the ground that it significantly overstates derivatives counterparty exposures due to the limited recognition of netting benefits. After issuance of the Original Proposals, the Basel Committee developed a Standardized Approach to Counterparty Credit Risk of Derivatives ("SA-CCR"),[63] and the Basel Committee's Large Exposures Framework employs this approach.

Under the New Proposal, instead of a requiring use of a CEM measure, covered companies would be permitted to calculate their potential future exposure to derivatives counterparties (other than credit and equity derivatives) using any methodology that they are allowed to use under the risk-based capital rules. These methodologies would include CEM for all covered companies and the internal models methodology for covered companies subject to the Board's advanced approaches risk-based capital rules. Notably, these other methodologies would permit netting and the recognition of collateral that will mitigate counterparty credit risk. The New Proposal does not adopt the Basel Committee's SA-CCR for measuring credit exposure to a derivatives counterparty, but the Board notes that it may consider incorporating SA-CCR into single counterparty credit limit requirements at a later time. FBOs would be placed at a significant disadvantage under the New Proposal because they would not be permitted to use the internal models methodology for measuring derivatives exposure to a counterparty. FBOs would be required to use CEM or the calculation set forth at 12 CFR § 217.132(c), which establishes the methodology for determining exposure at default for an over-the-counter ("OTC") derivatives contract that is not subject to a qualifying master netting agreement.

Risk-Shifting for Credit and Equity Derivatives

The Original Proposals would have given a covered company the option to reduce exposures to a counterparty based on eligible collateral or an eligible guarantee and would have required a covered company that purchased credit default swap ("CDS") protection to hedge the credit risk of making a loan to another firm or a sovereign, to recognize the dollar-for-dollar increase in exposure to the CDS protection provider. Many commenters believed that this approach was too conservative since a CDS purchaser would realize a loss only upon default of the original borrower and the CDS protection provider. These commenters suggested measuring exposures from derivatives hedges using the same methodology used for derivatives.

The New Proposal is more stringent than the Original Proposals as covered companies would be required to reduce exposure to a counterparty based on eligible collateral and would be required to recognize the exposure to the CDS protection provider. However, in cases where a company hedges its exposure to an entity that is a non-financial counterparty, the New Proposal would permit covered companies to calculate exposure to protection providers using the counterparty credit risk methodology for derivatives under the risk-based capital rules, consistent with commenters' suggestions.

Exposure Methodology for Securities Financing Transactions

The exposure methodology for securities financing transactions (repos, reverse repos, and securities lending and borrowing transactions) in the New Proposal remains largely unchanged from the Original Proposals. The Original Proposals assumed a 10-day collateral liquidation period and employed several conservative assumptions about correlations among securities that are loaned and securities that are received as collateral. The proposed methodology in the Original and

New Proposals includes the use of standardized supervisory haircuts and accounting for any market fluctuations in eligible collateral. Companies would be prohibited from applying internal estimates for haircuts and would be required to disregard any collateral that does not meet the definition of "eligible collateral" in the New Proposal.[64]

Many commenters to the Original Proposals argued that the Board's methodology for netting securities financing transactions was too conservative. These commenters pointed out that under the Board's risk-based capital rules, collateral volatility haircuts for securities lending and repurchase transactions may be multiplied by the square root of ½ to reflect a five-day liquidation period, rather than the ten-day period for other transaction types.[65]

The preamble to the New Proposal explains that the Board considered several alternatives such as (i) applying valuation adjustments on one side of the transaction, (ii) the formula recently proposed by the Basel Committee[66] where an entity's exposure for repo-style transactions would be equal to 40 percent of its "net exposure" from the transaction plus 60 percent of its "gross exposure" divided by the square root of the number of security issues in the netting set, and (iii) using standardized correlation matrices. Ultimately, the Board rejected these alternatives on the ground that they sometimes make improper assumptions about the correlation of securities (as is the case with valuation adjustments) and, with respect to the Basel Committee's formula and the standardized correlation matrices, on the grounds that they may be overly complex and subject the framework to arbitrage. However, the Board did move from a 10-day liquidation period to a five-day liquidation period in the New Proposal.

"Look-Through Approach" to Exposures to Special Purpose Vehicles

The Original Proposals reserved the Board's authority to require banks to "look-through" their securitization funds, investment funds, and other special purpose vehicles (altogether "SPVs") either to the issuers of the underlying assets in the vehicle or to the sponsor. The New Proposal would adopt the "look-through" approach.

Under the "look-through" approach, covered companies that have $250 billion or more in total consolidated assets or $10 billion or more in total on-balance-sheet foreign exposures would be required to recognize an exposure to each issuer of the assets held by the SPV if the company could not demonstrate that its exposure to the issuer of each underlying asset held by an SPV is less than 0.25 percent of the company's Tier 1 capital. If the covered company can demonstrate that its exposure to each underlying asset in an SPV is less than 0.25 percent of Tier 1 capital, the company would be permitted to recognize an exposure solely to the SPV and not to the underlying assets.

If a covered company in applying the "look-through" approach is unable to identify an issuer of assets underlying an SPV, the company would be required to attribute the exposure to a single "unknown counterparty." The covered company would then be required to aggregate all exposures to an unknown counterparty as if they related to a single counterparty. In addition, covered companies with more than $250 billion in assets would be required to recognize an exposure to third parties whose failure would likely result in a loss in the value of the company's investment in the SVP that is equal to the value of the investment in the SVP. The look-through approach is consistent with the Basel Committee's Large Exposures Framework and is designed to strengthen the oversight of so-called "shadow banking" institutions.

There are numerous critics of the Basel Committee's look-through approach that are likely to be similarly unhappy with the New Proposal. In particular, the requirement that a company treat an exposure to an SPV as an exposure to interconnected third parties as well creates a risk of counting these exposures twice. Complying with the look-through approach would also require that funds provide frequent information to banks about the funds' holdings, which may prove to be an expensive endeavor.

Exemptions for Exposures to the Government and Government-Sponsored Enterprises

The Original Proposals would have exempted exposures to the U.S. government, including Fannie Mae and Freddie Mac while operating under conservatorship or receivership of the Federal Housing Finance Agency.[67] The Basel Committee's Large Exposures Framework exempts exposures to all sovereigns and central banks and to many government-sponsored entities.

The Original Proposals also treated transactions with central counterparties the same as any other derivatives transaction. Many commenters supported expanding this exemption to include creditworthy non-U.S. sovereigns, U.S. States and their agencies, political subdivisions, and instrumentalities, and central counterparties.

The New Proposal is more aligned with the Basel Committee's Large Exposures Framework and the comments to the Original Proposals. The New Proposal would provide exemptions or exclusions for credit exposures to:

- The U.S. government, including U.S. government agencies, and Fannie Mae and Freddie Mac while operating under conservatorship or receivership of the Federal Housing Finance Agency;
- Foreign sovereign entities that are assigned a zero percent risk weight under the Board's capital rules;
- Trade exposures to qualifying central counterparties;
- Intraday credit exposure to a counterparty; and
- The Federal Home Loan Banks.[68]

In addition, the New Proposal provides an exemption for the exposures of an FBO to its home country sovereign. However, the Board did not exempt U.S. States and their agencies, instrumentalities, and political subdivisions from the credit exposure limits although commenters expressed support for these exemptions.

Compliance Requirements and Reporting

The Original Proposals treated all covered companies the same with respect to their compliance obligations—all covered companies would have been required to comply on a daily basis and submit a monthly report.[69] Covered companies with $250 billion or less in total consolidated assets and less than $10 billion in on-balance-sheet foreign exposure face less stringent compliance requirements under the New Proposal. These covered companies would be required to comply on a quarterly basis and report compliance on a quarterly basis. However, the New Proposal states that these institutions would need to have systems in place that allow them to calculate compliance on a daily basis, and would need to calculate compliance more often if directed to do so by the Board.[70]

A covered company with total consolidated assets of $250 billion or more, or $10 billion or more of on-balance-sheet foreign exposures, would face the same compliance requirements as the Original Proposals. These companies would be required to comply on a daily basis and submit a compliance report on a monthly basis.

Despite commenters having suggested the addition of a compliance transition period for any company that becomes a major covered company or major counterparty, the New Proposal does not add such a feature and there is no articulated consideration of these comments in the preamble to the New Proposal.

KEY DIFFERENCES BETWEEN THE LARGE EXPOSURES FRAMEWORK ADOPTED BY THE BASEL COMMITTEE ON BANKING SUPERVISION AND THE NEW PROPOSAL

Following the financial crisis, the Basel Committee began revising its existing capital adequacy guidelines and developed new capital and liquidity requirements ("Basel III") designed to strengthen the regulatory capital regime for internationally active banks.[71] In 2011, as part of the Original Proposals, the Board announced that it would implement substantially all of the Basel III capital rules.[72] In April 2014, after the Board published the Original Proposals, the Basel Committee finalized its Large Exposures Framework, which establishes credit exposure limits for internationally active banks.[73] One of the goals of the Large Exposures Framework is to "help ensure a common minimum standard for measuring, aggregating and controlling single name concentration risk across jurisdictions."[74]

The Large Exposures Framework is generally less stringent than the Board's Original Proposals. A 25 percent credit exposure limit to a single counterparty is imposed on all internationally active banks under the Large Exposures Framework, except for G-SIBs, which are subject to a 15 percent credit exposure limit for exposures to other G-SIBs (as identified by the Basel Committee). Jurisdictions may consider applying stricter limits to domestic SIFIs and for exposures to G-SIBs of smaller banks. Unlike the Original Proposals or the New Proposal, the Large Exposures Framework uses Tier 1 capital as the eligible capital base against which the single-counterparty credit limits apply for all covered institutions. Like the New Proposal, the credit limits imposed under the Large Exposures Framework apply to a bank's exposure to identified groups of connected counterparties. That is, the credit limits apply to counterparties that are interdependent and may be likely to fail simultaneously.

The Large Exposures Framework is scheduled to take effect on January 1, 2019. The European Union ("EU") has implemented much of Basel III through the Capital Requirements Regulation[75] ("CRR"), a EU-wide "single rulebook" for capital requirements, which took effect starting January 1, 2015. The CRR has comprehensive provisions on large exposures and counterparty concentration risk[76] which build on those of Basel II ("Limits to Large Exposures").

In brief, CRR's Limits to Large Exposures provides that an institution shall not incur an exposure, after taking into account the effect of credit risk mitigation[77] to a "client" or group of connected "clients" the value of which exceeds 25 percent of its eligible capital. Eligible capital in the EU under the CRR is defined as the sum of Tier 1 capital and Tier 2 capital that is equal to or less than one-third of Tier 1 capital.[78] Where that client is an institution or where a group of connected clients includes one or more institutions, that value cannot exceed 25 percent of the institution's eligible capital or EUR 150 million, whichever is higher, provided that the sum of exposure values, after taking into account the effect of credit risk mitigation in accordance with Articles 399 to 403,[79] to all connected clients that are not institutions does not exceed 25 percent of the institution's eligible capital.[80] Large exposures are defined in the CRR as exposures to a client or group of connected clients which, in the aggregate, equal or exceed 10 percent of the institution's eligible capital.[81] There is a list of exemptions from the definition of large exposures which allows some flexibility from the strict application of the rules.[82] However, for thinly capitalized banks with a relatively small client base, the rules prove perennially difficult from the point of view of capital constraints.

While the New Proposal incorporates much of the Basel Committee's Large Exposures Framework, there are several important differences between the New Proposal and the Large Exposures Framework:

- All "internationally active banking organizations" are subject to the Large Exposures Framework with Basel Committee member jurisdictions having the option to set more stringent standards and to extend the application to a wider range of banks. Only domestic BHCs, FBOs, and U.S. IHCs with total consolidated assets of $50 billion or more are subject to the New Proposal.
- The Large Exposures Framework uses Tier 1 capital as the denominator for all banks; the New Proposal uses Tier 1 capital as the denominator only for banks with $250 billion or more in total consolidated assets.
- The Large Exposures Framework defines an affiliate as a company that is owned 50 percent or more by the bank, whereas the New Proposal sets the ownership threshold at 25 percent or more.
- Under the Large Exposure Framework, a banking organization must report to its supervisor when its exposure to a single counterparty reaches 10 percent of eligible capital. There is no similar provision in the New Proposal, which instead requires periodic compliance reporting based upon asset size.
- The Large Exposures Framework exempts exposures to all sovereigns; for BHCs, the New Proposal exempts exposures to the U.S. government (not states), foreign sovereigns with a 0 percent risk weight under the Board's Basel III capital rules, and, for FBOs and U.S. IHCs, the New Proposal exempts exposures to the home country sovereign.
- The Large Exposure Framework adopts SA-CCR for measuring credit exposures to a derivatives counterparty, which is not a component of the New Proposal.[83]
- The Large Exposures Framework is expected to be fully implemented by January 1, 2019; the earliest compliance date for certain covered companies subject to the New Proposal is one year after the final rule's effective date.

Covered companies subject to the New Proposal are most likely to be impacted by the difference between the Large Exposures Framework and the New Proposal with respect to the aggregation of connected or affiliated counterparties. Covered companies subject to the limits of the New Proposal are likely to see far more single-counterparty credit exposures than under the Large Exposures Framework due to the 25 percent ownership or control threshold that applies under the New Proposal (versus the 50 percent threshold under the Large

Exposures Framework). This ownership information is also likely to be more difficult to obtain as 25 percent ownership may not be reflected in an organization's financial statements.

SUBJECTS FOR POSSIBLE COMMENT

Several features of the New Proposal are ripe for comment, including specific questions posed by the Board. These topics and questions include:

1. Capital Base
   - Are the definitions relating to capital stock and surplus and Tier 1 capital clear?
   - Should the single-counterparty credit limits applicable to covered companies with $250 billion or more in total consolidated assets be based on a different capital base than that used for other covered companies?

2. Asset Thresholds
   - Should more stringent credit exposure limits apply to credit exposures of a major covered company to a major counterparty than would apply to other exposures?
   - Are the definitions of major covered company and major counterparty appropriate?
   - Should more stringent credit exposure limits apply to exposures of major covered companies to a nonbank financial company subject to Board supervision?
   - Should the Board consider other limits or modifications to the proposed limits?

3. Differences from Basel Committee's Large Exposures Framework
   - Will the differences from the Basel Committee's Large Exposures Framework cause difficulty for internationally active banks?
   - Should the Board adopt SA-CCR?

4. Exposures to Individuals
   - Does including exposures to individuals raise compliance burdens for covered companies? What are the burdens?

5. Attribution Rule
   - What ways can the Board apply the statutory attribution rule in a manner that would be consistent with the goal of preventing evasion of the single-counterparty credit limits without imposing undue burden on covered companies?
   - Is additional regulatory clarity around the attribution rule necessary?
   - What is the potential cost or burden of applying the attribution rule as proposed?

6. Exemptions
   - Should all trade exposures to QCCPs be exempt from the proposed rules? Is the definition of "QCCP" sufficiently clear? Should the Board consider exempting any different or additional exposures to QCCPs? Would additional clarification on these issues be appropriate?
   - Should the Board exempt any additional credit exposures, such as exposures to U.S. states, from the limitations of the proposed rule? Why?

7. Aggregation of Company and Subsidiary Exposures
   - Is it appropriate to apply the limits of the New Proposal on a consolidated basis?
   - Should the definition of subsidiary be based on the definition in the Bank Holding Company Act or should it be limited to an entity that a covered company (i) owns, control, or holds with power to vote 25 percent or more of a class of voting securities; (ii) owns or controls 25 percent or more of the total equity; or (iii) consolidates for financial reporting purposes?
   - Should funds or vehicles that a company sponsors or advises be included as subsidiaries of a covered company?

8. Economic Interdependence and Control Relationship of Counterparties
   - Should covered companies be required to aggregate exposures to entities that are economically interdependent? Should they be required to aggregate exposures to entities that are connected by certain control relationships?
   - Are the factors for determining economic interdependence sufficiently clear? For determining whether a control relationship exists?
   - Are the thresholds for recognizing economic interdependence appropriate?
   - Will companies have access to all of the information required to complete an analysis of economic interdependence? Is this type of information collected

in the ordinary course of business as part of an underwriting or similar process?

9. Eligible Collateral for Securities Financing Transactions
    - Should the list of eligible collateral be broadened or narrowed? What should be added? Deleted?
    - Should covered companies be given the option to reduce their gross credit exposures by recognizing eligible collateral in some or all cases? Are there situations in which full shifting of exposures would not be appropriate?
    - Are the market volatility haircuts appropriate for the valuation of eligible collateral?

10. Look-Through Approach for SPVs
    - Is the proposed treatment of a covered company that has less than $250 billion or more in total consolidated assets and less than $10 billion or more in total on-balance sheet foreign exposures with respect to its exposures related to SPVs appropriate? What alternatives should the Board consider?
    - Is the proposed treatment of a covered company with $250 billion or more in total consolidated assets or $10 billion or more in total on-balance-sheet foreign exposures with respect to its exposures related to SPVs appropriate?
    - Are there situations in which the proposed treatment would result in recognition of inappropriate amounts of credit exposure concerning an SPV?
    - What alternative approaches should the Board consider?
    - Is the proposed treatment of exposures related to SPVs sufficiently clear?
    - Would further clarification or simplification be appropriate? What modifications should the Board consider?

11. Compliance Burdens
    - Should the Board consider a longer or shorter phase-in period for all or a subset of covered companies?
    - Is a shorter phase-in period for covered companies with $250 billion or more in total consolidated exposures, or $10 billion or more in total on balance-sheet foreign exposures, appropriate compared to firms below these thresholds?
    - Should the rule provide a cure period for covered companies that fall out of compliance? Under what circumstances should such a cure period be provided, and how long should such a period be?
    - If a cure period is provided, would it be appropriate to generally prohibit additional credit transactions with the affected counterparty during the cure period?
    - Are there additional situations in which additional credit transactions with the affected counterparty would be appropriate? What additional modifications or clarifications should the Board consider with respect to any cure period?

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ENDNOTES

1 Public Law 111-203, 124 Stat. 1376 (2010).

2 77 Fed. Reg. 594 (Jan. 5, 2012); 77 Fed. Reg. 76628 (Dec. 28, 2012) (collectively "Original Proposals"); 79 Fed. Reg. 17240 (March 27, 2014) (codified at 12 C.F.R. part 252).

3 Single-Counterparty Credit Limits for Large Banking Organizations, 81 Fed. Reg. 14327 (proposed March 16, 2016) (to be codified at 12 C.F.R. part 252) ("New Proposal").

4 12 U.S.C. § 5365(e).

5 The proposed limits would apply to FBOs with $50 billion or more in total *worldwide* consolidated assets. New Proposal, 81 Fed. Reg. 14345.

6 Opening Statement on the Proposed Rule Establishing Single-Counterparty Credit Limits for Large Banking Organizations by Board Chair Janet Yellen (March 4, 2016).

7 *Id.*

8 *Id.*

9 Memorandum to the Board of Governors of the Federal Reserve System from Governor Tarullo on Proposed rules to implement single-counterparty credit limits in section 165(e) of the Dodd-Frank Act (February 26, 2016) ("Staff Memo").

10 Specifically, nonbank SIFIs are included as counterparties for purposes of the 15 percent limit that applies to major covered companies. *See* New Proposal, 81 Fed. Reg. 14330.

11 Basel Committee on Banking Supervision, Bank for International Settlements, Standards: supervisory framework for measuring and controlling large exposures (April 2014).

12 12 U.S.C. § 5365. Section 165 of the Dodd-Frank Act defines a "bank holding company" consistent with section 2 of the Bank Holding Company Act of 1956 (12 U.S.C. § 1841), and includes "a foreign bank or company that is treated as a bank holding company for purposes of the Bank Holding Company Act of 1956, pursuant to section 8(a) of the International Banking Act of 1978 (12 U.S.C. § 3106(a))." *Id*.

13 12 U.S.C. § 5365(b)(1).

14 *Id.* § 5365(a) and (e)(1).

15 *Id.* § 5365(e)(3).

16 *Id.*

17 *See supra* note 2.

18 *Id.*

19 Lending Limits, 78 Fed. Reg. 37930 (June 25, 2013) (codified at 12 C.F.R part 32).

20 *See supra* note 11.

21 12 C.F.R. part 225

22 *See* 12 C.F.R. § 215.3(i), 12 C.F.R. § 223.3(d); *see also* 12 C.F.R. §32.2(b).

23 *See* 12 C.F.R. Part 225.

24 The Clearing House Association, Single Counterparty Credit Limits: The Clearing House Industry Study (July 2012).

25 New Proposal, 81 Fed. Reg. 14333.

26 The G-SIBs are Bank of America, Bank of New York Mellon, Citigroup, Goldman Sachs, J.P. Morgan, Morgan Stanley, State Street, and Wells Fargo, as of March 16, 2016. Financial Stability Board, 2015 update of list of global systemically important banks (Nov. 3, 2015).

27 Board of Governors of the Federal Reserve System, Calibrating Single-Counterparty Credit Limit Between Systemically Important Financial Institutions (March 4, 2016) ("White Paper").

28 *Id.* at 6.

29 Comparable charts appear in the Staff Memo, at 4-5, 11, *see supra* note 9.

30 New Proposal, 81 Fed. Reg. 14351, proposed § 252.71(b).

31 *Id.*, proposed § 252.73.

32 12 C.F.R. part 32; 78 Fed. Reg. 37930 (June 25, 2013).

33 12 C.F.R. part 217, subpart D.

34 New Proposal, 81 Fed. Reg. 14350, proposed § 252.71(e).

35 New Proposal, 81 Fed. Reg. 14332 (Question 6).

36 Enhanced Prudential Standards for Bank Holding Companies and Foreign Banking Organizations, 79 Fed. Reg. 17240 (March 27, 2014) (codified at Regulation YY, 12 C.F.R part 252).

37 Section 2(h)(2) of the Bank Holding Company Act allows qualifying FBOs to retain certain interests in foreign commercial firms that conduct business in the U.S.

38 New Proposal, 81 Fed. Reg. 14346; Staff Memo, *see supra* note 9 at 9. Some commenters to the Original Proposals as applied to FBOs argued that, in light of the Basel Committee's Large Exposures Framework that would apply to an FBO on a consolidated basis, it was unnecessary for the Board to develop single-counterparty credit limits for a FBO's combined U.S. operations. New Proposal, 81 Fed. Reg. 14330.

39 81 Fed. Reg. 14346.

40 12 U.S.C. § 1841(a).

41 New Proposal, 81 Fed. Reg. 14331.

42 Original Proposals, 77 Fed. Reg. 614.

43 *Id.*

44 *See, e.g.,* 12 U.S.C. 24(7); 12 U.S.C. 84; 12 C.F.R. parts 1 and 32; *see also* 12 U.S.C. 335 (applying the provisions of 12 U.S.C. 24(7) to state member banks).

45 *See* 12 U.S.C. § 24(7); 12 C.F.R. part 1.

46 New Proposal, 81 Fed. Reg. 14329.

47 New Proposal, 81 Fed. Reg. 14344.

48 Staff Memo at 3, *see supra* note 9.

49 Original Proposals, 77 Fed. Reg. 76655.

50 *Id.*

51 Staff Memo at 15, *see supra* note 9.

52 *See supra* note 27; *see also* discussion *supra* pp. 3-4.

53 *See* discussion, *supra* p. 6

54 *See* discussion, *supra* pp. 5-6.

55 New Proposal, 81 Fed. Reg. 14354, proposed § 252.76(a)(1)(ii).

56 *Id.*, proposed § 252.76(a)(2).

57 12 U.S.C. § 1841(a)(2).

58 New Proposal, 81 Fed. Reg. 14332.

59 *Id.* at 14337, proposed § 252.73(c); *see also* 12 U.S.C § 5365(e)(4).

60 Original Proposals, 77 Fed Reg. 618.

61 New Proposal, 81 Fed. Reg. 14337.

62 *Id.*

63 Basel Committee on Banking Supervision, The Standardized Approach For Measuring Counterparty Credit Risk Exposures (April 2014).

64 Despite commenters request that the Board expand the definition of eligible collateral, the New Proposal retains the definition of eligible collateral from the Original Proposals, which limits debt securities to bank-eligible investments that are investment grade. New Proposal, 81 Fed. Reg. 14337. The definition of "eligible collateral" for FBOs and IHCs excludes debt or equity securities issued by an affiliate of the FBO or IHC. *Id.* at 14347. This definition is more restrictive than eligible collateral under the Basel Committee's capital rules, which would permit recognition of mutual funds and money market shares.

65 New Proposal, 81 Fed. Reg. 14336.

66 Basel Committee, Second Consultative Document, Standards: Revisions to the Standardised Approach for credit risk, issued for comment by March 11, 2016 (December 2015).

67 Original Proposals, 77 Fed. Reg. 622.

68 New Proposal, 81 Fed. Reg. 14343-44.

69 *See* discussion, *supra* p. 7.

70 New Proposal, 81 Fed. Reg. 14344.

71 Basel Committee on Banking Supervision, International Regulatory Framework for Banks.

72 Original Proposals, 77 Fed. Reg. 599.

73 *See supra* note 11.

74 Basel Committee on Banking Supervision, Press Release: Supervisory framework for measuring and controlling large exposures—final standard (April 2014).

75 Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms (CRR).

76 *Id.* at Articles 387-403.

77 *Id.* at Articles 399-403.

78 *Id.* at Article 4(71).

79 *Id.* at Articles 399-403.

80 *Id.* at Article 395.

81 *Id.* at Article 392, 394.

82 *Id.* at Article 400.

83 The Board is considering the benefits of incorporating the SA-CCR into the Single-Counterparty Credit Rule. *See* New Proposal, 81 Fed. Reg. 14337.