November 26, 2018

Bank Capital Requirements

Federal Bank Regulators Propose Standardized Approach for Calculating the Exposure Amount of Derivative Contracts

SUMMARY

On October 30, the Federal Reserve Board, the FDIC and the OCC issued a proposed rule (the "*Proposal*") that would implement a new standardized approach for counterparty credit risk ("*SA-CCR*") for calculating the exposure amount of derivative contracts under the agencies' capital rules.[1] The agencies note that, as proposed, SA-CCR is intended to improve the risk-sensitivity and calibration relative to the existing U.S. standardized approach, the current exposure method ("*CEM*"), which was initially adopted in 1989 and last significantly updated in 1995.[2] The proposed SA-CCR would be "substantially consistent" with the Basel Committee on Banking Supervision's international standard, which became effective in 2017 and has been adopted and implemented in six jurisdictions, but not yet in the United States or the European Union.

For banking organizations subject to the advanced approaches,[3] which are the only organizations that would be required to use the proposed SA-CCR, the agencies estimate that the exposure amounts for derivative contracts overall would decrease by approximately 7 percent. The agencies estimate, however, that the proposed SA-CCR would result in a decrease of approximately 6 basis points, on average, in tier 1 risk-based capital ratios because of the application of the counterparty risk weight to the exposure amount to determine risk-weighted assets (the denominator of the ratio).[4] By contrast, the agencies estimate an increase of more than 30 basis points, on average, in the supplementary leverage ratio, which is not a risk-based measure, if the proposed SA-CCR replaces CEM for purposes of calculating total exposure in that ratio.

The proposed effective date is July 1, 2020.[5] Comments on the Proposal are due within 60 days of publication in the Federal Register.

APPLICATION OF SA-CCR

The points below provide a high-level summary of the key changes under the Proposal, if adopted.

- For advanced approaches organizations:
  - Require SA-CCR to be used (in place of CEM) under the standardized approach for purposes of determining risk-weighted assets for (i) non-cleared derivative contracts, (ii) contract exposure amounts for cleared derivative contracts, and (iii) default fund contributions;
  - Permit SA-CCR to be used instead of the internal models methodology ("*IMM*") under the advanced approaches to calculate exposure amounts for cleared and non-cleared derivatives (but require the same methodology be used for both); and
  - Require a modified version of SA-CCR to be used (in place of CEM) to determine the exposure amount of derivative contracts for purposes of calculating total leverage exposure (the denominator of the supplementary leverage ratio).[6]
- For banking organizations not subject to the advanced approaches ("*non-advanced approaches organizations*"), SA-CCR would be an optional approach, in addition to CEM, that may be used to calculate exposure amounts for non-cleared and cleared derivative contracts, and default fund contributions (but the same method must be used for all three purposes).
- The Proposal would also result in changes in other regulatory requirements that cite to the agencies' capital rules for purposes of calculating exposure amounts for derivative contracts, including:
  - For purposes of the Federal Reserve's single counterparty credit limit, include SA-CCR as a method to value derivative contracts, although advanced approaches organizations may continue to use IMM and non-advanced approaches organizations may continue to use CEM.
  - For purposes of the OCC's lending limit rules, add SA-CCR as an option for determining exposure amounts for derivative contracts.

BACKGROUND

The counterparty credit risk framework within the agencies' capital rules is used to determine the amount of capital that must be held against the risk of loss due to a counterparty's default before meeting all of its contractual obligations. Banking organizations are required to hold regulatory capital based on the exposure amount of their derivative contracts, which, in the case of risk-based capital requirements, is multiplied by the risk weight of the counterparty or exposure type to determine risk-weighted assets.[7] The proposed use of SA-CCR for measuring exposure at default ("*EAD*") for counterparty credit risk is intended to be "substantially consistent with the Basel Committee standard,"[8] which replaced CEM altogether in standardized approach calculations under the Basel capital framework.

CEM has long been criticized as an overly blunt measure of exposure amount of derivative contracts. The exposure amount of a derivative contract under CEM is equal to the sum of its current credit exposure, or replacement cost (the greater of zero and the on-balance sheet fair value of the derivative contract), and potential future exposure (the product of the notional amount of the derivative contract and a supervisor-provided conversion factor based on the derivative contract's type and remaining maturity

that is intended to reflect the potential volatility in the reference asset). As the agencies note in the Proposal, the supervisory conversion factors currently included in their capital rules were developed prior to the 2007-2008 financial crisis and have not been recalibrated since that time.

According to the agencies, relative to CEM, "SA-CCR provides a more risk-sensitive approach to determining the replacement cost and [potential future exposure] for a derivative contract."[9] The agencies further note that SA-CCR: (1) improves collateral recognition (for example, by differentiating between margined and unmargined derivative contracts), (2) increasing the amount of permitted netting by allowing a banking organization to recognize meaningful, risk-reducing relationships between derivative contracts within a balanced derivative portfolio (that is, mixed long and short positions), and (3) better captures recently-observed stress volatilities among the primary risk drivers for derivative contracts.[10] A detailed comparison of the calculation of exposure amounts under SA-CCR relative to CEM is included in **Annex I** to this memorandum. Despite these improvements, the Basel Committee standard has been criticized for insufficient recognition of netting benefits, not adequately differentiating between margined and unmargined transactions and being unreflective of the level of volatilities observed over recent stress periods.[11]

KEY ASPECTS OF THE PROPOSAL

The basic concept underlying the CEM and SA-CCR standards is largely the same. To determine exposure amount of derivative contracts, both measures sum the "replacement cost" (RC) of a contract or netting set and the "potential future exposure" (PFE) of the contract or netting set. CEM is calculated at the level of a qualifying master netting agreement. In an important departure from the Basel Committee standard, the proposed SA-CCR retains the approach in CEM to calculating exposure at the netting set level rather than at the level of each margin agreement, because "the Basel Committee standard does not reflect current industry practice and regulatory requirements."[12] The key differences between CEM and SA-CCR (detailed in **Annex I**) include the following:

- ***Replacement cost.*** Under CEM, replacement cost is simply the sum of the fair values of the contracts under a netting agreement, subject to a floor of zero, with the recognition of the risk-mitigating benefits of financial collateral separate from the determination of the exposure amount. In contrast, under the proposed SA-CCR independent collateral (also known as initial margin) and variation margin can be applied to reduce replacement cost and, therefore, the exposure amount. Although replacement cost also is subject to a floor of zero under the proposed SA-CCR, overcollateralization and net negative market position may reduce the measure of PFE, as discussed below under "Adjustments to PFE."
- ***Calculation of PFE.*** CEM starts with the notional amount of contracts under a netting agreement and applies a single supervisory conversion factor that varies based on asset class and remaining maturity that is designed to capture the volatility in the reference asset. Under the proposed SA-CCR, the notional amount of the contracts within a netting set would be adjusted by several supervisory factors that, like CEM, capture volatility in the reference asset but are meant to be more appropriately calibrated. The supervisory factors "would reflect the variability of the primary risk factor of the derivative contract over a one-year horizon" such that the factor would "scale down" the default one-year risk horizon, if necessary, "to the risk horizon appropriate for the derivative contract."[13]

- ***Offsetting within hedging sets.*** In contrast to CEM, the proposed SA-CCR would permit offsetting of long and short positions in the PFE calculation through the introduction of "hedging sets," which are derivative contracts within a netting set that have similar risk factors. The agencies propose to define five types of hedging sets, with a formula for netting within each that is particular to the type of hedging set: (1) interest rate, (2) exchange rate, (3) credit, (4) equity, and (5) commodities, with separate treatment of basis and volatility derivatives.

- ***Adjustments to PFE.*** Under CEM, netting may be taken into account with respect to 60 percent of the aggregate PFE of a netting set through the application of the "net-to-gross ratio" for the netting set (the ratio of the net replacement cost to gross replacement cost). In addition, as implemented in the United States by the agencies, CEM allows a banking organization to recognize the risk-mitigating benefits of financial collateral by allowing it either to apply the risk weight applicable to the collateral to the secured portion of the exposure or to net exposure amounts and collateral amounts according to a regulatory formula that requires haircuts for collateral. The proposed SA-CCR permits broader recognition of collateral through a "PFE multiplier" that reduces PFE to take account of both net independent collateral and variation margin, as well as negative fair value of the derivative contracts, which CEM does not take into account.

- ***Alpha factor.*** To arrive at the exposure amount, the proposed SA-CCR would apply a fixed multiplier of 1.4, referred to as the "*alpha factor*", to the sum of RC and PFE, which is the same multiplier as is used under the IMM. The alpha factor, which is not present in CEM, was included in the Basel Committee standard to add a level of conservatism and under the view that SA-CCR, a standardized approach, should not produce lower exposure amounts than a modelled approach.

- ***Differentiation between margined and unmargined derivative contracts.*** Under the proposed SA-CCR measurement, the exposure amount for a netting set that is subject to a variation margin agreement (an agreement to collect or post variation margin, as defined in the proposed rule)[14] is the lesser of the exposure amount for that netting set as calculated under the rule or the exposure amount for an equivalent netting set that is not subject to a variation margin agreement.[15]

- ***Impact of Proposal.*** The agencies estimate that advanced approaches organizations' overall exposure amount for derivative contracts would decrease by approximately 7 percent, reflecting a decrease of approximately 44 percent in the exposure amount of margined derivative contracts, and an increase of approximately 90 percent in the exposure amount of unmargined derivative contracts.[16] However, the agencies estimate that under the proposed SA-CCR, there would be an approximately 5 percent increase in advanced approaches organizations' standardized risk-weighted assets associated with derivative contract exposures because of the application of the counterparty risk weight to the exposure amount to determine risk-weighted assets, resulting in an approximately 6 basis point reduction on average in their tier 1 risk-based capital ratios.[17] The agencies also expect that exposure amounts would increase for interest derivative contracts, equity derivative contracts and commodity derivative contracts, and decrease for exchange rate derivative contracts and credit derivative contracts, largely due to the updated supervisory factors. In addition, the agencies expect that the exposure amount would decrease for contracts with banks, broker-dealers and central counterparties, and increase for contracts with other financial institutions (such as asset managers, investment funds and pension funds), sovereigns and municipalities, and commercial entities that use derivative contracts to hedge commercial risk.[18]

Other notable aspects of the Proposal include the following:

- ***Revisions to the cleared transactions framework.*** The Proposal would, consistent with the Basel Committee standard, revise the cleared transactions framework in the agencies' capital rules to: (1) require advanced approaches banking organizations to use SA-CCR (or IMM, under the advanced approaches) to determine the contract exposure amount for a cleared derivative contract,[19] and (2) simplify the formula used to determine the risk-weighted asset amount for a default fund contribution to a qualifying central counterparty ("*QCCP*") by eliminating the two methods currently included in the capital rules and introducing a new method intended to be "less complex than the current method one

but also more granular than the current method two."[20] Under the new method, the risk-weighted asset amount would be a clearing member banking organization's pro-rata share of the default fund.

- ***Revisions to the supplementary leverage ratio.*** Consistent with the Basel Committee standard on leverage capital requirements, the Proposal would require advanced approaches banking organizations to use a modified version of SA-CCR[21] (which does not account for independent collateral in the PFE and does not permit the same degree of netting in determining RC) to determine the on- and off-balance sheet amounts of derivative contracts for purposes of calculating total leverage exposure.[22] The agencies acknowledge that compared to CEM, the implementation of a modified version of SA-CCR for purposes of the supplementary leverage ratio on average would increase advanced approaches banking organizations' supplementary leverage ratios.[23] The agencies estimate that advanced approaches organizations' supplementary leverage ratio would increase by more than 30 basis points on average.[24]
- ***Revisions to OCC lending limits.*** The OCC proposes to revise its lending limit rule[25] to adopt SA-CCR as an option for calculating exposures under the lending limits.

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Annex I: Comparison of SA-CCR and CEM

NOTE: This Table reflects the steps to calculate exposure under SA-CCR that are common to all asset classes. There are unique aspects to the calculation for each asset class, as described in the Proposal.

	SA-CCR	CEM	Implications
Credit Exposure Formula	1.4(RC+PFE) (**§ 132(c)(5)**)	RC + PFE	
	Replacement Cost		
Step 1: Calculation of Replacement Cost (RC)	For unmargined contracts, RC= the greater of: • the sum of the fair values (after excluding any valuation adjustments) of the contracts within the netting set, less the net independent collateral and variation margin applicable to the contract; or • zero. For margined contracts, RC= the greater of: • the sum of the fair values (after excluding any valuation adjustments) of the contracts within the netting set, less the net independent and applicable variation margin; • the sum of the variation margin threshold and the minimum transfer amount, less the net independent collateral; or • zero. **§ 3.132(c)(6);** **§ 217.132(c)(6);** **§ 324.132(c)(6)**	RC=Net sum of all positive and negative mark-to-market values of the contracts subject to the netting agreement, subject to a floor of zero. **§ 3.34(a)(1)(i);** **§ 3.34(a)(2)(i);** **§ 217.34(a)(1)(i);** **§ 217.34(a)(2)(i);** **§ 324.34(a)(1)(i);** **§ 324.34(a)(2)(i)**	SA-CCR permits RC to be reduced by independent collateral and variation margin. RC is floored at zero even if the bank is in a net negative market position or the bank is overcollateralized. However, overcollateralization and net negative market value reduce the PFE multiplier, and by extension PFE, as described in Steps 8 and 9 below.
	Potential Future Exposure		
Step 2: Calculation of the adjusted notional amount for each contract by asset class	An adjusted notional amount is determined for each contract within an asset class as follows: • For interest rate and credit derivatives, the adjusted notional is the contract notional amount, converted to U.S. dollars, multiplied by the supervisory duration, which is calculated by formula	See Step 5 for the only adjustment to contract notional under the CEM.	This first adjustment of notional amount under the SA-CCR may increase or decrease the notional amount of a contract. The adjusted notional amount may be reduced in Steps 3 and 4 below.

	SA-CCR	CEM	Implications
	based on the length of time until the start and end dates of the contract (floored at 10 business days)[1]; • For FX, the notional of the foreign currency leg of the transaction is converted into U.S. dollars. If both legs are foreign currency, the adjusted notional is the leg with the larger converted U.S. currency value[2]; • For equity and commodity derivatives, the adjusted notional is the product of the fair value of one unit of the stock or commodity and the number of units referenced by the contract.[3] **§ 3.132(c)(9)(ii);** **§ 217.132(c)(9)(ii);** **§ 324.132(c)(9)(ii)**		
Step 3: Application of a "supervisory delta adjustment" to adjusted notional amount of each contract	A "supervisory delta adjustment" is applied to the adjusted notional amount of each contract to reflect whether the position is long or short and whether the payoff is linear. The "supervisory delta adjustment" will be: • 1 for a long position in a linear instrument; • -1 for a short position in a linear instrument; • Calculated by using the Black-Scholes model (modified to account for negatives interest rate currencies) for option contracts; or • for CDO tranches, a positive or negative (depending on position) fraction that is determined	None.	This step of SA-CCR determines whether the adjusted notional amount of the contract will be included in full or in part and as positive or negative in the hedging set in Step 6 below—that is, the offsetting that will be reflected in the calculation of the effective notional amount of the hedging set.

1 There are additional rules specifically addressing the adjusted notional value of variable notional swaps and leveraged swaps. (§ 132(c)(9)(ii)(A)(2)).

2 If there are multiple exchanges of principal, the adjusted notional amount is the notional mount multiplied by the number of exchanges of principal. (§ 132(c)(9)(ii)(B)(2)).

3 For volatility derivatives, the adjusted notional is the product of the underlying volatility and the notional amount. (§ 132(c)(9)(ii)(C)(2)).

	SA-CCR	CEM	Implications
	by formula. **§ 3.132(c)(9)(iii);** **§ 217.132(c)(9)(iii);** **§ 324.132(c)(9)(iii)**		
Step 4: Application of the maturity factor	A "maturity factor" is applied to the product of the adjusted notional and the supervisory delta adjustment. The "maturity factor" will be calculated by different formulas for margined contracts and unmargined contracts, subject to certain floors for margined contracts depending on whether the contract is cleared, number of contracts in the netting set, and whether there is an outstanding dispute over variation margin. **§ 3.132(c)(9)(iv);** **§ 217.132(c)(9)(iv);** **§ 324.132(c)(9)(iv)**	None.	This factor under SA-CCR will reflect the smaller risk of contracts maturing sooner, which CEM does not account for. Only the exposure of margined contracts could be increased by this factor.
Step 5: Application of the supervisory factor	A supervisory factor specified in Table 2 to § 132 of the Proposal is applied to the product of the adjusted notional amount, the supervisory delta adjustment and the maturity factor to reflect the level of volatility of the asset class. The result is the adjusted derivative contract amount. The volatility factor depends on the asset class, and the quality or type of the asset. **§ 3.132(c)(9)(i);** **§ 217.132(c)(9)(i);** **§ 324.132(c)(9)(i)**	The notional amount of each contract is multiplied by a conversion factor that varies based on asset class and remaining maturity of the contract to determine the adjusted notional amount of the contract, which will also be the potential future exposure ("PFE") for the contract. **§ 3.34(a)(ii)(A);** **§ 217.34(a)(ii)(A);** **§ 324.34(a)(ii)(A)**	Under SA-CCR, the supervisory factor reduces the adjusted derivative amount of the hedging set. The supervisory factor is based on whether the contracts are margined and, for credit derivatives, on the rating. Under CEM, application of the conversion factor reduces the notional amount of a contract. There are no other adjustments to the notional amount at the contract level.
Step 6: Offsetting adjusted derivative contract amounts of the contracts within a hedging set	Contracts within an asset class are assigned to hedging sets, e.g., all interest rate derivatives in the same currency or all FX derivatives for the same currency pair.[4, 5] The value of	None. CEM does not divide contracts into hedging sets.	Under SA-CCR, notional amounts may be offset within a hedging set. Under CEM, offsetting is not taken into account when

[4] If the risk of a derivative contract materially depends on more than one risk factor, a banking organization's primary federal regulator may require the banking organization to include the derivative contract in each appropriate hedging set. (§ 132(c)(2)(iv)). Additionally, separate hedging sets are required for basis derivative contracts and for volatility derivative contracts. (§ 132(c)(2)(iii)(F-G)).

[5] The agencies propose to define an exchange rate hedging set as all exchange rate derivative contracts within a netting set that reference the same currency pair, which would generally be consistent with the Basel Committee standard. Because this approach would not recognize economic relationships of exchange rate chains – when more than one currency pair can offset the risk of another – such as a Yen/U.S. dollar forward contract and a U.S. dollar/Euro forward contract that, taken together, may be economically equivalent, with properly set notional amounts, to a Yen/Euro forward contract. The agencies seek comment on an alternative definition, under which

	SA-CCR	CEM	Implications
	each hedging set (referred to herein as the "Hedging Set Amounts") would then be calculated by formulas allowing for full or partial netting, varying by asset class. • For interest rates, a hedging set is further divided into maturity buckets. The Proposal provides two alternatives—no offsetting between maturity buckets and partial offsetting. • Full offsetting is permitted within an FX hedging set. • Full and partial offsetting is permitted for credit, equity, and commodity derivatives. Full offset is permitted when the reference entity/commodity type is the same. Across entities or commodity types, partial offsetting is permitted. **§ 3.132(c)(8);** **§ 217.132(c)(8);** **§ 324.132(c)(8)**		determining the notional amount of a contract.
Step 7: Calculation of Gross PFE/Aggregated Amount	Hedging Set Amounts are added together to determine the aggregated amount of the netting set. **§ 3.132(c)(7)(ii);** **§ 217.132(c)(7)(ii);** **§ 324.132(c)(7)(ii);**	PFE of all contracts are summed to determine the aggregated amount of the netting set. **§ 3.34(a)(2);** **§ 217.34(a)(2);** **§ 324.34(a)(2)**	
Step 8: Calculation of PFE Multiplier	The PFE multiplier is intended to account for reductions in PFE caused by net independent collateral, variation margin and negative fair value of derivative contracts. The PFE multiplier is calculated by formula and reduces exponentially from a value of one as the value of financial collateral exceeds the net fair value of the contracts,	CEM does not take margin into account, and there is no recognition of collateral under CEM in the Basel framework in determining exposure amounts (although there can be some recognition of collateral as implemented in the U.S.).[6] See Step 10 for reduction based on market value.	Under SA-CCR, a netting benefit is recognized for negative fair value of derivative contracts, as well as margin and other collateral.

an exchange rate derivative contract hedging set would mean all exchange rate derivative contracts within a netting set that reference the same non-U.S. currency. The Proposal, at 38.

[6] However, for all derivative contracts, CEM allows a banking organization to recognize the risk-mitigating benefits of financial collateral by allowing it to either apply the risk weight applicable to the collateral to the secured portion of the exposure or net exposure amounts and collateral amounts according to a regulatory formula that requires haircuts for collateral.

	SA-CCR	CEM	Implications
	subject to a floor of 0.05. **§ 3.132(c)(7)(i);** **§ 217.132(c)(7)(i);** **§ 324.132(c)(7)(i)**	**§ 3.34(b);** **§ 217.34(b);** **§ 324.34(b)**	
Step 9: Application of PFE Multiplier	The PFE Multiplier is applied to the aggregate amount of the netting set, the product of which is the PFE. **§ 3.132(c)(7);** **§ 217.132(c)(7);** **§ 324.132(c)(7)**	None.	
Step 10: Reduction of Gross PFE for market value	See Step 8 for the reduction of exposure based on market value.	No netting is permitted on 40% of the Gross PFE. The net-to-gross ratio (NGR) is applied to 60% of the Gross PFE. NGR=RC (as determined under Step 1) divided by the sum of the positive current credit exposures. **§ 3.34(a)(2)(ii);** **§ 217.34(a)(2)(ii);** **§ 324.34(a)(2)(ii)**	Under CEM, a netting benefit is recognized for any negative market value. See Step 8 for the inclusion of a netting benefit under SA-CCR.
Step 11: Application of scaling multiplier	The sum of RC and PFE is multiplied by 1.4, the product of which is the exposure amount. However, the exposure amount of a netting set subject to a variation margin agreement is the lower of the exposure amount of the netting set and the exposure amount of the netting set calculated as if it were unmargined.[7] **§ 3.132(c)(5);** **§ 217.132(c)(5);** **§ 324.132(c)(5)**	None.	Under SA-CCR, the exposure is scaled by the same multiplier as is used under IMM.

[7] The exposure amount of a netting set that consists of only sold options in which the premiums have been fully paid and that are not subject to a variation margin agreement is zero. (§ 132(c)(5)(ii)).

ENDNOTES

1 Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, *Standardized Approach for Calculating the Exposure Amount of Derivative Contracts* (Oct. 30, 2018), *available at* https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20181030a1.pdf.

2 Proposal, at 12 and 22 (footnote 21).

3 The agencies note that they "are in the process of considering the appropriate scope of 'advanced approaches banking organizations' and may propose changes to the scope of this term in the near future" in a proposal that "would have an overlapping comment period with this proposal" and commenters should therefore "consider both proposals together for purposes of their comments to the agencies." Proposal, at 15-16.

Following the issuance of the SA-CCR proposal, the agencies have released an interagency proposal to tailor how certain aspects of the post-crisis bank regulatory framework apply to large U.S. banking organizations. The agencies note in the tailoring proposal that if the SA-CCR proposal were to be adopted, the agencies would allow a Category III firm to elect to use SA-CCR for calculating (i) derivatives exposure in connection with risk-based capital ratios, consistent with the SA-CCR proposal and (ii) total leverage exposure used to determine the supplementary leverage exposure (but a Category III firm would also be permitted to elect to continue to use CEM for this calculation). *See* Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, *Proposed Changes to Applicability Thresholds for Regulatory Capital and Liquidity Requirements* (Oct. 31, 2018), at 45. For additional information, please refer to our Memorandum to Clients.

4 The agencies note that "[t]otal risk-weighted assets [would] increase . . . while exposure amounts [would] decrease," explaining that "higher applicable risk weights [would] amplify increases in the exposure amount of certain derivative contracts, which [would] outweigh[] decreases in the exposure amount of other derivative contracts." Proposal, at 90 (footnote 63).

5 Proposal, at 13; Proposed 12 C.F.R. §§ 3.300(f); 217.300(g); 324.300(f).

6 Because the agencies' proposed net stable funding ratio ("NSFR") rules would cross-reference provisions of the agencies' supplementary leverage ratio rule that would be amended by this proposal, this proposal could impact elements of the NSFR rulemaking. The proposal notes more generally that because "many of the [Federal Reserve's] other regulations rely on amounts determined under the capital rule . . . the introduction of SA-CCR . . . could indirectly affect all such rules." Proposal, at 15.

7 Under the standardized approach, the risk-weighted asset amount for a derivative contract is the product of the exposure amount of the derivative contract and the risk weight applicable to the counterparty. Under the advanced approaches, the risk-weighted asset amount for a derivative contract is derived from using an internal ratings-based approach, which multiplies the exposure amount (or exposure amount at default) of the derivative contract by a models-based formula that uses risk parameters determined by the particular banking organization's internal methodologies.

Additionally, under the cleared transactions framework in the capital rules, both the standardized approach and the advanced approaches require a banking organization to determine the risk-weighted asset amounts of a banking organization's default fund contributions (that is, contributions or commitments to mutualized loss sharing agreements with central counterparties).

8 Proposal, at 12. *See* Basel Committee on Banking Supervision, The standardized approach for measuring counterparty credit risk exposures (March 2014, rev. April 2014), *available at* https://www.bis.org/publ/bcbs279.pdf.

9 Proposal, at 23.

10 Proposal, at 23-24.

11 Although the supervisory factors in the proposal reflect stress volatilities observed during the financial crisis, they are the same factors used in the Basel Committee standard (other than for single-name credit derivative contracts, the factors for which are intended to track the factors of the Basel Committee standard without using credit ratings, and the use of a single energy commodity class, as compared to the separate electricity and oil/gas components of the energy commodity class provided under the Basel Committee standard). Proposal, at 26, 55-56.

ENDNOTES (CONTINUED)

12 Proposal, at 24.

13 Proposal, at 26.

14 Proposed 12 C.F.R. §§ 3.2; 217.2; 324.2.

15 Proposal, at 27.

16 Proposal, at 89.

17 Proposal, at 90.

18 Proposal, at 89-90.

19 The trade exposure amount is the sum of the exposure amount of the derivative contract and the fair value of any related collateral held in a manner that is not "bankruptcy remote" (that is, collateral that would not be excluded from the bankruptcy estate in receivership, insolvency, liquidation or similar proceeding).

20 Proposal, at 76.

21 The modified version of SA-CCR that would be used to calculate total leverage exposure would recognize only certain cash variation margin in the replacement cost component calculation.

22 Proposal, at 81.

23 Proposal, at 82.

24 Proposal, at 90-91.

25 12 C.F.R. Part 32.

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