Basel Committee
on Banking Supervision

Regulatory Consistency Assessment Programme (RCAP)

Assessment of Basel III regulations –

United States of America

December 2014

BANK FOR INTERNATIONAL SETTLEMENTS

Note that this report refers to the RCAP grades prior to October 2025. The grade 'materially non-compliant (MNC)', ie one notch above the lowest grade, has since been renamed to 'partially non-compliant (PNC)' for greater clarity

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Glossary

ABCP	Asset-backed commercial paper
ALLL	Allowances for loan and lease losses
AMA	Advanced Measurement Approach
AT1	Additional Tier 1
BCBS	Basel Committee on Banking Supervision
BEICF	Business environment and internal control factors
BHC	Bank holding company
bps	Basis points
CCAR	Comprehensive capital analysis and review
CCF	Credit conversion factor
CCP	Central counterparty
CCR	Counterparty credit risk
CDS	Credit default swap
CET1	Common Equity Tier 1
CFR	Code of Federal Regulations
CRC	OECD's country risk classification
CRM	Credit risk mitigation
CVA	Credit valuation adjustment
DI	Depository institution
DTAs	Deferred tax assets
EAD	Exposure at default
EL	Expected loss
EPE	Expected positive exposure
FAQs	Frequently asked questions
FDIA	Federal Deposit Insurance Act
FDIC	Federal Deposit Insurance Corporation
FINMA	Swiss Financial Market Supervisory Authority
FR	Federal register
FRB	Federal Reserve Board
FX	Foreign exchange
G-SIB	Global systemically important bank
HVCRE	High-volatility commercial real estate
IMA	Internal Models Approach

IMM	Internal Models Method
IRB	Internal Ratings-Based approach
LGD	Loss-given-default
MR	Market risk
MRA	Matter requiring attention
MRIA	Matter requiring immediate attention
OCC	Office of the Comptroller of the Currency
OTC	Over-the-counter
PCA	Prompt corrective action
PD	Probability of default
PFE	Potential future exposure
PON	Point of non-viability
PSE	Public sector entity
QCCP	Qualifying central counterparty
RBA	Ratings-Based Approach
RCAP	Regulatory Consistency Assessment Programme
RMBS	Residential mortgage-backed securities
RWA	Risk-weighted assets
SFT	Securities financing transaction
SSFA	Simplified Supervisory Formula Approach
UL	Unexpected loss
USC	United States Code
USD	US dollar
VaR	Value-at-risk

Preface

The Basel Committee on Banking Supervision sets a high priority on the implementation of regulatory standards underpinning the Basel III framework. The prudential benefits of the agreed global reforms can fully accrue only if the Basel minimum requirements are incorporated into member jurisdictions' regulatory frameworks and implemented appropriately and consistently. In 2011, the Basel Committee established the Regulatory Consistency Assessment Programme (RCAP) to monitor, assess and evaluate its members' implementation of the Basel framework.[1]

This report presents the findings of the RCAP assessment team on the domestic adoption of the Basel risk-based capital standards in the United States and those standards' consistency with the Basel III framework. The assessment focuses on the adoption of Basel standards applied to the large internationally active US banks, ie the "core banks" of the US banking system.[2]

As a sequel to the 2007–08 global financial crisis, US regulatory agencies have undertaken several noteworthy initiatives designed to strengthen the prudential framework relating to bank capital. The agencies issued the final rule on Basel III risk-based capital in July 2013 and brought it into force on 1 January 2014. A significant number of new rules and policies have also been put in place as a result of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Given the structural features of the US banking system, including the presence of several large globally and systemically important banks, these are important steps towards ensuring financial stability.

The RCAP assessment team was led by Mark Branson, CEO of the Swiss Financial Market Supervisory Authority (FINMA). Michael Schoch, Head of Banking Supervision Department of FINMA, acted as deputy team leader. The assessment team consisted of seven technical experts drawn from China, the European Commission, Germany, Italy, Japan, Sweden and the United Kingdom. The main US counterpart for the assessment was the Federal Reserve Board (FRB). The Federal Deposit Insurance Corporation (FDIC) and the Office of the Comptroller of the Currency (OCC) were also engaged in the assessment process. The overall work was coordinated by the Basel Committee Secretariat with support from FINMA staff. The assessment relied upon the data, information and materiality computations provided by the US agencies. The report's findings are based primarily on an understanding of the current processes in the United States as explained by the counterpart staff and the expert view of the assessment team on the documents and data reviewed.

The assessment began in January 2014 and used data available up to 11 July 2014. It consisted of three phases: (i) completion of an RCAP questionnaire (a self-assessment) by the US agencies (September 2013 to January 2014); (ii) an off- and on-site assessment phase (February to June 2014); and (iii) a post-assessment review phase (June to mid-November 2014). The off-and on-site phases included two on-site visits for discussions with the US counterparts and representatives of two US global systemically important banks (G-SIBs). These exchanges gave the assessment team a deeper understanding of the implementation of the Basel risk-based capital standards in the United States. The third phase consisted of a two-stage technical review of the assessment findings: first by a separate

[1] The RCAP assessments aim to ensure that each member jurisdiction adopts the Basel III framework in a manner consistent with the framework's letter and spirit. The intention is that prudential requirements based on a sound, transparent and well defined set of regulations will help strengthen the international banking system, improve market confidence in regulatory ratios and ensure an international level playing field.

[2] See also Basel Committee on Banking Supervision (BCBS), *Basel III regulatory consistency assessment (Level 2) – Preliminary report: United States of America*, October 2012, www.bis.org/bcbs/implementation/l2.htm.

RCAP review team and feedback from the Basel Committee's Supervision and Implementation Group; and secondly, by the RCAP Peer Review Board and the Basel Committee. This two-step review is a key instrument of the RCAP process to provide quality control and ensure integrity of the assessment findings.[3] The focus of the assessment was limited to the *consistency* and *completeness* of the domestic regulations in the United States with the Basel minimum requirements. Issues relating to the integrity of prudential outcomes, capital levels of individual banks, the adequacy of loan classification practices or the US authorities' supervisory effectiveness were not in the scope of this RCAP assessment exercise.[4] Where domestic regulations and provisions were identified as not conforming with the Basel framework, those deviations were evaluated for their current and potential impact (or negligible impact) on the reported capital ratios for a sample of internationally active US banks. The assessment also identified some areas where follow-up actions could be taken.[5]

This report has three sections and a set of annexes: (i) an executive summary with the statement from the US agencies on the material findings; (ii) the context, scope and methodology, and the main set of assessment findings; and (iii) details of the deviations and their materiality along with other assessment-related observations.

The RCAP assessment team is grateful for the professional cooperation it received from all the US counterparts throughout the assessment process. In particular, the team sincerely thanks Michael Gibson, Art Lindo and the staff of the FRB for playing an instrumental role in coordinating the RCAP exercise. The assessment team would also like to thank the staff of the FDIC and the OCC involved with the RCAP assessment work. The series of comprehensive briefings and clarifications provided by the US counterparts helped the RCAP experts to arrive at their opinions. The team hopes that this RCAP assessment exercise will add to the good initiatives that have already been undertaken by the US agencies and help to further strengthen the prudential effectiveness and full implementation of the various post-crisis reform measures in the US.

[3] During the review period, the US authorities issued a notice of proposed rule-making on 18 November 2014 to address a number of findings with regard to the IRB minimum requirements and to increase the overall consistency of the US capital regulations with the Basel standards. The assessment cutoff date was thus extended to end-November 2014 under Basel Committee-approved procedures to allow members to introduce needed regulatory changes.

[4] Some of these issues will be covered by ongoing financial system stability assessment work by the IMF and will be completed in 2015, including an assessment of US compliance with the *Core principles for effective banking supervision*.

[5] US compliance with other Basel III standards on liquidity, leverage and systemically important banks (SIBs) will be assessed once they come on-stream as per the globally agreed Basel III timeline.

Executive summary

The US agencies' new framework for bank risk-based capital requirements came into force on 1 January 2014 via the US final rule. This marked a significant post-crisis strengthening of the US capital regime. Many other initiatives are being developed or are in the early stages of implementation. While the US has implemented a single comprehensive capital framework, different elements of the US risk-based final rule on capital apply to different banking organisations based on their size and international activity. As a general principle, the Basel standards designed for "internationally active" banks have been adopted in the US using the concept of "core banks", which are required to adopt the advanced Basel approaches.

Overall, and given the planned adoption and implementation of some amendments described in this report that the US regulatory agencies agreed to take and proposed publically, the assessment team finds the risk-based capital requirements in the US to be largely compliant with the minimum standards agreed under the Basel framework. The significance of the reforms undertaken in the US in recent years – some of which are still under way – is evidenced by the assessment team's view that 11 out of 13 components of the US capital framework comply or largely comply with the Basel framework. These components include scope of application and transitional arrangements, definition of capital, credit risk, operational risk, and Pillar 2 and 3 requirements relevant for consistent implementation. The assessment team notes the US authorities' continuing efforts to further strengthen and align the capital rules to the Basel III framework. Likewise, in several areas, the team noted a super-equivalent implementation of the Basel framework. These are detailed in the report but, in accordance with the RCAP assessment methodology approved by the Basel Committee, aspects where US requirements are stricter than the Basel standards were not taken into account in evaluating consistency and in assigning assessment grades.

While the team regards the US rules to be largely compliant overall, material deviations were identified in a number of areas. Two of the 13 Basel components are assessed as materially non-compliant: the securitisation framework and the Standardised Approach for market risk.

Regarding the securitisation framework, a number of divergences were identified that for some US core banks lead to materially lower securitisation RWA outcomes than the Basel standard. These differences are mainly related to the prohibition on the use of ratings in the US rules. Pursuant to the Dodd-Frank Act, the US rules cannot include provisions related to the Basel framework's Ratings-Based Approach (RBA) for securitisations, so the rules provide alternative treatments. The US agencies note that their alternative approaches are, on average, more conservative than the Basel standards, and are consistent with the G20 objectives of reducing mechanistic reliance on external credit ratings. The assessment team notes that while the securitisation framework represents a deviation at present, the Basel Committee is reviewing it and is likely to approve a framework that should potentially mitigate this deviation. The team acknowledges the US agencies' agreement to expeditiously consider an amendment to the US securitisation rules once the Basel Committee issues the revised securitisation framework. The assessment team welcomes this agreement and recommends a follow-up assessment once the US rules have been updated.

Regarding the Standardised Approach for market risk, the assessment team found that the US rules implement on a permanent basis a transitional rule in the Basel framework for securitisations in the trading book. This deviation has a material impact on the capital ratio of a few US core banks. The US agencies indicated that the rule was kept beyond the expiry date, because of the Basel Committee's fundamental review of the trading book regime. The US agencies agreed to consider changes to the US market risk framework as expeditiously as possible once the BCBS's fundamental review of the trading book is complete.

For other Basel components, a number of potentially material deviations have been identified, including for the US implementation of the Internal Ratings-Based (IRB) approach for credit risk. This is due in part to reliance on measurement concepts of US GAAP beyond what is consistent with Basel standards. Also, the US regulatory approach relies substantially on US supervisory processes rather than explicitly incorporating all of the detailed Basel minimum requirements in the formal corpus of regulatory instruments. As a consequence, in several cases the US rules do not incorporate the specific Basel minimum requirements, in particular for the IRB approach, where the Basel framework explicitly requires demonstration that these minimum requirements have been met. After the assessment was completed, the US agencies publically proposed amendments to the final rule which address a number of missing minimum requirements for the IRB framework. The amendments to the final rule are likely to be finalised in the second quarter of 2015. The US agencies also plan to publish complementary supervisory examination "work programmes" for banks that detail additional clarifications that are not included in the final rule. These additional regulatory initiatives considerably improved the level of compliance with the Basel IRB minimum standards. In their absence, the assessment of the IRB component would have led to a more conservative result.

The assessment also pointed out some deviations across other aspects of the Basel framework. Most notably, a number of US core banks, including one G-SIB, are still in so-called "parallel run" and therefore report capital ratios that do not include a separate capital charge for operational risk and credit valuation adjustment (CVA). The parallel run is a period during which a bank must show to the satisfaction of its supervisor that it can comply with the relevant standards of the advanced approaches, while the advanced approaches are not yet the basis for determining the capital requirements. While the assessment team acknowledges that the Basel framework does not explicitly prescribe the parallel run approach and that approval to report under an advanced approach following the parallel run should not be given lightly, it considers that the US approach leads to a protracted period of time during which the capital ratio of some large internationally active US banks is not comparable with those of banks in other jurisdictions.

The team listed a few issues for further guidance from the Basel Committee, including with regard to the definition of capital and the treatment of instruments issued under foreign law. Also, with regard to credit risk, a difference of views emerged on the Basel treatment of fair value assets under the IRB approach. The team would like to ask the Basel Committee to clarify its interpretation of these issues.

Looking ahead, the assessment team recommends that the Basel Committee reassess the grading of the US securitisation approach and – to the extent impacted – the overall assessment grading once the US agencies have revised their requirements to meet the new securitisation framework that the Basel Committee adopts. The team also suggests that the US agencies periodically review the impact of some of the deviations pointed out in the report as part of the Basel Committee's post-RCAP annual follow-up. Such a follow-up process would review progress made and steps taken to further improve consistency in the implementation of the Basel framework in the US and to ensure that deviations that are currently not material and not rectified do not grow in prudential significance. Further, the assessment team suggests that the IRB requirements be followed up through the post-RCAP follow-up or when another RCAP assessment is undertaken to ensure that they do not assume materiality. Further, the assessment team suggests that the IRB requirements are followed up through the post RCAP follow–up – or when another RCAP assessment is undertaken – to ensure that they do not assume materiality.

Response from United States

The US banking agencies welcome the opportunity to respond to the Basel Committee on the report's findings concerning the US implementation of the Basel framework as well as to express our sincere thanks to Mr Mark Branson, Mr Michael Schoch and the Assessment Team for their professionalism and integrity throughout this process.

We strongly support the implementation of a globally consistent Basel framework in which member jurisdictions adhere to standards as strong, or stronger than the agreed minimum requirements. In an effort to further promote the Basel framework's international implementation as well as to clarify existing US standards, the US agencies have published on 18 November 2014 a proposed rule that would revise elements of the US IRB approach. In addition, the US agencies plan to publish supervisory examination work programmes for banks that clarify supervisory expectations with regard to the implementation of the US IRB approach.

The US agencies concur with the report's overall rating of largely compliant as well as each of the subcomponent ratings of compliant and largely compliant. These findings indicate that, in the view of the Basel Committee, all provisions of the Basel framework have been satisfied with regard to compliant ratings, or only minor provisions have not been satisfied with regard to the largely compliant ratings. The overall largely compliant rating also confirms that there are no differences that could materially impact financial stability or the international level playing field.

The US agencies accept, but do not fully agree with, the report's finding concerning the US securitisation framework, which is primarily the result of a US statutory prohibition against any reliance on external ratings in US banking regulations. While this prohibition results in a deviation from the Basel framework, the agencies note that, on average, the US Simplified Supervisory Formula Approach (SSFA) results in a higher capital requirement for US firms than under the Basel RBA. The assessment team noted the: (1) Basel securitisation treatment is currently being revised to implement an approach similar to the US SSFA and (2) US SSFA is consistent with the Financial Stability Board's (FSB) stated directive of eliminating mechanistic reliance on credit ratings. However, these factors were not taken into account in the subcomponent rating.

Similarly, the US agencies do not fully agree with the finding regarding the US market risk framework. The Basel Committee has been working to significantly revise the market risk framework and the work was expected to be completed prior to the US assessment. The US agencies relied on the Basel Committee to complete its review and revise the framework in a timely manner, which was the primary basis for the US agencies retention of the transitional provisions.

Overall, the US agencies believe assessments of this type promote the level playing field among Basel member jurisdictions and improve transparency. Moreover, they can reveal areas where there are opportunities for improvement in national regulations. We recognise that Basel member jurisdictions are sometimes unable to implement Basel Committee standards to the letter, but we believe it is, nonetheless, important for all member jurisdictions to strive to achieve outcomes that are consistent with, or super-equivalent to, the substance of the Basel framework. The assessment shows that the US agencies have achieved a robust application of the Basel framework in the United States.

1 Context, scope and main assessment findings

1.1 Context

Status of implementation

In July 2013, the Federal Reserve System (Federal Reserve) and the Office of the Comptroller of the Currency (OCC) issued final rules to implement in the United States the Basel III risk-based capital regulatory reforms and certain changes required by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). The Federal Deposit Insurance Corporation (FDIC) issued a comparable interim final rule in July 2013 and finalised that rule in April 2014.[6]

The US agencies have generally chosen to implement the advanced approaches of the Basel framework only for their "core banks". Currently, there are 15 core banks, ie banks that exceed the threshold of USD 250 billion in total assets or USD 10 billion in on-balance sheet foreign exposures. Eight of the 15 core banks have been designated as global systemically important banks (G-SIBs) (Annex 8).[7] The core banks account for approximately 75% of US banking assets and nearly all of US banks' foreign exposures (see Annex 9 for an overview of the international reach of US core banks).[8] These banks are required to implement the Basel advanced approaches. Non-core banks can "opt in" to adopt the Basel advanced approaches.

The core banks are required to work towards implementation of the Basel advanced approaches and become subject to them after they receive approval from the US agencies. On 21 February 2014, eight core banks received permission to use the advanced Basel approaches in the calculation of their capital requirements.[9] Until 1 January 2015, the remaining seven core banks continue to base their capital requirements on the Basel I approach while they await approval. Basel I uses a small number of prescribed risk weights to compute risk-weighted assets.

All US banks adopting the advanced approaches are subject to a permanent capital floor using 100% of risk-weighted assets. The floor is currently based on the US general risk-based capital rules, which are based on Basel I standards (including the Basel III definition of capital). From 1 January 2015, the floor will be 100% of risk-weighted assets based on the new US standardised approach for credit risk, which is more in line with the Basel standardised approach. However, the US standardised approach

6 Reference: 78 Federal Register 62018 (October 11, 2013), 12 CFR Parts 208, 217 and 225 for the Federal Reserve's rules and 12 CFR Parts 3, 5, 6, 165 and 167 for the OCC's rules. See 78 Federal Register 55340 (September 10, 2013) and 12 CFR Parts 303, 308, 324, 327, 333, 337, 347, 349, 360, 362, 363, 364, 365, 390 and 391 for the FDIC's rules.

7 US banks designated as G-SIBs are (alphabetically): Bank of America, Bank of New York Mellon, Citigroup, Goldman Sachs, JPMorgan Chase, Morgan Stanley, State Street and Wells Fargo. The total assets of the US banking system are approximately USD 16 trillion. For a ranking and overview of G-SIBs, see www.financialstabilityboard.org/wp-content/uploads/r_141106b.pdf. The G-SIBs hold more than 60% of the total assets of the US banking sector.

8 Aside from the core banks, approximately 20 other US banks have international exposures, the sizes typically being very small. According to the FRB, the total amount of foreign assets not covered by Basel standards would be less than 3% of total foreign assets held by US banks.

9 The eight US bank holding companies that have received approval to exit the parallel run are Bank of New York Mellon, Citigroup, Goldman Sachs, JPMorgan Chase, Morgan Stanley, Northern Trust, State Street and US Bancorp. These firms will use the Basel advanced approaches framework to calculate and publicly disclose their risk-based capital ratios starting with the second quarter of 2014. Under the US capital rules, these firms must meet the minimum risk-based capital ratios under both the advanced approaches and the generally applicable risk-based capital frameworks. See www.federalreserve.gov/newsevents/press/bcreg/20140221a.htm.

excludes a capital charge for operational risk and CVA (see Section 1.4 and Annex 15 for further discussion).[10]

Status of approval of Basel advanced approaches

Number of banks, end-March 2014 Table 1

	Core banks with advanced approaches approved by US authorities	Core banks in parallel run*
Credit risk (IRB)	8	7
Counterparty credit risk (IMM)	8	7
Advanced CVA	8	7
Operational risk (AMA)	8	7

Number of US banks subject to the market risk rule	43 (29 Board-supervised, 13 OCC-supervised, 1 FDIC-supervised)
Of which: core banks	15

* Core banks in parallel run are not subject to explicit capital charges for operational risk and CVA risk.

Source: Federal Reserve Board.

Regulatory system and model of supervision

The United States operates under a dual banking system in which a bank may choose to be chartered by the federal government or by a state. Banks chartered at the state level are subject to supervision by both federal and state supervisors. Every US bank is subject to regulation, supervision and examination by a primary federal banking supervisor:

- for national banks and federal savings banks: the OCC
- for state banks that choose to be members of the Federal Reserve System (state member banks) and bank holding companies: the Federal Reserve
- for state banks that choose not to become members of the Federal Reserve System (non-member banks): the FDIC

1.2 Structure, enforceability and binding nature of prudential regulations

The US federal banking agencies have the authority to regulate and supervise banks and bank holding companies subject to their jurisdiction. The hierarchy of prudential regulation in the United States is as follows:[11]

[10] The floor is based on 100% of the new US standardised approach, and includes RWA for credit risk, market risk and securitisation and equity exposures. Similar to the Basel I floor in the Basel framework, the US standardised approach floor does not include RWA for CVA and operational risk. The resulting capital ratio is used to assess capital adequacy including under the US prompt corrective action framework, which establishes categories of capitalisation based on regulatory ratio requirements. Depending on the category of capitalisation, US regulatory agencies are required to take certain mandatory actions, except for “well capitalised” banking entities (other than bank holding companies).

(i) Federal statutes and legislative mandates, authorising the federal banking agencies to establish minimum capital requirements, capital adequacy standards (both for risk-based and leverage capital requirements), and safety and soundness standards.[12]

(ii) Regulations[13] and reporting requirements[14] that set out the capital adequacy rules and safety and soundness requirements issued by the federal banking agencies.

(iii) Policy statements, interpretations, supervisory guidance and manuals that address significant prudential policy and procedural matters.[15]

The agencies also use supervisory examination work programmes to help ensure that examiner assessments are consistently developed. These programmes provide more specific direction on how the standards and principles set forth in regulations, regulatory preambles or public guidance should be implemented. Certain Basel principles and requirements are therefore articulated in these work programmes because they are considered more appropriately reviewed and enforced during the examination process by the federal banking agencies. These documents are generally not public, but are often shared with banking organisations in order to make firms aware of supervisory expectations and to assist them in complying with the minimum regulatory requirements (see also Annex 12).

The assessment team examined the binding nature of the various regulatory documents issued by US agencies using the criteria applied in RCAP assessments (Annex 7). As a general principle, RCAP assessments only take into consideration documents that implement the Basel framework and set the Basel standards out in a manner that provides a formal basis for regulators, banks and associated third parties to ensure compliance with the minimum requirements. This also helps promote a level playing field and a consistent approach across Basel Committee members. Based on the assessment of these criteria, the assessment team concluded that the regulatory documents mentioned above, other than the work programmes, are eligible for the purpose of this assessment.

[11] In some cases, the US federal banking agencies have the discretion to determine the most effective form (eg regulations, reporting requirements, guidelines, supervisory guidance and interpretations) in which to promulgate revised or new requirements. Depending on the nature of the issues to be addressed, changes may be made as part of the agencies' regular, periodic review of regulations or issuance of interim final rules, or may occur through the development and issuance of policy statements or guidelines.

[12] The federal statutes are consolidated and codified in the United States Code (USC). Most of the relevant banking laws are found under Title 12, "Banks and Banking". State-chartered banks must also comply with applicable state law for certain banking activities. Disputes regarding the validity of a law and conflicts between federal and state laws are resolved by the courts. Both federal and state laws are considered valid until challenged and declared otherwise.

[13] The regulations are contained in the annual Code of Federal Regulations (CFR) along with any proposed or finalised amendments published in the daily Federal Register and publicly available on the agencies' websites. See 12 CFR 3 (national banks); 12 CFR 325.3, 12 CFR Part 325, appendices A, C and D (state non-member banks); 12 CFR Part 208, appendixes A, B, E and F (state member banks); 12 CFR Part 217 (state member banks, bank holding companies, and savings and loan holding companies); 12 CFR Part 225, appendixes A, B, D, E and G (bank holding companies); and 12 CFR Part 567 (savings associations).

[14] In terms of reporting requirements, the US federal banking agencies have authority to obtain financial, structural and any other information from banks and any of their affiliates. The reporting instructions allow the federal banking agencies to implement detailed interpretations of the capital framework through accurate reporting. Institutions are subject to potentially significant monetary penalties for failure to make available information or reports, to submit reports on a timely basis, or for submitting or publishing any false or misleading report or information.

[15] For general supervisory guidance, the Federal Reserve issues Supervision and Regulation Letters; the OCC issues Bulletins; and the FDIC issues Financial Institution Letters. All of these disseminate information to banking supervision staff and supervised banking organisations, and are available on the agencies' websites.

1.3 Scope of the assessment

Scope

The assessment team has considered all documents that effectively implement the risk-based Basel capital framework in the United States as of end-November 2014. This includes the notice of proposed rulemaking rectifying some of the assessment findings issued by US agencies on 18 November 2014 (Annex 4).

The assessment focused on two dimensions:

- a comparison of domestic regulations with the capital standards under the Basel framework to ascertain that all the required provisions have been adopted (*completeness* of the US domestic regulation); and
- differences in substance between the domestic regulations and the capital standards under the Basel framework and their significance (*consistency* of the US regulation).

Importantly, the assessment did not evaluate the adequacy of capital or resilience of the banking system in the United States, or the US agencies' supervisory effectiveness.

Identified deviations were assessed for their materiality (current and potential, or having an insignificant impact) using both quantitative and qualitative information. For potential materiality, in addition to the available data, the assessment used expert judgement on whether the domestic regulations met the Basel framework in letter and spirit (see Section 1.4).

Bank coverage

For the assessment of materiality of identified deviations, the US agencies provided data and materiality computations covering the 15 US core banks on a best efforts basis, and focusing on those banks for which the identified deviations are most relevant.[16] The team assessed that these banks cover more than 95% of total foreign exposures and deposits held by US banks (Annex 8).

Overview of the US banking sector — Table 2

	Total assets* (Q4 2013, USD trillions)	Foreign exposure (Q4 2013, USD trillions)	Off-balance sheet exposures** (Q4 2013, USD trillions)
All US banking institutions	18.1	3.4	313
G-SIBs	10.3	3.2	302
Core banks (including G-SIBs)	12.1	3.3	310

* Not including off-balance sheet assets.

** Off-balance sheet exposure includes unused commitments, financial standby letters of credit and foreign office guarantees, performance standby letters of credit and foreign office guarantees, commercial and similar letters of credit, securities lent, notional amounts of credit derivatives, spot foreign exchange contracts, all other off-balance sheet items (excluding derivatives) and total gross notional amounts of derivative contracts (including interest rate, foreign exchange, equity and commodity contracts).

Source: Federal Reserve.

[16] Data from the following core banks were collected (alphabetically): American Express, Bank of America, Bank of New York Mellon, Capital One, Citigroup, Goldman Sachs, HSBC North America, JPMorgan, Morgan Stanley, Northern Trust, PNC, State Street, TD Bank, US Bancorp and Wells Fargo. For practical purposes, and within the limits set by the Freedom of Information Act, for individual findings regulatory data were typically collected from nine core banks. The nine banks were separately selected by US authorities based on the materiality of the finding for affected exposures and relevance of the banks' business models.

Assessment grading and methodology

As per the RCAP methodology approved by the Basel Committee, the outcome of the assessment was summarised using a four-grade scale, both at the level of each of the 14 key components of the Basel framework and as an overall assessment of compliance: compliant, largely compliant, materially non-compliant or non-compliant.[17]

The materiality of the deviations was assessed in terms of their current or, where applicable, potential future impact (or negligible impact) on the banks' capital ratios. The quantification was, however, limited to the agreed population of internationally active banks. Wherever relevant and feasible, the assessment team, together with the US authorities, attempted to quantify the impact based on data collected from US banks in the agreed sample of banks (Annex 8). The non-quantifiable aspects of identified deviations were discussed and reviewed in the context of the prevailing regulatory practices and processes with the US authorities.

Ultimately, the assignment of the assessment grades was guided by the assessment team's collective expert judgement. In assigning grades, the assessment team relied on the general principle that the burden of proof rests with the assessed jurisdiction to show that a finding is not material or not potentially material. Section 2 and Annex 9 summarise the materiality analysis.

In a number of areas, the US rules go beyond the minimum Basel standards. Although these elements provide for a more rigorous implementation of the Basel framework in some respects, they have not been taken into account for the assessment of compliance under the RCAP methodology as per the agreed assessment methodology (Annex 10 lists areas of super-equivalence).

1.4 Main findings

The US agencies have made – and continue to make – significant progress in introducing strengthened requirements that apply to their large, internationally active banks. Overall, the US requirements largely meet the Basel minimum standards. That said, the assessment team identified some material departures from the Basel framework as well as many other deviations that are minor in terms of materiality. Of the 13 components assessed, two are graded as materially non-compliant, namely the securitisation framework and the Standardised Approach for market risk. Four components are graded as largely compliant, and seven components as compliant. One component was not applicable to the US (see details and other assessment observations in Section 2).

In determining the overall grade, the assessment team also took account of the follow-up actions and agreements made by the US agencies to further harmonise the US rules with the Basel standards. In particular, the US agencies have undertaken a comprehensive response that will help increase consistency of implementation with the Basel IRB standards. The clarification of a number of IRB minimum requirements in the US rules text will help make explicit several aspects that are being implemented through non-public supervisory work programmes. The publication of two key supervisory work programmes in the first half of 2015 will be another meaningful step towards improving the transparency and predictability of US IRB requirements. The proposed rules text amendments – which are public – have the agreement of the US agencies and are expected to become effective shortly after the agencies complete their due process requirements in 2015. Based on these – and given the nature of

[17] This four-grade scale is consistent with the approach used for assessing countries' compliance with the Basel Committee's *Core principles for effective banking supervision*. The actual definition of the four grades has been adjusted to take into account the different nature of the two exercises. In addition, components of the Basel framework that are not relevant to an individual jurisdiction may be assessed as not applicable (na). See www.bis.org/publ/bcbs264.htm for further details.

the deviations – the team has taken a view that the US IRB framework is "largely compliant." In the absence of the steps taken by the US agencies which will come on stream during 2015, the assessment team would have taken a more conservative position. The team has identified the IRB requirements for follow-up by the RCAP. Further, the agencies agreed to consider changes as soon as possible to the US securitisation framework upon finalisation of the new standard by the Basel Committee.

The assessment team used both quantitative impact data and expert judgement to derive the assessment grades. Based on data received from US regulatory agencies, material deviations were identified regarding the securitisation framework and market risk Standardised Approach. The impact is mainly driven by findings related to the approaches US agencies have introduced as alternatives to the use of external credit ratings (see below) and the permanent use of a transitional arrangement for securitisation positions in the trading book. In addition, a number of potentially material deviations have been identified with regard to the definition of capital and the US agencies' adoption of the IRB standards. A considerable number of non-quantifiable deviations have also been identified which, taken together, are considered to render a potentially material impact on the calculation of capital ratios by US core banks.

The main findings are summarised below. These should be read along with the list of detailed findings and observations in Section 2. The gaps rectified during the assessment process are listed in Annex 6.

Summary assessment grading — Table 3

Key components of the Basel capital framework	Grade
Overall grade:	LC
Scope of application	C
Transitional arrangements	C
Pillar 1: Minimum capital requirements	
Definition of capital and calculation of minimum capital requirements	LC
Capital buffers (conservation and countercyclical)	C
Credit risk: Standardised Approach	LC
Credit risk: Internal Ratings-Based Approach	LC
Credit risk: Securitisation framework	MNC
Counterparty credit risk framework	LC
Market risk: Standardised Measurement Method	MNC
Market risk: Internal Models Approach	C
Operational risk: Basic Indicator Approach and Standardised Approach	NA
Operational risk: Advanced Measurement Approaches	C
Pillar 2: Supervisory review process	
Legal and regulatory framework for the Supervisory Review Process and for taking supervisory actions	C
Pillar 3: Market discipline	
Disclosure requirements	C

Compliance assessment scale (see Section 1.3 for more information on the definition of the grades): C = compliant; LC = largely compliant; MNC = materially non-compliant; NC = non-compliant. One Basel component has been assessed as not applicable (na) as it has not been implemented by the US regulatory agencies.

Main findings by component

Scope of application

The Basel standards have been designed for "internationally active" banks.[18] However, the term "internationally active" is not specifically defined in the Basel text, leaving its implementation to the discretion of national authorities. In the United States, the agencies require "core banks" (as described above) to adopt the advanced Basel standards. Other banks may request to adopt the Basel advanced approaches (such banks are referred to as "opt-in banks"). All banks in the United States remain subject to the general US risk-based capital rules.

The definition of core banks includes: First, any depository institution (DI) meeting either of the following two criteria: (i) consolidated total assets of USD 250 billion or more; or (ii) consolidated total on-balance sheet foreign exposure of USD 10 billion or more. Second, any US-chartered bank holding company (BHC) meeting any of the following three criteria: (i) consolidated total assets (excluding assets held by an insurance underwriting subsidiary) of USD 250 billion or more; (ii) consolidated total on-balance sheet foreign exposure of USD 10 billion or more; or (iii) having a subsidiary DI that is a core bank or opt-in bank. Finally, any DI that is a subsidiary of a core or opt-in bank holding company is also considered a core bank.

According to information provided by the US regulatory agencies, the banking organisations subject to Basel standards account for nearly all of the international exposures held by US banking organisations (Annex 8). This holds for foreign exposures, foreign deposits, foreign liabilities, number of foreign offices and assets under management held in foreign offices. Therefore, the team considers the US scope of application of Basel standards to be compliant with the Basel Committee's intended scope of application.

Transitional arrangements

The Basel framework prescribes a capital floor based on 80% of the Basel I approach for banks that apply the advanced approaches for calculating capital requirements for credit risk (IRB) and operational risk (AMA). The US core banks that have exited parallel run are required to calculate a floor based on 100% of the new US standardised approach. The US agencies have explained that for a typical US bank the US floor will be at least as conservative as the Basel I floor.[19] While it cannot be excluded that under extraordinary circumstances the US floor may be less conservative than the Basel floor, taking into account the enhanced quality and volume of regulatory capital of Basel III relative to Basel I as well as the improved general conservatism of the calculation of RWA, the assessment team agrees with the US regulatory agencies that this is unlikely to happen in practice.[20] The team also notes that Basel II paragraph 49 states that "supervisors should have the flexibility to develop appropriate bank-by-bank floors that are consistent with the principles outlined in this paragraph." The US rules are assessed as compliant with the overall Basel III transitional arrangements.

[18] Paragraph 20 of Basel II notes that "(the) Framework will be applied on a consolidated basis to internationally active banks". See BCBS, *Basel II: international convergence of capital measurement and capital standards: a revised framework – comprehensive version*, June 2006, www.bis.org/publ/bcbs128.htm.

[19] Dodd-Frank Section 171 requires that any new US capital rule be at least as strenuous as the general risk-based capital rules (based on Basel I) that were effective on the date of enactment.

[20] Note that both the Basel I standard and the US standardised approach do not have a separate charge for operational risk and CVA risk and, thus, do not deviate from each other. This fact is being addressed in the assessment of the corresponding operational risk and CVA risk components.

Definition of capital

A key element of Basel III was the set of changes made to the standards that define the eligible components of regulatory capital. While a number of deviations are identified in the context of definition of capital, the data provided by US agencies suggest a relatively limited impact on the capital ratios. Overall, the US rules on the definition of capital are assessed as largely compliant with the Basel framework.

(i) Treatment of defined benefit pension fund assets

The Basel framework allows banks to risk-weight defined benefit pension fund assets when banks have unrestricted and unfettered access to these assets. Otherwise, the assets need to be deducted from Common Equity Tier 1 (CET1) capital. The US rule implements this requirement consistently, with one exception. The US rule allows FDIC-insured banks to risk-weight these assets and not deduct them from CET1 capital, without the condition of unrestricted and unfettered access. The US agencies explained that the FDIC has unrestricted and unfettered access to such assets in the event of a resolution of an insured depository institution, and that this ensures that the assets are available for the protection of depositors and other creditors of a bank (as per Basel III para 77). The team considers that the US treatment does not necessarily prevent FDIC-insured banks from including defined benefit pension fund assets in CET1 capital to which the bank would not have unrestricted and unfettered access.[21]

The US agencies clarified that bank holding companies are not FDIC-insured entities and therefore cannot make use of this exemption. The US agencies further explained that all internationally active core banks are part of bank holding companies, and that the vast majority of the pension fund assets are held at the holding company level and are fully deducted. As bank holding companies represent the highest level of consolidation for US core banks, the team considers the impact of the finding to be limited. The assessment team therefore considers the deviation as not material at present, but listed the finding for future follow-up assessments (Annex 12).

(ii) Treatment of deferred tax assets

The Basel standards require deduction of deferred tax assets (DTAs) that rely on the future profitability of banks. However, DTAs that result from temporary differences may be subject to threshold deductions.[22] The US rules do not explicitly require the deduction of DTAs that rely on future profitability, but allow risk weighting (100%) of DTAs that result from temporary differences and that could be realised through net operating loss carrybacks. The US agencies explained that these DTAs do not rely on the future profitability of banks but rather on past profitability.[23] The US agencies further clarified that the amount of these DTAs does not exceed the amount of taxes previously paid that could be recovered through net

[21] See also the Basel Committee RCAP assessment of Canada, www.bis.org/press/p140613.htm, p 15.

[22] Temporary differences arise when financial events or transactions are recognised in one period for financial reporting purposes and in another period, or periods, for tax purposes. These DTAs receive a risk weight of 250% up to a threshold and deducted from CET1 capital when they exceed the threshold.

[23] The team notes that the FDIC Rule, Part 325.5, defines DTAs that depend on future taxable income as follows: "(i) Deferred tax assets arising from deductible temporary differences that exceed the amount of taxes previously paid that could be recovered through loss carry backs if existing temporary differences (both deductible and taxable and regardless of where the related deferred tax effects are reported on the balance sheet) fully reverse at the calendar quarter-end date; and (ii) Deferred tax assets arising from operating loss and tax credit carry forwards." This implies that the FDIC considers that the DTAs arising from temporary differences that could be realised through net operating loss would not depend on future profitability of a bank as long as the amount of the DTAs does not exceed the amount of taxes previously paid that could be recovered through loss carrybacks.

operating loss carrybacks. The assessment team agrees that such DTAs do not depend on future profitability.

The assessment team notes that the Basel standards do not explicitly describe the treatment of DTAs arising from timing differences that the bank could realise through net operating loss carrybacks. The team also notes that the Basel Committee is considering further clarification on this point,[24] which it agrees is needed to avoid the risk of inconsistent treatment across jurisdictions of the term "rely on the future profitability of the bank to be realised".

(iii) Definition of general provisions

Basel III carries forward the Basel II treatment that permits the inclusion of "general provisions/general loan-loss reserves" in Tier 2 (up to a limit) for banks on the standardised approach for credit risk. However, it clarifies that they should not be included where they have been created "in respect of an identified deterioration in the value of any asset or group of subsets of assets" (Basel II para 49(vii)), noting that in such cases "they are not freely available to meet unidentified losses which may subsequently arise elsewhere in the portfolio and do not possess an essential characteristic of capital."

Under the US standardised approach, banks are permitted to include allowances for loan and lease losses (ALLL) in Tier 2 (subject to limits that are consistent with Basel standards).[25] According to the preamble of the US rules, ALLL are intended to cover "estimated, incurred losses as of the balance sheet date, rather than unexpected losses". The US agencies have further clarified that loans that are determined to be impaired (ie where it is probable that the creditor will be unable to collect all amounts due) are required to be charged off (ie deducted from the allowance).[26] In most cases, the lag between the recognition of impairment and the associated charge-off will not be more than 90 days. The US agencies also indicated that the entire ALLL are freely available to cover charge-offs on loans and leases regardless of where they fall in banks' portfolios. Although the ALLL are intended to cover charge-offs of losses that were estimated to have been incurred as of the balance sheet date, the ALLL are available to cover charge-offs of credit losses on loan and lease losses that were previously unidentified (ie unexpected); however, if charge-offs of previously unidentified losses result in an inappropriately low ALLL level, banks are expected to replenish their ALLL to appropriate levels through provisioning.

The team considers that the US rules do not explicitly prohibit inclusion of allowances in Tier 2 capital where they cover an identified deterioration of particular assets or known liabilities, whether individual or grouped. While data suggest that for a number of US core banks ALLL form a substantial part of Tier 2 capital, the assessment team considers that under the US rules, loans that are considered impaired are required to be charged off without a significant lag, which ensures that ALLL are substantially available to cover unexpected losses. While a timing difference between impairment and charge-off could potentially have a material effect on Tier 2 and the total capital ratio for banks that are in parallel run (which is based on the US standardised approach), as well as on the capital floor for US banks that have exited parallel run, the team judges the deviation as unlikely to be material.

(iv) Treatment of insurance subsidiaries

The Basel standards permit banks to consolidate significant investments in insurance entities as an alternative to the deduction approach on the condition that the method of consolidation results in a minimum capital standard that is at least as conservative as that which would apply under the deduction

[24] See Annex 13 of the Basel Committee RCAP assessment of Canada, www.bis.org/press/p140613.htm.

[25] The US standardised approach is applied as a floor to US core banks.

[26] See Commercial Bank Examiner Manual Section 2060.1.

approach. The consolidation is for regulatory, and not for accounting, purposes. This treatment has been specified in the Basel III definition of capital FAQs.[27]

The US agencies' capital treatment of significant investments in *unconsolidated insurance subsidiaries* of bank holding companies is consistent with the Basel approach, as these investments are required to be deducted. However, for insurance subsidiaries that are *consolidated* for accounting purposes the US approach is to risk weight the insurance entity's assets and liabilities and deduct its minimum capital requirement.[28] The US agencies' treatment does not require that the outcome be at least as conservative as the Basel deduction approach.

The US agencies take the view that the Basel treatment for insurance subsidiaries does not apply in the case where an insurance subsidiary is consolidated for accounting purposes. However, the assessment team holds the view that the Basel treatment applies to "fully owned insurance subsidiaries that are consolidated for regulatory capital purposes" as specified in FAQ 14.[29] The data provided by the US agencies show that investments in insurance subsidiaries are generally not material for the 10 largest US bank holding companies (eg the weighted average of the net assets of insurance subsidiaries accounted for less than 0.3% of the parents' RWA). The team considers that the deviation could become potentially material were a US core bank to acquire a large insurance company, as has happened in the past.

(v) Implementation of point of non-viability criterion

The Basel standards require a contractual principal loss absorption mechanism for all non-common Tier 1 (AT1) and Tier 2 instruments, unless the governing jurisdiction of the bank has in place laws that (i) require such Tier 1 and Tier 2 instruments to be written off upon such event; or (ii) otherwise require such instruments to fully absorb losses before taxpayers are exposed to loss. In addition, the Basel Committee has clarified that the relevant authority must have the power to trigger writedown/conversion of the instrument issued by a foreign subsidiary in addition to the relevant authority in the foreign jurisdiction.[30] The US rules do not include this latter specification because the US is implementing the statutory approach, and the US agencies believe this requirement does not apply to jurisdictions that adopt that approach.

The assessment team understands that one of the purposes of the point of non-viability (PON) press release is to ensure loss-absorbing capacity of the foreign subsidiary under the gone-concern scenario in cases where capital instruments issued by the subsidiary are included in the consolidated capital of the banking group. The team also notes that the PON press release states that the Committee's objective could only be met through a statutory approach "if it produces equivalent outcomes to the contractual approach".

The team considers that capital instruments issued by US banks under foreign law (either directly or via foreign branches or subsidiaries) may not necessarily allow the US authorities to trigger

[27] See FAQ 14 for Basel III paragraphs 78–89 (investments in own shares, investments in the capital of banking financial and insurance entities and threshold deductions), www.bis.org/publ/bcbs211.htm.

[28] That is, under the US approach the insurance entities' assets are risk-weighted as per the Basel standards and the minimum capital requirement of insurance underwriting risks is deducted from regulatory capital of the consolidated banking group: 50% from Tier 1 capital and 50% from Tier 2 capital.

[29] In addition, the team notes that FAQ 14 on the Basel III paragraphs on the insurance subsidiary state that a jurisdiction can apply an alternative approach to the deduction approach only in cases where the alternative approach results in a more conservative outcome than the deduction approach.

[30] See FAQ 4 on the PON press release, www.bis.org/publ/bcbs211.pdf

these instruments without contractual arrangements. The legal enforceability of the statutory approach outside the home jurisdiction is uncertain and has not been demonstrated. AT1 and Tier 2 instruments issued under foreign law would therefore, in the assessment team's view, not qualify as regulatory capital at the group's consolidated level, unless PON loss absorbency is implemented contractually in compliance with the Basel PON standards, or the authorities demonstrate they have the statutory powers to trigger these instruments.

Data suggest that the amount of AT1 and Tier 2 instruments issued by non-US subsidiaries is currently very small. Therefore, since the funding by US core banks is principally conducted in the United States, the assessment team considers the finding as not material at present, but listed it as an item for future follow-up assessments (Annex 12).

Capital buffers (conservation and countercyclical)

Basel III established a capital conservation buffer above the minimum capital requirements. When a bank's CET1 ratio falls into the buffer range, that bank becomes subject to a restriction on the distribution of future earnings. The US rule includes requirements for the capital conservation buffer and countercyclical buffer, and associated restrictions on distributions, consistent with the Basel III requirements. The US framework is therefore assessed to be compliant with the Basel buffer requirements.

The countercyclical buffer regime of Basel III works by extending the size of the capital conservation buffer when excess aggregate credit growth is judged to be associated with a build-up of system-wide risk. Here too, the US framework is consistent with the Basel expectations for the countercyclical buffer.

Credit risk: Standardised Approach

In the US rule, all banking organisations are required to apply the Standardised Approach starting from 1 January 2015. For advanced approaches core banks that have exited parallel run, the Standardised Approach will be used as a floor for calculating minimum capital ratios.

As indicated above, in accordance with the Dodd-Frank Act the US rules do not reference external credit ratings. The team does not consider this to be a deviation per se from the Basel framework, but the assessment team's focus has been on the potential for differences in regulatory outcome in comparison to the Basel standards. All of the findings mentioned below relate to this issue.

First, for claims on sovereigns, public sector entities (PSEs) and banks according to the OECD's country risk classification (CRC), the US rule assigns risk weights instead of external credit ratings. For domestic exposures the information and data received suggest that virtually all US public debt held by US banks is denominated in US dollars, and that a US downgrade (particularly below AA–) is highly unlikely over the assessment horizon (three to five years). For non-US exposures, based on a comparison of the US rule with those under a ratings-based approach, the assessment team judges that the deviations are unlikely to become material.

Second, for credit risk mitigation (CRM) the Basel standards use minimum external credit ratings to determine the eligibility of financial collateral. In contrast, the US rules accept "investment grade" securities, defined as having "adequate capacity to meet financial commitments for the projected life of the asset or exposure" and "adequate capacity to meet financial commitments if the risk of its default is low and the full and timely repayment of principal and interest is expected". As this is without reference to credit ratings, the possibility remains that US banks could use certain financial collateral that does not meet the Basel standards, such as unrated securities issued by non-bank firms or non-eligible unrated bank securities. In addition, it is possible that the "investment grade" criterion may expand the scope of eligible guarantors beyond the Basel approach. While the US rule does not refer to external ratings when defining "investment grade" collateral, the team's dialogue with the industry suggests that in practice US banks often use external ratings, among other market factors and internal analysis, to determine whether collateral is of “investment grade” quality. Although under the US rule an “investment grade” credit rating for a particular debt security does not necessarily mean that the bank can recognise the security as collateral for CRM purposes, the extent to which US banks use “investment grade” collateral that would not qualify under the Basel standards is not clear.

Finally, the US rule assigns supervisory haircuts for collateral based on the OECD’s CRC instead of on external credit ratings under the Basel standards.[31] While in some cases the standard supervisory haircuts in the US rule are more conservative than those contained in the Basel text, for sovereign issuers the US haircut on collateral may be different from the Basel approach, as high-income OECD members and other high-income euro zone countries that no longer receive CRC scores are risk-weighted 0% irrespective of their external credit ratings, as long as they remain non-default. Differences may also exist in the resulting haircuts for non-sovereign issuers.

Based on information and data provided by the US agencies, the assessment team finds that the US approach does not materially deviate from the Basel standards at present. However, if external credit ratings were to deteriorate, the team considers that a difference in outcomes with the Basel approach could result in less conservative CRM treatment and potentially become material. Overall, the US agencies’ implementation of the credit risk standardised approach framework is therefore considered to be largely compliant.

Credit risk: Internal Ratings-Based approach

The US rules are assessed as largely compliant with the Basel framework. The assessment team identified four areas of non-conformance with the Basel requirements: (i) reliance on accounting valuation; (ii) specific IRB minimum requirements; (iii) capital requirements for certain types of exposures; and (iv) recourse to standardised approach parameters. An overview is provided below; for details, see Section 2.3.4 of the detailed assessment findings.

(i) Reliance on accounting valuation

The Basel IRB framework determines capital charges both for unexpected (UL) and expected losses (EL) independent of accounting standards, to ensure consistency between and comparability of resulting capital adequacy measures across jurisdictions. UL and EL are based on risk parameter estimates for probability of default (PD), loss-given-default (LGD) and, in particular, exposure at default (EAD) determined according to the IRB minimum requirements. Accordingly, the Basel LGD estimates are based on an economic loss concept relative to EAD, and EAD is measured gross of specific provisions, partial write-offs and discounts. The Basel definition of default is broader than the accounting impairment concept (as it considers the likeliness of timely payment by the obligor without considering potential recoveries, which are instead reflected by the LGD). However, there is recognition of (eligible) accounting-based general and specific provisions against the IRB-based expected loss estimate EL = PD* LGD* EAD. That is, the Basel IRB framework recognises the extent to which expected losses are covered by accounting standards-based CET1 capital reductions for credit risk, and allows limited recognition of excess reductions as Tier 2 capital.

[31] Basel II paragraph 55 allows the use of consensus risk scores of Export Credit Agencies (ECAs) participating in the “Arrangement on Officially Supported Export Credits” published by the OECD. The OECD regularly updates CRCs and makes the assessments publicly available on its website; however, in 2012, the OECD determined that the automatic classification of high-income OECD members and other high-income euro-zone countries in CRC Zero should be terminated. The OECD explained that, the Country Risk Classifications are meant to reflect country risk but not sovereign risk and should not be compared with the sovereign risk classifications of private credit rating agencies. Thus transactions involving obligors in high income OECD members and other high income euro-zone countries no longer receive CRC scores and are subject to the market pricing disciplines. (For further information, see http://www.oecd.org/tad/xcred/crc.htm.)

The US rules rely on accounting valuation beyond what is allowed under Basel standards. The assessment team has identified that this can lead to the following:

(a) Delayed recognition or potential non-recognition of default events for retail exposures resulting in lower total EL and RWA where a default event is not (yet) recognised.

(b) Lower EAD for exposures with credit risk-related CET1 reductions (including fair value reductions) or discounts.[32] The lower EAD reduces both RWA and EL amounts for non-defaulted and defaulted exposures, and also allows recognition of accounting-based CET1 reductions for credit risk where these exceed total EL amounts. The US rules do fully recognise such excess accounting reductions via an EAD that is net of all accounting reductions to CET1 capital. This effectively treats excess accounting reductions as if they covered a portion of the RWA, ie the US rules treat excess accounting reductions as if they were added back into CET1 capital. This allows full recognition of excess accounting reductions for all three capital ratios, whereas the Basel standards limit recognition of such reductions to 0.6% of RWA as Tier 2 capital and do not allow any recognition for the CET1 and Tier 1 capital ratio.

(c) Lower EL amounts for non-defaulted fair-valued exposures where total fair value reductions do not exceed total EL amounts (PD*LGD*EAD) for fair-valued exposures. For non-defaulted exposures, the US rules determine IRB risk weights for unexpected loss correctly by subtracting the PD*LGD*EAD figure for expected loss as in the Basel risk weight function. However, unlike the Basel framework, US rules do not consistently determine EL for fair-valued exposures by this PD*LGD*EAD figure. EL for non-defaulted fair-valued exposures is set to zero for the comparison of total eligible provisions with total EL amounts. As a consequence, coverage of expected loss is limited to the extent of fair value reductions under US GAAP. Where total fair value reductions are less than total EL amounts determined by PD*LGD*EAD for fair-valued exposures, the US implementation creates a gap in coverage of credit risk compared to Basel standards. This gap is equal to the difference between the sum of EL amounts (PD*LGD*EAD) for fair-valued exposures and total fair value reductions. Data provided suggest that, currently, the fair value reductions of most US banks significantly exceed EL amounts for fair-valued exposures. Five US banks report significantly more conservative capital ratios than those that would be calculated under the Basel standards. For eight US banks, the approach appears less conservative than the Basel standards, but currently does not result in materially lower capital ratios. The assessment team concludes that the potential overestimation of capital ratios by the US treatment of fair-valued exposures is currently not material because of relatively high fair value reductions, but the situation could change if these fair value reductions were to decrease in the future.[33] Also, fair value adjustments consider factors other than changes in creditworthiness, such as changes in interest rates and liquidity. Given the number of variables that contribute to the difference between fair value and amortised cost, including changes in the composition of fair value exposures that a bank holds which are subject to change for various reasons, the assessment team considers the deviation potentially material.

(d) The EL will also be lower for defaulted exposures where accounting-based loss assumptions do not consider all economic loss contributions. Further, the US approach may result in higher recognition of general allowances as eligible provisions as it does not exclude the portion related to Standardised Approach risk weights. The US approach can thus result in lower CET1

[32] The US rules determine EAD as the accounting value ("carrying value"), so EAD under US rules is reduced by discounts, whereas the Basel standards do not allow such discounts by lower EAD estimates or the recognition of discounts as eligible provisions in the EL treatment as long as the exposure is not defaulted.

[33] The US authorities indicated that, in their view, this would be offset by higher EADs.

capital deductions for EL or excessive recognition of accounting-based CET1 reductions as Tier 2 capital.

The overall effect is that CET1 and Tier 1 capital ratios of US banks may be higher than when Basel standards are applied. The same is true for total capital ratios, except in those specific cases where total fair value reductions together with total other eligible provisions exceed total EL amounts (determined by the Basel standards) to an extent that the effect of not increasing Tier 2 capital in the numerator of the US ratio by excess fair value reductions is stronger than the effect of reducing EAD in the denominator of the US ratio. The limited data available suggest that the impact on capital ratios of US banks is, on average, not material at present. However, since the extended reliance on accounting valuation can result in lower capital requirements for expected and unexpected losses related to credit risk and in lower deductions from CET1 capital, this deviation is considered potentially material.

The US agencies have raised concerns that the Basel approach can create disincentives to using fair value accounting compared to holding assets at amortised cost. The assessment team believes these disincentives are limited since fair value reductions are treated as partial write-offs and therefore qualify as eligible provisions.[34] Given the potential material impact on bank capital ratios, the assessment team requests that the Basel Committee confirm this interpretation (Annex 13).

(ii) Non-inclusion of certain IRB minimum requirements

The US regulations set targets for rating systems, rating assignments and risk parameter estimates that are consistent with the overarching principle behind the IRB minimum requirements in the Basel framework. This includes being accurate, reliable, consistent and appropriately conservative. Further, data must be relevant, processes and systems must be consistent with internal use, etc. These targets are supplemented by more specific requirements in the US rules text itself, in the preambles to the final rule and the 2007 rules, and in other published documents such as supervisory letters that implement many of the specific IRB minimum requirements in a binding manner.

However, the US regulations do not specify certain of these targets in the full depth required by the Basel standards. The US authorities have taken the position that while these detailed requirements are not explicitly articulated in the US rule text, implementation of the specific provisions of the Basel framework is achieved through robust supervisory oversight, and note that US supervisors ask for much more than what is reflected in the rule text alone. As evidence of the sufficiency of their enforcement of these requirements and to highlight the robustness of their supervisory process, the US agencies have referred to studies by the Basel Committee which suggest that RWA for low-default portfolios are more conservative than in other jurisdictions.

Following completion of the assessment, the US agencies issued a proposed rule that would incorporate and clarify a number of minimum requirements into the final rule. The amendment is likely to be finalised in the second quarter of 2015. In addition, the US agencies committed to issue the supervisory examination work programmes that also clarify a further number of IRB minimum requirements. The amendment of the final rule addresses those missing minimum requirements that the US agencies identified as most relevant to US markets and banks. In particular, the requirements provide

[34] In particular, the team considers that the Basel standards do not require that partial write-offs be exclusively related to credit risk. The definitions of minimum EAD (Basel II para 308, 334) and of total eligible provisions (Basel II para 380) do not distinguish between credit risk-related and non-credit risk-related partial write-offs, but require that partial write-offs be attributed to the exposures treated under the IRB approach. Consequently, any fair value adjustments that have reduced CET1 capital, irrespective of the extent to which they reflect credit risk, can be treated as partial write-offs rather than a discount that becomes an eligible provision only when the exposure has defaulted.

more clarity regarding the information, data and systems that must be used by banking organisations to estimate IRB risk parameters (Annex 6).

The assessment team welcomes the rectifications, which further align the US final rule with the Basel standards. A number of missing IRB minimum requirements remain that may assume significance in the future. The assessment team recommends reviewing these missing minimum requirements through the post-RCAP follow-up assessment or when another RCAP assessment is undertaken to ensure that they do not assume materiality.

(iii) Capital requirements for certain types of exposures

For certain exposures, the US agencies' implementation of IRB minimum capital requirements deviates in the following aspects from the Basel standards. This may result in lower IRB capital requirements. Deviations relate to:

- extended scopes for (i) a waiver for 0.03% PD floor; (ii) double default recognition; (iii) treatment as retail; and (iv) risk weights for qualifying revolving retail;
- a narrower definition of equity exposures;
- missing recognition of high-volatility commercial real estate in other jurisdictions;
- missing prohibition of reflecting double default effects in PD/LGD for guaranteed retail exposures;
- potentially lower RWA for corporate leases where these expose the bank to residual value risk;
- potentially insufficient capital requirements for purchased receivables (zero for material dilution risk / potentially lower for credit risk); and
- a deviating approach to EAD for retail foreign exchange and interest rate commitments.

The US authorities have provided data indicating that for some types of exposures the deviations are currently not material. Further, the US authorities have confirmed in writing that based on their knowledge and available data the overall impact at present is not material. In the view of the assessment team, while lower capital requirements under specific circumstances have not represented a material deviation to date for a typical internationally active bank with a diversified portfolio and an average risk profile, the deviation may become material if a bank increases its exposure to such products. Comparably lower capital requirements can create incentives for shifts in banks' portfolios towards these products. The assessment team considers these deviations taken together as potentially material because of the broad range of products to which they relate.

(iv) Recourse to Standardised Approach parameters

The US rules take recourse to Standardised Approach parameters beyond the limits set by the Basel standards for:

(a) equity exposures where 0%, 20% and 100% risk weights may be applied beyond the limits of 10% capital and additional 10% capital for eligible legislated programmes;

(b) cash items in the process of collection to which fixed 20% risk weights are applied instead of risk-sensitive IRB risk weights for exposures to banks or central banks; and

(c) fixed risk weights of 100% for defaulted assets applied solely to the portion of the exposure not yet written off where the Basel standards require assigning an LGD that reflects unexpected losses during the recovery period on a risk-sensitive basis to the full EAD.

The deviation for equity exposures is assessed as potentially material. While data provided by the US agencies show that the current volume of 20% and 100% risk-weighted equity exposures is still within the 10% capital limit for legislative programmes, the assessment team notes that this limit is nearly exhausted for the most affected bank. The missing limit has thus not represented a material deviation to date, but could become relevant in the future. In the view of the assessment team, the large difference in risk weights compared to the 300% or 400% under the simple risk weight method of the Basel standards can further incentivise US banks to increase the share of such equity exposures. In addition, the team finds that – in contrast to the Basel standards – debt exposures with the economic substance of equity holdings might not always be required to be classified as equity under US regulations. This deviation is therefore considered potentially material.

The deviation for cash items in the process of collection is not currently material, but could assume significance if US banks were to substantially increase the share of these exposures, in particular with high-risk counterparts. The assessment team therefore recommends listing this finding for a follow-up RCAP assessment.

Regarding defaulted assets, data provided by the US agencies show that the finding is, on average, not material at present for the capital ratio of US banks. For most banks, the impact is limited and for some banks the result is even considerably more conservative than under the Basel standards. However, there is also a bank that reports a benefit of approximately 19 bps on the normalised capital ratio. The impact of using a fixed risk weight may increase if unexpected losses increase. This deviation is therefore considered potentially material.

Securitisation framework

The US agencies have implemented a securitisation framework that is, on average, more conservative than the Basel standards. Nevertheless, the assessment team has identified a number of divergences between the US rules and the Basel standards that for some US banks lead to materially lower securitisation RWA outcomes than the Basel standards, both for securitisations held in the banking book and those held in the trading book.[35] Overall, based on the materiality of the deviations identified by the assessment team, the US implementation of the securitisation framework is considered to be materially non-compliant.

These differences are mainly related to the prohibition on the use of ratings in the US rules. Pursuant to the Dodd-Frank Act, the US rules cannot include provisions related to the Basel RBA, and accordingly provide alternative treatments (such as the SSFA under both the credit risk and market risk aspects of the US rules) and a hierarchy of approaches that differs from the Basel provisions.

Although the assessment team understands that the US agencies calibrated the SSFA to produce risk weights largely comparable on a portfolio basis to those under the Basel RBA, estimates and analysis provided by the agencies show that the SSFA has a material impact on the securitisation RWA of several US banks. With regard to the credit risk framework, on average, the SSFA is more conservative than the RBA and relative to the RBA results in a weighted average (i) decrease in the normalised capital ratios of 6 bps and (ii) increase of 14.5% in securitisation RWA for the nine sample banks. However, for three banks the alternative approaches result in more than a 30% reduction in securitisation RWA (up to 52% for one bank). With regard to the market risk framework, for the sample of US banks, the deviation results in a maximum reduction in market risk RWA of 24.5%, and an average reduction of 9.1%. In capital ratio terms, the deviation results in a maximum change of 78.9 bps and an average change of 14 bps across banks in the sample. Overall, the US approach produces a material impact for a limited number of banks.

[35] For the purposes of the assessment, the impact of divergences in the securitisation framework on market risk RWA are considered in the securitisation component.

Historical data provided by the US agencies for securitisation issuances from 2005 and 2006 show that the SSFA typically results in a more conservative RWA than the RBA for all asset classes except for senior residential mortgage-backed securities (RMBS).[36] For three of the banks in the sample, RMBS represent more than 1% of total assets. Data provided by US agencies suggest that the differences in risk weights of senior RMBS may be attributed to external rating downgrades of AAA securities observed after 2009. Based on a paper provided by the US agencies, the average regulatory capital requirement under the SSFA is more conservative than the RBA for mezzanine RMBS positions, while it is significantly less conservative for senior RMBS exposures.

The potential future impact on capital ratios and the international level playing field of the deviations identified depends on several factors, including the asset class mix of individual bank portfolios, the risk of the underlying securitised exposures and the seniority of the securitisation exposure. As the analysis provided by the US agencies was based on a very specific pre-crisis vintage, and given the fact that the conservatism of the SSFA is directly connected to the delinquency rate, it is not clear whether the SSFA would deliver similar (conservative) results for more recent, post-crisis vintages. This aspect could be verified once a longer and more robust time series on securitisation asset classes is available.

The assessment team has also noted that the regulatory approach for securitisation is currently under revision by the Basel Committee, and that future amendment to the Basel securitisation framework will probably include a version of the SSFA derived from the one currently applied by the US agencies.[37] The agencies note that these alternative approaches are consistent with the FSB and BCBS objectives of reducing mechanistic reliance on external credit ratings.[38] Further, the agencies agreed to consider amendments to the US securitisation rules once the Basel Committee issues the revised securitisation framework (Annex 6). The assessment team welcomes this agreement and recommends a follow-up assessment once the US rules have been updated (Annex 12).

Counterparty credit risk framework[39]

In general, the US implementation of the counterparty credit risk (CCR) requirements is broadly in line with the Basel framework. However, the assessment team identified a number of deviations, one of which has a material impact on the capital ratio of at least one US bank.

The main deviation from the Basel framework is in the determination of counterparty weights applied in the standardised approach for CVA. In the Basel framework, credit ratings are used for this purpose, whereas the US requirements replace the direct references to credit ratings with probabilities of default due to the prohibition on the use of external credit ratings in the US regulations. Based on data received from the US authorities, although on average the impact on CCR RWA of this approach compared to the Basel standard is low, the impact is material for at least one US core bank. For that bank, the US approach results in CCR RWA that are 12.3% lower than would be the case under the Basel approach.

Further, as noted in Section 1.1, the US agencies have not incorporated the CVA capital charge in the new US standardised approach. US core banks that remain in parallel run will therefore not be subject to a separate CVA capital charge. The assessment team acknowledges that the Basel framework

[36] Analyses are based on Intex data over February 2006–January 2011, and represent 2005–06 securitisation vintages.

[37] The US agencies expect that the Basel Committee will issue the amended Basel securitisation framework by end-2014.

[38] See FSB, *Principles for Reducing Reliance on CRA Ratings*, October 2010.

[39] Of the available approaches for CCR in the Basel framework (the Internal Models Method, Standardised Method and Current Exposure Method) the US has not implemented the Standardised Method.

does not explicitly prescribe the implementation of the parallel run, and understands the view of the US regulatory agencies that the internal model approval process cannot be compromised. The team also considers that the issue will disappear once the remaining core banks have received approval to exit parallel run. At the same time, the team finds that the US approach results in a number of core banks not being subject to a separate capital charge for CVA risk for a protracted amount of time, which is considered not in line with the spirit of the Basel standards.

With respect to CCP-related requirements, no material deviations were identified. The most significant (but still not material) deviation identified was that the US rules allow banks which are clients (ie that clear their transactions through a clearing member) to apply the 2% risk weight to trade exposures in cases where client collateral is held in omnibus accounts. The Basel framework allows this application of a 2% risk weight in cases where certain conditions relating to segregation and portability of collateral are met. In the case of US omnibus accounts, the condition is not fully met; however, based on data from the US agencies on the size of exposures to which this deviation relates, the deviation is considered to be currently not material. The assessment team also considers that the deviation is unlikely to become material in the future.

Overall, based on the deviations identified by the assessment team, and their materiality, the US implementation of the CCR framework is considered to be largely compliant.

Market risk: Standardised Measurement Method

The US market risk rule implements only certain provisions of the standardised market risk measurement method of the Basel framework: the equity- and interest rate-specific risk provisions and the securitisation provisions.[40] The Standardised Measurement Method for general risk has not been implemented as US rules instead require general risk to be measured using the Internal Models Approach (IMA). Given that the scope of application of the US rule is large banks, which the Basel framework envisages would use the IMA, this is not considered by the assessment team to be a deviation.

The assessment team identified one deviation from the Basel framework with a material impact in regard to the treatment of non-modelled securitisation positions. Specifically, the US rules implement on a permanent basis a transitional rule in the Basel framework for securitisations in the trading book that permitted capital requirements to be based on the maximum of the capital requirement that would be held against either the sum of the bank's net long or net short non-modelled securitisation positions (rather than the capital requirement being the sum of the long and short requirements).

The US agencies indicated that the provision was adopted in this manner in anticipation of the Basel Committee's completion of the fundamental review of the trading book, which, though still in development, aims to improve risk sensitivity in part by allowing for increased recognition of hedging under the Standardised Approach. Notwithstanding the status of the fundamental review, this provision represents a material deviation from the Basel requirements. For the most affected banks, this deviation resulted in an 11% decrease in market risk RWA and a 23 bp increase in the capital ratio (relative to application of the Basel standards). On average, across the sample of US banks the deviations result in a 6% decrease in market risk RWA and a 6 bp increase in capital ratios. The assessment team is concerned that the impact may increase further over time.

40 The Basel framework treats securitisations held in the trading book under the market risk standardised method, and securitisations in the non-trading book under the credit risk securitisation framework. In practice, however, the framework applied in each situation is identical.

Overall, taking into account the above deviation, the assessment team considers the US implementation of the market risk standardised approach to be materially non-compliant.

Market risk: Internal Models Approach

The US agencies have implemented all elements of the Basel standard related to the market risk IMA. In a number of areas, some of the detailed specifications set out in the standard are not fully incorporated (eg specification of the risk factors to be included in VaR, or details of stress testing requirements); however, where this is the case there is always an overarching requirement which substantively addresses these details.

Therefore, overall the US requirements for the IMA for market risk are considered to be compliant with the Basel framework.

Operational risk: Basic Indicator Approach, Standardised Approach and Advanced Measurement Approaches

Of the available approaches for operational risk in the Basel framework (Basic Indicator Approach, Standardised Approach; Advanced Measurement Approaches) the US agencies have implemented only the Advanced Measurement Approaches (AMA). As already highlighted under the transitional arrangements, for core banks that are in parallel run and report Basel I capital ratios, no explicit capital requirements for operational risk apply. In the view of the assessment team, this implementation differs from that in most other Basel Committee jurisdictions and may hamper the comparability of risk-based capital ratios across internationally active banks during the parallel run period.

The US rules implementing the AMA are considered compliant with the Basel framework. While the US rules in general implement the requirements for operational risk in a manner consistent with the Basel framework, there are a few findings (mostly concerning some detailed technical criteria/requirements) which are not likely to have a material impact on the capital ratios. In particular, the US rules do not explicitly include some qualitative and quantitative requirements for the use of the AMA. To a certain extent, this reflects the fact that in a number of instances the US rules contain only the broad principles, while the details are left to supervisory guidance and practice. The assessment team considered these deviations as to be not material.

In addition to the above-mentioned findings concerning technical criteria/requirements, two deviations concerning the recognition of risk mitigants in the context of the AMA were found. The first concerns one of the eligibility criteria for using insurance: since US rules cannot refer to credit ratings, the Basel criterion that the insurance provider must have a credit rating of at least A (or equivalent) was changed to a criterion stipulating that the probability of default of the insurance provider cannot exceed 10 bps. While this deviation is currently not material (no bank using the AMA is using insurance for risk mitigation purposes at present), the assessment team considers that it could become material in the future. The second deviation concerns the possibility for supervisors to allow banks to use risk mitigants other than insurance under the AMA. Under the Basel framework, only insurance is currently allowed.[41] However, so far US banks have not been allowed to use this type of additional risk mitigant, which makes this deviation not material at present. The assessment team also considers that it is unlikely that it will become material in the future.

[41] Footnote 110 of the Basel II framework states that the Basel Committee will continue an ongoing dialogue with the industry on the use of risk mitigants for operational risk and, in due course, may consider revising the criteria for and limits on the recognition of operational risk mitigants on the basis of growing experience.

Supervisory review process

US adoption of the Pillar 2 framework is considered to be compliant with the Basel standards. Rules, Supervision and Regulation Letters, and guidance issued by the US agencies cover a wide range of supervisory review issues. For example, the US rule does not explicitly require banks to have in place and regularly review their CRM policies to control residual credit risk and to take immediate remedial action when needed. However, the assessment team finds high-level principles and requirements in certain related guidance that substantially cover this requirement, and therefore considers the finding as not material.

Disclosure requirements

The US requirements for disclosure requirements are considered to be compliant with the Basel framework. The disclosure requirements for advanced approaches banks that completed the parallel run are mostly consistent with the Basel Pillar 3 requirements, albeit with a few exceptions. First, the disclosure rules do not require banks to disclose quantitative information on investments in insurance entities where banks apply the “alternative approach” instead of the deduction approach. Due to the limited importance of insurance entities for US banks (see also the section on the definition of capital), this deviation has been judged as not material at present. Second, US agencies decided not to adopt certain disclosure templates for capital instruments (ie the main features template and the transitional template), since this information is already available in other public and regulatory filings (eg 10-K, 10-Q) on banks’ websites. This deviation has also been judged as not material.

Further, the team notes that certain disclosure requirements are not applied to core banks that are in parallel run. For example, there is no disclosure of operational risk by core banks in parallel run that report capital ratios based on Basel I until year-end 2014 and based on the new US standardised approach from 1 January 2015. Only those US core banks that have exited parallel run are fully subject to Pillar 3 requirements for advanced approaches banks.

The US agencies did not implement the Pillar 3 disclosure requirements for remuneration, although the US agencies have confirmed that rules are being prepared. The agencies also noted that a number of disclosures relating to remuneration have to be made under SEC rules, specifically Regulation S-K. Since all the banks in the sample are publicly listed companies, they are subject to those disclosures. However, while Regulation S-K mandates a number of requirements that match those mandated by the Basel framework in terms of substance, it has a more limited scope, as it covers remuneration of senior management but does not explicitly include remuneration of other material risk-takers. Nevertheless, the assessment team considered this deviation as unlikely to be material.

2 Detailed assessment findings

The component by component details of the assessment of compliance with the risk-based capital standards of the Basel framework are detailed below. The focus of Sections 2.1 to 2.5 is on findings that were assessed to be deviating from the Basel minimum standards and their materiality. Section 2.6 lists some observations and other findings specific to the implementation practices in the United States.

2.1 Scope of application

Section grade	Compliant
Summary	In the United States, the agencies require "core banks" to adopt the advanced Basel standards. The banking organisations subject to Basel standards account for nearly all of the international exposures held by US banking organisations. This holds for foreign exposures, foreign deposits, foreign liabilities, number of foreign offices and assets under management held in foreign offices.
Basel paragraph no	Basel II paragraph 20
Reference in domestic regulation	Subpart E, section 100, 78 FR 62204
Findings	The Basel framework applies to all "internationally active" banks. The US regulatory agencies require the implementation of the advanced Basel standards for all "core banks". The definition of core banks includes: First, any depository institution (DI) meeting either of the following two criteria: (i) consolidated total assets of USD 250 billion or more; or (ii) consolidated total on-balance sheet foreign exposure of 10 billion or more. Second, any US-chartered BHC meeting any of the following three criteria: (i) consolidated total assets (excluding assets held by an insurance underwriting subsidiary) of USD 250 billion or more; (ii) consolidated total on-balance sheet foreign exposure of USD 10 billion or more; or (iii) having a subsidiary DI that is a core bank or opt-in bank. Finally, any DI that is a subsidiary of a core or opt-in bank is also considered a core bank. Data analysis shows that this definition covers nearly all foreign exposures held by US banks. See also Annex 9.
Materiality	Not material

2.2 Transitional arrangements

Section grade	Compliant
Summary	The Basel framework prescribes a floor based on 80% of the Basel I approach for banks that apply the advanced Basel approaches. The US core banks that have exited parallel run are required to calculate a floor based on 100% of the new US standardised approach.
Basel paragraph no	Basel II paragraph 45–9
Reference in domestic regulation	37628-37629, Sec. 3; 62170-62171, Subpart D, Sec. 10(c); 62208, Subpart E, Sec. 121(d)
Findings	According to the Basel standards, banks using IRB or AMA should calculate a floor based on the minimum capital requirement under Basel I, including certain adjustments for capital deductions and add-ons, and multiply that number by 80% (the level of the floor). The resulting number is compared with the minimum capital requirement under the advanced approach and the difference between the two numbers must be added back into the RWA calculation for the advanced Basel

	approach. The US calculation of the floor for the total capital ratio differs from the Basel calculation. The US approach involves calculating two capital ratios: one based on the proposed US standardised approach (to be effective January 2015) and one based on the US advanced approach. US banks should then report the lower of the two ratios. The US authorities have indicated that the floor based on 100% US standardised approach is generally more conservative than the floor based on 80% of Basel I. The team notes that Basel II paragraph 49 states that "supervisors should have the flexibility to develop appropriate bank-by-bank floors that are consistent with the principles outlined in this paragraph". The prudential floor is meant to provide time to ensure individual implementations of advanced approaches are sound. The US capital floor ensures that advanced approaches banks do not decrease capital requirements relative to standard (non-model) approaches.
Materiality	Not material The assessment team concurs that the US 100% standardised floor will in almost all cases be more conservative than the Basel approach taking into account the enhanced quality and volume of regulatory capital of Basel III relative to Basel I as well as the improved general conservatism of the calculation of RWA. The US floor could only be less conservative for certain extreme and implausible scenarios. The finding is therefore considered not material.

2.3 Pillar 1: minimum capital requirements

2.3.1 Definition of capital

Section grade	Largely compliant
Summary	A number of deviations and interpretation differences between the US rules and the Basel framework have been identified, including for the treatment of defined benefit pension fund assets, general provisions, insurance subsidiaries and the implementation of point of non-viability (PON) criterion for capital instruments. With regard to defined benefit pension fund assets, US rules do not require FDIC-insured banks to deduct defined benefit pension fund assets from CET1 in cases where the FDIC has unrestricted and unfettered access to such an asset when the bank is in resolution. With regard to PON, the US agencies have chosen to implement the Basel PON loss absorbency standards through a statutory approach. The assessment team finds that the US rules do not address capital instruments that are issued under foreign law and are beyond the reach of the US statutory approach. Based on data provided by US agencies, the assessment team considers that the findings are not material at present.
Basel paragraph no	Basel III 52–6
Reference in domestic regulation	Subpart C, section 20(b), 78 FR 62173
Findings	Basel rules contain very specific eligibility criteria for regulatory capital instruments and do not allow for supervisory discretion. US regulatory agencies have discretion over the eligibility criteria of CET1/AT1/Tier 2 instruments. The US agencies have explained that the discretion is an example of reservation of authority, which is a common feature of US rules to allow the agencies to react on a case by case basis to unforeseen circumstances, including emergencies or requirements in newly enacted federal laws. As reported by the US agencies, banking agencies do not often exercise their reservations of authority, and when they do, they generally follow transparent

	procedures and publish their decisions. US administrative law generally requires agency action to be neither arbitrary nor capricious, which in turn requires that an agency's actions be transparent and supportable by evidence in the public record. Paragraph 20(e) of the US rules includes the following constraints on the use of the discretion: • A bank must receive prior approval from the corresponding federal banking agency before including a capital element in its capital, unless it corresponds to an element previously approved in a decision made publicly available. • A federal banking agency must consult with the other federal banking agencies before approving a capital element. • The decision approving a capital element must be made public, stating the reasons for the decision and describing the material terms of the capital instrument involved.
Materiality	Not material Currently the finding is not material. If the US agencies only exercise the discretion as they have explained, the finding is unlikely to become material. The Basel Committee would need to reassess the materiality of the impact as and when this discretion is exercised and publicised by the US agencies.
Basel paragraph no	Basel III paragraph 60
Reference in domestic regulation	Subpart C, section 20(d)(3), 78 FR 62175
Findings	Basel III paragraph 60 permits the inclusion of "General provisions/general loan-loss reserves" in Tier 2 (up to a limit). However, it clarifies that they should not be included where they have been created "in respect of an identified deterioration in the value of any asset or group of subsets of assets" noting that in such cases "they are not freely available to meet unidentified losses which may subsequently arise elsewhere in the portfolio and do not possess an essential characteristic of capital." The US rules do not explicitly prohibit inclusion of general provisions in Tier 2 capital that cover an identified deterioration of particular assets or known liabilities, whether individual or grouped. In the US general provisions are covered by allowances for loan and lease losses (ALLL). According to the preamble of the US rules, ALLL are intended to cover "estimated, incurred losses as of the balance sheet date, rather than unexpected losses", including allowances for particular assets (US GAAP, ASC 310/FAS 114). While the exclusion of allowances for particular assets from general provisions that are eligible to be counted in Tier 2 is not explicitly stipulated, US agencies explained that loans that are determined to be impaired (ie where it is probable that the creditor will be unable to collect all amounts due) are required to be charged off (ie deducted from the allowance). US agencies explained that regardless of whether provisioning is required under US GAAP, ASC 450/FAS 5 (ie general provisions) or ASC 310/FAS 114, the entire ALLL are freely available to cover charge-offs of credit losses on loans and leases regardless of where they fall in the portfolio. This was noted in the agencies' determination after the issuance of FAS 114, that ALLL amounts estimated under FAS 114 were eligible for inclusion as general allowances in Tier 2. US GAAP does not restrict charge-off against the portion of the ALLL created under ASC 310/FAS 114 to only those loans evaluated based upon that standard, thus although a portion of the overall ALLL relates to particular assets, that portion is actually available to cover unidentified losses which may subsequently arise elsewhere in the portfolio. The team is concerned that the US regulatory approach may allow a wider portion of ALLL to be included in Tier 2 capital than is intended under the Basel standards. In particular, where ALLL would not be freely available to meet losses that are presently unidentified, it would not qualify for inclusion in Tier 2 capital. The US agencies explained that the general ALLL represent allowances that are freely available to meet losses that are unidentified, and that any identified losses – amounts deemed uncollectible on specific loans – are required to be charged off under regulatory loss classification rules. The team also considers that the timing of the impairment of the loans and the charge-off (deduction from the allowance) would not necessarily always be the same. If the charge-off occurs after the impairment, Tier 2 capital might be temporarily inflated. The US agencies explained that a timing difference may exist

	between impairment and charge-off, but due to regulatory loss classification rules, it is only temporary, and likely not more than 90 days. The assessment team notes that the Basel Committee has agreed to review the treatment of general provisions across different accounting regimes.
Materiality	Unlikely to be material While the data suggest that for a number of US core banks ALLL form a substantial part of Tier 2 capital, it is noted that the largest component of ALLL is for loans that have not been individually identified as being impaired.
Basel paragraph no	Basel III paragraph 61
Reference in domestic regulation	Subpart B, section 10(c)(3)(ii)(B), 78 FR 62171
Findings	Basel standards prescribe that where the total expected loss amount is less than total eligible provisions, banks may recognise the difference in Tier 2 capital up to a maximum of 0.6% of credit risk-weighted assets, calculated under the IRB approach. A shortfall in eligible provisions must be deducted from CET1 capital. According to US rules the expected loss for fair value assets is set to zero (see IRB findings). This implies that there cannot be a shortfall in eligible provisions for fair value assets under US rules. It may also result in a higher recognition of eligible provisions in Tier 2 compared to Basel standards.
Materiality	The issue is assessed in the IRB section of the report.
Basel paragraph no	Basel III paragraph 62–3
Reference in domestic regulation	Section 2, 78 FR 62160 and section 21(c), 78 FR 62175
Findings	Basel does not include the countercyclical buffer in calculating the amount of the surplus CET1/Tier2/total capital of the subsidiary attributable to the minority shareholders. The US rule includes the countercyclical buffer for the calculation of the surplus which would lead to an increase in the minority interest that would be recognised in regulatory capital compared to the Basel framework. The US agencies explained they consider themselves compliant since they read the Basel text as that the countercyclical buffer is an extension of the conservation buffer and therefore allows inclusion of the countercyclical buffer for the calculation of minority interest.
Materiality	Not material According to data provided by the US agencies the assessment team judges the finding to be not material for the US banks at present (CET1 and Tier 1 minority interest is close to 0% of CET1 and Tier 1 capital respectively).
Basel paragraph no	Basel III paragraphs 69–70, Deferred tax assets
Reference in domestic regulation	Section 22(a)(3), 78 FR 62176; section 22(e), 78 FR 62178
Findings	The Basel standard requires deduction of deferred tax assets that rely on the future profitability of banks. However, DTAs that result from temporary differences may be subject to threshold deductions. The US rule allows risk weighting (100%) of DTAs that result from temporary differences and that could be realised through net operating loss carrybacks. According to the US agencies, these DTAs do not rely on the future profitability of banks but rather on past profitability of banks. The assessment team considers that the US rules do not explicitly require the deduction of DTAs that rely on future profitability. From discussions with the US authorities, the team understands that DTAs that could be realised through operating loss carrybacks do not rely on the future profitability of the banks.
Materiality	The team acknowledges that the Basel framework does not explicitly specify the treatment of DTAs that can be recovered through net operational loss carrybacks. In addition, the team notes that the Basel Committee is considering providing more

	clarity around the treatment of these DTAs.
Basel paragraph no	Basel III paragraphs 76–7
Reference in domestic regulation	Section 22(a)(5), 78 FR 62176; section 22(e), 78 FR 62178
Findings	The Basel standards requires deduction of defined benefit pension fund assets from CET1, unless the bank has unrestricted and unfettered access to the assets, in which case the assets may be risk-weighted as if they were owned directly by the bank. The US rule allows FDIC insured banks to risk weight defined benefit pension fund assets, without the condition that the bank must have unrestricted and unfettered access to the assets. US agencies explained that the FDIC has unfettered access to such assets in the event of a resolution of an insured depository institution. Under the FDI Act, when the FDIC is appointed as a receiver of a failed institution, it succeeds to all rights of the institution (12 USC 1821(d)(2)(A)), including the institution's right to a reversion upon termination of the pension plan. US agencies also explained that their treatment is aligned with the spirit of Basel text by referring to Paragraph 77. Paragraph 77 states that the deduction approach for defined benefit pension fund assets is to address concerns that "pension funds may not be capable of being withdrawn and used for the protection of depositors and other creditors of the bank". US agencies further clarified that the deduction of the pension fund assets is required at bank holding company level (section 22(a)(5)(i)) and all core banks have bank holding companies at the time of the assessment. The team considers that for bank holding companies the US rule is compliant with the Basel standard. At the same time, the team considers that the US treatment does not necessarily prevent FDIC-insured banks from including defined benefit pension fund assets in CET1 capital to which the bank would not have unrestricted and unfettered access.
Materiality	Not material The US agencies have indicated that the vast majority of the pension fund assets are held at the holding company level and are fully deducted. Taking into account that the bank holding companies are the highest level of consolidation for US core banks, the impact on the CET1 capital ratio for FDIC-insured core banks is considered limited. The assessment team therefore considers the deviation as not material. The team listed it as an item for future follow-up assessments (Annex 12).
Basel paragraph no	Basel III paragraphs 84–6, Basel II paragraph 30
Reference in domestic regulation	Definition of "significant investment in the capital of an unconsolidated financial institution" in section 2, 78 FR 62168; see section 22(c)(5), 78 FR 62177-8; see Subpart C, sections 22(d)(1)(iii) and 22(d)(2), 78 FR 62178; see section 22(c)(2), 78 FR 62177; and see section 22(f), 78 FR 62179
Findings	Basel permits banks to consolidate significant investments in insurance entities as an alternative to the deduction approach on the condition that the method of consolidation results is at least as conservative as that which would apply under the deduction approach (FAQ 14, issued in December 2011). The US capital treatment of insurance subsidiaries (consolidation of insurance subsidiary's assets and liabilities and deduction of its minimum capital requirement) does not require that it is at least as conservative as the Basel deduction approach and could therefore result in a potential overstatement of bank capital ratios. US agencies are of the view that the Basel framework on insurance subsidiaries does not apply to the case where a bank has consolidated subsidiary since Basel III paragraphs (84-86) deal with significant investments in "unconsolidated" financial and insurance entities. However, the assessment team understands that the intention of the Basel framework is to apply deduction approach also to the case where bank has consolidated insurance subsidiary since the risk related to insurance entity has different characteristic relative to those for banks as was noted in the Basel II (paragraph 30). FAQ 14 on the Basel III paragraphs on the insurance subsidiary states that jurisdiction can apply alternative approach to deduction approach only in the case where the alternative approach results in more conservative outcome than deduction approach. The team acknowledges that the FAQ applies also to "fully

	owned insurance subsidiaries that are consolidated for regulatory capital purposes." as is stated in the FAQs.
Materiality	Potentially material The US agencies have provided data that show that the capital requirements of insurance subsidiaries are at present not material for the largest US banks (eg the weighted average of net assets of insurance subsidiaries accounts for less than 0.3% of the banks' RWA. Hence the assessment team judges the deviation is not material at present. However, the team views this issue could become material if a US core bank were to acquire a large insurance company as has happened in the past and has listed it for a future follow-up assessment (Annex 12).
Basel paragraph no	Minimum requirements to ensure loss absorbency at the point of non-viability (PON) - paragraphs 6
Reference in domestic regulation	
Findings	Basel III (press release 13 January 2011) stipulates the inclusion of PON (point of non-viability) clauses is required for certain capital instruments to be eligible for AT1 or Tier 2, unless the governing jurisdiction of the bank has in place laws that (i) require such Tier 1 and Tier 2 instruments to be written off upon such event, or (ii) otherwise require such instruments to fully absorb losses before tax payers are exposed to loss (the statutory approach). The US has adopted the statutory approach. The FDIC is given the authority to place failing financial institutions that pose a significant risk to the financial stability of the US into receivership, and require capital instruments issued by failing banks to be written off or otherwise fully absorb losses before taxpayers are exposed to loss (Title II, section 210 of the Dodd-Frank Act). The US rules however do not address the treatment of capital instruments that are issued by US banks under foreign law. The assessment team considers that capital instruments issued by US banks under foreign law (either directly or via foreign branches or subsidiaries) do not allow the US authorities to trigger these instruments without contractual arrangements. The team finds the US rules do not contain provisions that would prevent US banks from including capital instruments issued under foreign law without clauses that would provide US authorities the right to write off these instruments. US agencies are of the view that this does not apply to jurisdiction which adopts statutory approach. However, the assessment team believes that spirit of the Basel framework is to ensure legal enforceability of the contractual approach so as the loss absorbing capacity in gone concern cases. The team believes this holds true also for statutory approach. The assessment team understands that one of the purposes of the PON press release is to ensure loss absorbing capacity of the foreign subsidiary under the gone-concern scenario in the case where capital instruments issued by the subsidiary to be included in the consolidated capital. In this regard, FAQ 4 on PON (issued in December 2011) clarifies that the relevant authority in jurisdiction of the consolidated supervisor must have the power to trigger writedown/conversion of the instrument in addition to the relevant authority in the jurisdiction of the foreign subsidiary. The team also notes that the PON press releases states that the Committee's objective could be met through a statutory approach "if it produces equivalent outcomes to the contractual approach." Taking into account the uncertainty of the legal enforceability of the statutory approach outside the home jurisdiction, the team is of the view that the requirement also applies to banks in jurisdiction which adopts statutory approach. The Basel Committee may wish to further clarify the scope of the PON press release for jurisdictions that adopt the statutory approach (including the applicability of the contractual terms related to PON to foreign subsidiaries of banking organisations under jurisdictions that opted for the PON statutory approach).
Materiality	Not material Since the funding by US core banks is principally conducted in the United States, the assessment team understands the significance of the funding via foreign subsidiaries is limited. Based information received from US agencies and on data for minority interest, the assessment team judges this finding to be not material at present.

2.3.2 Capital buffers (conservation and countercyclical)

Section grade	Compliant
Summary	No material deviations from the Basel framework are identified.

2.3.3 Credit risk: Standardised Approach

Section grade	Largely compliant
Summary	Basel defines eligible financial collateral to be debt securities with a minimum rating of BBB- or equivalent, as determined by a recognised external credit assessment institution (ECAI), or unrated debt securities issued by a bank. The US rule, however, uses self-defined "investment grade" as threshold instead of referencing external credit ratings. The possibility may arise that US banks use certain financial collateral that does not meet the Basel standards, such as unrated securities issued by non-banks or non-eligible unrated bank securities. Also, the US regulation assigns supervisory haircuts for collaterals based on the OECD's country risk classification (CRC) instead of external credit ratings under the Basel approach, and in particular, assigns a 0% risk weight for sovereign exposures to OECD members with no CRC scores irrespective of their external credit ratings. This leaves open the possibility of a less conservative CRM treatment than Basel standards.
Basel paragraph no	Basel II paragraphs 53–6
Reference in domestic regulation	78 FR 62180 Section 32 (a)
Findings	Under the Basel standards a zero risk weight only applies to claims on sovereigns that have a credit rating of AAA to AA– or OECD ECA risk scores of 0–1, or to domestic sovereign exposures denominated and funded in domestic currency. The US assigns a 0% risk weight for exposures to the US sovereign irrespective of its ECA risk score (or external credit rating) or the denomination and funding of the claims. For non-US sovereign exposures, the US rule assigns risk weights based on OECD membership status and the Arrangement on Officially Supported Export Credits, which has, however, terminated the Category Zero classification of High Income OECD and High Income Euro Area countries and subjected them to market credit risk pricing. However, in the US rule (78 FR 62180 Section 32(a) (2) and Table 1), some OECD members that are no longer assigned an ECA/CRC score of 0–1 still receive a risk weight of 0%.
Materiality	Not material The US agencies have provided a comparison of the US capital requirements with those under a ratings-based approach for sovereign exposures. The comparison of Basel Committee jurisdictions suggests that while the US rule is more conservative than the Basel RBA for a few countries, the risk weights of claims on sovereign for some countries are less conservative under the US rule. Further information/data provided by the US agencies suggest that virtually all US sovereign debt held by US banks is denominated in US dollars. The team further considers a US downgrade (particularly below AA-) as unlikely over the assessment horizon of three to five years. The current US sovereign rating is AAA (Fitch), Aaa (Moody's) and AA+ (S&P).
Basel paragraph no	Basel II paragraphs 57–8
Reference in domestic regulation	78 FR 62180 Section 32 (c) and (e)
Findings	Basel standards specify risk weights for exposures to public sector enterprises (PSEs) according to external ratings either for one-category-less-favourable-than-sovereign (option 1) or banks (option 2).

	The US rules apply fixed risk weights (20% for GSEs non-equity exposures, 20% for general obligation, 50% for revenue obligation) irrespective of the US sovereign credit rating. To foreign PSEs, the US rules assign risk weights based on (i) the CRC scores assigned to the PSE's home country, and (ii) whether the exposure is a general or a revenue obligation. But the risk weights for OECD members which no longer receive CRC scores are fixed at 20% for general obligation and 50% for revenue obligation, irrespective of their sovereign credit ratings.
Materiality	Not material Judged by the discussion with and information/data provided by the US agencies and based on the analysis that a US downgrade (particularly below AA-) is unlikely over a three to five year horizon, this deviation is assessed to be not material.
Basel paragraph no	Basel II paragraph 59
Reference in domestic regulation	78 FR 62180 Section 32 (b)
Findings	The Basel standards assign risk weights to exposures to multilateral development banks (MDBs) based on their credit assessment and allows a 0% risk weight if certain eligibility criteria are met. The US rule applies a 0% risk weight to MDBs in a manner largely consistent with the Basel standards, but adds “and any other multilateral lending institution or regional development bank in which the US government is a shareholder or contributing member or which the primary Federal supervisor determines poses comparable credit risk”.
Materiality	Not material The US agencies did not provide a list of the “any other” MDBs, but, based on the discussions and information received, the team understands that a 0% risk weight is assigned only if the US agencies determine that a multilateral lending institution or regional development bank exhibits the high credit quality of the MDBs, strong shareholder support and a shareholder structure comprised of a significant proportion of sovereign entities with strong creditworthiness. In the team’s view, this substantially covers the Basel eligibility criteria.
Basel paragraph no	Basel II paragraphs 60–4
Reference in domestic regulation	78 FR 62180 Section 32 (d)
Findings	The Basel standards derive the risk weight of claims on a bank from either the credit rating (score) of its sovereign of incorporation (option 1) or the external credit rating of the bank itself (option 2). If unrated, the risk weight will be 100% under option 1 or 50% (20% for short-term claims) under option 2. The US approach adopts option 1 for bank exposures. To claims on US banks, the US rule assigns a fixed risk weight of 20%, irrespective of the currency in which the exposures are denominated or funded. To exposures to non-US banks, the US rule assigns risk weights according to the OECD CRC scores; however, a 20% risk weight still applies when the home country of the non-US bank is an OECD member that receives no CRC score.
Materiality	Not material Based on the comparison of the US rule with those under a ratings-based approach for sovereign exposures and the data of claims on banks from selected foreign countries provided by the US agencies, this deviation is judged as not material.
Basel paragraph no	Basel II paragraphs 79–80
Reference in domestic regulation	78 FR 62180 Section 32 (a),(c)(e)(f);62086 Preamble VIII B.4
Findings	The Basel standards specify that certain higher risk claims, such as corporate exposures rated below BB–, claims on securities firms rated below B– and other higher risky assets (eg venture capital and private equity investments), are risk-weighted at 150% or higher.

	Under the US standardised approach, all corporate exposures (which include exposures to securities firms and any other exposure categories that are not otherwise defined in the rule) receive a flat risk weight of 100% regardless of their external rating. In addition, the guidance issued by the US agencies[42] outlines the kind of debt securities that may be purchased by US banking organisations, and effectively prohibits the purchase of securities that are deemed to be below investment grade. Corporate debt rated below BB– can only be held by a bank if it has been downgraded while on the bank's books. Therefore, most corporate debt held by banks is either unrated or rated investment grade (and therefore would be subject to a risk weight of no higher than 100%).
Materiality	Judged by the above, the finding is considered not material.
Basel paragraph no	Basel II paragraphs 115(i), 114 and 116
Reference in domestic regulation	78 FR 62215, Subpart E, Sec. 132; 62229, Subpart E, Sec. 134; 62162, 62164, 62167, 62166, Subpart A, Sec. 2 (definitions); 62169, Subpart A, Sec. 3 (operational requirements for CCR)
Findings	For Basel II para 115(i), there is no explicit language in US rules or guidance that describes "the surrender of rights on collateral posted to counterparties". For Basel II para 114, Section 131(d)(5) and (6) that are referenced in US rule apply to the advanced IRB approach but not to the foundation IRB or Standardised Approach. According to the US agencies, avoiding the effect of CRM double-counting (still recognising CRM's effect while it has been reflected in an issuer-specific rating) is a supervisory practice already in place under the securitisation framework. For Basel II para 116, it is not explicitly stipulated in US rules that the Pillar 3 disclosure requirement serves as a pre-condition for banks to obtain capital relief in respect of any CRM techniques.
Materiality	Not material
Basel paragraph no	Basel II paragraph 145
Reference in domestic regulation	78 FR 62164, Sec. 2; 62215, Sec. 132
Findings	In the US rules page 62165, investment grade is defined as having "adequate capacity to meet financial commitments for the projected life of the asset or exposure" and "adequate capacity to meet financial commitments if the risk of its default is low and the full and timely repayment of principal and interest is expected". While the US rule does not refer to external ratings when defining investment grade collateral, US banks are advised to consider external ratings, among other factors – including market data such as credit default swap spreads, financial information published by the issuer of the debt instrument, external credit assessments other than credit ratings and internal analysis – to determine whether collateral is of investment grade quality. Hence, an investment grade credit rating for a particular debt security does not necessarily mean that the bank can recognise the security as collateral for credit risk mitigation purposes under the US rule. However, there remains the possibility that US banks use certain collateral that do not meet the Basel II para 145 requirements, such as unrated securities issued by non-bank firms or non-eligible unrated bank securities. Also, it includes money market fund shares and other mutual fund shares whose price is publicly quoted daily, but does not require the shares being limited to investing in the instruments listed in this paragraph.
Materiality	Potentially material The data provided by the US agencies suggest that the impact of the deviation on RWA and the capital ratio is limited for the time being. However, the assessment team considers that the US approach opens the opportunity of expanding the scope of

42 www.occ.gov/news-issuances/bulletins/2012/bulletin-2012-18.html.

	eligible collateral in a less conservative way than the Basel standards, and does not exclude the possibility for the US banks to use certain collateral that does not meet the Basel requirements.
Basel paragraph no	Basel II paragraph 151, Basel III paragraph 111
Reference in domestic regulation	78 FR 62189, Sec. 37
Findings	Basel II para 151(as amended by Basel III para 111) assigns standardised supervisory haircuts according to external credit ratings. In the US rules, however, the Table 1 to Section 37 on page 62189 assigns haircuts based on risk weights derived from OECD CRC scores. While, in some cases, the standard supervisory haircuts in the US rule are more conservative than those contained in the Basel text, such as for investment-grade corporate issuers, for sovereign issuers the haircuts of collaterals can be underestimated because OECD members with no CRC scores are constantly risk-weighted 0% irrespective their external credit ratings. For non-sovereign issuers, there also remains the possibility of underestimating of haircuts and recognising non-eligible collateral. The US agencies have provided a comparison of the US capital requirements with those under a ratings-based approach for sovereign exposures. The comparison suggests that there are a few BCBS jurisdictions where the US rule is more conservative than the Basel RBA, but highlights two countries where the capital requirement is less conservative under the US rule.
Materiality	Potentially material The information and data provided by the US agencies suggest the US approach does not materially deviate from the Basel standards at present. However, the team considers that it does not exclude the possibility that if external credit ratings were to deteriorate, the difference in outcomes with the Basel approach could result in less conservative CRM treatment and become potentially material.
Basel paragraph no	Basel II paragraph 168
Reference in domestic regulation	78 FR 62183 Sec. 34(b)(2), 62188 Sec.37(c)
Findings	Basel II requires banks to scale up the minimum haircut numbers if the frequency of remargining or revaluation is longer than the minimum. The US rule does not have a clear reference to the up-scaling requirements of haircuts for derivative contracts under the standardised approach. Given that the US rule does not permit US banks to recognise the credit risk mitigation benefits of financial collateral if the contracts are not revaluated daily or subject to a daily margin maintenance requirement, this deviation is regarded as not material.
Materiality	Not material
Basel paragraph no	Basel II paragraphs 195, 197; Basel III paragraphs 120–4, 90
Reference in domestic regulation	78 FR 62162-62167, Subpart A, Sec. 2; 62169, Subpart A, Sec. 3; 62204, Subpart E, Sec. 101; 62229, Subpart E, Sec. 134 and 135
Findings	For Basel II 195 (as amended by Basel III para 120–4) on eligible guarantors, while the US is prohibited by law from using credit ratings, “other entities” that provide credit protection to a securitisation exposure can only be regarded as eligible guarantors when they have issued and outstanding “investment grade” unsecured debt securities without credit enhancement (see page 62162). However, there is possibility that the "investment grade" criteria may expand the scope of eligible guarantors beyond the Basel II approach (ie BBB– or better and A– or better at the time the credit protection was provided). For Basel II 197 (as amended by Basel III para 90), the US rule lacks the language that the “materiality threshold” is agreed in a guarantee contract, below which there is no payment obligation but exceeding which the guarantor must pay in full. According to Basel II and III, this threshold is treated as a retained first loss position (in securitisation exposure) and is subject to a 1250% risk weight. Discussion with US agencies and banks suggests it is not common business practice in the US for agreeing to the “materiality threshold”.

Materiality	Not material
Basel paragraph no	Basel II paragraph 206
Reference in domestic regulation	78 FR 62229, Sec. 134; 62230, Sec. 135; 62234, Sec. 142 (l)-(m)
Findings	Basel II paragraph 206 specifies the treatment of pools of CRM techniques: where a bank has multiple CRM techniques (eg collateral and a guarantee) covering a single exposure, the bank should subdivide the exposure into portions covered by each type of CRM technique. The US rule does not explicitly describe this requirement and related others in this paragraph.
Materiality	Not material

2.3.4 Credit risk: Internal Ratings-Based approach

Grade	Largely compliant
Summary	The team identified four areas of non-conformance with the Basel standards: (i) reliance on accounting valuation; (ii) specific IRB minimum requirements; (iii) capital requirements for certain types of exposures; and (iv) recourse to Standardised Approach parameters.
Basel paragraph no	Basel II paragraphs 308, 309, 334, 335, 376, 380–3, 384, 385, 452, 471, 474
Reference in domestic regulation	78 FR 62205 and 62206, Sec. 101(b); 78 FR 62163, Sec. 2; 78 FR 62162, Sec. 2; 78 FR 62176, Sec. 22(a)(6); 78 FR 62171, Sec. 10(3)(ii)(B); 78 FR 62215, Sec. 131(e)(4); 78 FR 62162, Sec. 2; 78 FR 62162 and 62163, Sec. 2; 78 FR 62206, Sec. 101(b); 78 FR 62171, Sec. 10(3)(ii)(B); 78 FR 62176, Sec. 22(a)(6); 78 FR 62162, Sec. 2; 78 FR 62205, Sec. 101(b); 78 FR 62205, Sec. 101(b)
Findings	*Reliance on accounting valuation* The US rules rely on accounting valuation beyond what is allowed under Basel standards. This can lead to: (a) delayed recognition or even non-recognition of default events for retail exposures, resulting in lower total expected loss (EL) and RWA where a default event is not (yet) recognised; (b) lower EAD for exposures with credit risk-related CET1 reductions (including fair value reductions) or discounts. The lower EAD reduces both RWA and EL amounts for non-defaulted and defaulted exposures, and also allows recognition of accounting-based CET1 reductions for credit risk where these exceed total EL amounts, which is not allowed by Basel standards for the CET1 and Tier 1 capital ratio, and only up to 0.6% of RWA as Tier 2 capital for the total capital ratio; (c) lower EL amounts for non-defaulted fair-valued exposures where fair value reductions do not exceed PD*LGD. The EL will also be lower for defaulted exposures where accounting-based loss assumptions do not consider all economic loss contributions. Further, the US approach may result in higher recognition of general allowances as eligible provisions because the portion related to Standardised Approach risk weights is not included. All this can result in lower CET1 capital deductions for EL or excessive recognition of accounting-based CET1 reductions as Tier 2 capital. (a) The Basel definition of default is based on unlikeliness to pay credit obligations in full, without recourse by the bank to actions such as realising security (if held), supplemented by a (backstop) criterion triggered when the exposure is past due for 90 (or up to 180) days [# 452, 453]. The US definition is generally consistent, except for retail exposures. For retail exposures, the US definition ignores default events (by Basel standards) for retail exposures as long as losses are not (yet) assumed or recognised under US GAAP, in case of fair-valued exposure even where fair value reductions for credit risk losses are not (yet) material. Assuming no loss can, in particular, occur where US GAAP allows/requires assumptions on the effect of recourse by the bank to actions such as realising security (if held). Also, a material postponement of principal, interest or fees, or a charge-off,

	writedown limited to interest or fees would not trigger a default under US rules which solely refer to charge-off, writedown of principal. In such cases, a default would not be triggered under US rules until the exposure is past due for more than 120 or, in case of residential mortgage exposure or revolving exposure, 180 days. Since PD remains lower than 100%, total required capital for EL and RWA can be lower than by Basel standards where LGD above zero indicates that losses cannot yet be finally excluded. In addition, as the US definition may result in fewer recorded default events, there may be a tendency for lower PD estimates for non-defaulted exposures. This is also not always compensated by a corresponding tendency for higher LGDs, because default events (by Basel standards) for which losses appear not yet certain enough for a full or partial charge-off, writedown of principal or material negative fair value adjustment under accounting standards will not necessarily also finally end up with no losses at all. Unlike accounting standards, the IRB approach requires a forward-looking risk assessment that also considers the possibility of future, presently unidentified losses. The US authorities have explained that the case of assuming no loss under accounting standards should be limited to mortgages and to some other collateralised loans, in particular auto loans, whereas other retail exposures are typically uncollateralised. The assessment team notes, however, that even for uncollateralised exposures, accounting standards usually assume only those losses that appear already sufficiently certain and might therefore not be as forward looking as the unlikeliness-to-pay criterion in the IRB definition of default, and beyond this does not prevent from ignoring other indications of unlikeliness to pay such as a material postponement. (b) With regard to the EAD, the Basel standard requires an EAD estimate gross of specific provisions, partial write-offs and discounts for corporates, sovereign, banks and retail exposures [#308, #334]. The US regulations limit EAD for on-balance sheet exposures to the net accounting value (additionally less allocated transfer risk reserves in case of transfer risk). This has two effects: • RWA and EL amounts can be lower, because of lower EAD, compared to Basel standards for (i) fair valued exposures for which fair value is reduced for increased credit risk, (ii) exposures for which losses are already assumed or recognised by accounting standards, (iii) transfer risk-related exposures to which transfer risk provisions are assigned, (iv) exposures with a discount; and (v) where US accounting standards recognise netting agreements beyond Basel standards. • The Basel standards limit recognition of credit risk related accounting reductions to CET1 capital at portfolio level to total EL amounts and do not recognise excess accounting reductions for the CET 1 and Tier 1 capital ratio, but only up to 0.6% of RWA as Tier 2 capital. In contrast, the US rules do fully recognise such excess accounting reductions via an EAD that is net of all accounting reductions to CET1 capital. This effectively treats excess accounting reductions as if this is like covering a portion of the RWA, ie the US rules treat excess accounting reductions like being added back to CET1 capital. This allows full recognition of excess accounting reductions for all three capital ratios whereas Basel standards limit recognition of such excess accounting reductions to 0.6% of RWA as Tier 2 capital and do not allow any recognition for the CET1 and Tier 1 capital ratio. (c) The determination of deductions for expected loss deviates from Basel standards in three aspects: • For non-defaulted exposures, the US rules determine IRB risk weights for unexpected loss correctly by subtracting the PD*LGD figure for expected loss as in the Basel risk weight function. However, unlike the Basel Framework, US rules do not consistently determine EL for fair-valued exposures by this PD*LGD figure. Instead, EL is set to zero. As a consequence, coverage of expected loss is limited to the extent of fair value reductions under US GAAP. Where total fair value reductions are less than total EL amounts determined by PD*LGD for fair-valued exposures, the US implementation creates a gap in coverage of credit risk compared to Basel standards. This gap is equal to the total positive differences

	between PD*LGD*EAD and the fair value reduction. The US authorities have explained that securities held at available for sale must be at least investment grade such that the EL component should be rather small compared to RWA. This should result in an immaterial impact of not deducting EL for fair valued exposures. While the assessment team can understand this logic, it notes that for other fair valued exposures the EL component might be relatively larger compared to RWA, in particular for fair valued loans in the banking book and for counterparty credit risk exposures constituted by fair valued derivatives both in the banking and in the trading book. Data provided suggest that currently fair value reductions of most US banks significantly exceed EL amounts for fair valued exposures. This results for 5 of the 13 banks in the sample in a significantly more conservative US capital ratios compared to Basel standards while for the other 8 banks the US capital ratios are less conservative than under Basel standards but without being materially less conservative. The assessment team concludes that the potential overestimation of capital ratios by the US treatment of fair valued exposures is currently not material because of relatively high fair value reductions. However, the deviation is considered as potentially material because it is impossible to exclude that fair value reductions significantly shrink within the next three to five years. Fair value adjustments consider factors other than changes in creditworthiness, such as changes in interest rates and liquidity. Given the number of variables that contribute to the difference between fair value and amortised cost, including changes in the composition of fair value exposures that a bank holds which are subject to change for various reasons, there is no way to substantiate whether the differences will hold/grow/shrink over the next three to five years. • For defaulted exposures, US rules base EL amounts on impairment estimates for allowance purposes under US GAAP. This can create a gap dependent on the extent that certain work out costs, material discount effects or other contributions to economic loss are not considered as required for the "best estimate of expected loss" under Basel standards [#471, #460]. • Basel standards require attributing general provisions to the standardised or IRB treatment of provisions generally on a pro-rata basis according to the proportion of credit risk-weighted assets subject to the standardised and IRB approaches. [#380-383]. The US rules recognise all general allowances regardless of whether they refer to exposures belonging to standardised approach or IRB portfolios. While the US authorities have explained that they do not apply the standardised approach to core banks, the assessment team is of the view that elements of the Basel standardised approach have been implemented in the IRB framework such that credit risk-weighted assets for these exposures are effectively determined based on the Standardised Approach.
Materiality	The overall effect of these deviations is that CET1 and Tier 1 capital ratios of US banks may be higher than when applying Basel standards. The same applies to total capital ratios, except in those specific cases where total fair value reductions together with total other eligible provisions exceed total EL amounts (determined by Basel standards) to an extent that the effect of not increasing Tier 2 capital in the numerator of the US ratio by excess fair value reductions is stronger than the effect of reducing EAD in the denominator of the US ratio. Since the over-reliance on accounting valuation can result in lower capital requirements for expected and unexpected losses related to credit risk and in lower deductions from CET1 capital, this deviation is considered potentially material.
Basel paragraph no	Basel II paragraphs 285, 306, 320, 332, 397, 398–9, 403, 405, 406, 407, 409, 410, 414–16, 417, 418–21, 422, 423, 424, 425, 428, 429–33, 434–7, 440, 441–2, 443, 444, 445, 449,458, 459, 462, 464, 467, 470, 471, 474, 475, 477, 478, 481, 482, 485–6, 489, 491–9, 504, 528, 534, 536
Reference in domestic regulation	78 FR 62229, Sec. 134(c); 78 FR 62205, Sec. 101(b); 78 FR 62206, Sec. 101(b); 78 FR 62209, Sec. 122(b)(2)(ii); 78 FR 62209, Sec. 122(b)(3); 78 FR 62209, Sec. 122(b)(1); 78 FR 62209, Sec. 122(b)(2)(i); 78 FR 62209, Sec. 122(b)(4); 78 FR 62209, Sec. 122(b)(2)(i); 78 FR 62209, Sec. 122(b)(2)(ii); 78 FR 62209, Sec. 122(b)(3); 78 FR 62209, Sec. 122(b)(1); 78 FR 62209, Sec. 122(a)(3); 78 FR 62209, Sec. 122(c)(9) and (10); 78 FR 62209, Sec.

	122(b)(2)(i); 78 FR 62209, Sec. 122(b)(5); 78 FR 62209, Sec. 122(b)(5); 78 FR 62209, Sec. 122(b)(5); 78 FR 62209, Sec. 122(b)(1); 78 FR 62210, Sec. 122(h); 78 FR 622111, Sec. 122(i)(6); 78 FR 62210, Sec. 122(i)(3) and (4); 78 FR 122(i)(5); 78 FR 62208, Sec. 122(a)(2); 78 FR 62209, Sec. 122(c)(2), 78 FR 62212, Sec. 101(b);; 78 FR 62209, Sec. 122(c)(2), (6), (9) and (10); 78 FR 62208, Sec. 122(a)(3); 78 FR 62209, Sec. 122(c)(1) and (7); 78 FR 62209, Sec. 122(e)(10); 78 FR 62210, Sec. 122(h); 78 FR 62205, Sec. 101(b); 78 FR 62209, Sec. 122(c)(2) and (3); 78 FR 62209, Sec. 122(c)(6); 78 FR 62207, Sec. 101(b); 78 FR 62209, Sec. 122(c)(6); 78 FR 62144; 78 FR 62163, Sec. 2; 78 FR 62206, Sec. 101(b); 78 FR 62215, Sec. 131(e)(2); 78 FR 62209, Sec. 122(c)(6); 78 FR 62206, Sec. 101(b); 78 FR 62159, Sec. 2; 78 FR 62206, Sec. 101(b); 78 FR 62209, Sec. 122(c)(6); 78 FR, 62215, Sec. 122(b)(2)(i); 78 FR, 62212, Sec. 131(d)(5)(i) and (ii); 78 FR, 62212, Sec. 131(d)(5)(ii); 78 FR, 62229, Sec. 134(c)(1)(i); 78 FR, 62229, Sec. 134(c)(2)(i)(A); 78 FR 62230, Sec. 134(e); 78 FR 62212, Sec. 131(c)(2) and (3), (d)(1)(iv) and (d)(4); 78 FR 62209, Sec.122(c)(9); 78 FR 62208, Sec. 101(b); 78 FR 62210, Sec. 122(i)(3); 78 FR 62209, Sec.122(c)(9); 72 FR 69321 Part III section 7 - Stress Testing; 72 FR 69313, Part III; 72 FR 69312; 72 FR 69312; 72 FR 69337-69338; 72 FR 69312; 78 FR 62209, Sec. 122(c)(2); 78 FR 62209, Sec. 122(c)(9); 72 FR 69312 SR Letter 11-7 (April 2011); SR Letter 11-7 (April 2011), Part VI; SR Letter 11-7 (April 2011), Part VI; SR 00-8 (SUP);
Findings	*Non-inclusion of IRB minimum requirements in regulation* The US regulations set targets for rating systems, rating assignments and risk parameter estimates that are consistent with the overarching principle behind the IRB minimum requirements in the Basel framework. This includes being accurate, reliable, consistent and appropriately conservative; data must be relevant, processes and systems must be consistent with internal use, etc. These targets are supplemented by more specific requirements in the rules text itself, in the preambles to the final rules and the previous 2007 rules and in other published documents such as supervisory recommendation letters that implement many of the specific IRB minimum requirements in a binding manner. The US regulations do not, however, specify certain of these targets in the full depth required by Basel standards. A number of specific minimum requirements of the Basel IRB framework are missing. The US authorities have taken the position that while these detailed requirements are not explicitly articulated in the US rule text, implementation of the specific provisions of the Basel framework is achieved through robust supervisory oversight, and note that US supervisors ask for much more than what is reflected in the rule text alone. They have also referred to studies by the Basel Committee which suggest that RWA for low-default portfolios are more conservative than in other jurisdictions. In the view of the team, if a bank is not required to demonstrate to its supervisor that these specific requirements are met, the bank (and its supervisor) might not become aware of certain weaknesses in systems or processes and might therefore erroneously assume that the targets for the IRB approach are achieved. While some of these misperceptions might be corrected afterwards through model backtesting when default rates or losses turn out to be higher than estimated, the Basel approach avoids this from the outset by a detailed set of specific minimum requirements. Moreover, insufficient specification can hamper the level playing field which requires consistency and comparability of RWA and expected loss amounts not only for a particular bank but across banks within a jurisdiction and across jurisdictions. In their response to the assessment, the US agencies issued a proposed rule that incorporates and clarifies a number of IRB minimum requirements. In addition, the US agencies intend to issue the work programmes that clarify a number of the IRB minimum requirements currently required by the US agencies. The proposed addresses those missing minimum requirements that the US agencies identified as most relevant to US markets and banks. In particular, the requirements provide more clarity regarding the information, data, and systems that must be used by banking organisations to estimate IRB risk parameters (Annex 6).
Materiality	The assessment team welcomes the rectifications, which further align the US final rule with the Basel standards. A number of missing IRB minimum requirements, however, remain which are considered of a less material nature. The team recommends re-assessing the materiality of the remaining missing minimum requirements through a

	future RCAP follow-up assessment and through the post-RCAP monitoring.
Basel paragraph no	Basel II paragraphs 285, 228, 229, 231, 232, 234, 236–8, 239–40, 243, 307(ii)(b), 331, 333, 338, 364, 365, 367, 368, 369–70, 371, 373–373(i), 493–9, 523, 524
Reference in domestic regulation	–
Findings	*Capital requirements for certain types of exposures* The US implementation of IRB minimum capital requirements deviates for certain exposures in the following aspects from Basel standards (Basel paragraphs in squared brackets). This may, under specific circumstances, result in lower IRB capital requirements. • Extended scope of *waiver for PD floor* of 0.03% [#285, 331, 229]: not limited to MDBs eligible for 0% standardised risk weight [#59] and domestic/foreign PSEs eligible for standardised treatment like sovereign [#58] but applied to: (i) all multilateral lending institutions and regional development banks in which the US government is a shareholder or contributing member, the US authorities have explained that currently this does not relate to any entity beyond the MDBs recognised by Basel II, paragraph 59, thus this is currently not material; (ii) any exposure "directly and unconditionally backed by the full faith and credit of a sovereign" without limiting this to domestic PSEs treated like the US sovereign under the standardised approach and to PSEs treated in other jurisdictions like the sovereign; while the US rules text does not explicitly require to ensure timely payment, the US authorities have explained that this is always understood as ensuring the timely payment of obligations; also, the US authorities have explained that they always decide recognition dependent on the treatment in the other jurisdiction; the assessment team notes, however, that the US rules do not require a decision by the supervisor for this treatment; and (iii) to any exposure directly and unconditionally guaranteed by eligible entities without requiring the other conditions required by Basel II. paragraph 484 for eligibility of the guarantee. • Extended scope of *double default recognition* [#307(ii)(b)]: not limited to guarantors externally rated A- (ie above investment grade) at least once but applied to all guarantors with at least investment grade. While US authorities have explained that domestic legal rules prevent from referring to external ratings, this does not explain why no comparable distinction between investment grade and the same level above investment grade has been implemented that is required by Basel standards to be met at least once, and more generally, why the preferential double default recognition is at all applied although the conditions for this treatment under Basel standards are legally not allowed to be applied in the USA; the US authorities have explained that currently no bank is using double default recognition. • *Commercial real estate exposures in other jurisdictions*: no mandatory classification as high-volatility commercial real estate (HVCRE) where classified as such in a foreign jurisdiction [#228]. The US authorities have explained that US banking organisations operating in foreign jurisdictions must also comply with capital requirements in that foreign jurisdiction. The assessment team notes, however, that capital allocated at a subsidiary for covering additional capital requirements in a foreign jurisdiction at individual level is not deducted from capital at consolidated level. Hence, the capital amount that exceeds lower US capital requirements for the same exposure can at the consolidated level still be used to meet capital requirements for other exposures in the US or in other jurisdictions. Consequently, where US rules do not increase capital requirements to that for HVCRE at the consolidated level, this results in less required capital for total exposures at the consolidated level. • *Retail exposures*: (a) broadened scope of retail treatment [#231, 232] that is: (i) for corporates not limited to small businesses; the position of the US authorities is that this is not relevant in practice because US banks manage even a small total exposure to a large corporate always individually, thus these exposures would never qualify for retail; (ii) allowed for each mortgage up to USD 1 million for corporate obligors

	irrespective of whether total exposure to the obligor already exceeds USD 1 million; and (iii) for exposures secured by one-to-four family residential property, not limited to exposures managed as a large pool instead of individually as corporate exposures. The position of the US authorities is that homogeneous risk drivers ensure that US banks manage this always on a pooled basis. In addition, the US agencies have explained that the smallest pools of retail exposures contain hundreds of exposures. At the same time, the assessment team notes that grouping exposures into a pool for purposes of capital requirements may not ensure that these exposures are indeed managed on a pooled basis; (b) no limitation of risk weights for qualifying revolving retail (QRR) [#234] to portfolios with lower volatility than average; the position of the US authorities is that this need not be implemented since all revolving retail portfolios of US banks always meet this condition because this is credit card portfolios of which the US authorities assume that they have always lower volatility than average; (c) no prohibition of reflecting double default effects in PD/LGD for guaranteed retail exposures [#333]. • *Equity exposures*: narrowed definition [#236-238] not including debt exposures with indefinite defer of settlement and with economic substance like equity ownership; the US authorities have explained that US banks do not have debt exposures with indefinite defer of settlement and have taken the position that the reference in the US definition to instruments or securities for which the return is based on the performance of a security or instrument that is an equity exposure is sufficient for ensuring that all exposures with economic substance like equity ownership are covered. The assessment team notes, however, that while the US definition would cover certain derivatives with equity exposures as underlying, this does not cover other cases, including debt obligations or other securities, partnerships or other vehicles structured with the intent of conveying the economic substance of equity ownership while the return is not based on the performance of a security or instrument that is an equity exposure. • *Leases*: (i) capital requirements for bank exposures to residual value risk of wholesale leases are measured using PD and LGD of the obligor (according to an announcement in the Preamble to the 2007 Rules text that a requirement to treat the net investment in a wholesale lease as a single exposure to the lessee will be adopted in the final rule that is, however, not found in the Rules text; thus banks that record the residual value as a separate asset might not be subject to any capital requirements for this residual value), and not assigned a 100% risk weight as prescribed under Basel standards [#524]; and (ii) no limitation of recognition of leased equipment as collateral to leases which do not expose the bank to residual value risk [#523]; the position of the US authorities is that this need not be implemented since corporate leases of US banks in practice do not expose the banks to residual value risk because US banks in practice fully cover the value of leased properties by payment obligations of either the lessee or a third party, and do not retain the leased equipment; in contrast, the US authorities have also provided data that show that residual value risk is recognised in the accounting of US bank but is currently not material. • *Purchased receivables*: (i) no capital requirements for material dilution risk [#369-370], the US authorities have provided data indicating that dilution risk is currently not material; (ii) top-down treatment allowed for purchased retail and corporates receivables without minimum operational requirements [#239-240, #243, #365, #493-499]; (iii) no prohibition of considering recourse to or guarantees from the seller or other parties in the calculation of PD and LGD estimates [#364]; (iv) EL set to zero for non-defaulted fair valued purchased receivables and impairment estimate for defaulted exposures, instead of an estimate of the pool's one-year EL [#365]; (v) own CCF estimates allowed instead of mandatory CCF of 75% [#367]; (vi) no limitation of exposure-weighted average effective maturity for undrawn amounts of purchase facilities to where conditions specified by Basel standards are met [#368]; (vii) EAD (carrying value) is net of non-refundable discounts for purchased

	receivables instead of gross, and recognition of discounts for securitised receivables not limited to refundable discounts [#371]; (viii) recognition of guarantees for purchased receivables not distinguished for the type of risk covered by the guarantee (credit risk and/or dilution risk) [#373-373(i)]. • *Foreign exchange and interest rate commitments in a bank's retail portfolio*: EAD not determined according to Standardised Approach [#338]; the US authorities have explained that this need not be implemented because US banks do not have such commitments in the retail portfolio.
Materiality	Potentially material The assessment team considers these deviations taken together as potentially material because of the broad range of products to which this relates. While lower capital requirements under specific circumstances, according to written confirmation by the US authorities, have not represented a material deviation to date for a typical internationally active bank with a diversified portfolio and an average risk profile, the deviation may become potentially material if a bank were to increase its exposure to such products in the future. Comparably lower capital requirements can create incentives for shifts in banks' portfolios towards these products.
Basel paragraph no	Basel II paragraphs 214, 260–1, 272, 344–5, 356–7, 471
Reference in domestic regulation	78 FR 62215, Sec. 131(e)(3)(ii); 78 FR 62207 and 62208, Sec. 121(b); 78 FR 62241 Sec. 152(b)(1) to (3); 78 FR 62211, Sec. 122 and 123; 78 FR 622; 15, Sec. 131(e)(4); 78 FR 62204, Sec. 100(b)(1) and (2); 78 FR 62214, Sec. 131(e)(2); 78 FR 62241, Section 152(c)(2); 78 FR 62241, Section 152(b)(3)(ii); 78 FR 62241 Sec. 152(b)(1) to (3); 78 FR Sec. 131(d)(2), 62168 Sec. 2; 78 FR 62241 Sec. 152(b); 78 FR 62241, Sec. 152(b)(1); 78 FR 62212, Sec. 131(d)(3) ; 78 FR 62241, Sec. 152(b)(2) and (3)(i)
Findings	*Recourse to Standardised Approach parameters* The US rules take recourse to Standardised Approach parameters beyond the limits set by Basel standards. This recourse goes beyond the Basel standards: (a) for equity exposures in the following cases: • a 0% risk weight is applied where the obligor's debt obligations do not qualify for a 0% standardised risk weight but the guarantor has a PD lower than 0.03%. This relates to (i) sovereigns that have no external rating that qualifies for a zero risk weight under the Standardised Approach. The US agencies assert that given that the Standardised Approach assigns sovereign risk weights using credit ratings, and the US rules may not use credit ratings, using PD lower than 0.03% is a reasonable proxy for sovereigns that would receive a 0% risk weight under the Standardised Approach; (ii) exposures which are solely, directly and unconditionally guaranteed by a sovereign entity but where the obligor's debt obligations are not eligible for the zero risk weight; and (iii) if entities which the US rules classify as multilateral development banks were to not meet the qualifying conditions according to Basel II, paragraph 59. The US authorities have explained that currently this classification is not applied to any other entity. • 20% and 100% risk weights are applied to selected entities established under US legislation and for community development targeted by a government where this exceeds the 10% capital limits that apply Basel standards separately for eligible legislated programmes and for other equity; the US authorities have explained that all these entities meet the eligibility conditions according to Basel II, paragraph 357 (legislative programmes), and that though each of these exposures is considered an equity under GAAP, returns on these investments typically are not in the form of residual claims on assets or income, but rather in the form of dividends or tax credits. The assessment team notes, however, that the Basel definition of equity refers to the way of achieving return exclusively for explaining "irredeemable". This does neither exclude shares entitled to dividends nor, unlike the US definition of equity, other exposures which have the economic substance of an equity investment but for which the return is not based on the

	performance of an equity instrument. The assessment team considers it therefore as relevant that the limit of 10% Tier 1 plus Tier 2 capital for eligible legislated programmes under Basel standards is not applied. No limit is established for the 20% risk-weighted equity exposures, though the US agencies have explained that bank investments in these entities generally are limited to those needed to become a member and gain access to funding. Also, explanations provided by the US authorities suggest that for the 100% risk-weighted community development a concentration limit per government is applied, by requiring that the bank's aggregate outstanding investments under this authority may not exceed 5%, but that limit may be raised up to 15% of capital if raising the amount does not pose a significant risk to the deposit insurance fund, and the bank receives written permission from the bank supervisor. While data provided by the US authorities suggest that the current volume of 20% and 100% risk-weighted equity exposures is still within the 10% capital limit, the assessment team notes that this limit is nearly exhausted for once core bank, thus the missing limit can become relevant in the future. The US agencies point out that while the limit for legislative programmes may become relevant, the amount of exposures that exceed the 10% limit for legislative programmes may still be eligible for a 100% risk weight as non-material equity exposures, consistent with the Basel standard. The team notes, however, that this is only allowed within the general limit for equity exposures of 10% Tier 1 plus Tier 2 capital. • risk weights of 100% are applied to the effective hedge portion of any short and long equity positions where the hedge has a remaining maturity of at least three months but less than year. Under the Basel standard these equity exposures would typically receive a risk weight of 300% or 400% under the simple risk weight method. This deviation is assessed as potentially material. In view of the team, the large difference in risk weights with the Basel standard can incentivise US banks to increase the share of such equity exposures. The team's assessment as potentially material takes also into account that – in contrast to the Basel standards – debt exposures with the economic substance of equity holdings are not required to be classified as equity under US regulations; the US authorities have provided data that suggest that this can be on average currently not material. (b) for cash items in the process of collection which receive under US rules the fixed 20% risk weight that is only applicable under the standardised approach, instead of a risk-sensitive IRB risk weight where such items constitute exposures to banks or to the central bank. Cash items in the process of collection includes (i) checks or drafts on other institutions that have either already been forwarded for collection, but for which the reporting bank has not yet been given credit, or that will be presented for payment or forwarded for collection on the following business day:; however, if the reporting bank has been given immediate credit by its correspondent for checks or drafts presented for payment or forwarded for collection and if the funds on deposit are subject to immediate withdrawal, the amount of such checks or drafts is considered part of the reporting bank's balances due from depository institutions. (ii) government checks drawn on the Treasurer of the United States or other government agency that are payable immediately upon presentation and that are in the process of collection: (iii) other items in the process of collection that are payable immediately upon presentation that are customarily cleared or collected as cash items by US depository institutions, such as: (a) redeemed US savings bonds and (b) amounts associated with automated payment arrangements in connection with payroll deposits; (c) Federal Reserve deferred account balances until credit has been received in accordance with appropriate time schedules established by the Federal Reserve Banks; at that time, such balances are considered part of the reporting bank's balances due from depository institutions; (d) checks drawn on another depository institution that has been deposited in one office of the reporting bank and forwarded for collection to another reporting bank; and (e) brokers' security drafts and commodity or bill-of-lading drafts payable immediately upon presentation in the United States. This might become potentially material given that IRB risk weights for exposures to banks can be significantly higher and with

	regard to the difference to a 100% risk weight where no IRB treatment is specified. The US authorities have explained that this is rather settlement risk and take the position that the 20% risk weight is a conservative proxy for the IRB risk weights. While the assessment team's view is that risk-sensitive IRB risk weights for exposures to other banks can be significantly higher than 20%, data suggest that the finding does not represent a material deviation to date. The team considers the impact could become potentially greater if US banks increase the share of these exposures. The item is therefore listed for a follow-up assessment. (c) for defaulted exposures to which US rules apply fixed risk weights of 100% whereas Basel standards require assigning an LGD that reflects unexpected losses during the recovery period on a risk-sensitive basis. This deviation is currently material for at least one US core bank. In addition, the US rules do not limit fall-backs from using internal rating systems to a fixed risk weight of 100% for immaterial portfolios to extraordinary circumstances; the impact can, however, be considered as not material since this is limited to immaterial portfolios.
Materiality	Potentially material The deviation for equity exposures is assessed as potentially material. In the view of the assessment team, the large difference in risk weights compared to the 300% or 400% under the simple risk weight method by Basel standard can incentivise US banks to increase the share of such equity exposures. The team's assessment as potentially material takes also into account that – in contrast to the Basel standards – debt exposures with the economic substance of equity holdings are might not always be required to be classified as equity under US regulations. While it has not represented a material deviation to date, the deviation for cash items in the process of collection can assume significance in the future given that risk-sensitive IRB risk weights for exposures to other banks can also be significantly higher than 20% and with regard to the difference to a 100% risk weight where no IRB treatment is specified. The 100% fixed risk weight for defaulted assets is already currently material for one US core bank.

2.3.5 Securitisation framework

Section grade	Materially non-compliant
Summary	The US agencies have implemented a securitisation framework that is on average more conservative than the Basel standard. Nevertheless, the assessment team has identified a number of divergences between the US rules and Basel standards that for some US banks lead to materially lower securitisation RWA outcomes than the Basel standards. These differences are mainly related to the prohibition on the use of ratings in the US rules. Pursuant to the Dodd-Frank Act, the US rules cannot include provisions related to the Basel RBA, and accordingly provide alternative treatments (such as the simplified supervisory formula, SSFA) under both the credit risk and market risk aspects of the US rules and a hierarchy of approaches that differs from the Basel provisions.
Basel paragraph no	(i) Basel II paragraphs 611–18 (ii) Basel III paragraphs 712(iii)–718
Reference in domestic regulation	(i) 78 FR 62232 (Para 141-155) (ii) 78 FR 62260
Findings	Under the credit risk and market risk frameworks, the assessment has identified a number of divergences between the US regulation and Basel requirements, mainly related to the restriction on the use of ratings in the US rules regarding securitisation. While the US rules incorporate the Basel framework's supervisory formula approach, pursuant to the Dodd-Frank Act, the US rules do not include any provision relating to the Basel RBA, and accordingly provide alternative treatments (such as the SSFA) and

	a hierarchy of approaches that are not in line with the Basel provisions.
Materiality	Material With regard to the credit risk framework, estimates and analysis provided by US agencies show that the impact of removal of ratings from the securitisation framework has a material impact on the overall RWA of a number of US banks. Although the SSFA seems to be on average more conservative than the RBA, there is a wide range of results that for few banks is up to 52% in terms of RWA. Further, additional data provided by US show that the SSFA is more conservative than the RBA for all asset classes except for senior RMBS; for some US banks the latter is an important asset class in terms of share of total assets. With regard to the market risk framework, for the sample of US banks, the deviation results in a maximum reduction in market risk RWA of 24.5%, and an average reduction of 9.1%. In capital ratio terms, the deviation results in a maximum change of 78.9 bps and an average change of 14 bps across banks in the sample.
Basel paragraph no	Basel II paragraphs 554–9
Reference in domestic regulation	78 FR 62232, Section 141(a), (b) 78 FR 62233, Section 142 (e)
Findings	The operational requirements for traditional securitisations are fundamentally based on US GAAP deconsolidation rules, which fix conditions for determining whether a transfer of securitisation exposures qualifies as a sale. Accordingly, US regulation does not specifically address some specific requirements provided by the Basel standards.
Materiality	Not material Although US regulation does not specifically address some specific requirements provided by the Basel standards, this deviation may be considered not material on a judgemental basis as the US GAAP rules assure a broadly compliance with the condition required by the Basel standards.
Basel paragraph no	Basel II paragraphs 577–9
Reference in domestic regulation	78 FR 62232, Section 141(a), (b) 78 FR 62233, Section 142 (e)
Findings	According to the US regulations, the definition of eligible ABCP liquidity facility does not specifically address all of the Basel provisions; the only requirement explicitly mentioned is in para 578 b) (asset quality test that precludes funding against assets that are in default).
Materiality	Not material The reference is relevant only where a banking organisation provides a liquidity facility to an ABCP conduit that the bank does not consolidate; otherwise, the liquidity facility becomes an intercompany transaction not computed for risk-based capital purposes. Against this background, the divergence is considered not material as the unused portion of eligible ABCP liquidity facilities that are extended to unconsolidated ABCP conduits as a percentage of total assets is less than 0.8% for all the 14 banks of the panel; in only one case is the exposure higher than 1% in terms of RWA.
Basel paragraph no	Basel II paragraph 582
Reference in domestic regulation	78 FR 62232, Section 141(a), (b) 78 FR 62233, Section 142 (e)
Findings	For “non-eligible” servicer cash advance facilities, banking organisations must hold risk-based capital against the amount of all potential future cash advance payments that they may be contractually required to provide during the subsequent 12-month period under the contract governing the facility. Instead, as clarified in the preamble, for the “eligible” facilities there is no capital requirement. This is equivalent to a CCF = 0% treatment that the Basel standards grant to undrawn SCAs that are unconditionally cancellable without prior notice. The definition of “eligibility” provided by US rules is not perfectly in line with the Basel requirement for a 0% CCF. In fact, according to the preamble, “An eligible servicer cash advance facility is a servicer cash advance facility in which: … (3) the servicer has

	no legal obligation to, and does not make, advances to the securitisation if the servicer concludes the advances are unlikely to be repaid." The bank is not obliged only under certain conditions; therefore, the facility is not "unconditionally" cancellable in a strict sense.
Materiality	Not material For one institution in the sample, this divergence results in a 1 bp change in the normalised capital ratio. There was no effect on the other institutions given the extremely small amount of non-reimbursable advances.

2.3.6 Counterparty credit risk framework

Section grade	Largely compliant
Summary	Of the available approaches in the Basel standard for CCR the US has not implemented the Standardised Method (however, it has implemented the alternative non-modelled approach – the Current Exposure Method). For the methods that have been implemented, the team identified one material deviation, which is related to the removal of credit ratings from the standardised CVA approach – in the Basel standards the counterparty weights within the standardised CVA formula are based on credit ratings of the counterparty. In the US implementation, these weights are allocated based on probabilities of default of the counterparties due to the prohibition under US law on the use of external credit ratings in US regulations.
Basel paragraph no	Basel III paragraph 46, Parallel calculation
Reference in domestic regulation	na
Findings	The US agencies have adopted an extended parallel run period during which core US banks report capital ratios based on Basel I standards (until end-2014) and the new US standardised approach (from January 2015). Seven core banks, including one US G-SIB, are currently in parallel run. The current Basel framework contains a dedicated capital charge for CVA, introduced with Basel III. However, both Basel I and the new US standardised approach do not have a separate charge for CVA. The US authorities have explained that the approval to exit the parallel run is not given lightly and that it takes time to build sufficient confidence in banks' internal models for calculating RWA. The assessment team acknowledges that the Basel framework does not explicitly prescribe the implementation of the parallel run, and understands the view of US regulatory agencies that the internal model approval process cannot be compromised. The team also considers that the issue will disappear once the remaining core banks have received approval to exit the parallel run. At the same time, the team finds that the US approach results in a number of core banks not being subject to a separate capital charge for CVA risk for a protracted amount of time.
Materiality	The assessment team considers that the US approach is not in line with the spirit of the Basel framework.
Basel paragraph no	Basel II paragraphs 4–5 of Annex 4
Reference in domestic regulation	There is no corresponding reference in the US rules.
Findings	The Basel framework (at para 4 and 5) sets out a list of characteristics of an SFT or OTC derivative. The US rule does not include these characteristics.
Materiality	Not material This is not considered to represent a specific requirement of the Basel framework and therefore is not considered to be a material deviation.

Basel paragraph no	Basel II paragraphs 10–19 of Annex 4
Reference in domestic regulation	78 FR 62162, 62167, 62170 & 62207
Findings	The Basel framework (para 13) requires that banks have internal procedures to ensure that, prior to any transaction being included in a netting set, there are legal opinions verifying that the conditions of para 11 and 12 are complied with. The Basel text (para 19, second sentence) also requires that the single legal exposure related to a cross-product netting agreement is factored into credit limit and economic capital processes. The US rule does not explicitly include these requirements.
Materiality	Not material In the case of the legal opinion requirement, the US requirements substantively address the need for a legally enforceable agreement through a range of specific requirements. In the case of the incorporation of cross-product netting agreements in credit limits and economic capital, this omission is not considered to be material and in any case would not affect capital ratios.
Basel paragraph no	Basel III paragraphs 20–4 of Annex 4
Reference in domestic regulation	78 FR 62219, Sec. 132(d); 62215, Sec. 131(e)(4); 62208, Sec. 122
Findings	The Basel framework (para 24) requires that a bank demonstrate that reversion to a non-modelled approach does not lead to regulatory arbitrage. This requirement is not explicit under the US rules; however, through discussions with US authorities this is understood to be considered as part of ongoing supervision of the relevant banks.
Materiality	Not material
Basel paragraph no	Basel III paragraphs 34–7 of Annex 4
Reference in domestic regulation	78 FR 62221
Findings	1. The Basel framework (para 35) requires that EPE in the own estimate of alpha must be used as if it were a fixed outstanding loan amount. The US rule does not explicitly include this provision. 2. The Basel framework (para 34) relating to own estimates of alpha is broad and does not indicate how economic capital should be measured. The US rules specify the risk measure that should be used for calculating the economic capital based on EPE – the requirement is that unexpected losses for all CCRs should be measured at a 99.9% confidence level over a one-year horizon.
Materiality	Not material 1. Given the very limited use of the option to produce an own estimate of alpha, the lack of explicit requirement to use EPE as a fixed outstanding loan amount is not considered to represent a deviation that would result in a material impact on RWA or capital ratios. 2. The US implementation is not considered to represent a significant deviation in practice from the Basel requirements – the requirement can be seen as a reasonable interpretation of the Basel approach.
Basel paragraph no	Basel III paragraphs 38–9 of Annex 4
Reference in domestic regulation	78 FR 62220, Sec. 132(d)(4)
Findings	The Basel rules specify in footnote 299 that the effective duration of an internal CVA model can be used instead of the maturity with prior approval. The US rules allow the same approach but do not require the approval of the relevant agency.
Materiality	Not material The lack of an explicit approval process is not considered to be a material deviation given the ongoing supervisory oversight of these modelled approaches.
Basel paragraph no	Basel III paragraphs 40–1 of Annex 4

Reference in domestic regulation	78 FR 62221 Sec. 132(d)(5)
Findings	1. The Basel framework (para 41(b)(ii)) stipulates that the shortcut method has to be backtested and that changes in the value of the collateral have to be reflected using the supervisory haircut or internal estimates method. The US rules do not mention these requirements explicitly. 2. In the Basel rules (para 41(ii)), the margin period of risk must be doubled for the subsequent two quarters in case of margin call disputes. The US rules (78 FR 62221) apply a doubled margin period of risk for one quarter only.
Materiality	Not material 1. Shortcut method treatment of collateral: the lack of an explicit requirement is not expected to result in a material divergence in practice, and given this method is used by a very limited number of banks in the US it is not considered to be a material deviation. 2. Margin call disputes: while a deviation, this represents a short-term effect on RWA and in any case is not expected to be triggered in many situations. The deviation is therefore not considered to be material.
Basel paragraph no	Basel III paragraphs 42–6 of Annex 4
Reference in domestic regulation	78 FR 62220, Sec. 132(d); Interagency supervisory guidance on CCR management 6/29/11
Findings	1. The Basel framework states (at para 42) that the bank must conduct ongoing periodic review of the IMM model. The US rules have a minor deviation in that they set the required period to be an annual review. 2. At para 43 the Basel framework requires that documentation about validation of the IMM model should be set to a level of detail that would enable a third party to recreate the analysis. The US rules and guidance contain requirements to document the model but are not explicit on this level of detail. 3. The Basel framework (at para 46(i)) has detailed requirements on backtesting. The US rules (section 132(d)(3)(ix)), and guidance 6/29/11 (section "validation of model and systems") also set backtesting requirements but not to the same level of detail as the Basel rules.
Materiality	Not material 1. Periodic review of the IMM model: the requirement for an annual review (rather than a periodic review) is an interpretation of the Basel requirement and therefore not considered to be a material issue. 2. Validation documentation: While there is no explicit requirement for documentation sufficient for a third party to recreate the analysis, the US rules appear to substantively address the requirements for adequate documentation of the IMM model that would produce the same result as the Basel requirement. 3. Backtesting: Although the detail of the Basel standard is not replicated in the US rules, it appears that the US requirements address all of the material requirements of the Basel framework.
Basel paragraph no	Basel III paragraphs 49–54 of Annex 4
Reference in domestic regulation	78 FR 62220, Sec. 132(d)(3); Interagency supervisory guidance on counterparty credit risk management 6/29/11
Findings	The Basel standard (at para 51(i)) prescribes the establishment of a specific “collateral management unit” that should be adequately staffed. The US rules set out the guidelines and policies for collateral management set out in the Basel standards but do not explicitly require the setting up of a collateral management unit.
Materiality	Not material The prudent management of collateral is fully addressed in the US rule, and this deviation is not considered to have a material impact on the resulting processes.
Basel paragraph no	Basel III paragraphs 55–8 of Annex 4
Reference in domestic regulation	78 FR 62220-62221; Interagency supervisory guidance on counterparty credit risk management 6/29/11

Findings	1. The Basel framework (paras 55–7) defines specific stress testing requirements for determining the adequacy of CCR capital and performing stress tests on positions with wrong-way risk. These detailed requirements are not explicitly included in the US text. 2. Para 58 of the Basel standard requires the EAD for specific types of transactions with specific wrong-way risk to be the value based on the jump-to-default of the underlying security. The US rules further specify the value of the EAD for each product type subject to the treatment for specific wrong-way risk.
Materiality	Not material 1. Although the detailed requirements are not entirely replicated in the US rules, there are general stress testing requirements and a range of requirements related to wrong-way risk in the Guidelines on Counterparty Credit Risk that substantively address the requirements of the Basel text. 2. The specific requirements for the EAD are more detailed than in the Basel text but appear to be a reasonable application of the principle required by the Basel standards.
Basel paragraph no	Basel III paragraphs 97–103 of Annex 4
Reference in domestic regulation	78 FR 62222, Sec. 132(e) and 132(e)(6)
Findings	1. The Basel framework (para 98) requires banks to use the advanced CVA approach where they have specific interest rate risk and IMM model permissions. In the US rules, a bank must obtain the prior written approval to use the advanced CVA approach for the CVA charge (section 122(d)). The US rules also allow a bank that has both the specific interest rate risk VaR and the IMM permissions to use the standardised approach of the CVA charge provided the bank explains the rationale for it. 2. The Basel framework (at para 99) states that when the VaR model does not appropriately reflect the specific risk of a certain counterparty, the standardised approach of CVA charge must be used. The US rules do not explicitly mention this requirement.
Materiality	Not material 1. Use of Advanced CVA approach: The US authorities have clarified that the use of the standardised CVA charge by banks with IMM and specific interest rate risk is expected to be limited and only for a temporary period, on that basis this is considered to be an immaterial deviation. 2. Use of standardised CVA when VaR does not capture specific risk of counterparty: This is expected to be addressed through supervisory processes and is therefore not considered to represent a material deviation.
Basel paragraph no	Basel III paragraph 104 of Annex 4
Reference in domestic regulation	78 FR 62222, Sec. 132(e)(6)
Findings	The Basel framework defines a specific treatment for counterparties which are constituents of an index hedge (Annex 4, para 104, last bullet point) in the standardised method for CVA. For any counterparty that is also a constituent of an index on which a CDS is used for hedging CCR, the notional amount attributable to that single name (as per its reference entity weight) may, with supervisory approval, be subtracted from the index CDS notional amount and treated as a single-name hedge of the individual counterparty. The same treatment applies in the US rules (page 62223) but without supervisory approval.
Materiality	Not material The US requirement mirrors that of Basel (only the approval process is missing) and therefore this is not considered to be a material deviation.
Basel paragraph no	Basel III paragraph 104 of Annex 4
Reference in domestic regulation	78 FR 62223

Findings	The Basel framework (at para 104) prescribes counterparty weights that should be used in the standardised approach for CVA, these weights are based on credit ratings. In the US rules, references to credit ratings have been replaced by a reference to probabilities of default (which had been calibrated to attempt to replicate the credit rating approach in the Basel framework) due to the prohibition on the use of external credit ratings in US regulations.
Materiality	Material Based on data from a sample of US banks the maximum impact on CCR RWA of this deviation was a decrease of 12.3%, the average impact was a decrease of 2.3%. This equated to a maximum impact to the capital ratio of 9.2 bps and an average impact of 0.9 bps.
Basel paragraph no	Basel II Section I of Annex 4 as amended by Basel III – CCPs
Reference in domestic regulation	78 FR 62159 (Section 2) and 62204 (Section 101)
Findings	Basel III (*Capital requirements for bank exposures to central counterparties*, July 2012) inserted a number of definitions in Section I, A. General Terms of Annex 4 of Basel II. The US rules implement those definitions, with the exception of the definitions of the terms "initial margin" and "offsetting transaction".
Materiality	Not material
Basel paragraph no	Basel II paragraph 6(i) of Annex 4 as amended by Basel III – CCPs
Reference in domestic regulation	78 FR 62181 (Section 32) and 62212 (Section 131)
Findings	The new paragraph 6(i) in Annex 4 states that exposures arising from the settlement of cash transactions are not subject to the treatment foreseen for derivatives and SFT transactions which are centrally cleared; instead they are subject to the treatment for settlement risk in Annex 3. Instead of applying the settlement risk treatment to trade exposures from products with settlement risk only the US rules allow banks to apply an EAD of zero to those exposures.
Materiality	Not material Since (i) under settlement risk rules non-zero capital charges apply only to transactions that remain outstanding for five or more days after the foreseen settlement date; and (ii) it is highly unlikely that any QCCP would wait so long before stepping in, the outcome under the Basel rules and the US rules is the same.
Basel paragraph no	Basel II paragraph 114 of Annex 4 as amended by Basel III
Reference in domestic regulation	78 FR 62170 (Section 3), 77 FR 6336
Findings	Paragraph 114 of Annex 4 allows banks which are clients to apply a 2% risk weight to their trade exposures to a clearing member provided certain conditions related to identification of transactions and to segregation and portability of collateral are met. US rules allow the use of the 2% risk weight in case of omnibus accounts established under 17 CFR parts 190 and 300. More specifically, the rules state that omnibus accounts satisfy the conditions for the application of the 2% risk weight.
Materiality	The rules laying down the functioning of omnibus accounts (also known as LSOC accounts) allow for the possibility that the collateral of non-defaulting clients is used in case of a shortfall in the omnibus account due to the joint default of a client and the clearing member. This means that the omnibus account structure does not meet the condition in point (a) of paragraph 114. Consequently, in accordance with the Basel framework, trade exposures of banks which are clients and the collateral of which is held in an omnibus account should be subject to the treatment specified in paragraph 115, ie a 4% risk weight. While it is the case (as also made clear in the preamble of the CFTC rule on LSOC accounts) that part of a client's collateral related to CCP-cleared transactions is actually held in accounts at the clearing member, the US authorities explained that those are segregated accounts and hence provide a sufficient amount of legal

	protection for the client in case of the clearing member's default. In view of this, the assessment team considers that the conditions for the application of paragraph 115 are not violated. The US agencies have explained that while it is possible for a non-defaulting client to incur a loss in case of a joint default (Section 766(h) of Chapter 7 of the US Bankruptcy Code would require non-defaulting clients to share losses on a pro-rate basis), the US rules provide a number of safeguards that significantly reduce the likelihood of such loss. One such safeguard is a statutory prohibition that prevents CCPs from using collateral provided by a non-defaulting client. Another one is that, although client accounts would be part of the clearing member's estate, the client accounts have a priority claim over other creditors of the bankruptcy estate of the clearing member. Ultimately, whether the loss will materialise for the non-defaulting client will depend on the size of the shortfall and the size of the defaulted clearing member's assets compared to that shortfall. In any case, the overall loss would be no more than the change in the exposure since the last margin call. Based on data provided by the US agencies, only three of the banking groups in the sample have exposures to CCPs as clients (ie they clear transactions through a clearing member that is external to the group). The deviation is currently not material for any of those three groups. In view of the safeguards provided in the US rules, while the probability of a loss for non-defaulting clients in case of a joint default is not zero, the assessment team considers that it is sufficiently low to allow it to conclude that the deviation is unlikely to be material in the future.

2.3.7 Market risk: Standardised Measurement Method

Section grade	Materially non-compliant
Summary	The US market risk rule implements only certain provisions of the Basel Standardised Measurement Method (equity and interest rate specific risk provisions and the securitisation provisions). For general market risk there is no standardised approach implemented, instead all banks are required to use the IMA (this is not considered to be a deviation as the Basel framework envisages larger banks (which the US rules apply to) using the IMA). For the elements implemented in the US rule the team identified one material deviation from the Basel standard requirements related to the securitisation framework. The US rule implements on a permanent basis a transitional rule in the Basel standard that permitted capital requirements to be based on the maximum of the capital requirement against long positions or short positions (rather than the sum of both). Other deviations were also identified but related to less material issues of detail within the Basel standard.
Basel paragraph no	Basel III paragraph 683(i)
Reference in domestic regulation	78 FR 62135
Findings	The Basel framework requires market risk capital requirements to be held against FX and commodity risks across the bank (with the exception of structural FX positions). The assessment team believes that Annex 4 para 102 permits that only eligible hedges of CVA risk included in the CVA calculation can be excluded from market risk capital. Eligible hedges for this purpose do not include non-credit hedges. The combination of these requirements implies that any commodity or FX hedges of CVA risk should have market risk capital against them under the Basel framework. The US rule (in its preamble at 78 FR 62135) indicates that non-credit hedges of CVA may be excluded from the application of the market risk rule to the extent that they are not themselves trading positions. For interest rate hedges, this does not represent a deviation as non-trading positions would not be in scope of the market risk rule under the Basel framework, However, where non-credit hedges of CVA risk include FX or commodity hedges of CVA their exclusion from market risk capital requirements is a deviation.

Materiality	Not material The US regulators provided data on the impact of this deviation for their banks. The impact was not material, typically 1% or less of market risk RWA.
Basel paragraph no	Basel III paragraphs 683(ii)–689(iv)
Reference in domestic regulation	Section 202, 78 FR 62251; Section 203, 78 FR 62252
Findings	1. The Basel framework definition of correlation trading positions (at para 689(iv)) requires all reference entities to be single-name products for which a two-way market exists, and excludes positions which reference a claim on a special purpose entity. The US rule (Section 202 78 FR 62251) requires "all or substantially all of the value of underlying exposures to be based on single companies for which a two-way market exists" and does not specifically exclude positions which reference an exposure to an SPE. This is a slightly wider scope than the Basel definition. 2. The Basel framework lists (at para 688) a range of attributes for a position to be eligible to be held in the trading book. One requirement is that dealers have the autonomy to enter into/manage the position within agreed limits and according to the agreed strategy. This explicit requirement is not present in the US definition of a covered position.
Materiality	Not material 1. Correlation trading position definition: based on discussions with US banks, this is not considered to significantly change the positions in scope of the correlation trading portfolio and therefore does not represent a material deviation. 2. Trading book eligibility: while autonomy of dealers is not an explicit requirement in the US rule, the more general requirements around trading and hedging strategies and management of covered positions are considered to substantively address the Basel requirements.
Basel paragraph no	Basel III paragraph 707
Reference in domestic regulation	78 FR 62218 (Section 132)
Findings	The Basel framework (at para 707) defines an approach for CCR PFE add-on factors which is based on the defined terms "qualifying" and "non-qualifying". The term "qualifying" is replaced with investment grade in the US text but is not based on ratings (whereas the Basel definition of qualifying relies on ratings).
Materiality	Not material After discussions with US regulators and their banks, the team considers that in practice this does not result in a material deviation as in the majority of cases these definitions are equivalent or the resulting US classification is more conservative as banks refer to the external credit rating as one factor in determining whether an entity is investment grade or not.
Basel paragraph no	Basel III paragraph 709(ii-1-)
Reference in domestic regulation	78 FR 62261 (Section 210)
Findings	The Basel framework (at para 709(ii-1-) states that the capital requirement for non-correlation trading securitisation positions shall be the higher of the requirement for long or short positions until 31 December 2013. After that date, the capital requirement should be the sum of the requirement for the long and short positions. The US rule does not have an end date for the maximum long/short treatment; instead, it is implemented as the permanent requirement. The US agencies indicated that the provision was adopted in this manner in anticipation of the Basel Committee's completion of the fundamental review of the trading book, which, though still in development, aims to improve risk sensitivity, in part, by allowing for increased recognition of hedging under the standardised approach. Notwithstanding the status of the fundamental review, the finding is considered a deviation from the Basel framework.
Materiality	Material

	Based on data from a sample of US banks, this deviation caused a maximum reduction in market risk RWA of 11%, and an average reduction of 5.8%. This equated to a maximum impact to the capital ratio of 23.5 bps and an average impact of 6.1 bps.
Basel paragraph no	Basel II paragraphs 710–712(ii)
Reference in domestic regulation	78 FR 62257-62260 (Section 210)
Findings	The Basel framework defines capital requirements for specific interest rate risk based on external credit assessments. The US rules use a similar structure and set of risk weights for the capital requirements but use country risk classifications (or investment grade vs non-investment grade) rather than external credit assessments as a proxy for credit quality.
Materiality	Not material The US regulators provided data which confirmed that the risk weights resulting from the US approach were lower only in a small number of cases – these were cases where country risk classifications did not reflect the same level of risk as when credit ratings are used. In practice these differences would only arise for banks that do not have permission to use an internal model for specific interest rate risk – overall the impact is therefore not material.
Basel paragraph no	Basel III paragraph 714
Reference in domestic regulation	78 FR 62257-62258 (Section 210)
Findings	The Basel framework allows an 80% offset for positions hedged by credit derivatives in the case where the value of the two legs always move in opposite directions but not broadly to the same extent. The example cited in that paragraph is a cash position hedged with credit derivatives where all terms (including the maturity) match. At para 715, a separate case is discussed where all terms match except the maturity, in which case capital should be held against the leg with the higher capital requirement. The US rule allows the 80% offset treatment to apply provided the maturities of the position and the credit derivative do not have more than a 30-day difference or for bought protection up to 90 days difference in their maturity.
Materiality	Not material Based on the limited range of portfolios for which this would have an impact, and the reality that in the case that the US rule matched the Basel framework US banks would instead probably use hedging contracts with matching maturity (by using OTC derivatives rather than exchange-traded) to negate any capital impact, this is not considered to be a material deviation.

2.3.8 Market risk: Internal Models Approach

Section grade	Compliant
Summary	The US rules are substantively in line with the Basel framework for the IMA for market risk.
Basel paragraph no	Basel III paragraphs 718(xlviii) and 718(lxxv)
Reference in domestic regulation	78 FR 62254-62255 (Section 205(a)(1))
Findings	The Basel framework lists a number of specific requirements for the risk factors that should be included in a VaR model to capture equity, FX and commodity risk. The US rule has a general requirement that sufficient risk factors must be included in the model and some but not all of the granular detail of the Basel requirements.
Materiality	Not material

	While there is no explicit and complete list of risk factors, the general requirement of the US rule should in practice produce substantively the same result as the Basel framework and therefore the deviation is not considered to be material.
Basel paragraph no	Basel III paragraphs 718(lxvii)–718(lxxiv)
Reference in domestic regulation	78 FR 62253 (Section 203(d))
Findings	The Basel framework contains a number of details related to the implementation of stress testing requirements and use of their results. The US rules do not replicate all of the detail of the Basel text, but there is a broad requirement to perform stress testing.
Materiality	Not material In practice, given the broad requirements within the US rules to perform stress testing and the supervisory focus on stress testing, this is not considered to represent a material deviation.
Basel paragraph no	Basel III paragraphs 718(xci-1-)–718(xciv) and 718(xcix)
Reference in domestic regulation	78 FR 62255 (Section 205(c))
Findings	1. The Basel framework (at para 718(xci-1-)) details requirements for specific risk backtesting of the VaR model. The US rule has no explicit requirements referring to specific risk backtesting, but Section 205(c) 62255 has a requirement for detailed sub-portfolio backtesting which is considered to have a similar outcome to specific risk backtesting prescribed in the Basel framework. 2. The Basel framework (at para 718(xcii)–(xciii) and 718(xcix)), supplemented by the Basel incremental risk charge guidelines, sets out detailed validation requirements for internal models. The US rule does not include the detail of all of these validation requirements but does have more general validation requirements. While the explicit detail of the validation requirements are not comprehensively covered in the US rule, the more general requirements are considered to substantively address the Basel requirements.
Materiality	Not material
Basel paragraph no	Basel III paragraphs 718(c)–718(cxii)
Reference in domestic regulation	78 FR 62253 (Section 203)
Findings	The Basel framework defines detailed considerations for the application of the prudent valuation requirements including a minimum list of valuation adjustments. The US rule incorporates a requirement for prudent valuation but not in the detail of the Basel rules; in particular, it does not include operational risk or future administrative costs in the list of valuation issues to consider.
Materiality	Not material While the US rule does not explicitly include all of the details of the Basel framework, it does contain the key details and the general requirements set out are considered to substantively meet the requirements of the Basel standard.

2.3.9 Operational risk: Basic Indicator Approach and Standardised Approach

Section grade	na
Summary	The US did not implement the Basic Indicator Approach and the Standardised Approach.
Basel paragraph no	Basel II paragraphs 44 and 647
Reference in domestic	na

regulation	
Findings	For those banks that have not yet been allowed to exit parallel run, the US rules do not apply a distinct capital charge for operational risk.
Materiality	Not material The US agencies explained that those banks are subject to the Standardised Approach for credit risk that contains an implicit capital charge for operational risk.

2.3.10 Operational risk: Advanced Measurement Approaches

Section grade	Compliant
Summary	The US rules in general implement the requirements for operational risk in a manner consistent with the Basel framework. Nevertheless, the assessment team identified a few areas where the US rules deviate from the Basel framework (mostly concerning some detailed technical criteria/requirements and the recognition of risk mitigants). With the exception of one deviation, all other deviations are considered as not likely to have a material impact on the capital ratios. The one deviation where there could be a material impact in the future (it is currently not material) concerns one of the eligibility criteria for recognising insurance as a risk mitigant and is a consequence of the fact that US rules cannot refer to credit ratings.
Basel paragraph no	Basel II paragraph 49
Reference in domestic regulation	78 FR 62170 (Section 10) and 62209 (Section 122)
Findings	Paragraph 49 requires the application of a capital floor for AMA banks similar to the floor specified in paragraph 46 of the Basel framework. Paragraph 49 allows supervisors to develop appropriate bank by bank floors subject to full disclosure of the nature of the floors adopted.
Materiality	Not material The US agencies explained that the applicable floor was equal to the capital charge calculated under the standardised approach for credit risk.
Basel paragraph no	na
Reference in domestic regulation	78 FR 62210 (Section 122)
Findings	The US rules allow advanced banks to use an alternative approach to the AMA for generating estimates of operational risk, subject to supervisory approval.
Materiality	According to the explanation of the US agencies, only one bank has so far been allowed to use an alternative approach, and the approach in question was the BIA. The permission was granted to a small, limited purpose bank within a bank holding company (the parent company is required to use the AMA) because the bank had a low level of assets, was engaged in a narrow line of business and the bank's nominal amount of operational losses made modelling operational risk exposure extremely challenging. While permitted to use the BIA, the bank is expected to: (i) collect operational loss data for use at the group level; (ii) implement the qualitative requirements of AMA; (iii) annually review and assess whether it could progress to the advanced approaches. In addition, US agencies explained that 11 banks were exempted from having to comply with capital requirements for operational risk (the vast majority of these banks are either limited purpose trust companies or credit card banks). They further clarified that these banks were, however, required to comply with certain conditions (eg they must capture loss event data for use at the group level and to submit on an annual basis written statement and supporting analysis that their size, complexity, risk profile and business strategy warrant an exemption). In view of the very limited number of cases in which an alternative approach has been

	allowed/exemptions have been allowed and in view of the nature of the banks involved, the deviation is considered not to be currently material.
Basel paragraph no	Basel II paragraph 656
Reference in domestic regulation	78 FR 62210 (Section 122)
Findings	Paragraph 656 of the Basel framework states that a bank that adopted AMA may, subject to the approval of its host supervisors and the support of its home supervisor, use an allocation mechanism for the purpose of determining the capital requirement for non-significant internationally active subsidiaries within the group. The supervisory approval is subject to the bank meeting certain conditions. The US rules do not contain language reflecting paragraph 656.
Materiality	Not material US agencies explained that bank holding companies, their subsidiary banks and other mandatory banks were required to calculate their operational risk capital separately and were not permitted to use an allocation methodology. In their view, this is implicit in the rules, which require each bank to calculate its regulatory capital and risk-weighted assets in accordance with those rules. They also explained that while in practice subsidiary banks leveraged elements of the quantitative systems that were often developed at the group level, these quantitative systems had to be calibrated to the characteristics of the individual bank. In view of the explanation provided by the US agencies the deviation is considered not material.
Basel paragraph no	Basel II paragraph 664
Reference in domestic regulation	78 FR 62210 (Section 122)
Findings	The third bullet of paragraph 664 states that in order to obtain approval for the AMA, a bank must satisfy its supervisors that it has sufficient resources in the use of the approach in the major business lines as well as the control and audit areas. The US rules do not contain language reflecting the third bullet of paragraph 664.
Materiality	Unlikely to be material The US agencies explained that they considered that the requirement was implicitly contained in the rule requiring senior management to ensure that all components of a bank's advanced systems function effectively.
Basel paragraph no	Basel II paragraph 665
Reference in domestic regulation	78 FR 62210 (Section 122)
Findings	The last sentence of paragraph 665 states that the operational risk measurement system must be capable of supporting an allocation of economic capital for operational risk across business lines in a manner that creates incentives to improve business line operational risk management. The US rules do not contain language explicitly reflecting that sentence.
Materiality	Unlikely to be material The US agencies explained that while the US rules did not specifically address the ability of an AMA to support allocation of economic capital for operational risk across business lines, they did implicitly cover that aspect of the Basel framework through requirements that the risk measurement systems and reporting support management's ability and incentives to improve operational risk management and reduce losses. The deviation is unlikely to be material.
Basel paragraph no	Basel II paragraph 666
Reference in domestic regulation	78 FR 62210 (Section 122)
Findings	Point (b) of paragraph 666 states that a bank's internal operational risk measurement system must be closely integrated into the day-to-day risk management process of

	the bank. Point (c) of paragraph 666 states that a bank must have in place procedures for taking appropriate action according to the information within the management reports. The US rules do not contain language explicitly reflecting those two requirements.
Materiality	Unlikely to be material The US agencies explained that the US approach was more flexible and applied the use expectation to the AMA framework more generally, that is in a way that included the use of the four data elements as well as the operational risk exposure for day-to-day risk management. They further explained that inherent in the final rule was the expectation that conformance with the requirements of law would not be a compliance exercise, and that the reported information needed to be meaningful and used for decision-making. Concerning procedures for taking appropriate action according to the information within the management reports, US agencies explained that while there was no explicit rule, bank examiners did verify whether reports were meaningfully discussed at management/board level.
Basel paragraph no	Basel II paragraph 672
Reference in domestic regulation	78 FR 62210 (Section 122)
Findings	Paragraph 672 states that internally generated operational risk measures used for regulatory capital purposes must be based on a minimum five-year observation period of internal loss data. At the same time, it states that when a bank first moves to the AMA a three-year historical data window is acceptable. The US rules implemented the five-year minimum. However, they also contain a provision that states that a supervisor can approve a shorter period to address transitional situations, such as integrating a new business line. This shorter period is not floored at three years.
Materiality	Not material Since the shorter period is only applicable for transitional purposes, it is unlikely that the lack of a three-year floor would lead to imprudent outcomes.
Basel paragraph no	Basel II paragraph 673
Reference in domestic regulation	78 FR 62210 (Section 122), Interagency Guidance on the Advanced Measurement Approaches for Operational Risk
Findings	Paragraph 673 lists the standards applicable to a bank's internal loss collection processes. One of them is that the bank must have documented, objective criteria for allocating losses to the specified business lines and event types. Another is that the bank's internal loss data must be comprehensive in that it captures all material activities and exposures from all appropriate sub-systems and geographic locations. Yet another one is that the bank must develop specific criteria for assigning loss data arising from an event in a centralised function or an activity that spans more than one business line, as well as from related events over time. The US rules do not contain explicit language reflecting those standards. The Interagency Guidance on the Advanced Measurement Approaches for Operational Risk contains language on the second standard.
Materiality	Unlikely to be material The US agencies explained that, while there is no explicit requirement, bank examiners do check how a bank captures events that affect multiple business lines, functional units, or units of measure.
Basel paragraph no	Basel II paragraph 676
Reference in domestic regulation	78 FR 62210 (Section 122), the Interagency Guidance on the Advanced Measurement Approaches for Operational Risk
Findings	Paragraph 676 lists the standards that the use of business environment and internal control factors (BEICFs) in a bank's risk measurement framework must meet. One such standard is that the choice of each factor needs to be justified as a meaningful driver of risk. Another is that the sensitivity of a bank's risk estimates to changes in the

	factors and the relative weighting of the various factors need to be well reasoned. In addition, the framework must also capture potential increases in risk due to greater complexity of activities or increased business volume. Yet another standard is that the framework and each instance of its application must be documented and subject to independent review within the bank and by supervisors. The US rules implemented the language on capturing potential increases in risk. They do not, however, contain explicit language on the above standards. Explicit language on the third standard was found in the Interagency Guidance on the Advanced Measurement Approaches for Operational Risk, June 2011.
Materiality	Unlikely to be material US agencies explained that key risk drivers were not clearly established across the industry and might have unique characteristics at each bank. They also explained that the above standards were implicitly captured through the requirement for periodic comparison of BEICFs to actual losses. In particular, in the agencies' view the expectation that BEICFs be tested against loss experience provided the mechanism by which to determine whether a BEICF was a meaningful risk driver and whether it was and remained sensitive to changes in controls and other factors that affect a bank's risk profile.
Basel paragraph no	Basel II paragraph 677
Reference in domestic regulation	78 FR 62244 (Section 161)
Findings	Under paragraph 677, only insurance can be used to mitigate the impact of operational risk. In addition to allowing insurance, the US rules allow banks to use other types of operational risk mitigants, subject to the approval of supervisors.
Materiality	Not material US agencies confirmed that no operational risk mitigant other than insurance has so far been approved by them, which makes the deviation not material at present. The assessment team also considers that it is unlikely that it will become material in the future.
Basel paragraph no	Basel II paragraph 678
Reference in domestic regulation	78 FR 62244 (Section 161)
Findings	Paragraph 678 lists the criteria that insurance needs to meet in order to be considered as an eligible operational risk mitigant. One criterion is that the insurance provider has a minimum claims-paying ability rating of A (or equivalent). In view on the limitations on the use of credit ratings, the US rules implemented a different criterion that states that the bank must deem that the insurance provider has strong capacity to meet its claims payment obligations and the obligor rating category to which the bank assigns the insurance provider must be assigned a PD equal to or less than 10 bps.
Materiality	Currently not material, but could become material in the future The Basel framework does not provide a mapping of credit ratings and PDs for the purpose of operational risk. At the same time, it does provide one for the purposes of the Standardised Approach for credit risk. In Table 2 of Annex 2 of the Basel II standards, the reference three-year cumulative default rate to which the credit rating of A is mapped is equal to 25 bps. This means that the associated PD is roughly equal to 8 bps. If that PD were used as a reference for operational risk as well, then the 10 bp threshold set in the US rules would not be much different. However, since the Basel standard refers directly to the credit rating, the relevant default rate is always the one currently observed for the A grade, not the above-mentioned reference default rate for the Standardised Approach for credit risk. Moreover, a bank's PD estimate is a forecast for all of its obligors in a grade that is not necessarily identical with the default rate observed in the past for those obligors that were rated by the rating agency. The US agencies have explained that of the eight banks that have so far received

	permission to exit parallel run, none currently uses insurance as a risk mitigant for operational risk. They further explained that so far only one of those banks has asked for approval to use insurance. In view of the above, the deviation is currently not material. However, in a situation where banks would start using insurance more widely, it could become material if the insurance were to be provided by unrated insurers or by insurers with a credit rating of less than A (or equivalent).

2.4 Pillar 2: supervisory review process

Section grade	Compliant
Summary	The US rule is overall in compliance with the Basel framework for the Pillar 2 component.
Basel paragraph no	Basel II paragraphs 767–9
Reference in domestic regulation	78 FR 62158 section 1(d); SR letters 95-51 and 97-21; OCC's Large Bank Supervision Handbook (January 2010)
Findings	According to Basel II, banks must (i) have in place and regularly review their written CRM policies and procedures to control residual credit risk; and (ii) take immediate remedial action if supervisors find the CRM procedures imprudent. These measures may include making adjustment to the CRM assumptions, giving less than full recognition of risk mitigation, and holding a specific additional amount of capital against residual risk. The US rule does not specifically describe this requirement, though some high-level principles can be observed in certain related guidance.
Materiality	Not material

2.5 Pillar 3: market discipline

Section grade	Compliant
Summary	Disclosure requirements of the US rule for advanced approaches banks which completed the parallel run period implement most Basel Pillar 3 requirements, with a few exceptions. Deviations that are identified for US disclosure rule for advanced approaches banks are those related to (i) disclosure requirements for investments in insurance entities; and (ii) the use of disclosure templates for capital. As regards (i), the Basel standards require banks to disclose quantitative information on investments in insurance subsidiaries in the case where banks apply alternative approaches to deduction approach, aiming to ensure conservatism of the alternative approach. The US does not require banks to disclose such information even though alternative approach (ie consolidation method) is applied for the calculation of regulatory capital for banks. US agencies provided the data which indicated that investments in insurance entities were limited compared to consolidated RWA. As per (ii), US agencies decided not to adopt disclosure templates (ie main feature template, transitional template) basically aiming to avoid duplication of disclosures made in public or regulatory filings such as 10-K, 10-Q. The information contained in the templates can generally easily be accessible in public or regulatory disclosures such as 10-K, 10-Q on banks' websites.
Basel paragraph no	Basel II paragraph 822 Table 1
Reference in domestic	Table 1 to Section 173, 62245

regulation	
Findings	The Basel standards require banks to disclose information on investments in insurance entities. The information to be disclosed includes total interests in insurance entities which are risk-weighted rather than deducted from capital or subjected to an alternative group-wide method. In addition, in cases where banks apply an alternative approach rather than the deduction approach (eg consolidation method), banks are required to indicate the quantitative impact on regulatory capital of using the alternative approach versus using the deduction approach. This is to ensure that the alternative approach is as conservative as the deduction approach at each period that they report or disclose these ratios (FAQ 14, Table 1(f)). The US rule permits banks to apply alternative approach (ie consolidation method) under which BHCs and savings and loan holding companies deduct an amount equal to the regulatory capital requirement for insurance underwriting risks established by the regulator of any insurance underwriting activities of the company: 50% from Tier 1 capital and 50% from Tier 2 capital. While the list of investments in insurance subsidiaries is disclosed in SEC filings of banks (ie 10-K), other quantitative information such as comparative results calculated both on the US approach and on the Basel approach are not disclosed.
Materiality	Not material The US provided the data, which indicated that the investments in insurance subsidiaries are not material for US internationally active banks (eg the net assets of insurance subsidiaries relative to parents' RWA ranged from 0% to 1.11% with the weighted average of 0.27%). See also definition of capital section.
Basel paragraph no	Basel 2.5 Table 9
Reference in domestic regulation	Table 9 to Section 173, 62249
Findings	The Basel standards require separate quantitative disclosure on securitisation exposure in the banking book and trading book. The US does not specifically require separate disclosure between securitisation in the banking book and trading book, but covers extensively disclosure requirements on securitisation except those related to the use of external ratings. Although separate disclosure is not directly required under the US framework, information on securitisations can generally be available in the banking book and in the trading book. For instance, the aggregate amount of on-balance sheet and off-balance sheet securitisation positions by exposure type in the trading book are disclosed under the market risk rule (Section 212). Also, the amortised cost and fair value of securitisation held in the banking book and trading book are disclosed separately in regulatory reports filed with the US Banking Agencies (eg Schedule RC-B and RC-D in the FFEIC 031, ie the Call Report).
Materiality	Not material
Basel paragraph no	Basel III paragraphs 90 and 27–30, Disclosure requirement for capital
Reference in domestic regulation	Table 2 to Section 173, 62245
Findings	Basel requires banks to disclose a description of the "main features" of regulatory capital issued. In order to ensure that banks fulfil the disclosure requirement, banks are required to complete a "main features template" included in the Annex 3 of the "Composition of capital disclosure requirement". The US does not directly implement the main features template itself, but requires banks to disclose "summary information on the terms and conditions of the main features of all regulatory capital instruments".
Materiality	Not material The US explained that the US agencies decided not to require banking organisations to make disclosures in more than one place, to reduce duplication and associated costs of the work, hence the agencies did not adopt the main features disclosure template. The main features of regulatory capital are available in public filings such as

	10-K, 10-Q which are available on banks' websites.
Basel paragraph no	Basel III paragraphs 92 and 31–3, Disclosure requirement for capital
Reference in domestic regulation	Section 172, 62244, and Table 2 to Section 173, 62245
Findings	The Basel standards require banks to make available on their websites the "full terms and conditions" of all instruments included in regulatory capital. The US does not explicitly require banks to provide the full terms and conditions of all instruments, but mandates banks to disclose "summary information on the terms and conditions of the main features of all regulatory capital instruments".
Materiality	Not material Under the US framework, all of the disclosures required by the rule are generally provided in one place on the banks' public websites. In cases where banks provide disclosures in more than one public or regulatory financial report, banks are required to provide a summary table specifically indicating the locations of all such disclosures.
Basel paragraph no	Basel III paragraphs 93 and 34–8, Disclosure requirement for capital
Reference in domestic regulation	No corresponding provision
Findings	The Basel standards require banks to disclose the specific components of capital, including capital instruments and regulatory adjustments that benefit from the transitional provisions. In order to ensure the comparability of the disclosures during the transitional period, the Basel framework includes the "Template during the transitional period". The US rules do not adopt the transitional template. The amounts subject to pre-Basel III treatment during the transitional period are not available in one particular template.
Materiality	Not material The US rules implement a capital disclosure template (Schedule A of FFIEC Form 10) which is identical to "Post 1 January 2018 disclosure template" in the Basel document ("Composition of capital disclosure requirement"). While the amounts subject to pre-Basel III treatment are not directly disclosed in the template, those amounts can generally be calculated by using regulatory filings such as the Reports of Condition and Income published by banks, FR Y-9 and SEC filings (10-K, 10-Q).
Basel paragraph no	Basel Pillar 3 disclosure requirements for remuneration
Reference in domestic regulation	Not available
Findings	The US did not implement the Pillar 3 disclosure requirements for remuneration.
Materiality	Unlikely to be material The US agencies have confirmed that rules on disclosure for remuneration are being prepared. They also noted that a number of disclosures have to be made under SEC rules, specifically Regulation S-K. Since all the banks in the sample are publicly listed companies, they are subject to those rules. Regulation S-K mandates a number of requirements that match, in terms of substance, those mandated by the Basel framework. However, compared to the disclosures in the Basel framework, Regulation S-K has a more limited scope as it only covers remuneration of senior management and does not explicitly include remuneration of other material risk-takers. Nevertheless, the deviation is considered unlikely to be material.

Annexes

Annex 1: RCAP assessment team and review team

Team leader:

Mr Mark Branson	Swiss Financial Market Supervisory Authority (FINMA)
Mr Michael Schoch (Deputy)	Swiss Financial Market Supervisory Authority (FINMA)

Team members:

Mr Pier Bierbach	Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin)
Mr Andreas Borneus	Finansinspektionen
Mr Sebastijan Hrovatin	European Commission
Mr Massimo Gangeri	Bank of Italy
Mr Derek Nesbitt	Bank of England
Mr Kentaro Tamura	Bank of Japan
Mr Qi Xiang	China Banking Regulatory Commission

Supporting members:

Mr Maarten Hendrikx	Basel Committee Secretariat
Mr Uwe Steinhauser	Swiss Financial Market Supervisory Authority (FINMA)

Review team members: [43]

Mr Stefan Blochwitz	SIG member, Bundesbank
Mr Karl Cordewener	Basel Committee Secretariat
Mr Carlos Orta Tejada	SIG member, National Banking and Securities Commission (Mexico)
Mr Olivier Prato	SIG member, French Prudential Supervision and Resolution Authority
Mr Rob Urry	PDG member, South African Reserve Bank

[43] The review team is separate from the RCAP assessment team, and provides an additional level of quality assurance for the report's findings and conclusions. The RCAP assessment team has also benefited from the feedback of the RCAP Peer Review Board. It has also worked closely with Mr Udaibir Das, Head of Basel III Implementation at the Basel Committee Secretariat.

Annex 2: Implementation of the Basel framework as of cut-off date

Overview of adoption of capital standards

Table 4

Basel III regulation	Date of issuance by BCBS	Transposed in US rule	Date of implementation in United States	Status
		Basel II		
Basel II: international convergence of capital measurement and capital standards: *a revised framework – comprehensive version*	June 2006	Risk-Based Capital Standards: Advanced Capital Adequacy Framework—Basel II; Final Rule	1 April 2008	green
		Basel 2.5		
Enhancements to the Basel II framework *Guidelines for computing capital for incremental risk in the trading book* *Revisions to the Basel II market risk framework*	July 2009	Joint notice of proposed rulemaking to amend the December 2010 market risk capital rule notice of proposed rulemaking to include alternative standards of creditworthiness for certain debt and securitisation positions	1 January 2013	green
		Basel III		
Basel III: a global regulatory framework for more resilient banks and banking systems – revised version	June 2011 (consolidated version)	Final rule on regulatory capital (register: 78 FR 62018) issued by the FRB and OCC on 11 October 2013 and by the FDIC on 14 April 2014 (register: 79 FR 20754).	1 January 2014	green
Pillar 3 disclosure requirements for remuneration	July 2011	Draft rule not yet issued	To be announced	yellow
Treatment of trade finance under the Basel capital framework	October 2011	Part of Basel III implementation (see above)	1 January 2014	green
Composition of capital disclosure requirements	June 2012	Final Federal Register notice for the revisions to the FFIEC 101[44]	In effect	green
Capital requirements for bank exposures to central counterparties	July 2012	Part of Basel III implementation (see above)	1 January 2014	green

Colour code: green = implementation completed; yellow = implementation in process; red = no implementation.

[44] See www.ffiec.gov/forms101.htm.

Annex 3: List of capital standards under the Basel framework used for the assessment

(i) Basel II: international convergence of capital measurement and capital standards: a revised framework – comprehensive version, June 2006

(ii) Enhancements to the Basel II framework, July 2009

(iii) Guidelines for computing capital for incremental risk in the trading book, July 2009

(iv) "Basel Committee issues final elements of the reforms to raise the quality of regulatory capital", press release, 13 January 2011

(v) Revisions to the Basel II market risk framework – updated as of 31 December 2010, February 2011

(vi) Basel III: a global regulatory framework for more resilient banks and banking systems, December 2010 (revised June 2011)

(vii) Pillar 3 disclosure requirements for remuneration, July 2011

(viii) Treatment of trade finance under the Basel capital framework, October 2011

(ix) Interpretive issues with respect to the revisions to the market risk framework, November 2011

(x) Basel III definition of capital – frequently asked questions, December 2011

(xi) Composition of capital disclosure requirements – rules text, June 2012

(xii) Capital requirements for bank exposures to central counterparties, July 2012

(xiii) Regulatory treatment of valuation adjustments to derivative liabilities: final rule issued by the Basel Committee, July 2012

(xiv) Basel III counterparty credit risk – frequently asked questions, November 2011, July 2012, November 2012

Annex 4: Local regulations issued by US authorities for implementing Basel capital standards

Overview of issuance dates of important US capital rules Table 5

Domestic regulations	Name of the document, version and date
Domestic Regulations implementing Basel II, Basel II.5 and Basel III	• (OCC) 12 CFR Parts 3, 5, 6, et al, issued jointly with FRB on 11 October 2013 • (FRB) 12 CFR parts 208, 217 and 225, issued jointly with OCC on 11 October 2013 • (FDIC) 12 CFR Parts 324, 325, et al, issued 10 September 2013 The FDIC issued an interim final rule on September 10, 2013. The interim final rule is substantively the same as the joint final rule issued by the FRB and OCC. The final rule for the FRB and OCC can be found in the Federal Register citation 78 FR 62018 (October 11, 2013). The FDIC's interim final rule can be found in Federal Register citation 78 FR 55340 (10 September, 2013) and finalised rule in 79 FR 20754 (April 14, 2014). The section numbers and paragraph references in the FDIC interim final rule generally align with those in the FRB/OCC version. A proposed rule that would amend the final rule was issued on 18 November 2014.

Hierarchy of US laws and regulatory instruments Table 6

Level of rules (in legal terms)	Type
Federal statutes and legislative mandates	Enacted by US Congress
Regulations	Issued by US regulatory agencies
Reporting requirements	Issued by US regulatory agencies
Policy statements	Issued by US regulatory agencies
Interpretations	Issued by US regulatory agencies
Supervisory guidance	Issued by US regulatory agencies
Supervisory manuals	Issued by US regulatory agencies

Annex 5: Details of the RCAP assessment process

A. Off-site evaluation

(i) Completion of a self-assessment questionnaire by US authorities

(ii) Evaluation of the self-assessment by the RCAP assessment team

(iii) Independent comparison and evaluation of the domestic regulations issued by US authorities with corresponding Basel III standards issued by the BCBS

(iv) Identification of observations

(v) Refinement of the list of observations based on clarifications provided by US authorities

(vi) Assessment of materiality of deviations for all quantifiable deviations based on data and non-quantifiable deviations based on expert judgement

(vii) Forwarding of the list of observations to US authorities

B. On-site assessment

(viii) Discussion of individual observations with US authorities

(ix) Meeting with selected US banks, accounting firms and a credit rating agency

(x) Discussion with US authorities and revision of findings to reflect additional information received

(xi) Assignment of component grades and overall grade

(xii) Submission of the detailed findings to US authorities with grades

(xiii) Receipt of comments on the detailed findings from US authorities

C. Review and finalisation of the RCAP report

(xiv) Review of comments by the RCAP assessment team, finalisation of the draft report and forwarding to US authorities for comments

(xv) Review of US authorities' comments by the RCAP assessment team

(xvi) Review of the draft report by the RCAP review team

(xvii) Review of the draft report by the Peer Review Board

(xviii) Reporting of findings to SIG by the team leader

Annex 6: List of actions made or planned by US authorities

Basel paragraph	Brief description of actions taken/actions forthcoming
Credit risk: securitisation framework	
Basel securitisation framework	The US agencies will consider changes to the US securitisation framework as expeditiously as possible within the constraints of US administrative law at such time as the BCBS securitisation revisions are complete.
Market risk	
Basel market risk Standardised Approach	The US agencies will consider changes to the US market risk framework as expeditiously as possible within the constraints of US administrative law at such time as the BCBS's fundamental review of the trading book is complete.
Credit risk: IRB	
Basel IRB minimum requirements	The US agencies' notice of proposed rule-making, issued on 18 November 2014 addresses the following missing IRB minimum requirements: 395, 401 – 402, 411, 414 – 416, 426, 427, 443, 448, 449, 450, 456, 463, 466, 470, 472, 476, 477, 478, 487. In addition, the US agencies intend to publish, as expeditiously as possible, the wholesale and retail credit risk work programmes, which contain certain detailed specifications for banking organisations seeking to use the advanced IRB approach. These will cover the Basel IRB minimum requirements detailed in paragraphs 403, 406, 409, 417, 418-421, 425, 428, 429-433, 434-437, 440 and 444 of Basel II.

Annex 7: Assessment of binding nature of US regulatory documents

The following table summarises the US agencies' self-assessment of the seven criteria used to determine the eligibility of US regulatory documents. The assessment team concluded that the regulatory instruments issued and used by US regulatory agencies as set out in Table 6 of Annex 4 are eligible for the RCAP assessment.

Criterion	Assessment
(1) The instruments used are part of a well defined, clear and transparent hierarchy of legal and regulatory framework.	The hierarchy of prudential supervision and regulation in the United States consists of the following levels: • Federal statutes and legislative mandates • Regulations • Regulatory reporting requirements • Policy statements, interpretations, supervisory guidance and manuals • Examinations and Communicating Examination Findings • Examination work programmes **Federal statutes and legislative mandates:** The United States Code is a consolidation and codification by subject matter of the general and permanent laws of the United States. Most of the relevant banking laws are found under Title 12, Banks and Banking.[45] **Regulations:** The text of each regulation is contained in the annual Code of Federal Regulations (CFR) along with any proposed or finalised amendments published in the daily Federal Register. The Federal Register also contains the preamble to the regulation. In addition, the agencies regulations are posted on their public websites.[46] **Regulatory reporting requirements:** The US federal banking agencies have authority under governing statutes and regulations to obtain financial, structural, and any other information from banks and any of their affiliates (including holding companies) in the form and with such frequency as the agencies deem necessary to determine and enforce banking laws and assess the safety and soundness of banks and holding companies.[47] **Policy statements, interpretations, supervisory guidance and manuals:** These documents address significant policy and procedural matters related to their supervisory responsibilities, including supervisory expectations with respect to the implementation of, and ongoing monitoring of compliance with, statues and regulations.[48]

[45] State-chartered banks must also comply with applicable state law for certain banking activities. In terms of capital adequacy, federal statutes (1) authorise the federal banking agencies to establish minimum capital requirements for banks, and (2) require the federal banking agencies to impose two types of capital adequacy standards (ie risk-based and leverage) on banks. The federal banking agencies also have the authority to establish minimum capital requirements for certain affiliates of banks, including bank holding companies.

[46] See for the Federal Reserve www.federalreserve.gov/bankinforeg/reglisting.htm, for the OCC www.occ.gov/topics/laws-regulations/occ-regulations/index-occ-regulations.html, and for the FDIC www.fdic.gov/regulations/laws/.

[47] See, eg, Books & Records laws and regulations 12 USC sections 161(a) and (c), 481, 484, and 12 CFR 5.34(e)(3) (national banks and their affiliates); 12 USC sections 1464(v), 1467(h), and 1467a(b)(2) (savings associations and their affiliates, including holding companies); 12 USC section 1817(a) (non-member banks and insured foreign branches); 12 USC sections 324, 483, 1817(a)(2), 1817(a)(3), 1844(c) (state member banks and their affiliates, including holding companies); 3105(c)(2) and 3108 (US offices of foreign banks and US operations of any affiliates of the foreign banks).

[48] The Federal Reserve issues Supervision and Regulation Letters for general supervisory guidance and Basel Coordination Committee Bulletins for specific supervisory guidance related to the advanced approaches; the OCC issues Bulletins; and the FDIC issues Financial Institution Letters. All of these issuances disseminate information to banking supervision staff, as well as to supervised banking organisations. The agencies also issue manuals to provide guidance to supervisory personnel in

	Examinations and Communicating Examination Findings: Banks and holding companies are subject to on-site reviews and off-site analyses. Supervisory findings as a result of an examination or inspection are communicated in writing through formal examination or inspection reports, reports summarising the results of targeted reviews, a roll-up of those reviews into a comprehensive report, any other supervisory communication, or some combination thereof. **Examination work programmes:** Supervisory examination work programmes are a tool used by the US federal banking agencies that set forth procedures and help ensure that examiner assessments are consistently developed. Such programmes have been established for many areas of the rule, including retail credit risk, wholesale credit risk, model risk management, trading book risk, implementation of the advanced measurement approach, and data and reporting. These programmes provide more specific direction on how the standards and principles set forth in regulations, regulatory preambles, or public guidance should be implemented.
(2) They are public and easily accessible.	Regulations, rule preambles, reporting requirements, guidelines, supervisory guidance, are published and made available on the US agencies' websites, the Federal Register, the Code of Federal Regulation, as well as other easily accessible locations as described above. Examination work programmes and examination findings (eg MRIAs and MRAs) are not publically available.
(3) They are properly communicated and viewed as binding by banks as well as by the supervisors.	Statutes, regulations, and reporting requirements are legally binding and violations thereof are directly enforceable against a banking organisation (see also under point 5). Policy statements, interpretations, guidance, examination manuals and supervisory examination work programmes establish the framework of supervisory expectations for safe and sound banking practices and failure to meet these expectations may result in lower examination ratings, denial of supervisory approvals, and supervisory actions, pursuant to which limits may be placed on the bank's activities, among other measures. These documents are considered to be binding in practice.
(4) They would generally be expected to be legally upheld if challenged and are supported by precedent.	Under section 8 of the Federal Deposit Insurance Act (FDIA), if a bank is deemed to be engaging in activities – including those related to capital adequacy – that are unsafe or unsound, the banking agencies have broad legal authority to take supervisory actions. Significant issues that arise from an examination, inspection, or any other supervisory activities and require remediation are designated as "matters requiring immediate attention" (MRIAs) or "matters requiring attention" (MRAs) and result in enforcement actions (see below).
(5) Consequences of failure to comply are properly understood and carry the same practical effect as for the primary law or regulation.	**Enforcement actions:** the appropriate agency may take formal or informal enforcement actions to compel the management and directors of a bank or holding company, or persons associated with it, to address: unsafe or unsound banking practices, violations of laws or regulations (including capital requirements), violations of any conditions the agency imposed in writing on the bank or bank holding company in connection with an application or request, and violations of any written agreement between the bank and the agency.[49] **Prompt corrective action:** US banks are subject to the federal banking agencies' prompt-corrective-action (PCA) requirements that establish a capital-based supervisory scheme that requires federal banking supervisors to place increasingly stringent restrictions on banks as their regulatory capital levels decline.[50]
(6) The regulatory provisions are expressed in clear language that complies with the	Section 722 of the Gramm-Leach-Bliley Act (Pub. L. 106–102, 113 Stat. 1338, 1471, 12 USC 4809) requires the Federal banking agencies to use plain language in all proposed and final rules. Also supervisory letters and policy interpretations are generally found to be clear and precise in their language. Supervisory manuals and work programmes are written to assist supervisors and regulatory

planning and conducting examinations of banks and inspections of bank holding companies that are to be used in conjunction with other supervisory guidance.

49 12 USC 1818(b). See section 5040.1 of the Federal Reserve's *Commercial Bank Examination Manual* for a description of formal and informal supervisory actions at www.federalreserve.gov/boarddocs/supmanual/cbem/5000.pdf.

50 Although holding companies are subject to risk-based and leverage capital requirements, they are not subject to the PCA framework.

Basel provisions in both substance and spirit.	experts in their supervision and are written in language that – while plain – is typically of a more explanatory or clarificatory nature.
(7) The substance of the instrument is expected to remain in force for the foreseeable future.	The documents related to regulatory capital and the hierarchy of prudential supervision and regulation in the United States are expected to remain in force for the foreseeable future.

Annex 8: Key financial indicators of US banking system

Overview of US banking sector as of 31 March 31 2014

Table 7

Size of banking sector (USD billions)	
Total assets of all banks[51] operating in the jurisdiction (including off-balance sheet exposures)	21,523
Total assets of all locally incorporated internationally active banks	14,999
Total assets of locally incorporated banks to which capital standards under Basel framework are applied (ie excludes foreign bank branches)	14,999
Number of banks	
Number of banks operating in the United States	1,162
Number of internationally active banks[52]	15
Number of banks required to implement Basel standards (according to domestic rules)	15
Number of global systemically important banks (G-SIBs)	8
Capital standards under the Basel framework	
Number of banks required to implement Basel equivalent standards	15
Use of advanced approaches by banks	15
Capital adequacy (internationally active banks[53]) (in USD billions and per cent)	
Total capital	1,107
Total Tier 1 capital	933
Total CET1 capital	871
Total risk-weighted assets	7,762
RWA for credit risk (percentage of total RWA)	65.76%
RWA for market risk (percentage of total RWA)	10.03%
RWA for operational risk (percentage of total RWA)	19.90%
Total off-balance sheet bank exposures[54]	2,769
Total Capital Adequacy Ratio (weighted average)	14.26%
Tier 1 ratio (weighted average)	12.02%
CET1 ratio (weighted average)	11.22%

51 In this table, all references to banks should be interpreted as references to bank holding companies.

52 The US banking agencies adopted the Basel II advanced approaches for credit risk and operational risk in December 2007. The advanced approaches rule, which was recently updated to incorporate the Basel 2.5 and III amendments, is applicable to large internationally banking organisations (advanced approaches organisations), defined as banking organisations with consolidated assets of $250 billion or more or on-balance sheet foreign exposures of $10 billion or more, as well as to all depository institution subsidiaries of bank holding companies that are subject to the rule. The US banking agencies have not adopted the Basel Standardised and Foundation Approaches for credit risk, or the Basic Indicator and Standardised Approaches for operational risk. Thus, banking organisations that are subject to the US advanced approaches rule are required to apply the advanced IRB approach for credit risk, the Advanced Measurement Approaches for operational risk and the market risk framework.

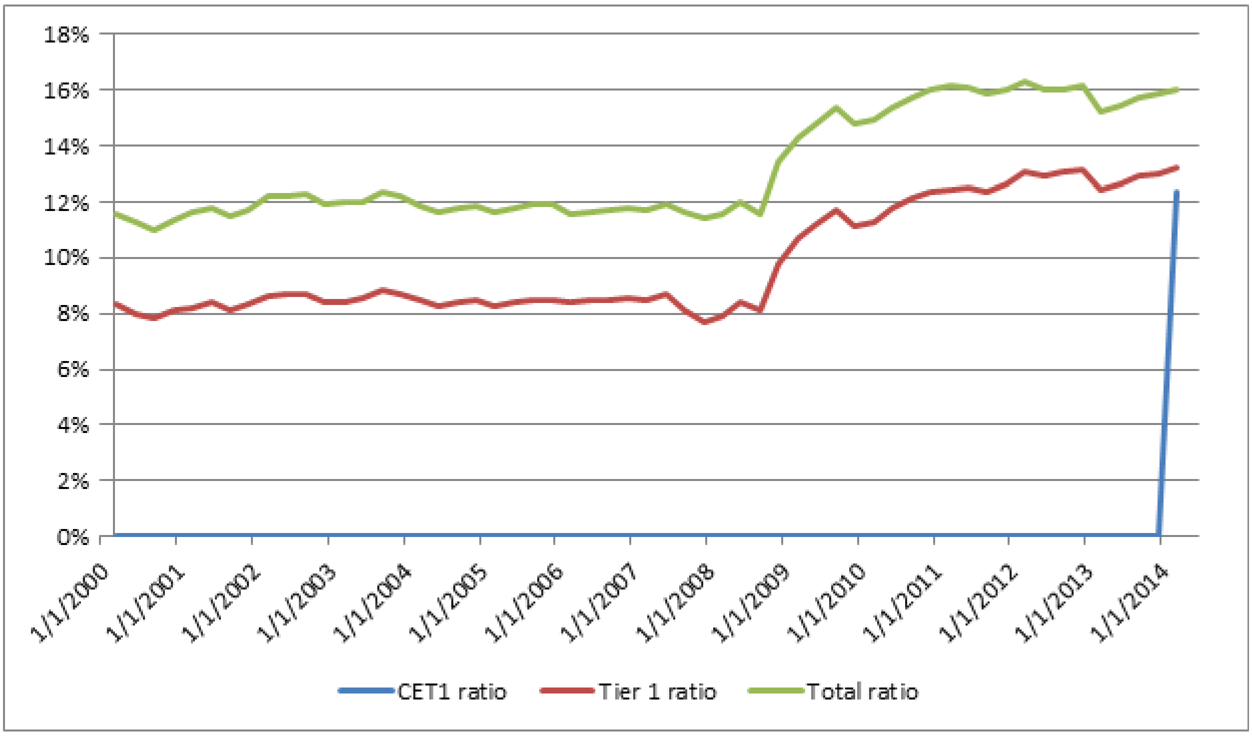
53 While there are 15 internationally active banks, these data capture only the universe of the 14 internationally active banks that currently file the FFIEC 101. One core bank has not begun reporting the FFIEC 101 but will begin reporting in the second quarter of 2014.

54 Includes the credit equivalent amount of off-balance sheet exposures. Data sources: FR Y-9C, FFIEC 101.

Evolution of capital ratios of US internationally active banks

Weighted average, in per cent

Figure 1

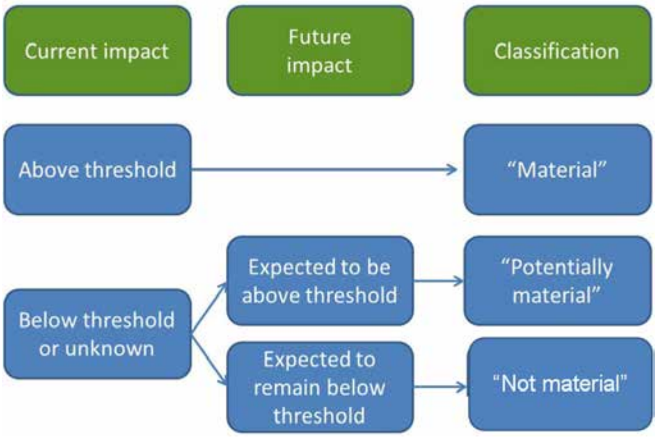


Source: Federal Reserve.

Annex 9: Summary of the materiality assessment and list of banks in the RCAP sample

The assessment of materiality distinguished between quantifiable and non-quantifiable gaps. For the US RCAP, an attempt was made to quantify the impact of all quantifiable gaps for each bank in the sample affected by the gap. In total, 20 gaps/differences were assessed based on bank data and data available to US authorities. In those cases where the computation of the impact was not straightforward, the computation erred on the conservative side. Where no data were available to quantify gaps, the review team relied on expert judgement. Following this approach, an attempt was made to determine whether gaps are "not material", "material" or "potentially material".

Classification of quantifiable gaps Figure 2



Number of gaps/differences by component Table 8

Component	Not material	Material	Potentially material
Scope of application	0	0	0
Transitional arrangements	1	0	0
Definition of capital	7	0	0
Capital buffers	0	0	0
Pillar 1			
Minimum capital requirements (general)	0	0	0
CR: Standardised Approach	9	0	2
CR: IRB	–	–	4[55]
Securitisation	3	1	0
Counterparty credit risk	15	1	0

55 Deviations have been grouped together according to their nature. The assessment team assessed the grouped deviations collectively as potentially material.

MR: Standardised Approach	5	1	0
MR: Internal Models	4	0	0
OR: SA/BIA	NA	NA	NA
OR: AMA	9	1	0
Pillar 2	1	0	0
Pillar 3	6	0	0

Materiality is defined based on quantitative benchmark thresholds (for the quantifiable gaps) and expert judgement (for the non-quantifiable gaps). See Section 2 for further information.

RCAP sample of banks

The following 15 US core banks were selected for the RCAP sample for the quantitative materiality testing. These banks cover approximately 75% of total banking assets in the United States and nearly all of the relevant international exposures of the US banking sector.

- JPMorgan Chase (G-SIB)
- Bank of America (G-SIB)
- Citigroup (G-SIB)
- Wells Fargo (G-SIB)
- Goldman Sachs (G-SIB)
- Morgan Stanley (G-SIB)
- Bank of New York Mellon (G-SIB)
- US Bancorp
- HSBC North America
- Capital One
- PNC Financial Services Group
- State Street (G-SIB)
- TD Bank US
- American Express
- Northern Trust

Indicator	Share of US G-SIBs as % of total US banking sector	Share of 15 US core banks, including G-SIBS, as % of total US banking sector
Total assets	63.2%	74.1%
Off-balance sheet exposures	96.4%	98.7%
Foreign exposure	93.6%	97.2%
Foreign deposits	89.6%	96.5%
Foreign liabilities	95.5%	99.2%
Number of foreign offices	80.7%	84.8%
Assets under management held in foreign offices	99.6%	99.6%

Source: Federal Reserve Board, data as of year-end 2012.

Annex 10: Areas where US requirements are regarded to be higher than the Basel standards

In several places, the US authorities have adopted a stricter approach than the minimum standards prescribed by Basel or have simplified or generalised an approach in a way that does not necessarily result in stricter requirements under all circumstances but never results in less rigorous requirements than the Basel standards. The following list provides an overview of these areas. The information in this annex has been provided by US regulatory agencies and has not been cross-checked or assessed by the RCAP assessment team. It should be noted that these areas have not been taken into account as mitigants for the overall assessment of compliance.

Transitional arrangements

- The US rules removed the transitional floors and adopted a permanent floor based on the US standardised approach, as imposed by US statute, which represents an additional requirement that is not currently included in the Basel standards. The floor imposed in the United States will generally be more conservative than the Basel approach, as the US floor is 100% of the US standardised approach while the Basel floor is 80% of the Basel I approach. Additional stringency is provided by the calibration of the US standardised approach, which was designed to be more conservative on a framework to framework basis than the general risk-based capital requirements that were based on the Basel I standards.

Definition of capital

- The US rules are more conservative than Basel III with respect to the definition of additional tier 1 capital – Basel III allows the inclusion of liabilities in additional tier 1 capital while the US rules only allow accounting equity instruments in additional tier 1 capital.

Credit risk: Standardised Approach

- The Basel text allows PSEs to be risk-weighted at the same level as the PSE's sovereign. Under the Basel Standardised Approach, the US agencies could justify a 0% risk weight for these exposures, but apply a more conservative risk weight of 20%.
- The US rules did not adopt the 75% risk weight for retail exposures. Such exposures are risk-weighted at 100%.
- The Basel text allows claims secured by residential property to be risk-weighted at 35%. The US rule sets a 50% (rather than 35%) risk weight floor on residential mortgages or a risk weight of 100% for those mortgage that do not qualify for a 50% risk weight.
- The Basel standardised text does not provide a specific treatment for HVCRE exposures, meaning such exposures receive a 100% risk weight. The US standardised approach sets 150% risk weight for HVCRE exposures.

- The Basel standardised text does not provide a specific treatment for equity exposures, meaning such exposures receive a 100% risk weight. Under the US standardised approach, most equity exposures are subject to risk weights ranging from 100% to 600%. Equity exposures to investment funds can receive a 1250% risk weight.
- While the US rules are prohibited by statute from referring to external ratings, the US agencies apply a definition of investment grade that requires firms to consider a variety of factors, including: available external credit ratings, market data such as credit default swap spreads, financial information published by the issuer of the debt instrument, external credit assessments other than credit ratings, and internal analysis. Firms, therefore, have a greater burden to support their determination that a debt security is investment grade if one factor is contradicted by another factor. Hence, an investment grade credit rating for a particular debt security does not necessarily mean the security qualifies as investment grade per the US rules.

Credit risk: Internal Ratings-Based approach

- The US rules do not recognise SMEs, therefore, are super-equivalent to the Basel text because they do not lower capital requirements via the correlation adjustment for SMEs.
- The US advanced approaches rules do not allow for partial use because of concern with cherry picking and because the US agencies believe that full use of the advanced approaches is consistent with risk management expectations for large, internationally active banks, and that their implementation of Basel II is super-equivalent to the Accord.
- The US agencies did not implement the slotting criteria. For A-IRB banks, US rules are super-equivalent because they require full implementation of PD/LGD.
- The capital requirement for defaulted exposures is EAD times 8%, rather than the difference between LGD and the bank's best estimate of expected loss. Under Basel paragraph 272, the capital requirement on a defaulted retail exposure may be zero where all of the economic loss is already captured by the best estimate of expected loss under current economic conditions (eg where unexpected losses cannot further increase under more adverse economic conditions) and therefore is instead deducted from CET1 capital rather than being included in RWA. The agencies believe this is imprudent, and instead require a fixed 100% risk weight or a 20% risk weight where covered by an eligible guarantee from the US government. This is more rigorous in those cases where unexpected losses are lower than 8% (or 1.6% if guaranteed by the U.S. government) of that percentage of the exposure that is not yet written off.
- Under Basel II, the capital requirement for a defaulted exposure is the difference between LGD and best estimate of expected loss. The US rule applies a capital requirement of EAD times 0.08. Given the US agencies' charge-off policy for defaulted retail loans, the capital requirement on a defaulted retail exposure may be zero and often would be zero or near zero for US banks if the US agencies adopted Basel paragraph 328. In particular, as described in the Uniform Retail Credit Classification Guidance[56], a bank must charge off defaulted retail exposures to their expected recoverable value less the cost to sell, so the loss-given-default after charge-off should be zero. The agencies believe this is imprudent, and instead require a more conservative 100% risk weight. The US rule is more conservative than Basel II with respect to those hedged

equity exposures where the remaining maturity is longer than one year by requiring a 100% risk weight on the matched portion of a hedged transaction (as opposed to full offset) and has requirements on the effectiveness of the hedge. Also note the word "offset" in paragraph 345. That implies a zero capital charge on the matched portion of a hedged equity position. The US treatment is more conservative because the agencies require USD 8 of capital for every USD 100 of the matched portion of a hedged equity position. In contrast to Basel II, the US agencies also require an *ex ante* and *ex post* statistical demonstration of the effectiveness of the hedge and describe alternative metrics that a bank must use. Basel II requires no such test of the effectiveness (ie correlation between the two sides of the two-part transaction). The measures of association specified in the US rule are conventional measures used by practitioners. Thus, the US treatment, in that it requires a 100% risk weight on a perfectly matched transaction, is much more conservative than the Basel II treatment, which will assign a zero charge to many hedged equity positions where fully matched.

Market risk

- The US rules provide for a surcharge of 8% on modelled correlation positions taking into account the fact that many banking organisations continue to have a limited ability to perform robust validation of their comprehensive risk model using standard backtesting methods. This provision exceeds the Basel framework requirements, and the inclusion of a surcharge is appropriate as a prudential measure for banking organisations to adequately validate comprehensive risk models and also incentivises banking organisations to improve models on an ongoing basis.

Leverage Ratio

- The US rules incorporate a pillar 1 leverage requirement for all banking organisations.
- The US rule applies a pillar 1 supplementary leverage requirement to advanced approaches banking organisations beginning in 2018. In addition, the largest, most systemic banking organisations will be required to meet a supplementary leverage ratio well above the 3% minimum standard. Covered bank holding companies will be required to hold a 2% leverage buffer, for a total of a 5% supplementary leverage ratio requirement. Insured depository institutions of covered bank holding companies will be required to meet a 6% supplementary leverage ratio requirement in order to be considered well-capitalised under the US prompt correction action framework. Currently, this enhanced supplementary leverage ratio requirement applies to eight US banking organisations designated as globally systemically important banks.

Annex 11: List of Basel approaches not allowed by US regulatory framework

The following list provides an overview of approaches that the US authorities have not made available to banks through the US regulatory framework. Where the Basel standards explicitly request certain approaches to be implemented under specific circumstances, the missing approaches have been taken into account in the assessment. However, where the Basel standards do not require jurisdictions to implement these approaches, they have been implicitly treated as "not applicable" for the assessment.

Operational risk

- Basic Indicator Approach and Standardised Approach

Counterparty credit risk

- Standardised Method

Annex 12: List of issues for post-RCAP assessment follow-up

The assessment team identified the following issues for post-RCAP assessment follow-up and for future RCAP assessments of the United States:

1. Treatment of defined benefit pension fund assets held by FDIC-insured banks.
2. Treatment of insurance entities in the definition of capital.
3. Additional Tier 1 and Tier 2 capital instruments issued by US banks and their subsidiaries under foreign law and their treatment under the US statutory approach.
4. For the IRB approach:

   A broader quantification of differences stemming from reliance on accounting valuation for EAD, EL and retail definition of default; and the volume and difference in capital requirements for those exposures where capital requirements under US rules are lower than Basel standards or where fixed risk weights as in the Standardised Approach are used beyond the limits allowed by the Basel standards for partial use, including for cash items in the process of collection; a follow-up assessment of the impact of missing minimum requirements not covered by the draft amendment issued by the US agencies.
5. Follow-up assessment of the US securitisation framework.

Annex 13: Areas for further guidance from the Basel Committee

The assessment team listed the following issues for further guidance from the Basel Committee. Additional detail is provided in Section 1.4 of the report.

- Definition of capital: the treatment of DTAs that could be recovered through operation loss carrybacks.
- Credit risk: the calculation of EAD and the application of the EL excess/shortfall mechanism for fair value exposures under the IRB approach.

Annex 14: US agencies' summary of their Pillar 2 supervisory review process[57]

1. Understanding of Pillar 2 and relevance for the overall supervisory activity

In the United States, Pillar 2 is the process for the supervisory review under the advanced approaches rule. These reviews are intended to help ensure a firm's overall capital adequacy by:

- confirming a banking organisation's compliance with regulatory capital requirements;
- addressing the limitations of minimum risk-based capital requirements as a measure of a firm's full risk profile – including risks not covered or not adequately addressed or quantified in the Pillar 1 capital charges;
- ensuring that each banking organisation is able to assess its own capital adequacy (beyond minimum risk-based capital requirements) based on its risk profile and business model; and
- encouraging banking organisations to develop and use better techniques to identify and measure risk.

Pillar 2 work is part of the overall US supervisory review process. The US agencies use a risk-based supervisory philosophy focused on evaluating risk, identifying material and emerging problems, and ensuring that individual banking organisations take corrective action before problems compromise their safety and soundness. An integral part of the supervisory process is determining a banking organisation's composite rating under the Uniform Financial Institutions Rating System (UFIRS) or "CAMELS" ratings from six component areas: Capital adequacy, Asset quality, Management, Earnings, Liquidity and Sensitivity to market risk.

2. Requirements for banking organisations

In the United States, the requirements for advanced approaches banking organisations have been established by the prior and revised regulatory capital rules and supplemented by the public document: Supervisory Guidance: Supervisory Review Process of Capital Adequacy (Pillar 2) Related to the Implementation of the Basel II Advanced Capital Framework. The guidance covers three main areas: (i) comprehensive supervisory review of capital adequacy; (ii) compliance with regulatory capital requirements; and (iii) internal capital adequacy assessment process.

3. Supervisory assessment

Examiners work full-time at large and complex financial institutions, including advanced approaches banking organisations. This enables the US agencies to maintain an ongoing programme of risk

[57] The information in this annex has been provided by US regulatory agencies.

assessment, monitoring and communications with firm management and directors. Objectives are designed to:

- Determine the condition of the banking organisation and the risks associated with current and planned activities, including relevant risks originating in subsidiaries and affiliates.
- Evaluate the overall integrity and effectiveness of risk management systems, using periodic validation through transaction testing.
- Determine compliance with laws and regulations.
- Communicate findings, recommendations and requirements to firm management and directors in a clear and timely manner, and obtain informal or formal commitments to correct significant deficiencies.
- Verify the effectiveness of corrective actions, or, if actions have not been undertaken or accomplished, pursue timely resolution through more aggressive supervision or enforcement actions.

4. Capital expectation

Minimum capital requirements as set by the statutory prompt corrective action (PCA) framework, which requires the US agencies to define separate capital levels for well capitalised, adequately capitalised, undercapitalised, significantly undercapitalised and critically undercapitalised institutions. Under the PCA framework, banking organisations face consequences and restrictions of increasing severity as their capital levels fall. The regulatory minimum capital ratios are standards that address only a subset of risks faced by firms. Therefore, a banking organisation should maintain capital well above regulatory minimum capital ratios, especially during expansionary periods when the economy may be growing robustly and earnings are strong but the inherent risks in a banking organisation's operations and balance sheet may be increasing. Equally emphasised is that a banking organisation at the "well capitalised" level under the PCA rule should not automatically assume that it has sufficient capital to cover all of its risks.

For advanced approaches banking organisations, the regulators' assessment of a firm's capital adequacy includes a review of the firm's own capital assessment and planning process. Moreover, firm and supervisory stress testing have become key inputs to capital planning at the largest banking organisations and to supervisory assessments of firms' capital adequacy. Examiners evaluate the banking organisation's approach to identifying and measuring material risks, assessing capital adequacy, identifying capital sources, raising capital when necessary, and preparing for contingencies. Examiners also consider management's capital assessment processes and oversight by the board of directors.

Under the Federal Reserve Board's (FRB) Comprehensive Capital Analysis and Review (CCAR) programme, the FRB approves a bank holding company's capital actions (eg planned dividends, issuances and repurchases as provided in the firm's baseline scenario) on an annual basis. These capital plan reviews are informed by stress tests conducted at large banks under requirements established by the US banking agencies as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act, as well as by the Dodd-Frank supervisory stress tests conducted by the FRB, the OCC and the FDIC. Additionally the OCC, FDIC and Federal Reserve recently published rules requiring financial companies with more than USD 10 billion in assets to conduct annual company-run stress tests using scenarios provided by the agencies that reflect a minimum of three sets of economic and financial conditions, including baseline, adverse and severely adverse scenarios.

5. Supervisory intervention measures

The US regulatory agencies use their supervisory and enforcement authorities to ensure that financial intuitions operate in a safe and sound manner and in compliance with the law. There is a broad range of supervisory and enforcement tools to achieve this purpose. When the normal supervisory process is insufficient or inappropriate to effect bank compliance with the law and the correction of unsafe or unsound practices, or circumstances otherwise warrant a heightened enforcement response, the agencies have a broad range of enforcement tools. Enforcement actions range from informal actions to formal actions. Where a banking organisation's capital is impaired, the agencies may issue a Capital Directive or a PCA Directive, when authorised by law.

Annex 15: US floor for banks using advanced Basel approaches

The risk-based capital ratio floor calculation based on the US standardised approach is imposed by statute. The floor is 100% of the US standardised approach ratio, and is considered more stringent than the Basel framework capital floor, which is 80% of Basel I requirements. It may be noted that additional stringency is provided by the calibration of the US standardised approach, which was designed to be more conservative on a framework to framework basis than the preceding general risk-based capital requirements that were based on the Basel I standards. Such a comparison is necessary to comply with certain statutory requirements under section 171 of the Dodd-Frank Act.[58]

The floor is implemented as follows: under the US rule in order to determine its minimum risk-based capital requirements, an advanced approaches banking organisation that has completed the parallel run process and that has received notification from its primary federal supervisor, must determine its minimum risk-based capital requirements by calculating the three risk-based capital ratios using total risk-weighted assets under the Standardised Approach and, separately, total risk-weighted assets under the advanced approaches. The lower ratio for each risk-based capital requirement is the ratio the banking organisation must use to determine its compliance with the minimum capital requirement.

For both ratios the capital definition is the same for CET1 and Tier 1. For the Total Capital ratio, however, the advanced approach excludes the general provisions included in Tier 2 (up to limit of 1.25% of standardised credit RWA) and includes excess provisions over expected losses (up to limit of 0.6% of credit RWA).

With respect to inclusion of risks in RWA, the differences between the US standardised and advanced approach capital ratios include:

- CVA risk is not included in standardised RWA.
- Operational risk is not included separately in standardised RWA.
- Market risk RWA: the standardised and advanced approaches are substantially identical. However, under the standardised approach the bank must use SSFA to determine the specific risk add-on for securitisation positions, whereas under the advanced approach the bank may use SFA (if permitted by the federal regulator).

[58] In particular, SEC 171 of Dodd-Frank states that "the minimum risk-based capital requirements established under this paragraph shall not be less than the generally applicable risk-based capital requirements, which shall serve as a floor for any capital requirements that the agency may require, nor quantitatively lower than the generally applicable risk-based capital requirements that were in effect for insured depository institutions as of the date of enactment of this Act".