DEPARTMENT OF REGULATORY AGENCIES

Division of Banking

COMMERCIAL BANKS

3 CCR 701-1

[Editor's Notes follow the text of the rules at the end of this CCR Document.]

CB1.1 Scope [Section 11-102-103, C.R.S.]

A. The Rules constitute a procedural guide for appearance and practice before, and action by, the Colorado State Banking Board. The Rules are promulgated pursuant to the provisions of the Colorado Banking Code, Section 11-102-103, C.R.S.

B. The regulations constitute substantive determinations of the Banking Board implementing various provisions of the Colorado Banking Code, as amended. Such regulations have been promulgated pursuant to the provisions of the Colorado Banking Code, Section 11-102-103, C.R.S.

CB1.11 Application Documents Confidential.

Applications and exhibits attached thereto shall be open to the public for reasonable examination in advance of the hearing. Upon request and for good cause shown, the Commissioner may suppress and treat as confidential all Financial and Biographical Reports attached to the application.

CB1.20 Decision and Order.

Copies of a decision and order of the Board shall be furnished by the Commissioner to all parties to the proceedings, to appropriate state and federal supervisory authorities, and to such other interested persons as the Commissioner may determine.

Every decision and order shall be signed by the Commissioner and shall bear the date of official publication. A copy of every decision and order shall be attached to the official minutes of the Board together with a certificate showing the persons to whom copies thereof have been provided.

CB101.7 Messenger Service

A. Definition. For purposes of this Rule, a "messenger service" refers to any service, such as a courier service or armored car service, that is used by a state bank (institution) and its customers to pick up from, and deliver to, specific customers at locations such as their homes or offices, items relating to transactions between the institution and such customers.

B. Pickup and delivery of items relating to nonbranching activities. An institution may establish and operate a messenger service, or use, with its customers, a third party messenger service, to transport items relevant to the institution's transactions with its customers without regard to the limitations set forth in Title 11, Article 105, C.R.S., provided the service does not engage in branching functions within the meaning of Section 11-101-401(10), C.R.S. In establishing or using such a facility, the institution may establish terms, conditions, and limitations that it deems appropriate to assure compliance with safe and sound banking practices.

C. Pickup delivery of items pertaining to branching functions by a messenger service established by a third party.

1. An institution and its customers may use a messenger service to pick up from, and deliver to, customers items that relate to branching functions within the meaning of Section 11-101-401(10), C.R.S. without regard to the limitations set forth in Title 11, Article 105, C.R.S., provided the messenger service is established and operated by a third party. In using such a facility, an institution may establish terms, conditions, and limitations, not inconsistent with this Rule, as it deems appropriate to assure compliance with safe and sound banking practices.

2. Whether a messenger service is established by a third party is based on a case-by-case review of all of the circumstances, provided a messenger service is established by a third party if:

   a. A party other than the institution owns the service and its facilities, or rents them from another party other than the institution, and employs the persons engaged in the provision of the service; and

   b. The messenger service:

      (1) Makes its services available to the public, including other depository institutions;

      (2) Retains ultimate discretion to determine which customers and geographical areas it will serve;

      (3) Maintains ultimate responsibility for scheduling, movement, and routing;

      (4) Does not operate under the name of the institution, and the institution and the messenger service do not advertise, or otherwise represent, that the institution itself is providing the service, although the institution may advertise that its customers may use one or more third party messenger services to transact business with the institution;

      (5) Assumes responsibility for the items during transit and maintains adequate insurance covering holdups, employee fidelity, and other in-transit losses; and

      (6) Enters into contracts with customers that provide that the messenger service acts as the agent for the customer when the items are in transit between the institution and the customer and, in the case of items intended for deposit, such items shall not be deemed to have been deposited until delivered to the institution at an established institution office, and, in the case of items representing withdrawals, such items shall be deemed to be paid when the item is given to the messenger service.

3. An institution is permitted to defray all or a part of the costs incurred by a customer in transporting items through a messenger service. Payment of such expenses may only cover costs associated with each transaction involving the customer and the messenger service. The institution may impose such terms, conditions, and limitations as it may deem appropriate with respect to the payment of such cost.

D. Pickup and delivery of items pertaining to branching activities where the messenger service is established by the institution.

An institution may establish and operate a messenger service to transport items relevant to the institution's transactions with its customers if such transactions involve one or more branching functions within the meaning of Section 11-101-401(10), C.R.S., provided the institution receives approval to establish the proposed branch pursuant to the relevant provisions of Title 11, Article 105, C.R.S. and Banking Board Rule CB101.54.

CB101.10 Fiduciary Self-Dealing [Section 11-102-104, C.R.S.]

A. Unless lawfully authorized by the instrument creating the relationship, by court order or by Colorado law, funds held by a state bank as fiduciary shall not be invested in stock or obligations of, or property acquired from, the bank or its directors, officers or employees of such affiliates. If the retention of stock or obligations of the bank or its affiliates is authorized by the instrument creating the relationship, by a court order or by Colorado law, a state bank as fiduciary may exercise rights to purchase its own stock or securities convertible into its own stock when offered pro rate to stockholders. When the exercise of rights or receipt of the stock dividend results in fractional share holding, additional fractional shares may be purchased to compliment the fractional shares acquired.

B. A state bank may sell assets held by it as fiduciary in one account if the transaction is fair to both accounts and if such transaction is not prohibited by the terms of the governing instrument.

C. A state bank may deposit funds of the estate or trust account as time or demand deposits in its own banking department and may borrow money on behalf of the fiduciary account from itself and may pledge or encumber estate or trust assets as security for such loan, provided such transactions are fair to the fiduciary account.

CB101.24 Agricultural Credit Corporations. [Section 11-105-304, C.R.S.]

A. A state bank may invest in an agricultural credit corporation upon application to and approval by the Banking Board. The Banking Board shall retain continuing authority to grant or deny each individual request based upon the information submitted therewith.

CB101.29 Bankers' Blanket Bond [Section 11-103-601, C.R.S.]

A. Any bankers' blanket bond procured by a state bank to satisfy the requirements of Section 11-103-601, C.R.S., shall provide that the bonding company providing the bond shall give at least ninety (90) days notice of cancellation or non-renewal of such bond to the bank and to the Commissioner.

B. Any state bank that experiences difficulty in obtaining and maintaining blanket bond coverage shall notify the Commissioner:

1. When there is a lapse in fidelity coverage; and

2. Monthly thereafter concerning actions and progress in obtaining coverage.

CB101.31 Lease Financing [Section 11-102-104, C.R.S.]

A. General Authority

A state bank may engage in lease financing transactions provided the lease is a net, full payout lease, representing a non-cancelable obligation of the lessee. A “net lease” is a lease in which the bank is not directly or indirectly obligated to assume the expenses of maintaining the property. A “full payout” lease is a lease for which the bank expects to realize both return of its full investment and the cost of financing the property over the term of the lease. This payout can come from (1) rentals; (2) estimated tax benefits; and (3) the estimated residual value of the property at the expiration of the term of the lease.

B. Limitations

Lease financing transactions entered into pursuant to this Rule are subject to the limitations on loans or extensions of credit pursuant to Banking Board Rule CB101.64. The Banking Board reserves the right to determine that such leases are also subject to the limitations of any other law, rule, or order.

C. Restrictions on Transactions with Affiliates

Lease financing transactions entered into pursuant to this Rule are subject to the following restrictions on transactions with affiliates:

1. The terms and circumstances of the transaction, including credit standards, must be substantially the same, or at least as favorable to the bank or its subsidiary as those prevailing at the time for comparable transactions with or involving other non affiliated companies;

2. In the case of any affiliate, the aggregate amount of lease transactions of the bank and its subsidiaries does not exceed 10 percent of the total capital of the bank; and

3. In the case of all affiliates, the aggregate amount of lease transactions of the bank and its subsidiaries does not exceed 20 percent of the total capital of the bank.

For the purposes of this Rule, any transaction by a bank with any person shall be deemed to be a transaction with an affiliate to the extent that the proceeds of the transaction are used for the benefit of, or transferred to that affiliate.

D. A bank may purchase or construct a municipal building, such as a school building, or other similar public facility and, as holder of legal title, lease the same to a municipality or other public authority having resources sufficient to make payment of all rentals as they become due. The lease agreement shall provide that upon its expiration the lessee will become owner of the building or facility.

E. Reference

1. Banking Board Rule CB101.64 is a Rule enacted by the Colorado State Banking Board and is administered by the Colorado Division of Banking.

2. For more detailed information pertaining to these provisions, please contact the Secretary to the Colorado State Banking Board at 1560 Broadway, Suite 1175, Denver, Colorado 80202, (303) 894-7575.

CB101.32 Activities That are Primarily Investments in Real Estate [Section 11-105-304(9)(a), C.R.S.

A. Pursuant to the provisions of Section 11-105-304(9)(a), C.R.S., a state chartered bank may make investments, not to exceed ten percent of its total assets, that are primarily investments in real estate, or may acquire and hold the voting stock of one or more corporations the activities of which are primarily investments in real estate; except that, unless otherwise approved by the Banking Board:

1. No state bank that has a regulatory composite examination rating (CAMELS) of “4” or “5” from any regulator shall make investments pursuant to Section 11-105-304(9)(a), C.R.S.; and

2. No state bank that has a regulatory composite examination rating (CAMELS) of “3” from any regulator and that is subject to a memorandum of understanding, cease and desist order, written agreement imposed by or entered into with any regulator of the state bank shall make total investments pursuant to Section 11-105-304(9)(a), C.R.S., in excess of five percent of its total assets.

CB101.36 Assessments and Fees

(Repealed and recodified within 701-10, AR16)

CB101.37 Transactions With Affiliates and Loans to Executive Officers, Directors, and Principal Shareholders [Section 11-105-302, C.R.S.]

A. Transactions With Affiliates

1. General Restrictions

a. A bank and its subsidiaries may engage in a covered transaction with an affiliate only if:

(1) In the case of any affiliate, the aggregate amount of covered transactions of the bank and its subsidiaries will not exceed 10 percent of the capital stock and surplus of the bank; and

(2) In the case of all affiliates, the aggregate amount of covered transactions of the bank and its subsidiaries will not exceed 20 percent of the capital stock and surplus of the bank.

b. For the purpose of this Rule, any transaction by a bank with any person shall be deemed to be a transaction with an affiliate to the extent that the proceeds of the transaction are used for the benefit of, or transferred to, that affiliate.

c. A bank and its subsidiaries may not purchase a low-quality asset from an affiliate unless the bank or such subsidiary, pursuant to an independent credit evaluation, committed itself to purchase such asset prior to the time such asset was acquired by the affiliate.

d. Any covered transactions and any transactions exempt under Paragraph (A)(4) of this Rule between a bank and an affiliate shall be on terms and conditions that are consistent with safe and sound banking practice.

2. Definitions

a. For the purpose of this Rule, the term “affiliate” with respect to a bank means:

(1) Any company that controls the bank and any other company that is controlled by the company that controls the bank;

(2) A bank subsidiary of the bank;

(3) Any company:

(a) That is controlled directly or indirectly, by a trust or otherwise, by or for the benefit of shareholders who beneficially or otherwise control, directly or indirectly, by trust or otherwise, the bank or any company that controls the bank; or

(b) In which a majority of its directors or trustees constitute a majority of the persons holding any such office with the bank or any company that controls the bank.

(4) Any company, including a real estate investment trust, that is sponsored and advised on a contractual basis by the bank or any subsidiary or affiliate of the bank; or

(5) Any investment company with respect to which a bank or any affiliate thereof is an investment advisor as defined in paragraph (1)(a)(20) of the investment company act of 1940; and

(6) Any company that the Division of Banking determines to have a relationship with the bank or any subsidiary or affiliate of the bank, such that covered transactions by the bank or its subsidiary with that company may be affected by the relationship to the detriment of the bank or its subsidiary.

b. The following shall not be considered to be an affiliate:

(1) Any company, other than a bank, that is a subsidiary of a bank, unless a determination is made under Paragraph (A)(2)(a)(6) of this Rule not to exclude such subsidiary company from the definition of affiliate;

(2) Any company engaged solely in holding the premises of the bank;

(3) Any company engaged solely in conducting a safe deposit business;

(4) Any company engaged solely in holding obligations of the United States or its agencies or obligations fully guaranteed by the United States or its agencies as to principal and interest; and

(5) Any company where control results from the exercise of rights arising out of a bonafide debt previously contracted, but only for the period of time specifically authorized under applicable state or federal law or regulation or, in the absence of such law or regulation, for a period of two years from the date of the exercise of such rights or the effective date of this Rule, whichever date is later, subject upon application to authorization by the Banking Board for good cause shown for extensions of time of not more than one year at a time; however, such extensions in the aggregate shall not exceed three years.

c. A company or shareholder shall be deemed to have control over another company if:

(1) Such company or shareholder, directly or indirectly, or acting through one or more other persons, owns, controls, or has power to vote 25 percent or more of any class of voting securities of the other company;

(2) Such company or shareholder controls in any manner the election of a majority of the directors or trustees of the other company; or

(3) The Division of Banking determines that such company or shareholder, directly or indirectly, exercises a controlling influence over the management or policies of the other company; and

(4) Notwithstanding any other provision of this Rule, no company shall be deemed to own or control another company by virtue of its ownership or control of shares in a fiduciary capacity, except as provided in Paragraph (A)(2)(a)(3) of this Rule, or if the company owning or controlling such shares is a business trust.

d. The term “subsidiary” with respect to a specified company means a company that is controlled by such specified company.

e. The term “bank” includes a state bank, industrial bank, and banking association.

f. The term “company” means a corporation, partnership, business trust, association, or similar organization and, unless specifically excluded, the term “company” includes a “member bank” and a “bank.”

g. The term “covered transaction” means with respect to an affiliate of a bank:

(1) Loan or extension of credit to the affiliate;

(2) A purchase of or an investment in securities issued by the affiliate; and

(3) A purchase of assets, including assets subject to an agreement to repurchase, from the affiliate, except such purchase of real and personal property as may be specifically exempted by the Banking Board by order of regulation.

h. The term “aggregate amount of covered transactions” means the amount of the covered transactions about to be engaged in added to the current amount of all outstanding covered transactions.

i. The term “securities” means stocks, bonds, debentures, notes, or other similar obligations.

j. The term “low quality asset” means an asset that falls in any one or more of the following categories:

(1) An asset classified as “substandard,” “doubtful,” or “loss,” or treated as “other loans especially mentioned” in the most recent report of examination or inspection of an affiliate prepared by either a federal or state supervisory agency;

(2) An asset in a nonaccrual status;

(3) An asset on which principal or interest payments are more than thirty days past due; or

(4) An asset whose terms have been renegotiated or compromised due to the deteriorating financial condition of the obligor.

k. The term “person” means an individual or a company.

3. Collateral for Certain Transactions with Affiliates

a. Each loan or extension of credit to, or guarantee, acceptance, or letter of credit issued on behalf of, an affiliate by a bank or its subsidiary shall be secured at the time of the transaction by collateral having a market value equal to:

(1) One hundred percent of the amount of such loan or extension of credit, guarantee, acceptance, or letter of credit, if the collateral is composed of:

(a) Obligations of the United States or its agencies;

(b) Obligations fully guaranteed by the United States or its agencies as to principal and interest;

(c) Notes, drafts, bills of exchange or bankers acceptances that are eligible for rediscount or purchase by a Federal Reserve Bank; or

(d) A segregated, earmarked deposit account with the member bank.

(2) One hundred ten percent of the amount of such loan or extension of credit, guarantee, acceptance, or letter of credit if the collateral is composed of obligations of any state or political subdivision of any state;

(3) One hundred twenty percent of the amount of such loan or extension of credit, guarantee, acceptance, or letter of credit if the collateral is composed of other debt instruments, including receivables; or

(4) One hundred thirty percent of the amount of such loan or extension of credit, guarantee, acceptance, or letter of credit if the collateral is composed of stock, leases, or other real or personal property.

b. Any such collateral that is subsequently retired or amortized shall be replaced by additional eligible collateral where needed to keep the percentage of the collateral value relative to the amount of the outstanding loan or extension of credit, guarantee, acceptance, or letter of credit equal to the minimum percentage required at the inception of the transaction.

c. A low-quality asset shall not be acceptable as collateral for a loan or extension of credit to, or guarantee, acceptance, or letter of credit issued on behalf of, an affiliate.

d. The securities issued by an affiliate of the bank shall not be acceptable as collateral for a loan or extension of credit to, or guarantee, acceptance, or letter of credit issued on behalf of, that affiliate or any other affiliate of the bank.

e. The collateral requirements of this paragraph shall not be applicable to an acceptance that is already fully secured either by attached documents or by other property having an ascertainable market value that is involved in the transaction.

4. Exemptions: The provisions of this section, except Paragraph (A)(1)(d) of this Rule, shall not be applicable to:

a. Any transaction, subject to the prohibition contained in Paragraph (A)(1)(c) of this Rule, with a bank:

(1) Which controls 80 percent or more of the voting shares of the member bank;

(2) In which the bank controls 80 percent or more of the voting shares; or

(3) In which 80 percent or more of the voting shares are controlled by the company that controls 80 percent or more of the voting shares of the bank.

b. Making deposits in an affiliated bank or affiliated foreign bank in the ordinary course of correspondent business, subject to any restrictions that the Division of Banking may prescribe.

c. Giving immediate credit to an affiliate for uncollected items received in the ordinary course of business.

d. Making a loan or extension of credit to, or issuing a guarantee, acceptance, or letter of credit on behalf of, an affiliate that is fully secured by:

(1) Obligations of the United States or its agencies;

(2) Obligations fully guaranteed by the United States or its agencies as to principal and interest; or

(3) A segregated, earmarked deposit account with the bank.

e. Purchasing securities issued by any company of the kinds described in section 4(c)(1) of the Bank Holding Company Act of 1956.

f. Purchasing assets having a readily identifiable and publicly available market quotation and purchased at that market quotation or, subject the prohibition contained in Paragraph (A)(1)(3) of this Rule, purchasing loans on a nonrecourse basis from affiliated banks.

g. Purchasing from an affiliate a loan or extension of credit that was originated by the bank and sold to the affiliate subject to a repurchase agreement or with recourse.

5. Rulemaking and Additional Exemptions

a. The Banking Board may issue such further regulations, including definitions consistent with this Paragraph (A)(2) of this Rule, as may be necessary to administer and carry out the purposes of this section and to prevent evasions thereof and as are consistent with federal banking law or regulation.

b. The Banking Board may, at its discretion, by regulation exempt transactions or relationships from the requirements of Paragraph (A)(1) and (A)(3) of this Rule if it finds such exemptions to be in the public interest and consistent with the purposes of this paragraph and as are consistent with federal banking law or regulation.

B. Restrictions on Transactions With Affiliates

1. General Provisions

a. Terms. A bank and its subsidiaries may engage in any of the transactions described in Paragraph (B)(1)(b) of this Rule only:

(1) On terms and under circumstances, including credit standards, that are substantially the same, or at least as favorable to such bank or its subsidiary, as those prevailing at the time for comparable transactions with or involving other nonaffiliated companies; or

(2) In the absence of comparable transactions, on terms and under circumstances, including credit standards, that in good faith would be offered to or would apply to nonaffiliated companies.

b. Transactions covered. Paragraph (B)(1)(a) of this Rule applies to the following:

(1) Any covered transaction with an affiliate;

(2) The sale of securities or other assets to an affiliate, including assets subject to an agreement to repurchase;

(3) The payment of money or the furnishing of services to an affiliate under contract, lease, or otherwise;

(4) Any transaction in which an affiliate acts as an agent, or broker, or receives a fee for its services to the bank or to any other person; and

(5) Any transaction or series of transactions with a third party:

(a) If an affiliate has a financial interest in the third party; or

(b) If an affiliate is a participant in such transaction or series of transactions.

c. Transactions that Benefit an Affiliate. For the purpose of Paragraph (B)(1) of this Rule, any transaction by a member or its subsidiary with any person shall be deemed to be a transaction with an affiliate of such bank if any of the proceeds of the transaction are used for the benefit of, or transferred to, such affiliate.

2. Prohibited Transactions

a. In General. A bank or its subsidiary:

(1) Shall not purchase as fiduciary any securities or other assets from any affiliate unless such purchase is permitted:

(a) Under the instrument creating the fiduciary relationship;

(b) By court order; or

(c) By law of the jurisdiction governing the fiduciary relationship; and

(2) Whether acting as a principal or fiduciary, shall not knowingly purchase or otherwise acquire, during the existence of any underwriting or selling syndicate, any security if a principal underwriter of that security is an affiliate of such bank.

b. Exception. Paragraph (B)(1)(a)(2) of this Rule shall not apply if the purchase or acquisition of such securities has been approved, before such securities are initially offered for sale to the public, by a majority of the directors of the bank who are not officers or employees of the bank or any affiliate thereof.

c. Definitions. For the purpose of Paragraph (B) of this Rule:

(1) The term “security” has the meaning given to such term in section 3(a)(10) of the Securities Exchange Act of 1934; and

(2) The term “principal underwriter” means any underwriter who, in connection with a primary distribution of securities:

(a) Is in privity of contract with the issuer or an affiliated person of the issuer;

(b) Is acting alone or in concert with one or more other persons, initiates or directs the formation of an underwriting syndicate; or

(c) Is allowed a rate of gross commission, spread, or other profit greater than the rate allowed another underwriter participating in the distribution.

3. Advertising Restriction. A member bank or any subsidiary or affiliate of a member bank shall not publish any advertisement or enter into any agreement stating or suggesting that the bank shall in any way be responsible for the obligations of its affiliates.

4. Definitions. For the purpose of Paragraph (B) of this Rule:

   a. The term “affiliate” has the meaning given to such term in Paragraph (A)(2)(a) of this Rule; but does not include any company described in Paragraph (A)(2)(b) of this Rule, or any bank;

   b. The terms “bank,” “subsidiary,” “person,” and “security,” other than security as used in Paragraph (B)(2) of this Rule have the meanings given to such terms in Paragraph (A)(2) of this Rule; and

   c. The term “covered transaction” has the meaning given to such term in Paragraph (A)(2)(g) of this Rule, but does not include any transaction which is exempt from such definition under Paragraph (A)(4) of this Rule.

5. Regulations. The Banking Board may prescribe regulations as are consistent with federal banking law or regulation to administer and carry out the purposes of Paragraph (B) of this Rule, including:

   a. Regulations to further define terms used in Paragraph (B) of this Rule; and

   b. Regulations to:

      (1) Exempt transactions or relationships from the requirements of Paragraph (B) of this Rule; and

      (2) Exclude any subsidiary of a bank holding company from the definition of affiliate for purposes of Paragraph (B) of this Rule if the Banking Board finds such exemptions or exclusions are in the public interest and are consistent with the purposes of Paragraph (B) of this Rule.

C. Loans to Executive Officers, Directors, and Principal Shareholders

1. General Prohibitions

   a. Terms and Creditworthiness

   No bank may extend credit to any of its executive officers, directors, or principal shareholders or to any related interest of that person unless the extension of credit:

      (1) Is made on substantially the same terms (including interest rates and collateral) as, and following credit-underwriting procedures that are not less stringent than, those prevailing at the time for comparable transactions by the bank with other persons that are not covered by this Rule; and

      (2) Does not involve more than the normal risk of repayment or present other unfavorable features.

      (3) Exception. Nothing in this Rule shall prohibit any extension of credit made pursuant to a benefit or compensation program that:

(a) Is widely available to employees of the bank and, in the case of extensions of credit to an insider of its affiliates, is widely available to employees of the affiliates at which that person is an insider; and

(b) Does not give preference to any insider of the bank over the other employees of the bank and, in the case of extensions of credit to an insider of its affiliates, does not give preference to any insider of its affiliates over other employees of the affiliates at which that person is an insider.

b. Prior Approval

(1) No bank may extend credit (which term includes granting a line of credit) to any of its executive officers, directors, or principal shareholders or to any related interest of that person in an amount that, when aggregated with the amount of all other extensions of credit to that person and to all related interests of that person, exceeds the higher of $25,000 or 5 percent of the bank’s total capital unless:

(a) The extension of credit has been approved in advance by a majority of the entire Board of Directors of the bank; and

(b) The interested party has abstained from participating directly or indirectly in the voting.

(2) In no event may a bank extend credit to any one of its executive officers, directors, or principal shareholders, or to any related interest of that person, in an amount that, when aggregated with all other extensions of credit to that person, and all related interests of that person, exceeds $500,000, except by complying with the requirements of this paragraph.

(3) Approval by the Board of Directors under Paragraph (C)(1)(b)(1) and (b)(2) of this44 Rule is not required for an extension of credit that is made pursuant to a line of credit that was approved under Paragraph (C)(1)(b)(1) of this Rule within 14 months of the date of the extension of credit. The extension of credit must also be in compliance with the requirements of Paragraph (C) of this Rule.

(4) Participation in the discussion, or any attempt to influence the voting by the Board of Directors regarding an extension of credit constitutes indirect participation in the voting by the Board of Directors on an extension of credit.

c. Lending Limit

No bank may extend credit to any of its executive officers or principal shareholders or to any related interest of that person in an amount that, when aggregated with the amount of all other extensions of credit by the bank to that person, exceeds the lending limit of the bank specified in Banking Board Rule CB101.64. This prohibition does not apply to an extension of credit by a bank to a company of which the bank is a subsidiary or to any other subsidiary of that company.

d. Aggregate Lending Limit

(1) General Limit. A bank may not extend credit to any insider unless the extension of credit is in an amount that, when aggregated with the amount of all outstanding extensions of credit by that bank to all of its insiders, does not exceed the bank’s total capital.

(2) Banks with Deposits of Less Than $100,000,000. Banks with deposits of less than $100,000,000 may by resolution of its Board of Directors increase the general limit specified in Paragraph (C)(1)(d)(1) of this Rule for a period ending May 18, 1993, to a level not to exceed two times the bank’s total capital, if:

(a) The Board of Directors determines that such higher limit is consistent with prudent, safe, and sound banking practices in light of the bank’s experience in lending to its insiders and is necessary to attract or retain directors or to prevent restricting the availability of credit in small communities;

(b) The resolution sets forth the facts and reasoning on which the Board of Directors bases the finding, including the amount of the bank’s lending limit to its insiders as a percentage of the bank’s total capital as of the date of the resolution;

(c) The bank has submitted the resolution to the Division of Banking;

(d) The bank meets or exceeds, on a fully phased-in basis, all applicable capital requirements established by the Banking Board; and

(e) The bank received a satisfactory composite rating in its most recent report of examination.

e. Overdrafts

(1) No bank may pay an overdraft of an executive officer or director of the bank or executive officer or director of its affiliates on an account at the bank, unless the payment of funds is made in accordance with:

(a) A written, preauthorized, interest-bearing extension of credit plan that specifies a method of repayment; or

(b) A written, preauthorized transfer of funds from another account of the account holder at the bank.

(2) This prohibition does not apply to payment of inadvertent overdrafts on an account in an aggregate amount of $1,000 or less, provided:

(a) The account is not overdrawn for more than five business days; and

(b) The bank charges the executive officer or director the same fee charged any other customer of the bank in similar circumstances.

(3) This prohibition does not apply to the payment by a bank of an overdraft of a principal shareholder of the bank, unless the principal shareholder is also an executive officer or director. This prohibition also does not apply to the payment by a bank of an overdraft of a related interest of an executive officer, director, or principal shareholder of the bank.

2. Additional Restrictions on Loans to Executive Officers

a. No bank may extend credit to any of its executive officers, and no executive officer of a bank shall borrow from or otherwise become indebted to the bank, except in the amounts, for the purposes, and upon the conditions specified in Paragraphs (C)(2)(c) and (d) of this Rule.

b. No bank may extend credit in an aggregate amount greater than the amount permitted in Paragraph (C)(2)(c)(3) of this Rule to a partnership in which one or more of the bank's executive officers are partners, and either individually or together, hold a majority interest. For the purposes of Paragraph (C)(2)(c)(3) of this Rule, the total amount of credit extended by a bank to such partnership is considered to be extended to each executive officer of the bank who is a member of the partnership.

c. A bank is authorized to extend credit to any executive officer of the bank:

(1) In any amount to finance the education of the executive officer's children;

(2) In any amount to finance or refinance the purchase, construction, maintenance, or improvement of a residence of the executive officer, if the extension of credit is secured by a first lien on the residence and the residence is owned (or expected to be owned after the extension of credit) by the executive officer. ("First lien" for the purpose of this Paragraph of this Rule includes not only a first mortgage or deed of trust but also a second or other junior mortgage or deed of trust where the bank holds all prior encumbrances and such junior encumbrance has the same priority with respect to liens of third parties as the first mortgage or deed of trust); and in the case of a refinancing, that only the amount thereof used to repay the original extension of credit, together with the closing costs of the refinancing, and any additional amount thereof used for any of the purposes enumerated in this paragraph (C)(2)(c)(2), are included within this category of credit; and

(3) For any other purpose not specified in Paragraphs (C)(2)(c)(1) and (2) of this Rule, if the aggregate amount of loans to that officer under this paragraph does not exceed at any one time the higher of 2.5 percent of the bank's total capital or $25,000, but in no event more than $100,000.

d. Any extension of credit by a bank to any of its executive officers shall be:

(1) Promptly reported to the bank's board of directors;

(2) In compliance with the requirements of general prohibitions, of Paragraph (C)(1) of this Rule;

(3) Preceded by the submission of a detailed current financial statement of the executive officer; and

(4) Made subject to the condition that the extension of credit will, at the option of the bank, become due and payable at any time that the officer is indebted to any other bank or banks in an aggregate amount greater than the amount specified for a category of credit in Paragraph (C)(2)(c) of this Rule.

3. Reference

a. Banking Board Rule CB101.64 is a Rule enacted by the Colorado State Banking Board and is administered by the Colorado Division of Banking.

b. This Rule does not include amendments to or editions of the referenced material later than the effective date of this Rule, June 30, 1997.

c. For more detailed information pertaining to these provisions, please contact the secretary to the Colorado State Banking Board at 1560 Broadway, Suite 1175, Denver Colorado 80202, (303) 894-7575.

CB101.38 Loans Secured by Corporate Stock [Section 11-105-302, C.R.S.]

A. No state bank shall make any loan or discount secured by the shares of its own capital stock or by its obligations subordinate to deposits. No state bank shall purchase the stock of any other corporation except such as it may necessarily acquire in the protection or satisfaction of previously existing loans made in good faith and except as provided by statute, including Section 11-105-304, C.R.S. A state bank may purchase its own stock upon obtaining written approval from the Colorado Division of Banking, and the affirmative vote of shareholders owning two-thirds of the bank's capital stock. The repurchase of such stock shall be in accordance with Section 7-106-302, C.R.S. This Rule shall not apply to any investment made by a bank acting as a fiduciary pursuant to the authority of Section 11-106-102, C.R.S., nor shall it apply to investments made pursuant to the authority of Sections 11-105-304(2), 11-105-304(9)(a), or 11-105-501, C.R.S.

CB101.39 Sale of Federal Funds [Section 11-105-302, C.R.S.]

A. Definition. "Sale of Federal funds" means, for purposes of this Rule, any transaction among depository institutions involving the transfer of immediately available funds resulting from credits to deposit balances at Federal Reserve banks or from credits to new or existing deposit balances due from a correspondent depository institution.

B. Sales of Federal funds with a maturity of one business day, or under a continuing contract, are not "loans and extensions of credit" for purposes of lending limits. However, sales of Federal funds with a maturity of more than one business day are subject to the lending limits.

C. A "continuing contract" refers to an agreement that remains in effect for more than one business day but has no specified maturity and requires no advance notice for termination.

CB101.40 Investment in Small Business Investment Companies [Section 11-105-304, C.R.S.]

A. Shares of stock in small business investment companies organized under the Small Business Investment Act of 1958, 15 USC 661 et seq., administered by the Small Business Administration, shall be eligible for purchase by state banks to the extent that in no event shall any state bank hold shares in an amount aggregating more than three percent of the bank's total capital.

B. This Rule does not include amendments to or editions of the referenced material later than the effective date of the Rule, July 1, 1990. For more detailed information pertaining to these provisions, please contact the secretary to the Colorado State Banking Board at 1560 Broadway, Suite 1175, Denver, Colorado 80202, 303-894-7584.

CB101.41 Investment in a Bank Service Corporation [Section 11-105-304, C.R.S.]

A. A state bank may invest not more than 10 percent of total capital, as defined in Banking Board Rule CB101.52, Paragraph (B)(33), in a bank service corporation. No state bank shall invest more than 5 percent of its total assets in a bank service corporation.

CB101.42 Loans [Section 11-105-303, C.R.S.]

Any state bank may make, arrange, purchase, or sell the following types of loans and extensions of credit.

A. Real Estate Lending

1. General.

a. Any state bank may make, arrange, purchase, or sell loans or extensions of credit secured by liens on interests in real estate.

2. Scope.

a. For the purposes of this Rule, loans secured by liens on interests in real estate include loans made upon the security of condominiums, leaseholds, cooperatives, forest tracts, construction project loans (except as specified in Paragraphs (B)(6) and (7) of this Rule), and land sales contracts.

B. Other

1. Insured or Guaranteed Loans.

a. When the bank relies substantially on the insurance or guaranty of a governmental agency in making a loan. This includes loans that are:

(1) Insured under the provisions of the National Housing Act, 12 USC 1701 et seq., administered by the Secretary of Housing and Urban Development;

(2) Insured under the provisions of the Bankhead-Jones Farm Tenant Act, 7 USC 1000 et seq., administered by the Secretary of Agriculture, or under the Housing Act of August 28, 1937, 42 USC 1401 et seq., administered by the Department of Housing and Urban Development, or Title V of the Housing Act of 1949, 42 USC 1441 et seq., administered by the Department of Housing and Urban Development;

(3) Guaranteed by the Secretary of Housing and Urban Development, for the payment of obligations of which the full faith and credit of the United States is pledged;

(4) Fully guaranteed or insured by a state, any agency or instrumentality of a state, or by a state authority for the payment of obligations of which the full faith and credit of the state is pledged, if under the terms of the guaranty or insurance agreement the bank will be assured of repayment in accordance with the terms of the loan;

(5) At least 20 percent guaranteed or insured under the provisions of the Servicemen's Readjustment Act, 38 USC 1801 et seq., administered by the Administrator of Veterans Affairs;

(6) Guaranteed under section 802 of the Housing and Community Development Act, 42 USC 5301 et seq., administered by the Secretary of Housing and Urban Development;

(7) Subject to a firm commitment to insure by a Government insuring agency. A firm commitment is a commitment in which a specific mortgagor is named; and

(8) Loans in which the Small Business Administration cooperates through agreements to participate on an immediate or deferred or guaranteed basis under the Small Business Act, 15 USC 631 et seq., administered by the Small Business Administration.

b. When the bank relies substantially upon private company mortgage insurance or guaranty, but only to the extent of the insurance or guaranty.

2. Loans where the Bank looks for repayment by relying primarily on the borrower's general credit standing and forecast of income.

3. Loans secured by an assignment of rents under a lease.

4. Loans secured by the pledge or assignment of another real estate mortgage.

5. Loans secured by a valid lien on timber.

6. Loans having maturities not to exceed sixty (60) months made to finance the construction of a building or buildings, where there is a valid and binding agreement entered into by a financially responsible lender or other party to advance the full amount of the bank's loan upon completion of the building or buildings.

7. Loans having maturities not to exceed sixty (60) months made to finance the construction of residential or farm buildings.

8. Loans for which a security interest is taken in a mobile home.

9. Loans made previously where a security interest in real estate is taken subsequently in good faith.

10. Any type loan that a national bank has the authority to make pursuant to the provisions of Section 24 of the National Bank Act, 12 USC 1 et seq., administered by the Comptroller of the Currency.

11. Any type loan approved from time to time by the Banking Board.

C. Reference

This Rule does not include amendments to or editions of the referenced material later than the effective date of the rule, July 1, 1990. For more detailed information pertaining to these provisions, please contact the secretary to the Colorado State Banking Board at 1560 Broadway, Suite 1175, Denver, Colorado 80202, 303 894-7584.

CB101.44 Dividends [Section 11-103-406, C.R.S.]

A. Purpose

This Rule applies restrictions to the declaration and payment of dividends by a state chartered commercial bank.

B. Definitions

For the purposes of this Rule, the following definitions apply:

1. Capital surplus means the total of surplus as reportable in the bank's Report of Condition and Income and surplus on perpetual preferred stock.

2. Retained net income means the net income of a specified period less the total amount of all dividends declared in that period.

C. Earnings Limitation on Payment of Dividends

Unless the dividend is approved by the Banking Board, a bank shall not declare a dividend if the total amount of all dividends, including the proposed dividend, declared by such state bank in any calendar year exceeds the total of the bank's retained net income of that year to date, combined with its retained net income of the preceding two years. The bank's net income during the current year and its retained net income from the prior two calendar years is reduced by any net losses incurred in the current or prior two years, and any required transfers to surplus or to a fund for the retirement of preferred stock.

D. Date of Declaration of Dividend

The state bank shall use the date a dividend is declared for the purposes of determining compliance with this Rule.

CB101.45 Generally Accepted Accounting Principles [Section 11-103-502(3)(a), C.R.S.]

A. Generally accepted accounting principles (GAAP) as defined in this Rule shall consist of those opinions and statements generally recognized and supported by the Accounting Principles Board (APB) or the Financial Accounting Standards Board (FASB).

B. While it is the Banking Board's intention to require that GAAP be followed whenever appropriate, certain statements filed by banks with various state and federal regulatory agencies are supervisory and regulatory documents, not primarily accounting documents. Because of the special supervisory, regulatory, and economic policy needs of these reports, the instructions do not always follow GAAP. In reporting transactions not covered in principle by regulatory instructions, banks may follow GAAP. However, in such circumstances, unless the bank has already obtained a ruling from another regulatory agency pursuant to the policies expressed in Section 11-101-102, C.R.S., a specific ruling shall be sought promptly from the Banking Board.

C. References: GAAP are issued by the FASB which is an arm of the Financial Accounting Foundation, an independently chartered institution. The APB is a committee of the American Institute of Certified Public Accountants. This Rule does not include amendments to or editions of the referenced material later than the effective date of this Rule. For more detailed information pertaining to this Rule, please contact the Secretary to the Colorado State Banking Board at 1560 Broadway, Suite1175, Denver, Colorado 80202, 303-894-7584.

CB101.46 Standards for Determining Value of Asset [Section 11-102-102(3)(a), C.R.S.]

A. For purposes of this Rule, the standard for the value of an asset shall be the lower of cost or market.

B. Valuation reserves, such as for bad debts or fixed asset depreciation, shall be established and assets will be depreciated or amortized, where appropriate, as required by generally accepted accounting principles or regulatory authorities.

C. References: Generally accepted accounting principles are issued by the Financial Accounting Standards Board which is an arm of the Financial Accounting Foundation, an independently chartered institution. This Rule does not include amendments to or editions of the referenced material later than the effective date of the rule, July 1, 1990. For more detailed information pertaining to these provisions, please contact the secretary to the Colorado State Banking Board at 1560 Broadway, Suite 1175, Denver, Colorado 80202, 303-894-7584.

CB101.47 Reports of New Executive Officers, Directors, and Persons in Control and Related Late Filing Penalty [Section 11-102-303(8) and (9), C.R.S.]

A. Any person who becomes an executive officer, director, or person responsible, directly or indirectly, for the management, control or operation of a bank, must notify the Division of Banking in writing within ninety (90) days thereafter.

The written notice must include a statement describing any civil or criminal offenses of which such person has been found guilty or liable by any federal or state court or federal or state regulatory agency.

B. In addition, any person who becomes an executive officer, director, or person responsible, directly or indirectly, for the management, control, or operation of a bank, must file a biographical report with the Division of Banking within ninety (90) days thereafter, if:

1. The bank has been chartered less than two (2) years;

2. Within the preceding two (2) years, the bank has undergone a change in control that required a notice to be filed pursuant to Section 11-102-303, C.R.S.;

3. Within the preceding two (2) years, the bank holding company became a registered bank holding company, unless the bank holding company is owned or controlled by a registered bank holding company, or the bank holding company was established in a reorganization in which substantially all of the shareholders of the bank holding company were shareholders of the bank prior to the bank holding company's formation; or

4. The bank or bank holding company is not in compliance with all minimum capital requirements applicable to the institution as determined on the basis of the institution's most recent report of condition, examination, or is otherwise in a troubled condition as indicated by a composite rating of 3, 4, or 5 at the institution's most recent examination by a state or federal banking regulator.

   The biographical report to be filed with the Division of Banking may be either on the form provided by the Division of Banking or the form filed with the institution's federal regulator for reporting the change of executive officer, director, or person in control.

C. For the purposes of this Rule, except as provided in Paragraph (D), the term “director” does not include an advisory director who:

1. Is not elected by the shareholders of the bank;

2. Is not authorized to vote on any matters before the board of directors; and

3. Provides solely general policy advice to the board of directors.

D. The Banking Board or the Division of Banking may otherwise determine that additional reporting is required of any person who becomes an executive officer, director, or person in control. Written notice will be provided by the Division of Banking to such person of any additional requirements.

E. The Banking Board may assess a $25.00 per day penalty for late filing of reports of new executive officers, directors, and persons in control that are required by Section 11-102-303(8) and (9), C.R.S., and this Rule. Said penalty may be waived by the Banking Board pursuant to statute. Filing of an incorrect report form is not grounds for the waiving of the penalty.

CB101.48 Investment in Federal Home Loan Bank [Section 11-105-304(7), C.R.S.]

A. A state bank may purchase and hold stock in and become a member of the Federal Home Loan Bank for the purpose of utilizing the services of, or otherwise interacting with, the Federal Home Loan Bank. The Federal Home Loan Bank Act, 12 USC 1424, provides Federal Home Loan Bank membership to any eligible bank insured by the Federal Deposit Insurance Corporation.

B. The Federal Home Loan Bank Act, also known as 12 USC 1424, amended 1989, is a law enacted by the United States Congress and administered by the Federal Housing Finance Board. This Rule does not include amendments to or editions of the referenced material later than the effective date of this Rule, November 30, 1990. For detailed information pertaining to these provisions, please contact the secretary to the Colorado State Banking Board at 1560 Broadway, Suite 1175, Denver, Colorado 80202, 303-894-7584.

CB101.49 Scope of Directors' Examinations [Section 11-103-502(3)(b), C.R.S.]

A. Definitions

   For purposes of this Rule, the term “reviewer” shall mean such public accountant or other independent person(s) as determined by the Banking Board.

B. Examination Scope

For the purposes of Section 11-103-502(3)(b), C.R.S., a state bank (institution) at a minimum shall perform annually the procedures as set forth in Appendix A as the scope of a directors' examination. The recommended procedures are intended to address the high risk areas common to all financial institutions. However, each institution must review its own particular business and determine if additional procedures are required to cover other high risk areas. The reviewer should be informed of, and permitted access to, all examination reports, administrative orders, and any additional communications between the institution and the Division of Banking, including the Colorado State Banking Board, as well as the appropriate federal regulatory agency. The reviewer should obtain institution management's written representation that he or she has been informed of, and granted access to, all such documents prior to completion of the field work.

C. Extent of Testing

Where the procedures set forth in Appendix A require testing or determinations to be made, sampling may be used. Both judgmental and statistical sampling may be acceptable methods of selecting samples to test. Sample sizes should be consistent with generally accepted auditing standards, or as agreed upon by the reviewer and the institution client. In any event, the sampling method and extent of testing, including sample size(s) used, should be disclosed in the directors' examination report.

D. Reports to be Filed with the Division of Banking

After the completion of the procedures or agreed-upon procedures set forth in Appendix A, the independent reviewer should evaluate the results of his/her work and promptly prepare and submit a report addressed to the board of directors of the institution. This report should detail the findings and suggestions resulting from performance of these procedures. Independent reviewers should include in their report, at a minimum:

1. Financial statements (balance sheet and statement of earnings as of the examination date);

2. The accounts or items on which the procedures were applied;

3. The sampling methods used;

4. The procedures and agreed-upon extent of testing performed;

5. The accounting basis, either generally accepted accounting principles (GAAP) or regulatory required accounting, on which the accounts or items being audited are reported;

6. The reviewer's findings; and

7. The date as of which the procedures were performed.

The reviewer should sign and date the report, which should also disclose the reviewer's business address.

The institution must send a copy of the report, the engagement letter, and any management letter or similar letter of recommendation to the Division of Banking and the appropriate federal regulators within thirty (30) days after its receipt, but no later than one hundred fifty (150) days after the date of examination. In addition, each institution should promptly notify the Division of Banking when any reviewer is engaged to perform a directors' examination and when a change in its reviewer occurs.

E. References

Generally accepted accounting principles are issued by the Financial Accounting Standard Board which is an arm of the Financial Accounting Foundation, an independently chartered institution. Section 23A of the Federal Reserve Act, also known as 12 USC 371c, is a law enacted by the United States Congress and administered by the Board of Governors of the Federal Reserve System. Regulation O of the Board of Governors of the Federal Reserve System, also known as 12 CFR 215, is a regulation enacted by the Federal Reserve Board under the authority granted by the United States Congress and administered by the Board of Governors of the Federal Reserve System.

This Rule does not include amendments to or editions of the referenced materials later than the effective date of the Rule, October 24, 1990.

For more detailed information pertaining to this Rule, please contact the secretary to the Colorado State Banking Board at 1560 Broadway, Suite 975, Denver, CO 80202, 303-894-7575.

Appendix A - CB101.49

For the purposes of Section 11-103-502(3)(b), C.R.S., a state bank (institution), at a minimum, shall have the following procedures performed annually.

A. Loans

1. Determine that the institution has policies that address the lending and collection functions. Read the institution's loan policies to determine whether they address the following items:

   a. General fields of lending in which the institution will engage and the types of loans within each field;

   b. Descriptions of the institution's normal trade area and circumstances under which the institution may extend credit to borrowers outside of such area;

   c. Limitations on the maximum volume of each type of loan product in relation to total assets;

   d. Responsibility of the board of directors in reviewing, ratifying, or approving loans;

   e. Lending authority of the loan or executive committee (if such a committee exists);

   f. Adherence to legal limits;

   g. Types of secured and unsecured loans that will be granted;

   h. Circumstances under which extensions or renewals of loans are granted;

i. Guidelines for rates of interest and terms of repayment for secured and unsecured loans;

j. Documentation required by the institution for each type of secured and unsecured loan;

k. Limitations on the amount advanced in relation to the value of various types of collateral;

l. Limitations on the extension of credit through overdrafts;

m. Level or amount of loans granted in specific industries or specific geography locations;

n. Guidelines for participations purchased and/or sold;

o. Guidelines for documentation of new loans prior to approval and updating loan files throughout the life of the loan;

p. Guidelines for loan review procedures by institution personnel including:

(1) An identification or grouping of loans that warrant the special attention of management;

(2) For each loan identified, a statement or indication of the reason(s) why the particular loan merits special attention; and

(3) A mechanism for reporting periodically to the board on the status of each loan identified and the action(s) taken by management.

q. Collection procedures, including, but not limited to, actions to be taken against borrowers who fail to make timely payments;

r. Guidelines for nonaccrual loans (i.e., when an asset should be placed on nonaccrual, individuals responsible for identifying non-performing assets and placing them on nonaccrual, and circumstances under which an asset will be placed back on accrual.); and

s. Guidelines for in-substance foreclosures.

2. Review the board of directors' minutes to determine that the loan policies have been reviewed and approved. Through review of the board of directors' minutes and through inquiry of executive officers, determine whether the board of directors revises the policies and procedures periodically as needed.

3. Obtain Loan Committee or, if applicable, board of directors' minutes and through a comparison of loans made throughout the period with lending policies, determine whether loans are being made within the loan authorization policy.

4. Select a sample of borrowers, including loans from each major category, and determine through examination of loan files and other institution reports whether lending and collection policies are being followed (e.g., type of loan is in accordance with loan policy, funds were not advanced until after loan approval was received from proper loan authorization level, loan is within collateral policies, insurance coverage is adequate, and institution is named as loss payee).

5. Select a sample of borrowers from each major category of secured loans and determine through examinations of files and other institution reports whether collateral policies are being followed (e.g., loan is adequately collateralized, documentation is present and properly prepared, assignments are perfected, and collateral is properly valued, marketable, and has not become susceptible to deterioration in realizable value).

6. Review policies for checking floor plan merchandise, warehouse inventory and accounts receivable by responsible institution personnel and test for compliance.

7. Determine whether participations purchased and participations sold transactions have been reported to and authorized by the board of directors or loan committee, if applicable, through review of appropriate minutes.

8. On a test basis, review participations purchased to confirm that the institution does its own independent credit analysis. Also, review participation documents and determine that terms and conditions between the lead institution and participants are specified, including:

    a. Which party is paid first;

    b. What happens in the event of default;

    c. How set-offs received by either institution are to be treated;

    d. How collection expenses are to be divided; and

    e. Who is responsible to collect the note in the event of default

9. Confirm sample of participations purchased and participations sold with participating institutions to verify that they are legitimate transactions and that they are properly reflected as being with or without recourse in the institution's records.

10. Balance detail ledgers or reconcile computer generated trial balances with the general ledger control accounts for each major category of loans, including loans carried as past due or in a nonaccrual status.

11. Confirm a sample of all loans within each major category; include past due and nonaccrual loans in the verification process.

12. Review multiple loans to the same borrower with the same person as guarantor to determine if they were made on consecutive days to circumvent the loan authorization policy and to determine whether policies and procedures are designed to assure that all related credits are considered in loan granting and administration. Review these loans for relationships to institution insiders or their related interests.

13. From reports to the board on the status of loans identified as warranting special attention, review the disposition of a sample of loans no longer appearing on these reports.

14. Test loan interest income and accrued interest by:

    a. Determining the institutions method of calculating and recording interest accruals;

    b. Obtaining trial balances of accrued interest;

c. Testing the reconciliation of the trial balances to the general ledger;

d. Determining that interest accruals are not made on nonaccrual loans;

e. Selecting sample items from each major category of loans:

(1) Determining the stated interest rate and appropriate treatment of origination fees and costs;

(2) Testing receipt of payments and correctness of entries to applicable general ledger accounts;

(3) Calculating accrued interest and comparing it to the trial balance; and

(4) Reviewing recorded book value for appropriate accretion of discount (net origination fees) and amortization of premium (net origination costs); and

f. Performing an analytical review of yields on each major category of loans for reasonableness.

B. Allowance for Loan Losses

1. Test charge-offs and recoveries for proper authorization and/or reporting by reference to the board of directors' minutes. Review charged-off loans for any relationship with institution insiders or their related interests.

2. Review the institution's computation of the amount needed in the allowance for loan losses as of the end of the most recent quarter. Documentation should include consideration of the following matters:

a. General, local, national, and international (if applicable) economic conditions;

b. Trends in loan growth and depth of lending staff with expertise in these areas;

c. Concentrations of loans (e.g., by type, borrower, geographic area, and sector of the economy);

d. The extent of renewals and extensions to keep loans current;

e. The collectibility of nonaccrual loans;

f. Trends in the level of delinquent and classified loans compared with previous loan loss and recovery experience;

g. Results of regulatory examinations; and

h. The collectibility of specific loans on the “watch list” taking into account borrower financial status, collateral type and value, payment history, and potential permanent impairment.

C. Securities

1. Review the investment policies and procedures established by the institution's board of directors. Review the board of directors', or investment committee, minutes for evidence that the policies and procedures are periodically reviewed and approved. The policies and procedures should include, but not be limited to:

   a. Investment objectives, including use of “held for sale” and trading activities;

   b. Permissible types of investments;

   c. Diversification guidelines to prevent undue concentration;

   d. Maturity schedules;

   e. Limitation on quality ratings;

   f. Hedging activities and other uses of futures, forwards, options, and other financial instruments;

   g. Handling exceptions to standard policies;

   h. Valuation procedures and frequency;

   i. Limitations on the investment authority of officers; and

   j. Frequency of periodic reports to the board of directors on securities holdings.

2. Test the investment procedures and ascertain whether information reported to the board of directors, or investment committee, for securities transactions is in agreement with the supporting data by comparing the following information on such reports to the trade tickets for a sample of items, including futures, forwards, and options:

   a. Descriptions;

   b. Interest rate;

   c. Maturity;

   d. Par value, or number of shares;

   e. Cost; and

   f. Market value on date of transaction, if different than cost.

3. Using the same sample items, analyze the securities register for accuracy and confirm the existence of the sample items by examining securities physically held in the institution and confirming the safekeeping of those securities held by others.

4. Balance investment subledger(s) or reconcile computer-generated trial balances with the general ledger control accounts for each type of security.

5. Review policies and procedures for controls that are designed to ensure that unauthorized transactions do not occur. Ascertain through reading of policies, procedures, and board of directors' minutes whether investment officers and/or appropriate committee members have been properly authorized to purchase/sell investments and whether there are limitations or restrictions on delegated responsibilities.

6. Obtain a schedule of the book, par, and market values of securities, as well as the rating classifications. Test the accuracy of the market values of a sample of securities and compare the ratings listed to see that they correspond with those of the rating agencies. Review the institution's documentation on any permanent declines in value that have occurred among the sample of securities to determine that any recorded declines in market value are appropriately computed. Examine the institution's computation of the allowance account for securities, if any, for proper presentation and adequacy.

7. Test securities income and accrued interest by:

   a. Determining the institution's method of calculating and recording interest accruals;

   b. Obtaining trial balances of accrued interest;

   c. Testing the reconciliation of the trial balances to the general ledger;

   d. Determining that interest accruals are not made on defaulted issues;

   e. Selecting items from each type of investment and money market holdings:

      (1) Determining the stated interest rate and most recent interest payment date of coupon instruments by reference to sources of such information that are independent of the institution;

      (2) Testing timely receipt of interest payments and correctness of entries to applicable general ledger accounts;

      (3) Calculating accrued interest and comparing it to the trial balance; and

      (4) Reviewing recorded book value for appropriate accretion of discount and amortization of premium; and

   f. Performing an analytical review of yields on each type of investment and money market holdings for reasonableness.

8. Review investment accounts for volume of purchases, sales activity and length of time securities have been held. Inquire as to the institution's intent and ability to hold securities until maturity. If there is frequent trading in an investment account, such activity may be inconsistent with the notion that the institution has the intent and ability to hold securities to maturity. Test gains and losses on disposal of investment securities by sampling sales transactions and:

   a. Determining sales prices by examining invoices or brokers' advices;

   b. Checking for the use of trade date accounting and the computation of book value on trade date;

c. Determining that the general ledger has been properly relieved on the investment, accrued interest, premium, discount and other related accounts;

d. Recomputing the gain or loss and compare to the amount recorded in the general ledger; and

e. Determining that the sales were approved by the board of directors or a designated committee or were in accordance with policies approved by the board of directors.

D. Insider Transactions

NOTE: For purposes of this section of the procedures, insiders include all affiliates of the institution, including its parent holding company, and all subsidiaries of the institution, as those terms are defined in section 23A of the Federal Reserve Act, as well as the institution's executive officers, directors, principal shareholders, and their related interests, as those terms are defined in section 215.2 of Federal Reserve Regulation O.

1. Review the institution's policies and procedures to ensure that extensions of credit to, and other transactions with, insiders are addressed. Ascertain that these policies include specific guidelines defining fair and reasonable transactions between the institution and insiders, and test insider transactions for compliance with these guidelines and statutory and regulatory requirements. Ascertain that the policies and procedures on extensions of credit comply with the requirements of Federal Reserve Regulation O.

2. Obtain an institution-prepared list of insiders, including any business relationships they may have other than as a nominal customer. Also obtain a list of extensions of credit to, and other transactions that the institution, its affiliates, and its subsidiaries have had with, insiders that are outstanding as of the audit date or that have occurred since the prior year's external auditing procedures were performed. Compare these lists to those prepared for the prior year's external auditing program to test for completeness.

3. Review the board of directors' minutes, loan trial balances, supporting loan documentation, and other appropriate institution records in conjunction with the list of insiders obtained from the institution to verify that a sample of extensions of credit to, and transactions with, insiders were:

   a. In compliance with institution policy for similar transactions and were at prevailing rates and terms at that time;

   b. Subjected to the institution's normal underwriting criteria and deemed by the institution to involve no more than a normal degree of risk, or present no other unfavorable features;

   c. Approved by the board of directors in advance with the interested party abstaining from voting; and

   d. Within the aggregate lending limits imposed by Regulation O or other legal limits.

4. Review the institution's policies and procedures to ensure that expense accounts of individuals who are executive officers, directors, and principal shareholders are addressed and test a sample of the actual expense account records for compliance with these policies and procedures.

E. Internal Controls - General Accounting and Administrative Controls

1. Review the board of directors' minutes to verify that account reconciliation policies have been established and approved and are reviewed periodically by the board of directors. Determine that management has implemented appropriate procedures to ensure the timely completion of reconciliations of accounting records and the timely resolution of reconciling items.

2. Determine whether the institution's policies regarding segregation of duties and required vacations for employees, including those involved in the EDP function, have been approved by the board of directors and verify that these policies and the implementing procedures established by management are periodically reviewed, are adequate, and are followed.

3. Confirm a sample of deposits in each of the various types of deposit accounts maintained by the institution. Inquire about controls over dormant deposit accounts.

4. Test to determine that reconciliations are prepared for all significant asset and liability accounts and their related accrued interest accounts, if any, such as “due from” accounts; demand deposits; NOW accounts; money market deposit accounts; other savings deposits; certificates of deposit; and other time deposits. Review reconciliations for:

   a. Timeliness and frequency;

   b. Accuracy and completeness; and

   c. Review by appropriate personnel with no conflicting duties.

5. Compare a sample of balances per reconciliations to the general ledger and supporting trial balances.

6. Examine detail and aging of a sample of reconciling items from those accounts whose reconciliations have been tested and reviewed and a sample of items in suspense, clearing, and work-in-process accounts by:

   a. Testing aging;

   b. Determining whether items are followed up on and appropriately resolved on a timely basis; and

   c. Discussing items remaining on reconciliations and in the suspense account with appropriate personnel to ascertain whether any should be written off.

      Review a sample of charged-off reconciling and suspense items for proper authorization.

7. Verify through inquiry and observation that the institution maintains adequate records of its off-balance sheet activities, including, but not limited to, its outstanding letters of credit and its loan commitments. Review the institution's procedures for monitoring the extent of its credit exposure from such activities to determine whether probable or reasonably possible losses exist.

F. Internal Controls - Electronic Data Processing Controls

1. Read the board of directors' minutes to determine whether the board of directors has reviewed and approved the institution's electronic data processing (EDP) policies, including those regarding outside servicers, if any, and the in-house use of individual personal computers (PCs) and personalized programs for official institution records, at least annually, confirm that management has established appropriate implementing procedures, and verify the institution's compliance with these policies and procedures.

   a. The policies and procedures for either in-house processing or use of an outside service center should include:

      (1) A contingency plan for continuation of operations and recovery when power outages, natural disasters, or other threats could cause disruption and/or major damage to the institution's data processing support, including compatibility of servicer's plan with that of the institution;

      (2) Requirements for EDP-related insurance coverage that include the following provisions:

         (a) Extended blanket bond fidelity coverage to employees of the institution or servicer;

         (b) Insurance on documents in transit, including cash letters; and

         (c) Verification of the insurance coverage of the institution or service bureau and the courier service;

      (3) Review of exception reports and adjusting entries approved by supervisors and/or officers;

      (4) Controls for input preparation and control and output verification and distribution;

      (5) “Back-up” of all systems, including off-premises rotation of files and programs;

      (6) Security to ensure integrity of data and system modifications; and

      (7) Necessary detail to ensure an audit trail.

   b. When an outside service center is employed, the policies and procedures should address the following additional items:

      (1) The requirement for a written contract for each automated application detailing ownership and confidentiality of files and programs, fee structure, termination agreement, and liability for documents in transit;

      (2) Review of each contract by legal counsel; and

      (3) Review of each third party review of the service bureau, if any.

2. In the area of general EDP controls, determine through inquiry and observation that policies and procedures have been established for:

a. Management and user involvement and approval of new or modified application programs;

b. Authorization, approval and testing of system software modifications;

c. The controls surrounding computer operations processing;

d. Restricted access to computer operations facilities and resources including:

(1) Off-premises storage of master disks and PC disks;

(2) Security of the data center and the institution's PCs; and

(3) Use and periodic changing of passwords.

3. With respect to EDP applications controls, inquire about and observe:

a. The controls over:

(1) Input submitted for processing;

(2) Processing transactions;

(3) Output;

(4) Applications on PCs; and

(5) Telecommunications both between and within institution offices.

b. The security over unissued or blank supplies of potentially negotiable items; and

c. The control procedures on wire transfers including:

(1) Authorizations and agreements with customers, including who may initiate transactions;

(2) Limits on transactions; and

(3) Call back procedures.

G. Trust Function

1. Supervisory Review

a. Determine the significant functions of the department, including areas of responsibility within the department and the financial institution.

b. Review the institution's written policies to determine that sufficient guidelines are established to meet fiduciary responsibilities and to comply with applicable laws. Policies should include:

(1) Account acceptance;

(2) Closed account review;

(3) Investments;

(4) Account review;

(5) Discretionary distributions;

(6) Conflicts of interest; and

(7) Other as needed for scope of fiduciary activities.

c. Ascertain the qualifications of the staff and of the board of directors giving consideration to the nature of the fiduciary responsibilities accepted.

d. Determine if board policies are implemented and followed.

2. Accounting and Physical Controls

a. Verify account assets. Include a confirmation from holders of assets retained outside the department.

b. Determine that the assets are adequately safeguarded, and held separately from other assets of the institution.

c. Verify that a vault record of assets under joint custody is maintained.

d. Verify prompt ledger control of assets, including worthless assets, received as original and subsequent deposits of assets, including stock splits and dividends.

e. Verify that fiduciary cash accounts are regularly and appropriately reconciled to demand deposit or money market account statements.

f. Verify that internal balancing control procedures are performed each time account ledgers are posted.

g. Verify that suspense or operating accounts are reconciled at least monthly, contain only appropriate items, and are cleared in a timely manner.

h. Reconcile or verify the proper reconcilement of each of the following to the department's general ledger at least quarterly:

(1) Income cash;

(2) Principal cash;

(3) Invested income;

(4) Invested principal;

(5) Each type of investment, such as stock, bonds, real estate loans and real estate; and

(6) Investments by issuer.

i. If applicable, verify reconcilements or reconcile outstanding bonds for bond trusteeships, or paying agent activities.

j. Verify the accurate payment of dividends.

3. Activity Control

a. Verify fees paid to the trust company.

b. Verify proceeds from sales of assets to brokers' invoices, sellers' receipts, or other evidence of sales price.

c. Verify payment for purchases of assets to brokers' invoices, sellers' receipts, or other evidence of purchase price.

d. Verify accuracy of amounts and receipt of income from investments.

4. Compliance

a. Verify that transactions between fiduciary accounts and directors, officers or employees of the institution, its holding company or other related entity do not constitute self-dealing. In general, self-dealing is considered to exist when the fiduciary uses or obtains the property held in a fiduciary capacity for his or her own benefit.

b. Review fiduciary account holdings of the following items in light of self-dealing issues.

(1) Stock, obligations, repurchase agreements, or deposit accounts with the institution, its affiliates or other related organizations in which there exists such an interest that might affect the best judgment of the institution.

(2) Obligations of directors, officers and employees of the institution, its holding company or affiliates or other entities with whom there exists a connection that might affect the exercise of the best judgment of the institution.

c. Verify that all accounts for which the institution has investment responsibilities are reviewed in accordance with Section 11-103-502(4), C.R.S.

d. Verify that cash receipts are promptly invested or distributed.

e. Verify and review the annual audit of each collective investment fund.

5. Administrative Review

a. Complete administrative reviews of all major account types, including but not limited to, personal trusts, estates, corporate trusts, collective investment funds, pension trusts and profit sharing trusts. An acceptable administrative review would perform the following practices:

(1) Determine that the original or authenticated copy of the governing instrument is on file;

(2) Determine that synoptic and history records are current, reliable and comprehensive;

(3) Determine that accounts are administered and invested in conformance with management policies, governing instruments, laws, regulations and sound fiduciary principles;

(4) Determine that the minutes of the board of directors and committee meetings document the review of trust company activities; significant practices for the board of directors' review include the acceptance of new accounts, the closing of accounts and the review of discretionary payments of principal or income; and

(5) Test the accuracy of account statements submitted to beneficiaries.

CB101.50 Qualifications for Independent Person(s) Assuming Responsibility for Due Care of Directors' Examinations [Section 11-103-502(3)(b), C.R.S.]

A. Qualifications

The following persons may qualify to be responsible for conducting a directors' examination of state-chartered banks:

1. A Certified Public Accountant(s) who holds an active certificate under the laws of this state, or who may practice in this state under a reciprocal agreement between Colorado and the holder's state of certification.

2. A qualified independent person(s) or firm whose credentials have been submitted to and approved by the Colorado State Banking Board to conduct such examinations. The Banking Board will take into consideration such things as past proven work of the person or firm, professional reputation, training and education, and capacity to perform the examination in a timely manner.

3. The Banking Board reserves the right to revoke any previously approved qualification for due cause.

B. Independence

A person who conducts or reviews and/or approves a directors' examination (person) of a state-chartered bank (institution) must be independent with respect to the institution in fact and appearance.

Independence will be considered impaired if, for example, during the period of the directors examination, or at the time of the issuing of the report, the person:

1. Had or was committed to acquire any direct or material indirect financial interest in the institution;

2. Was a trustee of any trust or executor or administrator of any estate if such trust or estate had or was committed to acquire any direct or material indirect financial interest in the institution;

3. Had any joint closely-held business investment with the institution or any officer, director, or principal stockholder thereof that was material in relation to the net worth of either the institution or the person; or

4. Had any loan to or from the institution or any officer, director, or principal shareholder thereof other than loans of the following kinds made by a financial institution under normal lending procedures, terms, and requirements:

   a. Loans obtained by the person that are not material in relation to the net worth of the borrower;

   b. Home mortgages; and

   c. Other secured loans, except those secured solely by a guarantee of the person.

Independence will also be considered to be impaired if, during the period covered by the financial statements, during the period of the directors' examinations, or at the time of the issuing of the report, the person:

1. Was connected with the institution as a promoter, underwriter, voting trustee, director or officer, or in any capacity equivalent to that of a member of management or of an employee;

2. Was a trustee for any pension or profit sharing trust of the institution;

3. Received or had a commitment to receive other compensation from the institution or a third party, for services or products of others to be procured by the institution; or

4. Received or had a commitment from the institution to receive a contingent fee. For this purpose, a contingent fee means compensation for the performance of services payment of which, or the amount of which, is contingent upon the findings or results of such services.

CB101.51 Minimum Capital Ratios [Section 11-103-201, C.R.S.]

A. Purpose

The Colorado State Banking Board believes that a minimum leverage ratio is necessary because the risk-based capital guidelines detailed in Banking Board Rule CB101.52 that are designed solely as a measure of credit risk, create the possibility for significant leverage. Assets that have no credit risk receive a zero percent risk weight and, therefore, require no capital. However, the Banking Board believes that every institution should have at least a base level of capital as protection against risks not measured by the risk-based capital ratio.

B. Definitions: For the purposes of this Rule:

1. Adjusted total assets means the average total assets figure required to be computed for and stated in an institution's most recent quarterly Consolidated Report of Condition and Income (Call Report), minus end-of-quarter intangible assets, deferred tax assets, and credit enhancing interest-only strips, that are deducted from Tier 1 capital, and minus nonfinancial equity investments for which a Tier 1 capital deduction is required pursuant to Paragraph (C)(1)(h) of Rule CB101.52. The Banking Board reserves the right to require an institution to compute and maintain its capital ratios on the basis of actual, rather than average, total assets when necessary to carry out the purposes of this regulation.

2. Tier 1 Capital means “Tier 1 Capital” as determined according to Banking Board Rule CB101.52-Risk-Based Capital Definitions and Adequacy, including the deductions described therein.

3. Tier 2 Capital means “Tier 2 Capital” as determined according to Banking Board Rule CB101.52-Risk-Based Capital Definitions and Adequacy, including the limitations described therein.

4. Total Capital means “Total Capital” as determined according to Banking Board Rule CB101.52-Risk-Based Capital Definitions and Adequacy, including the deductions described therein.

C. Reservation of Authority

1. Deductions from capital. Notwithstanding the definitions of Tier 1 Capital and Tier 2 Capital, the Banking Board may find that a newly developed or modified capital instrument constitutes Tier 1 Capital or Tier 2 Capital, and may permit one or more institutions to include all or a portion of the funds obtained through such capital instruments as Tier 1 or Tier 2 Capital, permanently or on a temporary basis, for the purpose of compliance with the Banking Board Rules.

   Similarly, the Banking Board may find that a particular intangible asset, deferred tax asset or credit-enhancing interest-only strip need not be deducted from Tier 1 or Tier 2 Capital. Conversely, the Banking Board may find that a particular intangible asset, deferred tax asset, credit-enhancing interest-only strip or other Tier 1 or Tier 2 Capital component has characteristics or terms that diminish its contribution to an institution's ability to absorb losses, and may require the deduction from Tier 1 or Tier 2 Capital of all of the component or of a greater portion of the component than is otherwise required.

2. Risk weight categories. Notwithstanding the risk categories in Banking Board Rule CB101.52, the Banking Board will look to the substance of the transaction and may find that the assigned risk weight for any asset or the credit equivalent amount or credit conversion factor for any off-balance sheet item does not appropriately reflect the risks imposed on an institution and may require another risk weight, credit equivalent amount, or credit conversion factor that the Banking Board deems appropriate. Similarly, if no risk weight, credit equivalent amount or credit conversion factor is specifically assigned, the Banking Board may assign any risk weight, credit equivalent amount, or credit conversion factor that the Banking Board deems appropriate. In making its determination, the Banking Board considers risks associated with the asset or off-balance sheet item as well as other relevant factors.

D. Minimum Capital Ratios

1. Risk-based capital ratio. All institutions must have and maintain the minimum risk-based capital ratios as set forth in Banking Board Rule CB101.52.

2. Total asset leverage ratio (Leverage Ratio). All institutions must have and maintain Tier 1 Capital in an amount equal to at least 3.0 percent of adjusted total assets.

3. Additional leverage ratio requirements. An institution operating at or near the level in Paragraph (D)(2) of this Rule should have well-diversified risks, including no undue interest rate risk exposure; excellent control systems; good earnings; high asset quality; high liquidity; and well managed on- and off-balance sheet activities; and in general be considered a strong organization, rated composite 1 under the CAMELS rating system. For all but the most highly-rated institutions meeting the conditions set forth in this Paragraph, the minimum Tier 1 leverage ratio is 4 percent. In all cases, institutions should hold capital commensurate with the level and nature of all risks.

E. Establishment of Minimum Capital Ratios for an Individual Institution

1. Applicability

The Banking Board may require higher minimum capital ratios for an individual institution in view of its circumstances. For example, higher capital ratios may be appropriate for:

a. A newly chartered institution;

b. An institution receiving special supervisory attention;

c. An institution that has, or is expected to have, losses resulting in capital inadequacy;

d. An institution with significant exposure due to risks from concentrations of credit, certain risks arising from nontraditional activities, or management's overall inability to monitor and control financial and operating risks presented by concentrations of credit and nontraditional activities;

e. An institution with significant exposure to declines in the economic value of its capital due to changes in interest rates;

f. An institution with significant exposure due to fiduciary or operational risk;

g. An institution exposed to a high degree of asset depreciation, or a low level of liquid assets in relation to short term liabilities;

h. An institution exposed to a high volume of, or particularly severe, problem loans;

i. An institution that is growing rapidly, either internally or through acquisition; or

j. An institution that may be adversely affected by the activities or condition of its parent company, affiliates(s), or other persons or institutions including chain banking organizations, with which it has significant business relationships.

2. Standards for determination of appropriate individual minimum capital ratios. The appropriate minimum capital ratios for an individual institution cannot be determined solely through the application of a rigid mathematical formula or wholly objective criteria. The decision is necessarily based in part on subjective judgment grounded in Banking Board and Division of Banking expertise. The factors to be considered in the determination will vary in each case and may include, for example:

a. The conditions or circumstances leading to the Banking Board's determination that higher capital ratios are appropriate or necessary for the institution;

b. The exigency of those circumstances or potential problems;

c. The overall condition, management strength, and future prospects of the institution and, if applicable, its parent company and/or affiliate(s);

d. The institution's liquidity, capital, risk asset and other ratios compared to the ratios of its peer group; and

e. The views of the institution's directors and senior management.

F. Unsafe and unsound practice. Any institution that has less than its minimum leverage capital requirement is deemed to be engaged in unsafe and unsound practice. Except that an institution that has entered into, and is in compliance with, a written agreement with the Banking Board; or has submitted to the Banking Board, and is in compliance with, a plan approved by the Banking Board to increase its Tier 1 leverage capital ratio to such a level as the Banking Board deems appropriate, and to take such other action as may be necessary for the institution to be operated so as not to be engaged in such unsafe or unsound practice will not be deemed to be engaged in unsafe or unsound practice on account of its capital ratios. An institution must file a written capital restoration plan with the Banking Board within forty-five (45) days of the date that the institution receives notice or is deemed to have notice that the institution is undercapitalized, unless the Banking Board notifies the institution in writing that the plan is to be filed within a different period. The Banking Board is not precluded from taking any enforcement action against an institution with capital above the minimum requirement if the specific circumstances deem such action to be appropriate.

G. Statute References to Capital

1. As referenced in the statutes the following definitions will apply:

a. Sections 11-103-202(1) and (2), C.R.S., shall refer to the leverage ratio.

b. Sections 11-103-203(3) and (4), C.R.S., shall refer to the leverage ratio.

c. Section 11-103-303(1)(a), C.R.S., shall refer to Total Capital.

d. Section 11-103-304(1)(d), C.R.S., shall refer to the leverage ratio and Tier 1, Tier 2, and Total Capital.

e. Section 11-103-402(1), C.R.S., shall refer to Total Capital.

f. Section 11-103-502(2)(a), C.R.S., shall refer to Total Capital.

g. Section 11-103-405(2), C.R.S., shall refer to Total Capital.

h. Section 11-103-702(1)(b), C.R.S., shall refer to the leverage ratio and Tier 1, Tier 2, and Total Capital.

i. Section 11-103-703(3)(b), C.R.S., shall refer to the leverage ratio and Tier 1, Tier 2, and Total Capital.

j. Section 11-103-801(1), C.R.S., shall refer to Total Capital.

k. Section 11-103-802(1)(a), C.R.S., shall refer to the leverage ratio.

l. Section 11-103-803(1)(b), C.R.S., shall refer to the leverage ratio and Tier 1, Tier 2, and Total Capital.

m. Section 11-103-806(1), C.R.S., shall refer to the leverage ratio.

n. Sections 11-105-304(2),(5),(6), and (8), C.R.S., shall refer to Total Capital.

o. Section 11-105-402(1), C.R.S., shall refer to Tier 1 Capital.

p. Section 11-105-501(2), C.R.S., shall refer to Tier 1 Capital.

CB101.52 Risk-Based Capital Definitions and Adequacy [Section 11-103-201, C.R.S.]

A. Purpose.

An important function of the Banking Board and the Division of Banking is to evaluate the adequacy of capital maintained by each regulated institution. Such an evaluation involves the consideration of numerous factors, including the riskiness of an institution's assets and off-balance sheet items. This Rule implements the Banking Board's risk-based capital guidelines.

The risk-based capital ratio derived from these guidelines is an important factor in the Banking Board and the Division of Banking's evaluation of an institution's capital adequacy. However, because this measure addresses only credit risk, the 8 percent minimum ratio should not be viewed as the level to be targeted, but rather as a floor. The final supervisory judgment on an institution's capital adequacy is based on an individualized assessment of numerous factors, including those listed in Banking Board Rule CB101.51(E)(1). With respect to the consideration of these factors, the Banking Board and Division of Banking will give particular attention to any institution with significant exposure to declines in the economic value of its capital due to changes in interest rates. As a result, it may differ from the conclusion drawn from an isolated comparison of an institution's risk-based capital ratio to the 8 percent minimum specified in these guidelines. In addition to the standards established by these risk-based capital guidelines, all state-chartered commercial banks must maintain a minimum capital-to-total assets ratio pursuant to Banking Board Rule CB101.51.

Certain components of capital, categories of on-balance sheet assets, and categories of off-balance sheet items appearing in this Rule may not apply to state chartered commercial banks. Nothing in this Rule shall be construed to increase the powers of state chartered commercial banks.

B. Definitions. For the purposes of this Rule, the following definitions apply:

1. "Adjusted carrying value" means the aggregate value that investments are carried on the balance sheet of the institution reduced by any unrealized gains on the investments that are reflected in such carrying value but excluded from the institution's Tier 1 capital and reduced by any associated deferred tax liabilities. For example, for investments held as available-for-sale (AFS), the adjusted carrying value of the investments would be the aggregate carrying value of the investments (as reflected on the consolidated balance sheet of the institution) less any unrealized gains on those investments that are included in other comprehensive income and that are not reflected in Tier 1 capital, and less any associated deferred tax liabilities. Unrealized losses on AFS nonfinancial equity investments must be deducted from Tier 1 capital pursuant to Paragraph (B)(10) of this Rule. The treatment of small business investment companies that are consolidated for accounting purposes under generally accepted accounting principles is discussed in Paragraph (C)(1)(h)(2) of this Rule. For investments in a nonfinancial company that is consolidated for accounting purposes, the institution's adjusted carrying value of the investment is determined under the equity method of accounting (net of any intangibles associated with the investment that are deducted from the institution's Tier 1 capital pursuant to Paragraph (C)(1)(e) of this Rule). Even though the assets of the nonfinancial company are consolidated for accounting purposes, these assets (as well as the credit equivalent amounts of the company's off-balance sheet items) are excluded from the institution's risk-weighted assets.

2. "Allowances for loan and lease losses" means those general valuation allowances that have been established through charges against earnings to absorb losses on loan and lease financing receivables. Allowances for loan and lease losses exclude allocated transfer risk reserves established, and specific reserves created against identified loss.

3. “Asset-backed commercial paper program” means a program that primarily issues externally rated commercial paper backed by assets or other exposures held in a bankruptcy-remote special purpose entity.

4. “Asset-backed commercial paper sponsor” means an institution that:

   a. Establishes an asset-backed commercial paper program;

   b. Approves the sellers permitted to participate in an asset-backed commercial paper program;

   c. Approves the asset pools to be purchased by an asset-backed commercial paper program; or

   d. Administers the asset-backed commercial paper program by monitoring the assets, arranging for debt placement, compiling monthly reports, or ensuring compliance with the program documents and with the program's credit and investment policy.

5. “Associated company” means any corporation, partnership, business trust, joint venture, association, or similar organization in which an institution directly or indirectly holds a 20 to 50 percent ownership interest.

6. “Banking and finance subsidiary” means any subsidiary of an institution that engages in banking- and finance-related activities.

7. “Cash items in the process of collection” means checks or drafts in the process of collection that are drawn on another depository institution, including a central bank, and that are payable immediately upon presentation in the country in which the reporting institution’s office that is clearing or collecting the check or draft is located; United States Government checks that are drawn on the United States Treasury or any other United States Government or Government-sponsored agency and that are payable immediately upon presentation; broker’s security drafts and commodity or bill-of-lading drafts payable immediately upon presentation in the United States or the country in which the reporting institution's office that is handling the drafts is located; and unposted debts.

8. “Central government” means the national governing authority of a country; it includes the departments, ministries and agencies of the central government and the central bank. The U.S. Central Bank includes the twelve Federal Reserve Banks. The definition of central government does not include the following: State, provincial or local governments; commercial enterprises owned by the central government that are entities engaged in activities involving trade, commerce or profit that are generally conducted or performed in the private sector of the United States economy; and noncentral government entities whose obligations are guaranteed by the central government.

9. “Commitment” means any arrangement that obligates an institution to:

   a. Purchase loans or securities; or

   b. Extend credit in the form of loans or leases, participations in loans or leases, overdraft facilities, revolving credit facilities, home equity lines of credit, liquidity facilities, or similar transactions.

10. “Common stockholders’ equity” means common stock, common stock surplus, undivided profits, capital reserves, and adjustments for the cumulative effect of foreign currency translation, less net unrealized holding losses on available-for-sale equity securities with readily determinable fair values.

11. “Conditional guarantee” means a contingent obligation of the United States Government or its agencies, or the central government of an Organization of Economic Cooperation and Development (OECD) country, the validity of which to the beneficiary is dependent upon some affirmative action; e.g., servicing requirements, on the part of the beneficiary of the guarantee or a third party.

12. “Deferred tax assets” means the tax consequences attributable to tax carryforwards and deductible temporary differences. Tax carryforwards are deductions or credits that cannot be used for tax purposes during the current period, but can be carried forward to reduce taxable income or taxes payable in a future period or periods. Temporary differences are financial events or transactions that are recognized in one period for financial statement purposes, but are recognized in another period or periods for income tax purposes. Deductible temporary differences are temporary differences that result in a reduction of taxable income in a future period or periods.

13. “Derivative contract” means generally a financial contract whose value is derived from the values of one or more underlying assets, reference rates or indexes of asset values. Derivative contracts include interest rate, foreign exchange rate, equity, precious metals and commodity contracts, or any other instrument that poses similar credit risks.

14. “Depository institution” means a financial institution that engages in the business of banking; that is recognized as a bank by the bank supervisory or monetary authorities of the country of its incorporation and the country of its principal banking operations; that receives deposits to a substantial extent in the regular course of business; and that has the power to accept demand deposits. In the United States, this definition encompasses all federally insured offices of commercial banks, mutual and stock savings banks, savings or building and loan associations (stock and mutual), cooperative banks, credit unions, and international banking facilities of domestic depository institutions. In addition, this definition encompasses all federally insured Colorado state chartered offices of industrial banks and trust companies. Bank holding companies are excluded from this definition. For the purposes of assigning risk weights, the differentiation between OECD depository institutions and non-OECD depository institutions is based on the country of incorporation. Claims on branches and agencies of foreign banks located in the United States are to be categorized on the basis of the parent bank’s country of incorporation.

15. “Equity investment” means any equity instrument including warrants and call options that give the holder the right to purchase an equity instrument, any equity feature of a debt instrument (such as a warrant or call option), and any debt instrument that is convertible into equity. An investment in any other instrument, including subordinated debt or other types of debt instruments, may be treated as an equity investment if the Banking Board determines that the instrument is the functional equivalent of equity or exposes the institution to essentially the same risks as an equity instrument.

16. “Exchange rate contracts” include: Cross-currency interest rate swaps; forward foreign exchange rate contracts; currency options purchased; and any similar instrument that, in the opinion of the Banking Board gives rise to similar risks.

17. “Goodwill” means an intangible asset that represents the excess of the purchase price over the fair market value of tangible and identifiable intangible assets acquired in purchases accounted for under the purchase method of accounting.

18. “Intangible assets” include mortgage and non-mortgage servicing assets [but exclude any interest only (IO) strips receivable related to these mortgage and nonmortgage servicing assets], purchased credit card relationships, goodwill, favorable leaseholds, and core deposit value.

19. “Interest rate contracts” include: Single currency interest rate swaps; basis swaps; forward rate agreements; interest rate options purchased; forward deposits accepted; and any similar instrument that, in the opinion of the Banking Board, gives rise to similar risks, including when-issued securities.

20. “Liquidity facility” means a legally binding commitment to provide liquidity to various types of transactions, structures, or programs. A liquidity facility that supports asset-backed commercial paper, in any amount, by lending to, or purchasing assets from any structure, program, or conduit constitutes an asset-backed commercial paper liquidity facility.

21. “Multifamily residential property” means any residential property consisting of five or more dwelling units including apartment buildings, condominiums, cooperatives, and other similar structures primarily for residential use, but not including hospitals, nursing homes, or other similar facilities.

22. “Nationally recognized statistical rating organization (NRSRO)” means an entity recognized by the Division of Market Regulation of the Securities and Exchange Commission (or any successor Division) (Commission or SEC) as a nationally recognized statistical rating organization for various purposes, including the Commission's uniform net capital requirements for brokers and dealers.

23. “Nonfinancial equity investment” means any equity investment held by an institution in a nonfinancial company through a small business investment company (SBIC) under section 302(b) of the Small Business Investment Act of 1958 or under the portfolio investment provisions of Regulation K. An equity investment made under section 302(b) of the Small Business Investment Act of 1958 in a SBIC that is not consolidated with the institution is treated as a nonfinancial equity investment in the manner provided in Paragraph (C)(1)(h)(2)(c) of this Rule. A nonfinancial company is an entity that engages in any activity that has not been determined to be permissible for an institution to conduct directly or to be financial in nature or incidental to financial activities under section 4(k) of the Bank Holding Company Act.

24. “OECD-based group of countries” comprises all full members of the OECD regardless of entry date, plus countries that have concluded special lending arrangements with the International Monetary Fund (IMF) associated with the IMF’s General Arrangements to Borrow but excludes any country that has rescheduled its external sovereign debt within the previous five years. These countries are hereinafter referred to as “OECD countries.” A rescheduling of external sovereign debt generally would include any renegotiation of terms arising from a country's inability or unwillingness to meet its external debt service obligations, but generally would not include renegotiations of debt in the normal course of business, such as a renegotiation to allow the borrower to take advantage of a decline in interest rates or other changes in market conditions. (As of November 1995, the OECD included the following countries: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Iceland, Ireland, Italy, Japan, Luxembourg, Mexico, the Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, the United Kingdom, and the United States; and Saudi Arabia had concluded special lending arrangements with the IMF associated with the IMF's General Arrangements to Borrow.)

25. “Original maturity” means, with respect to a commitment, the earliest possible date after a commitment is made on which the commitment is scheduled to expire (i.e., it will reach its stated maturity and cease to be binding on either party), provided that either:

    a. The commitment is not subject to extension or renewal and will actually expire on its stated expiration date; or

    b. If the commitment is subject to extension or renewal beyond its stated expiration date, the stated expiration date will be deemed the original maturity only if the extension or renewal must be based upon terms and conditions independently negotiated in good faith with the customer at the time of the extension or renewal and upon a new, bona fide credit analysis utilizing current information on financial condition and trends.

26. “Preferred stock” includes the following instruments:

    a. “Convertible preferred stock,” means preferred stock that is mandatorily convertible into either common or perpetual preferred stock;

    b. “Intermediate-term preferred stock,” means preferred stock with an original maturity of at least five years, but less than twenty (20) years;

    c. “Long-term preferred stock,” means preferred stock with an original maturity of twenty (20) years or more; and

    d. “Perpetual preferred stock,” means preferred stock without a fixed maturity date that cannot be redeemed at the option of the holder, and that has no other provisions that will require future redemption of the issue.

    For purposes of these instruments, preferred stock that can be redeemed at the option of the holder is deemed to have an “original maturity” of the earliest possible date on which it may be so redeemed.

27. “Public-sector entities” include states, local authorities and governmental subdivisions below the central government level in an OECD country. In the United States, this definition encompasses a state, county, city, town, or other municipal corporation, a public authority, and generally any publicly-owned entity that is an instrumentality of a state or municipal corporation. This definition does not include commercial companies owned by the public sector. (See “central government” definition for further explanation of commercial companies owned by the public sector.)

28. “Reciprocal holdings of bank capital instruments”means cross-holdings or other formal or informal arrangements in which two or more banking organizations swap, exchange, or otherwise agree to hold each other’s capital instruments. This definition does not include holdings of capital instruments issued by other banking organizations that were taken in satisfaction of debts previously contracted, provided that the reporting institution has not held such instruments for more than five (5) years or a longer period approved by the Banking Board.

29. “Replacement cost” means, with respect to interest rate and exchange rate contracts, the loss that would be incurred in the event of a counterparty default, as measured by the net cost of replacing the contract at the current market value. If default would result in a theoretical profit, the replacement value is considered to be zero. The mark-to-market process should incorporate changes in both interest rates and counterparty credit quality.

30. "Residential properties" means houses, condominiums, cooperative units, and manufactured homes. This definition does not include boats or motor homes, even if used as a primary residence.

31. "Risk-weighted assets" means the sum of total risk-weighted balance sheet assets and the total of risk-weighted off-balance sheet credit equivalent amounts. Risk-weighted balance sheet and off-balance sheet assets are calculated pursuant to Paragraph (D) of this Rule.

32. "Subsidiary" means any corporation, partnership, business trust, joint venture, association or similar organization in which an institution directly or indirectly holds more than a 50 percent ownership interest. This definition does not include ownership interests that were taken in satisfaction of debts previously contracted, provided that the reporting institution has not held the interest for more than five years or a longer period approved by the Banking Board.

33. "Total capital" means the sum of an institution's core (Tier 1) and qualifying supplementary (Tier 2) capital elements.

34. "Unconditionally cancelable" means, with respect to a commitment-type lending arrangement, that the institution may, at any time, with or without cause, refuse to advance funds or extend credit under the facility. In the case of home equity lines of credit, the institution is deemed able to unconditionally cancel the commitment if it can, at its option, prohibit additional extensions of credit, reduce the line, and terminate the commitment to the full extent permitted by relevant state and Federal law.

35. "United States Government or its agencies" means an instrumentality of the United States Government whose debt obligations are fully and explicitly guaranteed as to the timely payment of principal and interest by the full faith and credit of the United States Government.

36. "United States Government-sponsored agency" means an agency originally established or chartered to serve public purposes specified by the United States Congress, but whose obligations are not explicitly guaranteed by the full faith and credit of the United States Government.

37. "Walkaway clause" means a provision in a bilateral netting contract that permits a nondefaulting counterparty to make a lower payment than it would make otherwise under the bilateral netting contract, or no payment at all, to a defaulter or the estate of a defaulter, even if the defaulter or the estate of the defaulter is a net creditor under the bilateral netting contract.

C. Components of Capital. An institution's qualifying capital base consists of two types of capital--core (Tier 1) and supplementary (Tier 2).

1. Tier 1 Capital. The following elements comprise an institution's Tier 1 capital:

a. Common stockholders' equity;

b. Noncumulative perpetual preferred stock and related surplus (Preferred stock issues where the dividend is reset periodically based upon current market conditions and the institution's current credit rating, including but not limited to, auction rate, money market or remarketable preferred stock, are assigned to Tier 2 capital, regardless of whether the dividends are cumulative or noncumulative.); and

c. Minority interests in the equity accounts of consolidated subsidiaries, except that the following are not included in Tier 1 capital or total capital:

(1) Minority interests in a small business investment company or investment fund that holds nonfinancial equity investments, and minority interests in a subsidiary that is engaged in nonfinancial activities and is held under one of the legal authorities listed in Paragraph (B)(23) of this Rule.

(2) Minority interests in consolidated asset-backed commercial paper programs sponsored by an institution if the consolidated assets are excluded from risk-weighted assets pursuant to Paragraph (D)(7)(e)(1) of this Rule.

d. Less: Goodwill;

e. Less: Other intangible assets, except mortgage servicing assets, purchased credit card relationships, and nonmortgage servicing assets subject to the following conditions. (Intangible assets are defined to exclude IO strips receivable related to these mortgage and non-mortgage servicing assets. See Paragraph (B)(18) of this Rule. Consequently, IO strips receivable related to mortgage and non-mortgage servicing assets are not required to be deducted under this Paragraph. However, credit-enhancing IO strips as defined in Paragraph (E)(1)(b) of this Rule are deducted from Tier 1 capital pursuant to Paragraph (C)(1)(g) of this Rule. Any noncredit-enhancing IO strips receivable are subject to a 100 percent risk weight under Paragraph (D)(7)(d) of this Rule.) For the purpose of determining Tier 1 capital, mortgage servicing assets, purchased credit card relationships, and nonmortgage servicing assets will be deducted from assets and from common stockholders' equity to the extent that these items do not meet the conditions, limitations, and restrictions described in this section. Institutions may elect to deduct disallowed servicing assets on a basis that is net of any associated deferred tax liability. Deferred tax liabilities netted in this manner cannot also be netted against deferred tax assets when determining the amount of deferred tax assets that are dependent upon future taxable income.

(1) Valuation. The fair value of mortgage servicing assets, purchased credit card relationships, and nonmortgage servicing assets shall be estimated at least quarterly. The quarterly determination of the current fair value of the intangible asset must include adjustments for any significant changes in the original valuation assumptions, including changes in prepayment estimates. The Banking Board in its discretion may require independent fair value estimates on a case-by-case basis where it is deemed appropriate for safety and soundness purposes.

(2) Fair value limitation. For the purpose of calculating Tier 1 capital for minimum capital requirements (not for financial statement purposes), the balance sheet assets for mortgage servicing assets, purchased credit card relationships, and nonmortgage servicing assets will each be reduced to an amount equal to the lesser of:

(a) Ninety percent of the fair value of each intangible asset, determined pursuant to Paragraph (C)(1)(e)(1) of this Rule; or

(b) One hundred percent of the remaining unamortized book value.

(3) Tier 1 capital limitation. The total of all intangible assets that are included in Tier 1 capital is limited to 100 percent of Tier 1 capital, of which no more than 25 percent of Tier 1 capital can consist of purchased credit card relationships and non-mortgage servicing assets in the aggregate. Calculation of these limitations must be based on Tier 1 capital net of goodwill and all other identifiable intangibles, other than purchased credit card relationships, mortgage servicing assets and nonmortgage servicing assets.

f. Less: Certain deferred tax assets.

(1) Tier 1 capital limitations. The maximum allowable amount of deferred tax assets that are dependent upon future taxable income will be limited to the lesser of:

(a) The amount of deferred tax assets that the institution could reasonably expect to realize within one year of the quarter-end Call Report, based on its estimate of future taxable income for that year; or

(b) Ten percent of Tier 1 capital, net of goodwill and all intangible assets other than purchased credit card relationships, mortgage servicing assets, and non-mortgage servicing assets.

(2) Net unrealized holding gains and losses on available-for-sale securities. An institution may eliminate the deferred tax effects of any net unrealized holding gains and losses on available-for-sale debt securities before calculating the amount of deferred tax assets subject to the limit in Paragraph (C)(1)(f)(1) of this Rule. Institutions report these net unrealized holding gains and losses in their Call Reports as a separate component of equity capital, but exclude them from the definition of common stockholders' equity for regulatory capital purposes. An institution that adopts a policy to deduct these amounts must apply that approach consistently in all future calculations of the amount of disallowed deferred tax assets under Paragraph (C)(1)(f)(1) of this Rule.

(3) Consolidated groups. The amount of deferred tax assets that an institution can realize from taxes paid in prior carryback years and from reversals of existing taxable temporary differences generally would not be deducted from capital. However, for an institution that is a member of a consolidated group (for tax purposes), the amount of carryback potential an institution may consider in calculating the limit on deferred tax assets under Paragraph (C)(1)(f)(1) of this Rule may not exceed the amount that the institution could reasonably expect to have refunded by its parent company.

(4) Nontaxable purchase business combination. A deferred tax liability that is specifically associated with an intangible asset (other than purchased mortgage servicing rights and purchased credit card relationships) due to a nontaxable purchase business combination may be netted against that intangible asset in calculating the amount of net deferred tax assets under Paragraph (C)(1)(f)(1) of this Rule. Only the net amount of the intangible asset must be deducted from Tier 1 capital. Deferred tax liabilities netted in this manner cannot also be netted against deferred tax assets when determining the amount of net deferred tax assets that are dependent upon future taxable income.

(5) Estimated future taxable income. Estimated future taxable income does not include net operating loss carryforwards to be used during that year or the amount of existing temporary differences expected to reverse within the year. An institution may use future taxable income projections for their closest fiscal year, provided it adjusts the projections for any significant changes that occur or that it expects to occur. Such projections must include the estimated effect of tax planning strategies that the institution expects to implement to realize net operating loss or tax credit carryforwards that will otherwise expire during the year.

g. Less: Credit-enhancing IO strips (as defined in Paragraph (E)(1)(b) of this Rule). Credit-enhancing IO strips, whether purchased or retained, that exceed 25 percent of Tier 1 capital must be deducted from Tier 1 capital. Purchased and retained credit-enhancing IO strips, on a non-tax adjusted basis, are included in the total amount that is used for purposes of determining whether an institution exceeds its Tier 1 capital.

(1) The 25 percent limitation on credit-enhancing IO strips will be based on Tier 1 capital net of goodwill and all identifiable intangibles, other than purchased credit card relationships, mortgage servicing assets and non-mortgage servicing assets.

(2) Institutions must value each credit-enhancing IO strip included in Tier 1 capital at least quarterly. The quarterly determination of the current fair value of the credit-enhancing IO strip must include adjustments for any significant changes in original valuation assumptions, including changes in prepayment estimates.

(3) Institutions may elect to deduct disallowed credit-enhancing IO strips on a basis that is net of any associated deferred tax liability. Deferred tax liabilities netted in this manner cannot also be netted against deferred tax assets when determining the amount of deferred tax assets that are dependent upon future taxable income.

h. Less: Nonfinancial equity investments as provided by this section.

(1) General.

(a) An institution must deduct from its Tier 1 capital the appropriate percentage, as determined pursuant to Table A, of the adjusted carrying value of all nonfinancial equity investments held by the institution and its subsidiaries.

TABLE A
Deduction for Nonfinancial Equity Investments

Aggregate adjusted carrying value of all nonfinancial equity investments held directly or indirectly by institutions (as a percentage of the Tier 1 capital of the institution)1	**Deduction from Tier 1 capital (as a percentage of the adjusted carrying value of the investment)**
Less than 15 percent	8.0 percent
Greater than or equal to 15 percent but less than 25 percent	12.0 percent
Greater than or equal to 25 percent	25.0 percent

[1]For purposes of calculating the adjusted carrying value of nonfinancial equity investments as a percentage of Tier 1 capital, Tier 1 capital is defined as the sum of the Tier 1 capital elements net of goodwill and net of all identifiable intangible assets other than mortgage servicing assets, nonmortgage servicing assets and purchased credit card relationships, but prior to the deduction for disallowed mortgage servicing assets, disallowed nonmortgage servicing assets, disallowed purchased credit card relationships, disallowed credit-enhancing IO strips (both purchased and retained), disallowed deferred tax assets, and nonfinancial equity investments.

(b) Deductions for nonfinancial equity investments must be applied on a marginal basis to the portions of the adjusted carrying value of nonfinancial equity investments that fall within the specified ranges of the institution's Tier 1 capital. For example, if the adjusted carrying value of all nonfinancial equity investments held by an institution equals 20 percent of the Tier 1 capital of the institution, then the amount of the deduction would be 8 percent of the adjusted carrying value of all investments up to 15 percent of the institution's Tier 1 capital, and 12 percent of the adjusted carrying value of all investments equal to, or in excess of, 15 percent of the institution's Tier 1 capital.

(c) The total adjusted carrying value of any nonfinancial equity investment that is subject to deduction under Paragraph (C)(1)(h) of this Rule is excluded from the institution's weighted risk assets for purposes of computing the denominator of the institution's risk-based capital ratio. For example, if 8 percent of the adjusted carrying value of a nonfinancial equity investment is deducted from Tier 1 capital, the entire adjusted carrying value of the investment will be excluded from risk-weighted assets in calculating the denominator of the risk-based capital ratio.

(d) Institutions engaged in equity investment activities, including those institutions with a high concentration in nonfinancial equity investments (e.g., in excess of 50 percent of Tier 1 capital), will be monitored and may be subject to heightened supervision, as appropriate, by the Division of Banking to ensure that such institutions maintain capital levels that are appropriate in light of their equity investment activities, and the Banking Board may impose a higher capital charge in any case where the circumstances, such as the level of risk of the particular investment or portfolio of investments, the risk management systems of the institution, or other information, indicate that a higher minimum capital requirement is appropriate.

(2) Small business investment company investments (SBIC).

(a) Notwithstanding Paragraph (C)(1)(h)(1)(a) of this Rule, no deduction is required for nonfinancial equity investments that are made by an institution or its subsidiary through a SBIC that is consolidated with the institution, or in a SBIC that is not consolidated with the institution, to the extent that such investments, in the aggregate, do not exceed 15 percent of the Tier 1 capital of the institution. Except as provided in Paragraph (C)(1)(h)(2)(b) of this Rule, any nonfinancial equity investment that is held through or in a SBIC and not deducted from Tier 1 capital will be assigned to the 100 percent risk-weight category and included in the institution's consolidated risk-weighted assets.

(b) If an institution has an investment in a SBIC that is consolidated for accounting purposes but the SBIC is not wholly owned by the institution, the adjusted carrying value of the institution's nonfinancial equity investments held through the SBIC is equal to the institution's proportionate share of the SBIC's adjusted carrying value of its equity investments in nonfinancial companies. The remainder of the SBIC's adjusted carrying value (i.e., the minority interest holders' proportionate share) is excluded from the risk-weighted assets of the institution.

(c) If an institution has an investment in a SBIC that is not consolidated for accounting purposes and has current information that identifies the percentage of the SBIC's assets that are equity investments in nonfinancial companies, the institution may reduce the adjusted carrying value of its investment in the SBIC proportionately to reflect the percentage of the adjusted carrying value of the SBIC's assets that are not equity investments in nonfinancial companies. The amount by which the adjusted carrying value of the institution's investment in the SBIC is reduced under this Paragraph will be risk weighted at 100 percent and included in the institution's risk-weighted assets.

(d) To the extent the adjusted carrying value of all nonfinancial equity investments that the institution holds through a consolidated SBIC or in a nonconsolidated SBIC equals or exceeds, in the aggregate, 15 percent of the Tier 1 capital of the institution, the appropriate percentage of such amounts, as set forth in Table A of this Rule, must be deducted from the institution's Tier 1 capital. In addition, the aggregate adjusted carrying value of all nonfinancial equity investments held through a consolidated SBIC and in a nonconsolidated SBIC (including any nonfinancial equity investments for which no deduction is required) must be included in determining, for the purposes of Table A of this Rule, the total amount of nonfinancial equity investments held by the institution in relation to its Tier 1 capital.

(3) Nonfinancial equity investments excluded.

(a) Notwithstanding Paragraphs (C)(1)(h)(1) and (2) of this Rule, no deduction from Tier 1 capital is required for the following:

(i) Nonfinancial equity investments (or portion of such investments) made by the institution prior to March 13, 2000, and continuously held by the institution since March 13, 2000.

(ii) Nonfinancial equity investments made on or after March 13, 2000, pursuant to a legally binding written commitment that was entered into by the institution prior to March 13, 2000, and that required the institution to make the investment, if the institution has continuously held the investment since the date the investment was acquired.

(iii) Nonfinancial equity investments received by the institution through a stock split or stock dividend on a nonfinancial equity investment made prior to March 13, 2000, provided that the institution provides no consideration for the shares or interests received, and the transaction does not materially increase the institution's proportional interest in the nonfinancial company.

(iv) Nonfinancial equity investments received by the institution through the exercise on or after March 13, 2000, of an option, warrant, or other agreement that provides the institution with the right, but not the obligation, to acquire equity or make an investment in a nonfinancial company, if the option, warrant, or other agreement was acquired by the institution prior to March 13, 2000, and the institution provides no consideration for the nonfinancial equity investments.

(b) Any excluded nonfinancial equity investments described in Paragraph (C)(1)(h)(3)(a) of this Rule must be included in determining the total amount of nonfinancial equity investments held by the institution in relation to its Tier 1 capital for the purposes of Table A of this Rule. In addition, any excluded nonfinancial equity investments will be risk weighted at 100 percent and included in the institution's risk-weighted assets.

2. Tier 2 Capital. Tier 2 capital is limited to 100 percent of Tier 1 capital. The following elements comprise an institution’s Tier 2 capital:

a. Allowance for loan and lease losses, up to a maximum of 1.25 percent of risk-weighted assets. (The amount of the allowance for loan and lease losses that may be included in capital is based on a percentage of risk-weighted assets. The gross sum of risk-weighted assets used in this calculation includes all risk-weighted assets, with the exception of the assets required to be deducted from capital under Paragraph (D) of this Rule in establishing risk-weighted assets (i.e., the assets required to be deducted from capital under Paragraph (C) of this Rule. An institution may deduct reserves for loan and lease losses in excess of the amount permitted to be included as capital, as well as allocated transfer risk reserves and reserves held against other real estate owned, from the gross sum of risk-weighted assets in computing the denominator of the risk-based capital ratio.)

b. Cumulative perpetual preferred stock, long-term preferred stock, convertible preferred stock, and any related surplus, without limit, if the issuing institution has the option to defer payment of dividends on these instruments. For long-term preferred stock, the amount that is eligible to be included as Tier 2 capital is reduced by 20 percent of the original amount of the instrument (net of redemptions) at the beginning of each of the last five years of the life of the instrument.

c. Hybrid capital instruments, without limit. Hybrid capital instruments are those instruments that combine certain characteristics of debt and equity, such as perpetual debt. To be included as Tier 2 capital, these instruments must meet the following criteria:

(1) The instrument must be unsecured, subordinated to the claims of depositors and general creditors, and fully paid up;

(2) The instrument must not be redeemable at the option of the holder prior to maturity, except with the prior approval of the Banking Board;

(3) The instrument must be available to participate in losses while the issuer is operating as a going concern (in this regard, the instrument must automatically convert to common stock or perpetual preferred stock, if the sum of the retained earnings and capital surplus accounts of the issuer shows a negative balance); and

(4) The instrument must provide the option for the issuer to defer principal and interest payments, if

(a) The issuer does not report a net profit for the most recent combined four quarters; and

(b) The issuer eliminates cash dividends on its common and preferred stock.

(Mandatory convertible debt instruments that meet the requirements of Paragraphs (C)(2)(d)(1) through (7) and that unqualifiedly require the issuer to exchange either common or perpetual preferred stock for such instruments by a date at or before the maturity of the instrument (the maturity of these instruments must be 12 years or less), or that have been previously approved as capital by the Banking Board, are treated as qualifying hybrid capital instruments.)

d. Term subordinated debt instruments and intermediate-term preferred stock and related surplus are included in Tier 2 capital, but only to a maximum of 50 percent of Tier 1 capital as calculated after deductions pursuant to Paragraphs (C)(1)(d) through (h) and Paragraph (C)(3) of this Rule. To be considered capital, term subordinated debt instruments must meet the following requirements:

(1) Have original weighted average maturities of at least five years;

(2) Be subordinated to the claims of depositors;

(3) State on the instrument that it is not a deposit and is not insured by the Federal Deposit Insurance Corporation (FDIC);

(4) Be approved as capital by the Banking Board;

(5) Be unsecured;

(6) Be ineligible as collateral for a loan by the issuing institution;

(7) Provide that once any scheduled payments of principal begin, all scheduled payments shall be made at least annually and the amount repaid in each year shall be no less than in the prior year; and

(8) Provide that no prepayment (including payment pursuant to an acceleration clause or redemption prior to maturity) shall be made without the prior written approval of the Banking Board.

Also, at the beginning of each of the last five years for the life of either type of instrument, the amount that is eligible to be included as Tier 2 capital is reduced by 20 percent of the original amount of that instrument (net of redemptions). (Capital instruments may be redeemed prior to maturity with the prior approval of the Banking Board. The Banking Board typically will consider requests for the redemption of capital instruments when the instruments are to be redeemed with the proceeds of, or replaced by, a like amount of a similar or higher quality capital instrument. However, the Banking Board reserves the authority to deny redemption in such circumstances or to allow redemption in other circumstances, based upon its evaluation of the circumstances of each case. The Banking Board must be notified in writing of any request for redemption at least thirty (30) days in advance of such redemption.)

e. Up to 45 percent of pretax net unrealized holding gains (that is, the excess, if any, of the fair value over historical cost) on available-for-sale equity securities with readily determinable fair values. However, the Banking Board may exclude all or a portion of these unrealized gains from Tier 2 capital if the Banking Board determines that the equity securities are not prudently valued. Unrealized gains (losses) on other types of assets, such as institution premises and available-for-sale debt securities, are not included in Tier 2 capital, but the Banking Board may take these unrealized gains (losses) into account as additional factors when assessing an institution's overall capital adequacy.

3. Deductions From Total Capital (the sum of Tier 1 capital plus Tier 2 capital). The following items are deducted from total capital:

a. Investments, both equity and debt, in unconsolidated banking and finance subsidiaries that are deemed to be capital of the subsidiary. The Banking Board may require deduction of investments in other subsidiaries and associated companies on a case-by-case basis.

b. Reciprocal holdings of capital instruments issued by banks.

D. Risk Categories/Weights for On-Balance Sheet Assets and Off-Balance Sheet Items

1. The denominator of the risk-based capital ratio, i.e., an institution's risk-weighted assets, is derived by assigning that institution's assets and off-balance sheet items to one of the four risk categories detailed in Paragraph (D)(7) of this Rule. Each category has a specific risk weight.

2. Before an off-balance sheet item is assigned a risk weight, it is converted to an on-balance sheet credit equivalent amount pursuant to Paragraph (D)(8) of this Rule.

3. The risk weight assigned to a particular asset or on-balance sheet credit equivalent amount determines the percentages of that asset/credit equivalent that is included in the denominator of the institution's risk-based capital ratio. Any asset deducted from an institution's capital in computing the numerator of the risk-based capital ratio is not included as part of the institution's risk-weighted assets.

4. The Banking Board reserves the right to require an institution to compute its risk-based capital ratio on the basis of average, rather than period-end, risk-weighted assets when necessary to carry out the purposes of these guidelines.

5. Some of the assets on an institution's balance sheet may represent an indirect holding of a pool of assets, e.g., mutual funds, that encompasses more than one risk weight within the pool. In those situations, the institution may assign the asset to the risk category applicable to the highest risk-weighted asset that pool is permitted to hold pursuant to its stated investment objectives in the fund's prospectus. Alternatively, the institution may assign the asset on a pro rata basis to different risk categories according to the investment limits in the fund's prospectus. In either case, the minimum risk weight that may be assigned to such a pool is 20 percent. If an institution assigns the asset on a pro rata basis, and the sum of the investment limits in the fund's prospectus exceeds 100 percent, the institution must assign the highest pro rata amounts of its total investment to the higher risk category. If, in order to maintain a necessary degree of liquidity, the fund is permitted to hold an insignificant amount of its assets in short-term, highly-liquid securities of superior credit quality (that do not qualify for a preferential risk weight), such securities generally will not be taken into account in determining the risk category into which the institution's holding in the overall pool should be assigned. The prudent use of hedging instruments by a fund to reduce the risk of its assets will not increase the risk-weighting of the investment in that fund above the 20 percent category. However, if a fund engages in any activities that are deemed to be speculative in nature or has any other characteristics that are inconsistent with the preferential risk weighting assigned to the fund's assets, the institution's investment in the fund will be assigned to the 100 percent risk category. More detail on the treatment of mortgage-backed securities is provided in Paragraph (D)(7)(c)(6) of this Rule.

6. In addition, when certain institutions that are engaged in trading activities calculate the risk-based capital ratio under this Rule, the institution must also refer to Appendix B, which incorporates capital charges for certain market risk into the risk-based capital ratio. When calculating the risk-based capital ratio, such institutions are required to refer to Appendix B for supplemental rules to determine qualifying and excess capital, calculate risk-weighted assets, calculate market risk equivalent assets and add them to risk-weighted assets, and calculate risk-based capital ratios as adjusted for market risk. (Trading activity means the gross sum of trading assets and liabilities as reported in the institution's most recent Call Report.

7. On-Balance Sheet Assets. The following are the risk categories/weights for on-balance sheet assets:

    a. Zero percent risk weight.

        (1) Cash, including domestic and foreign currency owned and held in all offices of an institution or in transit. Any foreign currency held by an institution should be converted into U.S. dollar equivalents.

        (2) Deposit reserves and other balances at Federal Reserve banks.

        (3) Securities issued by, and other direct claims on, the United States Government or its agencies, or the central governments of an OECD country.

(4) That portion of assets directly and unconditionally guaranteed by the United States Government or its agencies, or the central government of an OECD country. (For the treatment of privately-issued mortgage-backed securities where the underlying pool is comprised solely of mortgage-related securities issued by GNMA (see Paragraph (D)(7)(b)(7) of this Rule)).

(5) That portion of local currency claims on, or unconditionally guaranteed by central governments of non-OECD countries, to the extent the institution has local currency liabilities in that country. Any amount of such claims that exceeds the amount of the institution's local currency liabilities is assigned to the 100 percent risk category of Paragraph (D)(7)(d) of this Rule.

(6) Gold bullion held in the institution's own vaults or in another institution's vaults on an allocated basis, to the extent it is backed by gold bullion liabilities.

(7) The book value of paid-in Federal Reserve Bank stock.

(8) That portion of assets and off-balance sheet transactions collateralized by cash or securities issued or directly and unconditionally guaranteed by the United States Government or its agencies, or the central government of an OECD country provided that:

(a) The institution maintains control over the collateral:

(i) If the collateral consists of cash, the cash must be held on deposit by the institution or by a third party for the account of the institution;

(ii) If the collateral consists of OECD government securities, then the OECD government securities must be held by the institution or by a third party acting on behalf of the institution;

(b) The institution maintains a daily positive margin of collateral fully taking into account any change in the market value of the collateral held as security;

(c) Where the institution is acting as a customer's agent in a transaction involving the loan or sale of securities that is collateralized by cash or OECD government securities delivered to the institution, any obligation by the institution to indemnify the customer is limited to no more than the difference between the market value of the securities lent and the market value of the collateral received, and any reinvestment risk associated with the collateral is borne by the customer; and

(d) The transaction involves no more than minimal risk.

NOTE: Assets and off-balance sheet transactions collateralized by securities issued or guaranteed by the United States Government or its agencies, or the central government of an OECD country include, but are not limited to, securities lending transactions, repurchase agreements, collateralized letters of credit, such as reinsurance letters of credit, and other similar financial guarantees. Swaps, forwards, futures, and options transactions are also eligible, if they meet the collateral requirements. However, the Banking Board may, at its discretion, require that certain collateralized transactions be risk weighted at 20 percent if they involve more than a minimal risk.

b. Twenty percent risk weight.

(1) All claims on depository institutions incorporated in an OECD country, and all assets backed by the full faith and credit of depository institutions incorporated in an OECD country. This includes the credit equivalent amount of participations in commitments and standby letters of credit sold to other depository institutions incorporated in an OECD country, but only if the originating institution remains liable to the customer or beneficiary for the full amount of the commitment or standby letter of credit. Also included in this category are the credit equivalent amounts of risk participations in bankers' acceptances conveyed to other depository institutions incorporated in an OECD country. However, institution-issued securities that qualify as capital of the issuing institution are not included in this risk category, but are assigned to the 100 percent risk category of Paragraph (D)(7)(d) of this Rule.

(2) Claims on or guaranteed by depository institutions, other than the central bank, incorporated in a non-OECD country, with a residual maturity of one year or less.

(3) Cash items in the process of collection.

(4) That portion of assets collateralized by cash or securities issued or directly and unconditionally guaranteed by the United States Government or its agencies, or the central government of an OECD country, that does not qualify for the zero percent risk-weight category.

(5) That portion of assets conditionally guaranteed by the United States Government or its agencies, or the central government of an OECD country.

(6) Securities issued by, or other claims on, United States Government-sponsored agencies.

(7) That portion of assets guaranteed by United States Government-sponsored agencies. Privately issued mortgage-backed securities, e.g., CMOs and REMICs, where the underlying pool is comprised solely of mortgage-related securities issued by GNMA, FNMA, and FHLMC, will be treated as an indirect holding of the underlying assets and assigned to the 20 percent risk category of this Paragraph (D)(7)(b). If the underlying pool is comprised of assets that attract different risk weights, e.g., FNMA securities and conventional mortgages, the institution should generally assign the security to the highest risk category appropriate for any asset in the pool. However, on a case-by-case basis, the Banking Board may allow the institution to assign the security proportionately to the various risk categories based on the proportion in which the risk categories are represented by the composition cash flows of the underlying pool of assets. Before the Banking Board will consider a request to proportionately risk-weight such a security, the institution must have current information for the reporting date that details the composition and cash flows of the underlying pool of assets. Furthermore, before a mortgage-related security will receive a risk weight lower than 100 percent, it must meet the criteria set forth in Paragraph (D)(7)(c)(6) of this Rule.

(8) That portion of assets collateralized by the current market value of securities issued or guaranteed by United States Government-sponsored agencies.

(9) Claims representing general obligations of any public-sector entity in an OECD country, and that portion of any claims guaranteed by any such public-sector entity.

(10) Claims on, or guaranteed by, official multilateral lending institutions or regional development institutions in which the United States Government is a shareholder or contributing member. These institutions include, but are not limited to, the International Bank for Reconstruction and Development (World Bank), the Inter-American Development Bank, the Asian Development Bank, the African Development Bank, the European Investments Bank, the International Monetary Fund and the Bank for International Settlements.

(11) That portion of assets collateralized by the current market value of securities issued by official multilateral lending institutions or regional development institutions in which the United States Government is a shareholder or contributing member.

(12) That portion of local currency claims conditionally guaranteed by central governments of non-OECD countries, to the extent the institution has local currency liabilities in that country. Any amount of such claims that exceeds the amount of the institution's local currency liabilities is assigned to the 100 percent risk category of Paragraph (D)(7)(d) of this Rule.

(13) Claims on, or guaranteed by, a securities firm incorporated in an OECD country, that satisfies the following conditions:

(a) If the securities firm is incorporated in the United States, then the firm must be a broker-dealer that is registered with the SEC and must be in compliance with the SEC's net capital regulation.

(b) If the securities firm is incorporated in any other OECD country, then the institution must be able to demonstrate that the firm is subject to consolidated supervision and regulation, including its subsidiaries, comparable to that imposed on depository institutions in OECD countries; such regulation must include risk-based capital standards comparable to those applied to depository institutions under the Basel Capital Accord.

(c) The securities firm, whether incorporated in the United States or another OECD country, must also have a long-term credit rating pursuant to Paragraph (D)(7)(b)(13)(c)(i) of this Rule; a parent company guarantee pursuant to Paragraph (D)(7)(b)(13)(c)(ii) of this Rule; or a collateralized claim pursuant to Paragraph (D)(7)(b)(13)(c)(iii) of this Rule. Claims representing capital of a securities firm must be risk-weighted at 100 percent pursuant to Paragraph (D)(7)(d) of this Rule.

(i) Credit Rating. The securities firm must have either a long-term issuer credit rating or a credit rating on at least one issue of long-term unsecured debt, from a NRSRO that is in one of the three highest investment-grade categories used by the NRSRO. If the securities firm has a credit rating from more than one NRSRO, the lowest credit rating must be used to determine the credit rating under this Paragraph.

(ii) Parent company guarantee. The claim on, or guarantee by, the securities firm must be guaranteed by the firm's parent company, and the parent company must have either a long-term issuer credit rating or a credit rating on at least one issue of long-term unsecured debt, from a NRSRO that is in one of the three highest investment-grade categories used by the NRSRO.

(iii) Collateralized claim. The claim on the securities firm must be collateralized subject to all of the following requirements:

a) The claim must arise from a reverse repurchase/repurchase agreement or securities lending/borrowing contract executed using standard industry documentation.

b) The collateral must consist of debt or equity securities that are liquid and readily marketable.

c) The claim and collateral must be marked-to-market daily.

d) The claim must be subject to daily margin maintenance requirements under standard industry documentation.

e) The contract from which the claim arises can be liquidated, terminated, or accelerated immediately in bankruptcy or similar proceedings, and the security or collateral agreement will not be stayed or avoided under the applicable law of the relevant jurisdiction. To be exempt from the automatic stay in bankruptcy in the United States, the claim must arise from a securities contract or a repurchase agreement under section 555 or 559, respectively, of the Bankruptcy Code, a qualified financial contract under section 11(e)(8) of the Federal Deposit Insurance Act, or a netting contract between or among financial institutions under section 401-407 of the Federal Deposit Insurance Corporation Improvement Act of 1991, or the Regulation EE.

c. Fifty percent risk weight.

(1) Revenue obligations of any public-sector entity in an OECD country for which the underlying obligor is the public-sector entity, but which are repayable solely from the revenues generated by the project financed through the issuance of the obligations.

(2) The credit equivalent amount of derivative contracts, calculated pursuant to Paragraph (D)(8)(g) of this Rule, that do not qualify for inclusion in a lower risk category.

(3) Loans secured by first mortgages on one-to-four family residential properties, either owner-occupied or rented, provided that such loans are not otherwise ninety (90) days or more past due, or on nonaccrual or restructured. If an institution holds the first and junior lien on a one-to-four family residential property and no other party holds an intervening lien, the transaction is treated as a single loan secured by a first lien for purposes of both determining the loan-to-value ratio and assigning a risk weight to the transaction. It is presumed that such loans will meet prudent underwriting standards. Furthermore, residential property loans made for the purpose of construction financing are assigned to the 100 percent risk category of Paragraph (D)(7)(d) of this Rule; however, these loans may be included in the 50 percent category of this Paragraph (D) if they are subject to a legally binding sales contract and satisfy the requirements of Paragraph (D)(7)(c)(4) of this Rule.

(4) Loans to residential real estate builders for one-to-four family residential property construction, if the institution obtains sufficient documentation demonstrating that the buyer of the home intends to purchase the home (i.e., a legally binding written sales contract) and has the ability to obtain a mortgage loan sufficient to purchase the home (i.e., a firm written commitment for permanent financing of the home upon completion), subject to the following additional criteria:

(a) The builder must incur at least the first 10 percent of the direct costs (i.e., actual costs of the land, labor, and material) before any drawdown is made under the construction loan, and the construction loan may not exceed 80 percent of the sales price of the presold home;

(b) The individual purchaser has made a substantial "earnest money deposit"of no less than 3 percent of the sales price of the home that must be subject to forfeiture by the individual purchaser if the sales contract is terminated by the individual purchaser; however, the earnest money deposit shall not be subject to forfeiture by reason of breach or termination of the sales contract on the part of the builder;

(c) The earnest money deposit must be held in escrow by the institution financing the builder or by an independent party in a fiduciary capacity; the escrow agreement must provide that in the event of default the escrow funds must be used to defray any cost incurred relating to any cancellation of the sales contract by the buyer;

(d) If the individual purchaser terminates the contract, or if the loan fails to satisfy any other criterion under this section, then the institution must immediately recategorize the loan at a 100 percent risk weight and must accurately report the loan in the institution's next quarterly Call Report;

(e) The individual purchaser must intend that the home will be owner-occupied;

(f) The loan is made by the institution pursuant to prudent underwriting standards;

(g) The loan is not more than ninety (90) days past due, or on nonaccrual; and

(h) The purchaser is an individual(s) and not a partnership, joint venture, trust, corporation, or any other entity (including an entity acting as a sole proprietorship) that is purchasing one or more of the homes for speculative purposes.

(5) Loans secured by a first mortgage on multifamily residential properties. The portion of multifamily residential property loans that is sold subject to a pro rata loss sharing arrangement may be treated by the selling institution as sold to the extent that the sales agreement provides for the purchaser of the loan to share in any loss incurred on the loan on a pro rata basis with the selling institution. The portion of multifamily residential property loans sold subject to any loss sharing arrangement, other than pro rata sharing of the loss, shall be accorded the same treatment as any other asset sold under an agreement to repurchase or sold with recourse under Paragraph (E)(2) of this Rule. For a multifamily residential property to be included in the 50 percent risk weight category it must comply with the following:

(a) The amortization of principal and interest occurs in not more than thirty (30) years;

(b) The minimum original maturity for repayment of principal is not less than seven (7) years;

(c) All principal and interest payments have been made on a timely basis pursuant to the terms of the loan for at least one year immediately preceding the risk-weighting of the loan in the 50 percent risk weight category, and the loan is not otherwise ninety (90) days or more past due, or on nonaccrual status;

(d) The loan is made pursuant to all applicable requirements and prudent underwriting standards;

(e) If the rate of interest does not change over the term of the loan:

(i) The current loan amount outstanding does not exceed 80 percent of the current value of the property, as measured by either the value of the property at origination of the loan (which is the lower of the purchase price or the value as determined by the initial appraisal, or if appropriate, the initial evaluation) or the most current appraisal, or if appropriate, the most current evaluation; and

(ii) In the most recent fiscal year, the ratio of annual net operating income generated by the property (before payment of any debt service on the loan) to annual debt service of the loan is not less than 120 percent;

(f) If the rate of interest changes over the term of the loan:

(i) The current loan amount outstanding does not exceed 75 percent of the current value of the property, as measured by either the value of the property at origination of the loan (which is the lower of the purchase price or the value as determined by the initial appraisal, or if appropriate, the initial evaluation) or the most current appraisal, or if appropriate, the most current evaluation; and

(ii) In the most recent fiscal year, the ratio of annual net operating income generated by the property (before payment of any debt service on the loan) to annual debt service on the loan is not less than 115 percent; and

(g) If the loan was refinanced by the borrower:

(i) All principal and interest payments on the loan being refinanced that were made in the preceding year prior to refinancing shall apply in determining the one-year timely payment requirement under Paragraph (D)(7)(c)(5)(c) of this Rule; and

(ii) The net operating income generated by the property in the preceding year prior to refinancing shall apply in determining the applicable debt service requirements under Paragraphs (D)(7)(c)(5)(e) and (f) of this Rule.

NOTE: For the purposes of the debt service requirements in Paragraphs (D)(7)(c)(5)(e)(ii) and (f)(ii) of this Rule, other forms of debt service coverage that generate sufficient cash flows to provide comparable protection to the institution may be considered for: (a) a loan secured by cooperative housing; or (b) a multifamily residential property loan if the purpose of the loan is for the development or purchase of multifamily residential property primarily intended to provide low- to moderate-income housing, including special operating reserve accounts or special operating subsidies provided by federal, state, local or private sources. However, the Banking Board reserves the right, on a case-by-case basis, to review the adequacy of any other forms of comparable debt service coverage relied on by the institution.

(6) Privately-issued mortgage-backed securities, i.e., those that do not carry the guarantee of a government or government-sponsored agency, if the privately-issued mortgage-backed securities are, at the time the mortgage-backed securities are originated, fully secured by, or otherwise represent, a sufficiently secure interest in mortgages that qualify for the 50 percent risk weight under Paragraph (D)(7)(c)(3) through (5) of this Rule, provided they meet the following criteria:

(a) The underlying assets must be held by an independent trustee that has a first priority, perfected security interest in the underlying assets for the benefit of the holders of the security;

(b) The holder of the security must have an undivided pro rata ownership interest in the underlying assets or the trust that issues the security must have no liabilities unrelated to the issued securities;

(c) The trust that issues the security must be structured such that the cash flows from the underlying assets fully meet the cash flow requirements of the security without undue reliance on any reinvestment income; and

(d) There must not be any material reinvestment risk associated with any funds awaiting distribution to the holder of the security.

NOTE: If all of the underlying mortgages in the pool do not qualify for the 50 percent risk weight, the institution should generally assign the entire value of the security to the 100 percent risk category of Paragraph (D)(7)(d) of this Rule; however, on a case-by-case basis, the Banking Board may allow the institution to assign only the portion of the security which represents an interest in, and the cash flows of, nonqualifying mortgages to the 100 percent risk category, with the remainder being assigned a risk weight of 50 percent. Before the Banking Board will consider a request to risk weight a mortgage-backed security on a proportionate basis, the institution must have current information for the reporting date that details the composition and cash flows of the underlying pool of mortgages.

d. One hundred percent risk weight. All other assets not specified above, including, but not limited to:

(1) Claims on or guaranteed by depository institutions incorporated in a non-OECD country, as well as claims on the central bank of a non-OECD country, with a residual maturity exceeding one year;

(2) All non-local currency claims on non-OECD central governments, as well as local currency claims on non-OECD central governments that are not included in Paragraph (D)(7)(a)(5) of this Rule;

(3) Asset- or mortgage-backed securities that are externally rated are risk-weighted pursuant to Paragraph (E)(4) of this Rule;

(4) All stripped mortgage-backed securities, including IO portions, principal only portions (POs), and other similar instruments, regardless of the issuer or guarantor;

(5) Obligations issued by any state or any political subdivision thereof for the benefit of a private party or enterprise where that party or enterprise, rather than the issuing state or political subdivision, is responsible for the timely payment of principal and interest on the obligation, e.g., industrial development bonds;

(6) Claims on commercial enterprises owned by non-OECD and OECD central governments;

(7) Any investment in an unconsolidated subsidiary that is not required to be deducted from total capital;

(8) Instruments issued by depository institutions incorporated in OECD and non-OECD countries that qualify as capital of the issuer;

(9) Investments in fixed assets, premises, and other real estate owned;

(10) Claims representing capital of a securities firm notwithstanding Paragraph (D)(7)(b)(13) of this Rule.

NOTE: An institution subject to the market risk capital requirements pursuant to Appendix B of this Rule may calculate the capital requirement for qualifying securities borrowing transactions pursuant to Paragraph (C)(1)(a)(2) of Appendix B of this Rule.

e. Asset-backed commercial paper programs subject to consolidation.

(1) An institution that qualifies as a primary beneficiary and must consolidate an asset-backed commercial paper program as a variable interest entity under generally accepted accounting principles may exclude the consolidated asset-backed commercial paper program assets from risk-weighted assets if the institution is the sponsor of the consolidated asset-backed commercial paper program.

(2) If an institution excludes such consolidated asset-backed commercial paper program assets from risk-weighted assets, the institution must assess the appropriate risk-based capital charge against any risk exposures of the institution arising in connection with such asset-backed commercial paper program, including direct credit substitutes, recourse obligations, residual interests, asset-backed commercial paper liquidity facilities, and loans pursuant to Paragraphs (D) and (E) of this Rule.

(3) If an institution is either not permitted to exclude consolidated asset-backed commercial paper program assets or elects not to exclude consolidated asset-backed commercial paper program assets from its risk-weighted assets, the institution must assess a risk-based capital charge based on the appropriate risk weight of the consolidated asset-backed commercial paper program assets pursuant to Paragraphs (D)(7) and (E) of this Rule. Any direct credit substitutes and recourse obligations (including residual interests and asset-backed commercial paper liquidity facilities), and loans that sponsoring institutions provide to such asset-backed commercial paper programs are not subject to a capital charge under Paragraph (E) of this Rule.

(4) If an institution has multiple overlapping exposures (such as a program-wide credit enhancement and an asset-backed commercial paper liquidity facility) to an asset-backed commercial paper program that is not consolidated for risk-based capital purposes, the institution must apply the highest capital charge applicable to the exposures but is not required to hold capital multiple times for the overlapping exposures under Paragraph (E) of this Rule.

f. Other variable interest entities subject to consolidation. If an institution is required to consolidate the assets of a variable interest entity other than an asset-backed commercial paper program under generally accepted accounting principles, the institution must assess a risk-based capital charge based on the appropriate risk weight of the consolidated assets pursuant to Paragraphs (D)(7) and (E) of this Rule. Any direct credit substitutes and recourse obligations (including residual interests), and loans that an institution may provide to such a variable interest entity are not subject to any capital charge under Paragraph (E) of this Rule.

8. Off-Balance Sheet Activities. The risk weight assigned to an off-balance sheet item is determined by a two-step process. First, the face amount of the off-balance sheet item is multiplied by the appropriate credit conversion factor specified in this Paragraph (D)(8). This calculation translates the face amount of an off-balance sheet item into an on-balance sheet credit equivalent amount. Second, the resulting credit equivalent amount is then assigned to the proper risk category using the criteria regarding obligors, guarantors and collateral listed in Paragraph (D)(7) of this Rule, or external credit rating pursuant to Paragraph (E)(4) of this Rule, if applicable. Collateral and guarantees are applied to the face amount of an off-balance sheet item; however, with respect to derivative contracts under Paragraph (D)(8)(g) of this Rule, collateral and guarantees are applied to the credit equivalent amounts of such derivative contracts. The following are the credit conversion factors and the off-balance sheet items to which they apply. However, direct credit substitutes, recourse obligations, and securities issued in connection with asset securitizations are treated as described in Paragraph (E) of this Rule.

a. One hundred percent credit conversion factor.

(1) Risk participations purchased in bankers' acceptances.

(2) Contingent obligations with a certain draw down, e.g., legally binding agreements to purchase assets at a specified future date.

(3) Indemnification of customers whose securities the institution has lent as agent. If the customer is not indemnified against loss by the institution, the transaction is excluded from the risk-based capital calculation. When an institution lends its own securities, the transaction is treated as a loan. When an institution lends its own securities or, acting as agent, agrees to indemnify a customer, the transaction is assigned to the risk weight appropriate to the obligor or collateral that is delivered to the lending or indemnifying institution or to an independent custodian acting on their behalf.

b. Fifty percent credit conversion factor.

(1) Transaction-related contingencies including, among other things, performance bonds and performance-based standby letters of credit related to a particular transaction. A “performance-based standby letter of credit” is any letter of credit, or similar arrangement, however named or described, that represents an irrevocable obligation to the beneficiary on the part of the issuer to make payment on account of any default by the account party in the performance of a non-financial or commercial obligation. Participations in performance-based standby letters of credit are treated pursuant to Paragraph (E) of this Rule. To the extent permitted by law or regulation, performance-based standby letters of credit include such things as arrangements backing subcontractors’ and suppliers’ performance, labor and materials contracts, and construction bids.

(2) Unused portion of commitments with an original maturity exceeding one year; however, commitments that are asset-backed commercial paper liquidity facilities must satisfy the eligibility requirements under Paragraph (D)(8)(f)(2) of this Rule. Participations in commitments are treated pursuant to Paragraph (E) of this Rule.

(3) Revolving underwriting facilities, note issuance facilities, and similar arrangements pursuant to which the institution’s customer can issue short-term debt obligations in its own name, but for which the institution has a legally binding commitment to either:

(a) Purchase the obligations the customer is unable to sell by a stated date; or

(b) Advance funds to its customer, if the obligations cannot be sold.

c. Twenty percent credit conversion factor.

(1) Trade-related contingencies. These are short-term, self-liquidating instruments used to finance the movement of goods and are collateralized by the underlying shipment. A commercial letter of credit is an example of such an instrument.

d. Ten percent credit conversion factor.

(1) Unused portion of asset-backed commercial paper liquidity facilities with an original maturity of one year or less that satisfy the eligibility requirements under Paragraph (D)(8)(f)(2) of this Rule.

e. Zero percent credit conversion factor.

(1) Unused portion of commitments with an original maturity of one year or less, but excluding any asset-backed commercial paper liquidity facilities.

(2) Unused portion of commitments with an original maturity of greater than one year, if they are unconditionally cancelable (see Paragraph (B)(34) of this Rule) at any time at the option of the institution and the institution has the contractual right to make, and in fact does make, either:

(a) A separate credit decision based upon the borrower's current financial condition, before each drawing under the lending facility; or

(b) An annual (or more frequent) credit review based upon the borrower's current financial condition to determine whether or not the lending facility should be continued.

(3) The unused portion of retail credit card lines or other related plans that are unconditionally cancelable by the institution pursuant to applicable law.

f. Liquidity facility provided to asset-backed commercial paper.

(1) Noneligible asset-backed commercial paper liquidity facilities treated as recourse or direct credit substitute. Unused portion of asset-backed commercial paper liquidity facilities that do not meet the criteria for an eligible liquidity facility provided to asset-backed commercial paper pursuant to Paragraph (D)(8)(f)(2) of this Rule must be treated as recourse or as a direct credit substitute, and assessed the appropriate risk-based capital charge pursuant to Paragraph (E) of this Rule.

(2) Eligible asset-backed commercial paper liquidity facility. Except as provided in Paragraph (D)(8)(f)(3) of this Rule, in order for the unused portion of an asset-backed commercial paper liquidity facility to be eligible for either the 50 percent or 10 percent credit conversion factors under Paragraph (D)(8)(b)(2) or (D)(8)(d) of this Rule, the asset-backed commercial paper liquidity facility must satisfy the following criteria:

(a) At the time of draw, the asset-backed commercial paper liquidity facility must be subject to an asset quality test that:

(i) Precludes funding of assets that are ninety (90) days or more past due or in default; and

(ii) If the assets that an asset-backed commercial paper liquidity facility is required to fund are externally rated securities at the time they are transferred into the program, the asset-backed commercial paper liquidity facility must be used to fund only securities that are externally rated investment grade at the time of funding. If the assets are not externally rated at the time they are transferred into the program, then they are not subject to this investment grade requirement.

(b) The asset-backed commercial paper liquidity facility must provide that, prior to any draws, the institution's funding obligation is reduced to cover only those assets that satisfy the funding criteria under the asset quality test as provided in Paragraph (D)(8)(f)(2)(a) of this Rule.

(3) Exception to eligibility requirements for assets guaranteed by the United States Government or its agencies, or the central government of an OECD country. Nothwithstanding the eligibility requirements for asset-backed commercial paper program liquidity facilities in Paragraph (D)(8)(f)(2), the unused portion of an asset-backed commercial paper liquidity facility may still qualify for either the 50 percent or 10 percent credit conversion factors under Paragraph (D)(8)(b)(2) or (D)(8)(d) of this Rule, if the assets required to be funded by the asset-backed commercial paper liquidity facility are guaranteed, either conditionally or unconditionally, by the United States Government or its agencies, or the central government of an OECD country.

(4) Transition period for asset-backed commercial paper liquidity facilities. Notwithstanding the eligibility requirements for asset-backed commercial paper program liquidity facilities in Paragraph (D)(8)(f)(1) of this Rule, the unused portion of an asset-backed commercial paper liquidity facility will be treated as eligible liquidity facilities pursuant to Paragraph (D)(8)(f)(2) of this Rule, regardless of their compliance with the definition of eligible liquidity facilities, until September 30, 2005. On that date and thereafter, the unused portions of asset-backed commercial paper liquidity facilities that do not meet the eligibility requirements in Paragraph (D)(8)(f)(1) of this Rule will be treated as recourse obligations or direct credit substitutes.

g. Derivative Contracts.

(1) Calculation of Credit Equivalent Amounts. The credit equivalent amount of a derivative contract equals the sum of the current credit exposure and the potential future credit exposure of the derivative contract. The calculation of credit equivalent amounts must be measured in U.S. dollars, regardless of the currency or currencies specified in the derivative contract.

(a) Current credit exposure. The current credit exposure for a single derivative contract is determined by the mark-to-market value of the derivative contract. If the mark-to-market value is positive, then the current exposure equals that mark-to-market value. If the mark-to-market value is zero or negative, then the current exposure is zero. The current credit exposure for multiple derivative contracts executed with a single counterparty and subject to a qualifying bilateral netting contract is determined as provided by Paragraph (D)(8)(g)(2)(a) of this Rule.

(b) Potential future credit exposure. The potential future credit exposure for a single derivative contract, including a derivative contract with a negative mark-to-market value, is calculated by multiplying the notional principal of the derivative contract by one of the credit conversion factors in Table B for the appropriate category. The potential future credit exposure for gold contracts shall be calculated using the foreign exchange rate conversion factors. For any derivative contract that does not fall within one of the specified categories in Table B, the potential future credit exposure shall be calculated using the other commodity conversion factors. Subject to examiner review, institutions should use the effective rather than the apparent or stated notional amount in calculating the potential future credit exposure. The potential future credit exposure for multiple derivative contracts executed with a single counterparty and subject to a qualifying bilateral netting contract is determined as provided by Paragraph (D)(8)(g)(2)(a) of this Rule.

TABLE B
Conversion Factor Matrix[1]

Remaining Maturity[2]	Interest Rate	Foreign Exchange Rate and Gold	Equity[2]	Precious Metals	Other Commodities
One Year or Less	0.0%	1.0%	6.0%	7.0%	10.0%
More Than One Year to Five Years	0.5%	5.0%	8.0%	7.0%	12.0%
More Than Five Years	1.5%	7.5%	10.0%	8.0%	15.0%

[1]For derivative contracts with multiple exchanges of principal, the conversion factors are multiplied by the number of remaining payments in the derivative contract.

[2]For derivative contracts that automatically reset to zero value following a payment, the remaining maturity equals the time until the next payment. However, interest rate contracts with remaining maturities of greater than one year shall be subject to a minimum conversion factor of 0.5 percent

NOTE: For purposes of calculating either the potential future credit exposure under Paragraph (D)(8)(g)(1)(b) of this Rule or the gross potential future credit exposure under Paragraph (D)(8)(g)(2)(a)(2) of this Rule for foreign exchange contracts and other similar contracts in which the notional principal is equivalent to the cash flows, total notional principal is the net receipts to each party falling due on each value date in each currency. No potential future credit exposure is calculated for single currency interest rate swaps in which payments are made based upon two floating rate indices (so-called floating/floating or basis swaps); the credit equivalent amount is measured solely on the basis of the current credit exposure.

(2) Derivative contracts subject to a qualifying bilateral netting contract.

(a) Netting calculation. The credit equivalent amount for multiple derivative contracts executed with a single counterparty and subject to a qualifying bilateral netting contract pursuant to Paragraph (D)(8)(g)(2)(b) of this Rule is calculated by adding the net current credit exposure and the adjusted sum of the potential future credit exposure for all derivative contracts subject to the qualifying bilateral netting contract.

(i) Net current credit exposure. The net current exposure is the net sum of all positive and negative mark-to-market values of the individual derivative contracts subject to a qualifying bilateral netting contract. If the net sum of the mark-to-market value is positive, then the net current credit exposure is equal to the net sum of the mark-to-market value. If the net sum of the mark-to-market values is zero or negative, then the net current credit exposure is zero.

(ii) Adjusted sum of the potential future credit exposure. The adjusted sum of the potential future credit exposure is calculated as:

$A_{net} = 0.4 \text{ X } A_{gross} + (0.6 \text{ X NGR X } A_{gross})A$

Net is the adjusted sum of the potential future credit exposure, A

Gross is the gross potential future credit exposure, and NGR is the net to gross ratio. A

Gross is the sum of the potential future credit exposure (as determined pursuant to Paragraph (D)(8)(g)(1)(b) of this Rule) for each individual derivative contract subject to the qualifying bilateral netting contract. The NGR is the ratio of the net current credit exposure to the gross current credit exposure. In calculating the NGR, the gross current credit exposure equals the sum of the positive current credit exposures (as determined pursuant to Paragraph (D)(8)(g)(1)(a) of this Rule) of all individual derivative contracts subject to the qualifying bilateral netting contract.

(b) Qualifying bilateral netting contact. In determining the current credit exposure for multiple derivative contracts executed with a single counterparty, an institution may net derivative contracts subject to a qualifying bilateral netting contract by offsetting positive and negative mark-to-market values, provided that:

(i) The qualifying bilateral netting contract is in writing.

(ii) The qualifying bilateral netting contract is not subject to a walkaway clause.

(iii) The qualifying bilateral netting contract creates a single legal obligation for all individual derivative contracts covered by the qualifying bilateral netting contract. In effect, the qualifying bilateral netting contract must provide that the institution would have a single claim or obligation either to receive or to pay only the net amount of the sum of the positive and negative mark-to-market values on the individual derivative contracts covered by the qualifying bilateral netting contract. The single legal obligation for the net amount is operative in the event that a counterparty, or a counterparty to whom the qualifying bilateral netting contract has been assigned, fails to perform due to any of the following events: default, insolvency, bankruptcy, or other similar circumstances.

(iv) The institution obtains a written and reasoned legal opinion(s) that represents, with a high degree of certainty, that in the event of a legal challenge, including one resulting from default, insolvency, bankruptcy, or similar circumstances, the relevant court and administrative authorities would find the institution's exposure to be the net amount under:

a) The law of the jurisdiction in which the counterparty is chartered or the equivalent location in the case of noncorporate entities, and if a branch of the counterparty is involved, then also under the law of the jurisdiction in which the branch is located;

b) The law of the jurisdiction that governs the individual derivative contracts covered by the bilateral netting contract; and

c) The law of the jurisdiction that governs the qualifying bilateral netting contract.

(v) The institution establishes and maintains procedures to monitor possible changes in relevant law and to ensure that the qualifying bilateral netting contract continues to satisfy the requirement of this section.

(vi) The institution maintains in its files documentation adequate to support the netting of a derivative contract. (By netting individual derivative contracts for the purpose of calculating its credit equivalent amount, an institution represents that documentation adequate to support the netting of a set of derivative contract(s) is in the institution's files and available for inspection by the Banking Board. Upon determination by the Banking Board that an institution's files are inadequate or that a qualifying bilateral netting contract may not be legally enforceable in any one of the bodies of law described in Paragraphs (D)(8)(g)(2)(b)(iv)(a) through (c) of this Rule, the underlying derivative contracts may not be netted for the purposes of this section.)

(3) Risk-weighting. Once the institution determines the credit equivalent amount for a derivative contract or a set of derivative contracts subject to a qualifying bilateral netting contract, the institution assigns that amount to the risk weight category appropriate to the counterparty, or, if relevant, the nature of any collateral or guarantee. However, the maximum weight that will be applied to the credit equivalent amount of such derivative contract(s) is 50 percent. (Derivative contracts are an exception to the general rule of applying collateral and guarantees to the face value of off-balance sheet items. The sufficiency of collateral and guarantees is determined on the basis of the credit equivalent amount of derivative contracts. However, collateral and guarantees held against a qualifying bilateral netting contract are not recognized for capital purposes unless it is legally available for all contracts included in the qualifying bilateral netting contract.)

(4) Exceptions. The following derivative contracts are not subject to the above calculation, and therefore, are not part of the denominator of an institution's risk-based capital ratio:

(a) An exchange rate contract with an original maturity of 14 calendar days or less (gold contracts do not qualify for this exception); and

(b) A derivative contract that is traded on an exchange requiring the daily payment of any variations in the market value of the contract.

E. Recourse, Direct Credit Substitutes and Positions in Securitizations

1. Definitions. For purposes of Paragraph (E) of this Rule, the following definitions apply:

a. “Credit derivative” means a contract that allows one party (the protection purchaser) to transfer the credit risk of an asset or off-balance sheet credit exposure to another party (the protection provider). The value of a credit derivative is dependent, at least in part, on the credit performance of a “reference asset.”

b. “Credit-enhancing interest-only strip” means an on-balance sheet asset that, in form or in substance:

(1) Represents the contractual right to receive some or all of the interest due on transferred assets; and

(2) Exposes the institution to credit risk directly or indirectly associated with the transferred assets that exceeds its pro rata claim on the assets whether through subordination provisions or other credit enhancing techniques.

c. “Credit-enhancing representations and warranties” means representations and warranties that are made or assumed in connection with a transfer of assets (including loan servicing assets) and that obligate an institution to protect investors from losses arising from credit risk in the assets transferred or the loans serviced. Credit-enhancing representations and warranties include promises to protect a party from losses resulting from the default or nonperformance of another party or from an insufficiency in the value of the collateral. Credit-enhancing representations and warranties do not include:

(1) Early-default clauses and similar warranties that permit the return of, or premium refund clauses covering, one-to-four family residential first mortgage loans (as described in Paragraph (D)(7)(c)(3) of this Rule) for a period not to exceed one hundred twenty (120) days from the date of transfer. These warranties may cover only those loans that were originated within one year of the date of transfer;

(2) Premium refund clauses that cover assets guaranteed, in whole or in part, by the U.S. Government, a U.S. Government agency, or a U.S. Government-sponsored enterprise, provided the premium refund clauses are for a period not to exceed one hundred twenty (120) days from the date of transfer; or

(3) Warranties that permit the return of assets in instances of fraud, misrepresentation or incomplete documentation.

d. “Direct credit substitute” means an arrangement in which an institution assumes, in form or in substance, credit risk associated with an on- or off-balance sheet asset or exposure that was not previously owned by the institution (third-party asset), and the risk assumed by the institution exceeds the pro rata share of the institution's interest in the third-party asset. If an institution has no claim on the third-party asset, then the institution's assumption of any credit risk is a direct credit substitute. Direct credit substitutes include:

(1) Financial standby letters of credit that support financial claims on a third party that exceed an institution's pro rata share in the financial claim;

(2) Guarantees, surety arrangements, credit derivatives and similar instruments backing financial claims that exceed an institution's pro rata share in the financial claim;

(3) Purchased subordinated interests that absorb more than their pro rata share of losses from the underlying assets;

(4) Credit derivative contracts under which the institution assumes more than its pro rata share of credit risk on a third-party asset or exposure;

(5) Loans of lines of credit that provide credit enhancement for the financial obligations of a third party;

(6) Purchased loan servicing assets if the servicer is responsible for credit losses or if the servicer makes or assumes credit-enhancing representations and warranties with respect to the loans serviced. Mortgage servicer cash advances that meet the conditions of Paragraph (E)(1)(i)(1) and (2) of this Rule, are not direct credit substitutes;

(7) Clean-up calls on third-party assets. Clean-up calls that are 10 percent or less of the original pool balance and that are exercisable at the option of the institution are not direct credit substitutes; and

(8) Unused portion of noneligible asset-backed commercial paper liquidity facilities.

e. “Externally rated” means that an instrument or obligation has received a credit rating from at least one nationally recognized statistical rating organization.

f. “Face amount” means the notional principal, or face value, amount of an off-balance sheet item; the amortized cost of an asset not held for trading purposes; and the fair value of a trading asset.

g. “Financial asset” means cash or other monetary instrument, evidence of debt, evidence of an ownership interest in an entity, or a contract that conveys a right to receive or exchange cash or another financial instrument from another party.

h. “Financial standby letter of credit” means a letter of credit or similar arrangement that represents an irrevocable obligation to a third-party beneficiary:

(1) To repay money borrowed by, or advanced to, or for the account of, a second party (the account party); or

(2) To make payment on behalf of the account party, in the event that the account party fails to fulfill its obligation to the beneficiary.

i. “Mortgage servicer cash advance” means funds that a residential mortgage servicer advances to ensure an uninterrupted flow of payments, including advances made to cover foreclosure costs or other expenses to facilitate the timely collection of the loan. A mortgage servicer cash advance is not a recourse obligation or a direct credit substitute if:

(1) The servicer is entitled to full reimbursement and this right is not subordinated to other claims on the cash flows from the underlying asset pool; or

(2) For any one loan, the servicer's obligation to make nonreimbursable advances is contractually limited to an insignificant amount of the outstanding principal amount of that loan.

j. “Nationally recognized statistical rating organization (NRSRO)” means an entity recognized by the Division of Market Regulation of the Securities and Exchange Commission (or any successor Division) (Commission) as a nationally recognized statistical rating organization for various purposes, including the Commission's uniform net capital requirements for brokers and dealers.

k. "Recourse" means an institution's retention, in form or in substance, of any credit risk directly or indirectly associated with an asset it has sold that exceeds a pro rata share of that institution's claim on the asset. If an institution has no claim on a sold asset, then the retention of any credit risk is recourse. A recourse obligation typically arises when an institution transfers assets and retains an explicit obligation to repurchase assets or to absorb losses due to a default on the payment of principal or interest or any other deficiency in the performance of the underlying obligor or some other party. Recourse may also exist implicitly if an institution provides credit enhancement beyond any contractual obligation to support assets it has sold. The following are examples of recourse arrangements:

(1) Credit-enhancing representations and warranties made on transferred assets;

(2) Loans servicing assets retained pursuant to an agreement under which the institution will be responsible for losses associated with the loans serviced. Mortgage servicer cash advances that meet the conditions of Paragraph (E)(1)(i)(1) and (2) of this Rule, are not recourse agreements;

(3) Retained subordinated interests that absorb more than their pro rata share of losses from the underlying assets;

(4) Assets sold under an agreement to repurchase, if the assets are not already included on the balance sheet;

(5) Loan strips sold without contractual recourse where the maturity of the transferred portion of the loan is shorter than the maturity of the commitment under which the loan is drawn;

(6) Credit derivatives issued that absorb more than the institution's pro rata share of losses from the transferred assets;

(7) Clean-up calls. Clean-up calls that are 10 percent or less of the original pool balance and that are exercisable at the option of the institution are not recourse arrangements; and

(8) Noneligible asset-backed commercial paper liquidity facilities.

l. "Residual interest" means any on-balance sheet asset that represents an interest (including a beneficial interest) created by a transfer that qualifies as a sale (pursuant to generally accepted accounting principles) of financial assets, whether through a securitization or otherwise, and that exposes an institution to any credit risk directly or indirectly associated with the transferred asset that exceeds a pro rata share of that institution's claim on the asset, whether through subordination provisions or other credit enhancement techniques. Residual interests generally include credit-enhancing IO strips, spread accounts, cash collateral accounts, retained subordinated interests (and other forms of overcollateralization) and similar assets that function as a credit enhancement. Residual interests further include those exposures that, in substance, cause the institution to retain the credit risk of an asset or exposure that had qualified as a residual interest before it was sold. Residual interests generally do not include interests purchased from a third party.

m. "Risk participation" means a participation in which the originating party remains liable to the beneficiary for the full amount of an obligation (e.g., a direct credit substitute) notwithstanding that another party has acquired a participation in that obligation.

n. "Securitization" means the pooling and repackaging by a special purpose entity of assets or other credit exposures that can be sold to investors. Securitization includes transactions that create stratified credit risk positions whose performance is dependent upon an underlying pool of credit exposures, including loans and commitments.

o. "Structured finance program" means a program where receivable interests and asset-backed securities issued by multiple participants are purchased by a special purpose entity that repackages those exposures into securities that can be sold to investors. Structured finance programs allocate credit risks, generally, between the participants and credit enhancement provided to the program.

p. "Traded position" means a position retained, assumed or issued in connection with a securitization that is externally rated, where there is a reasonable expectation that, in the near future, the rating will be relied upon by:

(1) Unaffiliated investors to purchase the position; or

(2) An unaffiliated third party to enter into a transaction involving the position, such as a purchase, loan or repurchase agreement.

2. Credit equivalent amounts and risk weights of recourse obligations and direct credit substitutes.

a. Credit-equivalent amount. Except as otherwise provided, the credit-equivalent amount for a recourse obligation or direct credit substitute is the full amount of the credit-enhanced assets for which the institution directly or indirectly retains or assumes credit risk multiplied by a 100 percent conversion factor.

b. Risk-weight factor. To determine the institution's risk-weighted assets for off-balance sheet recourse obligations and direct credit substitutes, the credit equivalent amount is assigned to the risk category appropriate to the obligor in the underlying transaction, after considering any associated guarantees or collateral. For a direct credit substitute that is an on-balance sheet asset (e.g., a purchased subordinated security), an institution must calculate risk-weighted assets using the amount of the direct credit substitute and the full amount of the assets it supports, i.e., all the more senior positions in the structure.

3. Credit equivalent amount and risk weight of participations in, and syndications of, direct credit substitutes. The credit equivalent amount for a participation interest in, or syndication of, a direct credit substitute is calculated and risk weighted as follows:

a. In the case of a direct credit substitute in which an institution has conveyed a risk participation, the full amount of the assets that are supported by the direct credit substitute is converted to a credit equivalent amount using a 100 percent conversion factor. The pro rata share of the credit equivalent amount that has been conveyed through a risk participation is then assigned to whichever risk-weight category is lower: the risk-weight category appropriate to the obligor in the underlying transaction, after considering any associated guarantees or collateral, or the risk-weight category appropriate to the party acquiring the participation. The pro rata share of the credit equivalent amount that has not been participated out is assigned to the risk-weight category appropriate to the obligor after considering any associated guarantees or collateral.

b. In the case of a direct credit substitute in which the institution has acquired a risk participation, the acquiring institution's pro rata share of the direct credit substitute is multiplied by the full amount of the assets that are supported by the direct credit substitute and converted using a 100 percent credit conversion factor. The resulting credit equivalent amount is then assigned to the risk-weight category appropriate to the obligor in the underlying transaction, after considering any associated guarantees or collateral.

c. In the case of a direct credit substitute that takes the form of a syndication where each institution or participating entity is obligated only for its pro rata share of the risk and there is no recourse to the originating entity, each institution's credit equivalent amount will be calculated by multiplying only its pro rata share of the assets supported by the direct credit substitute by a 100 percent conversion factor. The resulting credit equivalent amount is then assigned to the risk-weight category appropriate to the obligor in the underlying transaction, after considering any associated guarantees or collateral.

4. Externally rated positions: credit-equivalent amounts and risk weights.

a. Traded positions. With respect to a recourse obligation, direct credit substitute, residual interest (other than a credit-enhancing IO strip) or asset- or mortgage-backed security that is a “traded position” and that has received an external rating on a long-term position that is one grade below investment grade or better, or a short-term position that is investment grade, the institution may multiply the face amount of the position by the appropriate risk weight, determined pursuant to Tables C or D of this Rule (stripped mortgage-backed securities or other similar instruments, such as IO or PO strips, that are not credit enhancing must be assigned to the 100 percent risk category). If a traded position receives more than one external rating, the lowest single rating will apply.

TABLE C

Long-Term Rating Category	Examples	Risk Weight (In Percent)
Highest or second highest investment grade	AAA, AA	20
Third highest investment grade	A	50
Lowest investment grade	BBB	100
One category below investment grade	BB	200

TABLE D

Short-Term Rating Category	Examples	Risk Weight (In Percent)
Highest investment grade	A-1, P-1	20
Second highest investment grade	A-2, P-2	50
Lowest investment grade	A-3. P-3	100

b. Non-traded positions. A recourse obligation, direct credit substitute, residual interest (but not a credit-enhancing IO strip) or asset- or mortgage-backed security extended in connection with a securitization that is not a “traded position” may be assigned a risk weight pursuant to Paragraph (E)(4)(a) of this Rule if:

(1) It has been externally rated by more than one NRSRO;

(2) It has received an external rating on a long-term position that is one category below investment grade or better or a short-term position that is investment grade by all NRSROs providing a rating;

(3) The ratings are publicly available, and

(4) The ratings are based on the same criteria used to rate traded positions.

If the ratings are different, the lowest rating will determine the risk category to which the recourse obligation, residual interest or direct credit substitute will be assigned.

5. Senior positions not externally rated. For a recourse obligation, direct credit substitute, residual interest or asset- or mortgage-backed security that is not externally rated but is senior or preferred in all features to a traded position (including collateralization and maturity) an institution may apply a risk weight to the face amount of the senior position pursuant to Paragraph (E)(4)(a) of this Rule, based upon the traded position, subject to any current or prospective supervisory guidance and the institution satisfying the Banking Board that this treatment is appropriate. This Paragraph (E) will apply only if the traded position provides substantive credit support to the unrated position until the unrated position matures.

6. Residual Interests.

a. Concentration limit on credit-enhancing IO strips. In addition to the capital requirement provided by Paragraph (E)(6)(b) of this Rule, an institution must deduct from Tier 1 capital all credit-enhancing IO strips in excess of 25 percent of Tier 1 capital pursuant to Paragraph (C)(1)(e) of this Rule.

b. Credit-enchancing IO strip capital requirement. After applying the concentration limit to credit-enhancing IO strips pursuant to Paragraph (E)(6)(a) of this Rule, an institution must maintain risk-based capital for a credit-enhancing IO strip equal to the remaining amount of the credit-enhancing IO strip (net of any existing associated deferred tax liability), even if the amount of risk-based capital required to be maintained exceeds the full risk-based capital requirement for the assets transferred. Transactions that, in substance, result in the retention of credit risk associated with a transferred credit-enhancing IO strip will be treated as if the credit-enhancing IO strip was retained by the institution and not transferred.

c. Other residual interests capital requirement. Except as provided in Paragraphs (E)(4) or (5) of this Rule, an institution must maintain risk-based capital for a residual interest (excluding a credit-enhancing IO strip) equal to the face amount of the residual interest that is retained on the balance sheet (net of any existing associated deferred tax liability), even if the amount of risk-based capital required to be maintained exceeds the full risk-based capital requirement for the assets transferred. Transactions that, in substance, result in the retention of credit risk associated with a transferred residual interest will be treated as if the residual interest was retained by the institution and not transferred.

d. Residual interests and other recourse obligations. Where the aggregate capital requirement for residual interests (including credit-enhancing IO strips) and recourse obligations arising from the same transfer of assets exceed the full risk-based capital requirement for those assets, an institution must maintain risk-based capital equal to the greater of the risk-based capital requirement for the residual interest as calculated under Paragraphs (E)(6)(a) through (c) of this Rule or the full risk-based capital requirement for the assets transferred.

7. Positions that are not rated by an NRSRO. A position (but not a residual interest) extended in connection with a securitization and that is not rated by an NRSRO may be risk-weighted based on the institution's determination of the credit rating of the position, as specified in Table E of this Rule, multiplied by the face amount of the position. In order to qualify for this treatment, the institution's system for determining the credit rating of the position must meet one of the three alternative standards set out in Paragraphs (E)(7)(a) through (c) of this Rule.

TABLE E

Rating Category	Examples	Risk Weight (In Percent)
Investment grade	BBB, or Better	100
One category below investment grade	BB	200

a. Internal risk rating used for asset-backed programs. A direct credit substitute (but not a purchased credit-enhancing IO strip) is assumed by an institution in connection with an asset-backed commercial paper program sponsored by the institution and the institution is able to demonstrate to the satisfaction of the Banking Board, prior to relying upon its use, that the institution's internal credit risk rating system is adequate. Adequate internal credit risk rating systems usually contain the following criteria:

(1) The internal credit risk system is an integral part of the institution's risk management system that explicitly incorporates the full range of risks arising from an institution's participation in securitization activities;

(2) Internal credit ratings are linked to measurable outcomes, such as the probability that the position will experience any loss, the position's expected loss given default, and the degree of variance in losses given default on that position;

(3) The institution's internal credit risk system must separately consider the risk associated with the underlying loans or borrowers, and the risk associated with the structure of a particular securitization transaction;

(4) The institution's internal credit risk system must identify gradations of risk among “pass” assets and other risk positions;

(5) The institution must have clear, explicit criteria that are used to classify assets into each internal risk grade, including subjective factors;

(6) The institution must have independent credit risk management or loan review personnel assigning or reviewing the credit risk ratings;

(7) An internal audit procedure should periodically verify that internal risk ratings are assigned pursuant to the institution's established criteria;

(8) The institution must monitor the performance of the internal credit risk ratings assigned to nonrated, nontraded direct credit substitutes over time to determine the appropriateness of the initial credit risk rating assignment and adjust individual credit risk ratings, or the overall internal credit risk ratings system, as needed; and

(9) The internal credit risk system must make credit risk rating assumptions that are consistent with, or more conservative than, the credit risk rating assumptions and methodologies of NRSROs.

b. Program Ratings. A direct credit substitute or recourse obligation (but not a residual interest) is assumed or retained by an institution in connection with a structured finance program and a NRSRO has reviewed the terms of the program and stated a rating for positions associated with the program. If the program has options for different combinations of assets, standards, internal credit enhancements and other relevant factors, and the NRSRO specifies ranges of rating categories to them, the institution may apply the rating category applicable to the option that corresponds to the institution's position. In order to rely on a program rating, the institution must demonstrate to the Banking Board's satisfaction that the credit risk rating assigned to the program meets the same standards generally used by NRSROs for rating traded positions. The institution must also demonstrate to the Banking Board's satisfaction that the criteria underlying the NRSRO's assignment of ratings for the program are satisfied for the particular position. If an institution participates in a securitization sponsored by another party the Banking Board may authorize the institution to use this approach based on a program rating obtained by the sponsor of the program.

c. Computer Program. The institution is using an acceptable credit assessment computer program to determine the rating of a direct credit substitute or recourse obligation (but not a residual interest) extended in connection with a structured finance program. A NRSRO must have developed the computer program and the institution must demonstrate to the Banking Board's satisfaction that ratings under the program correspond credibly and reliably with the rating of traded positions.

8. Limitations on risk-based capital requirements.

a. Low-level exposure rule. If the maximum contractual exposure to loss retained or assumed by an institution is less than the effective risk-based capital requirement, as determined pursuant to Paragraph (E)(2) of this Rule, for the asset supported by the institution's position, the risk-based capital required under this Rule is limited to the institution's contractual exposure, less any recourse liability account established pursuant to generally accepted accounting principles. This limitation does not apply when an institution provides credit enhancement beyond any contractual obligation to support assets that it has sold.

b. Related on-balance sheet assets. If an asset is included in the calculation of the risk-based capital requirements under this Paragraph (E) of this Rule and also appears as an asset on an institution's balance sheet, the asset is risk-weighted only under this Paragraph (E) of this Rule, except in the case of loan servicing assets and similar arrangements with embedded recourse obligations or direct credit substitutes. In that case, both the on-balance sheet servicing assets and the related recourse obligations or direct credit substitutes must both be separately risk-weighted and incorporated into the risk-based capital calculation.

9. Alternative Capital Calculation for Small Business Obligations.

a. Definitions. For purposes of this Paragraph (E)(9):

(1) "Qualified institution" means an institution that:

(a) Is well capitalized without applying the capital treatment described in this Paragraph (E)(9), or

(b) Is adequately capitalized without applying the capital treatment described in this Paragraph (E)(9) and has received written permission from the Banking Board to apply the capital treatment described in this Paragraph (E)(9).

(2) "Recourse" has the meaning given to such term under generally accepted accounting principles.

(3) "Small business" means a business that meets the criteria for a small business concern established by the Small Business Administration.

b. Capital and reserve requirements. Notwithstanding the risk-based capital treatment outlined in Paragraph (C)(1)(g) and any other subsection (other than subsection (9) of this Paragraph (E)), with respect to a transfer of a small business loan or a lease of personal property with recourse that is a sale under generally accepted accounting principles, a qualified institution may elect to apply the following treatment:

(1) The institution establishes and maintains a non-capital reserve under generally accepted accounting principles sufficient to meet the reasonable estimated liability of the institution under the recourse arrangement; and

(2) For purposes of calculating the institution's risk-based capital ratio, the institution includes only the face amount of its recourse in its risk-weighted assets.

c. Limit on aggregate amount of recourse. The total outstanding amount of recourse retained by a qualified institution with respect to transfers of small business loans and leases of personal property and included in the risk-weighted assets of the institution as described in Paragraph (E)(9)(b) of this Rule may not exceed 15 percent of the institution's total capital after adjustments and deductions, unless the Banking Board specifies a greater amount by order.

d. Institution that ceases to be qualified or that exceeds aggregate limit. If an institution ceases to be a qualified institution or exceeds the aggregate limit in Paragraph (E)(9)(c) of this Rule, the institution may continue to apply the capital treatment described in Paragraph (E)(9)(b) of this Rule to transfers of small business loans and leases of personal property that occurred when the institution was qualified and did not exceed the limit.

F. Target Ratios

1. As of December 31, 1992:

a. All institutions are expected to maintain a minimum ratio of total capital (after deductions) to risk-weighted assets of 8.0 percent.

b. Tier 2 capital elements qualify as part of an institution's total capital base up to a maximum of 100 percent of that institution's Tier 1 capital.

c. In addition to the standards established by these risk-based capital guidelines, all institutions must maintain a minimum capital-to-total asset ratio, pursuant to the provisions of Banking Board Rule CB101.51.

APPENDIX A

MARKET RISK

A. Purpose and Applicability.

1. The purpose of this Appendix is to ensure that institutions with significant exposure to market risk maintain adequate capital to support that exposure. This Appendix supplements and adjusts the risk-based capital ratio calculations under this Rule with respect to those institutions.

2. Applicability.

a. This Appendix applies to any institution whose trading activity (on a worldwide consolidated basis) equals:

(1) Ten percent of more of total assets as reported in the most recent Call Report; or

(2) One billon dollars or more.

NOTE: Trading activity means the gross sum of trading assets and liabilities as reported in the institution's most recent quarterly Call Report.

b. The Banking Board may apply this Appendix to any institution if it deems it necessary or appropriate for safe and sound practices.

c. The Banking Board may exclude any institution otherwise meeting the criteria from Paragraph (A)(2)(a) of this Appendix from coverage under this Appendix if it determines the institution meets such criteria as a consequence of accounting, operational, or similar considerations, and the Banking Board deems it consistent with safe and sound practices.

B. Definitions

1. “Covered position” means all positions in an institution's trading account, and all foreign exchange and commodity positions, whether or not in the trading account. Positions include on-balance sheet assets and liabilities and off-balance sheet items. Securities subject to repurchase and lending agreements are included as if they are still owned by the lender. Asset-backed commercial paper liquidity facilities, in form or in substance, in an institution's trading account are excluded from covered positions, and instead, are subject to the risk-based capital requirements as provided in this Rule. (Subject to supervisory review, an institution may exclude structural positions in foreign currencies from its covered positions.)

2. “Market risk” means the risk of loss resulting from movements in market prices. Market risk consists of general market risk and specific risk components.

   a. “General market risk” means changes in the market value of covered positions resulting from broad market movements, such as changes in the general level of interest rates, equity prices, foreign exchange rates, or commodity prices.

   b. “Specific risk” means changes in the market value of specific positions due to factors other than broad market movements and includes default and event risk as well as idiosyncratic variations.

3. Tier 1 and Tier 2 capital are defined in Paragraph (C) of this Rule.

4. Tier 3 capital is subordinated debt that is unsecured; is fully paid up; has an original maturity of at least two years; is not redeemable before maturity without prior approval by the Banking Board; includes a lock-in clause precluding payment of either interest or principle (even at maturity) if the payment would cause the issuing institution's risk-based capital ratio to fall or remain below the minimum required under this Rule; and does not contain and is not covered by any covenants, terms, or restrictions that are inconsistent with safe and sound practices.

5. “Value-at-risk (VAR)” means the estimate of the maximum amount that the value of covered positions could decline during a fixed holding period within a stated confidence level, measured pursuant to Paragraph (D) of this Appendix.

C. Adjustments to the Risk-Based Capital Ratio Calculations

1. Risk-based capital ratio denominator. An institution subject to this Appendix shall calculate its risk-based capital ratio denominator as follows:

   a. Adjusted risk-weighted assets.

      (1) Covered positions. Calculate adjusted risk-weighted assets, which equals risk-weighted assets (as calculated pursuant to this Rule), excluding the risk-weighted amounts of all covered positions (except foreign exchange positions outside the trading account and over-the-counter derivative positions). (Foreign exchange positions outside the trading account and all over-the-counter derivative positions, whether or not in the trading account, must be included in adjusted risk-weighted assets).

(2) Securities borrowing transactions. In calculating adjusted risk-weighted assets, an institution also may exclude a receivable that results from the institution's posting of cash collateral in a securities borrowing transaction to the extent that the receivable is collateralized by the market value of the borrowed securities and is subject to the following conditions:

(a) The borrowed securities must be includable in the trading account and must be liquid and readily marketable;

(b) The borrowed securities must be marked to market daily;

(c) The receivable must be subject to a daily margining requirement; and

(d) The securities borrowing transaction must be a securities contract for purposes of section 555 of the Bankruptcy Code, a qualified financial contract for purposes of section 11(e)(8) of the Federal Deposit Insurance Act, or a netting contract between or among financial institutions, for purposes of section 401-407 of the Federal Deposit Insurance Corporation Improvement Act of 1991 or Regulation EE.

b. Measure for market risk.Calculate the measure for market risk, which equals the sum of the VAR-based capital charge, the specific risk add-on (if any), and the capital charge for de minimus exposures (if any).

(1) VAR-based capital charge. The VAR-based capital charge equals the higher of:

(a) The previous day's VAR measure; or

(b) The average of the daily VAR measures for each of the preceding sixty (60) business days multiplied by three, except as provided in Paragraph (D)(5) of this Appendix;

(2) Specific risk add-on. The specific risk add-on is calculated pursuant to Paragraph (E) of this Appendix; and

(3) Capital charge for de minimus exposure. The capital charge for de minimus exposure is calculated pursuant to Paragraph (D)(1) of this Appendix.

c. Market risk equivalent assets. Calculate market risk equivalent assets by multiplying the measure for market risk (as calculated in Paragraph (C)(1)(b) of this Appendix) by 12.5.

d. Denominator calculation. Add market risk equivalent assets (as calculated in Paragraph (C)(1)(c) of this Appendix) to adjusted risk-weighted assets (as calculated in Paragraph (C)(1)(a) of this Appendix). The resulting sum is the institution's risk-based capital ratio denominator.

2. Risk-based capital ratio numerator. An institution subject to this Appendix shall calculate its risk-based capital ratio numerator by allocating capital as follows:

a. Credit risk allocation. Allocate Tier 1 and Tier 2 capital equal to 8.0 percent of adjusted risk-weighted assets (as calculated in Paragraph (C)(1)(a) of this Appendix).

(An institution may not allocate Tier 3 capital to support credit risk.)

b. Market risk allocation. Allocate Tier 1, Tier 2, and Tier 3 capital equal to the measure for market risk as calculated in Paragraph (C)(1)(b) of this Appendix. The sum of Tier 2 and Tier 3 capital allocated for market risk must not exceed 250 percent of Tier 1 capital allocated for market risk. (This requirement means that Tier 1 capital allocated in this Paragraph must equal at least 28.6 percent of the measure for market risk.)

c. Restrictions.

(1) The sum of Tier 2 capital (both allocated and excess) and Tier 3 capital (allocated in Paragraph (C)(2)(b) of this Appendix) may not exceed 100 percent of Tier 1 capital (both allocated and excess).

(Excess Tier 1 capital means Tier 1 capital that has not been allocated in Paragraphs (C)(2)(a) and (b) of this Appendix. Excess Tier 2 capital means Tier 2 capital that has not been allocated in Paragraphs (C)(2)(a) and (b) of this Appendix, subject to the restrictions in Paragraph (C)(2)(c) of this Appendix.)

(2) Term subordinated debt (and intermediate-term preferred stock and related surplus) included in Tier 2 capital (both allocated and excess) may not exceed 50 percent of Tier 1 capital (both allocated and excess).

d. Numerator calculation. Add Tier 1 capital (both allocated and excess), Tier 2 capital (both allocated and excess), and Tier 3 capital (allocated under Paragraph (C)(2)(b) of this Appendix). The resulting sum is the institution's risk-based capital ratio numerator.

D. Internal Models

1. General. For risk-based capital purposes, an institution subject to this Appendix must use its internal model to measure its daily VAR, pursuant to the requirements of this Appendix. The Banking Board may permit an institution to use alternative techniques to measure the market risk of de minimus exposures so long as the techniques adequately measure associated market risk.

(An institution's internal model may use any generally accepted measurement techniques, such as variance-covariance models, historical simulations, or Monte Carlo simulations. However, the level of sophistication and accuracy of an institution's internal model must be commensurate with the nature and size of its covered positions. An institution that modifies its existing modeling procedures to comply with the requirements of this Appendix for risk-based capital purposes should, nonetheless, continue to use the internal model it considers most appropriate in evaluating risks for other purposes.)

2. Qualitative requirements. An institution subject to this Appendix must have a risk management system that meets the following minimum qualitative requirements:

a. The institution must have a risk control unit that reports directly to senior management and is independent from business trading units.

b. The institution's internal risk measurement model must be integrated into the daily management process.

c. The institution's policies and procedures must identify, and the institution must conduct, appropriate stress tests and backtests. The institution's policies and procedures must identify the procedures to follow in response to the results of such tests.

(Stress tests provide information about the impact of adverse market events on an institution's covered positions. Backtests provide information about the accuracy of an internal model by comparing an institution's daily VAR measures to its corresponding daily trading profits and losses.)

d. The institution must conduct independent reviews of its risk measurement and risk management systems at least annually.

3. Market risk factors. The institution's internal model must use risk factors sufficient to measure the market risk inherent in all covered positions. The risk factors must address interest rate risk, equity price risk, foreign exchange rate risk, and commodity price risk.

(For material exposures in the major currencies and markets, modeling techniques must capture spread risk and must incorporate enough segments of the yield curve--at least six--to capture differences in volatility and less than perfect correlation of rates along the yield curve.)

4. Quantitative requirements. For regulatory capital purposes, VAR measures must meet the following quantitative requirements:

a. The VAR measures must be calculated on a daily basis using a 99 percent, one-tailed confidence level with a price shock equivalent to a ten (10) business day movement in rates and prices. In order to calculate VAR measures based on a ten (10) day price shock, the institution may either calculate ten (10) day figures directly or convert VAR figures based on holding periods other than ten (10) days to the equivalent of a ten (10) day holding period (for instance, by multiplying a one (1) day VAR measure by the square root of ten).

b. The VAR measures must be based on an historical observation period (or effective observation period for an institution using a weighting scheme or other similar method) of at least one (1) year. The institution must update data sets at least once every three (3) months or more frequently as market conditions warrant.

c. The VAR measurements must include the risks arising from the non-linear price characteristics of options positions and the sensitivity of the market value of the positions to changes in the volatility of the underlying rates or prices. An institution with a large or complex options portfolio must measure the volatility of options positions by different maturities.

d. The VAR measures may incorporate empirical correlations within and across risk categories, provided that the institution's process for measuring correlations is sound. In the event that the VAR measures do not incorporate empirical correlations across risk categories, then the institution must add the separate VAR measures for the four major risk categories to determine its aggregate VAR measure.

5. Backtesting

a. Beginning one (1) year after an institution starts to comply with this Appendix, it must conduct backtesting by comparing each of its most recent two hundred fifty (250) business days' actual net trading profit or loss with the corresponding daily VAR measures generated for internal risk measurement purposes and calibrated to a one-day holding period and a 99 percent, one-tailed confidence level.

(Actual net trading profits and losses typically include such things as realized and unrealized gains and losses on portfolio positions as well as fee income and commissions associated with trading activities.)

b. Once each quarter, the institution must identify the number of exceptions that is, the number of business days for which the magnitude of the actual daily net trading loss, if any, exceeds the corresponding daily VAR measures.

c. An institution must use the multiplication factor indicated in Table 1 of this Appendix in determining its capital charge for market risk under Paragraph (C)(1)(b)(1)(b) of this Appendix until it obtains the next quarter's backtesting results, unless the Banking Board determines that a different adjustment or other action is appropriate.

TABLE 1
MULTIPLICATION FACTOR BASED ON RESULTS OF BACKTESTING

Number of Exceptions	Multiplication Factor
4 or Fewer	3.00
5	3.40
6	3.50
7	3.65
8	3.75
9	3.85
10 or More	4.00

E. Specific Risk

1. Specific risk surcharge. For the purposes of this Paragraph (C)(1)(b)(2) of this Appendix, an institution shall calculate its specific risk surcharge as follows:

a. Internal models that incorporate specific risk.

(1) No specific risk surcharge required for qualifying internal models. An institution that incorporates specific risk in its internal model has no specific risk surcharge for purposes of Paragraph (C)(1)(b)(2) of this Appendix if the institution demonstrates to the Banking Board that its internal model adequately measures all aspects of specific risk, including default and event risk, of covered debt and equity positions. In evaluating an institution's internal model, the Banking Board will take into account the extent to which the internal model:

(a) Explains the historical price variation in the trading portfolio; and

(b) Captures concentrations.

(2) Specific risk surcharge for modeled specific risk that fails to adequately measure default or event risk. An institution that incorporates specific risk in its internal model but fails to demonstrate that its internal model adequately measures all aspects of specific risk, including default and event risk, as provided by Paragraph (E)(1)(a) of this Appendix, must calculate its specific risk surcharge pursuant to one of the following methods:

(a) If the institution's internal model separates the VAR measure into a specific risk portion and a general market risk portion, then the specific risk surcharge equals the previous day's specific risk portion.

(b) If the institution's internal model does not separate the VAR measure into a specific risk portion and a general market risk portion, then the specific risk surcharge equals the sum of the previous day's VAR measure for subportfolios of covered debt and equity positions.

b. Specific risk surcharge for specific risk not modeled. If an institution does not model specific risk pursuant to Paragraph (E)(1)(a) of this Appendix, then the institution shall calculate its specific risk surcharge using the standard specific risk capital charge pursuant to Paragraph (E)(3) of this Appendix.

2. Covered debt and equity position. If a model includes the specific risk of covered debt positions but not covered equity positions (or vice versa), then the institution may reduce its specific risk charge for the included positions under Paragraph (E)(1)(a)(2) of this Appendix. The specific risk charge for the positions not included equals the standard specific risk capital charge under Paragraph (E)(3) of this Appendix.

3. Standard specific risk capital charge. The standard specific risk capital charge equals the sum of the components for covered debt and equity positions as follows:

a. Covered debt positions

(1) For the purposes of Paragraph (E) of this Appendix, covered debt positions means fixed-rate or floating-rate debt instruments located in the trading account and instruments located in the trading account with values that react primarily to changes in interest rates, including certain non-convertible preferred stock, convertible bonds, and instruments subject to repurchase and lending agreements. Also included are derivatives (including written and purchased options) for which the underlying instrument is a covered debt instrument that is subject to a non-zero specific risk capital charge.

(a) For covered debt positions that are derivatives, an institution must risk-weight (as described in Paragraph (E)(3)(a)(3) of this Appendix) the market value of the effective notional amount of the underlying debt instrument or index portfolio. Swaps must be included as the notional position in the underlying debt instrument or index portfolio, with a receiving side treated as a long position and a paying side treated as a short position; and

(b) For covered debt positions that are options, whether long or short, an institution must risk-weight (as described in Paragraph (E)(3)(a)(3) of this Appendix) the market value of the effective notional amount of the underlying debt instrument or index multiplied by the option's delta.

(2) An institution may net long and short covered debt positions (including derivatives) in identical debt issues or indices.

(3) An institution must multiply the absolute value of the current market value of each net long or short covered debt position by the appropriate specific risk weighting factor indicated in Table 2 of this Appendix. The specific risk capital charge component for covered debt positions is the sum of the weighted values.

TABLE 2
SPECIFIC RISK WEIGHTING FACTORS FOR COVERED DEBT POSITIONS

Category	Remaining Maturity (Contractual)	Weighting Factor (In Percent)
Government[1]	N/A	0.00
Qualifying[2]	6 Months or Less	0.25
	Over 6 Months to 24 Months	1.00
	Over 24 Months	1.60
Other[3]	N/A	8.00

1 The “government” category includes all debt instruments of central governments of OECD countries (as defined in Paragraph (B)(24) of this Rule) including bonds, Treasury bills, and other short-term instruments, as well as local currency instruments of non-OECD central governments to the extent the institution has liabilities booked in that currency.

2 The “qualifying” category includes debt instruments of United States Government-sponsored agencies (as defined in Paragraph (B)(36) of this Rule), general obligation debt instruments issued by states and other political subdivisions of OECD countries, multilateral development banks, and debt instruments issued by United States depository institutions or OECD-banks that do not qualify as capital of the issuing institution. This category also includes other debt instruments, including corporate debt and revenue instruments issued by states and other political subdivisions of OECD countries that are:

a. Rated investment grade by at least two nationally recognized credit rating services;
b. Rated investment grade by one nationally recognized credit rating agency and not rated less than investment-grade by any other credit rating agency; or
c. Unrated, but deemed to be of comparable investment quality by the reporting institution and the issuer has instruments listed on a recognized stock exchange, subject to review by the Banking Board.

3 The “other” category includes debt instruments that are not included in the government or qualifying categories.

b. Covered equity positions

(1) For the purposes of this Paragraph (E) of this Appendix, covered equity positions means equity instruments located in the trading account and instruments located in the trading account with values that react primarily to changes in equity prices, including voting or non-voting common stock, certain convertible bonds, and commitments to buy or sell equity instruments. Also included are derivatives (including written and purchased options) for which the underlying is a covered equity position.

(a) For covered equity positions that are derivatives, an institution must risk weight (as described in Paragraph (E)(3)(b)(3) of this Appendix) the market value of the effective notional amount of the underlying equity instrument or equity portfolio. Swaps must be included as the notional position in the underlying equity instrument or index portfolio, with a receiving side treated as a long position and a paying side treated as a short position; and

(b) For covered equity positions that are options, whether long or short, an institution must risk weight (as described in Paragraph (E)(3)(b)(3) of this Appendix) the market value of the effective notional amount of the underlying equity instrument or index multiplied by the option's delta.

(2) An institution may net long and short covered equity positions (including derivatives) in identical equity issues or equity indices in the same market.

(An institution may also net positions in depository receipts against an opposite position in the underlying equity or identical equity in different markets, provided that the institution includes the costs of conversion.)

(3)

(a) An institution must multiply the absolute value of the current market value of each net long or short covered equity position by a risk weighting factor of 8.0 percent, or by 4.0 percent if the equity is held in a portfolio that is both liquid and well-diversified. For covered equity positions that are index contracts comprising a well-diversified portfolio of equity instruments, the net long or short position is multiplied by a risk weighting factor of 2.0 percent.

(A portfolio is liquid and well-diversified if: (1) It is characterized by a limited sensitivity to price changes of any single equity issue or closely related group of equity issues held in the portfolio; (2) The volatility of the portfolio's value is not dominated by the volatility of any individual equity issue or by equity issues from any single industry or economic sector; (3) It contains a large number of individual equity positions, with no single position representing a substantial portion of the portfolio's total market value; and (4) It consists mainly of issues traded on organized exchanges or in well-established over-the-counter markets.)

(b) For covered equity positions from the following futures-related arbitrage strategies, an institution may apply a 2.0 percent risk weighting factor to one side (long or short) of each position with the opposite side exempt from charge:

(i) Long and short positions in exactly the same index at different dates or in different market centers; or

(ii) Long and short positions in index contracts at the same date in different but similar indices.

(c) For futures contracts on broadly-based indices that are matched by offsetting positions in a basket of stocks comprising the index, an institution may apply a 2.0 percent risk weighting factor to the futures and stock basket positions (long and short), provided that such trades are deliberately entered into and separately controlled, and that the basket of stocks comprises at least 90 percent of the capitalization of the index.

(4) The specific risk capital charge component for covered equity positions is the sum of the weighted values.

F. The Banking Board reserves the authority to modify the application of any provisions in this Appendix to any institution, upon reasonable justification.

CB101.53 Loan Production Office [Section 11-105-101(1) and 11-102-104(1)(a)]

A. Definitions:

1. A Loan Production Office (LPO) is any location in Colorado that is not a branch and where the only activities conducted are the solicitation and origination of loans by employees or agents of a bank or a subsidiary. Loan approvals must be made at the main office or branch location of a bank or its subsidiary.

2. A Branch means any branch bank, branch office, branch agency, additional office, or branch place of business situated in Colorado or another state of a financial institution located in this or another state at which deposits are received, checks are paid, and money is lent and trust powers may be exercised, if approved by its chartering authority.

B. A Colorado state bank or a state bank chartered in another jurisdiction that intends to open a LPO in Colorado, or operate a LPO under a name which differs in any way from the name approved by the Banking Board, shall file an application on the appropriate form provided by the Division of Banking (Division).

C. A bank or bank holding company that intends to open a LPO in Colorado shall provide the banking board with the name or names under which it proposes to conduct the business of such bank, or bank holding company. The bank or bank holding company shall not be eligible to open a LPO if the proposed name is either:

1. Identical to or deceptively similar to the name of any existing Colorado financial institution or LPO previously approved to operate in Colorado; except that this paragraph (a) shall not apply if the bank or bank holding company obtains express written consent of the affected existing Colorado financial institution or LPO; or

2. Likely to cause the public to be confused, deceived, or mistaken.

D. Application to Operate a LPO or Application to Change Location of a LPO shall be filed with the Banking Board on a form provided by the Division. The completed application shall be filed at least thirty (30) days prior to the anticipated first day of operations or use of a new name.

1. Every LPO application shall include the name or names under which the applicant proposes to conduct the business of such LPO. The application shall be accompanied by the applicable fee as set by the Banking Board pursuant to Section 11-102-104(11), C.R.S.

E. When processing a LPO application:

1. The Division will review all existing names and DBAs of banks or LPOs operating within the State of Colorado and compare the proposed name with existing approved bank or LPO names. Division staff will evaluate the proposed name to ensure it's not identical to existing names. If the proposed name is not identical, staff will conduct the procedure outlined in subsection E.2. If the proposed name is identical, then the applicant will be notified and asked to provide a new name.

2. The Division shall commence a fourteen (14) calendar day comment period by posting the proposed name on the Division's website and distributing the proposed name by email to its distribution mailing list;

    a. If no objections are received within the fourteen (14) calendar day period, the Division shall proceed with processing the application and submitting it to the Banking Board for approval;

    b. If an objection is received within the fourteen (14) calendar day period, the Division will notify the applicant. The applicant and the objector should provide a written response to the Division within thirty (30) calendar days, which the Division will provide to the Banking Board for its consideration.

    c. If the objector wishes to withdraw its objection, it may do so and provide express written consent to the LPO name.

3. The Board will evaluate the objection and written response, if any, and approve or deny the LPO name.

4. In the event of the Banking Board's denial of a proposed name, with or without an objection, the Applicant must submit a new name, which will be evaluated and published by the Division as outlined in (E)(1) and (E2), to operate in Colorado so that the new name is not identical to or deceptively similar to the name of any existing Colorado financial institution, or likely to cause the public to be confused, deceived, or mistaken.

F.

G. The applicant shall have one year from the date of approval in which to open the LPO and will notify the Division of its opening.

CB101.54 Branching Practices [Section 11-105-601, C.R.S., et. seq.]

A. Notification of intent to establish a branch pursuant to Section 11-105-602(3)(a), C.R.S.

1. Any bank, no matter the location of its principal place of business, upon thirty (30) days' prior written notice to the Banking Board or the Commissioner, may establish one or more de novo branches anywhere in this or any other state.

2. The notice of intent to establish a branch shall be filed on a form provided by the Division of Banking.

B. Change in Location of a Branch

1. The Banking Board may take into consideration the following factors in determining whether to approve or to deny an application for change in location of a branch:

    a. There are significant supervisory concerns with respect to the applicant or any affiliated institution; or,

    b. The applicant's record of helping to meet the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with the safe and sound operation of an financial institution, is less than satisfactory; or,

c. Any financial or other business arrangement, direct or indirect, involving the principal office or branch and insiders (directors, officers, employees, and shareholders owning or controlling, directly or indirectly, ten percent or more of the outstanding voting stock thereof) involves terms and conditions more favorable to the insiders than would be available in a comparable transaction with unrelated parties.

2. The location of a branch can be changed as follows:

a. A financial institution, without Banking Board approval, may relocate a branch not in excess of one-half mile from its approved location provided written notice is submitted to the Bank Commissioner at least thirty (30) days prior to relocation. The notice must include the new address of the branch and the effective date of the relocation.

b. A financial institution desiring to relocate a branch more than one-half mile from the approved location shall file an application with the Banking Board.

3. Application to change location of a branch shall be filed on a form approved by the Division of Banking.

C. Establishment of a Mobile Branch

1. Definitions

For purposes of this Rule, the term mobile branch shall refer to a vehicle equipped and operated in such a manner as to permit employees or agents of the financial institution to conduct transactions pertaining to branching activities as defined pursuant to Section 11-101-401, C.R.S. A messenger service established by the financial institution pursuant to Banking Board Rule CB101.7(D) for the pickup and delivery of items pertaining to branching activities is considered a mobile branch. The other provisions of this Rule, except for Paragraph (B), shall be applicable to mobile branches.

2. A financial institution authorized to operate a mobile branch shall comply with the following limitations:

a. A financial institution may equip and utilize interchangeable vehicles in the operation of a single mobile branch, provided such vehicles are not operated simultaneously.

b. A monthly log shall be maintained for each mobile branch operated. Such log shall identify the routes traveled and the locations of stops made during the month. This information shall be made available to Division of Banking staff in the same manner as required by Paragraph (F) of this Rule.

c. Physical security devices reasonably designed to provide for the protection of assets and the physical safety of the mobile branch personnel and customers shall be developed and implemented.

d. Surety bond coverage appropriate to the activities of the mobile branch shall be maintained.

e. A mobile branch shall only be operated at locations within the service area approved by the Banking Board.

f. A mobile branch shall not be operated in such a manner as to limit or exclude services to any class of customer within the approved service area.

D. Closing a Branch [Section 11-105-606, C.R.S.]

Any financial institution that seeks to close a branch previously in operation shall notify the Banking Board in writing of its intention and its reasons for such action, and shall include with such notice a copy of "The Notice of Branch Closing" required to be filed with the appropriate federal regulatory agency. Such notice shall be received by the Banking Board ninety (90) days prior to the proposed closing. Such branch may be closed, unless the Banking Board or Bank Commissioner, within fifteen (15) days of receipt of such notification, gives written notification of objections and the grounds therefore to the financial institution, or requests additional information. If the Banking Board or Bank Commissioner requests additional information, the above ninety (90) day period shall commence running upon receipt of such additional information.

E. Branch Hours of Operation

A financial institution shall notify the Bank Commissioner of the hours during which a branch will be open for business and any changes thereto on or before the effective date of the hours of operation.

F. Branch Records

Records of loans and deposits originating at a branch shall be made available to the Division of Banking staff at the principal office of the financial institution or such other central location as may be mutually agreed upon by the financial institution's management and the Bank Commissioner. A principal office is that office in this state that is designated as the principal office of the financial institution in its articles of incorporation and may also be known as a main office or a head office.

G. Notification of Conversion of an Affiliate or an Acquisition to a Branch

Notice of intent to convert an affiliate or an acquisition to a branch shall be filed on the form provided by the Division of Banking.

H. Meaning of Control and Controlling

For the purpose of Section 11-101-401, C.R.S., a financial institution shall be deemed to control an affiliate institution if the financial institution:

1. Directly or indirectly owns, controls, holds with power to vote, or holds proxies representing twenty-five percent or more of the outstanding voting stock thereof;

2. Controls in any manner the election of a majority of the directors thereof; or

3. Exercises a controlling influence over the management or policies thereof.

CB101.55 Contractual Acceptance of Deposits [Section 11-105-604, C.R.S.]

A. Board of Directors' Review and Approval

The board of directors of a financial institution shall fully review all relevant issues involved in a contract pursuant to Section 11-105-604, C.R.S. (deposit contract). Review and approval shall be noted in the minutes.

B. Filing of Deposit Contract

A financial institution that enters into a deposit contract must file with the State Bank Commissioner a copy of the deposit contract within thirty (30) days after its effective date.

C. Contents of Deposit Contract

In addition to the terms that would be found in any contract, including, but not limited to, the names of the parties, purpose of the contract, place of performance, consideration, and term, the following provisions are required in a deposit contract:

1. Extension or amendment. The contract shall provide that notice be given to the State Bank Commissioner within thirty (30) days after any extension or amendment to the contract.

2. Termination. The contract shall provide that notice be given to the State Bank Commissioner within thirty (30) days after the termination of the agreement and shall provide for reasonable disclosure to the customer prior to termination.

D. Any deposit contract entered into pursuant to the provisions of Section 11-105-604, C.R.S., shall not constitute a branch.

CB101.56 Investment in Tax Lien Sale Certificates of Purchase [Section 11-105-302, C.R.S.]

A. General Matters

1. Any institution desiring to invest in Tax Lien Sale Certificates of Purchase (TLSCP) must receive approval of the Banking Board prior to the commencement of the activity. The institution must file an application with the Banking Board on the form provided by the Division of Banking.

2. No institution that has a regulatory composite examination rating (CAMELS) of “4” or “5” from any regulator shall purchase TLSCPs. No institution that has a regulatory composite examination rating CAMELS of “3” from any regulator and that is subject to a memorandum of understanding, cease and desist order, or written agreement imposed by or entered into with any regulator of the institution shall purchase TLSCPs. In the event that a institution's CAMELS rating is reduced to a “4” or “5” or to a “3” subject to regulatory action, that institution shall make no additional purchases of TLSCPs except such endorsements to previously purchased TLSCPs as may be necessary to protect the institution's investment in TLSCP purchases made prior to the reduction in its CAMELS rating, or until such time as its CAMELS rating has been restored to “3” or better, and it otherwise qualifies to purchase TLSCPs.

3. Institutions that are approved to purchase TLSCPs shall be restricted to purchases of TLSCPs on property situated in the county in which that institution has its principal place of business, or situated in a contiguous county.

4. The purchase of TLSCPs shall be restricted to certificates arising from delinquent ad valorem taxes representing liens on 1-4 single family occupied residences, or undeveloped residential lots in established subdivisions the improvements of which are maintained by the county in which they are situated.

5 The purchase of a TLSCP and related endorsements shall not be considered an investment in real estate for purposes of Section 11-105-304(9)(a), C.R.S. until such time as a treasurer's deed to the underlying property is issued to the institution.

B. Capital Restrictions

1. The aggregate value of TLSCPs and endorsements owned by an institution shall not exceed 15 percent of the institution's Tier 1 Capital plus its loan loss reserves.

2. The face value of TLSCPs, not including endorsements, purchased in any one year shall not exceed 6 percent of Tier 1 Capital plus loan loss reserves. This restriction will provide a cushion for endorsements of certificates in future periods.

3. At no time shall the face value of any TLSCP for a single property exceed one percent of the institution's Tier 1 Capital plus loan loss reserves.

4. The value of a TLSCP shall mean the redemption price of the original certificate and subsequent endorsements.

C. Due Diligence Must Be Exercised By The Purchasing Institution:

1. Prior to acquiring a TLSCP, institutions shall:

   a. Obtain a written owners and encumbrances report;

   b. Make a physical inspection of the property;

   c. Obtain photographs of the property; and

   d. Obtain a copy of the assessment card for the property as prepared by the county assessor's office.

2. Prior to making an endorsement of a TLSCP, the institution shall update and review the property, including:

   a. A written updated owners and encumbrances report;

   b. Make a physical inspection of the property;

   c. Obtain photographs of the property; and

   d. Obtain an updated copy of the assessment card for the property as prepared by the county tax assessor's office.

3. Prior to making an application for a treasurer's deed on a TLSCP, the institution shall update and review the property, including:

   a. A written updated owners and encumbrances report;

   b. Make a physical inspection of the property;

   c. Obtain photographs of the property;

   d. Obtain an updated copy of the assessment card for the property as prepared by the county tax assessor's office; and

   e. Evaluate any and all risks attendant with property ownership at the time, including any potential environmental or hazardous material issues.

4. If at any stage of the above due diligence any unsafe or unsound risk is revealed, the institution shall not purchase, endorse, or apply for the deed.

5. The institution shall maintain records documenting its due diligence efforts for each TLSCP until such time as the underlying property is redeemed.

D. Regulatory Reporting

1. TLSCPs shall be included in the Report of Condition as “Other Assets” until such time as the treasurer's deed to the underlying property is issued to the institution.

2. TLSCPs shall be assigned to the 100 percent risk-weighted category for the calculation of risk-based capital pursuant to Banking Board Rule CB101.52.

CB101.57 [Repealed eff. 07/30/2015]

CB101.58 Investment in a Subsidiary [Section 11-105-304(7), C.R.S.]

A. General Limitations

A state bank may invest in a subsidiary corporation or limited liability company (LLC) that engages in activities in which the parent bank may engage, subject to the same limitations the parent bank would be subject to if it were engaged in the activity, provided that the parent bank holds at least an 80 percent ownership interest in the subsidiary corporation or LLC.

B. Additional Limitations

The subsidiary of a state bank may invest in a subsidiary corporation or LLC at less than an 80 percent ownership level provided that each of the following conditions are met:

1. The activities of the subsidiary corporation or LLC in which the investment is made are limited to activities that are part of, or incidental to, the business of banking;

2. The bank is able to prevent the subsidiary corporation or LLC from engaging in activities that do not meet the foregoing standard;

3. The bank's loss exposure is limited, as both a legal and accounting matter, and the bank does not have open-ended liability for the obligations of the subsidiary corporation or LLC; and

4. The investment is convenient or useful to the bank in carrying out its business and not a mere passive investment unrelated to the bank's business.

CB101.59 Investment Powers [Section 11-105-304(7), C.R.S.]

A. A state bank may make such investments, subject to such limitations, as a national bank can make pursuant to paragraph Seventh of 12 USC 24 and Part 1 of 12 CFR, Sections 1.3, 1.4, 1.5, 1.7, 1.8, 1.9, 1.10, and 1.11. These investment powers do not relate to underwriting or dealing in securities.

B. Reference:

1. 12 USC 24 was enacted by the United States Congress and is administered by the Comptroller of the Currency. 12 CFR 1 is issued and administered by the Comptroller of the Currency under the general authority of the national banking laws, 12 USC 1 et seq. and under specific authority contained in paragraph Seventh of 12 USC 24.

2. This Rule does not include amendments to or editions of the referenced material later than the effective date of the Rule, March 2, 2006. A copy of 12 USC 24 may be examined at any State Publications Depository.

3. For more detailed information pertaining to these provisions, please contact the Secretary to the Colorado State Banking Board at 1560 Broadway, Suite 1175, Denver, Colorado 80202, 303-894-7584.

CB101.60 Investments in Community Development Projects and Other Public Welfare Investments [Sections 11-103-101(4) and 11-105-304(7), C.R.S.]

A. A state bank may make investments as described in Paragraph (C), consistent with safety and soundness. This Rule provides the standards and procedures that apply to these investments.

B. Definitions.

For the purposes of this Rule:

1. “Adequately capitalized” has the same meaning as 12 CFR § § 325.103(b)(2) and 208.43(b)(2).

2. “Capital and surplus” means:

a. A bank’s Tier 1 and Tier 2 capital calculated under the risk-based capital standards under CB101.52, as reported in the bank’s Consolidated Report of Condition and Income; plus

b. The balance of a bank’s allowance for loan and lease losses not included in the bank’s Tier 2 capital, for purposes of the calculation of risk-based capital under CB101.52, as reported in the bank’s Consolidated Report of Condition and Income.

3. “Community and economic development entity” (CEDE) means an entity that makes investments or conducts activities that primarily benefit low- and moderate-income individuals, low- and moderate-income areas, or other areas targeted by a governmental entity for redevelopment, or would receive consideration as “qualified investments” under the investment test of the Community Reinvestment Act. The following is a non-exclusive list of examples of the types of entities that may be CEDEs:

a. Community development corporation subsidiaries;

b. Private or nonbank community development corporations;

c. CDFI Fund-certified Community Development Financial Institutions or Community Development Entities;

d. Limited liability companies or limited partnerships;

e. Community development loan funds or lending consortia;

f. Community development real estate investment trusts;

g. Business development companies;

h. Community development closed-end mutual funds;

i. Non-diversified closed-end investment companies; and

j. Community development venture or equity capital funds.

4. "Community development project" (CD Project): means a project to make an investment that meets the requirements of Paragraph (C) of this Rule.

5. "Eligible bank" means, for purposes of Paragraph (E) of this Rule, a state-chartered bank that:

a. Is well capitalized;

b. Has a composite rating of 1 or 2 under the Uniform Financial Institutions Rating System;

c. Has a Community Reinvestment Act (CRA) rating of "Outstanding" or Satisfactory;" and

d. Is not subject to a cease and desist order, consent order, formal written agreement or Prompt Corrective Action directive (see Section 38 of the Federal Deposit Insurance Act) or, if subject to any such order, agreement or directive, is informed in writing by the Division of Banking that the bank may be treated as an "eligible bank" for purposes of this Rule.

6. "Low-income" means an individual income that is less than 50 percent of the area median income, or a median family income that is less than 50 percent, in the case of a geography.

7. "Moderate-income" means an individual income that is at least 50 percent and less than 80 percent of the area median income, or a median family income that is at least 50 and less than 80 percent, in the case of a geography.

8. "Small business" means a business, including a small farm or minority-owned small business, that meets the qualifications for Small Business Administration Development Company or Small Business Investment Company loan programs in 13 CFR 121.301.

9. "Well capitalized" has the same meaning as in 12 CFR § § 325.103(b)(1) and 208.43(b)(1).

C. Public Welfare Investments. A bank or bank subsidiary may make an investment directly or indirectly under this Rule if the investment primarily benefits low- and moderate-income individuals, low- and moderate-income areas, or other areas targeted by a governmental entity for redevelopment, or the investment would receive consideration under the investment test of the Community Reinvestment Act as a "qualified investment."

D. Investment Limits

1. A bank's aggregate outstanding investments under this Rule may not exceed 5 percent of its capital and surplus, unless the bank is at least adequately capitalized and the Division of Banking determines, by written approval of a written request by the bank to exceed the 5 percent limit, that a higher amount of investments will not pose a significant risk to the deposit insurance fund. In no case may a bank's aggregate outstanding investments under this part exceed 15 percent of its capital and surplus.

2. A bank may not make an investment under this part that would expose the bank to unlimited liability.

E. After-the-Fact Notice and Prior Approval Procedures

1. After-the-Fact Notice. Subject to Paragraph (D)(1) of this Rule, an eligible bank may make an investment authorized by this Rule without prior notification to, or approval by, the Commissioner if the bank follows the after-the-fact notice procedures described in this Paragraph.

   a. An eligible bank shall provide an after-the-fact notification of an investment, within 10 business days after it makes the investment. The after-the-fact notice must include:

      (1) A description of the bank's investment;

      (2) The amount of the investment;

      (3) The percentage of the bank's capital and surplus represented by the investment that is the subject of the notice and by the bank's aggregate outstanding public welfare investments and commitments, including the investment that is the subject of the notice; and

      (4) A statement certifying that the investment complies with the requirements of Paragraphs (C) and (D) of this Rule.

   b. A bank that is not an eligible bank but that is at least adequately capitalized, and has a composite rating of at least 3 with improving trends under the Uniform Financial Institutions Rating System, may submit a letter to the Division of Banking requesting authority to submit after-the-fact notices of its investments. The Commissioner considers these requests on a case-by-case basis.

   c. Notwithstanding the provisions of this Paragraph, a bank may not submit an after-the-fact notice of an investment if:

      (1) The investment involves properties carried on the bank's books as "other real estate owned," or

      (2) The Division of Banking determines that the investment is inappropriate for after-the-fact notice.

2. Investments Requiring Prior Approval. If a bank does not meet the requirements for after-the-fact investment notification set forth in this Paragraph, the bank must submit an investment proposal to the Division of Banking.

   a. The bank's investment proposal must include:

(1) A description of the bank's investment;

(2) The amount of the investment;

(3) The percentage of the bank's capital and surplus represented by the proposed investment and by the bank's aggregate outstanding public welfare investments and commitments, including the proposed investment; and

(4) A statement certifying that the investment complies with the requirements of Paragraphs (C) and (D) of this Rule.

b. In reviewing a proposal, the Division of Banking considers the following factors and other available information:

(1) Whether the investment satisfies the requirements of Paragraphs (C) and (D) of this Rule;

(2) Whether the investment is consistent with the safe and sound operation of the bank; and

(3) Whether in investment is consistent with the requirements of this Rule and Division of Banking policies.

c. Unless otherwise notified in writing by the Commissioner, and subject to Paragraph (D)(1), the proposed investment is deemed approved after 30 calendar days from the date on which the Division of Banking receives the bank's investment proposal.

d. The Division of Banking, by notifying the bank, may extend its period for reviewing the investment proposal. If so notified, the bank may make the investment only with the Commissioner's written approval.

e. The Commissioner may impose one or more conditions in connection with its approval of an investment under this Rule.

F. Examples of Qualifying Public Welfare Investments

1. Investments that primarily support the following types of activities are examples of investments that meet the requirements of Paragraph (C):

a. Affordable housing activities, including:

(1) Investments in an entity that finances, acquires, develops, rehabilitates, manages, sells, or rents housing primarily for low- and moderate-income individuals;

(2) Investments in a project that develops or operates transitional housing for the homeless;

(3) Investments in a project that develops or operates special needs housing for disabled or elderly low- and moderate-income individuals; and

(4) Investments in a project that qualifies for the Federal low-income housing tax credit;

b. Economic development and job creation investments, including:

(1) Investments that finance small businesses (including equity or debt financing and investments in an entity that provides loan guarantees) that are located in low- and moderate-income areas or other targeted redevelopment areas or that produce or retain permanent jobs, the majority of which are held by low- and moderate-income individuals; and

(2) Investments that finance small businesses or small farms, including minority- and women-owned small business or small farms, that , although not located in low- and moderate-income areas or targeted redevelopment areas, create a significant number of permanent jobs for low- and moderate-income individuals;

(3) Investments in an entity that acquires, develops, rehabilitates, manages, sells, or rents commercial or industrial property that is located in a low- and moderate-income area or targeted redevelopment area and occupied primarily by small business, or that is occupied primarily by small businesses that produce or retain permanent jobs, the majority of which are held by low- and moderate-income individuals; and

(4) Investments in low- and moderate-income areas or targeted redevelopment areas that produce or retain permanent jobs, the majority of which are held by low- and moderate-income individuals;

c. Investments in CEDEs, including:

(1) Investments in a community development financial institution as defined in 12 U.S.C. 4742(5); and

(2) Investments in a CEDE that is eligible to receive New Markets tax credits under 26 U.S.C. 45D.

d. Other public welfare investments, including:

(1) Investments that provide credit counseling, financial literacy, job training, community development research, and similar technical assistance for non-profit community development organizations, low- and moderate-income individuals or areas or targeted redevelopment areas, or small businesses, including minority- and women-owned small businesses, located in low- and moderate-income areas or that produce or retain permanent jobs, the majority of which are held by low- and moderate-income individuals;

(2) Investments of a type approved by the Federal Reserve Board under 12 CFR 208.22 that are consistent with the requirements of Paragraph (C) of this Rule;

(3) Investments of a type determined by the Division of Banking to be permissible under this Rule; and

(4) Investments in minority- and women-owned depository institutions that serve primarily low- and moderate-income individuals or low- and moderate-income areas or targeted redevelopment areas.

G. Records and Remedial Action

1. Records. Each bank shall maintain in its files information adequate to demonstrate that its investments meet the standards set out in Paragraph (C) of this Rule, and that the bank is otherwise in compliance with the requirements of this Rule.

2. Remedial Action. If the Division of Banking finds that an investment under this part is in violation of law or regulation, is inconsistent with the safe and sound operation of the bank, or poses a significant risk to a Federal deposit insurance fund, the bank shall take appropriate remedial action as determined by the Commissioner.

H. Materials Incorporated by Reference

1. Code of Federal Regulations, (1-1-09 Edition)

a. 12 CFR Ch. II, §208.22 – Community development and public welfare investments, pages 195-197, Federal Reserve System;

b. 12 CFR Ch. II, §208.43 – Capital measures and capital category definitions, (b)(1) and (2), page 216, Federal Reserve System;

c. 12 CFR Ch. III, §325.103 – Capital measures and capital category definitions, (b)(1) and (2), page 193, Federal Deposit Insurance Corporation; and,

d. 13 CFR Ch. I, §121.301 – What size standards are applicable to financial assistance programs, pages 363-364, Small Business Administration.

2. United States Code, (1-8-08 Version)

a. Title 12 – Banks and Banking, Section 4702 - Definitions, pages 1567-1569; and,

b. Title 26 – Internal Revenue Code, Section 45D – New Markets Tax Credit, pages 196-199.

I. This Rule does not include any later amendments to or editions of the referenced material.

J. Copies of the above referenced information may be examined at the Division of Banking, 1560 Broadway, Denver, Colorado, 80202, by contacting the Secretary to the Colorado State Banking Board at banking@dora.state.co.us or (303) 894-7575.

K. This information is also available for examination at any State Publications Depository Library.

CB101.61 Appraisal of Other Real Estate [Section 11-105-401(1)(d), C.R.S.]

A. The initial appraisal of Other Real Estate (ORE) shall be performed by a registered, licensed, or certified appraiser as defined in Section 12-61-706, C.R.S. However, if the asset has a current book value of $400,000 or less for a 1-4 family residential property or $500,000 or less for all other real property at the time the asset is classified as ORE. an analysis, evaluation, opinion, conclusion, notation, or compilation of data may be performed by an officer, director, or regular salaried employee of a financial institution who has not, directly or indirectly, participated in the lending transaction or by an officer, director, or regular salaried employee of its affiliate who has not, directly or indirectly, participated in the lending transaction.

B. Subsequent appraisals of an ORE asset with a book value of more than the values noted above in A shall be performed by a licensed or certified appraiser as defined in Section 12-61-706, C.R.S., according to the following schedule:

1. All financial institutions shall obtain subsequent appraisals of an ORE asset at intervals not to exceed twenty-four (24) months.

2. If such an appraiser, as defined in Section 12-61-706, C.R.S., or other person approved by the Banking Board certifies in writing that the fair market value has not declined, such appraiser's or other person's opinion may be substituted for a subsequent appraisal.

C. Reference: Sections 12-61-706 and 718(2), C.R.S., are laws enacted by the Legislature of the State of Colorado and administered by the Board of Real Estate Appraisers of the Colorado Department of Regulatory Agencies. This Rule does not include amendments to or editions of the referenced material later than July 30, 1993. For more detailed information pertaining to these provisions, please contact the Secretary to the Colorado State Banking Board at 1560 Broadway, Suite 975, Denver, Colorado 80202, (303) 894-7575.

CB101.62 Pledging Assets [Section 11-102-104(5), C.R.S.]

A. A state bank may, upon the deposit with it of any funds by a federally-recognized Indian Tribe, or any officer, employee or agent thereof in his or her official capacity, give security for the safekeeping and prompt payment of the funds so deposited by the deposit of United States bonds and other collateral eligible under Banking Board Rule PDP3 for pledging to protect public deposits.

B. A pledge of eligible collateral shall be evidenced by a security agreement that:

1. Is in writing;

2. Was executed by the bank and the Indian tribe contemporaneously with acquisition of the collateral;

3. Was approved by the bank’s board of directors or loan committee, which approval is reflected in the official minutes of a meeting of the board or committee;

4. Has been an official record of the bank continuously from the time of execution.

CB101.64 Lending Limits [Sections 11-102-104(5), 11-105-302, 11-105-303, 11-105-304, and 11-105-305, C.R.S.]

A. Definitions

For the purposes of this Rule:

1. “Borrower” means a person who is named as a borrower or debtor in a loan or extension of credit; a person to whom a bank has credit exposure arising from a derivative transaction or a securities financing transaction, entered by the bank; or any other person, including a drawer, endorser, or guarantor, who is deemed to be a borrower under the “direct benefit” or “common enterprise” tests set forth in Paragraph (H)(2) and (3) of this Rule.

2. “Capital and surplus” means a bank’s Tier 1 and Tier 2 capital included in the institution’s risk-based capital; plus the balance of a bank's allowance for loan and lease losses not included in the bank’s Tier 2 capital, for the purposes of calculating risk-based capital.

3. "Close of business" means the time at which a bank closes its accounting records for the business day.

4. "Consumer" means the user of any products, commodities, goods, or services, whether leased or purchased, but does not include any person who purchases products or commodities for resale or fabrication into goods for sale.

5. "Consumer paper" means paper relating to automobiles, mobile homes, residences, office equipment, household items, tuition fees, insurance premium fees, and similar consumer items. Also included is paper covering the lease, where the bank is not the owner or lessor, or purchaser of equipment for use in manufacturing, farming, construction, or excavation.

6. "Contractual commitment to advance funds" includes a bank's obligation to:

   a. Make payment, directly or indirectly, to a third person contingent upon default by the bank's customer in the performance of an obligation under the terms of that customer's contract with the third person or upon some other stated condition;

   b. Guarantee or act as a surety for the benefit of a person;

   c. Advance funds under a qualifying commitment to lend, as defined in Paragraph (A)(18) of this Rule; and

   d. Advance funds under a standby letter of credit, as defined in Paragraph (A)(26) of this Rule, a put, or other similar arrangement.

   This definition does not include commercial letters of credit and similar instruments where the issuing bank expects the beneficiary to draw on the issuer, that do not guarantee payment, and that do not provide for payment in the event of a default by a third party.

7. "Control" is presumed to exist when a person directly or indirectly, or acting through or together with one or more persons:

   a. Owns, controls, or has the power to vote 25 percent or more of any class of voting securities of another person;

   b. Controls, in any manner, the election of a majority of the directors, trustees, or other persons exercising similar functions of another person; or

   c. Has the power to exercise a controlling influence over the management or policies of another person.

8. "Credit derivative" means a financial contract executed under standard industry credit derivative documentation that allows one party (the protection purchaser) to transfer the credit risk of one or more exposures (reference exposure) to another party (the protection provider).

9. "Current market value" means the bid or closing price listed for an item in a regularly published listing or an electronic reporting service.

10. “Derivative transaction” includes any transaction that is a contract, agreement, swap, warrant, note, or option that is based, in whole or in part, on the value of, any interest in, or any quantitative measure or the occurrence of any event relating to, one or more commodities, securities, currencies, interest or other rates, indices, or other assets.

11. “Effective margining arrangement (EMA)” means a master legal agreement governing derivative transactions between a bank and a counterparty that requires the counterparty to post, on a daily basis, variation margin to fully collateralize that amount of the bank’s net credit exposure to the counterparty that exceeds $25 million created by the derivative transactions covered by the agreement.

12. “Eligible credit derivative” means a single-name credit derivative or a standard, non-tranched index credit derivative provided that:

    a. The derivative contract meets the requirements of an eligible guarantee and has been confirmed by the protection purchaser and the protection provider;

    b. Any assignment of the derivative contract has been confirmed by all relevant parties;

    c. If the credit derivative is a credit default swap; which is a financial swap agreement that the seller of the credit default swap will compensate the buyer in the event of a loan default or other credit event; the derivative contract includes the following credit events:

        (1) Failure to pay any amount due under the terms of the reference exposure, subject to any applicable minimal payment threshold that is consistent with standard market practice and with a grace period that is closely in line with the grace period of the reference exposure; and

        (2) Bankruptcy, insolvency, or inability of the obligor on the reference exposure to pay its debts, or its failure or admission in writing of its inability generally to pay its debts as they become due and similar events;

    d. The terms and conditions dictating the manner in which the derivative contract is to be settled are incorporated into the contract;

    e. If the derivative contract allows for cash settlement, the contract incorporates a robust valuation process to estimate loss with respect to the derivative reliably and specifies a reasonable period for obtaining post-credit event valuations of the reference exposure;

    f. If the derivative contract requires the protection purchaser to transfer an exposure to the protection provider at settlement, the terms of at least one of the exposures that is permitted to be transferred under the contract provides that any required consent to transfer may not be unreasonably withheld; and

    g. If the credit derivative is a credit default swap, the derivative contract clearly identifies the parties responsible for determining whether a credit event has occurred, specifies that this determination is not the sole responsibility of the protection provider, and gives the protection purchaser the right to notify the protection provider of the occurrence of a credit event.

13. “Eligible guarantee” means a guarantee that:

a. Is written and unconditional;

b. Covers all or a pro rata portion of all contractual payments of the obligor on the reference exposure;

c. Gives the beneficiary a direct claim against the protection provider;

d. Is not unilaterally cancelable by the protection provider for reasons other than the breach of the contract by the beneficiary;

e. Is legally enforceable against the protection provider in a jurisdiction where the protection provider has sufficient assets against which a judgment may be attached and enforced;

f. Requires the protection provider to make payment to the beneficiary on the occurrence of a default (as defined in the guarantee) of the obligor on the reference exposure in a timely manner without the beneficiary first having to take legal actions to pursue the obligor for payment;

g. Does not increase the beneficiary’s cost of credit protection on the guarantee in response to deterioration in the credit quality of the reference exposure; and

h. Is not provided by an affiliate of the bank, unless the affiliate is an insured depository institution, bank, securities broker or dealer, or insurance company that:

(1) Does not control the bank; and

(2) Is subject to consolidated supervision and regulation comparable to that imposed on U.S. depository institutions, securities broker-dealers, or insurance companies (as the case may be).

14. “Eligible protection provider” means:

a. A sovereign entity (a central government, including the U.S. government; an agency; department; ministry; or central bank);

b. The Bank for International Settlements, the International Monetary Fund, the European Central Bank, the European Commission, or a multilateral development bank;

c. A Federal Home Loan Bank;

d. The Federal Agricultural Mortgage Corporation;

e. A depository institution; which means any bank or savings association;

f. A bank holding company; which means any company which has control over any bank or over any company that is or becomes a bank holding company;

g. A savings and loan holding company; which means any company that directly or indirectly controls a savings association or that controls any other company that is a savings and loan holding company;

h. A securities broker or dealer registered with the SEC under the Securities Exchange Act of 1934, 15 U.S.C. 78o et seq.;

i. An insurance company that is subject to the supervision of a State insurance regulator;

j. A foreign banking organization;

k. A non-U.S.-based securities firm or a non-U.S.-based insurance company that is subject to consolidated supervision and regulation comparable to that imposed on U.S. depository institutions, securities broker-dealers, or insurance companies, and

l. A qualifying central counterparty.

15. “Financial instrument” means stocks, notes, bonds, and debentures traded on a national securities exchange, OTC margin stocks, commercial paper, negotiable certificates of deposit, bankers’ acceptances, and shares in money market and mutual funds of the type that issue shares in which banks may perfect a security interest. Financial instruments may be denominated in foreign currencies that are freely convertible to U.S. dollars. The term “financial instrument” does not include mortgages.

16. “Loans and extensions of credit” means a bank’s direct or indirect advance of funds to, or on behalf of, a borrower based on an obligation of the borrower to repay the funds, or repayable from specific property pledged by or on behalf of the borrower; and any credit exposure, as determined pursuant to Paragraph (L) of this Rule, arising from a derivative transaction or a securities financing transaction.

a. Loans and extensions of credit for the purposes of this Rule include:

(1) A contractual commitment to advance funds as that term is defined in Paragraph (A)(6)(a) of this Rule;

(2) A maker or endorser's obligation arising from a bank’s discount of commercial paper;

(3) A bank’s purchase of securities subject to an agreement that the seller will repurchase the securities at the end of a stated period, but not including a bank’s purchase of Type I securities subject to a repurchase agreement where the purchasing bank has assured control over or has established its rights to the Type I securities as collateral;

(4) A bank’s purchase of third-party paper subject to an agreement that the seller will repurchase the paper upon default or at the end of a stated period. The amount of the bank’s loan is the total unpaid balance of the paper owned by the bank, less any applicable dealer reserves retained and held by the bank as collateral security. Where the seller’s obligation to repurchase is limited, the bank’s loan is measured by the total amount of paper the seller may ultimately be obligated to repurchase. A bank’s purchase of third party paper without direct or indirect recourse to the seller is not a loan or extension of credit to the seller;

(5) An overdraft, whether or not prearranged, but not an intra-day overdraft for which payment is received before the close of business of the bank that makes the funds available;

(6) The sale of Federal funds with a maturity of more than one business day, but not Federal funds with a maturity of one day or less or Federal funds sold under a continuing contract; and

(7) Loans or extensions of credit that have been charged off on the books of the bank in whole or in part, unless the loan or extension of credit:

(a) Is unenforceable by reason of discharge in bankruptcy;

(b) Is no longer legally enforceable because of expiration of the statute of limitations or a judicial decision; or

(c) Is no longer legally enforceable for other reasons, provided that the bank maintains sufficient records to demonstrate that the loan is unenforceable.

b. The following items do not constitute loans or extensions of credit for the purposes of this Rule:

(1) Additional funds advanced for the benefit of a borrower by a bank for payment of taxes, insurance, utilities, security, and maintenance, and operating expenses necessary to preserve the value of real property securing the loan, consistent with safe and sound banking practices, but only if the advance is for the protection of the bank's interest. However, such amounts must be treated as an extension of credit if a new loan or extension of credit is made to the borrower;

(2) Accrued and discounted interest on an existing loan or extension of credit, including interest that has been capitalized from prior notes, and interest that has been advanced under terms and conditions of a loan agreement;

(3) Financed sales of a bank’s own assets, including other real estate owned, if the financing does not put the bank in a worse position than when the bank held title to the assets;

(4) A renewal or restructuring of a loan as a new loan or extension of credit, following the exercise by a bank of reasonable efforts, consistent with safe and sound banking practices, to bring the loan into conformance with the lending limit, unless new funds are advanced by the bank to the borrower, except as permitted by Paragraph (C)(5) of this Rule, or a new borrower replaces the original borrower, or the Banking Board determines that a renewal or restructuring was undertaken as a means to evade the bank’s lending limit;

(5) Amount paid against uncollected funds in the normal process of collection; and

(6)

(a) The portion of a loan or extension of credit, sold as a participation by a bank on a nonrecourse basis, provided that the participation results in a pro rata sharing of credit risk proportionate to the respective interests of the originating and participating lenders. Where a participation agreement provides that repayment must be applied first to the portions sold, a pro rata sharing will be deemed to exist only if the agreement also provides that, in the event of a default or comparable event defined in the agreement, participants must share in all subsequent repayments and collections in proportion to their percentage participation at the time of the occurrence of the event.

(b) When an originating bank funds the entire loan, it must receive funding from the participants before the close of business of its next business day. If the participating portions are not received within that period, then the portions funded will be treated as a loan by the originating bank to the borrower. If the portions so attributed to the borrower exceed the originating bank's lending limit, the loan may be treated as nonconforming, subject to Paragraph (I) of this Rule, rather than a violation, if:

(i) The originating bank had a valid and unconditional participation agreement with a participating bank or banks that was sufficient to reduce the loan to within the originating bank's lending limit;

(ii) The participating bank reconfirmed its participation and the originating bank had no knowledge of any information that would permit the participant to withhold its participation; and

(iii) The participation was to be funded by the close of business of the originating bank's next business day.

(7) That portion of one or more loans or extensions of credit, not to exceed 10 percent of capital and surplus, with respect to which the bank has purchased protection in the form of a single-name credit derivative that meets the requirements of Paragraph (A)(12)(a) through (g) from an eligible protection provider if the reference obligor is the same legal entity as the borrower in the loan or extension of credit and the maturity of the protection purchased equals or exceeds the maturity of the loan or extension of credit.

17. "Person" means an individual; sole proprietorship; partnership; joint venture; association; trust; estate; business trust; limited liability company; corporation; not-for-profit corporation; sovereign government or agency; instrumentality; or political subdivision thereof; or any similar entity or organization.

18. "Qualifying commitment to lend" means a legally binding written commitment to lend that, when combined with all other outstanding loans and qualifying commitments to a borrower, was within the bank's lending limit when entered into, and has not been disqualified.

a. In determining whether a commitment is within the bank's lending limit when made, the bank may deduct from the amount of the commitment the amount of any legally binding loan participation commitments that are issued concurrent with the bank's commitment and that would be excluded from the definition of "loan or extension of credit" under Paragraph (A)(16) of this Rule.

b. If the bank subsequently chooses to make an additional loan, and that subsequent loan, together with all outstanding loans and qualifying commitments to a borrower, exceeds the bank's applicable lending limit at that time, the bank's qualifying commitments to the borrower that exceed the bank's lending limit at that time are deemed to be permanently disqualified, beginning with the most recent qualifying commitment and proceeding in reverse chronological order. When a commitment is disqualified, the entire commitment is disqualified and the disqualified commitment is no longer considered a "loan or extension of credit." Advances of funds under a disqualified or non-qualifying commitment may only be made to the extent that the advance, together with all other outstanding loans to the borrower, do not exceed the bank's lending limit at the time of the advance, calculated pursuant to Paragraph (G) of this Rule.

19. "Qualifying master netting agreement" means any written, legally enforceable bilateral agreement, provided that:

a. The agreement creates a single legal obligation for all individual transactions covered by the agreement upon an event of default, including bankruptcy, insolvency, or similar proceeding, of the counterparty;

b. The agreement provides the bank the right to accelerate, terminate, and close-out on a net basis all transactions under the agreement and to liquidate or set off collateral promptly upon an event of default, including upon an event of bankruptcy, insolvency, or similar proceeding, of the counterparty, provided that, in any such case, any exercise of rights under the agreement will not be stayed or avoided under applicable law in the relevant jurisdictions;

c. The bank has conducted sufficient legal review to conclude with a well-founded basis (and maintains sufficient written documentation of that legal review) that:

(1) The agreement meets the requirements of paragraph (b) of this definition; and

(2) In the event of a legal challenge (including one resulting from default or from bankruptcy, insolvency, or similar proceeding) the relevant court and administrative authorities would find the agreement to be legal, valid, binding, and enforceable under the law of the relevant jurisdictions;

d. The bank established and maintains procedures to monitor possible changes in relevant law and to ensure that the agreement continues to satisfy the requirements of this definition; and

e. The agreement does not contain a walkaway clause (that is, a provision that permits a non-defaulting counterparty to make a lower payment than it would make otherwise under the agreement, or no payment at all, to a defaulter or the estate of a defaulter, even if the defaulter or the estate of the defaulter is a net creditor under the agreement).

20. "Readily marketable collateral" means financial instruments and bullion that are salable under ordinary market conditions with reasonable promptness at a fair market value determined by quotations based on actual transactions on an auction or similarly available daily bid and ask price market.

21. "Readily marketable staple" means an article of commerce, agriculture, or industry, such as wheat and other grains, cotton, wool, and basic metals such as tin, copper and lead, in the form of standardized interchangeable units, that is easy to sell in a market with sufficiently frequent price quotations.

    a. An article comes within this definition if:

        (1) The exact price is easy to determine, and

        (2) The staple itself is easy to sell at any time at a price that would not be considerably less than the amount at which it is valued as collateral.

    b. Whether an article qualifies as a readily marketable staple depends upon existing conditions at the time the loan or extension of credit that is secured by the staple is made.

22. "Residential real estate loan" means a loan or extension of credit that is secured by 1-4 family residential real estate.

23. "Sale of federal funds" means any transaction between depository institutions involving the transfer of immediately available funds resulting from credits to deposit balances at Federal Reserve Banks, or from credits to new or existing deposit balances due from a correspondent depository institution.

24. "Securities financing transaction" means a repurchase agreement, reverse repurchase agreement, securities lending transaction, or securities borrowing transaction.

25. "Small business loan" means a loan or extension of credit secured by nonfarm nonresidential properties or a commercial or industrial loan as defined in the instructions for preparation of the Consolidated Report of Condition and Income.

26. "Standby letter of credit" means any letter of credit, or similar arrangement, that represents an obligation to the beneficiary on the part of the issuer to:

    a. Repay money borrowed by or advanced to or for the account of the account party;

    b. Make payment on account of any indebtedness undertaken by the account party; or

    c. Make payment on account of any default by the account party in the performance of an obligation.

27. "Type I security" means:

    a. Obligations of the United States;

    b. Obligations issued, insured, or guaranteed by a department or an agency of the United States Government, if the obligation, insurance, or guarantee commits the full faith and credit of the United States for the repayment of the obligation;

c. Obligations issued by a department or agency of the United States, or an agency or political subdivision of a State of the United States, that represent an interest in a loan or a pool of loans made to third parties, if the full faith and credit of the United States has been validly pledged for the full and timely payment of interest on, and principal of, the loans in the event of non-payment by the third party obligor(s); and

d. General obligations of a State of the United States or any political subdivision thereof; and municipal bonds if the bank is well capitalized as defined in Banking Board Rule CB101.52.

B. General Limitations

1. A bank's total outstanding loans and extensions of credit to one borrower may not exceed 15 percent of the bank's capital and surplus, plus an additional 10 percent of the bank's capital and surplus, if the amount that exceeds the bank's 15 percent general limit is fully secured by readily marketable collateral as defined in Paragraph (A)(20) of this Rule. To qualify for the additional 10 percent limit, the bank must perfect a security interest in the collateral under applicable law and the collateral must have a current market value at all times of at least 100 percent of the amount of the loan or extension of credit that exceeds the bank's 15 percent general limit.

C. Additional Limitations

The following loans or extensions of credit are subject to the lending limits set forth below. When loans and extensions of credit qualify for more than one additional lending limit, the additional limits are cumulative, i.e., increasing by successive additions.

1. Loans secured by bills of lading or warehouse receipts covering readily marketable staples as defined in Paragraph (A)(21) of this Rule.

a. A bank's loans or extensions of credit to one borrower secured by bills of lading, warehouse receipts, or similar documents transferring or securing title to readily marketable staples, may not exceed 35 percent of the bank's capital and surplus in addition to the amount allowed under the bank's general limit. The market value of the staples securing the loan must at all times equal at least 115 percent of the outstanding loan amount that exceeds the bank's general limit.

b. The staples must be nonperishable, may be refrigerated or frozen, and must be fully covered by insurance, if such insurance is customary. Whether a staple is non-perishable must be determined on a case-by-case basis because of differences in handling and storing commodities.

c. This additional limit applies to a loan or extension of credit arising from a single transaction or secured by the same staples, provided that the duration of the loan or extension of credit is:

(1) Not more than ten (10) months if secured by nonperishable staples; or

(2) Not more than six (6) months if secured by refrigerated or frozen staples.

d. The holder of the warehouse receipts, order bills of lading, documents qualifying as documents of title under the Uniform Commercial Code, or other similar documents, must have control and be able to obtain immediate possession of the staple so that the bank is able to sell the underlying staples and promptly transfer title and possession to a purchaser if default should occur on a loan secured by such documents. The existence of a brief notice period, or similar procedural requirements under applicable law, for the disposal of the collateral will not affect the eligibility of instruments for this additional limit.

(1) Field warehouse receipts are an acceptable form of collateral when they are issued by a duly bonded and licensed grain elevator or warehouse having exclusive possession and control of the staples, even though the grain elevator or warehouse is maintained on the premises of the owner of the staples.

(2) Warehouse receipts issued by the borrower-owner that is a grain elevator or warehouse company, duly-bonded and licensed and regularly inspected by state or Federal authorities, may be considered eligible collateral under this provision only when the receipts are registered with an independent registrar whose consent is required before the staples may be withdrawn from the warehouse.

2. Discount of installment consumer paper.

a. A bank’s loans and extensions of credit to one borrower that arise from the discount of negotiable or nonnegotiable installment consumer paper, as defined in Paragraph (A)(5) of this Rule, that carry a full recourse endorsement or unconditional guarantee by the person selling the paper, may not exceed 10 percent of the bank’s capital and surplus in addition to the amount allowed under the bank’s general limit. An unconditional guarantee may be in the form of a repurchase agreement or separate guarantee agreement. A condition reasonably within the power of the bank to perform, such as the repossession of collateral, will not make conditional an otherwise unconditional guarantee.

b. Where the seller of the paper offers only partial recourse to the bank, the lending limits of this section apply to the obligation of the seller to the bank, which is measured by the total amount of paper the seller may be obligated to repurchase or has guaranteed.

c. Where the bank is relying primarily upon the maker of the paper for payment of the loans or extensions of credit and not upon any full or partial recourse endorsement or guarantee by the seller of the paper, the lending limits of this Rule apply only to the maker. The bank must substantiate its reliance on the maker with:

(1) Records supporting the bank’s independent credit analysis of the maker’s ability to repay the loan or extension of credit, such records being maintained by the bank or by a third party that is contractually obligated to make those records available for examination purposes; and

(2) A written certification by an officer of the bank, authorized by the board of directors or any designee of that officer, that the bank is relying primarily upon the maker to repay the loan or extension of credit.

d. Where paper is purchased in substantial quantities, the records, evaluation, and certification must be in a form appropriate for the class and quantity of the paper involved. The bank may use sampling techniques, or other appropriate methods, to independently verify the reliability of the credit information supplied by the seller.

3. Loans secured by documents covering livestock.

a. A bank’s loans or extensions of credit to one borrower secured by shipping documents or instruments that transfer or secure title to, or give a first lien on livestock, may not exceed 10 percent of the bank’s capital and surplus in addition to the amount allowed under the bank’s general limit. The market value of the livestock securing the loan must at all times equal at least 115 percent of the amount of the outstanding loan that exceeds the bank’s general limit. For the purposes of this Rule, the term “livestock” includes dairy and beef cattle, hogs, sheep, goats, horses, mules, poultry, and fish, whether or not held for resale.

b. The bank must maintain in its files an inspection and valuation for the livestock pledged that is reasonably current, taking into account the nature and frequency of turnover of livestock to which the documents relate, but in any case not more than twelve (12) months old.

c. Under the laws of this state, persons furnishing pasturage under a grazing contract may have a lien on the livestock for the amount due for pasturage. If a lien that is based on pasturage furnished by the lienor prior to the bank's loan or extension of credit is assigned to the bank by a recordable instrument and protected against being defeated by some other lien or claim, by payment to a person other than the bank, or otherwise, it will qualify under this additional limit provided the amount of the perfected lien is at least equal to the amount of the loan, and the value of the livestock is at no time less than 115 percent of the portion of the loan or extension of credit that exceeds the bank’s general limit. When the amount due under the grazing contract is dependent upon future performance, the resulting lien does not meet the requirements of the additional limit.

4. Loans secured by dairy cattle. A bank’s loans and extensions of credit to one borrower that arise from the discount by dealers in dairy cattle of paper given in payment for the cattle, may not exceed 10 percent of the bank’s capital and surplus in addition to the amount allowed under the bank’s general limit. To qualify, the paper must:

a. Carry the full recourse endorsement or unconditional guarantee of the seller; and

b. Be secured by the cattle being sold, pursuant to liens that allow the bank to maintain a perfected security interest in the cattle under applicable law.

5. Additional advances to complete project financing pursuant to renewal of a qualifying commitment to lend. A bank may renew a qualifying commitment to lend, as defined in Paragraph (A)(18) of this Rule, and complete funding under that commitment if all of the following criteria are met:

a. The completion of funding is consistent with safe and sound banking practices and is made to protect the position of the bank;

b. The completion of funding will enable the borrower to complete the project for which the qualifying commitment to lend was made; and

c. The amount of the additional funding does not exceed the unfunded portion of the bank’s qualifying commitment to lend.

D. Not Subject to Lending Limits

1. Loans arising from the discount of commercial or business paper.

a. Loans or extensions of credit arising from the discount of negotiable commercial or business paper that evidences an obligation to the person negotiating the paper. The paper must:

(1) Be given in payment of the purchase price of commodities purchased for resale, fabrication of a product, or any other business purpose that may reasonably be expected to provide funds for payment of the paper; and

(2) Bear the full recourse endorsement of the owner of the paper, except that paper discounted in connection with export transactions, that is transferred without recourse, or with limited recourse, must be supported by an assignment of appropriate insurance covering the political, credit, and transfer risks applicable to the paper, such as insurance provided by the Export-Import Bank.

b. A failure to pay principal or interest on commercial or business paper when due does not result in a loan or extension of credit to the maker or endorser of the paper; however, the amount of such paper must thereafter be counted in determining whether additional loans or extensions of credit to the same borrower may be made within the limits of this Rule.

2. Banker acceptances. A bank’s acceptance of drafts eligible for rediscount or a bank’s purchase of acceptances created by other banks that are eligible for rediscount but not including:

a. A bank’s acceptance of drafts ineligible for rediscount, which constitutes a loan by the bank to the customer for whom the acceptance was made, in the amount of the draft;

b. A bank’s purchase of ineligible acceptances created by other banks, which constitutes a loan from the purchasing bank to the accepting bank, in the amount of the purchase price; and

c. A bank’s purchase of its own acceptances, which constitutes a loan to the bank’s customer for whom the acceptance was made, in the amount of the purchase price.

3. Loans secured by U.S. obligations. Loans or extensions of credit, or portions thereof, to the extent they are fully secured by the current market value of:

a. Bonds, notes, certificates of indebtedness, or Treasury bills of the United States or by similar obligations fully guaranteed as to principal and interest by the United States;

b. Loans to the extent they are guaranteed as to repayment of principal by the full faith and credit of the U.S. government, as set forth in Paragraph (D)(4)(b) of this Rule;

c. To qualify under this Paragraph, the bank must perfect a security interest in the collateral under applicable law.

4. Loans to or guaranteed by a federal agency.

a. Loans or extensions of credit to any department, agency, bureau, board, commission, or establishment of the United States, or any corporation wholly owned directly or indirectly by the United States.

b. Loans or extensions of credit, including portions thereof, to the extent they are secured by unconditional takeout commitments or guarantees of any of the foregoing governmental entities. The commitment or guarantee must:

(1) Be payable in cash or its equivalent within sixty (60) days after demand for payment is made:

(2) Be considered unconditional if the protection afforded the bank is not substantially diminished or impaired if loss should result from factors beyond the bank's control. Protection against loss is not materially diminished or impaired by procedural requirements, such as an agreement to pay on the obligation only in the event of default, including default over a specific period of time, a requirement that notification of default be given within a specified period after its occurrence, or a requirement of good faith on the part of the bank.

5. Loans to or guaranteed by general obligations of a state or political subdivision.

a. A loan or extension of credit to a state or political subdivision that constitutes a general obligation of the state or political subdivision, and for which the lending bank has an opinion of counsel or the opinion of the state Attorney General, or other state legal official with authority to opine on the obligation in question, that the loan or extension of credit is a valid and enforceable general obligation of the borrower; and

b. A loan or extension of credit, including portions thereof, to the extent they are guaranteed or secured by a general obligation of the state or political subdivision and for which the lending bank has an opinion of counsel or the opinion of the state Attorney General, or other state legal official with authority to opine on the guarantee or collateral in question, that the guarantee or collateral is a valid and enforceable general obligation of that public body.

6. Loans secured by segregated deposit accounts. Loans or extensions of credit, including portions thereof, to the extent secured by a segregated deposit account in the lending bank, provided a security interest in the deposit has been perfected under applicable law.

a. Where the deposit is eligible for withdrawal before the secured loan matures, the bank must establish internal procedures to prevent release of the security without the lending bank's prior consent.

b. A deposit that is denominated and payable in a currency other than that of the loan or extension of credit that it secures may be eligible for this exception if the currency is freely convertible to U.S. dollars.

(1) This exception applies to only that portion of the loan or extension of credit that is covered by the U.S. dollar value of the deposit.

(2) The lending bank must establish procedures to periodically revalue foreign currency deposits to ensure that the loan or extension of credit remains fully secured at all times.

7. Loans to financial institutions with the approval of the Banking Board.

   a. Loans or extensions of credit to any financial institution or to any receiver, conservator, or other agent in charge of the business and property of a financial institution when an emergency situation exists and a bank is asked to provide assistance to another financial institution and the loan is approved by the Banking Board.

8. Loans to the Student Loan Marketing Association. Loans or extensions of credit to the Student Loan Marketing Association.

9. Loans to industrial development authorities. A loan or extension of credit to an industrial development authority or similar public entity created to construct and lease a plant facility, including a health care facility, to an industrial occupant will be deemed a loan to the lessee, provided that:

   a. The bank evaluates the creditworthiness of the industrial occupant before the loan is extended to the authority;

   b. The authority's liability with respect to the loan is limited solely to whatever interest it has in the particular facility;

   c. The authority's interest is assigned to the bank as security for the loan, or the industrial occupant issues a promissory note to the bank that provides a higher order of security than the assignment of a lease; and

   d. The industrial occupant's lease rentals are assigned and paid directly to the bank.

10. Loans to leasing companies. A loan or extension of credit to a leasing company for the purpose of purchasing equipment for lease will be deemed a loan to the lessee, provided that:

   a. The bank evaluates the creditworthiness of the lessee before the loan is extended to the leasing corporation;

   b. The loan is without recourse to the leasing corporation;

   c. The bank is given a security interest in the equipment and in the event of default may proceed directly against the equipment and the lessee for any deficiency resulting from the sale of the equipment;

   d. The leasing corporation assigns all of its rights under the lease to the bank;

   e. The lessee's lease payments are assigned and paid to the bank; and

   f. The lease terms are subject to the same limitations that would apply to a bank acting as a lessor.

11. Credit Exposures arising from transactions financing certain government securities. Credit exposures arising from securities financing transactions in which the securities financed are Type I securities, as defined in Paragraph (A)(27).

12. Intraday credit exposures. Intraday credit exposures arising from a derivative transaction or securities financing transaction.

E. Special Lending Authority

1. In addition to the general limitations set forth in Paragraph (B) of this Rule, a bank that has applied to the Division of Banking, and received approval from the Commissioner, to exercise special lending authority may make loans or extensions of credit in an amount up to 10 percent of its capital and surplus.

2. The total amount of a bank's loans and extensions of credit made pursuant to Paragraphs (B) and (E) of this rule shall not exceed 25 percent of the bank's capital and surplus.

3. The total outstanding amount of a bank's loans and extension of credit to all of its borrowers made pursuant to Paragraphs (B) and (E) shall not exceed 250 percent of the bank's capital and surplus.

4. The special lending authority provided in this Paragraph (E) may not be used to increase the general limits for loans made to executive officers, directors, and principal shareholders as defined in Banking Board Rule CB101.37(C).

F. Application Process

1. A bank must submit an application to the Division of Banking and receive written approval from the Commissioner prior to using the special lending authority authorized in Paragraph (E) of this Rule.

2. The Commissioner will approve such requests for special lending authority upon receipt of a completed application and finding that such approval is consistent with safe and sound banking practices.

3. To be deemed complete, an application for special lending authority must include:

a. A copy of a written resolution by a majority of the bank's board of directors approving the use of the special lending limit in Paragraph (E) of this Rule and confirming the terms and conditions for use of the special lending authority;

b. A description of how the board will exercise its continuing responsibility to oversee the use of this special lending authority; and

c. Confirmation that the bank is in compliance with the minimum capital standards set forth in Banking Board Rule CB101.51; that the bank is not operating under a formal or informal enforcement or corrective action based on safety and soundness concerns; and that the bank's composite CAMELS rating, and the Capital, Asset Quality, and Management subcomponent ratings assigned at the most recent safety and soundness examination conducted by the Division of Banking, or the bank's primary federal regulator, are either "1" or "2."

4. The Commissioner may rescind a bank's authority to use the special lending limits in Paragraph (E) of this Rule at any time, based upon concerns about the bank's overall credit risk management systems and controls, a decline in capital, or deterioration in the bank's composite or component ratings. The bank must cease making new loans or extensions of credit in reliance on the special limits upon receipt of such notice.

G. Calculation of Lending Limits

1. Calculation date. For purposes of determining compliance with this Rule, a bank shall calculate its lending limit as of the most recent of the following dates:

    a. The last day of the preceding calendar quarter; or

    b. The date on which there is a change in the bank's capital category.

2. Effective date.

    a. A bank's lending limit calculated in accordance with Paragraph (G)(1)(a) of this Rule will be effective as of the earlier of the following dates:

        (1) The date on which the bank's Call Report is submitted; or

        (2) The date on which the bank's Call Report is required to be submitted.

    b. A bank's lending limit calculated in accordance with Paragraph (G)(1)(b) of this Rule will be effective on the date that the limit is to be calculated.

3. More frequent calculations. If the Banking Board determines for safety and soundness reasons that a bank should calculate its lending limit more frequently than required by Paragraph (G)(1) of this Rule, the Banking Board may provide written notice to the bank directing the bank to calculate its lending limit at a more frequent interval, and the bank will thereafter calculate its lending limit at that interval until further notice.

H. Combination Rules Combining Loans to Separate Borrowers

1. General rule. Loans or extensions of credit to one borrower will be attributed to another person and each person will be deemed a borrower when:

    a. The proceeds of the loan or extension of credit are to be used for the direct benefit of the other person, to the extent of the proceeds so used; or

    b. A common enterprise is deemed to exist between the persons.

2. Direct benefit. The proceeds of a loan or extension of credit to a borrower will be deemed to be used for the direct benefit of another person and will be attributed to the other person when the proceeds, or assets purchased with the proceeds, are transferred to another person, other than in a bona fide arm's length transaction where the proceeds are used to acquire property, goods, or services.

3. Common enterprise. A common enterprise will be deemed to exist and loans to separate borrowers will be aggregated when:

   a. The expected source of repayment for each loan or extension of credit is the same for each borrower and neither borrower has another source of income from which the loan, together with the borrower's other obligations, may be fully repaid. An employer will not be treated as a source of repayment under this Paragraph because of wages and salaries paid to an employee, unless the standards of Paragraph (H)(3)(b) of this Rule are met.

   b. Loans or extensions of credit are made:

      (1) To borrowers who are related directly or indirectly through common control, including where one borrower is directly or indirectly controlled by another borrower; and

      (2) Substantial financial interdependence exists between or among the borrowers. Substantial financial interdependence is deemed to exist when 50 percent or more of one borrower's gross receipts or gross expenditures, on an annual basis, are derived from transactions with the other borrower. Gross receipts and expenditures include gross revenues/expenses, intercompany loans, dividends, capital contributions, and similar receipts or payments;

   c. Separate persons borrow from a bank to acquire a business enterprise of which those borrowers will own more than 50 percent of the voting securities or voting interests, in which case a common enterprise is deemed to exist between the borrowers for purposes of combining the acquisition loan.

   d. The Banking Board determines, based upon an evaluation of the facts and circumstances of particular transactions, that a common enterprise exists.

4. Special rules for loans to a corporate group.

   a. Loans or extensions of credit by a bank to a corporate group may not exceed 50 percent of the bank's capital and surplus. This limitation applies only to loans subject to the combined general limit. A corporate group includes a person and all of its subsidiaries. For purposes of this Paragraph, a corporation or limited liability company is a subsidiary of a person if the person owns or beneficially owns, directly or indirectly, more than 50 percent of the voting securities or voting interests of the corporation or company.

   b. Except as provided in Paragraph (H)(4)(a) of this Rule, loans or extensions of credit to a person and its subsidiary, or to different subsidiaries of a person, are not combined unless either the common enterprise or direct benefit test is met.

5. Special rules for loans to partnerships, joint ventures, and associations.

   a. Partnership loans. Loans or extensions of credit to a partnership, joint venture, or association are deemed to be loans or extensions of credit to each member of the partnership, joint venture, or association. This Rule is not applicable to limited partners in limited partnerships or to members of joint ventures or associations if the partners or members, by the terms of the partnership or membership agreement, are not held generally liable for the debts or actions of the partnership, joint venture, or association, and those provisions are valid under applicable law.

   b. Loans to partners.

      (1) Loans or extensions of credit to members of a partnership, joint venture, or association are not attributed to the partnership, joint venture, or association unless either the direct benefit or common enterprise tests are met as defined in Paragraphs (H)(2) and (3) of this Rule. Both the direct benefit and common enterprise tests are met between a member of a partnership, joint venture, or association and such partnership, joint venture, or association, when loans or extensions of credit are made to the member to purchase an interest in the partnership, joint venture, or association.

      (2) Loans or extensions of credit to members of a partnership, joint venture, or association are not attributed to other members of the partnership, joint venture, or association unless either the direct benefit or common enterprise test is met.

6. Loans to foreign governments, their agencies, and instrumentalities.

   a. Aggregation. Loans and extensions of credit to foreign governments, their agencies, and instrumentalities will be aggregated with one another only if the loans or extension of credit fail to meet either the means test or the purpose test at the time the loan or extension of credit is made:

      (1) The means test is satisfied if the borrower has resources or revenue of its own sufficient to service its debt obligations. If the government’s support, excluding guarantees by a central government of the borrower’s debt, exceeds the borrower's annual revenues from other sources, it will be presumed that the means test has not been satisfied.

      (2) The purpose test is satisfied if the purpose of the loan or extension of credit is consistent with the purposes of the borrower’s general business.

   b. Documentation. In order to show that the means and purpose tests have been satisfied, a bank must, at a minimum, retain in its files the following items:

      (1) A statement, accompanied by supporting documentation, describing the legal status and the degree of financial and operational autonomy of the borrowing entity;

      (2) Financial statements for the borrowing entity for a minimum of three years prior to the date the loan or extension of credit was made, or for each year that the borrowing entity has been in existence, if less than three;

(3) Financial statements for each year the loan or extension of credit is outstanding;

(4) The bank's assessment of the borrower's means of servicing the loan or extension of credit, including specific reasons in support of that assessment. The assessment shall include an analysis of the borrower's financial history, its present and projected economic and financial performance, and the significance of any financial support provided to the borrower by third parties, including the borrower's central government; and

(5) A loan agreement or other written statement from the borrower that clearly describes the purpose of the loan or extension of credit. The written representation will ordinarily constitute sufficient evidence that the purpose test has been satisfied. However, when, at the time the funds are disbursed, the bank knows or has reason to know of other information suggesting that the borrower will use the proceeds in a manner inconsistent with the written representation, it may not, without further inquiry, accept the representation.

7. Restructured loans.

a. Non-combination rule. Notwithstanding Paragraphs (H)(1) through (5) of this Rule, when previously outstanding loans and other extensions of credit to a foreign government, its agencies, and instrumentalities (i.e., public-sector obligors) that qualified for a separate lending limit under Paragraph (H)(6)(a) of this Rule are consolidated under a central obligor in a qualifying restructuring, such loans will not be combined and attributed to the central obligor. This includes any substitution in named obligors, solely because of the restructuring. Such loans, other than loans originally attributed to the central obligor in their own right, will not be considered obligations of the central obligor and will continue to be attributed to the original public-sector obligor for the purposes of the lending limit.

b. Qualifying restructuring. Loans and other extensions of credit to a foreign government, its agencies, and instrumentalities will qualify for the non-combination process under Paragraph (H)(7)(a) of this Rule only if they are restructured in a sovereign debt restructuring approved by the Banking Board, upon request by a bank, for application of the non-combination rule. The factors that the Banking Board will use in making this determination include, but are not limited to, the following:

(1) Whether the restructuring involves a substantial portion of the total commercial bank loans outstanding to the foreign government, its agencies, and instrumentalities;

(2) Whether the restructuring involves a substantial number of the foreign country's external commercial bank creditors;

(3) Whether the restructuring and consolidation under a central obligor is being done primarily to facilitate external debt management; and

(4) Whether the restructuring includes features of debt or debt-service reduction.

c. Fifty percent aggregate limit. With respect to any case in which the non-combination process under Paragraph (H)(7)(a) of this Rule applies, a bank's loans and other extensions of credit to a foreign government, its agencies, and instrumentalities, including restructured debt, shall not exceed, in the aggregate, 50 percent of the bank's capital and surplus.

I. Nonconforming Loans

1. A loan or extension of credit, within a bank's legal limit when made, will not be deemed a violation but will be treated as nonconforming if the loan or extension of credit is no longer in conformity with the bank's lending limit because:

a. The bank's capital has declined, borrowers have subsequently merged or formed a common enterprise, lenders have merged, the lending limit or capital rules have changed; or

b. Collateral securing the loan to satisfy the requirements of a lending limit exception has declined in value; or

c. In the case of a credit exposure arising from a derivative transaction or securities financing transaction and as measured by the Model Method, the Current Exposure Method, or the Basel Haircut Method specified in this Rule, the credit exposure subject to the lending limits of Paragraph (G) or the increases after execution of the transaction.

2. A bank must use reasonable efforts to bring a loan that is nonconforming as a result of Paragraph (I)(1)(a) of this Rule into conformity with the bank's lending limit, unless to do so would be inconsistent with safe and sound banking practices.

3. A bank must bring a loan that is nonconforming as a result of circumstances described in Paragraph (I)(1)(b) of this Rule into conformity with the bank's lending limit within thirty (30) calendar days, except when judicial proceedings, regulatory actions, or other extraordinary circumstances beyond the bank's control prevent the bank from taking action.

J. Separate Limitations for Investment Securities

1. A bank may make loans or extensions of credit to one borrower up to the full amount permitted by this Rule and also hold eligible investment securities of the same obligor up to the full amount permitted by Banking Board Rule CB101.59. In order for a security to be an "investment security" it must be eligible for investment by a bank in accordance with the standards set forth in Banking Board Rule CB101.59.

K. Approval by Banking Board

1. Upon application by an institution to the Banking Board, the Banking Board may allow an institution to exceed the lending limit for a specific loan or extension of credit if the institution proves that the loan or extension of credit will not adversely impact the safe and sound operations of the institution or the protection of the depositors. In making its decision, the Banking Board shall consider the quality of the loan or extension of credit and the benefit to the community of the loan or extension of credit.

2. The Banking Board shall also have the authority to determine when a loan putatively made to a person shall, for purposes of Paragraph (H) of this Rule, be attributed to another person.

L. Credit Exposure Arising from Derivative and Securities Financing Transactions

1. Scope. This section sets forth the rules for calculating the credit exposure arising from a derivative transaction or a securities financing transaction entered into by a bank for purposes of determining the bank’s lending limit.

2. Derivative transactions.

a. Non-Credit Derivatives. Subject to paragraphs (2)(b) and (2)(c) of this section, a bank shall calculate the credit exposure to a counterparty arising from a derivative transaction by one of the following methods. Subject to paragraph (2)(c) of this section, a bank shall use the same method for calculating counterparty credit exposure arising from all of its derivative transactions.

(1) Model Method.

(a) Credit exposure. The credit exposure of a derivative transaction under the Model Method shall equal the sum of the current credit exposure of the derivative transaction and the potential future credit exposure of the derivative transaction.

(b) Calculation of current credit exposure. A bank shall determine its current credit exposure by the mark-to-market value of the derivative contract. If the mark-to-market value is positive, then the current credit exposure equals that mark-to-market value. If the mark-to-market value is zero or negative, then the current credit exposure is zero.

(c) Calculation of potential future credit exposure.

(i) A bank shall calculate its potential future credit exposure by using either:

a) An internal model that has been approved in writing by the Division or the bank's primary federal regulator for purposes of Paragraph L; or

b) Any other appropriate model, the use of which has been approved in writing for purposes of this section by the Division or the bank's primary federal regulator.

(ii) Any substantive revision to a model made after the bank has provided notice of the use of the model to the Division or the primary federal regulator must be approved by the Division or agency before a bank may use the revised model for the purposes of this part.

(d) Net credit exposure. A bank that calculates its credit exposure by using the Model Method pursuant to this paragraph may net credit exposure of derivative transactions arising under the same qualifying master netting agreement.

(2) Conversion Factor Matrix Method. The credit exposure arising from a derivative transaction under the Conversion Factor Matrix Method shall equal and remain fixed at the potential future credit exposure of the derivative transaction, which shall equal the product of the notational amount of the derivative transaction and a fixed multiplicative factor determined by reference to Table 1 below.

Table 1 – Conversion Factor Matrix for Calculating Potential Future Credit Exposure.[1]

Original maturity[2]	Interest Rate	Foreign exchange rate and gold	Equity	Other[3] (includes commodities and precious metals except gold)
1 year or less	0.015	0.015	0.20	0.06
Over 1 to 3 years	0.03	0.03	0.20	0.18
Over 3 to 5 years	0.06	0.06	0.20	0.30
Over 5 to 10 years	0.12	0.12	0.20	0.60
Over ten years	0.30	0.30	0.20	1.0

[1] For an OTC derivative contract with multiple exchanges of principal, the conversion factor is multiplied by the number of remaining payments in the derivative contract.

[2] For an OTC derivative contract that is structured such that on specified dates any outstanding exposure is settled and the terms are reset so that the market value of the contract is zero, the remaining maturity equals the time until the next reset date. For an interest rate derivative contract with a remaining maturity of greater than one year that meets these criteria, the minimum conversion factor is 0.005.

[3] Transactions not explicitly covered by any other column in the Table are to be treated as “Other”.

(3) Current Exposure Method. The credit exposure arising from a derivative transaction under the Current Exposure Method (other than a credit derivative transaction) shall be calculated pursuant to the guidelines outlined in (3)(a), (3)(b), and (3)(c) of this section.

(a) Single OTC derivative contract. Except as modified by paragraph (3)(c) of this section, the exposure at default (EAD) for a single OTC derivative contract that is not subject to a qualifying master netting agreement is equal to the sum of the bank's current credit exposure and potential future credit exposure (PFE) on the derivative contract.

(i) Current credit exposure. The current credit exposure for a single OTC derivative contract is the greater of the mark-to-market value of the derivative contract or zero.

(ii) PFE. The PFE for a single OTC derivative contract, including an OTC derivative contract with a negative mark-to-market value, is calculated by multiplying the notional principal amount of the derivative contract by the appropriate conversion factor in Table 4. For purposes of calculating either the PFE under this paragraph or the gross PFE under paragraph (3)(b) of this section for exchange rate contracts and other similar contracts in which the notional principal amount is equivalent to the cash flows, notional principal amount is the net receipts to each party falling due on each value date in each currency. For any OTC derivative contract that does not fall within one of the specified categories in Table 4, the PFE must be calculated using the “other” conversion factors. A bank must use an OTC derivative contract's effective notional principal amount (that is, its apparent or stated notional principal amount multiplied by any multiplier in the OTC derivative contract) rather than its apparent or stated notional principal amount in calculating PFE. PFE of the protection provider of a credit derivative is capped at the net present value of the amount of unpaid premiums.

Table 2 – Conversion Factor Matrix for OTC Derivative Contracts[1]

Remaining maturity[2]	Interest rate	Foreign exchange rate and gold	Credit (investment grade reference obligor)[3]	Credit (non-investment grade Reference obligor)	Equity	Precious metals (except gold)	Other
One year or less	0.00	0.01	0.05	0.10	0.06	0.07	0.10
Over one to five years	0.005	0.05	0.05	0.10	0.08	0.07	0.12
Over five years	0.015	0.075	0.05	0.10	0.10	0.08	0.15

[1] For an OTC derivative contract with multiple exchanges of principal, the conversion factor is multiplied by the number of remaining payments in the derivative contract.

[2] For an OTC derivative contract that is structured such that on specified dates any outstanding exposure is settled and the terms are reset so that the market value of the contract is zero, the remaining maturity equals the time until the next reset date. For an interest rate derivative contract with a remaining maturity of greater than one year that meets these criteria, the minimum conversion factor is 0.005.

[3] A bank must use the column labeled “Credit (investment-grade reference obligor)” for a credit derivative whose reference obligor has an outstanding unsecured long-term debt security without credit enhancement that has a long-term applicable external rating of at least investment grade. A bank must use the column labeled “Credit (non-investment-grade reference obligor)” for all other credit derivatives.

(b) Multiple OTC derivative contracts subject to a qualifying master netting agreement. Except as modified by paragraph (3)(c) of this section, the EAD for multiple OTC derivative contracts subject to a qualifying master netting agreement is equal to the sum of the net current credit exposure and the adjusted sum of the PFE exposure for all OTC derivative contracts subject to the qualifying master netting agreement.

(i) Net current credit exposure. The net current credit exposure is the greater of:

a) The net sum of all positive and negative mark-to-market values of the individual OTC derivative contracts subject to the qualifying master netting agreement; or

b) zero.

(ii) Adjusted sum of the PFE. The adjusted sum of the PFE, Anet, is calculated as Anet = (0.4xAgross)+(0.6xNGRxAgross), where:

a) Agross = the gross PFE (that is, the sum of the PFE amounts (as determined under paragraph (L)(2)(a)(3)(a)(ii) of this section) for each individual OTC derivative contract subject to the qualifying master netting agreement); and

b) NGR = the net to gross ratio (that is, the ratio of the net current credit exposure to the gross current credit exposure). In calculating the NGR, the gross current credit exposure equals the sum of the positive current credit exposures (as determined under paragraph (L)(2)(a)(3)(a)(i) of this section) of all individual OTC derivative contracts subject to the qualifying master netting agreement.

(c) Collateralized OTC derivative contracts. A bank may recognize the credit risk mitigation benefits of financial collateral that secures an OTC derivative contract or single-product netting set of OTC derivatives by factoring the collateral into its Loss Given Default (LGD) estimates for the contract or netting set. Alternatively, a bank may recognize the credit risk mitigation benefits of financial collateral that secures such a contract or netting set that is marked to market on a daily basis and subject to a daily margin maintenance requirement by estimating an unsecured LGD for the contract or netting set and adjusting the EAD calculated under paragraph (3)(a) or (3)(b) of this section using the Basel collateral haircut approach in paragraph (L)(3)(a)(3) of this section. The bank must substitute the EAD calculated under paragraph (3)(a) or (3)(b) of this section for ΣE in the equation in paragraph (L)(3)(a)(i) of this section and must use a ten-business-day minimum holding period (T[M] = 10).

b. Credit Derivatives.

(1) Counterparty exposure

(a) In general, notwithstanding paragraph (2)(a) of this section, a bank that uses the Conversion Factor Matrix Method or Current Exposure Method, or that uses the Model Method without entering an effective margining arrangement (EMA) as defined in Paragraph (A)(11) shall calculate the counterparty credit exposure arising from credit derivatives entered by the bank by adding the net notional value of all protection purchased from the counterparty on each reference entity.

(b) Special Rule for certain effective margin requirements. A bank must add the EMA threshold amount to the counterparty credit exposure arising from credit derivatives calculated under the Model method. The EMA threshold is the amount under an effective margining arrangement with respect to which the counterparty is not required to post variation margin to fully collateralize the amount of the bank's net credit exposure to the counterparty.

(2) Reference entity exposure. A bank shall calculate the credit exposure to a reference entity arising from credit derivatives entered by the bank by adding the net notional value of all protections sold on the reference entity. However, the bank may reduce its exposure to a reference entity by the amount of any eligible credit derivative purchased on that reference entity from an eligible protection provider.

(3) Special rule for central counterparties.

(a) In addition to amounts calculated under the model method and conversion method, the measure of counterparty exposure to a central counterparty shall also include the sum of the initial margin posted by the bank plus any contributions made by it to a guaranty fund at the time such contribution is made.

(b) The preceding paragraph of this section does not apply to a bank that used an internal model pursuant to Paragraph (L)(2) to this section to calculate the credit exposure if such model reflects the initial margin and any contributions to a guaranty fund.

(4) Mandatory or alternative method. The Division may require a bank to use a specific method set forth in Paragraph (L)(2) to calculate the credit exposure of derivative transactions or any specific, or category of derivative transaction if it finds, in its discretion, that such method is necessary to promote the safety and soundness of the bank.

3. Securities Financing Transactions.

a. In general. Except as provided by paragraph (L)(3)(b) of this section, a bank shall calculate the credit exposure arising from a securities financing transaction by one of the following methods. A bank shall use the same method for calculating credit exposure arising from all of its securities financing transactions.

(1) Model Method. A bank may calculate the credit exposure of a securities financing transaction by using a model approved in writing by the Division or the bank's primary federal regulator for purposes of Paragraph (L)(2)(a)(1) or any other appropriate model approved by the primary federal regulator.

(a) Any other appropriate model, the use of which has been approved in writing, for purposes of this section by the Division or the primary Federal regulator.

(b) Any substantive revisions to a model after the bank has provided notice of the use of the model to the Division or the primary federal regulator pursuant to paragraph (L)(3)(a)(1) of this section, or after the Division or appropriate primary federal regulator has approved the model, must be approved by the Division or the primary federal regulator before a bank may use the revised model.

(2) Basic Method. A bank may calculate the credit exposure of a securities financing transaction as follows:

(a) Repurchase agreement. The credit exposure arising from a repurchase agreement shall equal and remain fixed at the market value at execution of the transaction of the securities transferred to the other party less cash received.

(b) Securities lending.

(i) Cash collateral transactions. The credit exposure arising from a securities lending transaction where the collateral is cash shall equal and remain fixed at the market value at execution of the transaction of securities transferred less cash received.

(ii) Non-cash collateral transactions. The credit exposure arising from a securities lending transaction where the collateral is other securities shall equal and remain fixed as the product of the higher of the two haircuts associated with the two securities, as determined in Table below, and the higher of the two par values of the securities. Where more than one security is provided as collateral, the applicable haircut is the higher of the haircut associated with the security borrowed and the notational-weighted average of the haircuts associated with the securities provided as collateral.

(c) Reverse repurchase agreements. The credit exposure arising from a reverse repurchase agreement shall equal and remain fixed as the product of the haircut associated with the collateral received, as determined in Table 3 below, and the amount of cash transferred.

(d) Securities borrowing.

(i) Cash collateral transactions. The credit exposure arising from a securities borrowed transaction where the collateral is cash shall equal and remain fixed as the product of the haircut on the collateral received, as determined in Table 3 below, and the amount of cash transferred to the other party.

(ii) Non-cash collateral transactions. The credit exposure arising from a securities borrowed transaction where the collateral is other securities shall equal and remain fixed as the product of the higher of the two haircuts associated with the two securities, as determined in Table 3 below, and the higher of the two par values of the securities. Where more than one security is provided as collateral, the applicable haircut is the higher of the haircut associated with the security borrowed and the notational-weighted average of the haircuts associated with the securities provided as collateral.

Table 3 – Collateral Haircuts

	Residual maturity	Haircut without currency mismatch[1]
SOVEREIGN ENTITIES		
OECD Country Risk Classification 0-1	<= 1 year >1 year, <= 5 years >5 years	0.005 0.02 0.04
OECD Country Risk Classification 2-3	<= 1 year >1 year, <= 5 years >5 years	0.01 0.03 0.06
CORPORATE AND MUNICIPAL BONDS THAT ARE BANK-ELIGIBLE INVESTMENTS		
	Residual maturity for debt securities	Haircut without currency mismatch
All All All	<= 1 year >1 year, <= 5 years >5 years	0.02 0.06 0.12
OTHER ELIGIBLE COLLATERAL		
Main index[2] equities (including convertible bonds)		0.15
Other publicly traded equities (including convertible bonds)		0.25
Mutual funds		Highest haircut applicable to any security in which the fund can invest
Cash collateral held		0

[1] In cases where the currency denomination of the collateral differs from the currency denomination of the credit transaction, an additional 8 percent haircut will apply.
[2] Main index means the Standard & Poor's 500 Index, the FTSE All-World Index, and any other index for which the covered company can demonstrate to the satisfaction of the Federal Reserve that the equities represented in the index have comparable liquidity, depth of market, and size of bid-ask spreads as equities in the Standard & Poor's 500 Index and FTSE All-World Index.

(3) Basel Collateral Haircut Method. A bank may calculate the credit exposure of a securities financing transaction pursuant to Paragraph (3)(a) and (3)(b) of this section.

(a) EAD equation. A bank may determine EAD for an eligible margin loan, repo-style transaction, or netting set by setting EAD equal to max 0, $[(\Sigma E-\Sigma C) + \Sigma(Es \times Hs) + \Sigma(Efx \times Hfx)]$, where:

(i) ΣE equals the value of the exposure (the sum of the current market values of all instruments, gold, and cash the bank has lent, sold subject to repurchase, or posted as collateral to the counterparty under the transaction (or netting set));

(ii) ΣC equals the value of the collateral (the sum of the current market values of all instruments, gold, and cash the bank has borrowed, purchased subject to resale, or taken as collateral from the counterparty under the transaction (or netting set));

(iii) Es equals the absolute value of the net position in a given instrument or in gold (where the net position in a given instrument or in gold equals the sum of the current market values of the instrument or gold the bank has lent, sold subject to repurchase, or posted as collateral to the counterparty minus the sum of the current market values of that same instrument or gold the bank has borrowed, purchased subject to resale, or taken as collateral from the counterparty);

(iv) Hs equals the market price volatility haircut appropriate to the instrument or gold referenced in Es;

(v) Efx equals the absolute value of the net position of instruments and cash in a currency that is different from the settlement currency (where the net position in a given currency equals the sum of the current market values of any instruments or cash in the currency the bank has lent, sold subject to repurchase, or posted as collateral to the counterparty minus the sum of the current market values of any instruments or cash in the currency the bank has borrowed, purchased subject to resale, or taken as collateral from the counterparty); and

(vi) Hfx equals the haircut appropriate to the mismatch between the currency referenced in Efx and the settlement currency.

(b) Standard supervisory haircuts.

(i) Under the standard supervisory haircuts approach:

a) A bank must use the haircuts for market price volatility (Hs) in Table 4, as adjusted in certain circumstances as provided in paragraph (3)(b) of this section;

Table 4 – Standard Supervisory Market Price Volatility Haircuts[1]

Applicable external rating grade category for debt securities	Residual maturity for debt securities	Issuers exempt from the 3 basis point floor	Other issuers
Two highest investment-grade rating categories for long-term ratings/highest investment-grade rating category for short-term ratings.	≤ 1 year ……………..…..	0.005	0.01
	> 1 year, ≤ 5 years ….	0.02	0.04
	> 5 years ……………..	0.04	0.08
Two lowest investment-grade rating categories for both short- and long-term ratings.	≤ 1 year ……………..…..	0.01	0.02
	> 1 year, ≤ 5 years ….	0.03	0.06
	> 5 years ……………..	0.06	0.12
One rating category below investment grade ….	All ……………………..	0.15	0.25
Main index equities (including convertible bonds) and gold ………………..		0.15	
Other publicly traded equities (including convertible bonds), conforming residential mortgages, and nonfinancial collateral.		0.25	
Mutual funds ………………………………………………………………..		Highest haircut applicable to any security in which the fund can invest.	
Cash on deposit with the bank (including a certificate of deposit issued by the bank) ………………………………………………………………………		0	

[1]The market price volatility haircuts in Table 4 are based on a ten-business-day holding period.

b) For currency mismatches, a bank must use a haircut for foreign exchange rate volatility (Hfx) or 8 percent, as adjusted in certain circumstances as provided in paragraph L(3)(a)(3)(b)(i) of this section.

c) For repo-style transactions, a bank may multiply the supervisory haircuts provided in paragraphs L(3)(a)(3)(b)(i) of this section by the square root of 1/2 (which equals 0.707107).

d) A bank must adjust the supervisory haircuts upward on the basis of a holding period longer than ten business days (for eligible margin loans) or five business days (for repo-style transactions) where and as appropriate to take into account the illiquidity of an instrument.

(4). Mandatory or alternative Method. The Division or primary federal regulator may at its discretion require or permit a bank to use a specific method or methods set forth in paragraph (L)(3)(a) of this section to calculate the credit exposure arising from all securities financing transactions or any specific category of, securities transactions if the Division or the primary federal regulator finds, in its discretion, that such method is consistent with the safety and soundness of the bank.

4. Interpretive Guidance

This state rule is similar to parallel rules issued by the federal bank agencies. The federal banking agencies have also issued interpretative guidance in the form of an Explanatory Table. This Table may be found in the Federal Register, Vol 78. no 122, Tuesday, June 25, 2013, page 37939. To the extent that it is helpful, banks may refer to it for non-binding interpretative guidance.

M. Effective Date and Implementation Date

This rule shall be effective June 14, 2014. The Division of Banking retains full authority to address excessive exposure or undue concentrations through its safety and soundness authority.

CB101.65 Marketing Nontraditional Mortgage Loans [Section 11-102-106, C.R.S.]

A. Applicability

This rule applies only to nontraditional mortgage loans, as defined in Section C.2 below, made to individual borrowers for the purchase or refinancing of residential property.

B. Purpose

The Colorado State Banking Board finds that when promoting or describing nontraditional mortgage products, banks should provide consumers with information that is designed to help them make informed decisions when selecting and using these products.

C. Definitions

For the purpose of this Rule:

1. “Interest Only Mortgage Loan” means a nontraditional mortgage on which, for a specified number of years the borrower is required to pay only the interest due on the loan, during which time, the rate may fluctuate or may be fixed. After the interest-only period, the rate may be fixed or fluctuate, based on the prescribed index, and payments include both principal and interest.

2. “Nontraditional Mortgage” means any residential mortgage loan product that allows the borrower to defer repayment of principal and/or interest. This includes, without limitation, all interest-only residential mortgage products, payment option adjustable rate mortgages, and negative amortization mortgages, with the exception of a reverse mortgage and home equity line of credit, other than a simultaneous second-lien loan. Nontraditional mortgages do not include temporary loans or construction loans.

3. “Simultaneous Second-Lien Loan” means a lending arrangement where either a closed-end second-lien or a home equity line of credit is originated simultaneously with the first lien mortgage loan, typically in lieu of a higher down payment.

4. “Payment Option ARM” means a nontraditional adjustable rate mortgage that allows the borrower to choose from a number of different payment options. For example, Payment Option ARMs include, without limitation, loans whereby, each month, the borrower may choose a minimum payment option based on a “start” or introductory interest rate, an interest-only payment option based on the fully indexed interest rate, or a fully amortizing principal and interest payment option based on a 15-year or 30-year loan term, plus any required escrow payments. The minimum payment option can be less than the interest accruing on the loan, resulting in negative amortization. The interest-only option avoids negative amortization but does not provide for principal amortization. After a specified number of years, or if the loan reaches a certain negative amortization cap, the required monthly payment amount is recast to require payments that will fully amortize the outstanding balance over the remaining loan term.

5. “Reduced Documentation” means a loan feature that is commonly referred to as “low doc/no doc,” “no income/no asset,” “stated income,” or “stated assets.” For mortgage loans with this feature, however designated, an institution sets reduced or minimal documentation standards to substantiate the borrower’s income and assets.

D. Communications with Consumers

1. Promotional materials and other product descriptions must include information about the costs, terms, features, and risks of nontraditional mortgages that can assist consumers in their product selection decisions, including, as applicable, information on the following:

   a. Payment Shock - Banks should apprise consumers of potential increases in payment obligations for these products, including circumstances in which interest rates or negative amortization reach a contractual limit. For example, product descriptions shall, when appropriate, state the maximum monthly payment a consumer would be required to pay under a hypothetical loan example, after amortizing payments are required and the interest rate and negative amortization caps have been reached. Such information also should describe when structural payment changes will occur, and what the new payment amount would be, or how it would be calculated. If applicable, such descriptions shall indicate that a higher payment may be required at other points in time due to factors such as negative amortization or increases in the interest rate index.

   b. Negative Amortization - When negative amortization is possible under the terms of a nontraditional mortgage product, consumers shall be informed of the potential for increasing principal balances and decreasing home equity, as well as other potential adverse consequences of negative amortization. For example, product descriptions shall disclose the effect of negative amortization on loan balances and home equity, and describe the potential consequences to the consumer of making minimum payments that cause the loan to negatively amortize. (One possible consequence is that it could be more difficult to refinance the loan or to obtain cash upon sale of the home).

   c. Prepayment Penalties - If the loan documents allow a bank to impose a penalty in the event that the consumer prepays the mortgage, consumers shall be informed to this fact and that they may ask the lender about the amount of any such penalty.

   d. Cost of Reduced Documentation Loans - If a bank offers both reduced and full documentation loan programs, and there is a pricing premium attached to the reduced documentation program, consumers should be advised of the cost differential.

2. Promotional materials and other product descriptions outlined under Paragraph (C)(1) of this Rule shall be designed to reasonably:

   a. Focus on information important to consumer decision making;

   b. Highlight key information so that it will be noticed;

   c. Employ a user-friendly and readily navigable format for presenting the information;

   d. Use plain language, with concrete and realistic examples.

3. Banks shall provide consumers with information at a time and in a manner that will help consumers select products and choose among payment options. For example, institutions should offer clear and balanced product descriptions when a consumer is shopping for a mortgage – such as when the consumer makes an inquiry to the institution about a mortgage product and receives information about nontraditional mortgage products, or when marketing relating to nontraditional mortgage products is provided by the institution to the consumer – not just upon the submission of an application or at consummation.

4. When advertising nontraditional mortgages through certain forms of media, such as radio, television, or billboards, banks shall provide clear and balanced information about the risks of these products, to the extent reasonably practical.

E. Monthly Statements on Payment Option ARMs

Monthly statements that are provided to consumers on payment option ARMs shall provide sufficient information to allow consumers to make informed payment choices, including an explanation of each payment option available and the impact of that choice on loan balances. For example, the monthly payment statement shall contain an explanation, as applicable, next to the minimum payment amount, that making this payment would result in an increase to the consumer’s outstanding loan balance. Payment statements also shall provide the consumer’s current loan balance, what portion of the consumer’s previous payment was allocated to principal and to interest, and, if applicable, the amount by which the principal balance increased.

F. Practices to Avoid

1. Banks shall not present information regarding nontraditional loans in a manner that obscures significant risks to the consumer. For example, if a bank advertises or promotes a nontraditional mortgage by emphasizing the comparatively lower initial payments permitted for these loans, the institution must also provide clear and equally prominent information alerting the consumer to the risks. Such information should explain, as relevant, that these payment amounts will increase, that a balloon payment may be due, and that the loan balance will not decrease and may even increase due to the deferral of interest and/or principal payments.

2. Banks shall not advertise payment patterns that are structurally unlikely under the terms of a loan and shall avoid such practices as: giving consumers unwarranted assurances or predictions about the future direction of interest rates (and, consequently, the borrower's future obligations); making representations about the cash savings or expanded buying power to be realized from nontraditional mortgage products without stating the risks associated with nontraditional mortgages; suggesting that initial minimum payments in a payment option ARM will cover accrued interest (or principal and interest) charges; and making misleading claims that interest rates or payment obligations for these products are "fixed."

3. Banks shall not recommend that ARM borrowers select a nonamortizing or negatively-amortizing payment (for example, through the format or content of monthly statements).

G. Control Systems

1. Banks offering nontraditional mortgage products shall develop and use control systems reasonably designed to monitor whether actual practices are consistent with applicable policies and procedures. Such control systems shall address compliance and consumer information concerns as well as safety and soundness considerations. Lending personnel shall be trained so that they are able to convey information to consumers about product terms and risks in a timely, accurate, and balanced manner. As products evolve and new products are introduced, lending personnel shall receive additional training, as necessary, to continue to be able to convey information to consumers in this manner. Lending personnel shall be monitored to determine whether they are following these policies and procedures. Banks shall review consumer complaints to identify potential compliance, reputation, and other risks. Banks shall obtain legal review of nontraditional loan procedures as necessary. Banks shall not use compensation programs that compensate lending personnel for directing consumers to nontraditional mortgages.

2. If a bank utilizes a third party, such as a mortgage broker, correspondent, or other intermediary, to originate, purchase, or service nontraditional mortgage loans, or if a bank serves as an agent for a third party mortgage lender, the bank shall implement appropriate measures to mitigate risks relating to compliance with this regulation, and all other applicable state and federal laws and regulations. Such measures shall include, but are not limited to:

a. Conducting due diligence procedures for reviewing the knowledge and trustworthiness of the third party, and establishing criteria for entering into and maintaining relationships with such third parties;

b. Establishing criteria for third-party compensation, which may not include origination incentives that are inconsistent with this Rule;

c. Setting the terms for agreements with such third parties,

d. Establishing procedures and systems to monitor compliance with applicable agreements, bank policies, and laws, and

e. Implementing appropriate corrective actions in the event that the third party fails to comply with applicable agreements, bank policies, or laws.

H. Illustrations

In complying with the provisions of this Rule, banks may utilize the sample illustrations included in the "Illustrations of Consumer Information for Nontraditional Mortgage Products" issued by the Office of the Controller of the Currency, Treasury; Board of Governors of the Federal Reserve System; Federal Deposit Insurance Corporation; Office of Thrift Supervision, Treasury; and National Credit Union Administration on June 8, 2007, as such publication may be amended. Banks may provide information included in the sample illustrations, and expand, abbreviate, or otherwise tailor the material to the specific products offered by the bank, or provide the information required by this Rule in a format developed by the bank, or utilize other disclosures developed or published by the federal banking agencies for consumer use that contains similar information.

I. References

1. "Interagency Guidance on Nontraditional Mortgage Products Risks" refers to guidance issued by the Office of the Comptroller of the Currency, Treasury; Board of Governors of the Federal Reserve System; Federal Deposit Insurance Corporation; Office of Thrift Supervision, Treasury; and National Credit Union Administration. The interagency guidance was published in the Federal Register on October 4, 2006.

2. "Illustrations of Consumer Information for Nontraditional Mortgage Products" refers to guidance illustrations issued by the above referenced agencies. The guidance illustrations were published in the Federal Register on June 8, 2007.

3. Copies of the above referenced interagency guidance and illustrations may be examined at any State Publications Depository.

4. For more detailed information pertaining to these provisions, please contact the Secretary to the Colorado State Banking Board at *banking@dora.state.co.us* or (303) 894-7584.

CB101.66 Frequency of Board Meetings [Section 11-103-502, C.R.S.]

A. The board of directors (Board) of a state bank shall meet at least once each calendar quarter, unless the Colorado State Banking Board directs the meetings be held on a more frequent basis or less frequent basis in case of a disaster or emergency. If the Board of a state bank plans to change its current meeting schedule, the bylaws should be reviewed with regard to meeting frequency and updated, if necessary. A revised Board of Directors meeting schedule and a copy of the revised bylaws, if necessary, shall be provided to the Division no less than 30 days following receipt of approval of the change.

B. If other than monthly meetings are held, a director who fails to attend two consecutive meetings shall automatically cease to be a director unless the absence is satisfactorily explained to the banking board or commissioner, who shall, in that event, notify the president of such bank the approval of the continuation of the director.

C. If monthly meetings are held, a director who fails to attend three consecutive monthly meetings shall automatically cease to be a director unless the absence is satisfactorily explained to the banking board or commissioner, who shall, in that event, notify the president of such bank the approval of the continuation of the director.

D. Should a state bank's Board decide to again change its meeting schedule, the bank shall follow the process outlined in Section A.

Editor's Notes

History

Rule CB101.65 eff. 12/30/2007.

Rule CB101.60 eff. 08/30/2009.

Rules CB101.64 A-C, CB101.64 D.2, CB101.64.D 11-12, CB101.64 I.1, CB101.64 L-M emer. rules eff. 01/17/2013.

Rule CB101.64 eff. 05/15/2013.

Rule CB101.64 emer. rule eff. 02/20/2014.

Rule CB101.64 eff. 06/14/2014.

Rule CB101.57 repealed eff. 07/30/2015.

Rule CB101.53 eff. 03/16/2016.

Rule CB101.66 emer. rule eff. 08/18/2016.

Rules CB101.53 A.2, CB101.66 eff. 12/15/2016.

Rule CB101.54 A.1 eff. 08/14/2017.

Rules CB101.53 A.1, CB101.53 B eff. 04/14/2018.

Rule CB101.49 D.7 emer. rule eff. 04/02/2020; expired 07/29/2020.

Rule CB101.53 eff. 08/31/2020.

Rules CB101.49 D-E, CB101.61 eff. 04/14/2022.