

each Enterprise on a not less than quarterly basis.

(b) The determination of the capital classification shall be made following a notice to, and opportunity to respond by, the Enterprise.

(1) Not later than 60 calendar days after the date for which the minimum capital report is filed, OFHEO will provide each Enterprise with a proposed notice of classification in accordance with section 1368 of the Act (12 U.S.C. 4618). The proposed notice shall contain the following information:

(i) the proposed classification;  
(ii) the proposed minimum capital level; and  
(iii) the summary computation of the proposed minimum capital level.

(2) Each Enterprise shall have a period of 30 calendar days following receipt of a proposed notice of classification to submit a response regarding the proposed classification. The response period may be extended for up to 30 additional calendar days at the sole discretion of the Director. The Director may shorten the response period with the consent of the Enterprise or without such consent if the Director determines that the condition of the Enterprise requires a shorter period.

(3) The Director shall take into consideration any response to the proposed notice received from the Enterprise and shall issue a final notice of capital classification for each Enterprise not later than 30 calendar days following the end of the response period in accordance with section 1368 of the Act (12 U.S.C. 4618).

#### **Appendix A to Subpart A of Part 1750—Minimum Capital Level Components for Interest Rate and Foreign Exchange Rate Contracts**

The minimum capital level components for interest rate and foreign exchange rate contracts are computed on the basis of the credit equivalent amounts of such contracts. Credit equivalent amounts are computed for each of the following off-balance sheet interest rate and foreign exchange rate instruments:

##### **1. Interest Rate Contracts**

- a. Single currency interest rate swaps.
- b. Basis swaps.
- c. Forward rate agreements.
- d. Interest rate options purchased (including caps, collars, and floors).
- e. Any other instrument that gives rise to similar credit risks (including when-issued securities and forward deposits accepted).

##### **2. Foreign Exchange Rate Contracts**

- a. Cross-currency interest rate swaps.
- b. Forward foreign exchange rate contracts.
- c. Currency options purchased.
- d. Any other instrument that gives rise to similar credit risks.

Foreign exchange rate contracts with an original maturity of 14 calendar days or less and instruments traded on exchanges that require daily payment of variation margins are excluded from the minimum capital level computation. Over-the-counter options purchased, however, are included and treated in the same way as the other interest rate and foreign exchange rate contracts.

##### **3. Calculation of Credit Equivalent Amounts**

a. The credit equivalent amount of an off-balance sheet rate contract that is not subject to a qualifying bilateral netting contract in accordance with this Appendix A is equal to the sum of the current exposure (sometimes referred to as the replacement cost) of the contract and an estimate of the potential future credit exposure over the remaining life of the contract.

b. The current exposure is determined by the mark-to-market value of the contract. If the mark-to-market value is positive, then the current exposure is the mark-to-market value. If the mark-to-market value is zero or negative, then the current exposure is zero. Mark-to-market values are measured in United States dollars, regardless of the currency or currencies specified in the contract, and should reflect changes in the relevant rates, as well as counterparty credit quality.

c. The potential future credit exposure of a contract, including a contract with a negative mark-to-market value, is estimated by multiplying the notional principal amount of the contract by a credit conversion factor. The Enterprises shall use the effective rather than the apparent or stated notional amount in this calculation. The credit conversion factors are:

Remaining maturity	Interest rate contracts (percent)	Foreign exchange rate contracts (percent)
One year or less .....	0.0	1.0
Over one year .....	0.5	5.0

d. Because foreign exchange rate contracts involve an exchange of principal upon maturity, and foreign exchange rates are generally more volatile than interest rates, higher conversion factors have been established for foreign exchange rate contracts than for interest rate contracts.

e. No potential future credit exposure is calculated for single currency interest rate swaps in which payments are made based upon two floating rate indexes, so-called floating/floating or basis swaps. The credit exposure on these contracts is evaluated solely on the basis of their mark-to-market values.

##### **4. Avoidance of Double Counting**

In certain cases, credit exposures arising from the interest rate and foreign exchange instruments covered by this Appendix A may already be reflected, in part, on the balance sheet. To avoid double counting such exposures in the assessment of capital adequacy, counterparty credit exposures

arising from the types of instruments covered by this Appendix A may need to be excluded from balance sheet assets in calculating the minimum capital level.

##### **5. Collateral**

The sufficiency of collateral and guarantees for off-balance sheet items is determined by the market value of the collateral in relation to the credit equivalent amount. Collateral held against a netting contract is not recognized for minimum capital level purposes unless it is legally available to support the single legal obligation credit by the netting contract. The only forms of collateral that are formally recognized by the minimum capital level framework are cash on deposit in the bank; securities issued or guaranteed by the central governments of the OECD-based group of countries,<sup>1</sup> United States Government agencies, or United States Government-sponsored agencies; and securities issued by multilateral lending institutions or regional development banks. Excess collateral held against one contract or a group of contracts for which a recognized netting agreement exists may not be considered.

##### **6. Netting**

a. For purposes of this Appendix A, netting refers to the offsetting of positive and negative mark-to-market values in the determination of a current exposure to be used in the calculation of a credit equivalent amount. Any legally enforceable form of bilateral netting (that is, netting with a single counterparty) of interest rate contracts and foreign exchange rate contracts is recognized for purposes of calculating the credit equivalent amount provided that:

i. The netting is accomplished under a written netting contract that creates a single legal obligation, covering all included individual contracts, with the effect that the Enterprise would have a claim to receive, or obligation to pay, only the net amount of the sum of the positive and negative mark-to-market values on included individual contracts in the event that a counterparty, or a counterparty to whom the contract has been validly assigned, fails to perform due to default, insolvency, liquidation, or similar circumstances.

ii. The Enterprise obtains a written and reasoned legal opinion(s) representing that in the event of a legal challenge—including one resulting from default, insolvency, liquidation, or similar circumstances—the relevant court and administrative authorities would find the Enterprise's exposure to be such a net amount under:

<sup>1</sup> The OECD-based group of countries is comprised of all full members of the Organization for Economic Cooperation and Development (OECD), as well as countries that have concluded special lending arrangements with the International Monetary Fund (IMF) associated with the Fund's General Arrangements to Borrow. The OECD includes the following countries: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Iceland, Ireland, Italy, Japan, Luxembourg, the Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, the United Kingdom, and the United States. Saudi Arabia has concluded special lending arrangements with the IMF associated with the IMF's General Arrangements to Borrow.