78b, 78l(b), 78l(g), 78l(i), 78o–4(c)(5), 78q, 78q–1 and 78w; 31 U.S.C. 5318; 42 U.S.C. 4012a, 4104a, 4104b, 4106, and 4128.

2. In Part 208, § 208.13 is revised to read as follows:

§ 208.13 Capital adequacy.

The standards and guidelines by which the capital adequacy of state member banks will be evaluated by the Board are set forth in appendix A and appendix E to part 208 for risk-based capital purposes, and, with respect to the ratios relating capital to total assets, in appendix B to part 208 and in appendix B to the Board's Regulation Y, 12 CFR part 225.

3. In Part 208, § 208.31 is amended by revising paragraphs (e), (h), and (j) to read as follows:

§ 208.31 Definitions.

* * * * *

(e) *Risk-weighted assets* means total weighted risk assets, as calculated in accordance with the Board's Capital Adequacy Guidelines for State Member Banks: Risk-Based Measure (appendix A to this part 208) and adjusted for market risk in accordance with the Board's Capital Adequacy Guidelines for State Member banks: Market Risk Measure (appendix E to this part 208).

* * * * *

(h) *Tier 1 risk-based capital ratio* means the ratio of Tier 1 capital to weighted risk assets, as calculated in accordance with the Board's Capital Adequacy Guidelines for State Member Banks: Risk-Based Measure (appendix A to this part 208) and adjusted for market risk in accordance with the Board's Capital Adequacy Guidelines for State Member Banks: Market Risk Measure (appendix E to this part 208).

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(j) *Total risk-based capital ratio* means the ratio of qualifying total capital to weighted risk assets, as calculated in accordance with the Board's Capital Adequacy Guidelines for State Member Banks: Risk-Based Measure (appendix A to this part 208) and adjusted for market risk in accordance with the Board's Capital Adequacy Guidelines for State Member Banks: Market Risk Measure (appendix E to this part 208).

4. In part 208, Appendix A is amended by revising the first and second paragraphs of section I. to read as follows:

Appendix A to Part 208—Capital Adequacy Guidelines for State Member Banks: Risk-Based Measure

I. Overview

The Board of Governors of the Federal Reserve System has adopted a risk-based capital measure to assist in the assessment of the capital adequacy of state member banks.[1] The principal objectives of this measure are to (i) make regulatory capital requirements more sensitive to differences in risk profiles among banks; (ii) factor off-balance-sheet exposures into the assessment of capital adequacy; (iii) minimize disincentives to holding liquid, low-risk assets; and (iv) achieve greater consistency in the evaluation of the capital adequacy of major banks throughout the world.

The risk-based capital guidelines include both a definition of capital and a framework for calculating weighted risk assets by assigning assets and off-balance-sheet items to broad risk categories.[2] A bank's risk-based capital ratio is calculated by dividing its qualifying capital (the numerator of the ratio) by its weighted risk assets (the denominator).[3] The definition of qualifying capital is outlined below in section II. of this appendix A, and the procedures for calculating weighted risk assets are discussed in section III. of this appendix A. Attachment I to this appendix A illustrates a sample calculation of weighted risk assets and the risk-based capital ratio.

* * * * *

5. In Part 208, a new Appendix E is added to read as follows:

Appendix E to Part 208—Capital Adequacy Guidelines for State Member Banks: Market Risk Measure

I. Introduction

A. Overview

1. The Board of Governors of the Federal Reserve System has adopted a framework for determining capital requirements for the market risk exposure of state member banks.[1] For this purpose, market risk is defined as the risk of losses in a bank's on- and off-balance-sheet positions arising from movements in market prices. The market risks subject to these capital requirements are those associated with debt and equity instruments held in the bank's trading account, as well as foreign exchange risk and commodities risk throughout the bank, including options and other derivative contracts in each risk category.

2. Effective December 31, 1997, the market risk measure will be applied to all state member banks that, on a consolidated basis:

a. Have total assets in excess of $5 billion; and either have a total volume of trading activities (measured as the sum of the bank's trading assets and liabilities[2] on a daily average basis for the quarter) that is 3.0 percent or more of the total assets of the bank, or have interest rate, foreign exchange, equity, and commodity off-balance-sheet derivative contracts relating to trading activities whose total notional amounts exceed $5 billion; or

b. Have total assets of $5 billion or less; *and* have trading activities exceeding 10.0 percent of the total assets of the bank.

3. Such banks are still subject to the risk-based capital measure set forth in appendix A of this part, subject to the exclusion of certain assets specified in this appendix E. However, these banks must calculate their market risk-equivalent assets and determine risk-based capital ratios adjusted for market risk in accordance with this appendix E.[3]

4. The market risk measure provides two ways for a bank to determine its exposure to market risk. A bank may use its internal risk measurement model, subject to the conditions and criteria set forth in section III. of this appendix E (referred to as the internal models approach), or when appropriate, a bank may use all or portions of the alternative measurement system described in section IV. of this appendix E (referred to as the standardized approach).

a. With prior approval from the Federal Reserve, for regulatory capital purposes, a bank may use its internal risk measurement model to measure its value-at-risk[4] for each of the following risk factor categories; interest rates, exchange rates, equity prices, and commodity prices. The value-at-risk amount for each risk factor category should include volatilities of related options. The value-at-risk amount for each risk factor category is

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[1] Some banks are also subject to capital requirements for market risk as set forth in appendix E of this part. Banks that are subject to the market risk measure are required to follow the guidelines set forth in appendix E of this part for determining qualifying and eligible capital, calculating market risk-equivalent assets and adding them into weighted-risk assets, and calculating risk-based capital ratios adjusted for market risk. Supervisory ratios that relate capital to total assets for state member banks are outlined in appendix B of this part and in appendix B to part 225 of the Board's Regulation Y, 12 CFR part 225.

[2] The risk-based capital measure is based upon a framework developed jointly by supervisory authorities from the countries represented on the Basle Committee on Banking Regulations and Supervisory Practices (Basle Supervisors' Committee) and endorsed by the Group of Ten Central Bank Governors. The framework is described in a paper prepared by the Basle Supervisors' Committee entitled ''International Convergence of Capital Measurement,'' July 1988.

[3] Banks generally are expected to utilize period-end amounts in calculating their risk-based capital ratios. When necessary and appropriate, ratios based on average balances may also be calculated on a case-by-case basis. Moreover, to the extent banks have data on average balances that can be used to calculate risk-based ratios, the Federal Reserve will take such data into account.

[1] The market risk measure is based on a framework developed jointly by supervisory authorities from the countries represented on the Basle Committee on Banking Supervision (Basle Supervisors Committee) and endorsed by the Group of Ten Central Bank Governors. The framework is described in a paper prepared by the Basle Supervisors Committee entitled ''[Proposal to issue a] Supplement to the Basle Capital Accord to Cover Market Risks.'' [April] 1995.

[2] As reflected in the bank's quarterly Consolidated Reports of Condition and Income (call report).

[3] The Federal Reserve may apply all or portions of this Appendix E to other banks when deemed necessary for safety and soundness purposes.

[4] A bank evaluates its current positions and estimates future market volatility through a value-at-risk measure, which is an estimate representing, with a certain degree of statistical confidence, the maximum amount by which the market value of trading positions could decline during a specific period of time. The value-at-risk is generated through an internal model that employs a series of market risk factors (for example, market rates and prices that affect the value of trading positions).