c. A bank may, subject to approval by the FDIC, exclude from its foreign exchange positions any structural positions in foreign currencies. For this purpose, such structural positions are limited to transactions designed to hedge a bank's capital ratios against the effect of adverse exchange rate movements on subordinated debt, equity, or minority interests in consolidated subsidiaries and dotation capital assigned to foreign branches that are denominated in foreign currencies. Also included are any positions related to unconsolidated subsidiaries and to other items that are deducted from a bank's capital when calculating its capital base. In any event, such structural foreign currency positions must reflect long-term policies of the institution and not relate to trading positions.

d. The measure for market risk of commodities applies to a bank's total commodities positions, including commodity futures, commodity swaps, and all other commodity derivatives or other off-balance-sheet positions that are affected by changes in commodity prices. A commodity is defined as a physical product that is or can be traded on a secondary market (such as agricultural products, minerals (including oil), and precious metals), but excluding gold (which is treated as foreign exchange).

II. Qualifying Capital and the Market Risk-Adjusted Capital Ratio

A. Qualifying and Eligible Capital

1. The principal forms of qualifying capital for market risk are Tier 1 capital and Tier 2 capital as defined in, and subject to the conditions and limitations of, section I of appendix A of this part. A bank may use Tier 3 capital for the sole purpose of meeting a portion of the capital requirements for market risk. Tier 3 capital may be allocated only to support market-risk equivalent assets, and may in no event be allocated to support capital requirements associated with risk-weighted assets under appendix A of this part.

2. Tier 3 capital consists of short-term subordinated debt that is subject to a lock-in clause providing that neither interest nor principal payment is due (even at maturity) if such payment would cause the issuing bank to fall or remain below the minimum 8.0 percent risk-based capital requirement as set forth in appendix A of this part and adjusted for market risk.

3. In order to qualify as Tier 3 capital, the short-term debt must be unsecured, subordinated, and fully paid up; it must have an original maturity of at least two years; and it may not be redeemed before maturity without prior approval by the FDIC. In addition, it may not contain or be covered by any covenants, terms, or restrictions that are inconsistent with safe and sound banking practices.

B. Calculation of Eligible Capital and the Capital Ratio

A bank that is subject to the market risk measure must calculate its risk-based capital ratio and eligible capital as follows:

1. Determine total risk-weighted assets under appendix A of this part, excluding from risk-weighted assets:

a. All debt and equity instruments in the trading account required to be included under the measure for market risk, with the exception of over-the-counter derivatives or non-trading account instruments used to hedge trading account instruments and included in the measure for general market risk at the bank's option; and

b. All positions in commodities required to be included under the measure for market risk.

2. Calculate the total measure for market risk using the internal models approach, the standardized approach, or an approved combination of these two approaches:

a. *Internal Models.* i. For a bank approved to use the internal models approach under section III of this appendix C, the total measure for market risk is the higher of:

A. The bank's previous day's aggregate value-at-risk amount; or

B. An average of the daily aggregate value-at-risk amounts measured on each of the preceding 60 business days multiplied by a minimum ''multiplication factor'' of 3. The FDIC may adjust the multiplication factor for a bank to increase its capital requirement based on an assessment of the quality and historic accuracy of the bank's risk management system.

ii. Additionally, if a bank's internal model does not capture the specific risk of debt and equity instruments in the trading account,[9] the specific risk measure as calculated under the standardized approach may be added to the bank's measure for market risk.

b. *Standardized Approach.* A bank that has not obtained the FDIC's approval to use an internal model must use the standardized approach for measuring its market risk. For a bank using this approach, the total measure for market risk is the sum of the market risk measures for debt and equity instruments in the trading account, foreign exchange and commodities risk throughout the bank, and options and other derivative positions in each risk category as set forth in sections IV.A through IV.E. of this appendix C.

c. *Partial Models.* With approval from the FDIC, a bank whose internal model does not cover all risk factor categories may use the standardized approach for measuring market risk arising from the risk factor categories that are not covered. The FDIC will approve combining the two approaches only on a temporary basis in situations in which the institution is developing but has not fully implemented a comprehensive internal model. When a bank uses both approaches, each risk factor category (i.e., interest rates, equity prices, exchange rates, and commodity prices) must be measured using one or the other approach. The methods may not be combined within a single risk factor category. Once a bank adopts an acceptable internal model for a particular risk factor category, it may not revert to the standardized approach except in unusual circumstances and with the prior approval of the FDIC.[10] For a bank using a combination of approaches, the total measure for market risk is the sum of:

i. The appropriate value-at-risk measure (as determined in paragraph B.2.a. of this section, aggregating the value-at-risk measure for each risk factor category included in the internal model); and

ii. The measure for market risk for each risk factor category that is calculated using the standardized approach.

3. Calculate the market-risk equivalent assets by multiplying the total measure for market risk by 12.5 (i.e., the reciprocal of the 8.0 percent minimum risk-based capital ratio).

4. Add the market-risk equivalent assets to total risk-weighted assets (as determined in paragraph B.1. of this section). The sum of these two amounts is the denominator of the total risk-based capital ratio, adjusted for market risk.

5.a. In order to calculate eligible capital to be included in the numerator of the ratio, a bank must first allocate the qualifying Tier 1 and Tier 2 capital necessary to support total risk-weighted assets (as determined in paragraph B.1. of this section) in accordance with the terms and restrictions of section I of appendix A of this part, achieving at least the minimum supervisory ratio in section III. of appendix A of this part. Remaining Tier 1, eligible Tier 2, and eligible Tier 3 capital should then be allocated to support market-risk equivalent assets (as determined in paragraph B.3. of this section), achieving at least a minimum supervisory ratio of 8.0 percent, subject to the following restrictions:

i. Eligible Tier 3 capital may not exceed 250 percent of a bank's Tier 1 capital allocated for market risk;

ii. Tier 2 elements may be substituted for Tier 3 up to the same 250 percent limit, so long as the overall limits for Tier 2 capital set out in section I of appendix A of this part are not exceeded (i.e., Tier 2 capital may not exceed total Tier 1 capital, and long-term subordinated debt may not exceed 50 percent of Tier 1 capital); and

iii. The maximum eligible amount of Tier 2 and Tier 3 capital, summed together, may not exceed 100 percent of Tier 1 capital.

b. Eligible capital for the total risk-based capital ratio is then the sum of the bank's qualifying Tier 1 capital, its qualifying Tier 2 capital subject to the limits stated in this paragraph and eligible Tier 3 capital subject to the limits stated in this paragraph B.5.[11]

C. Consolidation and Reporting

1. The capital requirements for market risk apply to banks on a worldwide consolidated basis. The FDIC may, however, evaluate market risk on an unconsolidated basis when necessary (for example, when there are

[9] If a bank uses an internal model that measures specific risk of debt and equity instruments in the trading account, the measure should in no case be less than one-half the specific risk measure as calculated under the standardized approach (taking into account the effect of the multiplier under paragraph B.2.a.ii. of this section).

[10] Banks that have modeling capabilities are expected to use their internal models for measuring market risk for regulatory capital purposes. However, the FDIC may permit a bank to use another measurement technique for *de minimis* positions, activities in remote locations, minor exposures in a currency, or in activities that present negligible risk to the bank.

[11] Examples of the method used to calculate eligible capital are set forth in attachment I to this appendix C.