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Comptroller of the Currency  
Administrator of National Banks

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Washington, DC 20219

September 18, 2008

**Interpretive Letter #1104  
December 2008**

Dear [ ]:

This is in response to your letter dated April 1, 2008, seeking approval to assign a 10% risk weight to certain margin loans made by [ ] (the Bank) to institutional clients on terms equal to or more restrictive than the initial and ongoing margin requirements in the Federal Reserve Board's Regulations T and U (12 CFR parts 220 and 221, respectively) (Reg T and Reg U) and the New York Stock Exchange's (NYSE) Rule 431. Pursuant to 12 CFR §3.4(b), for the reasons and in accordance with the conditions set forth below, the OCC grants the Bank's request to assign a 10% risk weight to the margin loans at issue.

### **Description of the Loans**

Reg U applies to loans made by the Bank to customers for the purpose of buying or carrying margin stock. These loans are collateralized by margin stock as defined in Reg U. The Bank proposes to apply the requested risk-based capital treatment only to loans that satisfy both the requirements of Reg U and the more stringent requirements of Reg T and Rule 431 of the NYSE (Bank Margin Loans). These Bank Margin Loans are made only to institutional clients. In addition, you describe the Bank Margin Loans as having low credit risk because of (1) the initial margin requirements equal to or in excess of the Reg T requirements, (2) the ongoing margin maintenance requirements of NYSE Rule 431, (3) the Bank's internal policies with respect to ongoing margin maintenance requirements that are generally higher than those of Rule 431, (4) the Bank's daily mark-to-market and margin call policies, and (5) the Bank's general protection from the automatic stay in bankruptcy with respect to the Bank Margin Loans.

The initial margin requirements and ongoing margin maintenance requirements under Reg U, Reg T, and Rule 431 result in overcollateralization of the margin loans. For example, a customer who seeks to purchase a \$100 equity security may only borrow \$50 against that security under the terms of the margin loan agreement. The \$100 equity security collateralizes the \$50 loan. The Bank must mark-to-market the security daily and monitor the value of the security compared to the \$50 loan amount. If the market value of the security decreases below the 25% ongoing margin maintenance requirement of Rule 431 for equity securities, the Bank must make a margin

call and request the customer to post additional collateral. For example, if the value of the security falls to \$65, the equity in the account would fall to \$15 (\$65 security value less the \$50 loan amount.) Under the 25% ongoing margin maintenance requirement, the customer's equity must be at least 25% of the securities value, or \$16.25 in the example. If the customer fails to post additional collateral in response to the margin call, the Bank would sell sufficient securities pledged as collateral to increase the margin to the required maintenance level.

### **Current Risk-Based Capital Treatment**

Under the Office of the Comptroller of the Currency's (the OCC's) current risk-based capital rules (12 CFR Part 3, Appendix A), the capital treatment for a collateralized loan depends on the type of collateral posted by the borrower. If the borrower posts cash, securities issued or guaranteed by the United States Government, a United States Government-sponsored agency or the central government of an Organization for Economic and Cooperation and Development member (eligible collateral) as collateral and the transaction meets certain requirements, the Bank would be able to recognize the risk reducing benefits of the collateral by assigning the risk weight appropriate for the collateral to the collateralized portion of the loan.<sup>1</sup> Appendix A to the risk-based capital rules does not provide for the recognition of other types of collateral (ineligible collateral) and requires the Bank to assign the risk weight of the borrower to loans collateralized by ineligible collateral. Since Bank Margin Loans generally would be collateralized by ineligible collateral such as corporate equity and debt securities, the Bank would use the risk weight appropriate for the borrower without any recognition of the risk mitigating benefits of the collateral, which would typically result in a 100% risk weight for these types of margin loans.

### **Alternative Risk-Based Capital Approach**

The Bank is requesting approval for an alternative approach to determining the risk-based capital requirement for Bank Margin Loans. In the proposed alternative approach, the Bank would assign a risk weight of 10% to the principal amount of the loans in recognition of the pledged collateral, risk management policies surrounding the loans and resulting low credit risk of the loans.

Under the OCC's reservation of authority in 12 CFR § 3.4(b), on a case-by-case basis, the OCC may look to the substance of a transaction and assign a risk weight to an asset that more appropriately reflects the risks of that transaction. The OCC believes that the proposed alternative risk-based capital treatment described above more appropriately reflects the risks of the Bank Margin Loans described in this letter than the approach of 12 CFR Part 3, Appendix A. The OCC has reached this conclusion based on the low credit risk of the Bank Margin Loans resulting from the application of the Reg T initial margin maintenance requirements, the ongoing margin maintenance requirements of NYSE Rule 431, and the Bank's own internal policies and risk management of the business line as evidenced by the Bank's de minimis internal economic capital charge on the loans. This conclusion is based on the Bank's compliance with the conditions described below.

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<sup>1</sup> 12 CFR 3 Appendix A Section 3(a)(1)(viii) and Sections 3(a)(2)(iv) and (viii).

## **Conditions of the Alternative Risk-Based Capital Approach**

Only the Bank Margin Loans described in this letter are eligible for the risk-based capital treatment described above. In order to qualify for the risk-based capital treatment described above, the Bank Margin Loans must meet the following conditions:

1. The securities collateral for the Bank Margin Loans are liquid and readily marketable;
2. The Bank Margin Loans and associated collateral are marked to market daily;
3. The Bank Margin Loans are subject to the initial margin requirements under Reg T and daily margin maintenance requirements under NYSE Rule 431; and,
4. The Bank has conducted sufficient legal review to conclude with a well-founded basis (and maintained sufficient written documentation of that legal review) that it would be able to liquidate the collateral for the Bank Margin Loans without undue delay even in the event of a bankruptcy or insolvency of the borrower.

## **Conclusion**

Use of the alternative approach to calculate risk-based capital for the Bank Margin Loans described in this letter is dependent upon the loans and the Bank's risk management practices continuing to be in compliance with the conditions detailed in this letter. This approval and the activities and communications by OCC employees in connection with the bank's request do not constitute a contract, express or implied, or any other obligation binding upon the OCC, and do not affect the ability of the OCC to exercise its supervisory, regulatory and examination authorities under applicable law and regulations. Consequently, if in the future a change to the OCC's regulations results in a different approach to the calculation of risk-based capital charges for the loans described in this letter, the Bank would be subject to those revised regulations, notwithstanding this letter.

The OCC's determination is specifically conditioned on compliance by the Bank with all the commitments and representations it made in connection with its request, as well as the conditions imposed in this letter. This determination is based on the specific facts and circumstances of the Bank Margin Loans described in your correspondence and this letter. Any material change in those facts and circumstances or any failure by the Bank to observe any of its commitments or representations may result in a different view or in a revocation of the exception. Please be advised that the conditions of this approval are conditions "imposed in writing by the agency in connection with the granting of any application or other request" within the meaning of 12 U.S.C. § 1818 and, as such, are enforceable under 12 U.S.C. § 1818.

If you have further questions, please do not hesitate to contact the [ ], Examiner-in-Charge on [ ], or Margot Schwadron in the Capital Policy Division on 202-874-6022.

Sincerely,

*Signed*

Amrit Sekhon  
Director  
Capital Policy