CAPITAL COMPONENTS & RISK-BASED CAPITAL

This appendix is an abbreviated summary from the Capital Regulation. Refer to the regulation in 12 CFR §567 for important details and other items not included in this appendix. You will find relevant definitions in §567.1. We have organized this Appendix as follows:

- Composition of Capital.
- Risk-based Capital.
- Risk-based Capital Treatment for Recourse Exposures, Direct Credit Substitutes, and Residual Interests.

COMPOSITION OF CAPITAL

Tier 1 (Core) Capital

Tier 1 (core) capital includes:

- GAAP capital.

Less

- Investments in and advances to nonincludable subsidiaries.
- Goodwill and other intangible assets.
- Equity instruments not qualifying for Tier 1 capital[1] (for example, cumulative preferred stock).
- Servicing assets and purchased credit card relationships (PCCRs) in excess of limitations (see §567.12).
- Disallowed deferred tax assets (see Thrift Bulletin No. 56).
- Credit-enhancing interest-only strips in excess of 25 percent of Tier 1 capital (see §567.5 and §567.12).
- Accumulated gains on certain available-for-sale debt and equity securities[1] and qualifying cash-flow hedges.[2]

Plus

- Minority interests in equity accounts of fully consolidated includable subsidiaries.
- Mutual thrift nonwithdrawable and pledged deposit accounts.
- Accumulated losses on certain available-for-sale debt securities,[1] and accumulated losses on qualifying cash-flow hedges.[2]

Tier 2 (Supplementary) Capital

Tier 2 (supplementary) capital includes:

- Permanent capital instruments such as:
  - Mutual capital certificates and nonwithdrawable accounts not counted for Tier 1 capital.
  - Cumulative perpetual preferred stock.
  - Qualifying subordinated debt.
- Maturing capital instruments (for example, non-perpetual preferred stock).
- Allowance for loan and lease losses (ALLL) up to 1.25 percent of risk-weighted assets.
- Up to 45 percent of unrealized gains, net of unrealized losses on available-for-sale equity securities with readily determinable fair values.

Note: Tier 2 capital may not exceed Tier 1 capital.

Total (Risk-based) Capital

A thrift's total (risk-based) capital is the sum of:

[1] Refer to the TFR instructions. The purpose is to exclude certain components of GAAP capital that are not part of common stockholders' equity under regulatory capital definitions.

[2] Refer to the December 1998 interagency statement, "Interim Guidance on the Regulatory Reporting and Capital Treatment of Derivatives."

- Tier 1 capital.

Plus

- Tier 2 capital (to the extent that Tier 2 capital does not exceed 100 percent of Tier 1 capital).

Less

- Reciprocal holdings of the capital instruments of another depository institution.
- Equity investments (using the definition of equity investments in §567.1).
- Low-level recourse exposures and residual interests that the thrift chooses to deduct using the simplified/direct deduction method excluding:
  - — The credit-enhancing interest-only strips already deducted from Tier 1 capital. (See low-level recourse and residual examples further below.)

RISK-BASED CAPITAL

General Description

The risk-based capital requirement captures primarily credit risk from on-balance-sheet assets and most off-balance-sheet commitments and obligations. OTS requires a thrift to maintain a total risk-based capital ratio equal to at least 8 percent of assets after risk weighting. Most thrifts have a risk-based capital ratio of 10 percent or higher in order to manage a well capitalized status.

You determine a thrift's risk-weighted assets by allotting assets among the risk-weight categories. There are four standard risk-weight categories: 0 percent, 20 percent, 50 percent, and 100 percent.[3] The risk weight depends upon the nature of the assets, obligors, and collateral. In general, if a particular item can be placed in more than one risk category, you may assign it to the category that has the lower risk weight. However, the following procedures apply:

- You convert off-balance-sheet commitments and exposures to credit equivalent amounts by a conversion factor. You then risk weight the credit equivalent amounts in accordance with the rules used for on-balance-sheet assets.
- Many recourse exposures and direct credit substitutes generally require a gross-up capital treatment.
- Most residual interests receive a dollar-for-dollar capital treatment.

Assuming the PCA category of adequately capitalized, the effect of this risk weighting approach is the following:

Risk Weight Bucket	Effective Capital Charge
0%	No capital charge
20%	1.6%
50%	4.0%
100%	8.0%
200%	16.0%
Dollar-for dollar	100.0%

Risk Weights: On-Balance-Sheet Assets

Asset types not specifically addressed in the regulation automatically receive a 100 percent risk weight unless OTS determines that a different risk weight, or a different capital treatment is appropriate. Below is a general summary of the risk weight buckets:

0 Percent Risk-Weight Category

This category is for the lowest risk assets. This category includes:

- Cash.

[3] There is also a 200% risk weight-category used in the ratings-based approach. In addition, certain items receive a dollar-for-dollar capital treatment, equivalent to a risk weighting of 1250% (the reciprocal of 8%). See the Recourse section later in this Appendix.

- Obligations of, or fully guaranteed by, the full faith and credit of the United States Government (includes most GNMA obligations).
- Balances at Federal Reserve Banks.

20 Percent Risk-Weight Category

This category is for very high credit-quality assets. The 20 percent risk-weight category includes:

- Securities issued by or guaranteed by government sponsored agencies (including Fannie and Freddie for example), <u>*except for*</u> *their principal only securities (POs), interest-only securities (IOs)*, and their equity securities.
- Claims on, balances due from, and stock of the Federal Home Loan Banks.
- Items collateralized by cash held in a segregated deposit account at the thrift.
- The portion of assets collateralized by the current market value of U.S. Government securities.
- Assets conditionally guaranteed by the U.S. Government or its agencies.
- General obligations of state and local governments.
- Claims on domestic depository institutions.
- Asset-backed securities rated AAA or AA under the ratings-based approach, but excluding stripped securities.
- Certain claims on, or guaranteed by, qualifying securities firms.

  A *qualifying securities firm* in the United States is a broker-dealer registered with the Securities and Exchange Commission (SEC) that complies with the SEC's net capital regulations. A different definition applies to foreign-based firms. (See § 567.1.)

  For a claim on, or guaranteed by, a qualifying securities firm to qualify for 20 percent risk weight, the firm must have a long-term issuer credit rating, or a rating on at least one issue of long-term unsecured debt, from a nationally recognized statistical rating organization (NRSRO). The rating must be in one of the three highest investment grade categories used by the NRSRO. If two or more NRSROs assign ratings to the firm, the thrift must use the lowest rating to determine whether it meets the rating requirement. The firm may rely on the rating of its parent consolidated company *if the parent guarantees the claim*.

  A collateralized claim on a qualifying securities firm does not have to comply with the rating requirement if it meets all of the following requirements:

  — It is a reverse repurchase/repurchase agreement or securities lending/borrowing transaction executed using standard industry documentation.

  — It is collateralized by debt or equity securities that are liquid and readily marketable.

  — It is marked to market daily.

  — It is subject to a daily margin maintenance requirement under the standard industry documentation.

  — It can be liquidated, terminated or accelerated immediately in bankruptcy or similar proceeding, and the security or collateral agreement will not be stayed or voided under applicable law.

50 Percent Risk-Weight Category

This risk-weight category is for high credit quality assets. The 50 percent risk-weight category includes:

- Qualifying mortgage loans.
- Qualifying multifamily mortgage loans.
- Qualifying residential construction loans.
- Privately issued securities (excluding stripped or subordinated securities) backed by qualifying one- to four- family or multifamily mortgage loans – where the underlying loans are eligible for 50 percent risk weight.
- Most state and local revenue bonds.

- Asset-backed securities rated "A" under the ratings-based approach, but excluding stripped securities.

Qualifying mortgage loans are residential first mortgage loans on houses, condominiums, cooperative units, and manufactured homes. You do not include boats, motor homes, and time-share properties, even if they are a primary residence. Loans must not be over 90 days past due. You include mortgage loans on mixed-use properties that are primarily one- to four-family if they meet the qualifying criteria. If a thrift holds the first and junior lien(s) on a property, and no other party holds an intervening lien, you treat the transaction as a single loan secured by a first lien. Refer to 12 CFR §567.1 for the definition of qualifying mortgage loans. Note that the definition refers to and incorporates loan to value (LTV) criteria from the real estate lending guidelines in §560.101. Loans above 90 percent LTV will not typically qualify for 50 percent risk weight unless they have acceptable private mortgage insurance or other appropriate credit enhancement to effectively reduce their LTV to 90 percent or less.

Qualifying multifamily mortgage loans must meet the specific criteria of the regulation that tracks a federal statute. (Refer to the definition in 12 CFR §567.1.)

Qualifying residential construction loans must meet the specific criteria of the regulation. (Refer to 12 CFR §567.1.)

100 Percent Risk-Weight Category

This is the standard risk-weight category. You place assets not assigned another risk weighting in this category (excluding assets deducted from capital and residual interests which have a dollar-for-dollar capital requirement). You include the following in the 100 percent risk-weight category:

- Commercial loans and commercial real estate loans.
- Consumer loans.
- Second mortgage and home equity loans (except where you combine them with a qualifying first mortgage – see qualifying mortgage loan explanation above).
- Single-family and multifamily housing loans that do not qualify for the 50 percent risk-weight category.
- Construction loans.
- Mortgage-backed securities not qualifying for a lower risk-weight category, including most stripped securities (POs and IOs) issued by government sponsored agencies (but excluding subordinated classes, and excluding securities backed by subprime assets).
- Corporate debt securities.
- Bonds issued by a state or local government where a private party is responsible for payment.
- Repossessed assets and loans 90 days past due.
- Asset-backed securities rated "BBB" under the ratings-based approach, but excluding stripped securities.

Ownership in Mutual Funds (and other pooled assets)

For investments in investment companies, such as mutual funds, there are two alternatives:

- You may assign the entire investment to the risk-weight category applicable to the riskiest asset held in the investment company portfolio.
- You may assign different risk weights to the fund on a pro-rata basis, according to the investment limits for the different investment categories in the fund's prospectus.

The lowest risk weight for a mutual fund is 20 percent.

Off-Balance-Sheet Risk Exposures

Credit Conversion Factors for Off-Balance-Sheet Items

You determine risk weights for most off-balance-sheet items in a two-step process. First, you multiply the face amount of the item by a credit conversion factor to get the balance sheet credit equivalent amount. You then risk weight the credit equivalent amount based on the nature of the collateral, the obligor, or type of asset.

Example: Conversion of an off-balance-sheet item

The thrift has extended a $30,000 home equity line of credit with a multi-year term. The borrower has not yet drawn the $30,000 and the line of credit remains unfunded. As shown in the bulleted list below, the conversion factor for home equity lines of credit for terms over one year is 50 percent. Assume that the line qualifies for 50 percent risk weight under the definition of qualifying mortgage loan (that is, where it may be combined with the first mortgage and there is no intervening lien – explained above in the 50 percent risk weight section).

- You multiply the unfunded line by the 50 percent conversion factor: $30,000 x 50% = $15,000.
- You then risk weight the $15,000 that you calculated. $15,000 x 50% risk weight = a $7,500 risk-weighted asset.
- You multiply the risk-weighted asset x the 8% risk-based capital requirement. $7,500 x 8% = $600.

As a result, the thrift must hold $600 in capital for the unfunded $30,000 line.

Note: For recourse exposures, direct credit substitutes, and subordinate exposures (other than residual interests), you generally must first gross-up the entire group of assets or total exposure that the off-balance-sheet item supports.

There are four credit conversion factor groups: 0 percent, 20 percent, 50 percent, and 100 percent.

0 Percent Credit Conversion Factor Group

This group includes:

- The unused portion of unconditionally cancelable retail credit card lines.
- Unused commitments (including LIP) with an original maturity of one year or less. (*This applies to most commitments to originate 1-4 family loans*).

LIP and other unused commitments with an original maturity over one year *if* they are unconditionally cancelable at any time at the thrift's option *and* the thrift either: (1) makes a separate credit decision before honoring each draw, or (2) at least annually performs a credit review to determine whether or not the lending facility will continue.

20 Percent Credit Conversion Factor Group

This group is for a narrow set of trade-related contingencies. That is, short-term, self-liquidating instruments used to finance the movement of goods and collateralized by the underlying shipment. A commercial letter of credit is an example of such an instrument.

50 Percent Credit Conversion Factor Group

This group includes:

- Unused portions of commitments, including home equity lines of credit, with an original maturity exceeding one year.
- Most LIP commitments with an original maturity over one year.
- Transaction-related contingencies such as performance bonds and performance-based standby letters of credit related to a particular transaction. For example, arrangements backing subcontractors' and suppliers' performance, labor and materials contracts, and construction bids.

100 Percent Credit Conversion Factor Group

This group includes:

- Guarantees or financial guarantee-type standby letters of credit.
- Recourse arrangements.
- Forward agreements with a certain drawdown. For example, legally binding agreements to purchase assets at a specified future date.

- Risk participations purchased in bankers acceptances.

Interest-Rate and Foreign Exchange-Rate Contracts

The credit equivalent amount of an interest-rate or exchange-rate contract is the sum of the current credit exposure (that is, the replacement cost of the contract) and the potential future credit exposure of the contract. You calculate this as follows:

Begin with: Replacement value of the contract, that is, the fair value of the contract, but not less than zero.

Add: Potential future credit exposure. To obtain potential future credit exposure you multiply the notional principal amount of the contract by the appropriate credit conversion factor. You can find the conversion factors from the chart:

Remaining Maturity	Interest rate contracts	Foreign exchange rate contracts
One year or less	0.0%	1.0%
Over one year	0.5%	5.0%

Then: Once you determine the credit equivalent amount, you assign it to the risk-weight category appropriate to the counterparty, or, if relevant, to the nature of any collateral or guarantee. However, the maximum risk weight is 50 percent.

Note: There are certain exceptions to the above calculation for foreign exchange contracts with an original maturity of less than 14 days, and for interest rate and exchange rate contracts traded on an exchange requiring the daily payment of variations in the market value of the contract. Thrifts may use bilateral netting to compute the net replacement value for multiple contracts with the *same* counterparty under certain conditions specified in the regulation.

RISK-BASED CAPITAL TREATMENT FOR RECOURSE, DIRECT CREDIT SUBSTITUTES, AND RESIDUAL INTERESTS

On November 29, 2001, OTS and the other federal banking agencies issued a capital rule for recourse, direct credit substitutes, and residual interests in asset securitizations. The capital rule addresses many aspects of risk resulting from asset securitization. While it integrates some aspects of OTS's previously existing capital rules and guidance for recourse and direct credit substitutes, the rule is far more extensive in order to address a very complex, evolving securitization marketplace. This section outlines and highlights some aspects of the rule that should be of interest to many thrifts. However, because of the complex nature of the rule, we recommend that you refer to the rule itself and its extensive preamble published in the federal register, which are available through the OTS web site at: *www.ots.treas.gov/docs/73135.pdf.*.

You can find the definitions pertaining to the rule along with other terms used in the OTS capital regulations in 12 CFR §567.1. The capital treatment from the rule is in §567.6(b). Refer also to CEO Letter No. 162, "Implicit Recourse in Asset Securitizations," and to CEO Letter No. 163, "Capital Treatment of Recourse, Direct Credit Substitutes, and Residual Interests in Asset Securitizations." OTS issued these CEO letters on May 23, 2002. They provide important supplementary information.

Through the rule's reservation of authority, OTS looks to the substance of a transaction regardless of how others categorize the allocation of risk. OTS may find that the proposed capital treatment by the thrift does not appropriately reflect risk to the thrift. OTS may then require the thrift to apply another risk weight, conversion factor, or treatment that OTS deems appropriate.

This part contains three sections:

- Capital Treatment for Recourse and Direct Credit Substitutes.
- Capital Treatment for Residual Interests.
- The Ratings-based Approach.

Capital Treatment for Recourse and Direct Credit Substitutes

Recourse

The term recourse refers to a thrift's retention, in form or in substance, of any credit risk directly or indirectly associated with an asset it has sold. A recourse obligation typically arises when a thrift transfers an asset in a sale (a sale according to generally accepted accounting principles) and retains an obligation to repurchase the asset or to otherwise absorb losses on the asset. Examples of recourse obligations include:

- Assets sold under an agreement to repurchase.
- Credit-enhancing representations and warranties related to sold assets.
- Retained loan servicing with an agreement under which the thrift is responsible for losses associated with the loans serviced (except for servicer cash advances as defined in §567.1).
- Clean-up calls on assets sold (except for clean-up calls that are 10 percent or less of the original pool balance and that are exercisable at the option of the thrift).
- Credit derivatives that absorb more than the thrift's pro rata share of losses on transferred assets.
- Loan strips sold where the maturity of the transferred portion of the loan is shorter than the commitment under which the loan is drawn.

Recourse can also exist implicitly. Implicit recourse arises when a thrift repurchases assets, absorbs losses, or otherwise supports assets that it has sold, in instances where it is *not contractually required* to do so. Refer also to CEO Letter No. 162.

As with other off-balance-sheet exposures, you must convert a recourse exposure to an on-balance-sheet asset by obtaining a credit equivalent amount.

In the case of a simple loan sale with recourse, which may or may not involve asset securitization, you convert the entire balance of the loans sold to an on-balance-sheet asset using the 100 percent conversion factor.

In many instances a thrift retains a recourse exposure that is limited in dollar amount or as a percentage of assets transferred, but is designed to absorb the first losses that occur for the entire pool of transferred assets. The recourse exposure thus absorbs *more than its pro rata share of losses*. As a result, the general capital treatment for recourse exposures is gross-up, whereby the thrift must hold capital for the full amount of the transferred assets as if they were still on the balance sheet. OTS applies this relatively rigorous capital treatment because the recourse exposure receives more than its pro rata share of risk; it has the concentrated risk of all of the assets senior to it in the pool.

Therefore using the required gross-up approach, you obtain the credit equivalent amount by multiplying the *full amount of the credit-enhanced assets* for which the thrift directly or indirectly retains or assumes credit risk by a *100 percent conversion factor*. You assign this credit equivalent amount to the risk-weight category appropriate to the obligor in the underlying transaction after considering any associated guarantees or collateral. However, the following points apply:

- A thrift does not have to hold recourse capital for qualifying mortgage loans (50 percent risk weight 1-4 family loans) that it has sold, if the sales contract allows only a 120-day period for return of those loans. The thrift must have originated the loans within one year before sale. This exception would apply to a simple loan sale as well as a sale of loans into a securitization.
- There is an exception to the gross-up treatment for low-level recourse exposures where recourse is legally and contractually limited to an amount less than the on-balance-sheet capital requirement. OTS limits the capital requirement to the maximum exposure rather than the full ordinary capital requirement.

- A ratings-based approach allows a thrift to reduce its capital requirement for lower-risk, highly-rated recourse exposures.

Example: Recourse sale of loans

A thrift has sold $100 in qualifying mortgage loans (that is, 50 percent risk weight 1-4 family loans) into a securitization with an agreement to repurchase them for up to 180 days. Until the recourse period expires, total risk-weighted assets must include: ($100) x (100 percent conversion factor) x (50 percent r.w.) = $50. Thus, the capital requirement is: $50 x 8% = $4

Note: If the sales agreement limited the recourse to 120 days or less, there would be no capital requirement.

Example: Low-level recourse

A thrift contractually limits its maximum recourse exposure to less than the normal on-balance-sheet capital requirement for the assets sold with recourse. For example, if a thrift sells a $100,000 mortgage loan with 1 percent recourse, it is liable for $1,000 in losses, OTS requires the thrift to deduct $1,000 in computing the numerator for risk-based capital.

(This is in lieu of the thrift holding $4,000 in capital - assuming the loan qualifies for 50 percent risk weight).

The thrift may report this capital requirement in either of two ways: (1) a simplified/direct deduct approach where the thrift deducts the amount for computing total risk-based capital; or (2) a risk-weighted approach where the thrift multiplies the exposure by 12.5 (the reciprocal of 8%). In the risk-weighted method the thrift multiplies the $1,000 capital requirement by 12.5 for a risk-weighted asset of $12,500. Then, when the thrift multiplies $12,500 times the 8% risk-based capital requirement, the result is a $1,000 capital charge.

Direct Credit Substitutes

A thrift can guaranty, purchase, or assume a recourse exposure from another organization. We generally refer to these exposures as *direct credit substitutes*. A purchased subordinated security is an example of a direct credit substitute. Direct credit substitutes can be on- or off-balance-sheet. Examples of direct credit substitutes include:

- Financial standby letters of credit that support financial claims on a third party that exceed the thrift's pro rata share of the financial claim.
- Purchased subordinated interests that absorb more than their pro rata share of losses from the underlying assets.

When a thrift purchases a *subordinated asset-backed security* or similar interest, the thrift generally must gross-up the risk exposure in order to determine the capital requirement. This means that the thrift must hold capital against the total amount of the subordinated security plus all assets senior to it. However, the low-level recourse rule can apply to direct credit substitutes, and the ratings-based approach may also apply.

Example: Direct credit substitute – gross-up treatment

A thrift has purchased the first dollar loss subordinated interest of $5 in a securitization of $100 in qualifying mortgage loans (1-4 family 50% risk weight loans). The thrift must gross-up its exposure to include all exposures that are more senior to the security that the thrift owns. Thus the thrift must convert the $100 balance of the pool to an on-balance sheet asset at a 100% conversion factor. Then, the thrift risk weights the loans at 50%, resulting in $50 in risk-weighted assets. The capital requirement is $50 times 8 percent = $4.

Note: This example assumes that the first dollar loss position is **not** a credit-enhancing I/O strip (see Residual Interests below).

Capital Treatment for Residual Interests

Residual interests are on-balance-sheet risk exposures arising from sales (transfers) of financial assets that expose a thrift to credit risk on those transferred assets that exceeds a pro rata share of any claim that the thrift has on the assets. Residual interests do not include interests purchased from a third party, except for credit-enhancing interest-only strips. A primary example of a residual is a *retained* subordinated interest in assets formerly owned by the thrift.

The standard capital treatment for most residual interests is *dollar-for-dollar*. That is, the thrift must hold one dollar in capital for every one dollar in residual interests.

Example: Residual interests

A thrift has retained the first dollar loss subordinated interest of $15 in *its own securitization* of $100 in qualifying mortgage loans (50% risk weight 1-4 family). The risk-based capital requirement is $15, that is, $1 of capital for $1 of residual interests – dollar-for-dollar capital.

Similar to the low-level recourse example, the thrift may report this capital requirement in either of two ways:

- A simplified/direct deduct approach where the thrift deducts the amount for computing total risk-based capital.
- A risk-weighted approach where the thrift multiplies the exposure by 12.5 (the reciprocal of 8%).

In the risk-weighted method the thrift multiplies the $15 capital requirement by 12.5 for a risk-weighted asset of $187.5. Then, when the thrift multiplies $187.5 times the 8% risk-based capital requirement, the result is a $15 capital charge.

Credit-enhancing Interest-only Strips

Credit-enhancing interest-only strips (CE I/Os), whether retained or purchased, pose higher risk than most other residuals. If a thrift has a concentration of more than 25 percent of Tier 1 capital in CE I/Os, it must *deduct from Tier 1 capital*, the portion of CE I/Os that exceeds 25 percent of Tier 1 capital.

Example: Credit-enhancing I/O strip:

A thrift has the first dollar loss subordinated interest (whether retained or purchased) that is a credit-enhancing I/O strip, of $15 in a securitization of subprime auto loans. Tier 1 capital is $40 at onset. The thrift does not have any other CE I/Os.

- 25 percent of $40 is $10. $15 exceeds $10 by $5, so you deduct $5 in computing Tier 1 capital.
- Tier 1 capital is $35. ($40 - $5 = $35.)
- The thrift must also hold $10 in *risk-based* capital for this exposure because you deduct the same amount, $5, as above from the $15 I/O strip. The thrift must hold dollar-for-dollar risk-based capital against the remaining balance.

The Ratings-based Approach

The ratings-based approach allows for the possibility of a lower risk-based capital requirement (reflecting less risk) for certain recourse, direct credit substitutes, and residual interests arising from asset securitization. Ratings must be from one or more NRSROs, for example Standard & Poors, Moody's, and Fitch Ratings. Exceptions to the ratings-based approach include:

- Credit-enhancing I/O strips are *not* eligible for the ratings-based approach.
- Bonds not in security form are not eligible.
- Bonds not backed by assets are not eligible.

In general, the following schedule applies to long-term ratings:

Long-Term Rating Category	**Examples**	**Risk Weight**
Highest or second highest investment grade	AAA or AA	20%
Third highest investment grade	A	50%
Lowest investment grade	BBB	100%
One category below investment grade	BB	200%
More than one category below investment grade, or unrated	B or unrated	Not eligible for ratings-based approach.

Note: There is also a separate short-term rating table. Refer to the regulation.

The ratings-based approach makes a distinction between "traded" and "nontraded" positions. Nontraded positions require:

- An external rating by more than one NRSRO.
- Minimum rating assigned by each NRSRO that meets all of the following:
  - — Long term: no worse than one category below investment grade.
  - — Short term: investment grade.
  - — Rating must be publicly available.
  - — Rating must be based on the same criteria as for traded positions.

Note: The capital regulations allow for use of a thrift's internal ratings in limited circumstances *after* initial and ongoing OTS approval. The thrift must use software and ratings that correspond credibly and reliably to the NRSRO ratings.

Program Ratings

A thrift can use *program ratings* for certain risk exposures in particular secondary market loan programs. A thrift may make use of program ratings *after* OTS has reviewed the nature of the program and accepts, under specific conditions, a rating assigned to a particular risk exposure that the thrift retains. The rating must correspond credibly and reliably with an NRSRO rating, for example AA.