Issue of Concern: Credit Enhancing Representations (removal of 120 day safe harbor)

Under the Basel III Standardized proposal, if a banking organization provides a credit enhancing representation or warranty on assets it sold or otherwise transferred to third parties, including in cases of early default clauses or premium-refund clauses, the banking organization would treat such an arrangement as an off-balance sheet guarantee and apply a 100 percent credit conversion factor to the transferred loans while credit-enhancing representations and warranties are in place. Under the current general risk-based capital framework, risk based capital charges do not apply to residential mortgages once they are sold to third parties, even where the seller provides representations and warranties to take back mortgages that experience very early payment defaults (*i.e.*, within 120 days of sale of the mortgages).

Why was this an issue:

The proposed change would result in substantial additional capital charges for a significant volume of sold mortgages.

Final Rule:

In response to the comments, **the final rule retains the 120 day safe harbor** in the definition of the credit-enhancing representations and warranties for early default and premium refund clauses on residential mortgages that qualify for the 50% risk weight.