



**FEDERAL RESERVE BANK OF DALLAS**

**DALLAS, TEXAS 75222**

**Circular No. 76-93  
July 6, 1976**

**AMENDMENTS AND INTERPRETATION  
TO REGULATIONS D AND Q**

**TO ALL MEMBER BANKS  
AND OTHERS CONCERNED IN THE  
ELEVENTH FEDERAL RESERVE DISTRICT:**

On June 16, 1976, the Board of Governors of the Federal Reserve System adopted amendments to Regulation D (Reserve Requirements) and Regulation Q (Interest on Deposits) intended to provide greater flexibility to banks in adding to their capital structure. In addition, the Board made public the criteria it will use in evaluating requests by state member banks for approval of new subordinated debt and debenture issues as additions to the bank's capital structure.

A copy of the FEDERAL REGISTER notice announcing the Board's action is enclosed. The amendments and the criteria are effective July 26, 1976. The Comptroller of the Currency is issuing similar criteria for national banks, and the Federal Deposit Insurance Corporation is issuing regulatory amendments substantially similar to those adopted by the Board. In a related action, the Board adopted an interpretation that explains in more detail the amendments with regard to the meaning of average maturity of a serial, sinking fund, or amortized issue of subordinated debt. A copy of this interpretation is enclosed.

For specific proposals to approve the issuance of subordinated notes and debentures as an addition to capital under these new provisions, national banks should contact the Regional Administrator of National Banks, and state member banks should contact Marvin C. McCoy, Examination Department of this Bank, at (214) 651-6274.

For questions on interpretation of these new provisions, please contact Richard B. West, Senior Attorney of our Regulations Department, at (214) 651-6169.

The enclosed amendments and interpretation to Regulations D and Q should be inserted in your Regulations Binder. Additional copies will be furnished upon request to the Secretary's Office of this Bank.

Sincerely yours,  
T. W. Plant  
First Vice President

Enclosures

Extract From  
FEDERAL REGISTER  
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Title 12—Banks and Banking  
CHAPTER II—FEDERAL RESERVE SYSTEM  
SUBCHAPTER A—BOARD OF GOVERNORS OF  
THE FEDERAL RESERVE SYSTEM

[Regs. D and Q]

PART 204—RESERVES OF MEMBER  
BANKS

PART 217—INTEREST ON DEPOSITS

Definition of Deposits—Subordinated  
Notes

The Board of Governors has adopted amendments to Regulations D (12 CFR 204) and Q (12 CFR 217) that are intended primarily to provide greater flexibility in the issuance by member banks of subordinated notes and debentures that are considered part of the bank's capital structure. Regulations D and Q provide, in part, that if subordinated notes issued by a member bank meet certain specified requirements, the funds obtained from issuance of such notes will not be considered a "deposit" of a member bank and, therefore, will not be subject to reserve requirements and interest rate ceilings. The amendments adopted today would (1) modify the present requirement that an obligation have an original maturity of seven years or more to permit an obligation to be issued with an average maturity of seven years or more under certain conditions;<sup>1</sup>

<sup>1</sup> In a related action the Board also has adopted today an interpretation (see following document) that explains in more detail the amendments with regard to the meaning of average maturity of a serial, sinking fund, or amortized issue of subordinated debt.

(2) modify the present requirement that an obligation must be in an amount of at least \$500 to permit exceptions to be made by the appropriate Federal bank regulatory agency to the \$500 minimum denomination (a) to facilitate sale of convertible debt where, in order to satisfy preemptive rights of shareholders, the bank would be required to issue a convertible obligation of less than \$500 face amount, (b) to maintain a ratable unit offering to holders of preemptive rights where a subordinated debt obligation is issued exclusively as a part of a unit including shares of stock that are subject to such preemptive rights, or (c) to satisfy shareholders' ratable claims where an obligation is issued wholly or partially in exchange for shares of voting stock or assets pursuant to a plan of merger, consolidation, reorganization, or other transaction where the issuer will acquire either a majority of such shares of voting stock or all or substantially all of the assets of the entity whose assets are being acquired; (3) require the issuing bank to receive the approval of the appropriate Federal bank regulatory agency of any redemption prior to maturity or any payment pursuant to acceleration of maturity in event of default; and (4) permit the appropriate Federal bank regulatory agency, in exigent circumstances, to grant a waiver from the requirement that scheduled repayments shall be made at least annually and in an amount no less than that made in the prior year.

The amendments approved today are in substantially similar form as proposed by the Board on July 2, 1975 (40 FR 29732). The Board has carefully reviewed all comments received in response to its July proposal. The only substantive changes to the July proposal contained in the amendments adopted by the Board are (1) the proposed alternative 10-year minimum maturity for amortized issues was not adopted; (2) a provision was added that permits the appropriate Federal bank regulatory agency in exigent circumstances to waive the requirements that scheduled repayments shall be made at least annually and in an amount no less than that made in the prior year; and (3) a provision was added requiring that the shortest maturity in a serial note issue shall be at least five years.

These amendments apply to applications for new debt issues acted upon after the effective date of the amendments and would not affect the status of any outstanding issues. In all cases, the appropriate Federal bank regulatory agency is the Comptroller of the Currency for national banks and the Board of Governors for State member banks.

Since 1968, the Board has exempted from reserve requirements of Regulation D and interest rate limits of Regulation Q certain subordinated debt issues of member banks by providing an exception to be definition of deposits under Regulations D and Q. Upon review of the existing regulations, the Board believes that, in certain circumstances, greater flexibility should be available to permit

member banks to receive approval from the appropriate Federal bank regulatory agency for subordinated note and debenture issues that may not conform to the existing regulatory requirements.

Under the amendments, a member bank may issue subordinated obligations with terms providing for regular debt amortization or retirement to begin at any time so long as (1) the weighted average maturity of the obligation is at least seven years, and (2) once the reduction of principal begins, all scheduled repayments of principal shall be made at least annually and the amount to be repaid in any year shall be no less than that in the previous year. However, with regard to serial note issues, the amendments also require that the original maturity of any note in any such issue may be no less than five years. At the time of adoption of this amendment, the Board also issued an interpretation describing the maturity requirements for serial, sinking fund, and amortized issues, and interested parties are requested to review that interpretation.

The Board did not adopt the alternative proposed provision that would have permitted a member bank to issue notes with a 7-year minimum maturity in unamortized issues and a 10-year minimum maturity in amortized issues. A 10-year amortized issue, in effect, would permit a bank to issue an obligation with a 5-year average maturity, and the Board presently believes that an obligation with such an average maturity does not appear to be of a long-term nature so as to be regarded as capital.

The Board believes that the amendment authorizing the granting of exceptions to the \$500 minimum denomination will facilitate issuance of such notes in certain limited situations. In two of those situations, member banks would be permitted to issue notes of smaller denominations to satisfy preemptive rights of stockholders. The third situation in which an exception to the \$500 minimum denomination requirement could be granted is where an issuing bank would be required to issue obligations in face amounts less than \$500 in order to satisfy shareholders' ratable claims in the case of an obligation that is issued wholly or partially in exchange for shares of voting stock or assets pursuant to a plan of merger, consolidation, reorganization, or other transaction in which the issuer will acquire either a majority of such shares of voting stock or all or substantially all the assets of another entity. The amendments providing exceptions to the existing \$500 denomination requirement are intended to provide greater flexibility in very limited circumstances and are not intended to alter the existing requirement that subordinated issues of member banks be issued in denominations of \$500 or more. The Board does not believe these provisions will have a disruptive effect on flows of funds into competing depository institutions. Moreover, since the amendment requires that the shortest maturity permissible in a serial note issue shall be five years, it is expected that the regulation in general will have

no deleterious effects on such flows of funds.

The provision requiring the Federal bank regulatory agency to approve repayment (including payment pursuant to acceleration of maturity) prior to maturity is intended to permit the appropriate Federal bank regulatory agency to assess the impact of such payment on the capital structure of the bank. The Board does not believe that such a requirement will materially alter the market for bank obligations and believes that it is important for the banking supervisor to scrutinize the condition of the issuing bank prior to such repayment.

Effective July 26, 1976, and pursuant to its authority under section 19 of the Federal Reserve Act (12 U.S.C. 461) to define the terms used in that section, its authority to examine member banks under section 9 of the Federal Reserve Act (12 U.S.C. 325), its authority to take action to prevent unsafe and unsound banking practices (12 U.S.C. 1818b), and related provisions of the law, the Board amends Regulation D (12 CFR 204) and Regulation Q (12 CFR 217) as follows:

1. Section 204.1 of Regulation D would be amended by revising the introductory text of paragraph (f) and paragraph (f) (3) (i).

#### § 204.1 Definitions.

(f) *Deposits as including certain promissory notes and other obligations.* For the purposes of this Part, the term "deposits" also includes a member bank's liability on any promissory note, acknowledgment of advance, due bill, banker's acceptance, or similar obligation (written or oral) that is issued or undertaken by a member bank as a means of obtaining funds to be used in its banking business, except any such obligation that:

(3) (i) Bears on its face, in bold-face type, the following:

This obligation is not a deposit and is not insured by the Federal Deposit Insurance Corporation;

is subordinated to the claims of depositors, is unsecured, and is ineligible as collateral for a loan by the issuing bank and also expressly states said provisions on its face; has an original maturity of at least seven years, or, in the case of an obligation or issue that provides for any type of scheduled repayments of principal, has an average maturity<sup>1</sup> of at least seven years<sup>2</sup> and provides that once any such repayment of principal begins, all scheduled repayments shall be made at least annually and the amount repaid in each year is no less than in the prior year; is issued subject

<sup>1</sup> The "average maturity" of an obligation or issue repayable in scheduled periodic payments shall be the weighted average of the maturities of all such scheduled repayments.

<sup>2</sup> In a serial issue, the member bank may offer no note with a maturity of less than five years.

to a requirement that no repayment (other than a regularly scheduled repayment already approved by the appropriate Federal bank regulatory agency), including but not limited to a payment pursuant to acceleration of maturity, may be made without the prior written approval of the appropriate Federal bank regulatory agency;<sup>5</sup> is in an amount of at least \$500, *Except*, That the appropriate Federal bank regulatory agency may approve the issuance of an obligation that is less than \$500 if such lesser amount is necessary (a) to satisfy the preemptive rights of shareholders in the case of a convertible debt obligation, (b) to maintain a ratable unit offering to holders of preemptive rights in the case of an obligation issued exclusively as part of a unit including shares of stock which are subject to such preemptive rights, or (c) to satisfy shareholders' ratable claims in the case of an obligation issued wholly or partially in exchange for shares of voting stock or assets pursuant to a plan of merger, consolidation, reorganization, or other transaction where the issuer will acquire either a majority of such shares of voting stock or all or substantially all of the assets of the entity whose assets are being acquired; and has been approved by the appropriate Federal bank regulatory agency as an addition to the capital structure of the issuing bank; or (ii) meets all of the requirements in the preceding clause except the maturity requirement or the requirement that scheduled repayments shall be in amounts at least equal to those made in a previous year, and with respect to which the appropriate Federal bank regulatory agency has determined that exigent circumstances require the issuance of such obligations without regard to the provisions of this Part; or (iii) was issued or publicly offered before June 30, 1970, with an original maturity of more than two years; or

2. In Regulation D (12 CFR 204) footnotes 5a, 6, 7, and 8 would be renumbered 6, 10, 11, and 12 respectively.

3. Section 217.1 of Regulation Q would be amended by revising paragraph (f) (3) as follows:

§ 217.1 Definitions.

(f) *Deposits as including certain promissory notes and other obligations.* For the purposes of this Part, the term "deposits" also includes a member bank's liability on any promissory note, acknowledgment of advance, due bill, or similar obligation (written or oral) that is issued or undertaken by a member bank principally as a means of obtaining funds to be used in its banking business, except any such obligation that:

(3) (i) Bears on its face, in bold-face type, the following:

This obligation is not a deposit and is not insured by the Federal Deposit Insurance Corporation;

is subordinated to the claims of depositors, is unsecured, and is ineligible as collateral for a loan by the issuing bank and also expressly states said provisions on its face; has an original maturity of at least seven years, or, in the case of an obligation or issue that provides for any type of scheduled repayments of principal, has an average maturity<sup>6</sup> of at least seven years<sup>7</sup> and provides that once any such repayment of principal begins, all scheduled repayments shall be made at least annually and the amount repaid in each year is no less than in the prior year; is issued subject to a requirement that no repayment (other than a regularly scheduled repayment already approved by the appropriate Federal bank regulatory agency), including but not limited to a payment pursuant to acceleration of maturity, may be made without the prior written approval of the appropriate Federal bank regulatory agency;<sup>8</sup> is in an amount of at least \$500, *Except*, That the appropriate Federal bank regulatory agency may approve the issuance of an obligation that is less than \$500 if such lesser amount is necessary (a) to satisfy the preemptive rights of shareholders in the case of a convertible debt obligation, (b) to maintain a ratable unit offering to holders of preemptive rights in the case of an obligation issued exclusively as part of a unit including shares of stock which are subject to such preemptive rights, or (c) to satisfy shareholders' ratable claims in the case of an obligation issued wholly or partially in exchange for shares of voting stock or assets pursuant to a plan of merger, consolidation, reorganization, or other transaction where the issuer will acquire either a majority of such shares of voting stock or all or substantially all of the assets of the entity whose assets are being acquired; and has been approved by the appropriate Federal bank regulatory agency as an addition to the capital structure of the issuing bank; or (ii) meets all of the requirements in the preceding clause except the maturity requirement or the requirement that scheduled repayments shall be in amounts at least equal to those made in a previous year; and with respect to which the appropriate Federal bank regulatory agency has determined that exigent circumstances require the issuance of such obligations without regard to the provisions of this Part; or (iii) was is-

<sup>6</sup> The "average maturity" of an obligation or issue repayable in scheduled periodic payments shall be the weighted average of the maturities of all such scheduled repayments.

<sup>7</sup> In a serial issue, the member bank may offer no note with a maturity of less than five years.

<sup>8</sup> For the purposes of this Part, the "appropriate Federal bank regulatory agency" is the Comptroller of the Currency in the case of a national bank and the Board of Governors in the case of a State member bank.

sued or publicly offered before June 30, 1970, with an original maturity of more than two years; or

4. In Regulation Q (12 CFR 217), footnotes 5a, 6, 6a, and 7 would be renumbered 9, 10, 11, and 12, respectively.

In connection with its adoption of the regulatory amendments described herein, the Board has approved issuance of criteria to be applied in evaluating requests by State member banks for approval of new issues of subordinated notes and debentures "as an addition to the capital structure of the issuing bank." Proposed guideline criteria were released for comment by the Board on July 2, 1975, along with the proposed regulatory amendments, and the Board has revised the proposals based upon its own findings and review of the comments received.

Application of the criteria adopted today is intended to promote the accumulation by debt-issuing State member banks of an adequate cushion of equity capital, protect against excessive concentrations of debt repayment in any one year, and prevent the inclusion of terms in such issues that could be regarded as in conflict with safe and sound banking practices. The Board believes that publication of the criteria will enable banks to better plan their financing alternatives. In applying these criteria to a proposed issue, the Board will consider a full range of financial and other data.

In recognition of the wide differences in the structure, condition, and performance of banks, and particularly in light of temporary or unusual circumstances to which they may be subjected, the adopted criteria are more flexible than those proposed in July. The Board has revised the earnings coverage test, the retained net income test, and the test relating to avoidance of debt repayment concentrations by not specifying numerical standards in these criteria. Furthermore, the Board has incorporated a more general version of the requirement for accumulation of equity over the life of the debt into the retained net income test.

The new criteria also permit a State member bank to include as capital up to \$2 million of subordinated debt issued to a banking organization other than its parent bank holding company. Generally, the Board is opposed to including interbank debt as capital. The \$2 million exemption is for smaller banks that have no alternative source of funds.

In addition, several other changes to the July proposal have been made. The adopted criteria provide as follows: (1) debt to be retired out of the proceeds of a new issue will be excluded in calculation of the ratio of debt to equity, the earnings coverage ratio, and retained net income test; (2) the adjustment for net deficits in nonbank operations of bank holding companies will be eliminated from the earnings coverage calculation; (3) the calculation of the portion of lease payments to be included as fixed charges in the earnings coverage ratio has been modified somewhat; and (4) the Board will not approve debt is-

<sup>5</sup> For the purposes of this Part, the "appropriate Federal bank regulatory agency" is the Comptroller of the Currency in the case of a national bank and the Board of Governors in the case of a State member bank.

sues containing covenants "in conflict with safe and sound banking practices," whereas the previous proposal referred to covenants that "conflict with the public interest." Other minor changes were adopted. The Board believes that all the changes above clarify its intent in establishing criteria and that the changes do not represent a fundamental change in or a more restrictive approach.

In adopting these criteria, it is stressed that supervisory approval of applications for debt issuance by banks is not to be regarded as a substitute for, but rather as a supplement to, normal investor evaluation of the proposed issue.

The Comptroller of the Currency has advised the Board that he is adopting the same criteria for use in evaluating applications from national banks for approval of subordinated debt issues pursuant to 12 CFR 14.5.

**CRITERIA FOR EVALUATING A SUBORDINATED DEBT ISSUE AS AN ADDITION TO THE CAPITAL STRUCTURE OF A STATE MEMBER BANK**

In evaluating a bank's capacity to issue debt under the following criteria, the Board will take into account the full range of financial and other information available to the Board regarding the applicant. Such indicators and considerations include the recent trend and stability of earnings, impact of unusual income and expense developments on recent earnings, recent acquisitions or mergers through purchase of assets, prospective growth of the bank, quality of management, quality of assets, earnings coverage of loan losses, sensitivity of interest income and expense to changes in market rates, degree of reliance on potentially volatile sources of funds, and the relative strength of earnings of nonbank affiliates or subsidiaries. The bank's need for additional capital and the accessibility of additional equity also will be taken into account.

1. *Maximum ratio of debt to equity.* The total amount of subordinated notes and debentures outstanding, including the debt proposed to be issued but excluding any debt to be retired out of the proceeds of the new issue, should not exceed 80 per cent of a bank's equity capital base at time of issuance of the new debt.<sup>1</sup> However, banks with significant asset or management problems generally would not be presumed to be entitled to issue debt capital up to the 80 per cent ceiling.

2. *Earnings coverage of fixed charges.* A State member bank proposing to issue subordinated debt should demonstrate that its recent income record is sufficient to provide abundant assurance of that bank's continuing ability to pay the additional fixed charges out of current earnings.<sup>2</sup>

<sup>1</sup> A bank's equity capital base, for purposes of this test, is considered to include capital stock, surplus, undivided profits, capital reserves, and all reserves for losses on loans, including any related deferred tax liability.

<sup>2</sup> Definitions:

"Income" is defined as income before taxes and before fixed charges, including securities gains and losses, excluding extraordinary charges and credits, and adjusted where necessary to reflect actual net loan loss experience (charge-offs less recoveries) rather than other "provision for loan losses," plus an adjustment for earnings on the proceeds of the proposed issue equal to annual interest charges before taxes on the proposed issue.

"Fixed charges" is defined as annual interest charges before taxes on all existing debt,

3. *Retained net income.* A State member bank proposing to issue subordinated debt should demonstrate that its recent level of retained net income, viewed in conjunction with intended dividend policy, would exceed annual *pro forma* amortization on all subordinated notes and debentures by a sufficient margin to assure that bank's ability to replace each debt issue with equity by maturity.<sup>3</sup>

4. *Avoidance of debt repayment concentrations.* A State member bank proposing to issue subordinated debt should avoid excessive concentration of debt repayment in any one year.

5. *Approval of interbank debt transactions.* In general, the Board does not intend to approve as an addition to the issuing bank's capital structure a subordinated note or debenture issued by a State member bank directly or indirectly (through a holding company or otherwise) to a banking organization other than its parent bank holding company where that issue, together with other subordinated debt outstanding at that bank and held by such banking organizations, would exceed \$3 million unless specifically authorized as such an addition by the Board of Governors upon a presentation and finding of compelling circumstances.<sup>4</sup>

6. *Covenants in conflict with safe and sound banking practices.* No indenture or other contract covering the issuance of a subordinated note or debenture by a State member bank shall include any covenants, restrictions, or other terms that are determined by the Board to be inconsistent with safe and sound banking practices. Examples of such terms are those regarded as impairing the ability of the bank to comply with statutory or regulatory requirements regarding disposition of assets or incurrence of additional debt, limiting the ability of the Board or the chartering authority to take any necessary action to resolve a problem bank situation, or unduly interfering with the ability of the bank to conduct normal banking operations.

net of debt to be retired out of the proceeds of the new issue, plus those on the debt proposed to be issued. Fixed charges on existing debt would include annual interest on all outstanding mortgage debt and subordinated notes and debentures, plus the annual interest component in any payments, net of sublease income, under lease contracts having an original maturity of one year or more (or if the interest component is not readily ascertainable, one-third of annual payments net of sublease income under such contracts may be substituted).

<sup>3</sup> Definitions:

"Retained net income" is defined as net income after taxes minus dividends declared on common and preferred stock. In most circumstances banks which have issued additional shares of equity capital would receive credit for these new issues as if they had been part of retained net income.

"*Pro forma* amortization" is calculated for each issue of subordinated debt, including the proposed new issue but excluding debt to be retired out of the proceeds of the new issue, by dividing the original amount of the issue by the number of years from date of issue to maturity. Total *pro forma* amortization would be the sum of annual *pro forma* amortization for all such subordinated debt issues.

<sup>4</sup> "Banking organization," for purposes of this criterion, is defined as any commercial bank, mutual savings bank, bank holding company, or nonbank affiliate of a bank holding company.

By order of the Board of Governors,  
June 16, 1976.

GRIFFITH L. GARWOOD,  
Assistant Secretary of the Board.

[FR Doc.76-18503 Filed 6-24-76;8:45 am]

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

RESERVES OF MEMBER BANKS

AMENDMENTS TO REGULATION D†

Effective July 26, 1976, Section 204.1(f) is amended to read as stated below. Also, footnotes 5a, 6, 7, and 8 of Regulation D are renumbered 6, 10, 11, and 12, respectively.

SECTION 204.1 — DEFINITIONS

\* \* \* \* \*

(f) **Deposits as including certain promissory notes and other obligations.** For the purposes of this Part, the term "deposits" also includes a member bank's liability on any promissory note, acknowledgment of advance, due bill, banker's acceptance, or similar obligation (written or oral) that is issued or undertaken by a member bank as a means of obtaining funds to be used in its banking business, except any such obligation that:

\* \* \* \* \*

(3) (i) Bears on its face, in bold-face type, the following:

"This obligation is not a deposit and is not insured by the Federal Deposit Insurance Corporation;"

is subordinated to the claims of depositors, is unsecured, and is ineligible as collateral for a loan by issuing bank and also expressly states said provisions on its face; has an original maturity of at least seven years, or, in the case of an obligation or issue that provides for any type of scheduled repayments of principal, has an average maturity<sup>7</sup> of at least seven years<sup>8</sup> and provides that once any such repayment of principal begins, all scheduled repayments shall be made at least annually and the amount repaid in each year is no less than in the prior year; is issued subject to a requirement that no repayment (other than a regularly scheduled repayment already approved by the appropriate Federal bank regulatory agency), including but not limited to a payment pursuant to acceleration of maturity, may be made without

the prior written approval of the appropriate Federal bank regulatory agency;<sup>9</sup> is in an amount of at least \$500, *Except*, That the appropriate Federal bank regulatory agency may approve the issuance of an obligation that is less than \$500 if such lesser amount is necessary (a) to satisfy the preemptive rights of shareholders in the case of a convertible debt obligation, (b) to maintain a ratable unit offering to holders of preemptive rights in the case of an obligation issued exclusively as part of a unit including shares of stock which are subject to such preemptive rights, or (c) to satisfy shareholders' ratable claims in the case of an obligation issued wholly or partially in exchange for shares of voting stock or assets pursuant to a plan of merger, consolidation, reorganization, or other transaction where the issuer will acquire either a majority of such shares of voting stock or all or substantially all of the assets of the entity whose assets are being acquired; and has been approved by the appropriate Federal bank regulatory agency as an addition to the capital structure of the issuing bank; or (ii) meets all of the requirements in the preceding clause except the maturity requirement or the requirement that scheduled repayments shall be in amounts at least equal to those made in a previous year, and with respect to which the appropriate Federal bank regulatory agency has determined that exigent circumstances require the issuance of such obligations without regard to the provisions of this Part; or (iii) was issued or publicly offered before June 30, 1970, with an original maturity of more than two years; or

\* \* \* \* \*

(4) \* \* \*; or

(5) Arises from the creation of a bank acceptance of the type described in section 13 of the Federal Reserve Act and eligible for discount by the Federal Reserve Banks.

† For this Regulation to be complete as amended July 26, 1976, retain:

- 1) Printed Regulation pamphlet dated November 9, 1972;
- 2) Amendment effective July 12, 1973, Section 204.1(f);
- 3) Amendment effective November 26, 1973, Section 204.1(g);
- 4) Amendment effective October 14, 1974, Section 204.1(f);
- 5) Amendment effective November 10, 1975, Section 204.1(e)(1);
- 6) Supplement effective December 25, 1975; and
- 7) This slip sheet.

<sup>7</sup>The "average maturity" of an obligation or issue repayable in scheduled periodic payments shall be the weighted average of the maturities of all such scheduled repayments.

<sup>8</sup>In a serial issue, the member bank may offer no note with a maturity of less than five years.

<sup>9</sup>For the purposes of this Part, the "appropriate Federal bank regulatory agency" is the Comptroller of the Currency in the case of a national bank and the Board of Governors in the case of a State member bank.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

INTEREST ON DEPOSITS

AMENDMENTS TO REGULATION Q†

Effective July 26, 1976, § 217.1(f)(3)(i) is amended to read as stated below. Also, footnotes 5a, 6, 6a, and 7 of Regulation Q are renumbered 9, 10, 11, and 12, respectively.

SECTION 217.1 DEFINITIONS

\* \* \* \* \*

(f) **Deposits as including certain promissory notes and other obligations.** For the purposes of this Part, the term "deposits" also includes a member bank's liability on any promissory note, acknowledgment of advance, due bill, or similar obligation (written or oral) that is issued or undertaken by a member bank principally as a means of obtaining funds to be used in its banking business, except any such obligation that:

\* \* \* \* \*

(3) (i) Bears on its face, in bold-face type, the following:

"This obligation is not a deposit and is not insured by the Federal Deposit Insurance Corporation;"

is subordinated to the claims of depositors, is unsecured, and is ineligible as collateral for a loan by the issuing bank and also expressly states said provisions on its face; has an original maturity of at least seven years, or, in the case of an obligation or issue that provides for any type of scheduled repayments of principal, has an average maturity<sup>6</sup> of at least seven years<sup>7</sup> and provides that once any such repayment of principal begins, all scheduled repayments shall be made at least annually and the amount repaid in each year is no less than in the prior year; is issued subject to a requirement that no repayment (other than a regularly scheduled repayment already approved by

the appropriate Federal bank regulatory agency), including but not limited to a payment pursuant to acceleration of maturity, may be made without the prior written approval of the appropriate Federal bank regulatory agency;<sup>8</sup> is in an amount of at least \$500, *Except*, That the appropriate Federal bank regulatory agency may approve the issuance of an obligation that is less than \$500 if such lesser amount is necessary (a) to satisfy the preemptive rights of shareholders in the case of a convertible debt obligation, (b) to maintain a ratable unit offering to holders of preemptive rights in the case of an obligation issued exclusively as part of a unit including shares of stock which are subject to such preemptive rights, or (c) to satisfy shareholders' ratable claims in the case of an obligation issued wholly or partially in exchange for shares of voting stock or assets pursuant to a plan of merger, consolidation, reorganization, or other transaction where the issuer will acquire either a majority of such shares of voting stock or all or substantially all of the assets of the entity whose assets are being acquired; and has been approved by the appropriate Federal bank regulatory agency as an addition to the capital structure of the issuing bank; or (ii) meets all of the requirements in the preceding clause except the maturity requirement or the requirement that scheduled repayments shall be in amounts at least equal to those made in a previous year; and with respect to which the appropriate Federal bank regulatory agency has determined that exigent circumstances require the issuance of such obligations without regard to the provisions of this part; or (iii) was issued or publicly offered before June 30, 1970, with an original maturity of more than two years; or

\* \* \* \* \*

† For this Regulation to be complete as amended effective July 26, 1976, retain:

- 1) Printed Regulation pamphlet as amended effective December 4, 1975;
- 2) Supplement effective December 4, 1975;
- 3) Amendments effective March 1, 1976, to Sections 217.1(e)(3), 217.5(c)(3), and 217.6(i); and
- 4) This slip sheet.

<sup>6</sup> The "average maturity" of an obligation or issue repayable in scheduled periodic payments shall be the weighted average of the maturities of all such scheduled repayments.

<sup>7</sup> In a serial issue, the member bank may offer no note with a maturity of less than five years.

<sup>8</sup> For the purposes of this Part, the "appropriate Federal bank regulatory agency" is the Comptroller of the Currency in the case of a national bank and the Board of Governors in the case of a State member bank.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

RESERVES OF MEMBER BANKS

INTEREST ON DEPOSITS

INTERPRETATION OF REGULATIONS D AND Q

SECTION 204.119 — SERIAL, SINKING  
FUND REDEMPTION, AND AMORTIZED  
ISSUES AS CAPITAL\*

(a) On June 16, 1976, the Board amended § 204.1(f)(3) of Regulation D and § 217.1(f)(3) of Regulation Q to permit member banks to issue subordinated notes and debentures with weighted average maturities of at least seven years. When such issues satisfy all of the requirements of those sections and have been approved by the appropriate regulatory agencies, funds obtained from such issues will be regarded as an addition to capital and exempt from deposit treatment. In connection with those amendments, this interpretation is intended to describe more fully the method for the computation of weighted average maturity.

(b) Member banks should compute the weighted average maturity on serial issues, sinking fund issues, and amortized obligations as follows: (1) determine to the nearest month the maturity from the initial offering date of each set of notes maturing or to be called on the same day, or of each scheduled repayment in the case of an amortized issue, and multiply that maturity by the amount to mature or be redeemed or repaid on that day; (2) sum the weighted maturities computed in (1) above for the entire issue; and (3) divide the sum calculated in (2) above by the

total amount of the issue, thus obtaining the average maturity. The average maturity must in all cases be equal to or greater than seven years unless specific authorization has been obtained from the appropriate Federal bank regulatory agency.

As an example of the procedure described above, assume that on July 31, 1976, Bank X obtains approval from the Board and issues a \$10 million sinking fund issue. \$1 million of the notes are to be called on August 1, 1979, and \$1 million per year thereafter until all remaining notes are called on August 1, 1986. The table below summarizes Bank X's issue and illustrates the calculation of average maturity.

(1) Maturity in Years	(2) Amount Maturing (\$ million)	(3) Weighted Maturity (1) x (2)
1	0	0
2	0	0
3	1	3
4	1	4
5	1	5
6	1	6
7	1	7
8	1	8
9	1	9
10	3	30
	<u>10</u>	<u>72</u>

$$\text{Average Maturity} = \frac{\text{Sum of Weighted Maturities}}{\text{Amount of Issue}} = \frac{72}{10} = 7.2 \text{ years}$$

Hence, Bank X's issue has an "average maturity of at least 7 years," and satisfies the provisions of the Regulation.

\*This interpretation is also indexed as section 217.153.