

FEDERAL RESERVE BANK OF DALLAS

DALLAS, TEXAS 75222

Circular No. 81-242
December 28, 1981

DEFINITION OF BANK CAPITAL

TO ALL STATE MEMBER BANKS,
BANK HOLDING COMPANIES,
AND OTHERS CONCERNED IN THE
ELEVENTH FEDERAL RESERVE DISTRICT:

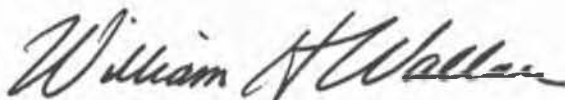
The Board of Governors of the Federal Reserve System has adopted a broadened definition of bank capital for its use in determining the adequacy of capital in state member banks. The adoption was made on the recommendation of the Federal Financial Institutions Examination Council (FFIEC) in the interest of promoting uniformity among Federal bank regulators.

The Board's action is more fully explained in the enclosed press release dated December 4, 1981. The new definition of bank capital adopted by the Board is also enclosed.

Questions relating to the new definition of capital should be directed to Marvin C. McCoy, Ext. 6657, or U. Anderson, Ext. 6275, of this Bank's Bank Supervision and Regulations Department.

Additional copies of this circular will be furnished upon request to the Department of Communications, Financial and Community Affairs, Ext. 6289.

Sincerely yours,



William H. Wallace
First Vice President

Enclosure

Banks and others are encouraged to use the following incoming WATS numbers in contacting this Bank: 1-800-442-7140 (intrastate) and 1-800-527-9200 (interstate). For calls placed locally, please use 651 plus the extension referred to above.

FEDERAL RESERVE press release



For immediate release

December 4, 1981

The Federal Reserve Board has adopted a broadened definition of bank capital for its use in determining the adequacy of capital in State member banks.

The definition was recommended to the Federal Reserve and to the other Federal bank regulators by the Federal Financial Institutions Examination Council in the interests of promoting uniformity among Federal bank regulators.

In adopting the Council's recommended definition of capital--set forth below--the Board made it clear that the definition applies only to bank capital and does not apply to the definition of capital for bank holding companies. The Board did indicate that in the application of the definition, it would take into account the level of bank equity represented by the proceeds of debt issued by the parent holding company. The Board expressed concern about the possibility of undue bank purchases of the subordinated debt of other banks and indicated that the level of such activity would be monitored through the examination process.

The Council's recommendations to the Federal regulators on bank capital made it clear that the regulators would have flexibility to depart from the recommended guidelines when warranted by the circumstances of particular cases.

Under the new definition, bank capital would consist of two main elements:

-- Primary capital consisting of common and perpetual preferred stock, surplus and undivided profits, contingency and other capital reserves, mandatory convertible instruments and 100 percent of funds set aside as reserves for possible loan losses.

-- Secondary capital consisting of limited-life preferred stock and subordinated notes and debentures. Further, secondary capital would:

- Amount to no more than 40 percent of the amount of primary capital, and
- Financing instruments in secondary capital would be phased out of the bank's capital as they approached maturity.

Limited-life preferred stock and subordinated notes and debentures would be considered eligible for consideration as secondary capital only if:

1. These instruments have an original weighted average maturity of at least 7 years;
2. Any serial or installment repayments, once begun, are made at least annually, with each payment no less than the previous one;
3. Together, such financing equals no more than half the amount of a bank's primary capital; and,
4. The percent of such issues considered as capital declines by a fifth each year when their maturity is less than five years distant. This would mean that such instruments would have no capital value when they have a maturity of less than a year.

With respect to any existing secondary capital, the Board will give consideration to supervisory standards relating to bank capital that were in effect at the time of the issue.

Separately, the Board decided not to accept a recommendation by the Council that would have required, if accepted by the Board, all State member banks to keep their books on an accrual accounting basis. The Board felt that this would impose an unnecessary burden on small banks that prefer to keep their accounts on a cash basis.

The new definition of bank capital adopted by the Board is attached.

Attachment

Attachment

DEFINITION OF BANK CAPITAL
TO BE USED IN DETERMINING CAPITAL
ADEQUACY OF STATE MEMBER BANKS

Primary Components of Bank Capital

The primary components of bank capital are considered to be:

- common stock
- perpetual preferred stock
- surplus
- undivided profits
- contingency and other capital reserves
- mandatory convertible instruments (capital instruments with covenants mandating conversion into common or perpetual preferred stock)
- allowance for possible loan losses.

Secondary Components of Bank Capital

It is recognized that other financial instruments can, with certain restrictions, be considered as part of bank capital because they possess some, though not all, of the features of capital. These instruments are:

- Limited-life preferred stock
- Subordinated notes and debentures

Restrictions Relating to Secondary Components

The secondary components will be considered as bank capital under the conditions listed below:

- The issue must have an original weighted average maturity of at least seven years.

- If the issue has a serial or installment repayment program, all scheduled repayments shall be made at least annually, once contractual repayment of principal begins, and the amount repaid in a given year shall be no less than the amount repaid in the previous year.
- The aggregate amount of limited-life preferred stock and subordinated debt qualifying as secondary capital may not exceed 50 percent of the amount of primary capital.
- As the secondary components approach maturity, redemption or payment, the outstanding balance of all such instruments --including those with serial note payments, sinking fund provisions, or an amortization schedule--will be amortized in accordance with the following schedule:

<u>Years to Maturity</u>	<u>Percent of Issue Considered Capital</u>
Greater than or equal to 5	100
Less than 5 but greater than or equal to 4	80
Less than 4 but greater than or equal to 3	60
Less than 3 but greater than or equal to 2	40
Less than 2 but greater than or equal to 1	20
Less than 1	0

(No adjustment in the book amount of the issue is required or expected by this schedule. Adjustment will be made by a memorandum account.)

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