FEDERAL RESERVE BANK OF DALLAS

DALLAS, TEXAS 75222

Circular No. 82-5
January 22, 1982

CAPITAL ADEQUACY

Guidelines

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

The Board of Governors of the Federal Reserve System and the Office of the Comptroller of the Currency have developed capital adequacy guidelines to provide a framework for assessing the capital of well-managed national banks, state member banks, and bank holding companies.

Printed on the following pages are copies of a joint agency news release dated December 17, 1981, and the Capital Adequacy Guidelines. Questions relating to the guidelines 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

William H. Wallace
First Vice President

JOINT NEWS RELEASE

COMPTROLLER OF THE CURRENCY

FEDERAL RESERVE BOARD

For immediate release December 17, 1981

The Comptroller of the Currency and the Federal Reserve Board today announced that they are issuing to the financial institutions they supervise guidelines to be used in assessing the adequacy of their capital.

The capital adequacy guidelines -- which are attached -- will be used by the two agencies in their examination and supervision of national banks, state chartered banks that are members of the Federal Reserve System and bank holding companies.

The agencies developed the guidelines in the interest of achieving greater consistency in their supervisory activities. The guidelines should also be helpful to banking organizations in their financial planning. The regulators stressed that the guidelines will be used in a manner that allows for consideration of differences in the situations of individual financial institutions.

One of the objectives of the agencies was to address the sizable existing disparity in capital ratios among banking organizations of different size. To this end, the agencies considered both qualitative characteristics and practical economic and market constraints which often account for differences in capital ratios. The program adopted will permit somewhat lower capital ratios for smaller banks than most of these institutions currently maintain. At the same time, the agencies indicated that their policies with respect to the multinational banking organizations -- at present, 17 institutions with assets in excess of $15 billion -- would be amended to insure that appropriate steps are taken to improve over time the capital positions of banking organizations in this group.

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The guidelines will be reviewed from time to time for possible adjustment commensurate with changes in the economy, financial markets and banking practices. As conditions permit, further consideration will be given to the differences in the capital ratios by size of institution.

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Attachment

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
OFFICE OF THE COMPTROLLER OF THE CURRENCY

CAPITAL ADEQUACY GUIDELINES

The Federal Reserve and the Office of the Comptroller of the Currency have developed capital adequacy guidelines to provide a framework for assessing the capital of well-managed national banks, state member banks and bank holding companies.[1/] The guidelines will be used in the examination and supervisory process and will be reviewed from time to time for possible adjustment commensurate with changes in the economy, financial markets and banking practices.

Objectives of the capital adequacy guidelines program are to:

- address the long-term decline in capital ratios, particularly those of the multinational group;
- introduce greater uniformity, objectivity and consistency into the supervisory approach for assessing capital adequacy;
- provide direction for capital and strategic planning to banks and bank holding companies and for the appraisal of this planning by the agencies; and,
- permit some reduction of existing disparities in capital ratios between banking organizations of different size.

Two principal ratio measurements of capital will be used: (1) primary capital to total assets; and (2) total capital to total assets. Primary capital consists of common stock, perpetual preferred stock, capital surplus, undivided profits, reserves for contingencies and other capital reserves, mandatory convertible instruments and the allowance for possible loan losses. Total capital includes the primary capital components plus limited life preferred stock and qualifying subordinated notes and debentures.

1/ Institutions that are under special supervision and those that have been in operation for less than two years are not included in the program.

The capital guidelines generally will be applied on a consolidated basis. However, for those bank holding companies with consolidated assets under $150 million, the capital guidelines will apply to the bank only, if: (1) the company does not engage directly or indirectly in any nonbanking activity involving significant leverage; and (2) no significant debt of the parent company is held by the general public.

Some bank holding companies are engaged in significant nonbanking activities that require capital ratios higher than those for the bank alone. In these cases, appropriate adjustments will be made in the application of the consolidated capital guidelines.

Institutions affected by the guidelines are categorized as either multinational organizations (as designated by their respective supervisory agency); regional organizations (all other institutions with assets in excess of $1 billion)[1/]; or community organizations (less than $1 billion in total assets).

Capital guidelines for the relatively small number of multinational organizations will continue to be formulated and monitored on an individual basis, taking into account their present and prospective financial condition. The supervisory agencies are increasingly concerned about the secular declines in the capital ratios of the nation's largest banking organizations, particularly in view of increased risks both domestically and internationally. In general, supervisory policies of the Federal Reserve and the Office of the Comptroller of the Currency, designed to arrest the secular decline in the capital ratios of this group of institutions, will be modified to insure that appropriate steps are taken to improve over time the capital positions of this group.

1/ May include some institutions located in money centers.

A minimum level of primary capital to total assets is established at 5 percent for regional organizations and 6 percent for community organizations. Generally, regional and community banking organizations are expected to operate above the minimum primary capital levels.

The agencies also have established capital guidelines for regional and community organizations for the total capital to total assets ratio. These guidelines consist of three broad zones:

	Regional	Community
Zone 1	Above 6.5%	Above 7.0%
Zone 2	5.5% to 6.5%	6.0% to 7.0%
Zone 3	Below 5.5%	Below 6.0%

Generally, the nature and intensity of supervisory action will be determined by the zone in which an institution falls.

For banking institutions operating in zone 1, the agencies will:

- o presume adequate capital if the primary capital ratio is acceptable to the regulator and is above the minimum level;
- o intensify analysis and action when unwarranted declines in capital ratios occur.

For banking institutions operating in zone 2, agencies will:

- o presume that the institution may be undercapitalized, particularly if the primary and total capital ratios are at or near the minimum guidelines;
- o engage in extensive contact and discussion with the management and require the submission of comprehensive capital plans acceptable to the regulator;
- o closely monitor the capital position over time.

The agencies' approach to institutions operating in zone 3 will include:

- o a very strong presumption that the bank is undercapitalized;
- o frequent contact with management and a requirement that the bank submit a comprehensive capital plan, including a capital augmentation program that is acceptable to the regulator;
- o continous analysis, monitoring and supervision.

The guidelines will be applied in a flexible manner with exceptions as appropriate. The assessment of capital adequacy will continue to be made on a case-by-case basis considering various qualitative factors that affect an institution's overall financial condition. Thus, the agencies retain the flexibility to recognize the unique characteristics of sound and well-managed banks.