FEDERAL RESERVE BANK OF DALLAS

Station K, Dallas, Texas 75222

Circular No. 84-87
August 15, 1984

TO: All state member banks and bank holding companies in the Eleventh Federal Reserve District

ATTENTION: Chief Executive Officer

SUBJECT: **Proposed revision to capital adequacy guidelines**

SUMMARY: The Board of Governors of the Federal Reserve System has requested comment on a proposed revision of its capital adequacy guidelines. In addition, the Board is requesting comment on a proposed supporting regulation establishing procedures for requiring compliance with capital requirements. Complete details are provided in the Board's press release and notice as published in the Federal Register. Written comments should be addressed to Mr. William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, Washington, D.C., 20551. All correspondence must be received by September 24, 1984, and should refer to Docket No. R-0526.

ATTACHMENTS: Board's press release and Federal Register document

MORE INFORMATION: State member banks should contact Marvin C. McCoy, Extension 6657; bank holding companies may direct inquiries to Richard J. Burda, Extension 6472

ADDITIONAL COPIES: Public Affairs Department, Extension 6289

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FEDERAL RESERVE press release

For immediate release July 26, 1984

The Federal Reserve Board today asked for comment on a proposed revision of its guidelines regarding capital adequacy for State member banks and bank holding companies, as well as on a proposed supporting regulation establishing procedures for requiring compliance with capital requirements.

The Board asked for comment during the 60-day period ending September 24, 1984.

The Board's proposed guidelines would increase minimum required primary and total capital for all but smaller State member banks and bank holding companies and would parallel proposed minimum bank capital adequacy requirements being considered by the other federal bank regulators.

In addition, the Board proposed to continue using -- at higher levels of capitalization for larger banks and bank holding companies -- its "zone" concept of appropriate capital for those institutions under its supervision, with the objective of encouraging State member banks and bank holding companies of all sizes to meet higher than minimum standards of total capital adequacy.

I. Proposed Policy Statement on Capital Adequacy

The Board proposed:

> All State member banks and all bank holding companies should have minimum primary capital equal to 5.5 percent of total assets and total capital equal to 6 percent of total adjusted assets.

For both regional and multinational State member banks and for bank holding companies this would be an increase in minimum capital requirements of one-half of one percent in minimum primary and total capital requirements. For community banks and bank holding companies (with assets of under $1 billion), there would be a decrease of one-half of one percent in the minimum <u>primary</u> capital requirements by comparison to current requirements. The minimum <u>total</u> capital requirement for these institutions would not be changed.

The Board proposed the reduction in minimum primary capital requirements for smaller banking institutions under its supervision in order to achieve uniformity with capital adequacy requirements being considered by the Federal Deposit Insurance Corporation and the Comptroller of the Currency for institutions they supervise.

At the same time the Board proposed continued supervisory use of its "zone" standards of appropriate total capitalization for all State member banks and all bank holding companies, regardless of size, as follows:

Zone 1 -- Institutions with capital equal to at least 7 percent of total assets would be considered adequately capitalized.

Zone 2 -- Institutions operating with total capital equal to 6 to 7 percent of their total assets would be considered marginally capitalized, subject to consideration of other financial factors.

Zone 3 -- Banking organizations with total capital equal to less than 6 percent of their total assets may be considered under-capitalized, in the absence of clear extenuating circumstances.

The Board also considered a number of definitional changes affecting its capital adequacy guidelines for State member banks:

--Intangible asets[1]/ would not be counted among the components of primary capital, or of assets, in determining the capital adequacy of State member banks. Equity commitment notes[2]/ would not be included in determining the primary capital of banks. Reserves for loan and lease losses would be added to total assets in computing all capital ratios.

(Primary capital of banks would thus include: common stock; perpetual preferred stock; capital surplus; undivided profits; contingency and other capital reserves; instruments mandating conversion into common or perpetual preferred stock; reserves for loan and lease losses and the bank's minority interest in the equity accounts of consolidated subsidiaries.)

1/ As defined in the quarterly report of condition (Call Report) banks file with their federal supervisors -- roughly, any amount over and above intrinsic value.
2/ A type of mandatory convertible security.

--Intangible assets would continue to be counted as part of the total capital of banks.

(Total capital of banks would thus include the intangible assets deducted from primary capital, the other components of primary capital and limited-life preferred stock and qualifying subordinated notes and debentures.)1/

These definitions and minimum requirements for bank capitalization are consistent with those being considered by the other federal bank regulators.

--In assessing the primary and total capital of bank holding companies the Board proposed:

Intangible assets would not be required to be netted out of primary capital. Instead, the amount and character of intangible assets would be taken into account in determining a company's compliance with the guidelines. Equity commitment notes would be included in primary capital. Also -- the only new element -- the asset base for calculating the primary and total capital ratios of bank holding companies would include the companies' reserves set aside for possible loan and lease losses, conforming to the calculation of primary and total capital of state member banks.

Thus, except for the treatment of intangible assets and equity commitment notes, primary components would be the same for both State member banks and for bank holding companies.

The Board's guidelines for capital adequacy of bank holding companies are designed to retain the flexibility in the Board's current guidelines by the inclusion of equity commitment notes and moderate amounts of intangible assets as a part of a bank holding company's primary capital.

The Board requested that commenters focus specifically on the differences between these proposed guidelines and those being proposed by the

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1/ Certain restrictions and maturity requirements -- set forth in the attached capital adequacy policy statements -- apply to and limit the use of these secondary components of capital.

other federal bank regulators. These issues include:

1. Issuing substantive capital requirements in a regulation or in the form of guidelines.

2. Relying upon the concept of capital zones as embodied in the Board's guidelines or only on a requirement of a "minimum capital" level.

3. Deducting intangible assets in deriving primary capital ratios.

4. Whether to include equity commitment notes as a component of primary capital.

The Board's proposed capital guidelines for banks and for bank holding companies, currently in one document, would be separated into separate guidelines.

The Board is proposing to increase the minimum required primary capital for regional and multinational banks in the light of the Board's concern with fostering improvements in the capital ratios of large banking organizations and the concern the Congress has indicated in the directions for improving capital ratios embodied in the International Lending Supervision Act of 1983.

The Board's further objectives in revising its guidelines are to achieve uniformity in capital requirements for State member banks and bank holding companies regardless of size, and uniformity among all federally insured banks.

The Board's proposed embodiment of its capital adequacy rules in a guideline, rather than a regulation, is designed to preserve the Board's flexibility in determining both appropriate capital levels of particular banks and bank holding companies and in defining the components of capital.

The Board regards determination of capital adequacy as a major objective of its supervision of banks and bank holding companies. It views maintenance of adequate capital levels as a key to protecting depositors and to ensuring the stability of the banking system.

II. The Proposed Procedural Regulation in connection with the Board's capital adequacy guidelines

The supporting procedural regulation proposes a number of supervisory actions such as submission of a plan for achieving capital adequacy and possible administrative enforcement actions, including possible denial of applications, that may be taken in the event a banking organization falls below required minimum ratios. The proposed rules place emphasis upon giving the Board flexibility to deal with situations of under-capitalization in the practical light of the circumstances of particular banks or bank holding companies, while insisting upon current and continued progress toward adequate capitalization.

The regulation refers to the Board's capital adequacy guidelines as setting the substantive capitalization standards.

The rules (set forth in detail in the attached Board notice) establish the procedures under which the Board, as provided for in ILSA, may issue a directive to a bank or bank holding company to increase its capital to a minimum or higher level, by written agreement, cease and desist order or otherwise.

The main elements of the proposed procedures include:

—All State member banks, and bank holding companies, that do not meet the Board's capital adequacy standards on the day of final promulgation of the regulation would be required to file a plan with the Board, within 90 days, to meet minimum capital requirements.

--Banks or holding companies that subsequently fail to meet the guideline requirements may be subject to a procedure after notice and opportunity to comment that could lead to the issuance, by the Board, of a directive mandating and setting a time limit for compliance, as well as specifying a schedule for achieving the required capitalization or the way in which it is to be achieved.

Attached are the Board's capital adequacy guidelines for banks and for bank holding companies, and the Board's proposed procedural regulations.

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Attachments

FEDERAL RESERVE SYSTEM

12 CFR Parts 208, 225, and 263

[Docket No. R-0526]

Capital Maintenance

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Proposed rulemaking.

SUMMARY: Capital adequacy is one of the critical factors the Board of Governors of the Federal Reserve System is required to analyze in taking action on various types of applications, such as mergers and acquisitions by bank holding companies, and in the conduct of the Board's various supervisory activities related to the safety and soundness of individual banks and bank holding companies and the banking system. This proposal establishes Guidelines for required and appropriate levels of capital for bank holding companies and state chartered banks that are members of the Federal Reserve System. The Board proposes to amend its Capital Adequacy Guidelines in a manner consistent with the provisions of capital adequacy under consideration by the Federal Deposit Insurance Corporation ("FDIC") and the Comptroller of the Currency ("Comptroller") in order to establish uniform minimum capital requirements for federally supervised banks. The Board also proposes revised Capital Adequacy Guidelines for bank holding companies. Finally, the Board proposes to issue a regulation setting forth procedures under which the Board may require compliance with the minimum capital requirements contained in the Guidelines.

DATE: Comments must be received by September 24, 1984.

ADDRESS: All comments, which should refer to Docket No. R-0526, should be mailed to William W. Wiles, Secretary of the Board of Governors of the Federal Reserve System, 20th and Constitution Avenue, NW., Washington, D.C. 20551, or deliver comments to the Office of the Secretary, Room 2200, Eccles Building, 20th and Constitution Avenue, NW., between the hours of 8:45 a.m. and 5:15 p.m. weekdays. Comments may be inspected in Room 1122, Eccles Building between 8:45 a.m. and 5:15 p.m. weekdays.

FOR FURTHER INFORMATION CONTACT: James E. Scott, Senior Attorney, Legal Division (202/452-3513), or Richard Spillenkothen, Manager, Projects and Planning Section, Division of Banking Supervision and Regulation (202/452-2594), or Anthony G. Cornyn, Section Chief, Financial Analysis and Special Studies Section, Division of Banking Supervision and Regulation (202/452-3450).

SUPPLEMENTARY INFORMATION:

Need for Capital Adequacy Standards

The Board, as a part of its responsibilities as a banking regulator, has acted to promote the maintenance of adequate capital in individual banks, in bank holding companies and in the banking system in general. In the Board's view, adequate capital performs several important functions in banking institutions, including providing additional protection against unforeseen losses, helping to maintain public confidence in particular institutions and in the banking system, partially protecting depositors from a threat of insolvency, and supporting reasonable growth of such institutions. As a result, the Board considers a determination of capital adequacy to be one of the major objectives of a bank examination or bank holding company inspection. Capital is one of the components that form the basis of the Uniform Financial Institution Rating System used by each of the federal bank supervisory agencies. In short, maintenance of adequate capital levels plays a key role in the programs and policies of the Board and other banking agencies in protecting depositors and ensuring the stability of the banking system.

This recognition of the importance of capital and a concern about the gradual decline in the ratio of capital to bank assets prior to 1981, particularly in the nation's largest banking organizations, prompted the Board and the Comptroller in December 1981, to adopt Capital Adequacy Guidelines for national and state member banks and bank holding companies. These Guidelines were designed to set a range of substantive capital levels for use by the Board and Comptroller in defining institutions that are adequately capitalized, those that are capitalized in a minimally acceptable fashion and those that are presumed to be undercapitalized, absent clear extenuating circumstances. The Guidelines provide national and state member banks and bank holding companies with targets or objectives to be reached over time. The Board has noted that many banks and bank holding companies, including the nation's largest banking organizations, have improved their capital position in order to comply with these Guidelines. The Board revised the Guidelines in June 1983 to provide specific ratio guidelines for multinational organizations. In December 1983, the Board reaffirmed the Guidelines (49 FR 794, incorporating the Guidelines as Appendix A of Regulation Y, 12 CFR Part 225).

Purpose of the Proposed Rulemaking

In November 1983, Congress enacted the International Lending Supervision Act of 1983 (12 U.S.C. 3901 *et seq.*) ("ILSA"), which directed that the federal banking agencies ". . . shall cause banking institutions to achieve and maintain adequate capital by establishing minimum levels of capital for such banking institutions and by such other methods as the appropriate Federal banking agency deems appropriate." (Section 908, 12 U.S.C. 3907). Pursuant to this authority and that contained in the Bank Holding Company Act, the Federal Reserve Act and the Financial Institutions Supervisory Act of 1966, the Board is proposing to amend its Capital Adequacy Guidelines to conform with changes in capital adequacy provisions currently under consideration by the Comptroller and the FDIC. Thus, uniform minimum capital levels will be established for all

bank holding companies and all federally regulated banks, regardless of size or primary federal supervisory agency.

The Board proposes to revise its Guidelines with respect to state member banks for two additional reasons: (1) To increase the required minimum primary and total capital levels for regional and multinational banks and (2) to establish uniform capital requirements for all state member banks regardless of size. The Board is also proposing procedural regulations which provide a mechanism to enforce the substantive requirements of the Guidelines.

The Board will also continue to require bank holding companies to meet minimum capital ratios. The Board has made a finding pursuant to section 910(a)(2) of ILSA (12 U.S.C. 3090(a)(2)) that uniform application of the capital requirements to bank holding companies is necessary to prevent evasions of the purposes of ILSA. The Board believes that it serves no purpose to increase bank capital at the expense of its parent holding company. The financial condition of a bank holding company continues to be a primary factor influencing the financial condition of its subsidiary bank or banks. The Board has repeatedly stated that a holding company must be a source of strength to its subsidiary banks, and has so required in its Regulation Y. The Board's proposed revisions of the Capital Adequacy Guidelines for bank holding companies are designed to increase the required minimum primary and total capital levels for the larger regional and multinational bank holding companies, and to establish uniform capital requirements for all bank holding companies regardless of size.

Amended Capital Adequacy Guidelines

The Board proposes to embody the substantive capital requirements and definitions in amended Capital Adequacy Guidelines that parallel the regulations being considered by the FDIC and Comptroller insofar as they require a minimum ratio of primary capital to adjusted total assets of 5.5 percent and a minimum ratio of total capital to total assets of 6 percent. The Board will continue to view total capital to asset ratios in terms of three "zones." Those institutions with total capital to total assets of less than 6.0 may be considered to be undercapitalized, absent clear extenuating circumstances. Those institutions with a total capital to total assets ratio of 6.0 to 7.0 percent are considered to be capitalized in a minimally acceptable fashion, subject to evaluation of other financial factors. Finally, those institutions with a total capital to total assets ratio of above 7.0 are presumed adequately capitalized. In all cases, the ratio of *primary* capital to adjusted total assets must be at least 5.5 percent.

Changes From Existing Guidelines for State Member Banks

The principal differences between the Board's current guidelines and the proposed guidelines for state member banks are found in the definitions of capital, as well as in the guideline ratios. The changes in the proposed definitions are: (1) The proposed definition of primary capital does not include equity commitment notes; (2) intangible assets are excluded from the sum of total primary capital components in deriving the numerator of the primary capital ratio; (3) the denominator of the *primary* capital ratio (total assets) includes the allowance for possible loan and lease losses but excludes intangible assets; and (4) the denominator of the *total* capital ratio (total assets) includes the allowance for possible loan and lease losses.

The changes proposed in the definitions of primary and total capital are to conform the Board's definitions with those under consideration by the Comptroller and the FDIC. The Board questions whether these changes are improvements in the definitions, especially the exclusion of equity commitment notes and all intangible assets, regardless of character, from the definition of primary capital. The Board's current guidelines provide flexibility in determining both the level and the type of intangible assets that may be included in calculating primary capital ratios. However, the Board believes that uniformity of definitions may be desirable in this area and it is, therefore, proposing capital definitions for state member banks that are the same as those being considered by the Comptroller and FDIC.

The changes in the substantive guidelines are: (1) The minimum adequate primary capital ratio for regional and multinational banks is increased from 5.0 to 5.5 percent; (2) the minimum adequate primary capital ratio for community banks is decreased from 6.0 to 5.5 percent; and (3) the minimum total capital ratio for regional and multinational banks (Zone 3) is increased from 5.5 to 6.0 percent, and (4) the Zone 1 and Zone 2 guidelines for total capital ratios for multinational and regional banks are each increased by one-half a percentage point.

The Board believes that the increase in the minimum required primary capital ratio for regional and multinational banks is appropriate given the Board's concern with fostering improvements in the capital ratios of large banking organizations and the Congressional concern embodied in ILSA for improving capital ratios. Consistent with this view, the Board has also increased each zone measuring the adequacy of total capital of multinational and regional banks by one-half a percentage point.

The minimum primary capital ratio of 5.5 percent represents a decrease in the minimum capital requirement for smaller community state member banks (assets under $1.0 billion). The Board is proposing this decrease in the interest of establishing a single uniform primary capital requirement for large and small banking institutions as well as an overriding interest in establishing a uniform minimum capital ratio with the FDIC and Comptroller of the Currency for all federally regulated banks. The Board notes, however, that the new Guidelines emphasize that banking organizations are expected to operate *above* the minimum primary capital level. Finally, the minimum *total* capital to total asset level that define Zones 1, 2 and 3 remain unchanged for small banking organizations.

Proposed Change From Existing Guidelines for Bank Holding Companies

Currently, the Board's Capital Adequacy Guidelines for both state member banks and bank holding companies are contained in one document. While the Board believes that conformity of the defintions and ratios used for all federally regulated banks serves an important policy purpose, the Board also believes that is it is desirable to retain certain features of the current guidelines for bank holding companies. Accordingly, the Board is proposing, in addition to the guidelines for state member banks, separate guidelines for bank holding companies.

The only change from existing Guidelines in the calculation of the capital ratios in the Guidelines for bank holding companies is that the asset base for calculating the primary and total capital ratios includes the allowance for possible loan and lease losses. As noted above, this is a conforming change being made for the calculation of these ratios for state member banks, and the Board believes that, for purposes of consistency, these reserves should also be included for these calculations in the asset base of bank holding companies.

The differences in the guideline ratios parallel those made for state member banks; i.e., (1) The minimum adequate primary capital ratio for multinational and regional bank holding companies is increased from 5.0 to 5.5 percent; (2) the

minimum adequate primary capital ratio for community bank holding companies is decreased from 6.0 to 5.5 percent; and (3) the minimum total capital ratios for mulitnational and regional bank holding companies is increased from 5.5 to 6.0 percent, and (4) the Zone 1, Zone 2, and Zone 3, guidelines for total capital for these bank holding companies are each increased by one-half a percentage point. The reasons for the changes in these rations parallel those discussed above for state member banks.

Differences in Treatment of State Members Banks and Bank Holding Companies

There are two significant differences in the proposed Guidelines regarding the treatment afforded banks and bank holding companies. These differences relate to the treatment of intangible assets and mandatory convertible securities. In computing the primary capital ratios of state member banks, adjustments would be made to reflect the existence of any intangible assets. Specifically, intangible assets would be deducted from the sum of the components of primary capital to derive the numerator of the primary capital ratio and would be deducted from the sum of total assets and the allowance for possible loan and lease losses to derive the denominator of the ratio. The Board believes that the specific deduction of intangibles from primary capital and total assets for the purpose of deriving primary capital ratios of both banks and bank holding companies may be undesirable because it reduces the flexibility of these institutions in structuring acquisitions. The Board currently takes the level and specific character of intangible assets into consideration in assessing the capital of individual banks and bank holding companies. However, the Board proposes to exclude intangibles when calculating the primary capital ratios of state member banks. The proposed capital guidelines for bank holding companies do not require intangibles to be deducted from either the sum of the total components of primary capital or from total assets to derive the primary capital ratio. The Board proposes not to exclude intangibles in computing primary capital ratios of bank holding companies in order to provide bank holding companies with additional flexibility. The Board does, however, intend to continue to take the level and specific character of intangible assets into consideration in evaluating the overall financial condition and capital adequacy of a bank holding company.

With respect to the treatment of equity commitment notes (a type of mandatory convertible security), the Board proposes to allow such instruments to continue to be counted as a form of primary capital for bank holding companies but to disallow these instruments as a form of primary capital in state member banks. The proposed exclusion of these instruments as a form of primary capital for banks is designed to achieve interagency uniformity in the definition of primary capital for banks. In deciding to continue to treat equity commitment notes as primary capital for bank holding companies, the Board notes that such instruments encourage the issuance of common and perpetual preferred stock over time and represent an attractive vehicle for raising long-term capital. The Board has limited the use of such instruments, however, to 10 percent of the bank holding company's primary capital exclusive of mandatory convertible securities.

The Proposed Procedural Regulation

The proposed regulation requires that any state member bank or bank holding company that does not meet the minimum capital standards (set forth in the Capital Adequacy Guidelines) when the regulation becomes effective, must submit to the appropriate Reserve Bank within 90 days a plan for increasing its capital to the minimum required level. Certain administrative and judicial enforcement procedures are outlined in the regulation in the event of the failure to submit a capital plan.

The Board may also require particular banks or bank holding companies to maintain more than the minimum level of capital if the financial condition, management, or future prospects of the institution make a higher capital level necessary and appropriate. Moreover, the Board will pay particular attention to liquidity and will discourage the practice of meeting capital guidelines by reducing the level of liquid assets relative to total assets of the institution. The process of determining the adequacy of an institution's capital will begin with a qualitative evaluation of the critical variables that directly bear on its overall financial condition. These variables include the quality, type and diversification of assets; current and historical earnings; liquidity; appropriate policies for loan charge-offs; risks arising from interest rate mismatches; the quality of management; and the existence of other activities that may expose the bank to risks, including off balance sheet risks. Institutions with significant weaknesses in one or more of these areas will be expected to maintain higher capital levels than the minimum set forth in the regulation. Institutions that are currently or prospectively under any formal administrative action, final order, or condition or agreement that sets forth a more stringent capital requirement shall continue to meet the requirement contained therein.

In addition to the traditional procedures used by the Board to set a higher capital level (e.g. written agreements or memoranda between the Board and the financial institution, cease and desist orders, and conditions attached to orders issued on applications or notices), the proposed regulation provides for a specific notice and comment procedure. The Board also reserves the right to consider failure to meet the minimum capital requirement established by the Guidelines, or such higher capital requirement set by the Board, as bearing adversely upon applications or notices that a bank or bank holding company may file.

Directives

Section 908 of ILSA (12 U.S.C. 3907) authorizes the appropriate banking agency to issue a directive to a banking institution that fails to maintain the minimum capital requirement. A directive may require a bank to submit and adhere to a plan for achieving such requirement. A directive, including a capital adequacy plan submitted thereunder, is a final order enforceable in the appropriate United States district court in the same manner and to the same extent as a final cease and desist order issued under 12 U.S.C. 1818(b). The issuance of a directive is discretionary, and a directive may be issued in lieu of, in conjunction with, or in addition to existing enforcement tools available to the agencies. The Board has proposed procedures leading to the issuance of a directive including notice and opportunity to comment.

Differences Among Proposed Agency Regulations

The major difference between the Board's proposal and those being considered by the FDIC and the Comptroller is the decision of the Board to embody the substantive capital requirements in a set of guidelines rather than in a regulation. The Board's experience with its Capital Adequacy Guidelines during the past 2½ years has demonstrated the need for flexibility in applying minimum capital ratios and even in defining "capital." The Board believes that rigidly defining failure to meet certain capital levels in all cases as a *per se* violation of law could hamper the Board's efforts in working with banks and bank holding companies to strengthen their capital positions and in evaluating capital adequacy in the

context of a broader range of factors it must consider in acting upon applications. In addition, the Board recognizes the difficulty of imposing a static definition on the components of capital. The use of flexible guidelines will permit the Board to adjust capital requirements and definitions more rapidly to changes in the economy, in financial markets and in banking practices. The FDIC has chosen to issue a regulation containing its substantive capital requirements. The Board, however, specifically requests comment on whether the capital requirements proposed in the Guidelines should be incorporated in a regulation.

The concern for flexibility has also led the Board's proposal to differ from those being considered by the other agencies in eschewing any general time deadlines in the enforcement process. The Board has reserved the right to decide how quickly a particular bank or bank holding company must respond to the notice of a directive and how quickly the Board must take action. The Board proposes to set time limits in each case based upon the unique circumstances of that case.

A third difference between the proposals of the Board and the FDIC is the Board's recognition of the need to treat total capital requirements for the spectrum of banks and bank holding companies in terms of broader zones rather than solely by means of a single minimum capital level. The zone concept provides banks with a general target range that defines more strongly capitalized institutions as well as those that are capitalized in a marginally adequate fashion and those that may be undercapitalized.

The Board's regulation provides an administrative procedure to establish higher than minimal capital for individual banks and bank holding companies. The FDIC would use the traditional cease and desist procedures to establish higher capital levels rather than the notice and directive procedure of the Board's regulation.

The Board also believes that banks and bank holding companies should be given 90 days from the effective date of this regulation to prepare a plan to increase capital. The FDIC has proposed 60 days.

Finally, the Board has decided to issue guidelines for bank holding companies that differ slightly from the bank guidelines of the Board and regulations of the FDIC. These differences, notably in the treatment of intangible assets and bank equity commitment notes, are described above in more detail.

The adoption of these proposed regulations is not expected to impose an additional capital requirement on a large number of institutions. Based on the December 31, 1983 Call Reports (which do not necessarily reflect adjustments for assets classified loss), more than 96 percent of all state member banks had primary capital ratios in excess of 5.5 percent, the primary capital requirement established by the Board's guidelines. In addition, most of the larger multinational and regional banks and bank holding companies (which were previously permitted lower capital ratios than smaller institutions) had primary capital ratios and total capital ratios that would exceed the proposed minimum capital ratio guidelines. It is recognized that there are a few large banks and bank holding companies that will be faced with a relatively large dollar shortfall in their capital accounts. While the Board will expect all institutions to make every effort to achieve compliance as rapidly as possible, in analyzing plans submitted to achieve compliance the Board will consider the individual circumstances and the reasonable capacity of these institutions to achieve compliance. Finally, the Board will continue to exempt from the Guidelines bank holding companies with under $150 million in consolidated assets, unless (1) the holding company or any nonbank subsidiary is engaged directly or indirectly in any nonbank activity involving significant leverage, or (2) the holding company or any nonbank subsidiary has outstanding debt held by the general public.

The Board stresses that capital requirements set forth in this proposed regulation are minimums and that all state member banks and bank holding companies are encouraged to maintain higher levels of capital. This will provide protection against unforeseen adversities as well as provide a greater measure of flexibility in terms of being able to take advantage of opportunities for sound growth as they arise.

Issues for Specific Comment

The Board requests that commenters specifically focus on the differences between these proposed Guidelines and those being considered by the FDIC and the Comptroller. These issues, as discussed above, include:

1. Issuing the substantive capital requirements within a regulation or in the form of Guidelines;

2. Relying upon the concept of capital zones as embodied in the Board's Guidelines or only upon a requirement of a "minimum capital" level;

3. Deducting intangible assets in deriving primary capital ratios; and

4. Including equity commitment notes as a component of primary capital.

Regulatory Flexibility Analysis Act

The Board certifies that the adoption of these proposals is not expected to have a significant economic impact on a substantial number of small entities within the meaning of the Regulatory Flexibility Act (5 U.S.C. 601 et seq.). In carrying out its responsibilities for supervising member banks and bank holding companies the Board has always considered the capital adequacy of banks and bank holding companies. In December 1981, the Board promulgated a written policy, its Capital Adequacy Guidelines, to inform banks, bank holding companies, and the public of its beliefs concerning capital and capital adequacy. The Board now proposes to amend its Guidelines to establish more uniform standards for large and small banking institutions and to attempt to establish uniformity among the federal banking agencies in the imposition of capital adequacy requirements.

Historically, the Board has required higher capital ratios in smaller banks and bank holding companies. To the extent that this regulation equalizes those requirements it will lessen the burden on small banks and bank holding companies.

This proposal does not duplicate, overlap or conflict with any existing federal laws and regulations governing state member banks and bank holding companies.

List of Subjects in 12 CFR Parts 208, 225 and 263

Banks, banking; Federal Reserve System; Holding companies; Capital adequacy; State member banks.

Pursuant to the Board's Authority Under the International Lending Supervision Act of 1983 (ILSA), 12 U.S.C. 3907, 3909; section 5(b) of the Bank Holding Company Act (BHC Act), 12 U.S.C. 1844(b); the Financial Institutions Supervisory Act of 1966 (FIS Act), 12 U.S.C. 1818; and sections 9 and 11(a) of the Federal Reserve Act (12 U.S.C. 248, 324, 329), the Board hereby proposes to adopt Capital Adequacy Guidelines for state member banks, to be reprinted in a new Appendix A to the Board's Regulation H, Membership of State Banking Institutions in the Federal Reserve System, 12 CFR Part 208; to adopt Capital Adequacy Guidelines for bank holding companies to be substituted for Appendix A of the Board's Regulation Y, 12 CFR Part 225; and to adopt a new Subpart D to its

Rules of Practice for Hearings, 12 CFR Part 263, as follows:

PART 208—MEMBERSHIP OF STATE BANKING INSTITUTIONS IN THE FEDERAL RESERVE SYSTEM

1. Authority for 12 CFR Part 208 is proposed to be revised as follows:

Authority: 12 U.S.C. 248, 321–338, 486, 1814, 3907, 3909, unless otherwise noted.

2. 12 CFR Part 208 is proposed to be amended by adding an Appendix A to read as follows:

Appendix A—Capital Adequacy Guidelines

Definition of Capital to be used in Determining Capital Adequacy of State Member Banks

Primary Capital Components

The components of primary capital are:

—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 and lease losses
—Minority interest in equity accounts of consolidated subsidiaries

For the purpose of calculating a bank's primary capital, intangible assets (as defined in the instructions to the bank Call Report) are deducted from the sum of the components of primary capital set forth above.

Secondary Capital Components

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

—Limited-life preferred stock
—Qualifying subordinated notes and debentures

For the purpose of determining aggregate secondary and total capital, the amount of intangible assets deducted from primary capital is added back to the components of secondary capital set forth above.

Restrictions Relating to Secondary Components

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

—The security issue must have an original weighted average maturity of at least seven years.
—The aggregate amount of secondary capital may not exceed 50 percent of the amount of the bank's primary capital.
—As subordinated debt or limited-life preferred stock approaches maturity, redemption or repayment, 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:

Years to maturity	Percent of issue considered capital
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 adjustments in the book amount of the issue is required or expected by this schedule. Adjustment will be made by a memorandum account.)

Minimum Capital Guidelines for State Member Banks

The Board of Governors of the Federal Reserve System has adopted minimum capital ratios and guidelines to provide a framework for assessing the capital of well-managed state member banks with no significant financial weaknesses.[1] The guidelines apply to all state member banks regardless of size and are to be used in the examination and supervisory process as well as in the analysis of applications acted upon by the Board. The Board will review the guidelines from time to time for possible upward adjustments commensurate with changes in the economy, financial markets and banking practices.

Objectives of the minimum capital guidelines are to:

—Introduce uniformity, objectivity and consistency into the supervisory approach for assessing capital adequacy;
—Provide direction for capital and strategic planning and for the appraisal of this planning by the Board; and
—Permit the elimination of disparities in capital ratios between banking organizations of different sizes.

Two principal ratio measurements of capital are used: (1) Primary capital to adjusted total assets (i.e., total assets plus the allowance for possible loan and lease losses less intangible assets), and (2) total capital to total assets plus the allowance for possible loan and lease losses. For the purpose of calculating these ratios, primary capital is defined as the sum of common stock, perpetual preferred stock, capital surplus, undivided profits, reserves for contingencies and other capital reserves, mandatory convertible instruments (excluding equity commitment notes), the allowance for possible loan and lease losses, and any minority interest in the equity accounts of consolidated subsidiaries, minus intangible assets. Total capital is calculated by adding to primary capital (as defined above) limited-life preferred stock, qualifying subordinated notes and debentures and the amount of intangible assets deducted from primary capital for the purpose of determining the primary capital ratio.

A minimum level of primary capital to adjusted total assets is established at 5.5 percent of all state member banks. Generally, these banks are expected to operate above the minimum primary capital ratio. Also, those state member banks that have a higher than average or excessive amount of their assets exposed to risk or a higher than average or excessive amount of off-balance sheet risk, will be expected to hold additional primary capital to compensate for this risk. Moreover, the Board will pay particular attention to liquidity and would discourage the practice of meeting the guidelines by decreasing the level of liquid assets relative to total assets. Banks with primary capital ratios below the 5.5 percent minimum will generally be considered to be undercapitalized unless they can demonstrate clear extenuating circumstances. Such banks, as described in greater detail below, will be required to submit an acceptable capital plan and will be subject to appropriate supervisory enforcement action.

The Board has also established a minimum total capital ratio of 6.0 percent for all state member banks and has raised the Zone 1 total capital ratio guideline for regional and multinational banks to 7.0 percent. These ratios establish three broad zones for total capital that apply to state member banks of all sizes:

Zone 1—Above 7.0%
Zone 2—6.0% to 7.0%
Zone 3 (Minimum Total Capital Ratio)—Below 6.0%

Generally, the nature and intensity of supervisory action will be determined by a bank's compliance with the required minimum primary capital ratio as well as by the zone in which a bank's total capital ratio falls. While an institution's position in the quantitative capital zones will normally trigger the below specified supervisory responses, qualitative analysis will continue to be used in determing minimum levels of capital for state member banks.

For banks operating in Zone 1, the Board will:

—Presume that capital is adequate if the primary capital ratio is acceptable to the Board and is above the 5.5 percent minimum

For banks operating in Zone 2, the Board will:

—Pay particular attention to other financial factors such as asset quality, liquidity, and interest rate risk as they relate to the adequacy of capital and, if they are not satisfactory and the Board concludes capital is not adequate, intensify its analysis and action.

Banks operating in Zone 3:

—May be considered undercapitalized, absent clear extenuating circumstances
—Would be required to submit a comprehensive capital plan that is acceptable to the Board and that includes a program for achieving compliance with the required minimum ratios within a reasonable time period

[1] Banks with significant weaknesses or those under special supervision may be subject to higher capital requirements than the guideline minimums.

—Would be subject to appropriate supervisory and/or administrative enforcement action, or the issuance of a capital directive, by the Board
—Would generally be subject to denial of applications by the Board unless a reasonable capital plan that is acceptable to the Board has been adopted.

In addition to compliance with the minimum primary and minimum total capital ratios, 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 Board retains the flexibility to make appropriate adjustments in the application of the guidelines to individual institutions.

The Board will issue regulations for enforcing the minimum capital requirements set forth above and for implementing the authority to issue capital directives as provided in the International Lending Supervision Act of 1983.

PART 225—BANK HOLDING COMPANIES AND CHANGE IN BANK CONTROL

3. Authority for 12 CFR Part 225 is proposed to be revised as follows:

Authority: 12 U.S.C. 1844(b), 3106, 3108, 1817(j)(13), 1818(b), 3907, 3909; and Pub. L. 98-181, Title IX.

4. 12 CFR Part 225 is proposed to be amended by revising Appendix A to read as follows:

Appendix A—Capital Adequacy Guidelines for Bank Holding Companies

Introduction

In adopting the capital adequacy guidelines program in December of 1981, the Board expressed concern about the secular decline in the capital ratios of the nation's largest banking organizations and stated that its supervisory policies would be modified to achieve a strengthening over time of the capital positions of the multinational group. Since the implementation of the capital guidelines program and the establishment of the 5.0 percent primary capital ratio guideline for the multinational banking organizations, considerable progress has been made in improving the capital ratios of the nation's largest bank holding companies. In particular, as of March 31, 1984, all of the multinational holding companies had primary capital ratios that exceeded 5.0 percent, and most of these organizations have achieved primary capital ratios that are significantly above this level.

The Board has stated on a number of occasions that capital adequacy is an extremely important financial factor and it believes that, as part of its ongoing effort to improve the capital positions of banking organizations, additional steps are appropriate at this time to encourage further strengthening of capital ratios. Moreover, Congress addressed the issue of capital adequacy in enacting the International Lending Supervision Act of 1983 ("ILSA"). This legislation requires the Federal banking agencies to establish appropriate minimum levels of capital for banking organizations, to cause banking organizations to achieve and maintain the minimum capital requirements and grants the agencies the authority to issue capital directives to assist in enforcing the minimums. In addition, ILSA provides that "The Chairman of the Board of Governors and the Secretary of the Treasury shall encourage governments, central banks, and regulatory authorities of other major banking countries to work toward maintaining and, where appropriate, strengthening the capital bases of banking institutions involved in international lending."

Capital Guidelines Program

In light of these developments and within the context of its continuing efforts to foster improvement in the capital ratios of large bank holding companies, the Board has made the following changes to the minimum capital ratios and guidelines that apply to multinational and regional bank holding companies:

—The minimum ratio of primary capital to total assets has been increased from 5.0 to 5.5 percent.[1]
—The minimum ratio of total capital to total assets (i.e., the Zone 3 minimum total capital ratio) has been increased from 5.5 to 6.0 percent.
—The Zone 1 total capital ratio guideline for multinational and regional bank holding companies is being raised from 6.5 to 7.0 percent, and the Zone 2 total capital guideline range will now be between 6.0 and 7.0 percent.

With respect to community bank holding companies, the Board has established a new minimum ratio of primary capital to total assets of 5.5 percent. This minimum is identical to the new primary capital requirement that has been established for multinational and regional bank holding companies. The minimum total capital ratio and guidelines that apply to community bank holding companies have not been changed.

In taking these steps, the Board has encouraged the strengthening of the capital ratios of large bank holding companies and has eliminated the existing disparities in the supervisory requirements for holding companies of different sizes.[2]

In light of the progress that has been made in improving capital ratios since the adoption of the guidelines program, most of the largest bank holding companies have primary capital ratios that exceed the new 5.5 percent minimum guideline. Those holding companies below the minimum guideline will be given a reasonable amount of time to implement plans for achieving compliance.

The capital guidelines program establishes minimum levels of primary capital and, generally, banking organizations are expected to operate above the minimums. The guidelines program assumes moderate amounts of on- and off-balance sheet risk and intangible assets. Banking organizations that have a higher than normal or excessive percentage of their assets exposed to risk, a higher than normal or excessive amount of off-balance sheet risk, or a higher than normal or excessive amount of intangible assets, will be expected to hold additional primary capital to compensate for these characteristics. In addition to the quality of loans, investments and other assets, the nature and amount of off-balance sheet risk and intangible assets will be taken into consideration in determining a holding company's compliance with the capital guidelines program. Moreover, the Board will pay particular attention to liquidity and would discourage the practice of meeting the guidelines by decreasing the relative level of liquid assets to total assets.

The increase in the capital guidelines for multinational and regional bank holding companies should be viewed in the context of the Board's continuing efforts to strengthen capital ratios, the ongoing discussions with foreign supervisory officials as required by ILSA and the on- and off-balance sheet risk factors discussed above. In light of these ongoing efforts and considerations, the Board will continue to review the capital positions and risk characteristics of the large bank holding companies and may consider additional steps, including further increases in the capital guidelines, to sustain the progress that has been made in strengthening the capital ratios of these institutions. As part of this process, the Board will continue to review the need for increases in capital guideline ratios to compensate for excessive amounts of off-balance sheet risk or intangible assets.

The capital guidelines generally apply to bank holding companies on a consolidated basis. The guidelines will not apply to holding companies under $150 million in consolidated assets unless (1) the holding company or any nonbank subsidiary is engaged directly or indirectly in any nonbank activity involving significant leverage or (2) the holding company or any nonbank subsidiary has outstanding significant debt held by the general public.

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[1] Primary capital for bank holding companies consists of common stock, perpetual preferred stock, capital surplus, undivided profits, reserves for contingencies and other capital reserves, mandatory convertible instruments including equity commitment notes, the allowance for possible loan and lease losses, and any minority interest in the equity accounts of consolidated subsidiaries. Total capital for holding companies consists of the primary components plus limited-life preferred stock and unsecured long-term debt of the holding company or its nonbank subsidiaries. To qualify, such debt must have an original weighted average maturity of seven years or more. For capital adequacy purposes, unsecured long-term debt of the holding company or its nonbank subsidiaries is also subject to the amortization adjustments that are made as the debt approaches maturity. Total assets for the purposes of calculating the primary and total capital guideline ratios is total assets plus the allowance for possible loan and lease losses.

[2] In separate but related actions with respect to commercial banks, the Federal Reserve, the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency have established minimum primary and total capital ratios of 5.5 percent and 6.0 percent, respectively, for banks of all sizes. These actions increase the minimum supervisory capital requirements for large banks and generally permit community banks to operate at the same capital levels as regional and multinational banks.

Some holding companies are engaged in significant nonbanking activities that typically require capital ratios higher than those of commercial banking organizations. The Board believes that, as a matter of both safety and soundness and competitive equity, the degree of leverage common in banking should not automatically extend to nonbanking activities. Consequently, in evaluating the consolidated capital positions of bank holding companies, the Board is placing greater weight on the building block approach for assessing capital requirements. This approach generally provides that nonbank subsidiaries of a banking organization should maintain levels of capital consistent with the levels that have been established by industry norms, Federal or State regulatory agencies for similar firms that are not affiliated with banking organizations or that may be established by the Board taking into account risk factors of a particular industry. The assessment of a holding company's consolidated capital adequacy must take into account the amount and nature of all nonbank activities, and a holding company's consolidated capital position should generally reflect the sum of the capital requirements of the organization's bank and nonbank subsidiaries as well as those of the parent holding company. The Board intends to be guided by these principles in determining compliance with the capital guidelines program.

Bank holding companies affected by the guidelines are categorized as either multinational companies (as designated by their respective supervisory agency); regional companies (all other institutions with assets in excess of $1 billion); or community holding companies (less than $1 billion in total assets). The minimum ratios and guidelines set forth below apply to bank holding companies of all size categories.

Minimum Guideline Ratios

The Board has established a minimum ratio of primary capital to total assets of 5.5 percent for all bank holding companies. Holding companies with primary capital ratios below the 5.5 percent minimum will generally be considered to be undercapitalized unless they can demonstrate clear extenuating circumstances. Such companies, as described in greater detail below, will be required to submit an acceptable capital plan and will be subject to appropriate supervisory enforcement action.

A minimum ratio of total capital to total assets of 6.0 percent has been established for all bank holding companies. In addition, the Zone 1 total capital ratio guideline for multinational and regional holding companies is being raised to 7.0 percent, which is the Zone 1 ratio for community organizations. The total capital ratio guidelines establish three broad zones for total capital that apply to holding companies of all sizes:

Zone 1—Above 7.0%
Zone 2—6.0% to 7.0%
Zone 3 (Minimum Total Capital Ratio)—Below 6.0%

Generally, the nature and intensity of supervisory action will be determined by a holding company's compliance with the required minimum primary capital ratio as well as by the zone in which a holding company's total capital ratio falls. While a company's position in the quantitative capital zones will normally trigger the below specified supervisory responses, qualitative analysis will continue to be used in determining minimum levels of capital for banking institutions.

For holding companies operating in Zone 1, the Board will:

—presume that capital is adequate if the primary capital ratio is acceptable and is above the 5.5 percent minimum

For companies operating in Zone 2, the Board will:

—pay particular attention to other financial factors such as asset quality, liquidity, and interest rate risk as they relate to the adequacy of capital and if they are not satisfactory and the Federal Reserve concludes capital is not adequate, intensify its analysis and action

Bank holding companies operating in Zone 3:

—May be considered undercapitalized, absent clear extenuating circumstances
—Would be required to submit a comprehensive capital plan that is acceptable to the Board and that includes a program for achieving compliance with the minimum required ratios within a reasonable time period
—Would be subject to appropriate supervisory and/or administrative enforcement action, or the issuance of a capital directive
—Would generally be subject to denial of applications unless a reasonable capital plan that is acceptable to the Board has been adopted.

While the critical first test of a holding company's capital adequacy is its compliance with the minimum supervisory guideline ratios, the Board will continue to take into account the various qualitative factors that affect an institution's overall level of risk and financial condition. The Board retains the flexibility to make appropriate adjustments in the application of the guidelines to individual institutions.

The Board will issue regulations for enforcing the minimum capital requirements set forth above and for exercising the authority to issue capital directives as provided in the International Lending Supervision Act of 1983.

PART 263—RULES OF PRACTICE FOR HEARINGS

5. 12 CFR Part 263 is proposed to be amended by revising the authority for the part, and by adding a new Subpart D to read as follows:

* * * * *

Subpart D—Procedures for Issuance and Enforcement of Directives To Require Compliance With the Board's Capital Guidelines

Sec.
263.35 Authority, purpose and scope.
263.36 Definitions.
263.37 Establishment of minimum capital levels.
263.38 Procedures for requiring maintenance of adequate capital.
263.39 Enforcement of directive.
263.40 Establishment of increased capital level for individual bank or bank holding company.

Authority: 12 U.S.C. 248, 324, 329, 1818, 1828, 1844, 3907, 3909, 15 U.S.C. 19.

Subpart D—Procedures for Issuance and Enforcement of Directives To Require Compliance With the Board's Capital Guidelines

§ 263.35 Authority, purpose, and scope.

(a) *Authority.* This subpart is issued under authority of the International Lending Supervision Act of 1983 ("ILSA"), 12 U.S.C. 3907, 3909; section 5(b) of the Bank Holding Company Act ("BHC ACT"), 12 U.S.C. 1844(b); the Financial Institutions Supervisory Act of 1966 ("FIS ACT"), 12 U.S.C. 1818(b)–(n); and sections 9 and 11(i) of the Federal Reserve Act, 12 U.S.C. 248, 324, 329.

(b) *Purpose and scope.* This subpart establishes procedures under which the Board may issue a directive or take other action to require a state member bank or a bank holding company to achieve and maintain adequate capital.

§ 263.36 Definitions.

(a) "Bank holding company" means any company that controls a bank as defined in section 2 of the BHC Act, 12 U.S.C. 1841, and in the Board's Regulation Y (12 CFR 225.2(b)).

(b) "Capital Adequacy Guidelines" means those guidelines contained in Appendix A to the Board's Regulation H (12 CFR part 208) in the case of state member banks and in Appendix A to the Board's Regulation Y (12 CFR Part 225) in the case of bank holding companies.

(c) "Directive" means a final order issued by the Board pursuant to ILSA (12 U.S.C. 3907(b)(2)) requiring a state member bank or bank holding company to increase capital to or maintain capital at the minimum level set forth in the Board's Capital adequacy Guidelines or as otherwise established under procedures described in § 263.40 of this subpart.

(d) "State member bank" means any state chartered bank that is a member of the Federal Reserve System.

§ 263.37 Establishment of minimum capital levels.

The Board has established minimum capital levels for state member banks and bank holding companies in its Capital Adequacy Guidelines. The Board may set higher capital levels as necessary and appropriate for a particular state member bank or bank holding company based upon its

financial condition, managerial resources, prospects, or similar factors, pursuant to the procedures set forth in § 263.40 of this subpart.

§ 263.38 Procedures for requiring maintenance of adequate capital.

(a) *Submission of capital improvement plan.* Any state member bank or bank holding company that may not be in compliance with the Board's Capital Adequacy Guidelines on the date that this regulation becomes effective shall, within 90 days, submit to its appropriate Federal Reserve Bank for review a plan describing the means and the time schedule by which the bank or bank holding company shall achieve the required minimum level of capital.

(b) *Issuance of directive*—(1) *Notice of intent to issue directive.* If a state member bank or bank holding company is operating with less than the minimum level of capital established in the Board's Capital Adequacy Guidelines, or as otherwise established under the procedures described in § 263.40 of this subpart, the Board may issue and serve upon such state member bank or bank holding company written notice of the Board's intent to issue a directive to require the bank or bank holding company to achieve and maintain adequate capital within a specified time period.

(2) *Contents of notice.* The notice of intent to issue a directive shall include:

(i) The required minimum level of capital to be achieved or maintained by the institution;

(ii) Its current level of capital;

(iii) The proposed increase in capital needed to meet the minimum requirements;

(iv) The proposed date or schedule for meeting these minimum requirements;

(v) When deemed appropriate, specific details of a proposed plan for meeting the minimum capital requirements; and

(vi) The date for a written response by the bank or bank holding company to the proposed directive, which shall be at least 14 days from the date of issuance of the notice unless the Board determines a shorter period is necessary because of the financial condition of the bank or bank holding company.

(3) *Response to notice.* The bank or bank holding company may file a written response to the notice within the time period set by the Board. The response may include:

(i) An explanation why a directive should not issue;

(ii) Any proposed modification of the terms of the directive;

(iii) Any relevant information, mitigating circumstances, documentation or other evidence in support of the institution's position regarding the proposed directive; and

(iv) The institution's plan for attaining the required level of capital.

(4) *Failure to file response.* Failure by the bank or bank holding company to file a written response to the notice of intent to issue a directive within the specified time period shall constitute a waiver of the opportunity to respond and shall constitute consent to the issuance of such directive.

(5) *Board consideration of response.* After considering the response of the bank or bank holding company, the Board may:

(i) Issue the directive as originally proposed or in modified form;

(ii) Determine not to issue a directive and so notify the bank or bank holding company; or

(iii) Seek additional information or clarification of the response by the bank or bank holding company.

(6) *Contents of directive.* Any directive issued by the Board may order the bank or bank holding company to:

(i) Achieve or maintain the minimum capital requirement established pursuant to the Board's Capital Adequacy Guidelines or the procedures in this subpart by a certain date;

(ii) Submit for approval and adhere to a plan for achieving the minimum capital requirement by a certain date;

(iii) Take other specific action as the Board directs to achieve the minimum capital levels, including requiring a reduction of assets or asset growth or restriction on the payment of dividends; or

(iv) A combination of the above actions.

(7) *Request for reconsideration of directive.* Any state member bank or bank holding company, upon a change in circumstances, may request the Board to reconsider the terms of a directive and may propose changes in the plan under which it is operating to meet the required minimum capital level. The directive and plan continue in effect while such request is pending before the Board.

§ 263.39 Enforcement of directive.

(a) *Judicial and administrative remedies.*—(1) Whenever a bank or bank holding company fails to follow a directive issued under this subpart, or to submit or adhere to a capital adequacy plan submitted pursuant to such directive, the Board may seek enforcement of the directive, including the capital adequacy plan, in the appropriate United States district court, pursuant to section 8(i)(2) of the Federal Deposit Insurance Act (12 U.S.C. 1818(i)(2)), in the same manner and to the same extent as if the directive were a final cease and desist order.

(2) The Board may also assess civil money penalties for violation of the directive against any bank or bank holding company and any officer, director, employee, agent, or other person participating in the conduct of the affairs of the bank or bank holding company, in the same manner and to the same extent as if the directive were a final cease and desist order.

(b) *Other enforcement actions.* A directive may be issued separately, in conjunction with, or in addition to any other enforcement actions available to the Board, including issuance of cease and desist orders, the approval or denial of applications or notices, or any other actions authorized by law.

(c) *Consideration in application proceedings.* In acting upon any application or notice submitted to the Board pursuant to any statute administered by the Board, the Board may consider the progress of a state member bank or bank holding company or any subsidiary thereof in adhering to any directive or capital adequacy plan required by the Board pursuant to this subpart, or by any other appropriate banking agency pursuant to ILSA. The Board shall consider whether approval or a notice of intent not to disapprove would divert earnings, diminish capital, or otherwise impede the bank or bank holding company in achieving its required minimum capital level or complying with its capital adequacy plan.

§ 263.40 Establishment of increased capital level for individual bank or bank holding company.

(a) *Establishment of capital levels for individual institutions.* The Board may establish a capital level higher than that specified in the Board's Capital Adequacy Guidelines for an individual bank or bank holding company pursuant to:

(1) A written agreement or memorandum of understanding between the Board or the appropriate Federal Reserve Bank and the bank or bank holding company;

(2) A temporary or final cease and desist order issued pursuant to section 8 (b) or (c) of the FIS Act (12 U.S.C. 1818 (b) or (c));

(3) A condition for approval of an application or issuance of a notice of intent not to disapprove a proposal;

(4) Or other similar means; or

(5) The procedures set forth in subsection (b) of this section.

(b) *Procedure to establish higher capital requirement*—(1) *Notice.* When the Board determines that capital levels above those in the Board's Capital Adequacy Guidelines may be necessary and appropriate for a particular bank or bank holding company under the circumstances, the Board shall give the bank or bank holding company notice of the proposed higher capital requirement and shall permit the bank or bank holding company an opportunity to comment upon the proposed capital level, whether it should be required and, if so, under what time schedule. The notice shall contain the Board's reasons for proposing a higher level of capital.

(2) *Response.* The bank or bank holding company shall be allowed at least 14 days to respond, unless the Board determines that a shorter period is necessary because of the financial condition of the bank or bank holding company.

(3) *Board decision.* After considering the response of the institution, the Board shall issue a written decision to the bank or bank holding company as to the appropriate capital level and the date on which this capital level will become effective. The Board may require the bank or bank holding company to submit a plan for achieving such higher capital level as the Board may set.

(4) *Enforcement of higher capital level.* The Board may enforce the capital level established pursuant to the procedures described in this section and any plan submitted to achieve that capital level through the procedures set forth in § 263.38 of this subpart.

By order of the Board of Governors, effective July 24, 1984.

William W. Wiles,

Secretary of the Board.

[FR Doc. 84-19965 Filed 7-27-84; 8:45 am]

BILLING CODE 6210-10-M